

High Yield Investment Alternatives

If you're retired or saving for retirement, it's likely that your stock-laden portfolio looks a little less invulnerable than it did a couple of years ago. It's possible, too, with interest rates on bonds, money market funds and bank CDs at all time lows, that you're counting on a fixed income that doesn't fully meet your needs.

"If only I could increase my monthly income without depleting my nest egg," you think, "and without losing sleep over the stock market."

Well, there are ways to make this happen: by investing in trust deeds, or private mortgages loans, by investing in tax liens certificates, and by investing in real estate investment trusts or REITS.

Private Mortgage Loans

Simply put, trust deeds are short-term loans to real estate investors secured by the value of the real property as collateral. Investors who invest in trust deeds typically make a 12 to 18 per cent return, paid out monthly, with a minimum investment of just \$50,000 and relatively low risk. As a result, they are able to enhance their lifestyle significantly without threat to their principal, or built a large nest egg, safely, in a relatively short period of time.

When you invest in a trust deed, you are in essence buying a mortgage secured by real estate. You receive fixed monthly payments from the borrower based on the terms of a promissory note.

You can invest in trust deeds on your own, lending your money directly to a borrower. But it wouldn't be advisable unless you have the time and expertise to evaluate property and to screen out borrowers, and know your way around the legal maze of real estate transactions.

Or, you can invest in trust deeds through companies that specialize in this type of investment.

By far the biggest attraction of trust deeds is their high yield. Borrowers, often real estate investors, are willing to pay interest rates of 12 percent and higher because they need a quick short-term loan to purchase or refinance a property without the hassles and red tape they may run into at a bank.

Or sometimes borrowers may not qualify for traditional financing at lower rates because of minor credit problems or liens against the property. Or the property may be too small or located in an area that makes conventional financing difficult.

Your protection against default is the property that secures the promissory note. That's why it is so important to invest in trust deeds with a low "loan-to-value ratio."

In other words, the loan should be only for a certain percentage of the appraised value of the property (and you must use a reliable and experienced appraiser). As a guideline, investors should seek loan-to-value ratios no higher than 70 percent for single-family homes, 65 percent for apartments and 65 percent for commercial and industrial developments.

One risk of trust deeds is lack of liquidity - you typically can't get your hands on your principal until the loan is paid off. Trust deed loans often are for a year or two.

Another risk is the possibility of default and foreclosure. True, you are likely to recover your money eventually and even make a profit from the sale of the foreclosed property. But in the meantime you may go months without receiving any interest payments.

That said, trust deeds available through reputable and experienced firms offer an attractive combination of risk and reward.

But what happens in a recession, particularly one in real estate?

If you believe property values are going down 10 percent, you are still protected by having claim to property assessed at a higher value than the loan amount. Of course, if you believe property values are going to go down 50 percent, then you are not protected.

But then many stocks and even some stock mutual funds have gone down 50 percent or more in the past year. That's why many investment advisors consider a portfolio of carefully selected first trust deeds with low loan-to-value ratios and secured by properties in desirable locations to be a much safer investment than stocks. And trust deeds historically have delivered similar or even higher long-term returns, without the nerve-wracking ups and downs of stocks.

TAX LIEN CERTIFICATES

How would you like to make money paying someone else's real estate taxes? There's a little-known investment opportunity available in 31 states where investors can put up as little as a couple hundred dollars to get in on the action. You're probably thinking: "I pay enough taxes as it is, why would I want to pay someone else's taxes, too?" Well, how does an annual interest return from 18 to 50 percent sound?

These returns are available through tax lien and tax deed certificates sold throughout the country on a county basis. Tax liens are what the local government places on properties where real estate taxes are late. Figuring that they won't get that money right away, the local government auctions off the lien to investors once or twice a year. These are called "tax sales."

If owner Smith owes \$2,000 in real estate taxes and hasn't paid it, the county will place a lien on his property and then auction that lien to an investor. The investor gets the lien for \$2,000 and the county gets the money it needs right away to pay its ongoing expenses. Meanwhile, the treasury or finance department then starts going after the money from the delinquent tax payer. They send nasty little notes, warning them of further action and placing stiff penalties and interest charges on the tax. These interest charges can be as high as 50 percent - and that's how the local government can then turn around and pay these investors 16, 18, 20 percent and more.

The place to find these nifty investments is at the local treasury or finance department. There are also web sites where the information has been compiled. You could end up paying as much as \$39 per state for the information or, as on one site I visited, \$49 for the whole country (encompassing 3,300 counties). Since more than likely you're going to go after local liens to start with, save yourself the money and just contact your local treasury or finance department. If you don't know where that is, then just call the main information number for your county or city and ask for the tax department - they can help you from there.

Basically, these are short term investment opportunities. After the lien has been auctioned off, the county lets the owner know that they may lose their property to the tax lien certificate holder if they don't pay the taxes and now taxes, interest and penalties. This gives the property owner another opportunity to redeem the tax bill and keep his/her property. If they don't, then the tax lien certificate holder can foreclose on the property.

In some areas, instead of a foreclosure, the government actually sells you a tax deed to the property - meaning if the taxpayer doesn't pay the taxes, you become owner of the property straight out. There are the amazing stories about people hitting it rich in these tax sales. There's one floating around about a gentlemen in Tulsa, Oklahoma who paid \$17 at a tax sale for a property he then sold for \$4,400 and another where the property was bought for \$298 in back-taxes and sold for \$8,450. It's also true that each year people are hit by lightning. There are risks and hazards with tax certificates. The property might be

trashed, you could lose your investment by not following procedures, title may be weak, and - lets face it - former owners may be both irate and well armed.

