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Advisers brace clients to ride out real estate slump

50% of advisers surveyed by InvestmentNews don't see improvement until 2009

By Charles Paikert

Hang in there — it may be a long wait.

That's what financial planners, advisers and brokers are telling their clients about the slumping real estate market.

About 50% of the planners and advisers who responded to an *InvestmentNews* online survey said the downturn wouldn't end until 2009, and more than 55% said they were advising clients interested in buying a residential investment property to sit tight.

GERARDO TABONES

Advisers navigate real estate decline

"I had a client who was talking about buying a house in Charleston, S.C.," said Mike Roney, vice president of investments in Columbus, Ohio, for St. Petersburg, Fla.-based Raymond James & Associates Inc. "I said, 'If you're thinking of living there one day, that's fine. But if you're buying it solely as an investment property, I would avoid it right now.'"

Brent McQuiston

Nearly 500 financial professionals responded to our online survey, conducted Oct. 9-16.

"Until recently, people were buying anything, and real estate became a game of musical chairs," said P.J. DiNuzzo, president of Beaver, Pa.-based DiNuzzo Investment Advisors Inc.

"Well, the music has stopped, and a lot of people don't have a chair," he said. "I'm advising clients to let the dust settle. If they were thinking of buying, look to rent. Discretion is the better part of valor, especially in a market that could still drop 10% to 20%."

Such recommendations were bolstered by recent activity on the Chicago Mercantile Exchange, where traders bet on further declines in housing prices. The traders expect home prices in 10 major cities to drop an average of about 10% from mid-2007 to November 2011, according to an analysis of prices for housing futures done by New York-based Tradition Financial Services Inc.

Concern about the falling real estate market has intensified since recently released reports from the Commerce Department and the Washington-based National Association of Realtors showed sales of new and existing homes falling to seven- and five-year lows, respectively, in August.

SLIDING PRICES

The slide in prices is hitting home: Nearly 25% of respondents to the survey said they had more than 15 clients who had been adversely affected by the downturn in the housing market.

One 59-year-old woman in the San Francisco Bay Area had been planning to retire and live on the proceeds from the sale of real estate properties she bought as an investment, according to her adviser, Steven Blake, a registered investment adviser for Next Financial Group in Foster City, Calif.

But after consulting with him, she abandoned that plan and decided to look for work so she could have an income while she waited for real estate prices to pick up. She may have to wait a while.

"I don't think that's going to happen until next year at the earliest," Mr. Blake said.

Clients who have recently built expensive new homes only to find those homes to be worth less than their mortgages have been particularly hard hit, said one Minneapolis financial planner who participated in the survey.

"They're facing a tough decision — do they try to ride it out, and if so, how long will it take? Or do they foreclose and take the loss?" said the adviser, who asked not to be identified.

"Refinancing is harder now," added Roger Desai, a registered investment adviser for R.S.D. Financial in Columbia, Md. "One of my clients was approved for a no-document loan a couple of months ago, but now the bank is asking for documents and more money down."

And in Punta Gorda, Fla., Bradley Teets, president of KDT Investments, said he helped a client restructure portfolio assets to provide income to help cover housing costs until they could sell their home.

"For [non-individual retirement account] investments, the client didn't realize they could borrow on margin to help make current payments to carry the real estate," Mr. Teets said.

REITS TO THE RESCUE?

The pain in the residential-home market, however, may be beneficial for a portfolio with a real estate allocation, according to advisers and planners.

To that point, 80% of all respondents to the *InvestmentNews* survey said they would advise their clients to maintain a target allocation if they had real estate investment trusts in their investment portfolios, and nearly 15% said they would advise clients to increase their REIT allocation.

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>
> **P.J. DiNuzzo**
> President
> DiNuzzo
> Investment Advisors

"I'm a big believer in real estate investment trusts," said Gregory Bersch, vice president of Premier Financial Partners LLC in St. Louis.

"What's bad for the housing sector is probably good news for apartment owners as rentals go up. It might be a good time for that kind of investment."

Bernard Kiely, president of Kiely Capital Management Inc. in Morristown, N.J., said, "My advice has been to stay the course and go back to your desired allocation. We recommend re-balancing at least once a year, and if your allocation is out of whack by 3% or more, to either bring it back or build it up."

While he continues to recommend real estate as an asset class, Sherman Doll, managing partner of Walnut Creek, Calif.-based Capital Performance Advisors LLP, also urges clients to be disciplined.

"They shouldn't be swayed by market timing," he said. "This may be a good time to buy real estate, but I don't believe in overweighting. It's the same as being underweighted. Real estate should be re-balanced to meet target allocations like any other asset class."

Appreciating prices globally have prompted some advisers to advise clients to invest more heavily in international REITs.

"I believe in the fundamental value of REITs as part of a diversified portfolio," said Joel Framson, president of Silver Oak Wealth Advisors LLC in Westwood, Calif. "I would still maintain a core position in REITs, but I would have more in international and less in domestic."

For clients willing — and able — to invest in commercial real estate, the current state of the market may be a buying opportunity, according to Brent McQuiston, vice president for Scottsdale-based WealthTrust Arizona.

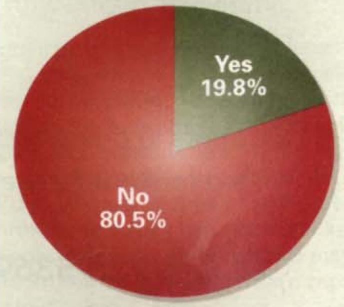
He cautioned, however, that investing in commercial properties is "very, very different [from residential homes or REITs]. It's like [comparing] apples and oranges."

Clients willing to make direct private investments through vehicles such as limited partnerships need to have long-term investment horizons and accept less liquidity than with a publicly traded investment, Mr. McQuiston said.

But for those who can, the market has created "lots of opportunities" in office, retail, multifamily and industrial properties, he said.

Home sweet home?

Do you have any clients who are being forced to delay their retirement because they were counting on their homes as a major source of retirement income?



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No matter what kind of real estate decision a client makes, the recent market turmoil underscores the need for careful planning, said Barry Glassman, senior vice president at Cassady & Co. Inc. in McLean, Va.

"We're advising clients to map out a decision tree," he said. "Most people haven't mapped out their various options. The national housing numbers are virtually meaningless. What is meaningful is the impact of a decision in a client's specific circumstance. The key is to map out a plan so that decisions are understood in advance. It's the essence of planning."

Most advisers and planners agree, and many apparently have already laid out solid planning fundamentals for their clients: More than 80% of respondents to the *InvestmentNews* survey said that in spite of the current real estate slump, they did not have any clients who were being forced to delay their retirement because they were counting on their homes as a major source of retirement income.

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