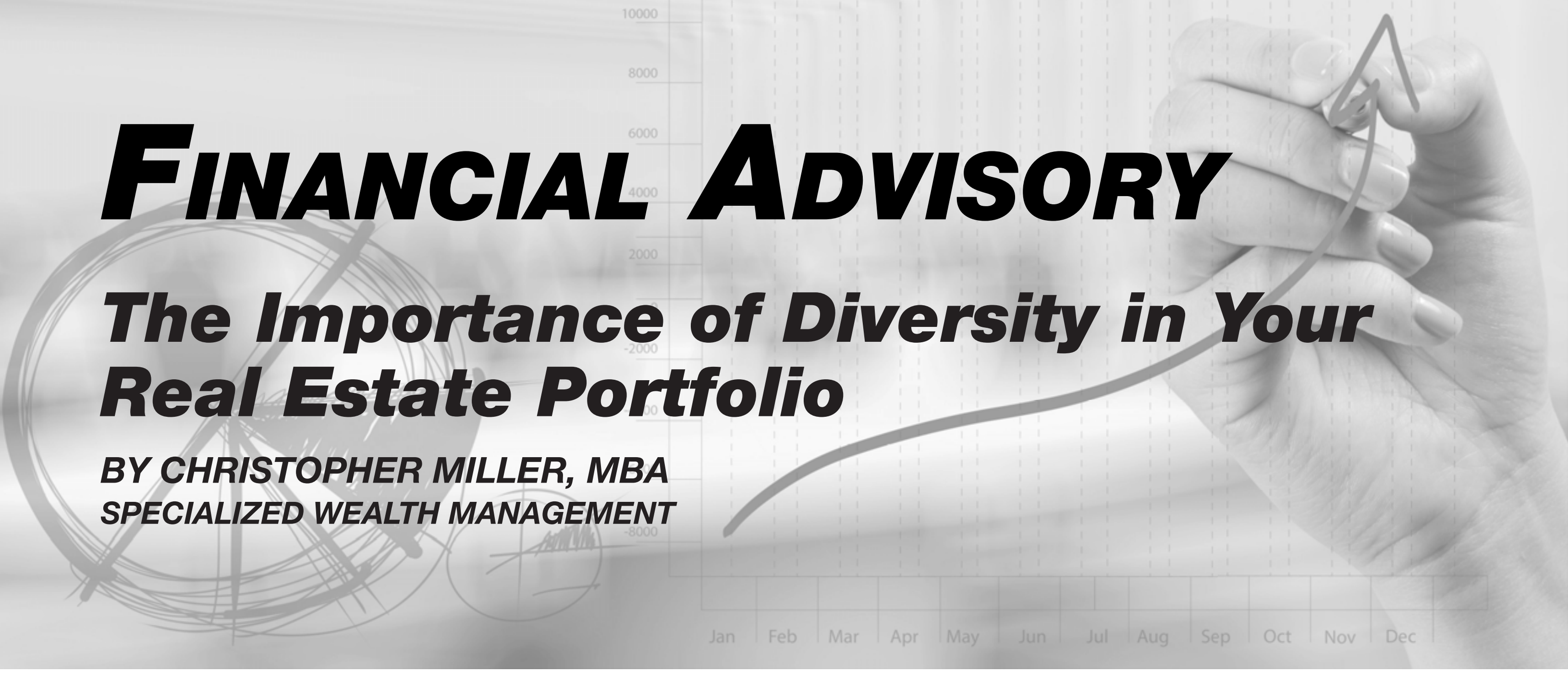

FINANCIAL ADVISORY

The Importance of Diversity in Your Real Estate Portfolio

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Our editorial deadline for this magazine is one month prior to publication. This makes writing about rapidly developing events such as the Coronavirus crisis particularly challenging. It is hard to predict the future, but that's kind of what my job is – I help my clients buy real estate in places that I think will show excellent growth over the next decade. Rather than buying in Orange County today "because it has grown so much since 1985;" why don't we buy somewhere that looks like Orange County did in 1985? Somewhere that has indicators suggesting that explosive growth is coming.

