REAL ESTATE INVESTING

How Real People Get Rich

Buying buildings and land can be hugely profitable—or a huge headache. Meet five folks who are doing it right.

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(Photo: istockphoto.com)

There's something about real estate that captures the imagination in a way that quarterly 401(k) statements just don't. Perhaps it's the *realness* of it. Many companies that appeared in the stock pages 30 years ago no longer exist, but that old, seven-bedroom Victorian on the corner is probably still there. Even if it's not, the land beneath it is. And chances are, it's worth a heck of a lot more than it was back then. Real estate is "an investment vehicle that never goes out of business," says Marty Stone, co-author of *The Unofficial Guide to Real Estate Investing*. "That's as close to being a completely secure place to put your money as anything."

Secure? With all this talk of a real estate bubble? True, certain urban markets—New York City, San Francisco—may well be overvalued, but that doesn't mean there aren't deals to be found. Since the late 1960s, not one year has gone by when the median existing home price in the U. S. has fallen. One reason: Real estate is a limited resource. "Buy land," Mark Twain once said. "They've stopped making it." Another advantage: leverage. If you put $30,000 down on a $300,000 property and it appreciates 3% in the first year, you've just notched a 30% return. That doesn't include any rental income the property might be bringing in. How else can you make so much with so little? That's what the five individuals and families in this story asked themselves. Some are investing in real estate on the side; some have made it their primary business. Here's what they did right—and wrong—along the way.

The Second Chance

Nobody knows the risks of real estate investing better than Jim Silveria. In his 20s, the 51-year-old Long Beach, Calif., native began a career as a mini-real estate mogul, snapping up rental properties that were soon worth about $1 million, thanks to a rising market. Problem was, the rents he collected weren't high enough to cover his mortgage payments. When interest rates soared, hurting market appreciation, he was in trouble. In 1984 he declared bankruptcy.

Burned, he retreated, eventually starting a new career as a loan officer at a local bank. "I definitely had a bad taste in my mouth," he says. But in 1994, with real estate cheap again, he summoned the courage to tiptoe back in. He's doing it differently this time. For Silveria, it's all about the cash flow. His first purchase was an eight-unit apartment building in Long Beach for $230,000. Rents brought in $3,200 a month; his mortgage and expenses came to $1,600 a month. That meant nearly $20,000 a year in his pocket (before taxes). "From the get-go, I had a positive cash flow," he says. "That's the key."

A year later, in 1995, Silveria bought a ten-unit apartment building financed by the seller for $290,000, which gave him another $18,000 a year in cash flow. In 1997 he bought a 20-unit building for $320,000, with 20% down and the seller financing the rest. The building was in bad shape—homeless people had been camping out there, and it needed lots of paint, new carpeting, and new linoleum—but the cash flow was a healthy $4,000 a month. He converted it to condos and sold it earlier this year for $1.5 million.

What about that first property, which he still owns? The rents have doubled, and appreciation kicked in. The building he bought for $230,000 is now worth about $1 million. Today Silveria sits on a total of $5 million in equity on six properties and enjoys $20,000 a month of cash flow—enough to allow him to quit his bank job five years ago, travel, spend more time with his two young grandchildren, and look for more properties. (He lives in one of his buildings: "With the rents I get below, I live here for free.")

What about the dreaded midnight knocks on his door from tenants with leaky pipes? Not for him. Silveria has a part-time property manager to whom he pays about 5% of his cash flow, or $10,000 a year. His tenants don't even know he's the owner. Silveria prefers it that way: He doesn't look like the bad guy when the rents go up.

And what if the market goes south? First of all, says Silveria, it's not if, it's when: "It *will* happen." But this time, he has calculated, he can cut his rents in half and still have positive cash flow. "You have to prepare yourself for the storm," he says. "I'll be able to weather it."

