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Wealth Building Through Real Estate

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INVESTMENT MANAGERS ALWAYS ADVISE THEIR CLIENTS TO DIVERSIFY THEIR PORTFOLIOS. One diversification strategy is to invest in real estate. We are convinced that wealth building opportunities abound in the Chicago residential real estate market — so much so that we both regularly invest in it. Besides its ability to appreciate, investment property has several other advantages that other investments do not. If you are considering diversifying your portfolio to include residential real estate, consider the following before you make your move.

Your first real estate investment should be your home. This seems fairly self-evident, and it usually takes several year's worth of appreciation and equity build-up for homeowners to grasp that their home purchase has become their most important "accidental asset." The numbers can be staggering: a home purchased for $300K five years ago that appreciates at a very modest 5% annually results in a gain of $82,880, thanks to the power of compound interest. That gain also doesn't account for the fact that the homeowner purchased the home with a 10% down payment, then leveraged his money through a mortgage. At the end of five years, he will have $112K in equity in his home and will have made over a 50% annual return on his investment. That return is hard to find anywhere else. And when it comes time to sell your home, sellers are exempt from capital gains on sale proceeds of up to $250K as a single and $500K as a couple — and homeowners get to take advantage of this law every time they sell their primary residence. Bottom line: home ownership can change your life financially.

Another advantage of homeownership is that the home's equity can be tapped for other investments, either by refinancing and taking equity out as cash, or by taking a home equity loan. This is a very popular route that many of our investor clients have used to buy their first investment properties.

Investment properties appreciate just like primary homes. In addition, residential investment properties generate income through rent. It's hard to find an investment that pays its owner income while it appreciates. Depending on the numbers, an investment property may actually generate income in excess of debt, achieving a positive cash flow. Properties that generate as much income as debt are cash flow neutral, and those whose debt exceeds its income are cash flow negative. Cash flow positive and neutral properties almost always make good investments; the former pays its owner more money than it takes to own the property, and the latter costs its owner nothing to own while it appreciates. Negative cash flow properties might also make good investments under certain circumstances. We worked with a client that purchased a condominium from a developer in a six unit building for the lowest price in the building, then rented it. He wasn't able to cover his expenses through rent, but he knew he bought his unit for $35K under market. He sold it two years later and made $30K.

In Chicago, the most popular residential investment properties come in two forms: multiunit apartment buildings starting at two flats and going from there, or single units in condominium complexes. Both offer significant advantages, but multiunit buildings are typically more expensive to purchase and require more property management, both in upkeep and maintenance, and in unit rental and rent collection. It's for these reasons that the first time investment buyer usually turns to condominium units.

Condominium investment properties get harder to find as positive or neutral cash flow units in the more popular neighborhoods, and that includes the West Loop. One strategy that investors have used to circumvent this is to buy a unit before the development is built. If you live in the West Loop, you have seen signs advertising "pre-construction pricing" on signs for buildings that exist only on paper. If investors are well-informed, they are often able to take advantage of developer incentives early in a project's inception to purchase well-priced units. Developers usually require 5% of the unit's purchase price as earnest money to secure the unit, then the balance on closing. The advantage for investors is that a unit might not be delivered for 18 to 24 months or more after purchase, giving the investor-owner that time to gain appreciation. When the unit does deliver, the investor can either turn around and sell it, or rent it at market rates until it becomes advantageous to resell.

We usually recommend to our investors that if they decide to pursue a preconstruction investment strategy that they concentrate on the lower priced units, as they are more affordable, sell faster and are subject to significant upward price pressure.

We are aware of investment opportunities throughout the city, but we do not recommend any project without first defining our clients' investment criteria. If you would like to discuss your investment criteria with us, please feel free to contact us.

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The real estate professionals at Knepp Realty Group are in the business of meeting or exceeding our clients' expectations. We strive to accomplish this goal with every client, and we do it by taking personal responsibility for the financial betterment of our clients. The people that make up our company determine how well we serve our clients in this regard, and together the team is dedicated to our clients' success. When looking to buy or sell residential real estate in Chicago, look no further than Knepp Realty.

For more information, please contact us or look us up at:
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