Chapter 1: Introducing Real Estate Investing

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Real estate is everywhere: the apartment or house you call home, the mall where you go shopping for groceries and clothes, and the office where you work. Even the park where you take your kids and walk your dog is property with potential investment value. But like any other investment, real estate has its risks, too. Remember the old saying "land rich, cash poor"? The expression summarizes the very real wealth that exists in land but also the financial dangers land ownership poses if you don't have a strategy. What kind of real estate interests you most? Have you considered the skills — and weaknesses — you bring to your role as an investor? Building wealth through real estate investing means becoming land rich in order to become cash rich, too. You want to do it right!

In this chapter, we discuss the various opportunities awaiting you as an investor, and some of the risks real estate carries. We look at some of the considerations you should bear in mind as you're sizing up the different investment tools available. Finally, we investigate how real estate can fit into a long-term financial plan, and the implications that it can have for your retirement and your estate.

Investigating Real Estate Investing

So what's the big deal about real estate, anyhow? Why is everyone from the government honchos who manage the Canada Pension Plan right on down to your Uncle Ed buying property? In this section, we check out the advantages of real estate and compare property relative to other kinds of investments you may consider as part of your portfolio.

Discovering the opportunities

Statistics from the Canadian Real Estate Association indicate that residential real estate has increased in value by an average of more than 5 percent a year over the past 30 years. While there have been some significant dips during that period, and not every property will make the same gains in every year or from city to city, the trend is unmistakable: The long-term potential for the appreciation of your real estate investment can be tremendous if you manage to structure your properties properly. And several reasons bolster our argument that an investment in real estate makes sense. We outline them below.

Leverage opportunities

Leverage is all about using a small amount of your own money and letting someone else's cash do the rest of the work. Because real estate provides the loan's *security,* a guarantee of repayment if you're unable to pay off the loan, the risk can be low if things go right for you. If you run into financial trouble and your *creditors,* the people who've loaned you cash, demand immediate repayment and call your loan, your property could be subject to proceedings that lead to its sale. Providing the property sells for more than the amount owing, you stand to emerge relatively unscathed. The nature of forced sale of your property depends on the province and the mortgage documents you have signed. For example, in Ontario the power of sale process does not require court approval, whereas in some other provinces the foreclosure and property sale process requires the court to be involved throughout.

Equity opportunities

By paying down a mortgage, you're paying down the liability value of the property and making its value your own. Real estate is therefore unlike many other investments because it gives you a chance to build *equity* — your share of the property's net worth at the time of purchase — over the course of the investment rather than invest everything upfront and hope for the best. Given the chance for an appreciation in the value of your property while you're making those payments, that's a significant advantage over other forms of investments where leverage is not involved

WARNING!

Beware of negative equity! Although real estate is a convenient means of building equity (and that's a good thing), a drop in the market can bring destruction and result in *negative equity,* a situation in which the market value of a property is less than the mortgage it secures. This typically happens when an investment is financed with too much debt, a condition known as being overleveraged, and was a common scenario in the United States following 2006 as interest rates on certain types of sub-prime mortgages began increasing and saddling buyers with payments they couldn't afford. It has also been an issue in a minority of cases in Canada. To some investors, negative cash flow is more relevant than negative equity. In this scenario, the investor would consider negative equity an unrealized loss that over time could turn into positive equity as the market improves. Leveraging is the key to successful investing, not overleveraging. The latter concept implies excessive risk taking, which for many investors would not be a prudent investment business model.

REMEMBER

Be careful because real estate is the major cause of families going bankrupt.

Return opportunities

That's return on money, not the chances you'll return alive from a property! But you'll probably do that, too, and get to enjoy the benefits of a net return of as much as 150 percent annually on your investment. How do we figure that? Simply put, the return is calculated on your investment.

If you buy a $200,000 property with a $20,000 down payment and the property increases in value by half over five years, the increase in equity is $100,000. That amounts to approximately $75,000 after the government taxes the appreciation in the property's value, or *capital gain.* This would represent a return of 375 percent over five years, or at least 75 percent annually on your original investment of $20,000. Given that the debt you incurred to buy the property would have decreased over the course of the five years, and provided leasing allowed you to see income from the property, you would enjoy an even greater return on your investment.

