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Photo by Bill Cobb.

Surprising Kansas City

A hub of transportation and growth in the center of it all

It may not be a flashy city, but Kansas City is quietly and steadily growing its economy and population—and, consequently, its real estate values. Investors seeking cash flow and long-term growth potential just might be pleasantly surprised by the opportunity in a metropolitan area known for its affordable quality of life.

Kansas City shares many of the traditional benefits of a Midwest economy, including stability and conservative growth without major dips or jumps. For a cash flow or long-term buy-and-hold investor, the Kansas City market provides plenty of opportunities.

A steady, diverse economy

The Kansas City area, home to approximately two million people, is one of the fastest growing cities in the nation with one of the fastest growing job markets in the Midwest, according to the Kansas City Area Development Council (KCADC). Major employers include Sprint Nextel Corporation, Hallmark Cards, H&R Block, Cerner, General Motors and Ford.

The area has plenty of job openings, Chris Dowell, local realtor with the Dowell Taggart team, said. Although the city doesn't have many Fortune 500 company headquarters, many smaller and medium sized companies are moving to the area because of the convenience of "being in the middle of everywhere" and the availability of affordable housing, he said.

As the major city nearest to the geographical center of the continent, Kansas City is a natural transportation hub. "Transportation is huge here, the trains and the trucking," Chris Lengquist, a local investor and Keller Williams realtor, said.

"The economy doesn't really depend on any one thing," Sharon Sigman, a local realtor with Weichert Realtors, said. "If a company...moves someplace else, it's really not going to ruin the economy."

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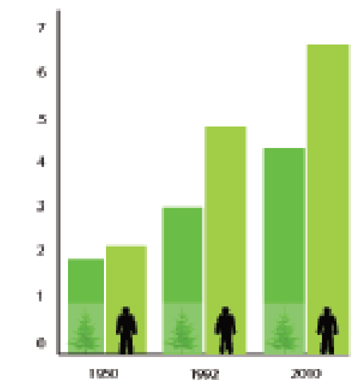
World Population Growth vs. Wood Demand

Wood demand (in billions of meters^3)
Growth rate: 77 million meters^3

Population (in billions)
Growth rate: 100 million per year



Data from Roger Dickie New Zealand, Ltd and the UNFAO Forecast, Widman Research, April 1994

From the Editor

As an investor, I have been consistently disappointed in the quality of information available for investors in real estate, business and other non-traditional investments. The Internet offers an almost unlimited amount of content, but no clear map on how to navigate it. The time required to filter through that information to find credible answers and insight, even from the most powerful search engines, is daunting. With this in mind, NuWire Investor was born to filter through the mass of information and bring to light what is relevant, credible and intriguing for investors.

There are many publications, media outlets and rating services that cover the traditional investments of stocks, bonds and mutual funds. Unfortunately for investors in more controlled assets such as real estate, small business and lending, there is little market guidance from media sources. Traditional newspapers and magazines rarely cover stories from the perspective of an alternative investor. We at NuWire Investor aim to change that. We feel passionately about investments that allow for greater profit, more control and added flexibility. We think that in order to succeed financially, most individuals need to *at least* approach investing as a part-time hobby.

Our goal, and it starts with this first subscription-only issue, is to arm investors with inexpensive knowledge that can help them use controlled investments to achieve their own personal goals and dreams. It is our belief that the key to becoming a successful investor is having access to great information. Our commitment is to be one of your valued sources of great investing information.

We hope you find our May 2007 issue beneficial, and we encourage you to share your feedback with us. Your comments will help us continue to refine and evaluate the quality of the content we deliver, in an effort to consistently improve its value to NuWire Investor subscribers (NuWire Investors).

Best of luck in your investing endeavors.

Jeremy Ames,
Executive Editor

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Affordability increases buyer pool

Residents of the Kansas City area benefit from an affordable cost of living relative to average salaries, according to the American Chamber of Commerce Researchers Association (ACCRA) Cost of Living Index. This makes Kansas City one of the most affordable large U.S. cities, according to the KCADC.

"We have a lot of disposable income here compared to other markets around the country as far as your tenants and your homeowners are concerned," Lengquist said.

Because the cost of living is relatively low, Kansas City has a large pool of prospective homebuyers. This is an advantage during a period when subprime lending looms as a dangerous problem for much of the nation.

Disposable income and affordable homes make it easier for first-time buyers to afford homes in Kansas City than in many other national markets. The first-time homebuyer market is "still real strong," Dowell said, because "you can still get homes here in the $110,000 to $120,000 price range."

"I'm very much into education and conferences, and I do a lot of national training…so I really get a good look at what's going on around the country, and I'll tell you, what really excites me about the Kansas City area is that it's one of the few places left in the country where you can get a three bedroom, two bath, two car garage home for...$60,000 to $70,000," Brad Korn, a local Keller Williams realtor, said.

One of Kansas City's main advantages "is that it's so much easier to get into investment property," Michael Fry, a local property manager, said. "You're really getting a great value."

A conservative investor's market

"The real estate market in Kansas City is pretty stable," Ron Yarbrough, a certified mortgage planning specialist based in the Kansas City area, said.

