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JIM: When looking at a diversified portfolio, real estate is often a forgotten asset class, and with all the negative press is it really a good investment today? Well, today we have special guest Ryan Parson who has grown up in his family's real estate business and is currently chairman and chief investment officer at Heritage Capital USA. He's the director of investor relations at Colonial Capital Management, and he's a national speaker on real estate investing and portfolio management. Welcome, Ryan.

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RYAN: Hello, Jim, thanks for having me today.

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JIM: I have been looking forward to this because I know of your background of investing in real estate and it's something that it's really hard for a lot of people to put their finger on. We had this major decline in real estate, and yet I hear in some areas it's doing really well. I know for myself personally last about two years ago I was told that the real estate market was improving and yet I had real difficulty selling my house. I had to sell it for less than what I had into it, and I owned the house for 18 years, so what the heck is going on out there?

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RYAN: Well, there's a lot of examples out there like that, Jim, even in our current day and it really has to do with what took place back in 2008 when you had two significant market conditions coming together, and one of course that we all know very well was the stock market, and what was happening with the decline on Wall Street, and just the amount of investor capital or investor cash that was fleeing the stock market while simultaneously, Jim, you had all these banks that were amassing a significant amount of what were called or are called non-performing mortgages. As we all remember is as people were losing their jobs or becoming under employed and not being able to pay their mortgages, all of these what were performing loans started turning into non-performing loans, and that and those two elements, stock market declining and the rise of these defaulted mortgages in this country really had a significant ripple effect, that even still to this day, Jim, going on eight years later we're seeing the backlash of that, but it's also simultaneously creating a significant opportunity for investors to also take advantage of and really be part of the solution to the problem as well.

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JIM: So tell me, Ryan, before we get into some of that, I'd like to explore, dig a little deeper in where things are at just in the general sense. Now, I keep hearing that foreclosures are in decline yet real estate isn't moving much. What's going on there, is it real that things are getting that much better or what's happening?

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RYAN: Well, there is overall depending on the lens that you're looking at it through, Jim, and what really happened, the peak of the foreclosure start meaning new foreclosures filed by the bank, really happened in April of 2012 there, and so going on three and a half years ago it's been on a steady decline ever since, and if you hear that in the media you tend to believe that, well, this housing crisis must be over, it's returned to some degree of normalcy, but for what you just mentioned it hasn't necessarily done that.

Just because the big banks aren't foreclosing doesn't mean there's not still what we call phantom or shadow inventory out there, and what has happened, the banks have moved to a liquidation strategy of the mortgages instead of foreclosing on those defaulted mortgages, and that liquidation strategy has really meant that they are selling those non-performing loans at some pretty steep discount into the private investor marketplace, whether that's hedge funds, whether that might be REITs or even to private individuals. Those loans are being sold into what I call the private secondary market today because it's more efficient for the private sector to be able to work through those loans, work with the borrowers to help them get performing on their mortgage again, than it is for the large box, big box banks to do it.

We've all heard the stories, Jim, well the bank wouldn't work with me, the bank couldn't find a mortgage payment that I could afford based on what my situation is for my family need today. When it's the private investor market that can hold those assets and work with the borrowers, I would say in a more diligent format, there is a significant greater amount of success both for the homeowners and the investors in that realm today, plus it's just plain and simply more cost effective for the banks to not to have to deal with them and sell them at a discount, and get them into the hands of an investor or an institution more better geared, believe it or not, to help the homeowners than the big bank can themselves.

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JIM: We've seen a lot of consolidation in the big bank area, and one thing I know, I mean I've worked with a lot of small banks and bank presidents there and board members in these small community banks, and it's almost, it's almost counter intuitive what's happening. You have first of all, all these loans that were, supposedly we have to be pre-approved or these loans were getting approved for people that probably had no business taking out mortgages, and then the ramifications of that were now the feds are coming in and saying, you need to foreclose on a certain amount of these loans, and they're not looking at people, they're just looking at paper and say you've got this much debt, you've got this much equity, we need to clean up your balance sheets, and it's pretty much almost like a carpet bombing effect, they just start foreclosing on all of these, and that I think was the first wave.

