**Is Your Real Estate Portfolio Diversified?**

"[You should have a strategic asset allocation mix that assumes that you don't know what the future is going to hold.](http://www.azquotes.com/quote/932482?ref=asset-allocation)"

*—Ray Dalio*

So you've conquered the your local real estate market. You've got 6 or 8 rentals, each earning cash flow. Congratulations! Now... what if a natural disaster decimates the area, or if the economy suffers a major setback? Uh oh....

If you were heavily invested in New Orleans before Hurricane Katrina, Detroit Michigan before automotive industry layoffs, or almost ANY market prior to the Great Recession, you understand the risk.

Investing in real estate is a time-tested strategy and one of the BEST ways to diversify away from the stock and mutual fund investments that most Americans already have. However, if your real estate investments aren't diversified, you could be vulnerable to setbacks and losses. So let's look at some options to make your real estate portfolio "bullet proof."

**Locations, Locations, Locations.**

A fantastic location (singular) is great, but if circumstances or the local economy changes the desirability of a location, you're better off with having multiple properties in multiple locations. Consider different cities, different areas of the country, even (perhaps) international real estate—of course with care, caution, and reliable professional advice!

Another wise move is to diversify the *types* of economies that fuel your real estate investments, such as working class neighborhood homes, commercial properties such as office spaces, and resort condos popular with upscale retirees and vacationers.

Would you prefer to be a "hands off" investor and skip all the location scouting, negotiation, tenant management and plumbing problems? You can! The simplest way to expand the types of properties you invest in is by becoming a private lender by financing bridge loans for commercial projects, residential lease option properties, or through real estate equity investing (being a fractional investor on an apartment building).

Even if you enjoy investing locally, first deeds of trust or bridge loan funds that invest in properties elsewhere can give your investment strategy stability and diversity.

**Types of Real Estate Investments**

Another way to diversify is to invest in different types of real-estate-based investments. There may be endless options, but some of the more popular types of real estate investments include:

**1. Rental Homes.** A great "bread and butter" investment, you can get started by either renting out a home you move out of when your purchase a new one, or purchasing a home specifically for the purpose of renting. Either way, you'll want to do your math! Perhaps the biggest mistake people make with real estate is counting on appreciation while paying too little attention to cash flow. We think that cash flow should be the cake, and appreciation—if you get it—makes for wonderful "icing on the cake." (Truth Concepts [Real Estate Analysis Calculator](http://truthconcepts.com/buy-now/real-estate-analysis/) can be used to calculate returns.)

Done wisely, buy-and-hold rental homes can allow you to take advantage of long-term cash flow as well as potential appreciation. You can keep it for years or even decades until market conditions are excellent for selling, while your tenants pay your mortgage and other costs.

**2. Commercial Rental Real Estate.** This is similar to rental homes or residential real estate that you own and rent out, except these properties are commercial in nature, such as office buildings, warehouses, or storefronts.

Commercial real estate can be an excellent investment, although you might expect higher start-up costs. Commercial markets can also be more fickle than residential markets, so be aware. While residential markets tend to be fairly stable, it is not unusual for office buildings to sit empty during a downturn, or for a "hot neighborhood" to turn sluggish when the next hot neighborhood surfaces (one reason to consider shorter-term bridge loan investments or funds when it comes to commercial real estate).

**3. Commercial Bridge Loans.** You may be familiar with residential bridge loans as a temporary financing tool that allow a homeowner buying their *next* home to access the equity in their *current* home until they can sell it. With a commercial bridge loan, the temporary financing is done on a commercial property, such as a hotel, office or apartment building. A "bridge loan" puts financing in place while a property is improved or rehabbed, or while an income history is established that can allow the owner to secure permanent financing at more favorable terms.

When you invest in bridge loans, you are technically a "private lender," rather than an investor. There are multiple opportunities for private lenders, from short-term first deeds of trust (often one year term), to bridge loan funds, which require longer terms, yet offer higher returns. (Bridge loan funds are available to accredited investors only, with one million dollars in net worth, not counting their residence, or $250k annual income/$300k for couples.)

Want more cash flow? Our clients who become private lenders earn at least 7% annually, and yes, you can use a self-directed IRA. If you have lazy assets and would like monthly checks, let us know you'd like to put your dollars to work!

**4. Apartment Buildings.** Perhaps the "gold standard" of real estate investments, multi-family apartment buildings typically produce higher returns than rental homes. A well-managed apartment building in a desirable area can generate low double-digit returns consistently, plus nice tax advantages and the potential for future appreciation!

