Composting trash into treasure
By Curtis Seltzer
Creative Real Estate Magazine, February, 2008.

A real-estate investor can learn a lot from a good compost heap of his own making.

E. B. White, as fine a writer as America has ever produced, did much of his best thinking for the New Yorker next to his compost heap on his salt-water farm in Maine. He sat in an old chair beside his pile "whenever I feel sociable and friendly toward the land," which was often. As his pile composted kitchen waste and manure, he composted story ideas.

There's nothing flashy or fast about composting. Discarded organic stuff rots and festers in its own heat and in its own good time. Occasionally, you stir it around like an emerging idea, giving all points of view equal consideration. Eventually, good stuff comes out from what began as a yucky, stinky mess.

Real-estate investors, like farmers, generate compost fixin's sooner or later. The question is what they do with them. I've learned that the best place to put a good goof up is in the pile, along with bad luck, poor timing, unforeseen circumstances, crossed stars, plans that didn't work, memories of people who treated me unfairly, miscellaneous grumbles, errors in judgment and those cases when I assumed that public authority would act both rationally and reasonably.

I tend this pile of error and grievance. I live next to it. I add to it. I turn it regularly, often at 3 in the morning. I hope that my reward is better judgment, which I try to apply in my current garden of investments.

Here are three loads of fertile soil I've pulled from my own heap over the years.

Research Counts. The one time I was badly burned in real estate happened because I could not properly research a project before getting into it. Real-estate investing is not a matter of following your gut. It's not a matter of making impulsive buys and then figuring out what to do. It's not a matter of assuming that if you build it, they will come.

It's a matter of pre-offer research. The investor needs to dig deeply into the property and his plans for it before dollar one is offered to the seller. You have to know as much about the property's assets and liabilities as the seller. You have to know which marginal assets can be cashed out quickly if things fall apart unexpectedly. If resale is part of your strategy, you have to do pre-offer market research to the best of your ability. Nothing is as dispiriting as waiting for buyers who don't appear.

Property investors understand that time costs money. I'm leery of any deal that requires that some part of a recent acquisition be sold by a fixed future date to make everything come out. Many military campaigns, like WW II's Operation Market Garden, that depend on complex coordination and objectives achieved by a certain hour end with unnecessary blood on the ground, or worse. The same is true of real-estate deals that depend on domino after domino falling in exactly the right way at precisely the scheduled moment.

Getting flips and sales of severable assets done is often more a matter of waving at passing deadlines than meeting them. Investors, therefore, must factor into their planning the cost of some time slop, which always costs less in the long run than going splat next week.

Investments that are built around the idea of selling some of the severable assets of an acquired property to finance the purchase and keeping of core assets has always worked for me. I'm not alone. Everyone from a 16-year-old kid making a hotrod to a billionaire M&A tycoon knows how to sell what's not wanted in order to keep what is.

Land investments are usually capable of parting-out a parcel here and an unwanted house there. Merchantable timber and minerals may also be sold if their sale doesn't steeply discount the value of the remaining core asset. The same applies to conservation easements that can be donated for their substantial local, state and federal tax benefits.

This approach can also be used on a residential house sitting on one half of a double lot or commercial real estate where something can be split off for sale while most of the asset is retained for leasing and long-term appreciation.

Investors protect themselves by researching and lining up such sales during escrow. Pre-purchase contingent sales of marginal assets shift the time cost of holding them away from you, the investor. Simultaneous closings reduce closing costs.

Partners.
Many good reasons exist for having partners in real-estate ventures—help with financing, shared risk, more knowledge, division of labor, etc. But the investor's compost heap is often filled with the detritus of partnerships gone sour. To avoid feeding your pile the scraps of broken friendships, follow some simple rules.

First, make sure that all partners have identical investment objectives and agreement exists about how decisions will be made. This sounds easier than it usually is.

Second, don't expect more of a partner than the partner is able and willing to give. This has to be determined before you get into something, not after the roof has fallen in.

Third, agree beforehand on an emergency bail-out plan that allows a partner to extricate himself if new circumstances require it. A partition suit is not generally the best way for one partner to get needed cash out of an investment, but it may be his only alternative in the absence of a pre-crisis protocol governing emergencies.

Fourth, agree on an end-game before purchase as well as a process for revising the agreed end-game if compelling circumstances arise. Difficult partnership situations emerge when one partner wants to sell today and the other wants to pass along his interest to his heirs.

Fifth, know your partner. Everyone has quirks, even my wife who is even more practically perfect than Mary Poppins. If you know that your potential partner is a procrastinator, you have to decide before becoming entwined whether you can tolerate endless dithering or whether it will put you in a basket. Each partner has a responsibility to the other to know what he can't live with.

Buy wrong; sell wrong. This lesson is in every investor's pile of festering reminisces.

The right price to a buyer is that which he can comfortably afford over time in light of his plans for the property. It has little to do with the seller's asking price, appraisal value, comp values of recent sales, comp values of current asking prices or tax-assessed value.

It's always safer to be conservative in projecting future appreciation than hopeful. Same with cash flow from partial sales and lease income.

If you allow yourself to stampede yourself into buying when asking prices are irrationally exuberant, you will have to hold through the correction and hold some more through the lagged appreciation to make any money.

Timing the market is hard to do. But calculating the right purchase price given conservative assumptions with some room for error is not. And to the extent that you get the purchase price right for your circumstances and the property itself, you don't have to count on luck or back-end timing to make a profit.

Composting life's lessons is the opposite of garbage in/garbage out. Composting investment experience turns your baggage and grudges into material that enhances your prospects.

The trick with compost is to not intervene too much. If you turn it every five minutes it won't work. You need to give your failures time before they can teach you the right lesson.
Investors, like writers and farmers, should value their compost pile. Wisdom is not free, but good stuff is produced in the end, given patience and just enough poking.

Curtis Seltzer operates a consulting business for land buyers in Blue Grass, Virginia.

He is the author of How To Be A DIRT-SMART Buyer of Country Property,

May, 2007. Visit www.curtis-seltzer.com. He writes a weekly column, Country Real Estate, for newspapers, magazines and online venues. He writes a monthly column for Creative Real Estate Magazine.