Financial Advisory

Where Property Appreciation Comes From

BY CHRISTOPHER MILLER, MBA
SPECIALIZED WEALTH MANAGEMENT

In addition to income, we landlords also enjoy the appreciation of our investments. This appreciation, with the use of leverage, accounts for how many of us have made our fortunes. My client list includes a former gas company technician, several engineers and many former teachers who have become multi-millionaires as a result of their appreciating real estate investments.

This week, I am going to talk about where this appreciation comes from. This article was inspired by a conversation I had with a client last week. He asked me "Will I get better appreciation if I invest in California?" We will get an answer for him later in the article.

INVESTMENT PROPERTIES ARE DIFFERENT THAN RESIDENCES

It is important to point out that your house is valued differently than investment property is. Although we real estate investors sometimes buy single family houses to rent for income and growth potential, most home buyers do not – they are simply buying a place for their family to live. Most homebuyers buy houses the same way they buy cars or a refrigerator: by look for one with the features they desire. Wealthier buyers can afford more, and often buy more expensive models.

An investment property, like an 8-unit apartment building, is valued based on the income that

Please turn to page 15

WANT A REPLACEMENT PROPERTY WITHOUT ACTIVE MANAGEMENT?

Recent offerings, located nationwide, have included:

• Office • Apartments • Triple Net • Retail • Energy Royalties

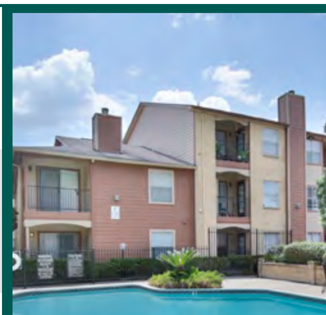
I have completed over three hundred 1031 exchanges for investors.
$200,000+ equity required.

Learn more about our investment programs at www.ChrisMiller1031.com

SPECIALIZED WEALTH MANAGEMENT

Contact Chris Miller, MBA
for a free consultation
877-313-1868
Chris@SpecializedWealth.com
2522 Chambers Rd., Suite 100
Tustin, CA 92780

Investing in real estate, with or without use of a 1031 exchange, carries the risk of losing your principal, income or tax benefits. Additionally, the IRS has issued inflexible guidelines for completing tax-deferred 1031 exchanges. Failure to follow these guidelines could lead to a loss of tax benefits. 1031 Exchanges can involve significant fees. This does not constitute an offer to buy or sell any security. Investments may be illiquid in nature and those seeking to dispose of their investments early may be unable to do so. Securities offered through Emerson Equity LLC. Member FINRA/SIPC, MSRB registered. Advisory services offered through Emerson Equity LLC an SEC registered investment advisory. Emerson Equity LLC and Specialized Wealth Management are unaffiliated.



Continued from page 12

it can produce. If you own an apartment property that is empty and want to sell, every real estate broker you meet with will suggest that you lease it up before listing the property. This is good advice: real estate investors buy property for the income it generates, and they will pay a multiple of that income for the property. When you use a Gross Rent Multiplier (GRM) or a Net Operating Income (NOI) measurement to value a property – you are placing a dollar value on every dollar of income that the property generates. No matter which measurement you use, more income = a higher value.

HOW APPRECIATION HAPPENS

Now that we have established that higher income = higher value, we see that rising income in the future can lead to rising values in the future. A property with rents that doubled over 25 years will have appreciated faster than one with rents that only rose by 70%.

WHERE CAN WE SEE MORE APPRECIATION

There's a reason that all stockbrokers' literature contains the disclaimer "past performance is no indication of future returns" – because it certainly is not. (Although he'll tell you it is.) Sears stock cost $6.07 / share in January of 1981 and hit $51.95 in November of 2004. Not counting dividends or proceeds from the spin-offs on Dean Witter and Allstate in the 1990's that is a 9.78% annual return from appreciation alone. Pretty good, but what happened over the next 23 years? (It looks like Sears died 15 years in.)

In the same way, we shouldn't expect the hot real estate markets of the past to continue as they have. Orange County exploded between 1985 and today. Can we expect the same level of growth over the next 35 years? That wouldn't be reasonable – there isn't enough room left to build. When we read about sky-high rents in San Francisco; can we assume they will continue to grow at the same rates into the future?

WILL WE SEE HIGHER APPRECIATION IN CALIFORNIA?

Let's move back to my investor's original question. My answer is that nobody has a crystal ball that tells these things, but let's take a look at where we are.

California has seen explosive growth, but we are running out of land to develop and places to put everyone – particularly on our freeways. At the same time, our residents are fleeing to states with lower costs of living that look like California did many years ago (wide open and ready to grow.) Prices simply can't rise until nobody can afford to live here – they will need to naturally correct by slowing their rate of growth.

Certain areas in Texas and Florida, and the Atlanta suburbs, on the other hand; look like Orange County did back in 1985. Businesses and people are moving in, and there is plenty of space to develop. I think a good case can be made that rents will grow faster in these areas than in California – and therefore we can see more appreciation.

Both of my sets of grandparents were from Ohio – from Cleveland and Toledo. John D. Rockefeller – once the richest man in the world, chose to live (and be buried in) Cleveland. Both of these cities saw fantastic growth in the early 20th century. Things changed by the middle of the century, and now my grandparents' former homes aren't worth much more than they sold for in the 1980's. I certainly don't think that California is going the way of the rust belt cities. My point is that things change and we, as investors, want to be where the positive change and growth is happening. If you have any questions, my office number is (877) 313-1868.

This does not constitute an offer to buy or sell any security. Investments in securities are not suitable for all investors. Investment in any security may involve a high degree of risk and investors should review all "Risk Factors" before investing. Investors should perform their own due diligence before considering any investment. Past performance and/or forward-looking statements are never an assurance of future results. Examples given in this article are for illustrative purposes only. Individual results may vary based on IRS tax changes, market conditions or tenant occupancy. Securities offered through Emerson Equity LLC, member FINRA/SIPC. Emerson Equity LLC is not affiliated with Specialized Wealth Management. California Insurance License # 0I80282. Copyright 2019 Specialized Wealth Management. All rights reserved.