7 Tips to Increase Your Real Estate Profits in Today's Markets

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Higher-Level Details of the Real Estate Market

Learn how it will affect your investing.

I speak with dozens of real estate investors each week – from the brand-new, just getting ready to get their feet wet, wannabe investors to the grizzled, old-school investors who have been buying and selling property for nearly as long as I've been alive. While we spend a lot of time talking about the tactical aspects of real estate investing – how to find deals, how to make more money on a flip, how to market and find buyers, etc. – I've found that not nearly enough investors are concerned with higher-level details of the real estate market, and how it will affect their investing.

> *"Where we are in that cycle and how we can use that information to improve our ability to find and profit from deals.*

The goal of this article is to spend a little time discussing the bigger picture of the real estate market cycle, where we are in that cycle and how we can use that information to improve our ability to find and profit from deals. Regardless of your experience level or understanding of real estate markets, in general, I think you'll find this discussion interesting and thought-provoking, and hopefully you'll walk away with some new insights to help you make more money.

Overview of How Real Estate Cycles Work

While we all know that real estate values tend to trend upwards over time, anyone who has been in this business for at least 10 years will tell you that prices don't move upwards in a straight line. Sometimes values increase tremendously over short periods of time; sometimes values increase very slightly; there are periods of time where values tend to remain flat – they don't increase or decrease significantly; and, of course, there are even times when real estate values will drop.

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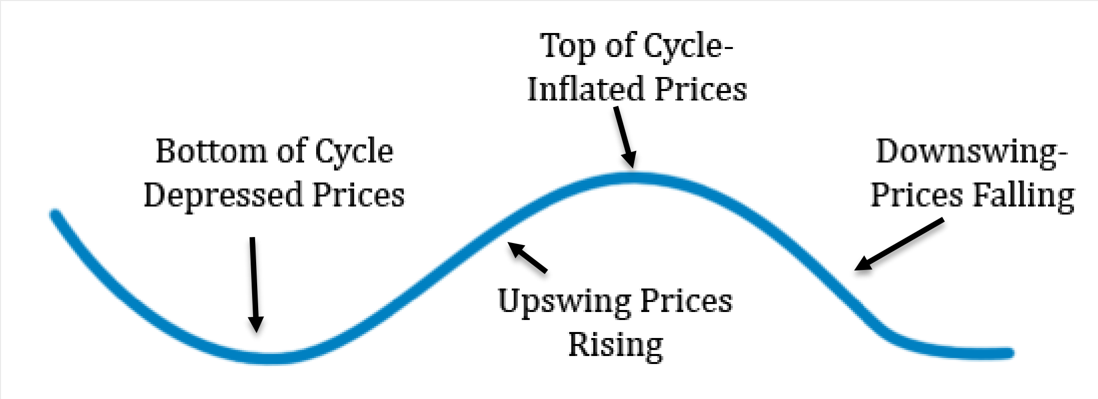
If you map these trends over long-periods of time – decades, for example – you'll find repeating cycles that look pretty much like you'd expect from any cyclical financial market:



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Of course, if history is any indication, the upswing part of most real estate cycles will be higher than the subsequent downswings; this means that average prices over long periods of time will trend upwards. This is why investing in real estate over the long-term is almost always profitable. You may come in at a bad time, but if you keep investing, the cycle will play out, and the upswings will outperform the downswings.

> "*Where are we in the current cycle and how do we use that information to help us make better investing decisions?*

With that said, to be successful in real estate investing, you have to be able to adjust your investing strategies for different points in the cycle. So, the important question here is: Where are we in the current cycle and how do we use that information to help us make better investing decisions, which in turn lead to more profitable investments?

While we can never know exactly where we are in a real estate cycle (except in hindsight), there are clues that we can glean from various sources. For example, most experts would agree that right now (2017 - 2018), we are on a major upswing in the market. I like to use the following major analysis tools when I'm considering where the real estate market may be in a current cycle.

