

Passive Real Estate Investment

Alternatives to Active Participation Real Estate Investing

Active participation real estate investing involves ownership of real property. If the property is income producing, such as single family homes, apartments, office buildings, warehouses or retail centers, the investor must be involved in the day to day management of his property. If the property management is out sourced the investor gives up a significant portion of his return to the management company; further the property manager must still be supervised and major decisions affecting the property such as repairs, capital improvements, expenditures, market positioning, timing of sales, rent rates etc., must still be made by the investor. If the investor is a rehabber or flipper, real estate becomes more of a business rather than an investment. Many successful real estate “investors” are actually real estate “operators” in the real estate *business*.

Perhaps you, like I, want to capture the high yields and potential capital appreciation of investing in real estate, but don't want the management hassles and time commitment involved in active property ownership. Maybe you have a full time job or business, or perhaps you're retired looking for greater income than bank CDs and greater security than a volatile stock market. Or perhaps like me, having owned income producing property for many years, you're tired of “tenants and toilets”. If so, consider passive real estate investments, i.e., investing in real estate *securities*.

Types of Passive Real Estate Investments

REITs

Real Estate Investment Trusts are companies that own, manage and operate income producing real estate. They are organized so that the income produced is taxed only once, at the investor level. By law, REITs must pay at least 90% of their net income as dividends to their shareholders. Hence REITs are high yield vehicles that also offer a chance for capital appreciation. There are currently about 150 publicly traded REITs whose shares are listed on the NYSE, ASE or NASDAQ. REITs specialize by property type (apartments, office buildings, malls, warehouses, hotels, etc.) and by region. Investors can expect dividend yields in the 5-9 % range, ownership in high quality real property, professional management, and a decent chance for long term capital appreciation.

Real Estate Mutual Funds

There are over 100 Real Estate Mutual Funds. Most invest in a select portfolio of REITs. Others invest in both REITs and other publicly traded companies involved in real estate ownership and real estate development. Real estate mutual funds offer diversification, professional management and high dividend yields. Unfortunately, the investor ends up paying two levels of management fees and expenses; one set of fees to the REIT management and an additional management fee of 1-2% to the manager of the mutual fund.

Real Estate Limited Partnerships

Limited Partnerships are a way to invest in real estate, without incurring a liability beyond the amount of your investment. However, an investor is still able to enjoy the benefits of appreciation and tax deductions for the total value of the property. LPs can be used by landlords and developers to buy, build or rehabilitate rental housing projects using other peoples money. Because of the high degree of risk involved, investors in Real Estate Limited Partnerships expect to earn 15% - 20% + annually on their invested capital.

Real Estate Limited Partnerships allow centralization of management, through the general partner. They allow sponsors/developers to maintain control of their projects while raising new equity. The terms of the partnership agreement, governing the on-going relationship, are set jointly by the general and limited partner(s). Once the partnership is established, the general partner makes all day to day operating decisions. Limited partner(s) may only take drastic action if the general partner defaults on the terms of the partnership agreement or is grossly negligent, events that can lead to removal of the general partner. The LPs come in all shapes and sizes, some are public funds with thousands of limited partners, others are private funds with as few as 3 or 4 friends investing \$25,000 each.

High Yield Private Mortgage Notes and Trust Deeds

These notes are fully secured by income producing real estate, and the loan proceeds are used by the professional real estate investor for the acquisition, rehabilitation or equity cash out of residential and commercial properties. Investors have the opportunity to obtain above market returns of 12 - 14% in first trust deed positions and 15 - 18% returns in second trust deed positions. These loans are usually for duration of one year and provide a monthly income with interest only payments.

Private Mortgage Notes usually do not exceed 65% of the current appraised property value. Private Mortgage Brokers originate these loans, and are able to obtain these high yields because of the unique advantages these loans offer to the professional real estate investor. They are able to close most loans in 2 weeks or less whereas institutional lenders require 6 weeks or more to close and fund a commercial mortgage loan. Further these loans are asset based; the real property itself is the basis of the lending decision. Hence, if the property is producing sufficient income to pay the note interest and the value of the property will fully secure the note and provide sufficient equity, then borrower credit is not an issue. Instead of concentrating on minute detail of the borrower's credit history as institutional lenders do, private mortgage note holders concentrate their due diligence efforts on the real estate securing the loan. They provide a borrower with the ability to borrow on underwriting criteria not available through institutional lenders, hence investors in private mortgage notes are able to receive much higher yields with no increased risk.

Don H Konipol is General Partner of Managed Mortgage Investment Fund LP, a private investment fund that provides short term asset based financing for commercial and residential real estate investments in Texas. These loans are used when conventional financing is inappropriate or unavailable. Don can be reached at dkonipol@yahoo.com or 832-577-8838.