Although Kansas City doesn't experience the "big growth" that occurs on the coasts, "the big difference here is that we get steady growth, basically 5 percent year in, year out, hardly ever any dips. It's just a nice safe place for long-term real estate investing," Lengquist said.

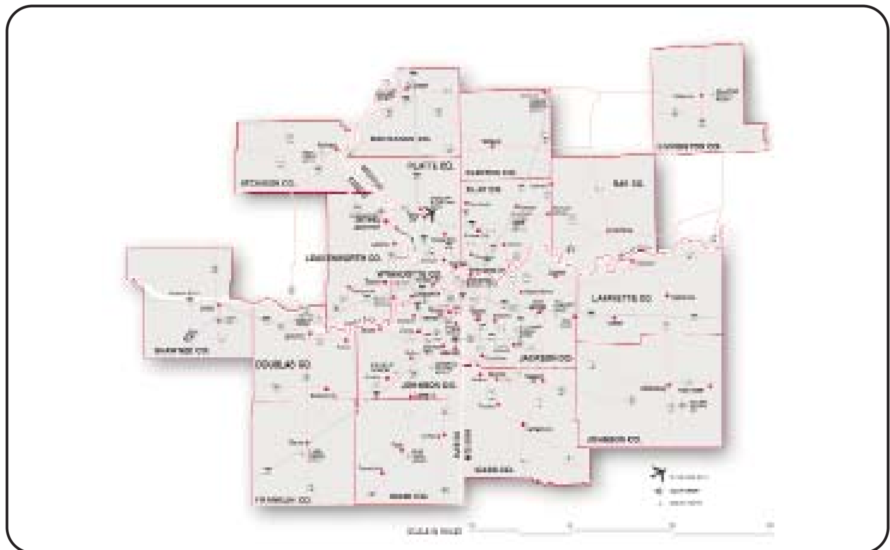
Kansas City is really not a get-rich-quick market for real estate, Fry said. "The properties here are not overpriced, not so much affected by the housing market bubble, and therefore much safer and stable in the long run."

Indeed, *Fortune's* May 2006 issue dubbed Kansas City a "safe haven for real estate."

"You can get a better rate of return here than you can in a lot of the other states," Sigman said.

The area has "great cash flow opportunities" as well as "a very consistent 5 to 7 percent appreciation," Dowell said. Most of his investors are focused on either cash flow or long-term buy-and-hold strategies.

The Kansas City Vicinity



Map courtesy of the Kansas City Area Development Council.

Flipping is less successful and "not really our cup of tea here in the Midwest," he said. "In the Midwest, if you look to buy a property and flip it, you've got to really do your research...because we don't have the margins like they do when things are going right on the coasts."

Although he doesn't recommend flipping, Dowell said investors who want to flip should look for areas with less competition, such as Wyandotte County and areas north of the river.

Lengquist agreed that "there's just not enough margin" in many properties for a buy-and-sell approach to be profitable. Investors interested in rehabbing will find the most success in neighborhoods just outside the downtown core, such as Waldo and Brookside, because "you're just going to have a bigger pool of people who are looking to buy," he said.

Conservative, realistic investors succeed in Kansas City, Dowell said. Those expecting dramatic short-term appreciation are looking in the wrong place. "A very conservative investor will do very well here. You don't typically see the investors lose a lot of money here."

The most successful investors in

Kansas City combine a buy-and-hold approach with cash flow, Fry said. "Cash flow is air for investors, and without it you can't stay in the game very long. But at the same time where you're going to see much of your gains over time is through property appreciation."

Korn sees the flat market as an opportunity for investors. "You can buy houses at a little better price now" and rent them out without much difficulty. "The whole Kansas City area has got a good rental market."

Single and multi-family strategies

Single family properties hold the most potential for long-term appreciation, Lengquist said. Another advantage is "a real large pool of potential buyers" when it comes time to sell, he said.

Many out-of-state investors are interested in duplexes and fourplexes, Korn said, but he personally leans toward the three bedroom, two bath, two car garage, fenced yard home "because I know that that is going to be in high demand no matter what."

The easiest properties to rent are three bedroom duplexes and single family houses with garages, dishwashers, washer/dryers and refrigerators in stable, family-friendly suburban neighborhoods, Fry, who specializes in the southern Kansas City suburban area, said.

One bedroom apartments and condos are also "pretty quick to rent," but two and four bedroom properties are more difficult, Fry said.

Many investors like multi-family properties because they offer a more steady income; if one unit is vacant, the investor still receives income from the other units. "It provides them with a little bit of a margin for error," Lengquist said.

Lengquist said the downside to multi-family properties is that they tend to appreciate along with rental rates rather than neighborhood values. "So there are positives and negatives in both," he said. "It comes down to the criteria of the particular investor."

Regardless of the specific strategy, the main pitfall lies in getting "sticker excited," said Korn, who has seen many investors pay too much for properties. "You definitely need somebody who really knows the area, that can look at what the neighborhood's been selling for." Long-distance investors need to find local comparables and avoid comparing prices to their local markets.

Downtown revitalization

During the 1990s, Kansas City's downtown core "hollowed out," with population loss at the core and growth around the periphery, according to an October 2002 report by the Brookings Institution Center on Urban and Metropolitan Policy.