Major Analysis Tools

Observation

While I use the term "observation" here, I could just as easily be using the term "common sense." If you look around and pay attention, you can typically get a good idea of where the local market is in a real estate cycle. Across the board, we have seen an increase in real estate values across most asset classes (that's a fancy way of saying, "across most different types of real estate") and in most areas of the country, for the past few years. Again, just using common sense and the power of observation, we should be able to conclude that values are trending upwards and that we are headed towards the top of the cycle, not the bottom of the cycle.

Data

While there are literally thousands of factors that contribute to the ever-changing real estate market in any given area, there are some factors that tend to appear more often than others and that tend to have a much larger influence (and meaning) than others. Specifically, there are four key factors that tend to influence real estate market cycles and also tend to provide an indication of where we are in a cycle:

1.) Population Trends: Population growth or contraction is perhaps the strongest influencer of real estate cycles. When populations grow, the demand for housing can quickly out-pace the existing supply, creating a "seller's market." This increased demand for housing and apartment units causes vacancies to drop, as people are willing to rent any available space. The competition by buyers causes rents to rise, and increased income pushes the value of investment properties up.

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On the other hand, when population rates are trending down, supply out-paces demand for housing, and consequently rents will drop and vacancies will start to rise. As property income drops in this "buyer's market," the value of the properties themselves drop, and prices fall.

2.) Employment Trends: Employment growth or contraction is important because it is a key indicator of what is likely going to happen with population growth. For example, when a big company moves into a city, it has a big impact on population. Not only does it bring employees with it and hires local talent, but it also provides a stable population of consumers who need services such as restaurants, auto repair, hair-dressers, etc. So, while a company may move into town with 1,000 employees, the service industry to support those 1,000 employees may bring another 1,000 or 2,000 people to the area. Employment growth can quickly drive population growth.

Of course, when companies leave town or lay off employees, it tends to have a negative effect on population trends, and also on the real estate market. Again, not only will the employees leave town, but there is now less demand for the accompanying service industry, and those service workers will likely leave town searching for greener pastures elsewhere.

3.) Building: When populations are increasing, builders go crazy trying to keep up with the demand for housing. Generally, builders are so focused on getting as much housing inventory on the market as quickly as possible that they don't notice when supply starts to overtake demand. This leads to overbuilding, where there are too many rental units on the market than are being demanded.

With too much inventory, vacancies start to rise, which leads to falling rents, and ultimately falling property values. Eventually, builders will stop building, but by then it's often too late, as the market is more than saturated.

If there is still a strong underlying economy in the local area, population should continue to grow, and eventually the over-supply of housing units will be absorbed. If the underlying economy is not strong, it may take many years for the excess housing units to get absorbed, and the local real estate market may stagnate for long periods of time.

> “ *Locations where there is a high divorce rate, families will tend to be smaller, and the demand for housing will tend to be higher.*

4.) Socio-Economic: Trends in number of households and household income play a key role in the vacancy and income rates experienced in the surrounding markets.

For example, in locations where there is a high divorce rate, families will tend to be smaller, and the demand for housing will tend to be higher. Changes in household income also play an interesting role in investment real estate; when household incomes surpass a certain threshold, people start to buy houses as opposed to renting, thereby hurting the investment market.

I won't go into a lot of detail here (you can look up a lot of this type of data using the Census Bureau and the Bureau of Labor Statistics websites), but suffice-it-to-say, if you look at population trends, employment trends, building trends and socio-economic trends over the past decade, things have been increasing/improving a nice pace, and all indications are that we are in a more financially secure place as a nation than we were back in 2008-2010.

Hopefully, that's enough information to convince you that we're currently in an upswing in the real estate market. Assuming so, the big question now is: How can we leverage this information to help us be more profitable with our deals?

While I still think it's a great time to be flipping houses in most parts of the country, here are my seven biggest recommendations for anyone looking to jump into their first (or second or hundredth) deal in this market.

7 Steps to be More Profitable

1) **Be certain of your numbers**. While this is important in any market cycle, it's especially important in a hot market. Knowing and verifying your rehab budget, your ARV and your "fixed costs" (buying costs, holding costs and selling costs) is tremendously important when the market could level out – or downturn – while your project is in the works. In fact, this is where a great lender can be invaluable – crowdfunding lenders, hard money lenders and private lenders should all take an active role in helping their borrowers validate their numbers and ensure that the deal being funded makes sense and "pencils out."