Tax opportunities

Real estate offers several tax advantages for you as an investor, especially if you've developed an investment strategy that accounts for taxes. Taxes erode the return you'll see on investments yielding a fixed return, such as bank accounts, bonds, and guaranteed investment certificates (GICs), but not Tax-Free Savings Accounts (TFSAs). Stocks and other equities put your principal at risk. Leveraged real estate investments, however, often are subject to a reduced tax rate. The tax advantages range from tax-free capital gains on your principal residence to savings as great as 50 percent on taxes levied on capital gains from investment properties. You might also be able to deduct investment expenses and write off any depreciation in property values.

Hedge opportunities

No, we're not suggesting you hide from your creditors in a bush! The kind of hedging we're talking about means taking shelter from the effects of inflation, which works to erode your buying power. The rate of inflation varies from month to month, year to year, and even country to country. But real estate typically appreciates at a rate three to five percentage points above the inflation rate. So if inflation is running at 3 percent, look for your investment in real estate to appreciate at 6 to 8 percent. If you choose wisely, your investment stands a good chance of increasing at a rate greater than that of inflation, as Figure 1–1 shows.

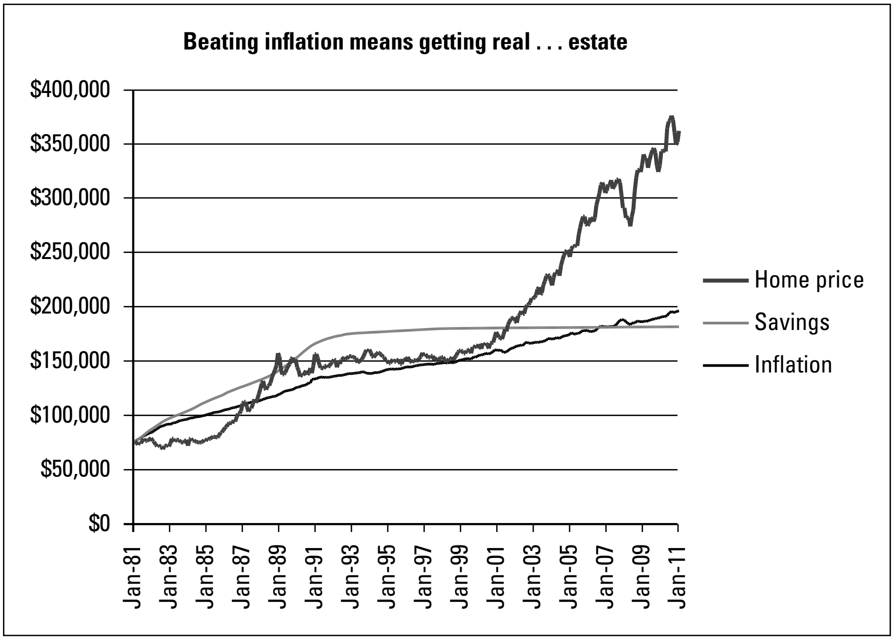

Figure 1-1: Average home prices haven't always increased at the same rate as inflation, but they've steadily outpaced increases attributed to mere inflation.

REMEMBER

You're paying off your mortgage in dollars that reflect inflation, also known as *real dollars.* So, although the value of your mortgage will diminish over time, you will typically enjoy a higher income thanks to salary increases or rental revenue increases that will help make your mortgage more affordable to carry over the long term.

Flexibility opportunities

Real estate offers a variety of investment options that give you flexibility in terms of how much attention they demand and the amount of risk you'll bear. By investing in just one property rather than several, or in partnership with family or friends, you can limit (or increase) your involvement to the level that suits you. Be warned when investing with family because blood and money often do not mix well. Make sure all your co-ownership documents are sound.

Learning opportunities

Most investments entail some sort of learning process. Real estate is no different. Prior involvement in buying property, such as a home, may make it easier, but don't underestimate the need to learn about the particular dynamics of investing in real property. Real estate investment also offers opportunities to learn about the community issues and economic trends at work in neighbourhoods. And, if you're game for the role of landlord, you'll also have a chance to improve your people-management skills.

Homing In on Residential

Buying a home is typically the first major real estate purchase you'll make. But if you've never considered your home as the starting point for an investment portfolio, why not? Even tycoons need somewhere to lay their heads, and finding a home for yourself is a convenient way to explore and hone the skills you'll need to tackle more complex deals as an investor.

Home-buying is a chance to practise the basic acquisition skills you'll need to select and secure properties. If you decide to rent out a suite in your condominium, townhouse, or house, you'll be able to test your management and human relations skills, as well as other joys of being a landlord. And, of course, home ownership brings regular opportunities to familiarize yourself with the hands-on maintenance that makes up the practical side of managing a real estate investment.

