

Buy Low, Rent High

To Redbrick Partners, slow real estate markets mean a fast path to profits by acquiring cheap homes and turning them into rental properties.



Jonas Lee spends most days driving slowly through unfamiliar neighborhoods. He may look lost—constantly leaning out the window, craning his head in contorted ways—but don't be fooled. He's doing the most critical part of his job: scoping out homes for his Washington, D.C., investment firm, Redbrick Partners, to add to its growing stable of rental properties.

Lee is doing more drive-bys than ever these days. A handful of housing markets, such as southern Florida and certain neighborhoods of Washington, D.C., are wildly overbuilt. Prices are dropping. And developers who raced to build new houses and condos during the boom are likely to soon be begging for buyers. "There's going to be blood in the water," Lee says. "A big pileup."

Where there's blood, there's opportunity. Redbrick creates and manages private investment

funds made up of an unusual commodity—cheap houses, usually in working-class neighborhoods. The four-year-old company owns about 1,000 properties in urban enclaves in Eastern states: row houses scattered across Baltimore; townhouse-style homes in Hartford, Conn.; small brick houses packed around Philadelphia.

Lee looks for homes priced below \$200,000 (some as cheap as \$50,000), for a couple of reasons that any investor would do well to consider in a down market. First, cheaper homes are less vulnerable to sharp price declines. Second,

they typically offer better overall returns from rental income than upscale homes. Redbrick fixes up its properties, rents them out, and occasionally snags a profit by selling them. Since its founding in 2002, the company has closed three multimillion-dollar funds.

So where is Redbrick prospecting now? No region has Lee more bullish than southern Florida—where the long-term prospects are attractive but, as Redbrick co-founder Tom Skinner puts it, the near-term fundamentals are "out of whack." It's a new

market for Redbrick, and Lee, who has been scouting parts of Miami, Fort Lauderdale, and Fort Myers, predicts that buying opportunities will begin in early 2007. "The next couple of years will be ugly," he says, optimistically.

Lee says developers are offering condos in the region at 20 percent below appraisal value. Redbrick expects the discount to grow to 40 percent because developers lose money every day they own a property. Making the equation even more appealing is that rental prices are holding steady.

Lee and Skinner use a simple formula to calculate the overall return, or yield, of a rental property: rent divided by two divided by price. (See "Making the Rent Pay," above.) Lee says small landlords often overestimate rental income because they underestimate costs like maintenance, management, and vacancies. The advice Lee gives most often to aspiring real estate owners is to focus on a local market and get to know it really well. "Just wait and watch," he says. "If you know the market, you'll know when an anomaly comes up." And, he adds, that's more likely to occur in the next two years than in the past two. — P.S.

MAKING THE RENT PAY

Redbrick's formula for evaluating rental properties.

$$\frac{(\text{RENT} \div 2)}{\text{PRICE}} = \text{YIELD}$$

RENT: Divide annual rental income in half to account for the cost of vacancies, maintenance, insurance, and taxes.

PRICE: The full price you paid for the property, including closing costs.

YIELD: The return on your investment. In today's market Redbrick looks for 5 to 7 percent.

Note: Redbrick says this formula works best for properties worth less than \$250,000.



ON THE PROWL Lee, in front of one of Redbrick's newly acquired row houses in Stamford, Conn., has bought more than 1,000 single-family homes for the investment fund he co-founded four years ago.