The Accidental Landlords

Steve White's real estate investing career began in 1998 when he and his wife, Annabeth, moved out of their new home. The couple had bought a $340,000 three-bedroom house in the Studio City area of Los Angeles less than two years before, putting $63,000 down. But the mortgage payments were so high that White, an actor/comedian whose film credits include *Do the Right Thing* and *Clockers,* had begun to feel that he was "working for the house." Show-biz incomes are unpredictable, and he had known several successful comics who had lost their homes to the bank. "I will *not* get foreclosed on," White, now 39, remembers vowing to himself. So he told his wife they were going to be renters again.

Instead of selling, however, the couple found tenants for their house. The tenants paid $3,200 a month, an amount that not only covered the mortgage but also helped pay for the $1,800-a-month apartment the Whites moved into. That turned out to be a pivotal first lesson in the virtues of passive income.

Six years later White has parlayed that original $63,000 into the Studio City house, a 29-unit apartment building in L.A., and two houses in Las Vegas, where he now lives for much of the year. He got the money to do that by refinancing his original house as it soared in value, then buying and selling a series of smaller properties, racking up capital gains of $2.1 million along the way. His cash flow is now a robust $9,000 a month. What's more, the Whites have contracts on two additional properties in Vegas and one in Scottsdale. White credits good advice from his broker at RE/MAX, who explained the allure of Los Angeles's perennially low vacancy level and suggested he buy

undervalued multi-unit buildings with healthy cash flow in less affluent neighborhoods.

On average, White says he spends only about one day a week managing his properties, partly because he has help. At his 29-unit building, for example, he provides a free apartment to a couple who act as his on-site managers, in charge of collecting rents, writing leases, and filling vacancies. "I give them a bump every month if they have all the rents in on time and the building is full," he says. In each of his smaller buildings, he deputizes a tenant as his representative: "I give them a credit off their rent, and they help me post memos and keep an eye on the building." White maintains that people are misguided when they think investing distracts them from their primary careers. "It actually is the exact opposite, and I'm living proof," he says. "It frees you up."

The College Investors
Bert Cox, a 44-year-old father of two in Bow, N.H., had long dabbled in real estate while working as an environmental engineer. But five years ago he and his stay-at-home wife, Donna, 43, got serious when they considered they'd have to pay for eight years of college in just five years —Allison is now 16 and Stephanie is 15—and had less than $12,000 in savings earmarked for tuition. The Coxes feel strongly that the girls should be able to attend whatever college they like, no matter what the cost.

They figured they'll need $5,000 to $6,000 a month while their daughters are in school to finance their degrees without taking college loans. Their plan: Do it through cash flow from real estate, because "real estate allows a lot more leverage" than other kinds of investments, says Bert.

In 2000 the Coxes bought two two-family houses in Keene, a college town an hour away, where property prices were low and rents were relatively high. They collect $4,000 a month for the four units and pay expenses of roughly $2,600 a month. Two years ago they spent $265,000 on a huge Victorian in Concord that was split into five units; it brings in about $1,500 a month after expenses. And they just bought a four-unit apartment building in a nearby town that had been depressed but has recently shown signs of revitalization. Cox figures that once he finishes sprucing the place up and fills it with tenants, it will supply him with an additional $1,500 a month. The Coxes also own one single-family rental house and two homes that are under a lease/purchase agreement (for more on such agreements, see "The Rent-to-Own Strategists").

Bert has been scrupulous about not letting their properties get overleveraged. He gets the money for new down payments by saving the excess rents from their existing properties and by fixing up and flipping others. Once the girls start school, the thinking goes, they'll stop buying new properties and funnel the cash flow toward tuition. How close are they to the $6,000 a month they'd projected? "We're not there yet," Bert concedes. "But we will be by the time the girls go to college." That gives them another two years to reach their goal.

The Land Speculator
In his 20s, 73-year-old Bryce Thompson decided that the town he lived in—Princeton, N.J.—was so serendipitously situated between New York City and Philadelphia that the land in and around it would be valuable someday. "It doesn't take an Einstein to figure that out," he says. So he

began investing in raw land. He bought his first 89 acres with two friends back in 1959 for about $2,000 an acre. With that purchase, as with subsequent ones, "I was conservative," he says. "I stuck to the cheapest land because I figured it couldn't go lower."

