Private Money Update

CLEAR SKY FINANCIAL NEWSLETTER

August 2020

Letter from the Editor

Happy August! July was a slow month for loan originations, most likely due to vacations and a lack of investors finding new deals to flip. We are STILL one of the few private lenders who are lending. Because of this, we continue to get more experienced borrowers, as well as our current borrower base, and August was another great month!

CHUCKLE'S CORNER

"If we begin with certainties,
we shall end in doubts;
but if we begin with doubts,
and we are patient in them,
we shall end in certainties."
— Sir Frances Scott

Food for Thought

Thank you to those who attended our July and August webinars. We did our 4th COVID-19 webinar on August 26. You can see replays of this webinar, and our other events, at http://www.cskyfinancial.com/upcominevents.html. If you are not on our invite list for these webinars, please let us know, and we will happily add you to the list!

In This Issue:

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How to Build a Residential Rental Property Portfolio

The COVID-19 environment is starting to lead us into a recessionary environment. If you ever wanted to start purchasing rentals this is a GREAT time to start. We feel prices will eventually start to fall and that there will be some good value buys. The most important factor to consider is CASH FLOW! We have not seen any indicators that rents will drop.

The most powerful tool in building wealth is the concept of residual income. Residual income is when an asset generates money for you every month. As you build on the number of assets, the income being generated should eventually replace your time-based income. One of the ways to build residual income in real estate is to purchase rental properties, convert them into performing assets, and manage them. You can always pay somebody to manage them, but we prefer to manage our own for the time being. It will cost between 8% to 10% of the monthly rents to hire a property manager. There are obvious cash flow reasons to purchase rentals, and there are also other reasons to purchase:

1. Income is paying down your mortgage for you (provided you have one). We always take mortgages especially in a low interest environment.
2. You get the leverage of market appreciation. Buy in areas that you feel will appreciate.
3. You get to write off depreciation on your income taxes as an expense against cashflow.

The best technique to purchase rentals is the "BRRR" Method. The "BRRR" method is widely known and it stands for "Buy, Renovate, Refinance and Repeat". Below, I will list the strategies that we (Clear Sky Properties) use to purchase rentals.

1. Buy one RENTAL at a time. Do not overdo it. Get the property performing with a stable tenant and make sure the property is in a stable rentable condition.

2. ALWAYS purchase into an equity position. This will shield you from a market downturn. If you buy into a 20% equity position and the market turns down 10%, you still have a slight equity position. We look to purchase into a 20 to 25% equity position.

3. Use the 100 times rent rule, or 1% of the purchase/renovation price. If the rents are $2,000 we look to purchase/renovate the property for $200,000. Keep in mind this is just used as a guide. If the purchase/renovate cost is between $180,000 to $220,000/$230,000 then it will fit our model.

4. Get stable tenants. Tenant stability means a lot of things to us. The obvious stability factors are income/credit. We take this one step further and focus on the time a tenant has stayed at a previous address. The longer the better. We want our tenants to move in and stay for a least 5 years or more, as this enables us to buy more houses and build a bigger and more stable rental portfolio.

Thank you for taking the time to read this article – I hope you found it helpful! If you follow these recommendations, you will be well on your way to building a residential rental property portfolio.

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The Post Pandemic Real Estate Market

In the D.C. metro region, we are experiencing the lowest inventory levels for housing product in many years. It is a wonderful market for sellers. Sellers who are listing their homes now are seeing quick sales and in many cases, multiple offers. While there are fewer buyers than prior to the pandemic, there are disproportionately more buyers than sellers. Many people who would otherwise consider selling their house are not putting their house on the market because the inventory available for a "move up" opportunity is limited. This creates a cycle of low inventory levels and that is coupled with extremely low interest rates.

In June, the Commerce Department reported that homebuilding starts increased 17% from May. Compared with a year ago, housing starts were still down 4%. However, on a monthly basis, construction activity rose for both single-family properties (up 17.2%) and multifamily buildings (up 18.6%). Builders are clearly reading the market and understand the need for new homes to match overwhelming demand.

Buyers are acting aggressively. Buyers who are getting outbid in multiple-offer situations are competing with buyers who are willing to waive inspection contingencies and committing to make up the difference between the contracted purchase price and lender-appraised value if the appraisal comes up short. This aggressive buying reminds me of the run-up to the real estate crash of 2008 – a red flag.

Investors who sell in a seller's market face a problem. They need to figure out where to invest the proceeds of the sale. The circumstances that make it attractive to cash out are the same that make buying anything on the market right now a bad financial move.

In most cases, the asking prices for multifamily properties are too high to generate a decent return. I don't think you can assume that rents are going to go up enough in the medium term to offset the higher purchase prices. Commercial real estate post pandemic does not look promising at all. Retail and office space will take years to recover from the pandemic. A lot of office space won't even ever be used in the same way. So many people are going to choose to continue to work from home that there will be a major oversupply of office space. Shared work space concepts like WeWork may never recover and maybe overtaken by workers using Zoom and other online collaboration tools. Commercial retail and office space will be cheap, but that doesn't matter if there are no tenants. Warehouse and distribution centers supporting e-commerce and server farms are going to be an area for growth, but this is a very specialized kind of investment that won't work for the average investor.

Investors are trying to figure out how to convert commercial space to residential uses. I've heard of malls in Washington State being converted to housing. This type of use change will take a really long time to happen in the D.C. metro area. The likelihood that local governments will support changed uses in the near term is small.

With the exception of the current overbuying, all indicators tend to show price stabilization/moderate increase due to high demand in the residential real estate space.

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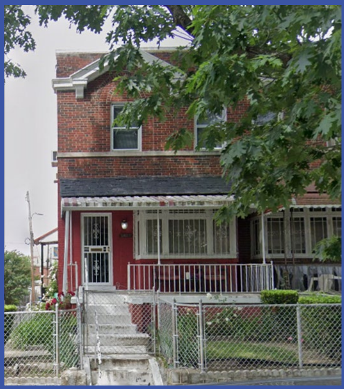
July Deals

8 Novak Dr.



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