Investing begins at home

For many, the family home has a venerable position worth more than its weight in gold. Making money on it is the last thing some people consider doing — but more than one homeowner has been delighted to find that his home has appreciated in value, bringing him a sizeable nest-egg just in time for retirement. For families who have occupied the same home for several decades, the original investment can deliver a return in both happy memories and hard cash.

Buying a home with the added motive of seeing it double as an investment property will intensify the importance of many of these issues. You'll be scouting features that not only are desirable to your family as occupants but also could appeal to potential tenants. You'll also be conscious of points that could help the home fetch a higher resale value when it comes time to sell.

Rent out a suite, pay down a mortgage

Tenants aren't called "mortgage-helpers" for nothing. Homeowners looking to build equity in their property can do so far faster if they have rental income feeding into their cash flow than by going it alone. Tenants also help a mortgage out in another way: Most mortgage companies will factor rental revenue into the value of a home when calculating the amount of a mortgage you can obtain when you're buying.

Tenants can help you pay off a mortgage faster, whether it's for your primary residence or a full-fledged rental property. Figure 1–2 shows why tenants can give you something to rave about — at least from a financial perspective.

Take the example of a $125,000 bungalow with a finished basement (separate entrance, of course) in Charlottetown. Renting the basement to a student at University of Prince Edward Island for $500 a month would give you enough to add an extra $100 a week to your mortgage payments. Assuming an average interest rate of 6 percent over a standard 25-year term, those extra payments could reduce the length of your mortgage by 11 years and save you just over $37,300 in interest.

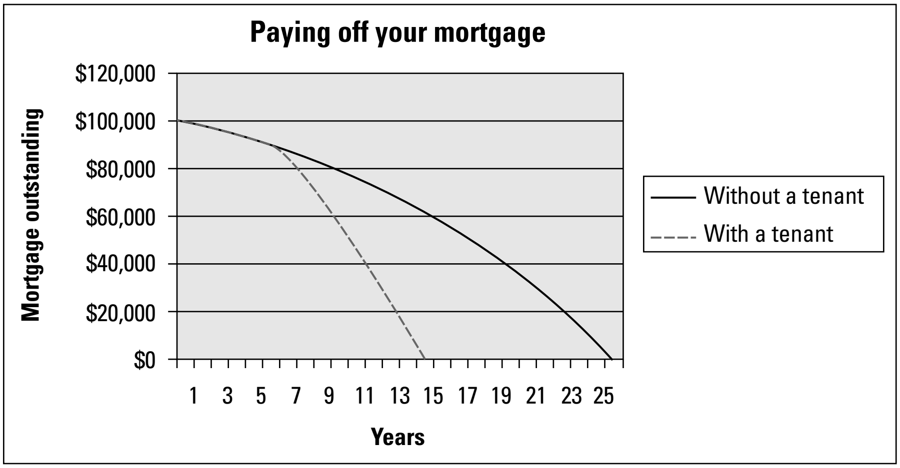

Figure 1-2: A mortgage-helper can significantly shorten the standard life of a $100,000 mortgage.

Being a landlord isn't for everyone, however. Renting a suite in your home to a tenant, even temporarily, not only gives you some extra cash to put toward the mortgage, but also gives you a good idea of whether you want to become a full-time landlord on a larger property or multiple properties.

WARNING!

A shifting rental market is one of the major risks to renting a suite in your home. This is particularly true in smaller college or university towns, where you may be able to count on only eight months of rental income a year. Should demand for rental accommodation slacken, you may lose your ability to levy rents adequate to service your mortgage.

INVESTIGATE

Modifying your home for rental purposes (so long as local bylaws allow, of course) will affect your insurance coverage, so for peace of mind make sure your policy protects you with additional coverage. Insist that tenants obtain their own home insurance and provide you with a copy. You need to be sure you're covered in case a fire starts in the rental suite and your own property is consumed.

Managing tenants

Even the best tenants and properties require attention. From maintenance you might otherwise ignore, to keeping track of and collecting rent, you have to keep on top of issues that you wouldn't have to watch if you were just counting on your property to rise in value rather than generate revenue. Knowing some of the scenarios that could arise will help you prepare and be a more confident landlord — and a more successful investor! Right now it's worth emphasizing the importance of having a rental agreement, especially if you're renting a suite in your primary residence.

TIP

To cut off potential problems at the pass, ask prospective tenants to complete a tenancy application form soliciting information such as rental history, names of previous landlords and other references, and the right to do a credit bureau investigation.

