Real Estate Investing Podcast

Why It's So Risky NOT to Evaluate and Manage Risk

Hosted by: Joe McCall

Featuring Special Guest: Jason Hartman

Joe: Welcome, this is the Real Estate Investing Mastery Podcast. Hey, everybody. Welcome again to Real Estate Investing Mastery. I'm really glad you're here. We got a follow-up interview with Jason Hartman. Our last interview with him was so good that we wanted to bring him again and talk about some really, really important topics related to real estate investors. Namely, looking at risk and looking at how does risk affect your portfolio, affect your investments, affect your future because it's really important that you manage risk well.

One of the things I love about what Jason does, he takes a value approach to investing. It's not get rich quick. It's not like day trading, if you're familiar with stock and stuff like that. It's maybe more of the Warren Buffett way of getting wealthy over the long haul with conservative, value place. That is the best way to long-term wealth.

There's no other tool better than real estate. There is no better asset class than real estate for that kind of stuff. Let me just tell you real fast here. If you go to realestateinvestingmastery.com and you'll find a previous episode that we did with Jason, make sure you go check that out because we had some really valuable free bonuses in there. On of them was Jason's 10 Commandments to real estate investing.

Also, we had a PDF report in there about what Jason teaches us in regards to Refi 'Til Ya Die, which is a controversial topic; but if you look at the numbers you might think, "Ugh. This is interesting." If you want to know more about it, you can go to Jason's website at jasonhartman.com or you can look him up in iTunes. He has a great podcast. You should check it out.

Go to realestateinvestingmastery.com, download our fast-cash survival kit. It's free. As we always say, if you don't like it, we'll give your money back. Check it out. It's a free video series on how Alex and I use virtual assistance in our business; how we do all of our marketing, how we find deals, how we negotiate deals and how we wholesale properties in multiple different markets all across the US.

It's really cool. Thousand and thousands of people have downloaded it. Learned a lot. It's the same kind of stuff you'd pay a thousand dollars for. It's really cool. Leave us a review in iTunes. I am looking here at iTunes. It just updated. We've got really good reviews from people. I want to read them off.

this is from Indie Holmes. Just basically says that, "Great podcasts. Joe always gives real information and education on these podcasts. Thanks." Robi Cock says, "As beginning real estate investor, I'm learning so much from Joe and Alex. I've paid lots of money to other investors for the knowledge and info Joe and Alex are giving away for free. This is a must-listen podcast for real estate investors, new and experienced."

I'll read one more here from JRB 66212. "These podcasts are great. I've listened to at least ten of them and each of them has some valuable information that I can use. Thanks Joe and Alex." There's a bunch of them on here; but I want to let you know, please leave us a review on iTunes. If you go back about six or seven episodes, there's some video I did there on how you can get some really cool free bonuses if you leave us a review.

We're going to send you the bonus whether you leave us a positive or a negative review. I'm not going to say that we'll only give you these free books if you leave a positive review. If you leave a review, let us know and we'll be glad to send you some free bonuses that I think you get a lot out of it. One of them is a book that I wrote called Flipping Houses while on vacation. Another one is a book we wrote called Being Brilliant at the basics. That book is about marketing automation and delegation; and how you can automate you business to run without you for the most part.

Also, some videos I did on an all-day Saturday workshop on how to flip these options. I think you're going to get a lot of really good stuff. You'd get all that for free if you just leave us a review on iTunes and send that email to my assistant, about you review; and we'll sen that stuff.

Okay. Let's just jump right in to Jason. Jason, how are you doing my man?

Jason: Hey. Good, Joe. How are you?

Joe: I'm really good.

Jason: I'm reading your reviews. They're awesome. Good job.

Joe: Those of you who are listening know that Jason has another podcast. I was giving him a hard time on our last episode.

Jason: You were; and I deserved it, by the way.

Joe: I was giving him a hard time because we have more reviews than he does. Although, he's been doing this ... I think you mentioned before, you have like 1,500 podcast episodes.

Jason: Not on the Creating Wealth Show; but that one's got 428 as of this time that we're talking. With all the other shows, yes. I'm terrible, man. I'm too shy. I don't ask for reviews. I got to do what you do. You've taught me some good stuff here. I appreciate that. Thank you.

Joe: I should of keep my mouth shut because now Jason has like 10 times of listeners that we do. He's going to get online and ask his quadrillion millions of people that are listening to leave him reviews. Then he's going to have double anybody else.

Jason: I have like, six or seven listeners. That's all.

Joe: Jason, what are some of the other podcasts you listen to? You've been doing podcast forever. You must have some favorite podcast you listen to, right?

Jason: You know, I switch around; but I've been podcasting for seven years. I started the Creating Wealth Show back in 2007. That's been great. I've learned a lot doing the podcast. One of the things I love about it is I get to talk to such interesting people all day long. That's really good. Gosh, favorite other podcast? I've been sort of behind on my podcast. I've got like 62 of them on my list here, on my phone. I've been listening to one of the audio books lately. I'm always listening to some audio.

I just kind of surf around and switch around. I'll tell you what I really do like. That is a ... I don't know these guys or anything. I just like their podcast because I'm really into future thinking and upcoming technologies, things like that. This one called FW Thinking, FW meaning forward thinking, is really great. I really like that one. I listen to that. Of course, your podcast is excellent.

I tried to listen to some of my own although there's no way I can listen to all of them, just too much. It's interesting going back because I'm like, "Did I really say that? Guess I did."

Joe: Oh, yeah.

Jason: I listen to Stansberry a bit; but with a grain of salt, let's say. I'll put it that way. I listen to ... I don't know. I'm sort of all over the board right now. If you asked me that a few years ago, I would have been a little more committed properly.

