THE NEGATIVE CASH FLOW DILEMMA

Over the past several years, there has been a "feeding frenzy" for small income properties. The stock market has left seriously depleted a number of retirement accounts. Rental properties have become the obvious answer for those seeking to generate wealth.

First Problem: Prices have increased much more rapidly than have rents. Prices are increasing and investment returns have dropped.

Second Problem: It has become too easy to buy those small rental properties. First: Mortgage interest rates for those small rental properties (houses, duplexes, three-plexes and four-plexes) are extremely attractive. Second: Residential lenders allow purchases to be made with very small cash down payments.

Result: Many small rental property investors have been lulled into a false security when buying smaller rental properties. They are attracted by big price increases, but they are not paying much attention to the bottom line performance of the property.

Concern: Rents for smaller rental properties have not increased much in the past three years. First time homebuyers have moved out of rentals and into homes of their own. New apartment complexes have increased the supply of competing rental units. Consequently, vacancy rates increased substantially in that same period. Only recently have vacancy rates dropped to a point where rents can be increased without a fear of a move-out disaster.

Point: The extremely high available leverage generates the opportunity for even greater negative cash flow even in more normal times. However, the inability to increase rents has resulted in some serious negative cash flow for small property investors.

BIG QUESTION: How Do You Cope With Negative Cash Flow?

You have several choices:

1. Sell one or more of your properties. Then use the net equity as a cash flow reserve to cover other negative cash flow properties. While this will eliminate the negative cash flow, this is not very exciting. Without property, your net worth will not grow as quickly to a point of financial independence. Keep the properties, and you will need a second job to support your investing habit.

2. Increase your rents. This is only really possible when other landlords for similar properties are doing the same thing. If you move substantially ahead of the market, you will increase your probability for vacancy, and even more negative cash flow.

MORE REASONABLE SOLUTIONS

1. Set a cash flow reserve from the on-set. There are several options:

a. prepay several months of mortgage payments; and,

b. set a cash flow reserve equal to at least two months worth of PITI payments.

This strategy will give you at least a six month holding period, even if your income have been reduced to zero.

2. Seek out a trusted person to become your tenant-in-common "joint owner" in the negative cash flow property. In lieu of a cash down payment, your co-investor will be required to make a monthly payment equal to the negative cash flow

This strategy will allow you to retain a large portion of the property, while eliminating the negative cash flow during the holding period.

3. Refinance your loan will more attractive repayment terms. Rene' Nelson is our go-to source for
residential mortgage loans for rental houses, duplexes, triplexes and fourplexes

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