Rental contracts should include the following:

- ✦ The number of permanent residents allowed in the unit
- ✦ The term of the lease — whether month-to-month, renewable after a year, or reverting to month-to-month after an initial term (usually a year)
- ✦ Whether or not pets and smoking are allowed
- ✦ The damage deposit and grounds for its return or retention.

Managing property

Your ability to attract tenants and charge a higher rent will increase with the quality of the suite you offer. Be prepared to make modest, ongoing investments in the suite that will allow you to maximize the rent you can reasonably expect a tenant to pay. Painting the suite may enable you to charge a higher rent that will more than pay for the paint job over the course of the tenancy. Getting in the habit of investing in regular maintenance and upgrades in your own home will prepare you for the economics of managing a stand-alone residential investment.

Securing Commercial and Industrial Properties

Commercial and industrial properties are not the most glamorous investments, but if they pass muster with the Canada Pension Plan and other institutional investors, why not with you? Buying an office building or warehouse is more complex than buying the average home, but with leases typically running for years at a time, you stand a good chance of enjoying a more stable cash flow than you would from residential properties. The trick is finding the opportunities, especially if you're just starting out. Although anyone can relate to residential housing, investing in commercial and industrial properties requires preparation and the help of experienced advisers.

TIP

Hunting commercial properties

What the Multiple Listing Service (www.realtor.ca) is for residential real estate, ICX (www.icx.ca) is for non-residential properties. It is one of several services that can help you locate commercial and industrial properties. The larger commercial real estate listing firms also publish their listings, not all of which are necessarily linked to the MLS system. Don't forget to check out the various media that publish real estate listings, whether targeted specifically to real estate investors, such as Western Investor (www.westerninvestor.com), or trade publications for specific industries. A wide range of print and electronic resources exist to help you uncover opportunities.

However high the standards you have for residential real estate, houses are relatively simple propositions when it comes to market influences. By contrast, commercial and industrial properties are subject to diverse factors and influences rooted in economic trends. People shop in only so many places, and only so much office space is required in each community. And warehouses? They're not quite as numerous as coffee shops.

Still, opportunities exist to do well by commercial and industrial properties, which are home to the businesses that can be the lifeblood of communities. However, this is generally not a viable option for investors with less than $50,000 to invest.

Assessing classes

Several classes of commercial and industrial real estate exist, with the most recognizable being retail, office, and industrial, each with a different level of liquidity, based on the performance of the local economy and the shifting measure known as investor confidence:

- **Retail:** The humble shop front is a mainstay of main streets everywhere. But often a private landlord will own the building, which may or may not have some residential units above. Indeed, a mixed-use building in a smaller town can provide your portfolio with a measure of diversity by giving you a stake in two asset classes at once. Many large urban centres feature retail units within condo developments. The retail units are sold off like the apartments above, and at comparable prices. Providing you can find a tenant who will meet the needs of the surrounding neighbourhood — this often requires some skill, rooted in a knowledge of the neighbourhood and an ability to devise a lease package that will attract the right tenants — you will be able to reap the benefits of their success.

Small community-oriented plazas with just a few shops can also provide a steady income and, in the right location, appreciation in value if resold for redevelopment.

Retail units also work well if you need premises for your own business. Just as you buy a home rather than rent an apartment so you can build equity in your own property rather than someone else's, buying commercial space can be a good long-term investment. Car dealerships are typical examples; some auto dealers make more money off the lots from which they sell cars than from the cars themselves. Depending on your business, you may be able to operate out of a piece of property that will make you more money than your business ever does.

✦ **Office:** Office space is a type of real estate few businesses can do without. Similar to residential, it's available in both stand-alone buildings and larger developments ranging from condo developments to business parks.

Despite exposure to shifts in the economy, office properties generally allow you to implement longer-term leases than are typically possible on other forms of real estate. Businesses value long-term arrangements to ensure the stability of their own operations, and you can use that fact to stabilize your investment portfolio.

Although it's worth noting that vacancies are often higher than for residential real estate, remember that you'll also be able to charge a higher rent, and contract for increases over the life of a lease.

✦ **Industrial:** The workhorses of the real estate sector, industrial properties are probably the least glamorous assets you'll encounter. Barebones construction makes them functional rather than fashionable, designed as they are to serve the needs of manufacturers, distributors, or any grab-bag of blue-collar uses. But the basic service they provide also makes them stable investments with a good potential for return.