Joe: I'm looking through my list here, too. It's hard for me to ... A lot of them are real estate-related. I got a lot of them here that I listen to. You know one of my favorite ones? Dan Carlin, hardcore history. Have you ever heard of him?

Jason: I have. I used to listen to that one. That is a very good podcast, I agree.

Joe: He talks about history in a real dramatic. That's only he can do. I used to listen to that a lot.

Jason: Before we move into actual real estate investing here, I do want to recommend a couple good audio books though. I've been really into audio books. I love this one; and I have not had him on my show yet. Michio Kaku, which is kind of a hard name to pronounce. I think that's probably Japanese.

He's got a fantastic book called *The Future of the Mind*. That is really good. Then I've had John Mauldin on my show twice. He's got a book called *Code Red*, which is pretty good.

Joe: What are they about?

Jason: *Code Red* is about economics and end the world, doom-and-gloom type of stuff; but it's still interesting. Although, I don't really believe in that. What I part from a lot of these guys, and I've interviewed most of them on my show, is that ... A lot of these are economists, Joe. I think you might agree with me on this. A lot of them are just doing the math; and there's way more to the story than math.

When I say that, here's what I mean. They look at the U.S. and they think, "Oh my gosh, we're 17 trillion in debt. We've got all these unfunded mandates over the next 10, 20 years between ..." The numbers there are staggering. They're between 16 and 220 trillion dollars. Meaning, all that stuff that the government has to pay for, all the promises that they've made over the next 10, 20 years whether it be in the form of Medicaid, Medicare, social security, other entitlement programs.

It suddenly seems like we've got this whole generation of young people that are mysteriously disabled, nowadays. What I mean when I say that is they're collecting disability benefits from the government because unemployment has ran out. All of these government promises that the government simply cannot afford to keep. All of these economists out there and a lot of people in the survival and the preppier community, I have a show on that too called the Holistic ....

Joe: You do, really?

Jason: Yeah.

Joe: Okay.

Jason: I got a show on everything, right? It's called the Holistic Survival Show. I've interviewed a good over 200 of those people. I got to tell you, I don't think they're right. I think they've got interesting stuff to say; and it is reasonable to be prepared at some reasonable level. It only costs about $200 to $300 per person in your household to have reasonable, responsible preparations.

I would not spend my life doing it like some of these people do. Their argument is that the dollar is going to collapse. The United States economy's going to collapse. The global economy is going to collapse. That's what the *Red Code* book is about by John Mauldin. I know I'm on a bit of a tangent here. I can see where they're coming from.

I used to really agree with them; but the problem is, Joe, is that they're just doing the math. Yes, if you look at the numbers, they're bleak, I agree. The reality is, the U.S. is in a very, very enviable position when you look around the world. It's kind of like being the least ugly girl at the ugly girl dance. Other countries are in much worse positions than the United States.

Think about what we've got going for us here. This is a good reason. I know you've got listeners from all over the world. I've got listeners from a 164 countries, all over the world, too. We've got the reserve currency of the world. There is a lot of rumbling that that will not continue; but basically, every international transaction has to be reduced to dollars before the trade is made.

There are countries trying to trade outside of the dollar. I get it. I know that. That's not going to go away. Why isn't it going to go away? It's not going to go easily, at least, because we have to biggest military the human race has ever known by a huge margin.

We're not going to give up the reserve currency status. Why would we? There's no way we're going to let that go easily.

A lot of the conspiracy theorists think that, "Hey, that's why we pick on countries and invade them. We find other reasons we say to do it." I'm not saying anything that this is right or fair or moral. I'm not saying that. I'm just saying, it is. That's all

Joe: I was thinking while you were talking, I picked up a book one time. I was listening to ... I'm generally more conservative but I like to listen to NPR a lot just 'cause I can't stand commercials.

Jason: NPR is ... Yeah, I agree. That's why I listen to podcasts because I can't stand commercials.

Joe: I was thinking of this book ... They interviewed this one guy, one time and he wrote a book called *Why Nations Fail*. It was phenomenal. He wrote it in 2012. He talks in there about the origins of power, prosperity and poverty. *Why Nations Fail*. It was a fascinating interview. I only got through half way of the book. I don't know. I just got busy. I never finished it.

I've always been wanting to go back. It's fascinating. You hear him talk about how America ... The reasons of American success and how if we ... I'm doing a horrible job explaining what he talked about; but because at the time before America was "discovered", a lot of the Europeans were going to South America because of gold. I'm not even going to attempt it because I'm going to butcher it. Kind of, America was the "leftovers."

Jason: It doesn't matter that much. Like, if you get that story exactly right because the basic story is that we're in debt up to our eyeballs, the country spends too much, blah, blah, blah. I have heard that argument about a zillion times. I used to really agree with it. I do agree with it from a math point-of-view.

My point is that it's not just about math. There's a lot more to it. America is still the most innovative country on earth. Look at all the creations. I don't see ... for better or worse, say whatever you want about it; but I don't see Facebook coming out of Japan. I don't see Twitter coming out of China. All of this stuff seems to start here.

Yes, a lot of the Asian countries do a great job of scaling it up and manufacturing it and knocking it off. I get it. There are great things about those countries; but the original idea is usually American, for most things. Look at all the incredible technology we've got going on now, whether it be in the field of genetic engineering, bio technology, nanotechnology, energy, the electric car. There is a whole new breakthrough in battery technology.

I'm not a believer in electric cars but I may have to change my mind because they've got some pretty good breakthroughs. In the world of energy, Loki just announced last week that they discovered a ... They made a major breakthrough in fusion technology. Meaning, not splitting the atom but fusing it together, which is clean, safe, abundant, cheap and produces zero waste. No nuclear waste.

