

Investing Strategy:

Buying Pre-Construction Properties in 'Emerging Markets'

By Michael Mazzella

Pre-construction investing is one of the hottest ways to make money in real estate today. There is limited competition in this area, as most people simply don't know about it yet, or are hesitant to invest away from their back yard. Savvy investors, however, have been quietly buying pre-construction properties for years, as pre-construction investments can be very profitable.

Pre-construction investing is when you purchase a property before it's even built. You are actually purchasing the lot and the plans for a home or condo. When developers decide to build a new subdivision or high-rise condo, they need plenty of capital in order to start construction of their large project. To raise capital, they need to pre-sell a certain number of sites or units. Once they have accomplished this, they can approach the lender to get a loan to begin construction on the entire development.

Buying into the pre-construction or first phase of a development is less expensive (and typically more lucrative) than getting into the later phases. The prices/costs to the end user may not have been fully established yet, so the pre-construction prices are often substantially lower than the prices which will be established during the latter phases of development. In fact, developers may initially sell pre-construction units at break-even, or even as a loss leader!

Here are some of the factors I consider when doing pre-construction investing:

1. First and foremost, I only invest in America's best emerging markets. I always research & choose my market first, before I begin looking for actual properties to buy within that market. Any profit-making strategy that I do as an investor, regardless, will perform even better in a market where the property values are very likely to rise at the same time.

Don't just buy pre-construction anywhere. There are areas in Florida and elsewhere, where developers have overbuilt, and are now struggling to unload these properties. You will avoid this by doing good research, and choosing a strong emerging market first, before you begin buying properties.

2. To find a good emerging market, I first look at 'past performance' and the 'present situation' of key markets. This is historical data, and all factual information, and it's pretty easy to find. I speak with realtors, investors, developers, community planners, and other key players on the ground. Recently, I spoke with the mayor of Biloxi, MS, a city that is in the emerging market I am currently buying properties in. This helps me to narrow my choices down.

Next, I want to determine the 'outlook' for a given market. This is where I can make the big money. I will consider key market indicators, such as:

- Average DOM
 - Employment rates, and per-capita income
 - New housing starts / Permits for New Home Construction
 - Sales of Existing Homes
 - Months Supply (of listed homes on the market)
 - If less than 5 ½ months, that market is experiencing high demand
 - If more than 6 ½ months = low demand
 - Foreclosures
 - The city's "Master Plan," to identify the 'path of progress.' Where new roads and sewer lines are going in; rezoning from agricultural to residential use; airport expansions; big box stores, such as Wal-Mart and Home Depot; new malls & business parks, etc. All this stuff is planned out years in advance!
3. Am I buying below market value, or below the public offering price? This is essential, as I am making as much profit as possible, right from the beginning. I do not buy at full retail price. Doing so would mean I'm relying completely on the market appreciation to make a profit, and the deal is highly speculative, because I cannot control the market. By buying below market price, I have built-in equity, so even if the market does not do what I'm expecting, I have mitigated my risk to a level I am comfortable with, and I am still in a good position to make a profit.
 4. If I'm investing for cashflow, compare the benefits of investing in an emerging market, versus investing in a flat or weak market: In the flat market, I will make money from the cashflow only. But by simply doing the same thing in an emerging market, I will make my cashflow, PLUS any gains in capital appreciation from the increasing value of my properties.
 5. I will ask the developer, "How many phases?" The more the better, and we want to be in the beginning phases. Obviously pre-construction is best, and phase 1 is second best.
 6. What is the build-out time for the development? Again, the longer the better, as the build-out of the community is what drives the appreciation.
 7. Is the builder experienced and reputable?
 8. Who is providing the financial backing behind the project? Make sure the lender is capable of handling a project of this magnitude.
 9. How much will the builder require that I put down? 20% is common, however, I look for deals where I can put down 10% or less. This enables me to buy more properties.
 10. Can I assign the contract prior to construction? I will always have at least 2 exit strategies in place before I buy, and this may be one of them.
 11. Can I rent the property out once it's completed, or do they only sell to owner-occupants?

12. Other keys..

- Affordability is important to my exit strategy, as there will be more potential buyers on the back end.
- Waterfront / coastal properties: There is huge demand for waterfront homes. (Another profit strategy I can stack!)

In sum, there are many advantages of Pre-construction Investing in Emerging Markets:

1. It's one of the most profitable forms of investing, whether our investment objective is cashflow, capital gains from appreciation, tax benefits, or 'all of the above.'
2. Hands-off strategy - very little of my time is required, and as an investor from Hawaii, I don't need to spend time in the emerging market. Virtually everything I need to do, can be done from here!
3. An abundance of good deals. Real estate investors quickly learn that one of the most difficult things about being successful is finding a steady supply of good deals. I have found this is not a big issue in an emerging market, where we have plenty of good deals and less competition.
4. We are getting 'instant appreciation' up front by buying below market; 'market appreciation,' from the continuing emergence of the market; and sometimes cashflow from the property. In this way, we are actually stacking profit centers!
5. You never have to make a mortgage payment if you sell when the unit is completed and ready to occupy. I recently bought several pre-construction condos in Biloxi, (one of the nation's best emerging markets right now). The project will be completed in March of 2009 - this means, I am riding appreciation for almost 2 years in a hot market. It is currently appreciating at 17%, and is ranked as the 3rd hottest market in the nation by the NAR. I have the option of selling these units as soon as they are built, before I even make my first mortgage payment! On top of that, I was able to buy these units substantially below the price they are being sold to the public. It just doesn't seem fair! ;-)
6. Multiple exit strategies available: I can choose to cash out early, or hold longer term to increase wealth.
7. No marketing & no rehabbing involved.
8. No door-knocking, calling strangers, or competing with dozens of other investors at courthouse auctions.
9. Only a minimal power-team is required:
 - a. In the emerging market, I need a good Realtor, a Property Management company, & an escrow company.

- b. Back here at home, I need an investor-savvy Mortgage broker, who is also licensed to do loans in whatever state(s) I'm investing in. One of my current mortgage brokers, for instance, is licensed in all 50 states and she is an investor herself.

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