Know what your tenants are doing with the industrial space you're leasing! The activities of some tenants raise the risk of soil contamination, which could negate any return rents hand you and even land you in debt or, worse, legal trouble.

Assessing liquidity

A property's *liquidity* — its ability to be sold — is more important in assessing the long-term potential of non-residential assets than homes and apartments. But it is also more complex to determine, depending on your familiarity with the several factors at play. Most residential buyers, for example, don't examine trends in a specific industry to determine where to buy a home. But you'll want to study the demand for retail space in a community if you're buying a strip mall, or examine commodity price trends if you've been offered a warehouse previously used by the forest sector. Are you up for the challenge?

An asset's liquidity is a function of its attractiveness and appeal to investors, perhaps even more than market cycles (which we discuss in Chapter 3). An asset in Montreal, for example, will tend to have greater liquidity than a property in Corner Brook — not because Corner Brook is a bad place to invest, but because Montreal is a larger centre with a more diverse economy and, in short, more opportunities for the use of the property. Properties that can deliver a greater return than more expensive assets will also enjoy healthy liquidity, regardless of how the broader market is faring.

The greater the future demand for a property, the better your chance of seeing a return when the time comes to sell — whether that's next year or five years away. Factors to take into account include

- The property's proximity to properties used by similar or complementary businesses
- Prospects for the growth of the sector the property serves
- The economic strength of the community in which the property is located
- The property's proximity to transportation networks that may enhance its appeal to users in a sector other than that of the current user

For example, a port is a good location for a warehouse, but an office building located nowhere near other offices might be a hard sell to potential tenants and therefore future buyers.

Laying Into Condos

TIP

Condos (short for condominium), also known as strata-titled units in British Columbia and co-proprietorships in Quebec, are more than just apartments. Although residential condos (both apartments and townhomes) are the best-known form of this type of real estate, it also encompasses commercial and hotel properties. Residential condos are the primary form, however, with commercial and hotel units available in smaller numbers. When people talk of condos, they almost always mean residential.

Because condo units are generally subject to the building council's regulations, condos carry some of the perils of joint ownership. Condo bylaws occasionally limit activities allowed in suites, including the ability to rent units. You need to check the bylaws before you make any commitment. There could be some provinces that permit condo rentals as a right. Because provincial legislation can change at any time, you need to do your due diligence research in advance. Read the provincial legislation online, and check with a condo lawyer. Condo fees have the potential to vary, with special levies possible for maintenance and repairs. Just because a problem didn't affect your suite, the mere fact that it happened in the building at all may subject you to these levies and diminish the value of your unit.

Investing in residential condos

Residential condos are popular investments. Vancouver, which boasts one of Canada's most active condo markets, has seen as many as half the units in some new buildings sold to investors. That's an important statistic, but not great news if you're planning to rent a unit in that kind of situation. Investors who purchase a unit with the intention of renting it out want to know they have a reasonable hope of finding tenants, something that's more difficult to do when several landlords are competing for the same limited number of prospects.

On the other hand, condos can be an attractive alternative to standard rental accommodation. And this raises the potential for them to command a higher rent than other forms of residential rentals. Barring a glut of similar product, and providing your unit is in an appropriate neighbourhood, condos can be an affordable means for you to claim a slice of the rental market.

INVESTIGATE

Because condos are run by a council which are often very amateur because many members are volunteer neighbours, make sure you know what the rules allow before you buy. Some buildings limit suites available for rental, others limit the kinds of improvements that can be made or whether pets are allowed. Other issues to consider include management fees and the potential for upcoming expenses, which are usually shared among the owners. Ask to see the minutes of the council meetings and view other records associated with the building's operation and management.

Investing in commercial condos

Retail, office, and industrial condos are relatively few in number. The usual precautions regarding investment in the condo class aside, guidelines for investing in these properties are similar to those for other forms of commercial property.

Owner-occupiers reap the most advantages of owning a commercial condo, however. Some of the benefits include

- **Fixed business costs:** Because you own the commercial space, you aren't subject to rising rents. Although operating costs may fluctuate based on condo fees, as a member of the building council you have some input into what those fees will be.
- **Tax advantages:** The standard business-related advantages of occupying property you own hold true for condo units, including opportunities to deduct depreciation and business expenses associated with the unit.
- **Appreciation in value:** Like any other investment, you also reap the benefit from any appreciation in property value — the reason you became an investor in the first place!

