



Frye Financial Center Business Update

Weekly Commentary



THE REAL ESTATE TRAP... (psssst...INVESTING IN REAL ESTATE IS NOT ALL IT'S CRACKED UP TO BE)

Let's face it, when it comes to Real Estate, my advice over the past few years has been dead on, 100% correct. I have been warning readers to be careful about speculating on Real Estate, especially condominiums in South Florida. Over the last few months we have seen countless articles and exposes on falling condo prices, slowing home sales, increases in foreclosures, etc. I have enclosed a couple of links to some of my past writings, including advice to my newly married daughter to rent rather than buy an apartment in the Denver area—she and her hubby do thank me.

Previous Newsletters

[Rent...Don't Buy](#)
[Joining the Bubble Choir](#)

BUT WE LOVE OUR REAL ESTATE PURCHASES. DON'T WE?

Often when clients come in to our office to do their Financial or Estate plans, and we review all of their accounts and assets, they exclaim, "Thank heavens for the Real Estate Boom and my real estate holdings!" Now, being the respectful chap that I am, I usually say nothing after that particular refrain, but this is what I'm thinking;----- Maybe, just maybe, in this particular example, this client is giving the heavens a bit too much credit. Perhaps things are not as clear as they seem.

And here's why;

ACTIVE VERSUS PASSIVE INVESTING

To put it in the simplest of terms, Real Estate investing is active and Stock Market investing is passive. When one buys stocks as an investment, one pays for the securities--- period. You can watch the investment, you may pay an annual management fee--- but that's about it. Essentially, you know what your costs are and you need do nothing further to support your investment.

Real Estate is a completely different story. You must manage it, repair it, maintain it, and periodically improve it. You pay real estate taxes, many insurances, utility bills, as well as numerous service people: landscapers, pool professionals, exterminators---need I go on?

So when you calculate the returns on these 2 types of investments you need to figure in all of these costs.....and did I mention headaches? Anyone out there like myself owning and managing a small office building?

To illustrate all of this more clearly, I am going to share my personal experiences.

OK, THIS IS MY LIFE

I am the type of person that doesn't change things too often. I founded Financial Center in 1979 and it has operated continuously in North Dade for 29 years. I have been married to the same beautiful woman since 1976. I have lived in the same home since 1988 and I purchased my first small office building in 1995. I think my personal Real Estate experiences and real estate returns are good examples of what I am trying to convey.

MY PERSONAL REAL ESTATE EXPERIENCES (A sampling)

RESIDENTIAL EXAMPLE:

I bought my home in Sky Lake in 1988 for \$460,000--- its about 4,500 sq ft and is lakefront property. I think I can sell it today for about \$1,000,000. Sounds like a reasonable investment, right?... Wrong! OK—here's the reality:

The annual compounded return before expenses over 19 years is 4.4%--That is, \$460,000 will grow into \$1,000,000 over 19 years if the average annual rate of return is 4.4%. Now let's deduct real estate taxes, home improvements, repairs, maintenance, and all of the other nasty stuff.

My adjusted, estimated annual return on this investment is now----ready?-----1%!!!... What Real Estate Boom? Ouch! I didn't come close to keeping up with inflation.

Had I invested the same \$460,000 in a combination of 75% stocks and 25% bonds in 1988, I would have approximately, \$2,718,000 today.

(Please do not fire me as your financial planner---I do own stocks and bonds too!)

COMMERCIAL EXAMPLE

I bought my first small commercial office building in the Aventura area in 1995. I paid \$300,000 for the 3600 ft property just down the street from Frye Financial Center. I recently put the building up for sale for \$1.4 million to test the waters. I got an offer at \$1.2 million that fizzled. I'm fairly certain that I can sell it now for \$1 million.

Now that still sounds like a great deal and the numbers are, in fact, significantly better than in the previous example.... I paid \$300,000, for the building 12 years ago and can now sell it for \$1,000,000 ..Did I triple my money?

Let's crunch the numbers and see what my true appreciation is.

\$300,000 growing into \$1,000,000 would be an annual return of approximately 10.5%.... not that shabby. The Stock Market, as measured by the S&P 500 index, was up around 8% for the same period.

But when we get into the active/passive issues the situation changes. I had major roof repairs completed during the 12 years and, ultimately, had to replace the entire roof. I had to install an entirely new septic tank 2 times over the past few years, after numerous emergency drainings. There were paintjobs, door replacements, sprinkler system upgrades, etc. While the rental income covered my expenses in the early years, when taxes, insurances, and maintenance costs began to soar, the building began to run at a deficit.

After considering all of the above, my bottom line estimated annual return from the building during the absolute boom years in the Aventura marketplace is 7.5%

Then there is the time and aggravation aspect. As well as the expense involved in all of the repairs and maintenance, there is the significant amount of time spent on getting quotes, overseeing the vendors, etc. And please tell me how I quantify the aggravation from tenants? For example, a tenant called me with an emergency in the middle of a business meeting to tell me that there was a dead stray cat in his parking spot...lovely. It amazes me how there can be so many issues and problems in managing a small building with only 3 tenants.

The annual return from the Stock Market, including the crash years was 8%. I would have made slightly more and would have had many less grey hairs and many more hours spent the way I wanted to spend them.

By the way, for now, I did decide to keep the building. I brought up the rental rates to be more in line with the current going rate, and turned over the management to a professional. The time and aggravation of trying to sell the building wore me down!!!

CONCLUSION

While you can all thank your lucky stars for your Real Estate investments, I for one am not as dazzled by them. I see my passive stock and bond investments as the heroes in my asset portfolio and the Real Estate holdings as high maintenance bench players.

I know, I maybe exaggerating a bit, but that's the liberty of the column writer. I also know that many of you love your homes and nobody, including me, has passion for an equity investment or a bland bond. In fact, I also love my home. I love the fragrance of my backyard citrus trees and the view from my kitchen window of the shimmering lake as it reflects the early morning sun. But after I look at that 1% return over 19 years and the \$2.7 million I could have had in a balanced stock and bond portfolio, my beloved home begins to creak and smell a bit, and did I tell you what global warming might do to my lake.

Until next time,

Austin A. Frye, MBA, JD, CFP®

If you know of someone who may enjoy reading this newsletter, please reply to this email with their contact information.

Don't keep us a secret!

The S&P 500 index was used for stock market returns and the Lehman Long Government Credit index was used for bonds returns. Expense deductions (excluding depreciation) were estimated in performing the calculations. For simplification purposes, the income tax on gains from sales were not included.

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