Joe: Interesting.

Jason: And could sit on the back of a pickup truck. A reactor, a fusion reactor. They say that's ten years away from reality.

Joe: I'll tell you one more book that I really, really like, *The Pumpkin Plant*.

Jason: I know that one.

Joe: It's fantastic book. Kind of similar along the lines of The One Thing.

Jason: I've heard of that.

Joe: It's about focusing your business. A giant pumpkin farmer, these guys are just obsessed with raising huge vegetables. They spend thousands of dollars for one little seed. When they get that seed, they focus all their energy on planting it and cultivating it, nurturing it. When that pumpkin starts getting its branches and growing all of its pumpkins, they look for the best pumpkin in the vine. The one that has the most promise. Then they cut everything else off.

They focus their energy on that one giant pumpkin. It's a book taking the farm analogy into business and focusing on your sweet spot, focusing on what you're good at. I found it really was applicable to me and my real estate investing business. Similar on the lines of *The One Thing* by Gary Keller.

Jason: That was great.

Joe: Focusing on that ... What's the one thing you need to do in your business right now to make your life easier and more abundant? Lot of different topics. A lot of good book out there we could talk about all day. I totally butchered the *Why Nations Fail* and why you should read that book.

Jason: You can think on that fly with everything well while you're managing the audio equipment and making sure the sound is good.

Joe: But it's a good book.

Jason: Hell yeah.

Joe: I only read half.

Jason: I heard good things about the pumpkin book, too. But I didn't read it.

Joe: The guy also wrote a book called *The Toilet Paper Entrepreneur*, I believe. I've not read that. I think it's about creating, writing up a business plan on toilet paper and being successful with it or something.

One of the things I want to talk to you about, Jason, was evaluating risk. Obviously, risk is an important part of this business; but why? Why is risk so important to consider in real estate investing today?

Jason: There are so many people out there, Joe, who call themselves real estate investors. I'm sure you've come across this many times in your career. They're really just gamblers. They're really just speculators. They're not investing. To me, for something to qualify as an investment, it has to create income or cash flow. Otherwise, it's just a speculation.

If someone's investing in ... Well, I shouldn't say investing. If they're speculating and gambling in gold, non-dividend paying stocks, silver platinum palladium, California real estate that doesn't cash flow, which, unfortunately, nothing in California cash flows. They all pick on Miami, same story pretty much. The Northeastern States, same story. All over Europe, I couldn't find anything that made sense either when I looked over there.

That is not investing. To be in investment, the critical factor is income. Investments produce income. Warren Buffett would agree with me one that. Even though I don't agree with Warren Buffett on the stock market being good. It's got to produce income. That's the first thing that frustrates me. You've seen that, right? Where a lot of people are out there saying, "Oh, I'm a real estate investor and nothing I have produces cash flow or income." Right?

Joe: I saw that especially in 2005, 2006 when everybody was thinking that to make money, you buy a property and do a cash out and refi on it. The problem was that they were counting on appreciation and forgetting the fundamentals. Forgetting the importance of cash flow. I couldn't agree more.

Jason: You should be able to invest in something without anything great happening, you should be able to make money. Appreciation is the icing on the cake. If it comes, great. We'll enjoy it as much as the next person; but we're not going to enter on an investment based on appreciation.

I think that's a critical thing. The next layer of this is something it took me 19 years to discover, Joe. It just kind of happened by accident. I was buying my first out-of-state property. I had always been a California speculator. I lived in California virtually all my life. I bought properties and they appreciated. I made money and I thought I was brilliant.

Really, I was just lucky. Sometimes I wasn't so lucky. Sometimes, I had to hold the property long enough to ultimately be lucky, which is kind of a weird thing. I say that about entrepreneurs. The whole point of business is, stay in business long enough for something good to happen. I'd say that applies with real estate investing, too; because if you can't hold on to the real estate, in other words, if you're forced to sell it because you didn't properly manage income and cash flow, that's a bad thing.

You don't want to be put into that position. How do we avoid that? We buy things that are sensible from day one. We don't speculate. That's the first thing. You're a wholesaler so you're not in the business where you have to deal with that. You're doing a transactional nature when you wholesale. I'm sure you have long-term investments, too.

Joe: This still really does apply because most wholesalers, the smart ones, are taking their profits after they make their expenses and investing in income-producing assets.

Jason: Wholesaling is a business and that should be distinguished from investing, which is just a long-term stuff you buy and hold that is on the sidelines. It doesn't require a lot of attention and management. The wholesaling, you got to be active. One of the things I love about your work is you teach people how to do that from any location. That's super cool. Here's what happened. I'll just tell a little story for your listeners.

Joe: Okay.

Jason: I was buying this property and I was getting insurance for it. My insurance broker was a gal named Jennifer. Jennifer called me up and said, "Okay, we're going to insure this property for a 135,000." That's when a light bulb went on in my head. I thought, "Hmm. You're giving me $135,000 insurance on this property and I paid $159,000 for the property. I know that you as my insurance company do not insure the land, you only insure the improvement or the house sitting on the land."

Because the house could burn down. The apartment complex could burn down; but the land will always be there so you don't get insurance on the land. They just insure the improvement. One of the keys here is for every investor must understand that they should not look at a real estate deal as one thing.

They should look at it as two component parts. One component is the land value and the other is the improvement value, the structure sitting on the land. That's what I'm calling the improvement. The house, the apartment complex, what ever it is. Okay?

Joe: Okay.