Dreaming of Recreational Properties

Recreational properties are more than a cottage at the lake for an investor. From fractional ownership to islands with development potential, the opportunities available are wide-ranging and far-flung. And, as a type of property hit hardest by the slowdown in real estate when development financing tightened at the end of the 2000s, many offer opportunities for investors seeking lower-priced units that will let them capitalize on the coming wave of baby boomer retirees.

Should you have the chance to sell either your principal residence or recreational property, you have the option of naming one of the two properties as your principal residence. Generally, this is the one with the largest capital gain; as your principal residence it would not be subject to capital gains tax. The other property would be subject to capital gains tax. Talk to your accountant!

Cottages and cabins

Cottages and cabins are a simple form of recreational property with the same potential to appreciate in value as any other residential asset. Renovations and the possible renting out of cottages provide the opportunity to boost value and provide cash flow on an ongoing basis. When compared to other forms of recreational real estate, this is probably the one most familiar to people and easily understood.

Many cottages come with an acreage that provides recreational opportunities. The acreage itself may be a good investment if you have the foresight (and good fortune) to buy in the path of urban development. Calgary is a good example of a city that has swallowed up many smaller communities in the course of its growth, turning countless former retreats from city life into part of the city itself — and handing the former owners of the properties a windfall to boot.

Fractional ownership

Fractional ownership, as the name implies, gives you an equity share in a property — usually a resort-style development — with rights to access it in proportion to your share. For example, if you own 10 to 25 percent of a property, you have rights to use it 10 to 25 percent of the time.

Unlike a time share, in which you purchase only rights to use the property in proportion to your interest, a fractional ownership purchase puts your name on the title deed, along with those of the other owners. The owners generally have an agreement outlining the procedure for selling interest in the property. To avoid any misunderstandings or conflict, make sure you have a proper legal structure and appropriate documentation of the arrangement.

One of the draws of fractional ownership is that your unit is often in a rental pool when you're not using it. Even if that option isn't offered, you may be able to rent it yourself. You need to have your real estate lawyer read the unit contract before any commitment. Either way, you'll get to enjoy some income in addition to having a getaway for your own use.

Most fractional ownerships of residential properties where the owner is registered on the land title as a fractional owner tend to be from ¼ to 1⁄10. It could have a higher fraction, but that is not the norm. In most cases, based on the per unit cost of the fraction, the actual aggregate purchase value of the "investment" could be valued many times more than the actual market value.

Resorts by the suite

Earlier in this chapter we talk about condo developments in the context of hotels. Many resort properties offer similar investment opportunities. Like fractional ownership arrangements, these allow owners to acquire a stake in a property that's more affordable than if they had full ownership.

Developers have pursued these types of developments because they reduce the risk of proceeding with construction. You benefit from access to the suite for set periods of time each year, as well as proceeds from the net profits of the suite's operation.

Some overseas resort projects undertaken by or marketed to Canadians may seem like attractive opportunities, but be sure to thoroughly investigate the risks. We briefly discussed cross-border investing above, but resort properties are worth special scrutiny — most people want a vacation property that's a slice of heaven rather than a taste of, er, the other place. Moreover, local factors may complicate development of a project you're considering solely based on the plans. Be sure you understand what safeguards exist for investors, and know your exit strategy.

Developing a Taste for Raw Land

Just because something hasn't been built on a piece of property doesn't mean the property's worthless. Sometimes the value has yet to be realized. As a *land banker,* someone who buys up properties for the value of the land alone, you can be the first to realize a value from property that will be in demand in the future. The future purchaser may be another investor, an individual who wants to build a home, or even a developer with visions of a subdivision. The land you bank doesn't have to be in the city, either; it can just as easily be in a rural community with a growing residential population.

TIP

Raw land is good if you're an investor with a long-term plan. The downside of land banking is the chance you'll find yourself waiting a long time before the value of the land increases enough to make it worth selling.

Staking your claim

You may feel like an old-time prospector when you first buy a piece of raw land. It might not pan out for you, regardless of your gut feeling. But for the low price at which you can buy undeveloped land in many parts of Canada, raw land is frequently a gamble worth taking. Whether you're in the city or the countryside, several alternatives can help you make good on your investment.

Choosing a locale, as with every other real estate purchase, requires research into the area's current conditions and future prospects. Because the return you're looking for probably requires the development of the property into something new, your attitude should be similar to that of a renovator: Look for a site with the potential to be popular, and one that is showing signs of a turnaround. For a rural community, the clues might lie in proximity to an urban centre, and demographic trends such as an influx of retirees or younger couples.

