

How to Maximize Your Profits with Real Estate Investments in 2008

20 Strategies for Success

A Special Report for Smart Investors

by Rubin Ferziger, Esq.

Good opportunities have always existed for astute real estate investors, and 2008 has excellent potential for profit. Success is the result of making the right deal from the very start with each opportunity, and carefully planning your investment program.

The following strategies address both residential and commercial property purchases. You'll also find discussion of a critical legal issue with cooperative apartment investments that has recently surfaced. This latest development, involving the "imposter syndrome" has created a dangerous trap, which even many knowledgeable investors are unaware of or ignoring.

Please understand that these investing rules are not legal advice. Real estate is a sophisticated investing modality, in which only competent, experienced professionals can assist you. These are ideas to discuss with your lawyer and other real estate industry practitioners, so you can make the best investment decisions possible.

With that in mind, here are twenty of the most important investment principles we see successful investors using.

1 – Know what you want to buy. Having absolute clarity about what you want to purchase and why saves time by focusing your efforts, and is a protection against making a bad deal. In writing, list what specific criteria you are looking for in investment property, and what economic benefit you expect each element to deliver, based on your particular financial situation. Establish the maximum you are willing to pay. Review the list with your attorney and accountant before you begin your search.

With this list in hand, you'll find what you're looking for faster. You'll be more objective when evaluating and negotiating the purchase. And you'll also find it easier to wait until you locate the right deal. Impulsive buying usually leads to legal trouble and financial loss.

2 – Buy good property in a good neighborhood. Only invest in desirable or up-and-coming neighborhoods, or those nearby. Invest in properties that will attract the caliber of tenants you want to rent to. Lower quality properties in marginal or poor neighborhoods tend to draw tenants who are less financially stable. That means you're more likely to have difficulty collecting rent. It puts you at risk, and costs you legal fees and aggravation.

When you want to sell, you want a fast, easy transaction. Investing in choice properties helps facilitate a quick, smooth sale.

3 – Invest in extra research. It can pay big dividends. The most important thing you can learn is the true motivation of the seller. It's best to hire professional research assistance. For example, knowing whether the owners have a lawsuit pending, potential tax difficulty, are getting divorced, or have an upcoming balloon payment can give you a significant advantage in negotiating a purchase. If the sellers have a financial obligation they can't meet, they're facing a deadline that can work to your benefit. All this information is usually a matter of public record.

Hiring professionals to do a thorough search can also uncover facts that help protect you from a bad purchase. For example, with a residential co-op investment, a search of board minutes can reveal complaints about noisy or problematic neighbors. Problem neighbors can make your tenants move out, disrupting your cash flow and raising costs. They can also be raised as a buyer's concern when you want to sell. You may then have to grant a price concession to sell the unit. Good research can save you from these kinds of difficulties.

With co-op or condo investments, the financials, board meeting minutes and any upcoming costs for building-wide repairs or improvements, are the three most important things to check. If you're investing in commercial properties, in addition to the financials, contract review is critical. Have your attorney look through all contracts relating to building management, such as those for maintenance, service, roofing, heating, ventilation, air conditioning, and pest control. If there are any union contracts, they need careful study.

We represented a client who wanted to purchase a property located downhill from what was previously a manufacturing facility. Preliminary environmental tests were clean, but we felt additional testing should be done just to be safe. The new tests revealed toxic discharges, however these did not impact the property the client was considering. The client ultimately made the purchase, knowing it was free of toxic waste. The important point here is that through additional research, potential liability was discovered. Even though in this case it was resolved to the client's satisfaction, it could just as easily have been a problem.

4 – Know what's going on around you. Especially in hot markets where a lot of development is taking place, you should anticipate the impact of any existing or future construction projects on your investment. For example, let's say your property has an excellent view because there's a group of small walkup buildings across the street. At some point those parcels may be acquired, demolished and replaced by a large residential or commercial development. Then your wonderful view will be gone, which affects the value of your investment.

Nearby construction taking place over an extended period can affect your ability to attract tenants and purchasers. No one wants to listen to jackhammers all day long for months. Retail commercial tenants especially will be concerned about the effect on their clientele.

Of course, new construction can work to your benefit as well. Neighborhoods that border affluent or upward trending areas and are being developed can be carried along for the ride, and increase in value.

If you're investing in neighborhoods that are prospects for development and upgrading, you should carefully weigh risks against opportunities. Visit numerous properties, and talk to as many owners, brokers, and residents as you can. If you want to take a more sophisticated approach, you can have a real estate market analysis done, but it still isn't a substitute for spending time in the neighborhood and getting your own sense of it.