Jason: She said, "Okay, Jason, we're going to give you $135,000 worth of insurance for the house." I backed it out just deductively reasoning. Then my land value, according to the insurance company, is $24,000. Being a California guy all my life, I wasn't used to that. That was just a sort of a mind blowing experience, Joe, because I thought, "In California, my land value's $300,000 and the house sitting on the land is $200,000."

That was what my typical deal look like and I paid 500,000 for both. I only got $1800 a month for a cash flow, which was terrible. That was not investing. That was speculating; but you can make money speculating if you're lucky. Better to be lucky than good. Now that we've divided the equation up into the improvement value and the land value, let's look at what influences the cost of these things and the value of these things.

Improvement value is dictated by the cost to build it plus the builders' profit. The reason this is important is that if those two things can't be achieved, then builders stop building. Over the last several years, that's what we saw. We saw a climate where almost nothing was being built. Now that the market has come back, builders are out there, in force, building lots of stuff because they can get the cost to build plus a profit margin for themselves; so they're happy to build.

Back in 2009 or 2008, they wouldn't build anything because they couldn't achieve that, right?

Joe: Right.

Jason: What influences improvement value? Let's dissect that a little bit. then I'll tell you what happened to me. I'll continue with my story. What influences improvement value is: Number one, environmentalism and building restrictions. In an area where it is very difficult to build something, everything that is already built becomes more valuable. That would be an argument why California prices are so high.

That would have been great if you were in California investing in 1972; and you got to ride that wave for a couple of decades. Hey, more power to you. That was great; but it just doesn't make sense anymore. We don't recommend it. There's an old riddle, what you call a developer? A developer is somebody who wants to build a house at the beach or in the woods. What do you call an environmentalist? Somebody who already owns a house at the beach or in the woods.

Joe: Yeah, right. Got you.

Jason: As long as they've got theirs, they're not going to be welcoming to anybody else. The other thing that influences the value of the improvement sitting on the land is the industrialization of developing countries. Look at China and India. Look at the massive amount of consumption going on in those countries. Consumption of lumber, of petroleum products, of concrete, of steel, of copper wire, of glass, of all of the ingredients that we as real estate investors own and control when we buy and improve property.

I don't like vacant land as an investment. I don't think it's a very good investment, at all.

Joe: It doesn't provide cash flow, right?

Jason: It doesn't produce income. Yeah, exactly. I like to improve property because it provides cash flow and income. When we invest in real estate, Joe, what we're really investing in if we're doing it, in my opinion, right by buying low land value markets is we're really commodities investors. We own lots of copper wire, lots of petroleum products, lots of steel, lots of lumber, lots of concrete and we own lot of energy because it takes a lot of energy to build a house.

We actually own the cost of labor that went in to building that house. What we get to do is ... Normally, commodities investor goes to the Chicago exchange and they buy commodities. They buy pork bellies or coffee beans or soy beans or lumber or steel or whatever the commodity is, or gold. What I call ... My philosophy of investing is, I call it Packaged Commodities Investing because these commodities are all assembled or packaged in a form of a house or an apartment building. Isn't that nice?

Joe: Okay.

Jason: A lot of times, even now still a little bit, we can buy these commodities already assembled for less than what they're actually worth. What I mean by that is that, in any of the markets we recommend, it costs about $85 to $95 per square foot to build a house. Our investors can still buy these houses for anywhere between $50 and $70 per square foot. Plus, the land is free.

Joe: Will you explain? What do you mean by that?

Jason: If they buy a ... I don't have one these in front of me; but if I was looking at jasonhartman.com in the property section, I will just be looking and I would see something like this. I'd see a house that is, say, 1300 square feet, and it is $60 per square foot. That's $78,000. You could buy that whole deal for $78,000 including land.

My point is, you can't build it for $60 per square foot today. You've already locked in your potential for gain. I don't call that potential for gain, Joe, appreciation. I call it something else. I call it, get this one it's a mouthful, regression to replacement cost.

Joe: That's a Twittable.

Jason: Yeah, that's a Twittable. Thank you. Twittable, I like that. Twit that one folks.

Joe: Say it again.

Jason: Regression to replacement cost.

Joe: Explain that. Why is it important?

Jason: Because the value doesn't really increase. It simply goes back to what it's actually worth; and it's worth $85 per square foot today to rebuild that house. If the house burned down and your insurance company covered replacement cost, they would not pay you $60 per square foot. They would pay you $85 per square foot because that's what it would cost to actually build it.

In that example, the 1300 square foot house times $85 is $110,500. What did I say it would cost, $78,000? You have already got a difference of $32,500 locked in, in that property dormant at the day you buy it in the form of regression to replacement cost. Appreciation is something entirely different in my opinion because appreciation is when the market goes up, the whole market goes up.

I'm just talking about when a piece of wood is worth what a piece of wood is actually cost. That's not appreciation in my eyes.

Joe: Okay.

Jason: Are you following me on that?

Joe: Yeah; but why is that important?

Jason: It's important because, going back to this example, at the same time I was buying this $159,000 property. I lived in California. I was buying a house in Orange County, California where I'm from.

Joe: Which is really nice.

Jason: Yeah, it's really nice; but I left it three years ago. That's kind of a different story. I moved to Arizona. I live in Phoenix. At Orange County, at the same time I was buying this house for $159,000, I was also buying a house to live in for $815,000, which is a starter home in Orange County. What's interesting about this house is that ... Before I tell you that story, let me just do one thing.

Industrialization of developing countries. I want to tell you something about 2004 because that's the timeframe I'm talking about. Ten years ago, 2004. That year, the government told us inflation was 3.3%. Yet, that same year the price of steel and iron went up by 34%, more than 10 times the rate of inflation.

