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Hosted by: Doug & Andrea Van Soest

Episode 16 – How Can You Successfully Invest in an Ever-Changing Market?

Andrea: Welcome back. This is Episode 16.

Doug: Spouses Flipping Houses.

Andrea: And this is the first work week of the New Year, 2016, and Doug and I always get super hyped up for the start of a new year. We always have these goals that we've lined out, and we've got a plan of how to get there, and we're always super excited, and we kind of hit the ground running fast and furious, pretty much every year at this time.

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And so we pretty much have thought that there would be no way we could record a podcast this week because we are so busy, but we had a topic on our mind, and we decided you know what, let's just record it in the car.

Doug: Yeah, because we are spending the majority of our time in the car this week, in the rain, in the car.

Andrea: Yes, so if you don't know, Southern California is pretty much under El Niño. It has hit; it's crazy; it's wild out here, so that combined with the fact that it's just been a great start to this new year, lots of deals and appointments already under contract, and so we're getting going. It's exciting.

Doug: It is. It is.

Andrea: So anyways, that being said, sound quality might not be so good. We're in the car today. We got our nine-year-old son in the backseat. Say hi Weston—

Weston: Hi

Andrea: And he's hanging out with us today.

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Doug: There was snow on the road. Well, slush or snow or something in San Diego. Crazy! I've never seen that before.

Andrea: Yeah, pretty wild for Southern California. Yeah, so we are in the car. We just drove down to San Diego to meet with a new contractor and get him started on a job down there, and we're headed back. And then Doug is going to turn around and head down to La Hacienda Heights, which is north from where we are. It's literally been wild.

We've been all over Southern California this week, but it's fun, and it's exciting, and good stuff is happening over here.

Doug: Good stuff's happening, moving and shaking.

Andrea: So anyways, what we wanted to talk about today is the fact that we got an email from one of the real estate clubs here in Southern California, and they have a speaker coming up, and his main topic is just this huge doom and gloom type of a thing.

Yeah, the sky is falling and this next year, the real estate market is going to be worse than it was in the previous decline, and that sort of thing.

And just really kind of a fear based thing, and so we've had people saying, "Oh are you going to stop working? What are you guys going to

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do? Are you scared? How are you going to mitigate your risk?" And so we wanted to chat about that.

Doug: It's interesting the effect that the media plays on just the general public and on what people think is going on in the market. It just might come from something they saw on Nightline or the Nightly News, and generally that information is really dated. It's usually like six months behind already on what's actually happening in the market, and sometimes it's not even accurate at all.

It might just be based on a little local area or something that might be going on in a particular community that they're talking about, so you know, just take all of the information you might hear or read about with a grain of salt. And really, the point we're going to make today is to know what's going on in your own local market.

Andrea: Yeah, so people will ask, "What is the best market for real estate investing?" And the answer is that there is no such thing. You can be successful in a market where prices are going up.

You can be successful in a market where prices are tumbling. You can be successful in a flat market, a buyer's market, a seller's market. It does not matter.

The thing is that there are different strategies that some might use in different markets, and you need to be aware of what those are. Can you hear the rain on my windshield?

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Doug: It is raining. We're not really sure what to do with rain here in Southern California. It doesn't happen that much. So the freeway is going to slow down here in a second, I know.

Andrea: That's hilarious. It's pretty loud. So anyways, you just kind of need to be aware of what is going on in the market, and then know what strategies to use in each particular kind of market, and just be aware and make smart choices. It's not as terrifying as I think people might lead you to believe.

So we want to talk about a few of the ways that you can sort of mitigate your risk when the market is changing. The first one is don't speculate.

Speculating, if you're not sure, is what people were doing back in 2003, 2004, in California where they would go into a homebuilder's office basically, and put down money on a house, and they were just basically banking on the fact that when that home was done in eight/nine months later, that prices would have increased so much that they could make a profit, because prices were increasing pretty rapidly at that point.

And this became a strategy for people making money, and it happened to be working, but that was all by chance. That is not investing; that is absolutely speculating, basically gambling.

Doug: Yeah, and people were literally camping out at the sales offices for the release of the next phase or whatever, just to get a chance to

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purchase one of these lots that were going to be built. So when you see stuff like that happening, it might be time to raise an eyebrow and say *maybe I should sit on the sidelines for a second.* When your barber is talking about flipping a house, and they're going to do this kind of thing, I don't know just a red flag there. It might be a bubble forming.

Andrea: Yeah, and not to say that one is right now, but something to be aware of. And the other thing that you can do to mitigate your risk is to understand how global and national trends can affect your local market and the market in general. So rapidly rising interest rates would be something to look out for.

I know the Fed has already raised rates, and I don't think it has trickled right down to the mortgages yet, but it probably will. So just keep an eye out on that.

Doug: Can I comment on that real quick. Raising rates doesn't necessarily equal prices going down either. People will tend to think that. Generally, at least from our experience and experts we pay attention to, when there's a slow increase in interest rates, especially when they've been low for a long time, that typically gives a bump to the market for a while and gives fuel to it.