TIP

Try to find the best fit between the land you purchase and what your research tells you is fuelling the long-term potential of the surrounding community. You want to be where the action is, so that you can benefit from the potential future interest in your site.

REMEMBER

Raw land comes with just as many responsibilities as any other property. You have to make sure your property conforms to any local bylaws, especially with regards to appearance and cleanliness. You don't want it to become a liability, and you will be liable if hazards exist on it that could bring others to harm. You also want to ensure it meets environmental conditions, so that you don't find yourself with a nasty surprise when the time comes to sell.

Goin' country or swingin' in the city?

Development often follows a relentless pace. The patch of grass where you played as a kid has become a block of town houses. As a real estate investor you may not want to lose what was, but you can't help thinking of what's to come.

This country wouldn't have any cities had someone not first put up a house and begun developing undeveloped land. Because the cost of urban property is often quite high, opportunities to secure vacant lots are sometimes most frequent in rural communities. British Columbia and Ontario considered the trend so significant that legislation in these two provinces limits the use of farmland.

Vacant lots in urban settings are subject to far more variables, including the use of surrounding properties, local zoning, and carrying costs (especially property taxes). You must often be prepared to hold land for a long time before you see a return. Often, the payoff comes from having a property someone else needs to pursue a development. Through strategic buying, a small investment can deliver a decent return relative to the time spent managing it.

This is true in small towns as well as cities. A small town won't always be small, especially if it is adjacent to a growing city. Calgary is a good example of a city that's grown, absorbing smaller communities in its path. Had you owned a parcel of land in some of those communities when they were outside the city, you might be enjoying a wealthy retirement today.

Banking on land

Rather than holding a single lot, you may have the opportunity to acquire a large tract of land. As a land banker you may add to this tract, or wait patiently to sell it either in whole or in part to a developer. Although land bankers typically deal with residential land, some bank land for other uses.

The main risk to banking land is that you're not receiving any income from it, unless you've been able to lease it to a farmer for grazing purposes, or otherwise make use of it. At the same time, you have to pay taxes and other carrying costs until you see a return. Knowing how long you can afford to carry the property is key to planning its eventual sale.

Deciding to build

Because you won't see a significant return on your investment in raw land until it's developed, it's important to plan potential uses for the property. What kind of development promises the greatest payoff? Are you willing to do it yourself? If not, are you willing to *joint-venture,* or partner, with a fellow investor or developer? Perhaps, in rare cases, you will be able to see a return by merely holding the land and selling it at a profit.

Becoming a developer

You're not likely to become a developer with your first piece of property, unless you're undertaking renovations. But if you've got the cash to fund development, why not add value to part or all of the land you've been acquiring? This can include everything from a single building on a rural acreage to an urban in-fill project that takes a sliver of land to a higher and better use.

Partnering with others

Sometimes it can pay to enter into an arrangement with a partner that allows you to reap a return from the development of your land. Perhaps you supply the land alone, or commit to arranging the servicing; perhaps you do more, such as undertake rezoning that poises it for development. Whatever the arrangement, this can allow you to see a better return than you would by selling off the raw land to an eager developer.

A partnership could also speed the sale of the land if your hopes for the area where you bought haven't quite come true. One developer we know had a tract of land subdivided for sale as development lots for single-family homes. But the lots weren't selling. So the developer approached a home builder who designed custom homes on the lots. The partnership added value to the land, allowing the developer to sell the lots for much more than the market value of the bare land, and the home builder was able to make a few sales, too.

Holding out for a gain

Occasionally, the land you've assembled and patiently held will yield a return without any improvement at all. This can happen when development happens on surrounding properties and the prospects for your property become brighter by association. Or perhaps the land itself is suitable for a particular use, such as growing grapes rather than apples, and the price of vineyard land is rising. You'll be able to take advantage of the shift.

Needless to say, if you're planning to hold land, you should have a long-term plan that supports that objective.

Howdy, Partners: Buying into Syndicates

Syndicates, in which money from investors supports a property's acquisition for investment purposes, have a checkered past. Reforms to the regulations governing them have boosted their favour among investors who have an appetite for real estate but no desire to actually own or manage property themselves.

Syndicated properties offer several benefits, including potentially a lower degree of risk because the syndicator rigorously scrutinizes properties before investors join the syndicate. Syndicated properties also typically offer a higher return to investors than comparable properties investors manage themselves because they enjoy the attention of a dedicated management team.

Syndication generally occurs through investment firms charged with selling the investment to clients. The investment managers at such firms are similar to those who manage equities, insofar as they're alert to trends in the investment world and determined to manage assets for the best return possible.