Joe: I remember those days. I was in commercial construction during that time and lost some jobs, lost a lot of money because steel prices were going up. Go ahead.

Jason: Lumber, that same year, was up 17%. I'm sure you know this all too well. Gypsum or wallboard was up 20%. When that stuff all increases in value, the price of your property increases in value. This is the way you can eliminate risk. I'll tie this all in here. Just stick with me, folks. I was buying this house for $115,000.

I remember my girlfriend, at the time, her name was Monique really, really adamantly tried to talk me out of this deal. In a way, she was probably right. Even though I made a bunch of money on it. Let me tell you want happened. In my seminars, I show a copy of my tax bill from the tax collector. John Moorlach was the Orange County Treasurer tax collector at that time. Maybe he still is. I'm not sure.

He said that of this $815,000 value, on the tax bill they divide up the land and the improvement value or the building sitting on the land. He said that the land was worth $659,000 and the improvement, the 1800 square foot house, was worth $156,000. For a total of 815. I'm rounding a little bit; but $815,000, basically. It was interesting because comparing this to my house out of state that I was buying; that was 115,000 and the improvement was 135, and the land was 24. The house in Orange Country was 815; the improvement was only 156 and the land was 659, for a total of 815,000.

When Jennifer, the insurance broker, called about that out-of-state property, I thought, "Wow. When my improvement value is really high as a ratio to my land value ... "I call this the LTI ratio, the Land To Improvement Ratio. A lot of people in real estate are familiar with the LTV ratio, the Land To Value ratio. My little acronym is LTI, the Land to Improvement ratio. I think that dramatically, dramatically, Joe, reduces an investors risk. Here is why.

Here's what happened. I moved in to the $815,000 house. A year goes by. I noticed the market is going nuts. It's 2005. We all know what it was like back then. It was psychotic. It made no sense, at all. But, like I said, I'd rather be lucky than good any day. I was lucky.

I noticed all the values in my area are going up. I wanted to buy more out-of-state properties that actually made sense. I wanted to use my nonsensical psychotic equity in California in the nutty market that we had. I called up the bank and said, "Hey, I want to refinance and get cash out of this property so I can buy more properties nationwide." They sent over an appraiser. The appraiser said, "Congratulations, Mr. Hartman. Your house is now worth $1.3 Million."

I thought, "You got to be kidding me. It's only been a year. I paid $815,000 a year ago and now, it's worth 1.3? This is unsustainable. It's the total bubble. Refinance it. I'm going to take the money out." That was a very smart move. The question, Joe, is ....

Joe: You refinanced it and you took the money out; so you still owned it?

Jason: I still owned it.

Joe: So why is that a smart move?

Jason: Because I got to buy a whole bunch of cash-flowing properties nationwide. I got to diversify. I got to strip the equity out of the property, which is a great move for many reasons; but here's the question I have for your listeners. Listeners, when the property goes from 815,000 to 1.3 million, what went up in value? Remember those two components, improvement value and land value?

Where was the gain made if you were to dissect it? It was made in land value. It's the land that went up. Look, a year later you could still rebuild that house for about the same price it cost to build it a year before. Maybe it'll be little more expensive; but it wasn't $485,000 more expensive, right?

Joe: Right.

Jason: Then another year goes by and the interest rates went down a little bit. I called the same bank, again it was Credit Union. I called the Credit Union again and I said, "Hey, I want to refinance again and lower my rate." They sent the same appraiser out a year later. His name is Eric. By the way, it's funny because he later came to my seminar and I illustrated this whole point with him sitting in the front row.

It was just funny for him to see this. He says, "I'm sorry to tell you that the value of your property has actually gone down on the last year. It's now only worth $1,215,000." Now I lost $85,000. I'm two years into this deal. Where did the loss come from? Did it come from the improvement or the land?

Joe: The land.

Jason: It came from the land. What does this tell us? It tells us that high land value markets are very risky markets. Think about it. If at one point, its 1,215,000. If the land value goes to half ... Let's just estimate the land value at 1,000,000 and the structure, the improvement sitting on the land at 215,000. We'll say that went up, too, which it probably did, a little bit.

The land value was about 1,000,000 versus the land value of my property out of state, by the way it was in Georgia. That land value is $24,000. Of the land value gets cut in half in the California property, I'm going to lose half a million dollars. If the land value on the Georgia property gets cut in half, I'm going to lose $12,000.

Where is the risk? The risk is in high land value markets. Also, coincidentally, high land value markets never, Joe I'm sure you'll agree, they never cash flow.

Joe: No.

Jason: You can never get a good rent to value ratio on high land value markets.

Joe: No, not unless you build maybe large commercial property or large multi-families; but that's not what we're talking about here.

Jason: Even then, you're still going to get a much bigger cash flow in a low land value market.

Joe: True. When you're analyzing a market, you're looking at this kind of stuff, right?

Jason: Absolutely.

Joe: You're looking at, what do you call it, the LTI ratio, the Land to Improvement ratio. How do you find that? How do you determine what that ratio is when you're looking at a market?

Jason: That's an awesome question. There are three ways to do it. Number one, your insurance company forms an opinion about that. Like I said, Jennifer called me and said, "We're going to insure the Georgia house for 135,000." I know I was paying 159 for it; so 24,000, by deduction, is land value. An appraiser will also determine land value and improvement value; and divide it up. Then, like I mentioned, the tax collector on the $815,000 house.

The tax collector forms an opinion of land value and improvement value. There's three ways to find out; Insurance provider, tax collector/tax assessor or appraiser. That's how you know. Here's how you'll know without any of those. Just when you're out there in the world.