So now what you're saying is the banks realized how inefficient they were and they found a less expensive way to deal with this and clean up their balance sheets by selling these non-performing assets. Is that a safe assessment?

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RYAN: You're absolutely right there, and throughout all of this time from 2008, especially at the early stages of it, Jim, when it just, it really blew up the whole industry. None of the banks were really ready for this huge amount of inventory of non-performing loans that were on their books.

Ironically one of the pieces that happened throughout all of the illustrious regulation that's come down from Washington, and I know you talk about various regulatory elements on your shows, Jim, and part of what was happening believe it or not is that the banks were being hamstrung. It really wasn't completely the bank's fault either where the feds were saying, you will not foreclose on these people. We are not going to be the administration that foreclosed on America and really put all of the stipulations that were very difficult for the banks to even try to work through a loan modification, let alone actually foreclose, but what really happened with that, Jim, is that as that, those regulatory issues were being imposed and then no one was paying the mortgages, which also then meant nobody was paying the property taxes, nobody for paying for the city services like water and sewer and trash services, as you know to your point in these small communities, that that's where a large portion of those communities revenues come from, and if all of the sudden nobody is paying those because either nobody is living in the house, nobody is re-working that loan to get that house reoccupied again, or so on and so forth, what really started to change is when the local municipalities started saying back to Washington, look, you have to let them foreclose. We've got to have these properties re-occupied again. We need the city services being paid again, and that's really what we've seen the last three and four years now, Jim, to really help turn the overall real estate market around in what was otherwise would be these zombie assets that are out there really blighting our neighbors and our community, and causing the revenue stream for the local communities to not be there.

That's where you've seen now so much of a greater shift to cleaning up the balance sheets of the banks, and now that they've got the ability to do that is why we're seeing that shift again to them selling these assets versus having to deal with them on their own because they're still even to this day, somewhere between seven and eight million non-performing mortgages in this country today. There's no one institution big or small that's capable of dealing with it all.

09:01

JIM: You know what's interesting, too, and I'm sure a lot of our listeners have seen this happening, and I know I've had some dealings where I know of business owners who were current on everything but because of the re-evaluations, the banks were being forced to foreclose on their owns even though they were performing, they were paying their mortgage payments and everything else, but the deck to equity ratio because of the drop in the values created a situation where the banks were being forced to foreclose even on performing loans, and one thing I saw too is I was involved with some of these real estate investment trusts where a lot of these got over leveraged.

They took advantage of the easy money and let's say they borrowed 10% to make an investment on a loan, they got their tenants in there, everything is working great but all the sudden the valuations are 60%, 70% of what they used to be. Their debt to equity isn't right, the banks say we're not going to renew your three-year note and continue to extend the way we always have been, and they don't have the cash to pay it down and boy, a lot of investors got hit with that, and the problem that we see a lot of times too then is we see all these problems and like when the stock market crashes, everybody gets out, then they think stocks are all bad all the time.

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RYAN: Right.

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JIM: Real estate, if you look at the long term returns, real estate and stocks are kind of neck and neck in long term returns as far as total return. The differences I see with stock market, most of it is growth of the asset, a little bit in dividends. Real estate is kind of just the opposite, a lot more comes from the distributions because of rents and a little bit more for growth, but at the end of the day you take the total returns are pretty close, so I think, we talked about a lot of bad stuff here so let's shift gears and talk about the opportunity after we take a short break, so please stay tuned.