The downtown core is showing strong signs of growth and revitalization. Approximately $4.5 billion is being invested in the downtown core, including the Power and Light District, Sprint Center, H&R Block World Headquarters and renovation of the Kansas City Convention Center, according to the KCADC.

"There's a lot of growth downtown," Sigman said. The downtown area is being cleaned up and is becoming nicer and safer, she said.

"I think that a lot of the younger people are moving back into the city," Lengquist said. "People are excited about the city again."

The downtown area is experiencing a condo boom in its urban core, Lengquist said, but he is "not sold on their returns as far as investments go."

Kansas City's condo market "is very strong," Korn said. "You will hear controversy when you talk to people whether or not it's tapped out or whether it's just beginning. I think it's somewhere in the middle there."

While young professionals "like access to the nightlife obviously and to the downtown areas where they're most likely going to be working," Lengquist said he sees more opportunity in areas slightly outside the urban core.

"I think that there are much better places to put your money than the condos downtown," Lengquist said. He said returns will be better in "the Waldos and Brooksides and Overland Parks and Olathes."

Suburban strength

The suburbs in the seven counties surrounding Kansas City hold two-thirds of the area's population, according to a November 2005 article in the *Kansas City Star*.

The Kansas City area straddles the Kansas and Missouri border, with

growth currently expanding outward in all directions, Korn said.

In the past, the nicer northern suburbs were isolated little islands, but "now everything's starting to grow together" as Kansas City proper expands, Korn said.

"Younger families are really attracted to luxury apartments or the loft areas, and there's just been an explosion and growth of the luxury apartments, especially in Johnson County, Kansas, in the last couple of years. The building of luxury apartments have slowed but they still continue to be rented at a very high rate," Fry said.

On the Missouri side, the Raymore and Belton areas are experiencing notable growth as well, Fry said.

"The new construction and the subdivision building...has slowed down. You've really seen a lot of builders kind of pull back a little bit just with the market flattening out and the amount of inventory coming on the market…the existing homes right now are just a really, really good value," Korn said.

The northern and southwestern suburbs have higher prices than the eastern side of the city, Korn said. He said the best values and opportunities for cash flow are found in the east.

Cash flow is a little more difficult to achieve in the north, and it is significantly tougher on the Kansas side because property values are higher, Korn said.

Kansas City's Affordability

City	Ratio of Median Home Value to Median Family Income	Median Home Value	Median Family Income
Kansas City	2.4	$157,000	$65,400
Miami	6.7	$311,000	$46,350
Washington, D.C.	5.0	$428,000	$86,200
Los Angeles	9.6	$525,000	$54,450
New York	7.9	$457,000	$57,650
San Francisco	9.4	$835,000	$88,450

Above
Source: CNN Money

Comparable Investments

City	Price	Cap Rate
Kansas City	$325,000	9.31%
Miami	$950,000	7.05%
Washington, D.C.	$960,000	6.32%
Los Angeles	$1,580,000	4.52%
New York	$2,200,000	5.00%
San Francisco	$2,625,000	3.74%

Right
Numbers were pulled from recent listings of 12-unit buildings of comparable age, size and type.

Future outlook

In the future, most local experts expect to see moderate, consistent growth in property values.

"I think…we're going to continue to average about 7 percent over a 10-year period of time, but that could be 3 percent this year and 12 [percent] next, but I think we're going to continue with our average that we've had over the last 30 years," Yarbrough said.

The low prices Kansas City is experiencing mean that "it's the best time for a buyer to take advantage of that market," Korn said. He expects appreciation to "kick back up again this year" and reach around 2 to 3 percent.

Although he has not yet seen many lease options, Dowell expects them to grow in popularity as some buyers find it more difficult to get financing because of stricter lending standards.

The subprime market problems may also lead to an increase in foreclosures, Fry said. Investors should prepare for opportunities in buying out property owners and saving them from bank ruptcy, as well as traditional foreclosure purchases and rehabs, he said.

Although a spike in foreclosures could have a temporary negative effect on property values, "that might be a great time for an investor to get in, purchase some properties at great prices and then see the values go up over time," Fry said.

The future outlook for Kansas City is one of stability and predictability, Korn said. "I don't see any little secret things coming out, or some new big wave hitting…what you see is just going to consistently grow for a little while, and it's just a very consistent market." ■

Front of the Curve

What investors need to know to be in the know

When markets are bullish, it's easy to be a successful investor; you buy something and it increases in value. Unfortunately, stock, real estate and other investment markets are constantly changing.

Successful investors seem to stay a step ahead of the crowd, sensing opportunity when others see risk. These investors make money in both up-trending and down-trending markets. What is the secret that allows them to stay at the front of the curve? It's what and who they know, of course.

Know People

Successful investors know a network of reliable, credible sources is key to staying ahead of the pack. Investors who are social have an advantage in identifying contacts, building relationships and cultivating trust and respect.

"You have to be really, really well networked," David Dweck, a south Florida realtor, hard money lender and investor, said. "I always have my investor cap on, no matter what I do."

Dweck, who holds leadership roles in two investment clubs, uses every possible social opportunity to build and expand his network. Civic organizations, business meetings, charity events and school activities can "help you get connected with the people who could potentially bring you deals," he said.