You just know that any market that has high land value is not a good market to invest. I mean, it's a good market to gamble and ride the appreciation wave if you can time the market now. I don't know about you but I have been in this business longer than I care to admit, over two decades. Over 20 years, I have never met anybody who can reliably predict appreciation and depreciation.

Those people I call gamblers ... I'm just too conservative nowadays. I'm just older and more conservative. I don't want to gamble. I want to be an investor. I want to get cash flow out of my properties. Like we talked about on the last episode of your show, the refi 'til ya die methodology is the most tax-efficient way to extract that wealth from your properties.

Joe: Jason, let me ask you. That property you were talking about in California, you refinanced that at the height of the market.

Jason: Yup.

Joe: Still looking back even though you used that equity to buy some of other investment properties, the value probably dropped on that home. Do you still own it?

Jason: No, I sold it. That's a good question. I sold it in 2011 for, get this, $915,000.

Joe: So you still sold for more than what you've bought it for, originally.

Jason: But a lot less than the peak, yeah.

Joe: If you don’t mind me asking, did you owe more than what it was worth when you sold it? Did you have to come up with cash, with money?

Jason: Well, yes and no. That's a very good question. My opinion is that the borrower is always in the driver's seat. That's why it's good to be a borrower. Real estate is the most debt-friendly asset in America. It's also the most tax-friendly asset in America; and it's the most historically proven asset class in America.

My lender, who had financed many of my properties, sent me a letter. Actually they sent me like eight of them or nine of them because that's how many properties they had financed. It was just a formal letter they obviously sent to every borrower. In, I'm guesstimating, in 2007 or 2008 ... I remember this letter. I think it was on blue paper so I kind of noticed it. It was kind of like, "Why is it in blue paper?" They obviously wanted you to pay attention to it.

It says, "We, here at the Credit Union, understand that times are hard." I was current on all my payments. They didn't send this to me. They sent it to every borrower. "We understand that times are tough. If you need help, call us because we'd be happy to help you with a loan modification." I thought, "Are you kidding me? Wait. You're soliciting all of your thousands of borrowers offering to modify their loans."

I really don't know why that happened. I think that there was just so much political pressure. Keep in mind, we were moving right into a presidential election. There was just so much political pressure and probably a whole bunch of incentives, I wasn't even aware of, in the banking system that would incentivize these lenders to do workouts, short sales, loan modifications, whatever…

Get this. They did a workout for me. I didn't even ask for it, at first. They volunteered.

Joe: Wow.

Jason: What they did is they basically said, "We will take and we will lop half of the balance off. You pay the other half in a no-interest note." I'm still paying on that, by the way. But get this, it's zero interest. I think it was for either eight or 10 years.

Joe: Oh, wow.

Jason: I mean, that was an awesome deal if you ask me. They offered it. I was unsolicited.

Joe: I'm still trying to figure out why the banks were so much of that.

Jason: I'll tell you, it got even better later. Listen to this. A lot of people listening already know this. Bank of America and the other big banks, but especially B of A, they were so hated like the most hated company in country, probably at the time, at least. B of A was offering workouts to people. I know a bunch of people that took advantage of this.

Where they would basically do is what's called a no documentation. Their name for it, I think, was cooperative short sale. They did this for, probably, millions of people. Millions of people, I bet, took advantage of this. Where they would pay you as the owner of the property to do a short sale. They would pay you anywhere from 6 to $32,000. You didn't have to supply any tax returns or income documentation or anything.

There was some efficiency that I do not understand. It goes on or some political pressure. Some kinds of incentives in the banking system that I do not ... I'm not privy to them. Probably, most people aren't. These lenders, during the worst part of the financial crisis, they just wanted to clear things off the books. The government must just paid them to do it. Maybe it was part of the TARP deal. I don't exactly know how that worked; but it definitely was going on for millions and millions of people.

Joe: There was obviously some financial reason why the banks are doing that.

Joe: One of the other reasons to have that kind of a clearing is because there is a principle in economics called price discovery. When you clear the market, it allows for price discovery. That maybe one of the things. They just had all that pressure to have price discovery. Okay. What was your question, though?

Joe: We were talking about looking at that evaluating risk at high land markets. Let's say you're looking at an investment in a good area. Let's say, Dallas, Texas or St. Louis, Missouri where I live, where that Land to Improvement ratio. Is that what you call it again?

Jason: Yup, LTI. Land To Improvement ratio's very desirable in both of those markets.

Joe: The lower the ratio is, the better. Right?

Jason: The lower the land component is, yes, the better.

Joe: Talk a little bit about evaluating risk when you're looking at just one market.

Jason: It's always true in one market. If you're looking in Dallas, for example, you're going to be okay because you're going to have a very good LTI ratio there. If you're comparing markets and you're looking in Dallas and you're also looking where I used to live in New

Port Beach, California, it's going to be pretty obvious that you have much lower risk in Dallas. In that example.

Same is true Houston, Atlanta, Memphis, a ton of other places. You know what's interesting, too? I interviewed on my show, just Friday although this isn't published yet, Consuelo Mack who is on PBS. I know you like PBS, right?

Joe: Yeah.

Jason: They're affiliated with NPR, I don't exactly understand how that all works. Anyway, she has this show called Wealthtrack on air. She is a well-known financial commentator and so forth. She said ... This is a great quote, Joe. She said the Midwest is her favorite emerging market. She talks about it like it's a country.

Joe: Like a third world? Like Mexico or something?

Jason: No, she said that in a very positive way.

Joe: Okay. Okay.

Jason: She is very big on the Midwest. Her next best choice is the Southeast from the South. Those are great place to invest with good LTI to Land To Improvement ratios.