Because the liens are auctioned, a hot property might only be available with unattractive terms. In some jurisdictions, you may "win" the property but then be responsible for all unpaid taxes and mortgages. If you have to foreclose, that may result in another round of costs. In some jurisdictions, the owner may have an "equity of redemption" right that allows him or her to re-acquire the property after a foreclosure action. Be aware of these and other risks and act accordingly. Investors must carry out due diligence to limit risk. This means researching the properties (which are usually publicized in a local newspaper or on the tax departments web site a few weeks before the sale), understanding your potential obligations, knowing what the rules are, speaking with local brokers and attorneys, and realizing that while you may do well in the best circumstances, the "best circumstances" may be rare.

Most impacted property owners (about 95 to 98 percent) actually pay the taxes. So most folks who invest in these certificates are doing so for the interest paid on their money. There's a lot more to these sales, and various jurisdictions have different rules. As an example, visit the Montgomery County, Md., tax sale web page for a good example of what will be required of tax sale. For those interested, research the process, visit an auction first to watch how its done, know the rules, and then decide if this is an investment for you.

REAL ESTATE INVESTMENT TRUSTS

A REIT is a company that buys, develops, manages and sells real estate assets. REITs allow participants to invest in a professionally-managed portfolio of real estate properties. REITs qualify as pass-through entities, companies which are able distribute the majority of income cash flows to investors without taxation at the corporate level (providing that certain conditions are met). As pass-through entities, whose main function is to pass profits on to investors, a REIT's business activities are generally restricted to generation of property rental income. Another major advantage of REIT investment is its liquidity (ease of liquidation of assets into cash), as compared to traditional private real estate ownership which are not very easy to liquidate. One reason for the liquid nature of REIT investments is that its shares are primarily traded on major exchanges, making it easier to buy and sell REIT assets/shares than to buy and sell properties in private markets.

Following WWII, the demand for real estate funds skyrocketed and President Eisenhower signed the 1960 real estate investment trust tax provision which established the special tax considerations qualifying REITs as pass through entities (thus eliminating the double taxation). This law has remained relatively intact with minor improvements since its inception. REIT investment increased throughout the 1980s with the elimination of certain real estate tax shelters. Investments in real estate provided investors with income and appreciation. The Tax Reform Act of 1986 allowed REITs to manage their properties directly, and in 1993 REIT investment barriers to pension funds were eliminated. This trend of reforms continued to increase the interest in and value of REIT investment. Today, there are over 300 publicly traded REITs operating in the United States their assets total over \$300 billion. Approximately two-thirds of these trade on the national stock exchanges.

REITs fall into three broad categories:

Equity REITs: (96.1%)

Equity REITs invest in and own properties (thus responsible for the equity or value of their real estate assets). Their revenues come principally from their properties' rents.

Mortgage REITs: (1.6%)

Mortgage REITs deal in investment and ownership of property mortgages. These REITs loan money for mortgages to owners of real estate, or invest in (purchase) existing mortgages or mortgage backed securities. Their revenues are generated primarily by the interest that they earn on the mortgage loans.

Hybrid REITs: (2.3%)

Hybrid REITs combine the investment strategies of Equity REITs and Mortgage REITs by investing in both properties and mortgages.

Individual REITs are able to distinguish themselves by specialization. REITs may focus their investments geographically (by region, state, or metropolitan area), or in property types (such as retail properties, industrial facilities, office buildings, apartments or healthcare facilities). Certain REITs choose a broader focus, investing in a variety of types of property and mortgage assets across a wider spectrum of locations.

The current REIT industry's investment choices can be broken down by property type as follows:

- Retail 20.1%
- Residential 21.0%
- Industrial/Office 33.1%
- Specialty 2.3%
- Health Care 3.8%
- Self Storage 3.6%
- Diversified 8.5%
- Mortgage Backed 1.5%
- Lodging/Resort 6.1%

Both foreign and domestic sources provide investment in the REIT market. REITs are owned by thousands of individuals, as well as large institutional investors including pension funds, endowment funds, insurance companies, bank trust departments and mutual funds. Investment goals for REIT share ownership are much the same as investment in other stocks--current income distributions and long-term appreciation potential.

The majority of REIT shares can be purchased on the major stock exchanges, and orders can be placed through stockbrokers. Financial planners and investment advisors can help to match an investor's objectives with individual REIT investment. REITs also provide an annual report, prospectus and other financial information directly to an investor. Recently, mutual funds have emerged specializing in REIT investment.

In general, REITs and their performance have some common characteristics with small-cap stocks and bond-like investments. The market capitalization of the average REIT on the Wilshire Real Estate Securities Index is \$340 million. REITs comprise 6% of the small-cap index, the Russell 2000. However, REITs have advantages over stocks and bonds in terms of dividends: between 1995 and 2000, the average dividend yield on REITs (7.3%) is six times that of the Russell 2000 average dividend. Furthermore, all REITs pay dividends, whereas less than half of the Russell 2000 stocks pay dividends.

The long term performance of an individual REIT is determined by the value of its real estate assets at any given time. One of the primary incentives for REIT investment is the low correlation of its value to that of other financial assets. Because of this, REITs possess low relative historical volatility and provide some degree of inflation protection. In addition to the advantages of an investment which avoids double taxation and requires no minimum investment, REITs offer investors current income that is usually stable and often provides an attractive return. Another factor attractive to the investor is that a REIT's performance is monitored on a regular basis, by independent directors of the REIT, analysts, auditors, and the business and financial media.

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