The downside of apartment buildings is that it's not a beginner's game. There can be significant financial investment, plus managerial experience required to do it well. Done poorly, you can end up losing money and/or dealing with nightmare tenants or lawsuits.

**5. Real Estate Equity Investing.** We can make referrals to a company with an excellent track record of happy clients that offers the upsides of investing in apartment buildings *without* the burdens of selecting, purchasing and managing them. They offer investors a fractional share of equity, along with healthy cash flow and a plan that puts their initial investment back in their pocket by the fourth year... while still maintaining an equity position and continued cash flow!

This company works with accredited investors only, and if you are qualified, we'd be happy to get you further information on request. ([Ask us about "real estate equity investing"](http://prosperitypeaks.com/contact).)

**6. "Flipping" Homes.** In spite of the popularity of cable TV shows that make this look easy, it's not! It's trickier and less profitable than you think. Quality contractors aren't cheap, and if you do the work yourself, you have to factor in the value of your time. There can be big risks involved, as a dip in the market can wipe out your profits, and your money has a cost, which is ignored by misleading "reality show math." As former Seattle realtor Kate Phillips notes, TV shows fail to factor in interest costs, lending costs, or closing costs such as title, escrow, so consider these shows as entertainment, not factual representations of investments.

**7. Lease-to-own homes.** Investing in lease-to-own single family homes can be a successful strategy in certain markets, such as those with depressed housing prices. According to professional real estate investor, Jimmy Vreeland, lease-to-own strategies offer unique advantages to investors willing to learn how to do it well. Lease-to-own sellers/landlords experience decreased management burdens because tenants are hopeful buyers willing to care for their future property and assume maintenance tasks themselves.

**8. REITs.** REITs are very popular with investors right now because of recent favorable returns and the ease of investment. Most function much like a mutual fund or a private equity fund and offer a "hands off" way to invest in real estate. However, REITs can offer similar downsides as mutual funds, performing poorly in a down economy. According to a [*New York Times* article](http://www.nytimes.com/2008/12/14/realestate/commercial/14sqft.html), during the financial crisis, "Just as stocks fell fast and furiously, so, too, didmost REIT shares." In 2008 alone, commercial property REITs (the majority) dropped 49% in value, while mortgage REITs lost 42%. Thus, even though some REITs have revised strategies after such losses, we don't recommend then as a proven diversification strategy.

**9. Land.** While land can have its place in a portfolio, it's not one we recommend for most investors. Unless the land is being leased (perhaps for farming or camping), land does not typically produce cash flow. So purchasing land is usually speculative in nature—you're hoping or assuming the price will rise—and while you wait, you've got property taxes to pay.

**10. Part-time rentals.** Like to travel? Fancy a vacation home? Savvy investors look for second homes that can earn money when they're not there. This works especially well for properties with year-round demand, such as New York City condos, resort homes in Hawaii, or beachfront properties in Southern California or Florida. You can hire a management company to manage rentals, or manage them yourself using AirBnB.com or VRBO.com (vacation rentals by owner).

Of course, while you're away... you can also rent our your "first" home, too! Laura Lavigne is a life coach with a travel bug who rents two rooms on AirBnB.com when at home. Then she packed her bags for a 6-month trip to Europe, renting out her entire home (to a single party, requiring no day-to-day management). In this way, she has all but eliminated her mortgage payment year-round, giving herself increased income and freedom, while building equity in a six-figure asset that also provides a "home base."

**Is It Time to Diversify?**

Ultimately, a safe bet is to diversify into multiple types of real estate investments. Currently, we work with several companies offering one or more opportunities for investors who wish to be private lenders.

And if the thought of investing in something a bit "out of the ordinary" makes you a bit nervous, consider a few things:

* **Real property.** Unlike stocks and bonds, real estate investments are secured by real physical assets. (That's why it's called "real" estate!) Real estate markets don't drop to zero in a matter of months like Enron stock did in 2001.
* **Collateral confidence.** Banks and other lenders routinely lend from 75% up to 100% on real estate. Now ask your banker what percentage they'll lend you with your IRA as collateral.
* **It's insured.** What if a property is destroyed in a worse-case scenario fire, flood, or storm? Chances are, it's covered by insurance... unlike your mutual funds.
* **Start small, go slow.** You don't have to trade all of your stocks for real estate-based investments overnight, or ever. You can start with as little as $25k with some investments, gaining confidence as you receive regular checks.

Whether you want to add real estate to your portfolio or diversify the holdings you already have, get in touch with us for more information. We specialize in helping clients "Build Wealth Without Wall Street," and we'll show you how to diversify away from market risk and use time-tested strategies for better results!

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