Gaining strength in numbers

The benefit of syndicates is that you're not alone. The acquisition of the property is through a partnership, meaning your share is one of several.

You pay for the limited risk the investment entails because the syndicator takes a cut of the proceeds on the property's sale, and the profits are shared with other investors. Among the benefits you enjoy are capital appreciation and even deferred taxes. As with any service for which you pay, however, shop around and find an investment and management team with which you feel comfortable.

Knowing the risks

Syndicates aren't risk-free. You run the chance an investment may not work out. But the advantage is that you're not the one taking the initial hit. Thanks to securities regulations, even if you lose your shirt, you're not likely to lose your pants as well. The partnership syndicating investment in the property is legally bound to live up to its obligations to investors.

REMEMBER

Before anteing up your hard-earned cash, however, speak with your tax accountant, financial planner, or lawyer for their opinions on the investment and the safeguards it provides.

Researching Real Estate Investment Trusts

Real estate investment trusts (REITs) have gained popularity in recent years for the regular dividends they promise from the ongoing operation of their assets — by definition, real estate. Like syndicates, they offer an efficient means of investing in real estate while avoiding direct ownership of property.

What's the excitement about?

Like public companies, *income trusts* are traded on the stock exchanges. Shares in the company are known as *units,* which can fluctuate in value but which entitle their holders to a share in the distributable income flowing from the business of the trust. For real estate investment trusts (REITs), that business is the operation of the various buildings in its portfolio. These can include apartment buildings, seniors' care facilities, shopping centres, office buildings, hotels, or any other class of real estate in which the REIT chooses to invest.

TECHNICAL STUFF

Trust units trade on the stock exchanges like stocks but are different. Although stocks represent an ownership stake in the company that issues them, trust units entitle holders to distributions from the business or businesses that deliver their profits to the trust.

The range of REITs in Canada offers investors opportunities to invest in most classes of real estate. The low degree of risk (beyond fluctuations in market value) makes them a good choice for conservative investors who want a stake in the real estate market.

Choosing an asset type

The constraints of the trust structure eliminate some of the guesswork you'll have to do as you weigh the merits of the various REITs. Regardless of the asset classes in which REITs are invested, they're limited to paying unitholders out of their taxable earnings, and are accountable to their unitholders for distributions that aren't made.

Searching for the perfect trust is as simple as opening the business pages of your daily newspaper or browsing the Internet. Searching the terms *investment trust, REIT,* and even *income fund* and *income trust* presents you with several options. You can then investigate the trusts that interest you via more online searching, looking up financial statements on SEDAR (`www.sedar.com`) if they're Canadian, or consulting your investment adviser.

Regardless of the trust structure, the assets managed by the operating business of the trust are subject to the same forces that apply to every other building in their class. Multi-family residential properties tend to have stable incomes, for example. Hotel REITs operate in a more volatile environment and will tend to see greater fluctuations in the returns they can deliver. Shopping centres also offer a measure of stability, but will provide a return that reflects the strength of the retail sector.

Don't take the word *trust* literally! The trust's assets remain subject to the trends influencing the sector in which they operate. These trends will have an impact on their operations, profitability, and, in turn, the amount of the distributions you receive. In extreme cases, if the operating business of the trust performs poorly, a distribution may not land in your lap at all. On the other hand, as witnessed when stock markets dove in late 2008, an otherwise solid REIT may be discounted by the market regardless of how well its real estate is performing, because the units of the REIT are seen as just one more equity.

Reading financial statements

To get a better grasp of what the trust in which you're considering investing is all about, one of the most important things you can do is crack open its books. Thanks to SEDAR (`www.sedar.com`), an electronic database handling the filings of all public companies in Canada, this is relatively easy to do. SEDAR, which stands for System for Electronic Document Analysis and Retrieval, logs quarterly financial statements, annual reports, annual information forms, and all other public documents issued by the various real estate investment trusts that operate in Canada.

Studying the statements SEDAR collects gives you some insight into the performance of a trust, any issues it may have faced, and how its executives handled them. Don't neglect the notes to the financial statements, which can harbour extra information not expressly stated in the formal part of the quarterly and annual reports! Before you even glance at a trust's financial statements, have a look at the annual information form. It provides an overview of the trust's business, its development, and observations on the risks to the operating business from which it receives the profits.

Understanding the operation of a given trust can be invaluable in helping you decide whether to buy units in the trust, or to opt for one involved in an asset class more to your taste.