Prices actually go up for a time because it plays into people's emotions of *the rates might be going up, I better buy a house now while I can lock-in at a lower rate than it will be maybe in three or four months.*

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And that can go on for a while, so it's just not a cut-and-dry rates are going up, *Oh no! Prices are going to fall*. That's typically not the case.

Andrea: Yeah, another thing to watch out for though or keep your eye on is the fact that it is an election year, and so there may be tax rule changes and unknowns that come along with a new president coming into play. So just keep an eye on the tax changes that might be taking place and anything that affects home ownership or investors can be big.

I know in the 1990s, there was a change in the depreciation rules for investors, and that had a big impact, so you do need to keep an eye on what's happening nationally as well as your local market.

A source that we really love is The Norris Group. And Bruce Norris is a very well-respected market timing expert for Southern California. He's got really great data. He pays attention like nobody's business. I mean these documents that come down from the government that nobody reads; he reads them.

Doug: He puts together his own conclusion based on the data that he collects, and reads, and researches, and the reason we really like him is because he's an investor. So he's invested, with his own funds and his own company money, into the market, and so he doesn't have an agenda.

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He's really just trying to figure out what is the best strategy for his own investing. And he obviously shares that information and does some training and things, but we really, really respect the predictions and the market conclusions that he comes to because of that fact, that he, himself, is fully invested in the market.

Andrea: Yeah, another source that we like is The Realty Track. They've got a lot of great data on there as well, so that's something that you can kind of look through just to keep yourself informed. It's really important to be informed, but you also want to be aware of where you're getting your information.

So you know, if you're getting reports from the National Association of Realtors, well keep in mind that they don't ever want to tell you that the market is going to be bad, because they want their realtors to be selling houses, and that affects them.

Doug: And they want people to be buying houses as well, so it might be skewed a little bit.

Andrea: Yeah, you just need to know what is their benefit, and what's their angle, and just keep all of these things in mind.

Doug: Right.

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Andrea: Another way that you can mitigate your risk is to keep an eye on the amount of inventory.

Doug: Yeah, so typically what the general assumption is that six months of inventory is considered a balanced market. And you know, what is months of inventory? Sometimes you hear that and people don't really know what that means.

So what does six months of inventory really mean? Well, they get that number by taking a segment of the market, or maybe they'll take a zip code or a community or state, whatever it is, and they figure out the number of homes that are currently available for sale in that particular segment of the market. And then they will figure out over the past period of time, how many sales have actually happened.

Let's say it's a chunk of time like a year— they'll take a number of sales that have happened in the past year in that market, and then they'll divide that by the months and figure out how many months, I'm sorry how many sales occurred each month.

And they'll take the current number of homes for sale and divide that by the sales per month, and that comes up with how many months it would take to sell all of the homes that are currently listed.

So six months of inventory would mean that it would take, in a normal market, if the market continues as it is, it would take six months to sell off all of those homes that are available. That's what that means, so how we use that information is say you're under six months of

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inventory. That typically is a seller's market because there are less homes available for sale.

So right now in California, we're hovering around four months of inventory on average, and in our market that's the same. So we're slightly a seller's market. During the crash, when Andrea and I first started investing in 2008, I think it got up to maybe 15 or 16 months worth of inventory sometimes, which is an over flooding amount of available homes for sale, which is a buyer's market because of the simple fact that there are tons of homes available.

So people are dropping prices to get their homes sold. That's a buyer's market. So six months is kind of considered balanced, just so you kind of have a gauge on what that months of inventory really means.

Andrea: And how can they go about finding out the amount of inventory for their market?

Doug: Yeah, so you mentioned Realty Track. That's probably a good source nationwide to go to. I think they would have that information. Zillow is actually becoming pretty good at providing that information as well.

Zillow.com, I'm not sure exactly where in there, but you can type in your zip code in there or something, and they would usually give you about a six month or year history. And you can see a little graph on the inventory levels and the number of sales, things like that.

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Or if you happen to have access to the MLS or you're an agent, you can go on your MLS and get that information, or go to your local realtor board. In California, it's called C.A.R., the California Association of Realtors, and just Google that. And they'll have that information as well. It's usually about 30 days behind, but it's pretty good information for finding your inventory in your market.

Or you can do the search and math yourself. I do that sometimes for specific communities, like say a golf course community out in the desert, because it's going to be very different (as far as the supply and the months inventory versus just your typical track neighborhood in Riverside).

So I would narrow it down to just that particular community, and then I run the sales, and I run the listings and figure out what the inventory is myself. So I can kind of have an idea what it's like to buy and sell in that particular community.

Andrea: So good stuff! Another way to mitigate your risk is to make sure that you're getting the right deal based on what's happening in the market.

So what I mean by that is back in 2009 when prices were declining pretty rapidly, we were usually buying properties at between 60 and 65 percent of the after-repaired value, and then subtracting out repairs after that. That would be our purchase price.