SEC regulations limit many people and companies in how and to whom they can advertise their investment offerings. For this reason, many of the best investment opportunities can only be found through word-of-mouth. The bigger the network an investor has, the more choices and opportunities for investing are available.

Established relationships give investors an edge in highly competitive markets. In the real estate market in Edmonton, Alberta, for example, relationships and contacts are crucial, Les Michaelson, a real estate investor and president of the Edmonton Revenue Property Investors Association, said.

A commercial or multi-family property in Edmonton does not sell through the MLS, Michaelson said. "It sells by word-of-mouth. It sells by a realtor getting a listing and giving a guy like me a phone call that is kind of in their back pocket already. Or...a list of buyers that have contacted them."

Most foreign countries don't even have an official listing system for properties, so word-of-mouth is the main way real estate deals are done.

A network of solid sources can also help minimize mistakes by providing insider knowledge. Many lessons can be learned the easy way—through the experience of others—rather than the hard way, through personal experience.

The most successful investors are careful to take advice from the right people. Many novices listen to "experts" who don't really have practical experience in the field, Robert Locke, an Atlanta area real estate investor and property manager, said. Experienced contacts can save an investor from some painful mistakes and headaches.

Investment clubs and associations are a good way to begin building a base of credible contacts; investors who gather at those meetings trade insider information and work together to make deals, Locke said.

An investor should "affiliate with a real estate investors association or real estate investment club in their area and get good, solid advice from someone who's been there, done that," Dweck said.

Investors in the U.S. can find a local Real Estate Investment Association (REIA) chapter through

www.nationalreia.com, Katherine Swanberg, a Seattle area real estate investor, said.

"I think if you're just starting out, you need to network. You need to show up at these meetings and find people in your community, in your industry, doing the kind of investing you want to do, so you can find a mentor program, a coaching program," she said.

Know Your Market

There are many ways for investors to develop knowledge of a market. In an era where vast amounts of information are available through the Internet, investors must develop trusted go-to sources to provide a balanced overall perspective. Sources may include informed people, experts, books, investment publications, websites and seminars.

"It really matters to take time to understand the city, the area, the neighborhood...and to not jump in too quickly," Michael Fry, a Kansas City property manager, said. "I've seen owners that get excited about real estate, they put a lot of money out there too fast without really understanding what they're doing...I've seen a couple owners go into foreclosure over it."

"Pay attention to what is going on," Dweck said. "It's not a matter of being trendy. It's just a matter of following the market and then being able to perform in that market."

> "You have to be a voracious reader."
>
> David Dweck, realtor/investor

Some market observation can occur in ordinary social interactions, Joel Kotkin, an internationally recognized authority on global, economic, political and social trends, said. "If you go to a party and everybody's complaining about what's going on, and they're talking about moving someplace else, well, that tells you something."

The media also can provide valuable market information. "You have to be…a voracious reader. I start my day every day with a local real estate and law newspaper," Dweck said. "If you're not in the loop, if you're not consistently feeding your brain and getting out there…you'll never get a deal done."

Investors can also use the media to identify negative public perceptions that could deter others. Negative media hype can cause investors and homebuyers to pause, Todd Millar, owner of an Edmonton area investment company, said. "That is where the opportunity lies...in these plateaus....If you're investing on a fundamental market where you can go in and see that as just a temporary lull."

Educational seminars can be helpful, even for experienced investors. "You can never stop learning…I spend a lot of money on my education," Dweck said. He attends a seminar outside his area every year and constantly reads real estate books.

Investors should be choosy about which seminars they spend money on, Swanberg, who is vice president of her local investment club, said. "It's hard...for a new investor to find really good content, and to not pay for a lot of fluff."

Swanberg said she would rather see people "pick a strategy and focus and do a couple deals and systemize what they're doing. I think their results would be better than if they went out and spent money and bought 10 different boot camps on 10 different ways to invest."

Along with diligent research and education, practical experience is a natural way to continue enhancing market knowledge. Dweck suggested investors keep journals so "they can really keep track of what they're doing or not doing." This helps people be accountable to themselves, he said, and reveals how their actions align with their plans.

Know Thyself

Finally, successful investors know their own strengths and weaknesses, as well as which strategy fits them best. They then use discipline to stick with that strategy, even in the face of temptation.

Investors need to determine their competitive strength and expertise. This means "finding where your comfort level is, where your expertise is, and investing in it. If your real expertise is understanding the dynamics of core cities, then you ought to try to figure out how to take advantage of those trends," Kotkin said.

A careful analysis of risk tolerance will help determine the investment style and strategy that best fits a particular investor. Age, existing wealth and a variety of other individual factors combine to determine risk tolerance.

Some investors consider lifestyle issues and other non-financial factors. Chris Lengquist, for example, invests in real estate within 20 minutes of where he lives in a Kansas City suburb. As a realtor, Lengquist already spends a significant amount of time driving, so he wants to minimize the commute to his rental properties.

The small percentage of investors who are actively participating in their field of expertise full-time may be able to safely concentrate on a certain type of investment. The vast majority of investors, however, will benefit from diversification across a variety of investments so that if one sector experiences a downturn, others will buoy the portfolio.

Diversification also enables investors to make higher risk investments. By diversifying risks over several types of investments, an investor can maximize returns while keeping overall portfolio risks manageable.

