FINANCIAL ADVISORY

What is the "Pain Factor" of Your Investments?

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At a trade show recently, I spoke with a new real estate investor who was experiencing pain with his investments. For his first experience as a landlord, he chose a rent-controlled 4-unit property. This property, it turned out, causes more pain than he is ready for: as he inherited 2 (so far) problem tenants.

This month's article isn't a judgement on which properties are better than others – the answer to that will depend on an individual investor's wants, needs and unique circumstances. A property that is too painful for one may be just right for another. This month, we'll discuss the "pain factor" of real estate investments to help decide which may be right for you. I will illustrate with some examples:

A FRANCHISED RESTAURANT

The small business owner sits on the high end of our pain scale. Although the income from a business can be higher than that from owning passive real estate, that higher income comes from massive commitments of your time and financial resources. Payroll, purchasing, advertising and supervising employees will take up the bulk of your time, energy and worries as a business owner. I used to live close to three Subway restaurants, and it wasn't unusual to see the same man working

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behind the counter at all three stores. Why? Because he owned those three stores, and needed to show up and make sandwiches when one of his employees didn't come to work.

APARTMENTS

As my readers know, apartments can offer full time income with part time work – provided that one has the capital to make an initial investment. With apartments, investors can manage the level of pain they can handle from the property. Choosing non-rent-controlled properties can limit the amount of pain caused by government regulation. Buying a property with 15 or less apartment units (in California) can limit the pain caused by needing to hire an on-site manager[1]. Most importantly; pain can be minimized by choosing your tenants carefully.

I once heard that we landlords need to think of choosing tenants like business owners think of hiring employees. If a landlord screens and chooses his tenants carefully, he is more likely to end up with buildings full of renters who pay on time. Landlords who rent to the first prospective tenants that show up tend to have more problems. I have listened to countless stories from landlords who "believed in" a tenant who just got evicted or declared bankruptcy and were shocked when that tenant never paid a dime in rent. (Although I was rarely shocked when the story ended that way.)

If you find yourself constantly complaining about bad tenants; then perhaps:

A. You need to do a better job of "hiring" good residents for your properties.

B. Your property produces pain that is above your personal threshold. Consider selling it and completing a tax-deferred 1031 Exchange into a property that produces less pain – and make your life easier.

WHAT SORT OF PROPERTIES ARE RIGHT FOR YOU?

What level of pain is right for you? Everyone's answer to this question will be different. Did you ever ride in a limousine, only to sit up front to "keep an eye" on the driver and give him directions, or are you content to sit back and let those you hired do all the work for you? Me – I'd prefer to just drive myself.

The pain scale in real estate runs from high to low: from owning a management-intensive property like a hotel on the high end, all the way to owning partial interests of property on the lower end. Which level is best for you? That's something that only you can decide – after learning about your options. If you'd like to learn some more, I'd love to talk about it with you. My toll-free number is (877) 313-1868.

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[1]California Code of Regulations Title 25, section 42 states, in part, "A… …responsible person shall reside upon the premises and shall have charge of every apartment house in which there are 16 or more apartments…" thus necessitating a full-time on-site manager.