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Well nowadays, it's kind of a flat market, but prices are up from there, and it's fairly predictable what we'll be able to sell a home for. So we're paying 76 to 78 percent of after-repaired value minus repairs.

Doug: Yeah, quite a bit more because it is, like I mentioned, sort of a seller's market right now, and it's a lot easier to sell your house now than it was in 2009.

Andrea: So if you are out there trying to get a 65 minus repairs deal right now, you're probably not going to get a deal. But, if things do change and prices start declining, and you're trying to get a 78 percent minus repairs deal, you're going to lose your shirt. You have to just gauge what's happening and know where your offer should be.

Also, if prices are declining, what we did back in 2009 and those days was to be really cautious with our after repaired value that we would determine. So we would kind of get an idea if prices were declining, say one percent per month or two percent per month, then take that out of your after-repaired value. Don't assume that what it's worth today is what it's going to sell for in three or four months.

Be aware of the fact that if prices are declining, what it's actually going to sell for in the future.

Doug: You have to know the trend that you're in. If you're in a declining market, which is when we started, there's still a good strategy for that, but just like you said, you have to plan ahead and

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know that you're probably going to be listing this home in 90 days, 120 days, whatever it is, and take that percentage off o your value, because that's where your prices will realistically be at that time.

Andrea: Okay, so our last tip for mitigating your risk in a changing market is to have multiple exit strategies. So for us, that means we pretty much hang out in the first-time homebuyers inventory. And especially right now, that will not change for 2016. The reason for that is that there is a lot of things we can do with those properties if for some reason, we can't flip it like we thought.

So we can keep it for a rental; most of them, they'll rent. It makes sense.

Doug: There's a couple reasons to hang out in that type of inventory, and if you don't know what first-time homebuyer inventory is, it's kind of starter homes, smaller homes, two/three-bedroom homes. Typically, it depends on your area, but under 2,000 square feet, usually around 1500 square feet or so.

There are a couple reasons, yeah, but those are rentable homes. Those are great homes to rent out to families. People are looking for that type of home, young families, even single people like the have an extra bedroom or two. And also, I don't know the exact percentage, but the majority of sales and transactions that happen for homes take place in that first-time homebuyers inventory.

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So there's always people looking for that, and you can sell it usually easier than if you have a McMansion that you're trying to unload.

Andrea: Right, because lending rules are different for those higher price points. There's just a lot of things that can affect.

Doug: The FHA limit is another factor in there. You want to stay at or below that FHA loan limit for your area.

Andrea: And you know, other people have the strategy of buying the expensive homes and flipping those, and that's a whole different ballgame. But in a changing market, that just might not be where you want to be.

Because if you're trying to sell, let's say a $2 million dollar home, and you're only way to sell it is for somebody with either a whole lot of cash or a whole lot of lending power to come in and buy that from you, you might be in trouble. The great thing about real estate is the fact that it is not like the stock market, which can drop off of a cliff overnight.

With real estate, you can pretty much keep your eye on things and watch where it's headed, watch the trends. It doesn't change overnight, and that's the great thing. It gives you time to kind of adjust, and figure out what you're going to do, and how you're going to acclimate to what's coming.

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Doug: Right, yeah even in 2007/2008/2009. If anytime real estate in California fell off a cliff, in any of our history, that would be the time. And it still took a couple of years for it to go all the way down to where it bottomed out, two to three years. I mean it took a long time, so you don't lose half of your value in a matter of hours like you can in the stock market. So yeah, that's just one of the reasons we like real estate as an investment.

Andrea: Yeah, so basically, all of this is to say just be smart, keep your eye on what's coming, pay attention. Know that it's a possibility that prices could decline in the next couple of years, but don't necessarily operate from such a place of fear that you're not going to take any action just because you're afraid.

As long as you're being smart, you know what's happening in your market, you know the inventory, you can make good choices and still be successful.

Doug: And another thing, especially if you're going to be keeping houses as rentals, if that's your strategy, make sure it works from a rent standpoint, because prices go up, prices go down. If you're going to have that house for a long time, you're not as concerned about that if you're going to keep the house for cash flow and rent it out.

Andrea: Yeah, if the cash flows, then you're okay. You're okay if prices decrease a little bit. If you can still cover the mortgage with your cash

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flow, you're good. So that's pretty much all we have for you today. This is kind of like a real day-in-the-life for us because we're on the road.

Doug: Got our kid with us.

Andrea: Headed back from a job site, got a lot of great stuff going on, and we're really, really excited about 2016.

Doug: Yeah so please if you haven't, check us out on our website and get our free gifts if you haven't done that, SpousesFlippingHouses.com. We really appreciate all of the nice feedback and comments we've received on iTunes, so keep those coming. We really appreciate it.

Andrea: And we will be back next week in our recording studio/office not in the car, hopefully!

Doug: Have a good week!

Andrea: Goodbye!

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