Joe: Interesting.

Jason: Very desirable.

Joe: Again, what do you determine to be a risky investment in one market and a good invest in the same market?

Jason: If it's the same market, then you're going to have low land values market wide. Then the next thing you start looking at is the RV ratio, what I call the Rent to Value ratio. We ideally, at this time, like to get 1% as our target for rent to value ratio. Sometimes people get more. Sometimes they get less; but 1% per month. On other words, if it's a hundred thousand property, it should rent for $1000 per month. If it's a $200,000 property but it's still in a good LTI ratio of market ...

I'll give you an example. One of our clients just called before he started investing with us. He bought nine properties through us; but he bought one before he knew about us. It's in Atlanta. Atlanta's a good market. I like Atlanta. This was an expensive house that he shouldn't have bought. It was a $285,000 property.

He's only betting $1650 a month for that property. Even though the Land To Improvement ratio is good, the rent to value is bad because it's just too expensive of a property that doesn't make a good rental property being in that price range. In Atlanta, for example, or most anywhere at this time, if you go above the $150,000 you start to really get into the point where it doesn't work, in terms of rent to value ratio.

One thing I did want to caution for your listeners, Joe, is that even though the numbers would be really, really good in terms of both of these things in a place like Detroit, I wouldn't recommend Detroit. Detroit has a whole another set of problems. It has a declining population. In any place when the population is declining, all bets are off. It doesn't matter how good anything looks. The other problem is that if you get into an area where these properties are too cheap, it becomes hard to collect.

There are just too many collection problems in really, really, really low-end properties. Although the numbers look good in paper, in practice they don't seem to really work out.

Joe: There's not a ratio really that you can use to look at those kind of metrics, I think.

Jason: I think if someone was working in Detroit, I would be wholesaling. That might be okay in that market. I mean, I wouldn't buy and hold for long-term rental there. When you've got a city that used to have about 1.6 million people and now it has about 800,000, I think it's too problematic.

Joe: Let's say ... Let's just go back to Atlanta. There's some neighborhoods in Atlanta that you wouldn't recommend to investors to buy in.

Jason: Oh, yeah. Definitely.

Joe: What are some of the risks the you look for? Because you can find properties in rough areas that have two to three percent rent to value ratio. On a number scale, that looks fantastic but you know ... You talk to people on the ground there and they're like, "Man, that's a bad area. It's hard to get good tenants, etc, etc." What else do you look for when evaluating the risk on those kinds of deals?

Jason: We like to be just slightly below the medium price in any given area. We like good, high-quality neighborhoods that are a little bit below the middle kind of area. That's our favorite. Some people say, and I think this is kinda funny but it says, "If you need a gun to collect your rent, don't buy there. If you need a knife, it might be okay."

In other words, it's sort of a scale of how bad the neighborhood is, right? The bad neighborhood stuff was just not my thing. We like kinda nice neighborhoods, not super nice. Most investors can afford to live in a much nicer neighborhood than what we'd recommend they'd buy for investment. You start to get in to problems on that low, low end where you get those 2%-3% RV ratios.

You got people who are using their houses as a meth lab. It's just problematic. Listen. everything I say ... A lot of people had broken ... These are just my philosophies. People have made money in all of this stuff; but understand, it's a specialty. If you're going to invest in war zone neighborhoods, then understand, that's what you should do. You should be a specialist. You should have a gun and whatever else you need to do business there.

I met a guy at one of my seminars who ... he really invests in these neighborhoods. He says he just really gets to know his tenants. They like him. It's a specialty.

Joe: To find whether a neighborhood is good or not, just ask a property manager or try to find a property. If you have a hard time finding somebody to manage a property in that area, that's probably not an area you want to invest in.

Jason: Very, very good point. There's another one I can give your listeners here. One of our clients, his name is David, and he bought a bunch of properties from us in Indianapolis. We've always liked Indy pretty well. It has been a pretty perineal good market, Indianapolis. He uses something he calls the free lunch metric. I actually did a podcast on this. I thought it was such a funny idea and a cool idea.

What he does is, he goes on the web and he looks at how many students in the schools are getting free lunches. He will use that as a metric to determine how low on the socioeconomic ladder a neighborhood is, by how many free lunches there are.

Joe: Interesting.

Jason: I just thought that was kind of funny. He popped into my door in my office one day and told me about this. I thought, "You know what? I'm sticking a microphone in front of you. You got to tell everybody about this." We did a show on it.

Joe: We're not saying that free lunches are bad.

Jason: Who says there's no free lunch, right?

Joe: Now, let's talk about, Jason, once you've got property, how do you manage the risk when you own property? What are some of the ways you teach people to do that?

Jason: That's a whole another subject for another episode; but generally, you just have to be good manager. Be a good manager of your managers. The vast majority of our clients use property managers. They don't do their own management, although we have a few that do. We also have taught people how to self-manage properties from a distance. I have done that successfully, myself.

You've got to stay on top of things. You should assume that each property will take about one hour per month of your time. You've got to get organized. Use a software. We currently use Property Tracker, which has been great. It will help you track your properties and do that part of it. Just pay attention to things. Respond quickly. Don't give your managers ... If you have a property manager don't give them too long leash.

What I mean by that is they will all put things into their property management agreements that say they have the right to have discretionary budget for repairs, a couple hundred dollars per month. In today's world where everybody's connected and can respond really quickly to emails and so forth, I don't think you need to do that anymore. I think you give them $100 per month, maybe $200 per month. The key is, it's per month, per property not per incident.

Per month is all discretionary. Everything else beyond that, they've got to get your approval. When they email you to get your approval, because most of this happens by email, do not be a pushover. If it's something that is more than $200 or $300, I'd request another quote; and you want to get the quote on the actual vendor's quote sheet, not the property manager's quote sheet.