Certain strategies work better for certain types of investors. For example, investors who can afford to wait for long-term returns may benefit from a buy-and-hold strategy where they ride out short-term market dips. These investors will be less likely to get forced into selling too low during a downturn.

Investors who keep a close pulse on trends may be suited to a contrarian approach in which they buy investments that are out of favor or undiscovered but have future growth potential. Contrarian investors know that early adopters experience the greatest success; it is the inexperienced latecomers who suffer when a market peaks and falls.

A market that has already experienced large increases attracts many new investors, Dweck said. "And that's where people get caught. They get caught up in the hype…and there are plenty of people left holding the bag."

"Be cautious because when everybody is jumping in on something, it's usually when the smart money is getting out," Brandon Rolheiser, a real estate agent and investor from Edmonton, said.

"I like to get in when nobody's looking at a particular commodity," Mike Norman, an internationally-known contrarian investor who is regularly highlighted in various media, including Fox News and BizRadio, said. He buys commodities that he feels are undervalued and then waits "until eventually the market prices it at what its true price should be."

For example, recent housing market problems have created a negative sentiment about timber and lumber, Norman said, "and that gives an opportunity to buy in on the cheap."

When the investment becomes popular and prices rise, contrarian investors sell for a profit. Finding the discipline to sell a successful investment is challenging for many, and then taking that money and investing it in a less popular market is emotionally difficult.

"Whenever I see a lot of interest develop, whenever I see all kinds of new ways to speculate or invest in a particular theme, I pull back," Norman said. It requires discipline to get involved when an investment is out of favor, he said.

Once an investor has committed to a strategy and has gained knowledge of the market and the right people, the last step is overcoming fears. Many investors hesitate at this stage even after a solid education and expert advice that will likely minimize failures.

"I think the best piece of advice is just to get out of your own way. I think the biggest obstacle that I have is my own fear of messing things up," Swanberg said.

"I have never learned more in a boot camp or a seminar or a class than I have from just actually doing it and doing it wrong," Swanberg said. She advises that people "just get out of their own way and move forward and screw it up if you have to."

Although education and research are crucial, "you're not going to be able to know the answer to everything before you move forward," she said.

Once the research is done and an informed decision can be made, that information must be put into action. "If people want to jump into the game, it's not too late. Don't be a procrastinator," Dweck said. "Get educated, and then do it. You've got to get off the old rusty dusty and do it." ■

> "Be cautious when everybody is jumping in on something."
>
> Brandon Rolheiser, real estate agent/investor

How to know people:

* Join an investment club
* Join investing blogs or forums
* Network at social events

How to know your market:

* Talk to people (pulse others)
* Monitor investment media
* Read financial books
* Take educational seminars
* Learn from practical experience

How to know yourself:

* Analyze your situation
* Commit to a strategy
* Overcome fears and take action

Be Your Own Bank

Save money by borrowing from—and repaying—yourself

You probably don't sit around calculating how much interest you pay to banks and other lenders each year, but chances are you have financed large purchases, such as homes, education, cars and major appliances.

The interest paid on these items can add up to hundreds of thousands of dollars, perhaps more, in the course of a lifetime. People often have to decide how much money to allocate for their retirement and how much to paying down current debt.

But what if it were possible for people to save for retirement in a vehicle that allowed them to finance their life in a way that provided advantages over borrowing from a bank or lender?

That is exactly what R. Nelson Nash had in mind when he pioneered the Infinite Banking Concept. In essence, Infinite Banking, and other similar systems adapted from Nash's original idea, involves paying into a whole life insurance policy with an insurance company that allows policy holders to take loans collateralized on their individual policies.

How it works

Infinite Banking and other individualized banking systems rely on participating whole life insurance policies, which build up equity and pay dividends. Policy holders pay premiums—which vary based on the amount of the death benefit chosen, along with other factors, such as the age and health of the policy holder—into a whole life insurance policy for a period of five to seven years and let the policy increase in value. This is known as the capitalization phase.

"Generally, we try to fund most of the money into it in the first five years," Tom McDermott, president of Asset Protectors & Advisors Group, said. "The longer you can allow it to accumulate, obviously, the more you can pull out for retirement savings, the more you can pull out for larger items."

After the capitalization phase, the policy becomes self-supporting; the returns on the policy at that point will be enough to cover the premiums. The annual dividends are based on how well the insurance company did that year. Insurance companies must invest the premiums received "in order to produce the benefits that are promised," Nash wrote.

Through the use of a paid-up additions rider, policy holders benefit from having their dividends reinvested into their policy, thus increasing the value of their policy and subsequent death benefit.

Policy holders are able to borrow up to 100 percent of the cash value of their whole life policy at any time with no tax penalties. A policy holder "outranks every potential borrower in access to the money that must be lent," Nash wrote.

With this structure in place, policy holders are able to essentially act as their own personal bankers. They can loan themselves money from their own life insurance policies, and the interest payments go back to their own accounts.

Whole Life Insurance

Whole life insurance provides lifetime protection for the insured through a guaranteed sum of money to be distributed to the insured's beneficiaries upon the insured's death. Whole life insurance policies can build up equity, which can be withdrawn or borrowed against.

People who participate in individualized banking are able to borrow money from—and repay—themselves when financing major purchases, rather than relying on and paying interest to banks and other outside lenders.

