Ventura County Star

URL: http://www.venturacountystar.com/vcs/business/article/0,1375,VCS_128_4589192,00.html

Resist taking out second mortgage now

If Donald Trump suggests otherwise, tell him he's fired

By Neal Frankle, Neal@WealthResourcesGroup.com
April 2, 2006

The Donald is coming to the Los Angeles Convention Center on April 8 and 9 along with other real estate gurus. Hosted by the Learning Annex, they'll be here to tell you (for a fee) that if you want to be wealthy, invest heavily in real estate.

I'm sure that many people will learn a great deal about real estate at the convention, but beware. Some of the speakers, Trump included, will probably encourage you to take equity out of your home by getting a second mortgage or equity line and use that capital to buy more real estate.

In my opinion, that's a risky move that makes no sense right now. I'm not the only one. Let me tell you about a couple I met several weeks ago who jumped into real estate investing and now face a real financial jihad.

Jim and Evelyn took equity out of their home two years ago when they heard how hot real estate was. They bought four rental home properties in Las Vegas and Arizona, and as a result, they've gained more than $100,000 in equity. That's great, if they can hold onto the real estate, but I doubt they'll be able to do so.

You see, they put 20 percent in as down payments and financed the balance for each of the investments.

However, prices were high and rents were low, so the mortgage payment for these properties exceeded the rent they received right from the start.

So they go deeper and deeper into their own pockets each month to finance the real estate.

Now the story gets really scary.

You see, it costs them about $2,000 a month out of pocket just to hold on to the real estate. Jim and Evelyn don't have that extra two grand, so they took out more loans to finance the monthly deficit.

They took out an equity line of credit, and each month that loan grows larger and larger.

By the time I met them, that loan had grown to more than $50,000. So half of the equity growth they were so proud of was gone.

What will happen if one or two renters move out of the rentals? The income will drop and the negative cash flow will balloon to more than $5,000 a month. Where will they get the money to pay back all those loans?

Ultimately, Jim and Evelyn run the real risk of building up a huge loan and then, if real estate prices drop, they could lose everything they have, including their own residence.

Many experts agree that the crazy real estate market of the last three years has pushed prices to wacky levels. As interest rates continue to rise, many homeowners and real estate investors will be pushed beyond their financial breaking point. This could lead to a glut of real estate sellers and a (sharp) decline in prices. Every time the interest rates go up, I want you to envision thousands of potential real estate buyers leaving the market. The Mortgage Bankers Association projects that the rate for a 30-year fixed rate mortgage will climb to 7.3 percent by the end of 2006.

Also, let's talk about appreciation. I remember that in 1999, you couldn't go anywhere without someone telling you how much money he or she made on tech stocks. Nowadays, everyone tells me how much he or she made in real estate. In fact, every week, one or two people call me to talk about how they want to buy another house or two and flip it.

That's a bad sign.

Finally, ask yourself if you have the time and temperament to be a landlord. I know that I don't want Jethro from "The Beverly Hillbillies" calling me up at 11 p.m. on a Sunday night because his garbage disposal won't work.

There's no denying that real estate has been a great investment, but it hasn't always been nor can anyone promise that it always will be.

With interest rates rising and speculation approaching frothy levels, it's a good time to be very cautious.

Certainly, if anyone, including Trump, tells you to pull equity out of your home to buy real estate in this market, you should respond with two words: "You're fired!"

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