5 – Be cautious about using an attorney referred by your broker. Some real estate brokers may recommend attorneys whose predisposition is to close transactions rapidly. Needless to say, these brokers are concerned about a quick sale. However, you need a lawyer in your corner who is more inclined to halt a deal if certain aspects need clarity or further investigation. You generally get better protection from an attorney with a more conservative and methodical approach, so be careful in your choice of counsel. It may be to your advantage to find your own lawyer.

Also, keep in mind that you get what you pay for with professionals. Cut-rate prices can be an indication of poor advice and bad service. An attorney whose tendency is simply to get the deal done, and misses or overlooks important details, can easily put you at risk for future legal liability.

One of our clients had the misfortune of being represented by such a practitioner, and almost lost her entire life savings on a property purchase. The attorney misadvised her about contractual obligations to get a mortgage within a specified time frame. She had not obtained a mortgage and was required to notify the seller about the delay, but didn't. This contractually forced her to either buy or lose her deposit. We negotiated a small payment settlement and fortunately got the rest of her money back. This is a good example of the horror of bad advice. The situation could easily have had tragic financial consequences.

6 – Assemble multiple sources of financing. Good deals sometimes need individually tailored financing structures that are outside conventional parameters. The most successful investors employ a wide variety of financing techniques, calling on both commercial and private sources as needed.

Having a private source of financing may give you a number of advantages you would not have with a commercial lender. First, in some instances you can respond to opportunities more quickly. Second, you might negotiate better interest rates and terms. Third, you may be able to set up financing structures that would be outside the criteria a commercial lender would accept.

On the down side, you may have higher payments. You could also end up with bad blood if family or friends get involved with a deal that turns sour, or they need to pull out their money too soon.

Commercial lenders are highly regulated, so financing arrangements are generally more stable than with private sources, and that's a benefit. However, they're also less flexible. If your deal doesn't meet their standards, you don't get the money.

In either scenario, be sure to have your attorney review all the paperwork, as there are a vast number of regulations that apply to loan transactions, in addition to any special arrangements negotiated between the parties. If these are not strictly complied with, you can easily have legal and tax problems. Also, keep in mind that the more parties involved in putting together your financing, the more complex your deal becomes. Compliance is then more difficult. Here's an example.

We handled the purchase of a \$12,000,000.00 condominium in the AOL Time Warner building in New York City. The transaction involved several legal entities and individuals located throughout the United States. The contracts specified that any delay would incur substantial penalties. The problem was that none of the parties could attend the closing, which would have caused a delay. We were able to amend the documents and close anyway, saving our client from significant penalties, because he had us handling all the paperwork on the deal from the very start.

7 – Do not guarantee anything personally. Don't sign personal guarantees. If you do, and later have a problem making payments on the property, lenders can sue and seize your personal assets. Patience is an attribute of great investors. It's better to wait until you can make a deal with terms that offer you the most protection. Don't forsake safety to take advantage of quick profits in a rising market.

Things can change quickly, and since real estate investing involves major sums, your profits and investment program can be wiped out. Greed has destroyed even sophisticated investors. Be clear on your risk tolerance for every transaction, and have an exit strategy in case things don't work out as you plan.

8 – Falling in love is fatal. It sounds basic, but it isn't. Emotions are both subtle and powerful, and cloud reasoning. Even the most experienced investors can lose perspective in a bidding war, especially in a market that is thought to hold enormous profits. Be prepared to walk away from any transaction that doesn't meet your buying criteria. On several occasions, we've seen buyers make serious errors because they let their emotions affect their judgment. The deal seemed so good they had to have it – and overpaid.

We represented a client who was about to purchase a large commercial facility that was entirely unsuited for the purpose he had in mind. We pointed out the property's deficiency to him, and suggested that if he wanted to make the buy, he'd be better off leasing it to someone else and getting cash flow from rents. And that's what we did. In

this case love wasn't fatal, but foresight saved the day. One of the great things about real estate investing is that with some creativity and good transaction-making skills, you can figure out a way to profit even if your original plan isn't workable.

9 – Buy volume for a discount. If you have the money to buy multiple units, you can negotiate a discount. For example, if you're dealing with a building in the early development stages, and agree to buy five units in the project, you may be able to make an attractive discount offer to the developer and in effect buy wholesale.

10 – If you buy with partners, have a written partnership agreement. It's surprising how many investors buy real estate with partners, yet either have no written partnership agreement or an inadequate one. Have a real estate attorney draft an agreement that spells out what each partner's contribution and obligations are, how profits and other benefits are to be divided up, and what happens if the partnerships ends.

In the absence of a carefully thought out partnership plan and an effective written agreement, here's an example of what can occur.