Whoever is actually doing the work, in other words swinging the hammer or turning the wrench on that plumbing, that's who you need that quote from. Not the manager. Needs to be from that plumber or that contractor or whatever. If it's over $500, $600 or higher than that, three quotes. You will be amazed at how much latitude there is in these prices. Don't be afraid to negotiate.

Joe: That's a good point. I think a lot of people are afraid to manage their properties themselves. They don't need to be, maybe. I have some really good friends ...

Jason: It's pretty easy.

Joe: It is.

Jason: It's not very hard.

Joe: It is. You know, I've some good friends in Baltimore, Maryland area who own a bunch of rental property. For a long, long time, several years, they're always fighting their property managers over their properties. They got tired of managing the managers. It almost became just as much work so they just said, "You know what? Forget it. We're going to do it ourselves." They hired a part-time assistant. They hired a part-time assistant and they gave her some books on managing property. There's a lot of really good books on managing rental property, a lot of good resources out there.

They gave her the systems that they already use in all that. They found out that it wasn't hard, at all. It was easy for this part-time assistant to manage all the properties for them. They had less headache and less hustle because it was done in-house. They saved a lot of money by doing it. I'm not saying ...

I'm not knocking property managers; but if you've got enough properties, you should think about maybe hiring your own part-time assistant or maybe even a virtual assistant. I don't know. I'd prefer somebody local for that. You'd be surprise how easy it is to manage those properties. You still don't have to hear about all the details because you got somebody else on your team to take care of that for you.

Jason: You know what else? A lot of times, your tenant can manage those repair items and things like that. It's amazing how helpful some of your tenants are. I mean, it really is. Not all of them but some are just wonderfully helpful. A lot of them will do all the work themselves. I had this one ... A petroleum engineer in Houston, he was great. He was fixing up my property. He said, "Hey, this is broken; but I'm going to take care of it for you."

One of the things I've noticed, Joe, is that I think when the tenant has to come to the owner directly for something, they tend to not bother you that much. If it's just some big institution like a property management company, there's no person behind it. They don't feel like in need to maintain their relationship. They don't mind being a pest if it's some big company, right?

If they got to come to you, a human being, and say, "Hey, can you fix this or something?" You know, a lot of times they'll just take care of stuff. They really do. It's amazing. The other thing you're going to be surprise with is how helpful local realtors can be. Tap into that network. They're looking for business, obviously. They can be super helpful and they can do a lot of stuff for free.

They'll refer you to repair people or do walkthroughs for you. All kinds of stuff. It's amazing. Just tap in all that stuff.

Joe: That's good.

Jason: Good stuff.

Joe: Is there anything else you want to mention about risk and how you manage it and things to look at?

Jason: We could talk forever, you and I. I think we covered the topic pretty good.

Joe: A lot to think about. Definitely some deep things. I think you've gotten more technical and analytical than any other guest we've had, which is right at my alley. I love those kinds of things to talk about. I think that it's important to know your numbers, obviously. Right? If you don't know your numbers, you could be sinking and not even know it.

Jason: Most definitely. Most definitely. Well, Joe, it's been great to talk to you again. That's a great point you made because a lot of people, in the game of real estate, they're winning and they don't even know it because they don't know how to keep score. That's critically important. We could talk about that on another show about reading performance and all of that kind of stuff someday; but yeah, it's good.

Joe: Jason, you do several live events a year that you take people out to look out properties; but you're not just take them on a bus and go on look at properties. You actually sit down with them and educate them and train them. I've been wanting to go in one of your events for years. I've never have done it. When is your next one and did you have that more of matter of that planned out?

Jason: It depends when you're going to publish this. Our Birmingham property tour is in Birmingham, Alabama. That's a Creating Wealth Seminar on Saturday. Then it's the property tour on Sunday. We'd love to have you and your listeners. That's the weekend before Thanksgiving. You can register for that at jasonhartman.com and click on Events. Every January is our big event, our Meet the Masters event in Irvine, California. That's Southern California. That's a two-day event, really two and a half days because people are there Friday night.

Then all day Saturday and Sunday where we have different speakers from all over the country fly in to present asset protection, property management, a whole bunch of other stuff. The thing I'd like to say, it is not a pitch-fest. If you've been to those kind of events, mine aren't like that. You don't need to bring your wallet, in other words. Leave your money at home.

Joe: Good, very good. Jason, is there a good place for people can go to to maybe get some ... You put a lot of thought into this. Do you have a training materials, educational materials that people can get, courses or books?

Jason: Sort of our core product is the Creating Wealth study course, which is available at jasonhartman.com and the store. Also, we do that event live. Come live if you can. If not, get the training course. It's digital download. It's really easy and it's not expensive, at all. That's available, too; and just listen to the podcast, the Creating Wealth Show.

Joe: Very good, Jason. Thank you very much. Appreciate it. Hey, everybody. Go to Real Estate Investing Mastery to get these show notes. If you go to the previous episode we did with Jason, we gave you a link in there to download the ten commandments of real estate investors. We also talked about in that episode, Refi 'Til Ya Die, how the numbers work. You can get that on the previous show notes.

Maybe I'll try to get it again in these show notes; but Jason, you've been a great guest. I sure appreciate you being in this show. Everybody should really check out his podcast. It's very good. He goes into a lot of detail in depth on the economy, the global big picture of things and how it affects us today in our own lives. Thank you, Jason, very much. I appreciate it.

Jason: Thanks, Joe, and happy investing to you and your listeners.

Joe: All right everybody, see you guys later.