

Focus on the Fundamentals

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There's a lot of excitement in the market these days surrounding Real Estate Investing. But with the excitement comes the dangers of jumping into a hot market without doing the proper research. In late 1999 and early 2000, a great number of investors jumped into the 'dot-Com' craze for no other reason than the fact that someone they knew 'just made a fortune in something'. In spite of an overwhelming amount of evidence that the price to earnings ratios were so out of whack that a correction was inevitable, thousands of investors continued to pump millions of dollars in what soon became the 'Dot-Bombs' – and why – because they got caught up in the hype.

Well here we are some seven years later and many of those same investors are thanking the Real Estate Gods for giving them a second chance. The question is, are they about to fall victim to the same fate yet again? Have they already missed the boat? Is it too late to invest in real estate?

These are all very good questions and in fact, it gives cause to reflect on the mistakes of the past. Many did indeed lose money with the inevitable crash of the dot-bombs, but what often isn't remembered is that a great many others continued to make money during and after the crash. Why did some people make money while others lost? Simple – Fundamentals.

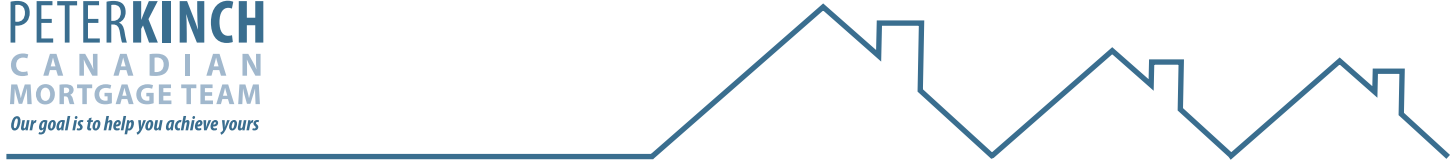
The Fundamentals of the stock market were screaming out to any one willing listen. Quite simply – the market couldn't sustain the continued investment into companies that weren't even producing a product, let alone a profit. Yet during the same period, those who stuck to the fundamentals of investing (proven to be true over years) not only avoided mistakes, but actually made fortunes.

The same is true today in real estate. There are a great many jumping on the bandwagon for no other reason than the fact that they know someone who made a lot of money last year. But like the fundamentals that governed the 'dot coms', real estate has certain fundamentals and if they are ignored amidst the hype of a heated market, be forewarned – do so at your own peril. However, just like the stock market of 2000, those who understand the fundamentals are poised to make great profits – they just don't have the luxury of not doing their homework anymore.

There's an old saying in real estate, 'A hot market covers up a lot of sins'. And that saying is especially true of the hot real estate market that we've seen over the past few years. Two to three years ago, you could have bought virtually anything in Alberta or Vancouver or the Okanagan and you would have looked like a genius. Can you still find good deals today? Can you still make a lot of money today? Absolutely! But the difference is that you may have to spend some time and pay attention to some fundamentals first.

There are a variety of important fundamentals, but for our purposes, I want to focus on just a few. To me, there are two simple fundamentals that I look for if I am buying a property as a buy and hold long-term investment. One, I want to know that there will be someone to rent it from me, and two, I want to know that there will be someone around who can afford to buy it off me when the time comes to sell it. For this reason, I want to look for an area that has a good long-term outlook for employment. One in which the fundamentals suggest people are currently gainfully employed and the prospects for future employment numbers look equally as good. A fundamental such as this – based on facts, not speculation, brings tenants for your units and the buyers necessary to move the prices upward. Markets may go up and they may go down, but as long as your unit remains tenanted, your mortgage will be paid by someone else and your equity will increase.

This may seem obvious, but as certain markets start to lose a little steam, a degree of due diligence becomes even more important than before. And by the way, you are not the only one who thinks the fundamentals in a particular market are important. Your bank does too. The factors that make a property a good investment for you are the same factors that the bank is measuring when they are considering lending you the money to buy that prospective property. The bank is going to look at where you are buying, and they will be looking and measuring trends – especially



employment trends, which typically impact vacancy ratios. They will also be looking at cash flow. If the cash flow is a little weak, the focus will shift back to your employment income to make up the shortfall. If there are concerns about growing vacancies, the bank will again shift their attention to both your income and your overall portfolio strength. At the end of the day, a good lender will always ask themselves 'Would I want to own this property?' A bank is not in the business of making loans so that they can foreclose on properties, in fact, that is the last thing in the world they want to do. That is the reason they put so much emphasis on fundamentals such as vacancy ratios and cash flow.

Not every property you buy must have positive cash flow. In some areas, it's a virtual guarantee that they won't, but that doesn't make it a bad investment. In fact, there are many areas, where the upside potential of equity appreciation can easily offset the fact you may have to feed the property for a short term. It simply means that you may have to do a little more due diligence and learn more about what fundamentals drive the particular market in which you are buying. If you don't, you may find yourself swapping war stories with a 'Dot- Bomb' veteran one day about how you got caught up in the hype and ignored the fundamentals.

Until then happy investing,

Peter Kinch