[BREAK]

11:48

JIM: Welcome back as we continue to visit with Ryan Parsons, and Ryan you've had a lot of experience in real estate, and you've been a private investor in real estate and you've worked with a lot of clients, helping people invest in real estate, and before the break we were talking about all the bad stuff going on and thousand there are still a lot of foreclosures out there and there's a lot of non-performing mortgages, and sometimes where there's a lot of bad things happening there can be some pretty good opportunities, and let's talk about that a little bit, and it's not necessarily, you talked about how the banks had non-performing assets in lieu of foreclosure they're selling these assets, to while investors might come in and buy these assets off the bank balance sheets, it's not that they're kicking people out in the street and doing things like that, they're actually able to work with people in a way that the banks aren't, and it's almost a win-win situation.

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RYAN: It's a significant win-win situation I think, Jim, and as you've alluded to before the break there of realizing that there is good to come out of all of this, and one of the biggest elements as you were talking about, return. In talking about any type of investment class is looking at how you are acquiring a particular asset, and do you buy an asset at retail price or do you buy an asset as a discount, and we all like, Jim, to be able to get anything bought on sale, and that's what really has been created under these market conditions is being able to buy these assets at some pretty tremendous discounts today, in large part because of the assets are non-performing.

They're not necessarily picture perfect. There are challenges that need to be worked through. What has really created because of these market conditions today is that the banks are willing and very able to sell these assets at very significant discounts in part because of the things that you mentioned, the borrower may have lost their job due to the unfortunate market down turn and so they're not paying their mortgage, and so to attract a good quality investor to buy that mortgage, it's going to be bought at a substantial discount which creates a nice opportunity in the marketplace to know that you as an investor have bought an asset at a discount, but then that gives you good room to work with the homeowner to find a new mortgage amount and a modification plan that can be very helpful and very comfortable for them so that they can continue to stay in their home.

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JIM: There are a lot of ways to do this, and we were talking about real estate in general, let's kind of explore the different ways there are to invest in real estate. One way is you go out and buy a property. Now, one thing I've always told people, and I've been a big believer of this for many, many, many years from the time I bought my first house, I had a duplex, and I even looked at the duplex, I didn't look at it as an investment, I looked at it as a place to live and live inexpensively because I had my tenant paying part of the rent, but I never looked at it as an investment, and any place you live it's a quality of life issue, and most people kind of fool themselves when they buy the big house that they say, well, this is going to be a good investment, but they never take in all the cost of maintenance, their property taxes, the insurance, and if people were ever totally honest with themselves, I think very few people will find that the house that they bought to live in turned out to be an investment.

When we're talking about investment real estate, let's talk about the different types of investments that are available, so Ryan, what are the different ways we can invest in real estate?

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RYAN: Sure, so you make a great point I think, too, Jim about our own private properties that we live in, those are what I call a use asset, on an investment asset, so I completely agree with you there, versus maybe owning a rent property. That seems to be, Jim, when people are saying to themselves, hey, I think I need to have more direct real estate as part of my overall portfolio or some appropriate mix inside of that portfolio. They typically start off by buying rental property, and maybe a rental property in their own backyard or maybe a rental property somewhere elsewhere they know they've got a good property manager, but regardless they buy that house to put a tenant in there, and as you properly mentioned, Jim, there are taxes that need to be paid, there is maintenance that needs to be done, there's insurance that needs to be paid but that owning that physical piece of property is typically where most real estate investors start at.

You collect the rents every month, pay all the expenses, and hopefully have dollars over at the end of the month or at the end of the year to put in your pocket. There can certainly be some very strong advantages to that because owning the real estate can serve as a potential hedge against inflation as we've talked about, Jim, is that the property values may increase over time, and so some investors tend to look at that as a potential hedge against inflation, that's one example.

Another example is like what you've also alluded to, maybe owning some commercial properties where, or multi-family properties like apartment complexes might be another avenue where you have multiple tenants into one piece of real estate. Another asset class within the overall real estate scope might be what has been termed as hard money lending where as a private investor you go make a private loan to another investor who may be buying a property to fix it up and turn around and re-sell it at a profit, but they come to you much like they would a bank, but they come to you as a private investor to get the loan from as opposed to going to a bank. Again that falls into that hard money lending bucket, and this fourth area that's become very, very common today is again buying an existing loan as a deep discount from a bank or hedge fund of those natures. Those are generally the four categories of real estate, Jim, that I see most investors taking advantage of today.