"Your average American family is not saving money...at the same time, they're spending approximately 34.5 cents on every dollar in interest to finance their lifestyle through banks and different finance companies," David Kane, president of the benefits division at York International, said.

By depositing cash into a life insurance policy rather than using it for a major purchase, investors retain the ability to earn interest on that cash. Further, by borrowing from their own life insurance policy, they avoid having to spend that 34.5 cents per dollar on outside financing, and can instead pay that to their own policy.

The borrowed money can be used to finance any purchase, whether or not a lender would typically grant a loan for it. The policy holder, as banker, gets to set the loan requirements.

"You are totally and completely independent from all other sources of financing," Rebecca Rice, owner of Rebecca Rice & Associates, said. "You have control of your own banking system and you're able to control the amount of money that goes into your bank."

Policy holders must make sure that they pay back any loans they take out. If they don't, the system of growing the policy's value will fail.

People who follow through on utilizing the insurance policy as a bank are able to supercharge the returns guaranteed by the policy while financing things they would have financed anyway. The difference is that all the interest payments go back to the policy, not to a bank or other lender.

"The Infinite Bank is really like a complete financial system. It will provide money for your lifestyle, for your retirement and for your heirs," Kane said. "It works well in all phases of wealth."

The advantages

Perhaps the most obvious advantage of individualized banking is that it offers life insurance coverage—something most people need anyway. Life insurance is a low risk investment; there are guaranteed returns, and life insurance companies are noted for their longevity.

There are also tax benefits. "In a properly structured life insurance program, if you borrow the money out of the policy, the proceeds are tax free," McDermott said. "As long as you don't lapse the policy, no taxes are due. When the death benefit is paid, it is paid income tax free, minus the withdrawals. We structure these programs so that the income stream is tax free through age 100 and the policy has a no lapse provision in it so as not to generate a taxable event."

In addition to providing capital for borrowing, policies can also provide a stream of retirement income for policy holders. There are no age limits on policy withdrawals.

"This is the front of the wave for retirement planning," McDermott said. "Setting up something like an Infinite Banking plan...allows you to save for retirement planning and [know] exactly what your tax exposure is going to be when you start pulling the money out. And if you pull it out correctly, you're going to have zero tax exposure."

Insurance policies are also safe from exposure to litigation and creditors. "Insurance policies are protected from...taxes, creditors, litigation, things like that," Steve Sappington, co-founder and registered principal of TWM Group, LLC, said. "We have, for example, a lot of doctors who use this Infinite Banking Concept...because it shelters assets."

In addition to being safe, individualized banking is flexible. Policy holders can borrow money and use it for purchases for which financing is usually hard to come by, such as foreign real estate. Policy holders can even become lenders themselves, borrowing money to lend it to other people in order to earn further interest.

People who use individualized banking can use their policy in a variety of ways without turning any money over to a bank or other lender at any time. "It's really phenomenal," Rice said.

The disadvantages

Still, it is by no means a perfect system. It typically takes several years for policies to grow to the point that the returns equal the costs of the premium, and for there to be a significant enough value in the policy to warrant borrowing from it.

The initial stages of individualized banking are analogous to starting a small business; there are a few years where money is spent before any money comes in. In addition, policy holders must be dedicated to building up the value of their policies.

"Just plan on really funding that policy well for seven years, then you're going to be able to do some really nice things as a result from that,"

Sappington said. He compared the initial stages to a jet taking off. A jet uses a lot of fuel to take off but becomes much more efficient after the initial surge of fuel use.

In addition to building up their policies, policy holders must be dedicated to paying back loans, though there is certainly more flexibility involved, since policy holders are paying themselves back. If unforeseen circumstances arise, policy holders can change their repayment schedule as necessary, rather than worrying about foreclosure, repossession or damaged credit. However, failing to pay back loans will diminish the effectiveness and efficiency of the system.

People who want to use an individualized banking system will need someone familiar with it to help them set it up, and not all insurance brokers are aware of the system.

Those interested in individualized banking will need to do research to make informed decisions. Fees, commissions and the percentage of the premium that goes toward building the account's value vary by company, and there are many ways to structure whole life policies.

Nash offers a six-week class to insurance brokers in which he teaches them how to properly set up the system. A list of people who have taken his class and are certified to set up Infinite Banking is available here: http://www.infinitebanking.org/links/usagents.php. ■

The experts quoted in this article have participated in Nash's Infinite Banking training.

Canadian Boom Town: Edmonton

How oil sands have spurred rapid growth in Alberta's capital city

A housing demand that outstrips supply is almost unheard of in the current U.S. market, but conditions are radically different in the Canadian province of Alberta, which is facing a housing shortage and rapid price acceleration.

Edmonton, Alberta's capital, is the closest major city to the lucrative oil sands projects in northern Alberta. The oil sands have attracted almost $140 billion to the province, and people are flocking to the area in search of high paying jobs.

With unemployment at approximately 3 percent, Edmonton has redefined the concept of "full employment"; job opportunities far outnumber potential workers.

The population influx has driven rental vacancy rates to less than 1 percent in Edmonton and the surrounding areas. It has also spurred rapid price acceleration, much to the delight of property owners, who saw values increase by 52 percent in 2006.