Thompson's strategy: Buy and hold—sometimes for a very long time—until he can make a killing. He held on to his initial land purchase for years, then sold it in dribs and drabs, buying more land all the while. In 1978 he sold 2.7 acres for nearly $30,000 an acre. In 1984 he sold 5.8 acres for $85,000 an acre. In 2000 he sold 13 acres for $164,000 an acre. Now he's under contract to sell 5.9 acres at $203,000 an acre. Those sales represent only a small part of his holdings (he controls about 5,000 acres). Thompson estimates that he has so far unloaded 20% of his land to residential or commercial developers—where the real money is. He has sold about 30% to local and state governments.

Though Thompson declines to estimate his net worth, he has clearly made serious money doing this. But land speculation isn't for everyone. While you're sitting on the acreage, hoping it will rise in value, you have to pay taxes and interest. Consider the 5.9-acre parcel Thompson is selling now. The land cost him $2,000 an acre 45 years ago, but he says he has poured about $43,000 more into each acre when he factors in taxes, interest, the cost of improving roads, and the cost of bringing in water, utility, and sewage systems. What's more, land provides little to no cash flow; Thompson often leases his to farmers, but that income is usually not enough to meet his costs. And it's difficult to find financing: Banks generally want land buyers to put down 50% of the purchase price.

"There were times when it sure wasn't any fun," Thompson says. Like the years 1991 through 1994, when he lost an average of $1.7 million annually and tried to keep two banks at bay by putting up more and more collateral. He avoided foreclosure by just three days for several properties and by an hour for others. "Last year was the first year I didn't have to sell when I didn't want to," he says. "It's wonderful not to have that pressure when you get older."

The Rent-to-Own Strategists

Hans and Janice van der Kolk know the value of doing one thing in real estate investing and doing it well. Ten years ago 44-year-old Hans, the CEO and primary owner of a building-products manufacturer in Palmetto, Fla., met a real estate investor who told him about a potentially lucrative strategy. It was this: Buy a house, fix it up, rent it to a tenant—typically one who is trying to clean up his credit—and give that tenant the option to buy the house at a specified price in a certain time period. The rent-to-own tenant agrees to maintain the house, so expenses are minimal.

The van der Kolks were game to try it. In 1998, with $14,000 from a line of credit on their home, they bought a $65,000, three-bedroom concrete-block home in Bradenton that had been a foreclosure (they found it on the website of the U.S. Department of Housing and Urban Development). Over the next four weeks they spent an additional $3,000 and tons of sweat equity filling four dumpsters with debris, putting three coats of paint on every wall and cabinet, laying tiles in the kitchen and carpet everywhere else, and installing new brass knobs on each door and cupboard. They then took out an ad in the local paper offering the house for a 48-month lease ($925 a month) with an option to buy for $92,000 at any time before the end of the lease. (They

charged $1,500 up front for that option.) Of the $925 per month rent, the van der Kolks would put $100 aside toward the tenant's down payment. If the tenant never wound up buying, the couple would keep that money.

A dozen renters were interested—and the van der Kolks also got offers to buy the place outright for $85,000. "We were tempted by the cash," says Hans. "But there was more money to be made the other way." Here's why. Had they taken the cash offer, they would have made roughly $17,000 (before taxes). With lease-purchase, they'd get about $20,000 more. If the tenant couldn't manage to clean up his credit enough to buy at the end of the lease, they'd just start the process again with a new tenant. So far the van der Kolks have completed four lease-purchase deals, clearing about $30,000 to $40,000 per property, says Hans. It would have been even more had they anticipated the rapid housing appreciation of the past few years.

What about investing in the stock market? This family doesn't. "I cannot tell you what's going to happen in my own company next year," explains Hans. "Why would I gamble on a company that I don't control?"

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