We represented the managing partner of a real estate company that owned many properties in an undervalued area, which became extremely valuable as years passed. A conflict about division of ownership and management developed, and the partners ended up in a court battle. In a case of this sort, there are invariably many issues of law beyond those relating to real estate, making litigation complicated and expensive. Although we secured the client's interests with an intricate court and business strategy, if the partners had entered a written agreement from the start, they would have saved a great deal of money, time and energy.

11 – Have a contingency plan. If you buy with the intention of selling for a relatively quick profit, have a backup plan in case you can't unload the property. That means making sure you can rent it out profitably for as long as you may have to hold it. At the very least, you need to break even.

12 – Choose your mortgage broker carefully. There are real estate brokers who may refer you to mortgage professionals they think will facilitate a quick sale. If the mortgage broker's agenda is a fast closing, he or she might not take time to shop around enough for the lowest interest rates possible. It may be better to hire your own independent mortgage broker and have that firm check ten to twenty loan sources for the best deal. Major banks are among those lenders with the most competitive rates.

13 – Never borrow beyond what the investment can repay. Some buyers will invest in a property with negative cash flow in hopes of taking advantage of appreciation when they sell. This is a dangerous practice. No one can predict appreciation with guaranteed accuracy. The same cyclical economic forces that turn a profit when the market is on an upswing, often victimize those who intend to flip properties. If the income the property generates can't service the debt, don't buy.

14 – Make your profit going in. Especially if you are a cash buyer, put your money in deals that can be purchased at a discount relative to market value. This ultimately can give you a competitive edge, because to the extent your costs are smaller, you can afford to rent or sell for less than the competition. This translates into better lease renewal rates, higher profits and stronger protection for your investment. Only by setting up price, terms, tenancy and management properly at the very beginning will you realize a profit when you sell.

This is particularly important if you are entering an arrangement that combines real estate interests with a business venture. If this is what you're getting involved in, hire an attorney with both real estate and business experience to assist you. A business attorney can help you anticipate and plan for the broader spectrum of issues that arise, and devise an exit strategy that protects you if things don't work out.

We represented a client that had interests in a retail location with a partner, with whom conflict developed. The case also involved intellectual property, employment issues and contract law, all of which commonly arise with many businesses today. We addressed and resolved these items so that the client was able to retain property interests and continue doing business. In this instance, the client was fortunate because we were able to bring things to a harmonious conclusion, without litigation.

It's best to create a plan that takes all profit-related elements into consideration from the start. That gives you the best chance of succeeding, and avoiding an investment that eventually becomes a money pit.

15 – Don't buy new construction without careful financial analysis. In the current business, legal and tax environment, new construction often has monetary and other disadvantages that must be offset to maximize profits. Here are six of them.

First, on most new construction purchases, tax burdens may be shifted on to you that would otherwise be the responsibility of the seller. You can avoid these taxes entirely with older residential or commercial property.

Second, you may also pay the seller's attorney fees.

Third, on residential new construction your actual closing date is less predictable, since closings can only take place when the building is ready for occupancy. When the developer is ready, you are usually given a short time frame for closing. If for any reason you are unable to close then, you pay monthly common charges and real estate taxes until you do. If there's an extended period from the time you first enter into contract up until closing, your financial circumstances may change. If you lose a mortgage commitment or can't meet your obligations, you may lose your deposit and have legal difficulties.

Fourth, in a condo or co-op, the developer may have control of the Board of Directors for the next three to five years. In a large development, it may take that long to sell enough units for buyers to gain a controlling interest. Here's an example of the danger in that

scenario. If the development company controls the voting, and decides to rent many of its units for cash flow benefits, it can affect the value of your purchase. Buildings with many renters aren't as attractive to buyers, and apartment prices are generally lower than fully owner-occupied developments. That's because it's well known that renters don't take care of property as well as owners.

Fifth, if you want to sell your unit, you may not be able to because you're competing with the developer. The builder can offer buyers a brand new unit, along with special incentives you can't. This cages you in financially.

A sixth hazard: if the developer fails on another project and can't sustain mortgage commitments on your building, the resulting foreclosure can drive the value of your unit down. Similarly, if the developer needs to raise cash and sharply discounts remaining unsold units to raise it, your apartment loses value.

If you are able to buy at a discount, or strike a deal that's financially attractive in other ways, it may make sense to buy new construction. But go into every new construction deal knowing you'll have extra hurdles to clear for your good investment to be profitable. New construction has more treacherous pitfalls than most investors realize.

16 – Get title insurance for co-ops. With it, you'll be protected against a fraudulent trend of recent years, involving "impostors." Here's a hypothetical example.