While competition is growing, Edmonton may still offer opportunities for profit.

Energy drives growth

Alberta was Canada's fastest-growing province from 2001 to 2006, with a 10.6 percent population increase—twice the national growth rate, according to the 2006 census. The previous five-year period saw a similar rate of growth, the census showed.

The province now has a population of more than three million, with one million in the greater Edmonton area.

Alberta averaged annual economic growth of 3.8 percent for 10 years, outperforming Canada's 3.3 percent overall rate, according to the provincial government's website. Alberta's productivity was $58,535 GDP per paid worker in 2004, the highest in Canada, the site said.

The oil industry in particular has contributed to Alberta's growth. Oil and gas produce one quarter of Alberta's GDP, almost 70 percent of Alberta's exports and 35 percent of the provincial government's revenues, according to the Alberta government's website.

"Alberta's driven by the oil industry," Jon Hall, marketing manager for the Edmonton Real Estate Board, said, and there has recently been a "massive expansion" in the oil patch. "There's $140 billion worth of capital infrastructure, industrial commercial capital infrastructure, being built in Alberta."

As the projects grow and technology improves, oil sands become cheaper to convert, enabling energy companies to see greater profits. This attracts even more companies to the area.

"Pretty much every weekend that you open up the newspaper, there's some new expansion being announced that's billions of dollars in the north somewhere," local RE/MAX realtor Rhonda Navratil said.

Almost 70 percent of the oil sands remain open for exploration and lease, according to the Alberta government's website, and skilled workers are in high demand.

"There are billions of dollars worth of projects that are on the books that haven't even been started yet because we don't have enough manpower," Les Michaelson, president of

the Edmonton Revenue Property Investors Association, said.

After Alberta's unemployment rate reached an astoundingly low 3 percent, "I think [economists have] taken their economics textbooks and thrown them out the window," Richard Goatcher, the Canada Mortgage and Housing Corporation's senior market analyst in the Alberta capital region, said.

"We just can't get enough people in here to get the job done. So that's drawing a lot of tradespeople here...any kind of construction worker on the planet who's willing to work can find work here," he said.

Photo courtesy of Syncrude Canada Ltd.

Energy dependence

Alberta's reliance on the energy sector may seem risky to outsiders, but the money invested into Alberta is "smart money," Todd Millar, owner of local real estate investment company Glenn Simon Inc., said. Companies "don't invest that without doing a lot of research."

"Unless they find an alternative energy source to oil, I think it looks fairly strong for the next decade or two," local realtor and investor Brandon Rolheiser said.

> "In reality it's work that ultimately drives real estate prices."
>
> Les Michaelson, president of the Edmonton Revenue Property Investors Association

The U.S. prefers to import from Canada rather than the Middle East or Venezuela. Alberta/Canada has been the largest oil supplier and the largest gas supplier to the U.S. for six years in a row, according to the Alberta government's website.

The Kyoto protocol could generate new environmental regulations, but "there is such a need and a demand for oil...the demand is so high from the States that I don't think that they could really get away with shutting down what's happening up here," Michaelson said.

Alberta is "diversifying to create more stable economic growth," the provincial government's website said. Energy now comprises a quarter of Alberta's GDP, down from one third 20 years ago, the site said.

Agriculture, lumber, manufacturing, nanotechnology and biotechnology are also strong economic components, said Millar, who said he considers the economy diverse.

Edmonton's large population base is not focused on just one industry or business, so "there's quite a lot of diversity in the marketplace here," Navratil said.

Competition

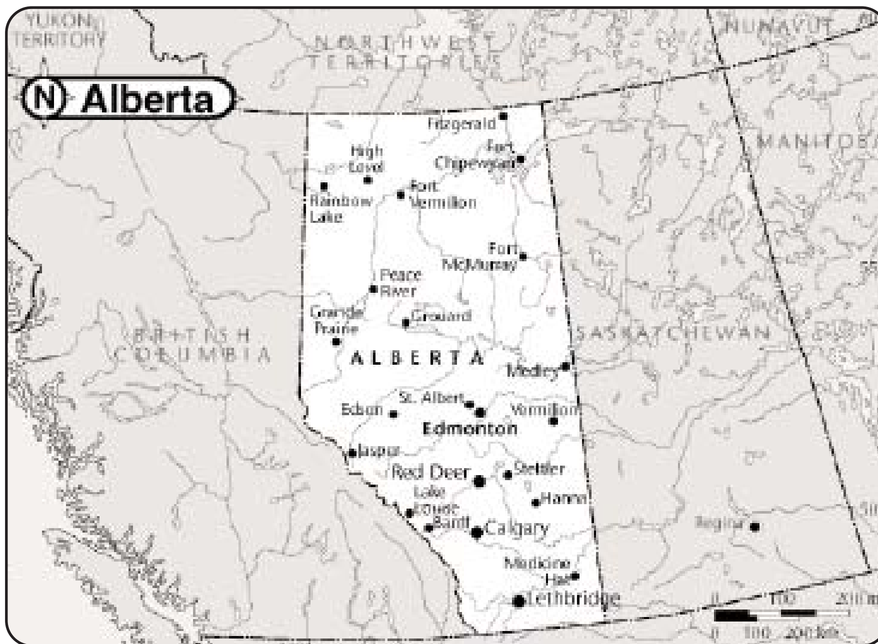
High paying jobs are attracting many new residents in need of housing. "Everybody seems to want to come to Edmonton, especially for a job," Michaelson said. "And in reality it's work that ultimately drives real estate prices."