2) **Keep projects quick.** There are parts of the market cycle (just after a bottom of the cycle, for example) where taking your time on a project can actually help you generate increased profits. When a market is trending upwards and appears that it will continue to do so for at least another year or two, taking your time on a project means that your ARV will likely increase from the start of the project until completion. But, when you're further into an upswing, dragging out a project won't necessarily get you extra gains, and could ultimately cost you some profit if things turn while you're dilly-dallying.

This also means that if you have to choose between a big-and-more-profitable project and a small-but-less-profitable project, going for the smaller project isn't necessarily a bad choice.

3) **Don't take on more than you can reasonably work on simultaneously.** To build on the tip above, in this type of market, I recommend not buying a lot of properties with the intent to rehab them in sequential order (one after the other). In some markets, there are opportunities to buy lots of properties in short periods of time (for example, the winter months in very cold climates), but that often means not having the manpower to rehab them all at once. While that might be okay in certain other parts of the market cycle, late in an upswing is not the right time. If you have properties sitting for months waiting to be rehabbed, you run the risk of the market turning before you ever start rehabbing them.

If you're going to buy multiple properties without the ability to rehab them all at once, I highly recommend wholesaling the ones you can't get do or partnering with other investors who have extra bandwidth to take on the projects.

4) **Have multiple exit strategies for each project.** While rehabbers hate to think about what they'll do if a property can't sell (I know I do!), it's important in this type of market to have a Plan B…and perhaps a Plan C, as well. These days, I'm focusing on buying properties that I'm confident would make decent rentals or lease-option properties if a scenario were to arise where I couldn't resell them for a profit. There are lots of other potential exit strategies for a rehabbed properties that ultimately can't be flipped – make sure that you have at least one or two of those other options at your disposal when you're considering buying a flip.

5) **Avoid thin deals.** While there are times when real estate markets make drastic turns (take 2007-2008, for example), typically the move from upswing to downswing is a lot more subtle, and often there is a period of flat values between the upswing and the

downswing. With that in mind, if you have a deal with 15-20% returns built into the numbers, that means that the market can potentially drop 15-20% and you still won't be losing money on the deal.

But, when you start taking on deals with 5-10% returns, if the market has even a minor correction, you could be facing potential losses on your deals. For that reason, I highly recommend that you focus on the deals that have the greatest returns available, and when in doubt, try to pay a little bit less for a property than you might have paid for that same property in the past.

6) **Avoid large amounts of leverage.** What got a lot of rehabbers in trouble back in 2007-2010 was the fact that they were taking loans on their properties for nearly the entire value of the property (what we refer to as high amounts of leverage). That meant that even a small correction meant that the value of the property was less than what was owed to the lender, and unless the rehabber could come up with some cash, the lender was likely going to be put in a position where he or she needed to foreclose. Many rehabbers lost many, many properties this way in the last real estate recession.

Instead, if you're going to get funding on your flip deals, focus on keeping LTV (loan-to-value ratio) at no more than about 75%. This way, even if there is a 25% correction in the market, you still can avoid the risk of foreclosure on your properties.

> *" focus on keeping LTV at no more than about 75%*

7) **Focus on the largest buyer demographics.** Every market has a "sweet spot" for rehabs – that range of values, locations, house styles, finishing materials, etc. that appeal to the widest range of buyers and that are easiest for buyers to get financing for. When a market shifts into a downswing, these are the types of deals that are the most likely to still get sold, simply because there are more potential buyers out there who may be interested in the property when it's listed for sale. In other words, when you're in a situation where the market may turn, avoid doing high-end rehabs that have fewer potential buyers and more difficult financing requirements; avoid very low-end rehabs where buyers tend to be more difficult to qualify for financing; and avoid "taste specific" rehabs that will appeal only to a small segment of the buyer pool.

Investing towards the top of the market can provide some fantastic opportunities that aren't available in other markets, but as we have discussed, there are some risks. If you follow the tips above to help avoid and mitigate those risks, you can take advantage of the market, maximize your profits and continue to thrive throughout this market cycle.

Happy Investing!

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