



Managing shrinking equity

Surviving a Deflating Raft in Shark-Infested Seas

By Scott C. Seckel

The median sales price of an existing home peaked in May 2007 at \$222,700. As of May this year, it had fallen about 9 percent to \$208,600, according to the National Association of Realtors. All together, home equity *theoretically* fell by \$879 billion in the past year, according to the National Association of Home Builders.

But this assumes that everyone sells their home and goes to cash. Residential real estate does not work like this. Only 5 percent of total housing stock is bought and sold in any one year. Only these houses are market priced, the rest will sell sometime in the next five to seven years at that future market price. Historically average home price changes settle out at 5 percent appreciation per year.

FAIR WEATHER FOREVER?

"I've had Stanford graduates and people with MBAs think this 40 or 50 percent return was going to last forever," said Keith Reuben of California Financial & Investment Advisors in Belmont, California. "You couldn't tell them otherwise."

Roger Simard advises on investment holistically, from real estate to stocks and bonds.

"We've sent people to the bankruptcy attorney," said Simard, founder of Genesis Financial and Real Estate Services in Tempe, Arizona. "They had no other option. One guy was \$7,000 upside-down on his monthly cash flow. It's usually that last one or two properties."

BATTEN HATCHES, COUNT SOULS

Advising on what to do about shrinking equity in a real estate portfolio relies on a complete financial portrait of each investor, but four experts offered some three general rules of thumb:

1. HOLD WINNERS — Buy and hold investors have the best chances for survival in a down market. Flippers will more than likely lose money, said Gary Raimo, a real estate and mortgage industry consultant in Rancho Cucamonga, California.

"Turnover is out the window," said Raimo, president of ROVRgroup. "You have to reevaluate your position and your capital base. Can you sustain a longer period of time holding the property? If you're going to hold and be successful, it's going to be ten years."

Can you or should you just ride out the situation? While it may be like spending the night in the cold woods, the dawn will come, said Michael Gray, a certified public accountant and real estate investment advisor in San Jose, California.

"The problem people have with their time horizons in their heads is that tomorrow is going to be pretty much like today so we can't see a way out," Gray said. "We're going through a correction right now. We've gone through them before, though not so severe as right now, but things come back, sometimes for the better."

2. SELL LOSERS — Can you continue to carry properties you can't rent or which aren't paying the mortgage?

"If you're not getting the rent and you don't have the income to support it, you're either going to sell it or let it foreclose," Gray said.

If you can't wait out the long hold everyone predicts, "sell and take a loss like it's a bad stock," Simard said. "Don't obsess over your two homes that are doing badly. Focus on the eight that are doing well."

A loss isn't all bad, Gray said. "With rental properties, they may have an offsetting loss they can use against that income," he said. "With a business property like a rental property, it's a Section 1231 loss in tax lingo. You can use that loss against income you report." Sales don't always have to involve a loss. "Look

for other asset classes or other types of real estate," Simard said. He recommended selling the suburban home and buying in good urban inner core neighborhoods. "They'll come back sooner."

A distressed investor may be able to negotiate a lease-option with a tenant as well, Raimo said. "It may help you to release the property when you need to get out."

3. CALL FOR HELP — Hire an advisor who can give a true picture of your financial situation. Reuben recommended a financial advisor with a view of everything: real estate, cash, equities, other assets and employment.

"Anyone who thinks too linearly isn't good," he said. "Everything connects to everything else. . . . Keep your money in circulation. Keep it moving. Don't have it sitting. That's what I would leave people with."

RESOURCES

California Financial & Investment Advisors, Inc.
www.cfirealestate.com
650-558-9101

Genesis Financial
www.genfinre.com
888-902-9191

Kingman Winslow CPA
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