

BUY AND HOLD---OR BUY AND FOLD?

The clever investor in real estate has some very basic decisions to make before making any purchase. Among them is the need for an up-front decision concerning the time to hold that property after purchasing. It all sounds pretty straightforward---but is critical because it affects risks taken, necessary financing, and taxation of the profits.

I have a personal philosophy that affects my own real estate interests---which, like most financial philosophies, is affected by my own cash needs. I buy a real property, fix-up and sell in as short a time as is possible. Guess why? I have immediate cash needs that must be responded to as soon as possible.

Just for the record, although buying fixer-upper properties is an outstanding way to make money in the real estate game, this process has one major flaw: all the money goes out in the beginning of the project, and little money trickles in until the property is sold. This means that if you have spent a sizeable amount of cash to purchase, evict (if necessary), and repair before renting the property for a reasonable length of time (even in a strong rental market), the cash return normally is miniscule until you take the steps of final clean-up, marketing and selling the property. As long as the market remains stable or swings upward, your financial picture is attractive. Should the selling or rental market migrate downward, you again have to decide when and if to sell to get your investment cash back.

When a property is purchased, eviction (if any) and repairs are completed, and the property is sold through escrow, you will know immediately whether you made a good investment and will show a strong return on your investment capital.

The investor in a single family dwelling should be able to get in and out of the above process within four to five months---barring the unforeseen. This is probably a good time to mention that the above time frame must be expanded if you choose to do all or some of the repairs yourself.

With a quick turnover of the property, the effect of market variations and the cost-of-money changes are minimized. Finding good renters and maintaining occupancy are not part of the investment process. Obviously, carrying costs such as maintenance, taxes, debt, utilities, and property management also are reduced.

If buying properties, fixing them up, and reselling them without rental is such a good deal, why isn't everyone just doing that? There are some serious drawbacks to the above process that make retention of your chosen property for a protracted period attractive to those blessed with long-range vision and capital.

For instance, taxation of the residual profit upon sale will be at an escalating rate as you accumulate taxable income through a series of property sales. You enjoy none of the property appreciation that accompanies those who buy and hold.

Should you decide to buy, repair, and rent out your property, you will get some significant advantages that are not available to me.

Some of your ongoing expenses during your rental period are tax deductible expenses. The initial financing established upon purchase should lock in the interest rate available and (in an escalating cost-of-money period) tend to be more attractive as money costs escalate. Property management cost, property repair and upgrade costs, and taxes paid are tax deductible. Taxation normally is based on the time the money is received so that the positive cash flow from a rental property will flow slowly back to you as monthly rent is paid. If property ownership has exceeded one year and a day when the property is finally sold, the profit should be taxed at the lower capital gains rate.

Buying and holding remote property (property that you will not manage yourself) forces you to rely on the experience, supportive attitude, business skills, and honesty of others (the property managers) who will have a great impact on the success of your buy-and-hold property investments. Even initial property management setups tend to change over time, and what seems so convenient and satisfying today may not hold true throughout your period of property ownership.

Where the buy-and-hold properties are located out of your direct sight and contact (exp: investments in other states), you become susceptible to property selling price, selling procedure changes, and the local competitive rental market. Those who buy new properties during the initial development phase from the developer find themselves in competition with renters and sales of newer properties offered by that same developer in a later phase of construction.

As I said earlier, I have made my choice. I buy properties, fix-up and sell—basically because I need the immediate cash return and don't like the risks that accompany long term ownership. It isn't the right choice for everyone by any means. There are good reasons why buy-and-hold makes good sense---particularly in the long run. So, take a deep look into your investment soul and get involved!

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