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JIM: Ryan, I've got to emphasize this point, too, I've come across clients and they've got a bad stock so then all stocks are bad.

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RYAN: Right.

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JIM: Or they're in, they might be in just one area of stocks, so you have, with stocks you have the company risk, you have geography risk, you've got the industry risk, you've got the general market risk. You've got the same thing with real estate, and if you look there are definite different classes as you talked about. For example, hotels as real estate and you've got day to day tenants. You can go to storage facilities or maybe apartments, you've got month to month. You can go into commercial real estate and you might have 10-year leases, so there are all different kinds of risk, different types of returns, but at the end of the day if you're going to invest in these types of assets you want to diversify just like you do with stocks, and there are different ways to invest in real estate. You might do it privately or individually, you might join a group that's involved in a partnership that you might do this with, but for the average person there are also tools that it doesn't take a lot of money to get involved.

There are things like mutual funds, there are REITs which are real estate investment trusts, there are partnerships, there are different things that you might be able to invest in as a way of diversifying an overall portfolio, and with anything the more diversified you are, the better you are hedging yourself against individual risks that are there, but there's also so many opportunities.

I've got to make this point, Ryan, you said earlier when do people buy, they want to buy at a discount. Well, that's true when they go shopping, but usually they're investing, people tend to buy things when they're high and their neighbors are doing it, you know, and when things are low everybody is panicking and leaving. Do you find that in your walk of life?

19:52

RYAN: No, it's a great point, and there certainly is that out there. It's riding what I call the emotional train of investing, and what we really try to work with when we see investors that are out there is realizing that there are discounts in really good markets, in good market time, and there are discounts in maybe more challenging time. The idea is to be able to identify the right assets and series of assets that provide the appropriate discount given the risk that you're taking on, and so what I think is also important to note here, Jim, I think you said it very eloquently, there's risk in anything that you do, any investment that you make there is risk, it's how you choose to manage that and who you have along with on your power team to help you manage through all of that, and so just understanding that there are those risks involved and what the market is rewarding, or how the market rewards those investors for taking on that risk is what's appropriate to realize, and so there is, you're right about that, Jim, you don't want to let your emotions get the best of you in any sort of an investment situation, because you're right, we all know that we stand around the water cooler and talk about all the good and talk about all the bad, and if you make those decisions sometime, even on all the good it might not be the most appropriate thing even at that time, and certainly sometimes exiting real estate at a down time is not particularly necessarily, especially if you're not levered or have too much debt against your investment.

You brought that up earlier on some of these properties that banks were foreclosing on even though the loan was perfectly performing, they didn't renew the line of credit or they didn't extend the terms and the borrower lost it, and that's a great example of having too much debt or too much leverage against your asset. If you don't have that and you have more of an equity position, even in some of the darkest of real estate times, you can ride your way through that because you're not obligated to a bank, and that's where we see investors who do really well with real estate over a long period of time. They manage how much debt they have against their real estate portfolio and have a very long term horizon when it comes to that element of real estate within their overall investment portfolio.

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JIM: Well, Ryan, this has been great. I think you've shed a lot of light on the subject, and real estate seems to always be the forgotten asset class, and one thing is this is certainly an area you don't want to go it alone. There are a lot of moving parts, and you want to work with a team that understands what your goals and objectives are, and understands the investments because whatever you do, you should, in today's market there shouldn't be any sacred cows but there also shouldn't be any slaughtered cows. You should consider all these different assets as important parts of an overall diversified portfolio, so thank you, Ryan.

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RYAN: Thank you for having me, Jim. We appreciate you.

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JIM: Thanks for joining us this week, and tune in again next week as we explore another phase of the Real Wealth process, and remember if anything you heard in today's show you'd like to get more information about, contact your Real Wealth advisor. Also if you feel that any of this information would be helpful to a friend or family member, just click the Forward to a Friend button.