A couple purchased a cooperative apartment twenty years ago. They got divorced, and the wife stayed in the apartment. She later decided to move. Since her original husband's name was still on the stock certificate and proprietary lease, she got someone to pose as him at closing and completed the sale. This is a crime, but it does happen.

Subsequently, her original husband surfaced, and was told by the new owners that the unit was purchased from the wife and her "husband." He of course informed them that he had no knowledge of the transaction, and initiated a lawsuit to regain a share of the proceeds.

According to case law, his claim is valid.

Amazingly, even with the existence of this kind of fraud, few banks or attorneys insist on getting co-op title insurance. As a smart investor, you should. By law, an impostor cannot transfer ownership. So in a situation like the example, you buy the co-op and legally you'd end up owning nothing, except a lawsuit.

Title insurance of course is essential for every real estate investment, especially where an estate situation is involved. There may be unknown heirs. In one estate case we handled involving a house, 26 heirs materialized unexpectedly prior to closing. If there is an estate, particularly with a co-op purchase, your antennae should go up. Take the extra step to protect yourself with co-op title insurance.

17 – Only pay for improvements that increase eye appeal and profit. When it comes time to sell, only certain improvements will make your property more desirable and give you the best return on investment.

Kitchens and bathrooms should be your main focus for upgrades that raise the value of residential property. Paint, counters, cabinets and landscaping are your best bets in terms of improvements that increase eye appeal, and don't have to be major expenditures.

For commercial property investment, you'll get the best return from improvements to lobbies, hallways, elevators and bathrooms.

18 – Take precautions with professionals. In dealing with builders, architects and interior decorators, hire firms that have been doing business locally for at least three years. Find out if there's state or municipal licensing for their profession, and be sure the firm has valid licensing. Your lawyer can help you with this. Ask if you can see work they've done for others, especially jobs similar to yours. Check with the Better Business Bureau for any complaints.

All your agreements should be in writing, and reviewed by an attorney. Consulting counsel early on can avoid many problems later. Your contracts should detail specific materials to be used, including quality, grades, brands, and models. If any professional does not perform according to the time frames required in the contract, and you agree to an extension of time, have your lawyer draft an amendment that permits the extra time, but keeps all other provisions in force. Otherwise, if there's further delay they may assert you waived the additional protections.

Treat each interaction with a professional with the same concern and caution you would in any other important business relationship. Here's why, by way of example. We handled a case involving an unscrupulous contractor, who got our client to sign a contract that was actually a mortgage on his house. Not only was the repair work faulty, but the contractor sold the mortgage to a third party and then disappeared. Since the client had stopped making payments because the work was bad, the third party foreclosed on his house.

We went to court and got the mortgage and note cancelled, freeing the client from further payments and protecting his home. This story has a happy ending, but not all do.

Warning: don't sign any agreement with professional without an experienced attorney reviewing it first.

19 – Monitor your insurance coverage carefully. Insure for replacement cost, rather than cash value. This means that at the time you submit your claim, your carrier must pay the cost of replacing damaged property at current rates, which may be much more than you originally paid. You can lower rates with a higher deductible, so set your deductible as high as you can comfortably afford. With your reduced cost, consider purchasing additional coverage. Consult an experienced real estate attorney and a good insurance broker to assess your needs.

20 – If you hire a property manager, check tax, insurance and loan payments.

Horror stories exist in which a managing agent did not pay one or more of these expenses in a timely manner. If the manager is handling payment of these items, have bank statements and copies of cancelled checks forwarded to you every month. Check them carefully yourself or have an outside auditor do it. Interest and penalties for late payments, especially on taxes, can be devastating to your profits.

This rule applies to all time-sensitive or crucial bills and payments, and all required government-reporting filings.

Take the long-term view with your investment strategy.

Speculators buy in anticipation of short-term increase, fueled by inflation, interest rates and other cyclical factors. It's as easy to be a victim of these cycles as it is to be a beneficiary. Successful investors take a longer-term view of the market. This is the key difference between investing and speculating.

By applying these strategies, you can guard your investment portfolio from unnecessary risk. They'll assist with maximizing profit opportunities, whether you decide to buy and hold, or sell more frequently for short-term gain. In either scenario, these principles will help you succeed.

About Rubin Ferziger, Esq.

Rubin Ferziger, Esq. is a business and real estate attorney practicing in New York City. He has represented commercial clients and individuals for over thirty years. He handles matters involving corporate law, partnerships, financing, contracts, employment issues and intellectual property. As a sole practitioner, he brings a creative approach to complex legal issues, and is dedicated to his clients and their success.

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