Our current economic situation has highlighted a concept that I have always talked about with my investors: the importance of diversity in your real estate portfolio. While the slowdown in the economy has affected the entire nation, some sectors of the market are affected less than others. On the other side of that coin: in good times, some areas will rise faster than others. For example; both sets of my grandparents followed all their children and dozens of nieces and nephews when they left Ohio in the 1980's. Today, their houses aren't worth much more than what they sold them for back then.

AVOID CONCENTRATION RISK

Proper diversification of our real estate investments helps us to avoid Concentration Risk. When we concentrate all of our assets in one market sector (for example: strip malls in Phoenix), our risk is higher because a problem in that market can affect us greatly.

To illustrate the importance of diversity, I often tell a story about a friend of mine: Back in early 2001 – in perhaps the greatest example of market timing in history – he sold his pay telephone holdings in Los Angeles for $1 million. He followed that, however, with some very poor timing – buying a highly-leveraged hotel to operate just before the September 11, 2001 terrorist attacks. Concentrating all of his assets into one market

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sector created a devastating loss for him. Unfortunately, I did not enter the 1031 Exchange market until December of 2001 – too late for him.

WHAT IS DIVERSIFICATION?

In real estate, a diverse portfolio can vary by product type, geographic location, tenant, and by industry. For diversification purposes, I focus on these market sectors:

CLASS A APARTMENTS IN GROWING METROPOLITAN AREAS

Class A Apartments typically are the "high end" apartments in a given area, and tend to attract more white-collar workers. These apartments typically enjoy premium rents and the highest values in their markets. As with any property; care must be taken to purchase these units at a good price. After all; the best way to create appreciation is to buy at a lower price.

CLASS B APARTMENTS IN GROWING METROPOLITAN AREAS

Class B Apartments typically target more of a blue-collar market. As many of these tenants will be "renters for life," these properties can have lower turnover rates – which can help keep expenses down. Prices are generally lower for Class B properties – which can lead to higher cash on cash returns for investors and higher appreciation potential upon sale.

SINGLE-TENANT, NET-LEASED PROPERTIES

A large focus of my business over the past decade has been on single-tenant, net-leased retail properties that are leased long-term to large, national, "credit tenants." (A "credit tenant" has publicly-rated debt by S&P or Moody's. They can't back out on your lease without causing themselves much larger problems.) These properties are performing well during this challenging economy – AutoZone, CVS Pharmacy, and Fresenius Dialysis – as well as a bottling plant and a fast-food restaurant distribution facility are all open for business as usual, and are paying their rent as agreed.

HOW MY CLIENTS DIVERSIFY: WITH PARTIAL INTEREST PROPERTIES INCLUDING THE DELAWARE STATUTORY TRUST (DST)

Most of my 1031 Exchange clients come to me with between $500,000 and $4 million of equity that they want to reinvest. Even on the higher end of that spectrum; it is really hard to create a good diversified portfolio. By using the DST, we can put $1 million in an apartment property in the Washington, DC Metro Area, $1 million in an apartment in the Atlanta suburbs, $1 million in a dialysis services provider in Dallas and $1 million in a diversified portfolio of net-leased properties spread out across the country and combined into a single DST offering. By doing so, we can create a nice stream of potential monthly income while spreading out our investment dollars to limit "all our eggs in one basket" risk. As a bonus: having a diverse portfolio with exposure to multiple areas will also give us more chances to "hit a home run."

A DIVERSE PORTFOLIO CAN DECREASE YOUR STRESS IN CHALLENGING ECONOMIC TIMES

When economic adversity strikes; owning a diverse real estate portfolio can make it easier to sleep at night. If I owned 100 apartment units here in California, and this represented the bulk of my assets, I would be a bit worried (to say the least) about rent freezes, eviction moratoriums, some groups' demands for "rent forgiveness," and the current bill in the California legislature that would require a 25% decrease in rent. If I had moved just 25% of my assets out of California and into a diverse portfolio – this would comfort me greatly.

Would you feel better with a more diverse real estate portfolio? If you have any questions, call my office at (877) 313-1868.

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