"The builders are pretty much running as fast as they can, trying to put as much product out there as they can, and they can't keep up," Goatcher said. "Demand still outstrips supply, so we're seeing all kinds of price acceleration."

The major markets in Alberta "have vacancy rates below 1 percent and are seeing rental increases of double digit percentage levels...of course, that's enticing investors to purchase revenue properties," Goatcher said.

Edmonton's 52 percent jump in property values in 2006 has also attracted investor attention.

"It's a hot market," Michaelson said. "There's an awful lot of competition from other investors from all over the place...it's very possible to overpay for a property if you don't know what you're doing."



"There's a lot of money in this province now looking for investments," and many outsiders accustomed to higher prices are paying "ridiculous prices for property," Rob Winters, local investor and managing partner of EGM Properties Inc., said.

The "snowballing effect" caused by outside investors concerns Goatcher. "We've got way too many people trying to do too much at the same time," he said. "Everybody wants to come here and spend money."

Many people are making unconditional offers because they are "desperate to buy any property," Winters said. "I think that is very short sighted...there's just a lot of money being thrown at properties."

"If you're familiar with the market or you work with someone who's familiar with the market, you can take more time and get involved in private deals or opportunities where there is less of that frenzied competition," Winters said.

Affordability

In spite of increasing competition, many experts feel that prices remain reasonable. Edmonton is "a very affordable city even though we've had record increases in the last two or three years," Vince Laberge, president of the Canadian Home Builders' Association—Edmonton Region, said.

Small investors may get pushed out by rising prices, Millar said, but "when you look more long term it's still so affordable."

The affordability index in Alberta is still very good compared to other regions of Canada, Winters said.

Alberta's per capita investment was $18,520 in 2005, more than double the $7,764 per capita for Canada, the Alberta government's website said. "One attraction is Alberta's tax advantage: lowest personal income tax, low corporate income taxes, no capital tax, no provincial sales tax, no payroll tax and the lowest gasoline taxes in the country," according to the site.

"In Alberta, the salaries are higher, the taxes are lower and the houses are incredibly affordable. They're much cheaper than Toronto or Vancouver," Millar said.

A lack of rent controls attracts investors, Michaelson said. Ontario and British Columbia restrict increases, but in Edmonton, "it's whatever the market will bear," he said. "It's an all-round free economy up here...the rents have been depressed for such a long time that now we're trying to play catch up here."

"Edmonton's just done a catch up," Hall said. "We've been so far behind the curve."

Condos edge out rentals

Edmonton has one of the lowest population densities of any major North American city, according to the AlbertaFirst website, but it is filling in as the population grows.

Some of the less desirable areas near downtown and the university remain relatively inexpensive and are likely to undergo revitalization, Rolheiser said.

More developed neighborhoods just outside the downtown core, such as Oliver and Glenora, can be good investments, Millar said. "They're mature neighborhoods, they have easy access to the downtown core, but...there's less product there...it's more expensive to get in."

Condominium apartments, which are

> "In Alberta, the salaries are higher, the taxes are lower and the houses are incredibly affordable."
>
> Todd Millar, real estate investment company owner

popular because many newcomers cannot afford single detached homes, comprise most of the downtown activity, Goatcher said.

Condo conversions are removing apartment buildings from the rental market, Winters said.

"Some of those get remodeled and put back in rentals, but most of them are being purchased by homeowners" because houses are less affordable, he said. "Even though there's rapid and record housing construction, it almost seems that the rental market is shrinking."

"Highrise condominiums are going up a dime a dozen downtown, and many of those are being purchased by investors," Hall said. "Nobody's building rental properties at this point...they're mostly building condominiums."

As condo conversion projects reduce supply, the rental market may become even more competitive—and more profitable for investors who own rental properties.

Edmonton's Rental Rate Increases

Numbers for structures with at least three rental units

Type	2004	2005	2006
Studio	0.2%	1.8%	9.4%
1 bed	1.5%	1.8%	9.5%
2 bed	1.1%	0.3%	10.4%
3 bed	0.9%	1.2%	10.8%

Source: Canada Mortgage and Housing Corporation's 2004, 2005 and 2006 Rental Market Reports for the Edmonton Metropolitan Statistical Area.

Directions of growth

Edmonton may be growing denser, but "the real growth is outside the city of Edmonton itself," Hall said. Census Canada reported that areas just outside the city are all in the high growth category, with population growth of more than 10 percent in the last five years, he said.

The northeast, the southwest, and the west are all growing with new construction, Hall said. "New home construction happens on the outer edge. The city is being built in concentric rings."

Winters prefers to invest in the northeast and southeast because of the proximity to industrial mega projects located 30 minutes northeast of Edmonton.

Northeast Edmonton has been underpriced compared to other areas of the city, Rolheiser said. "But it's in close proximity to a lot of the refineries" and draws people who commute to the oil sands, he said.

The east side of Edmonton is "the depressed part of the city" and may offer low prices for properties that will become more valuable as the city expands, Michaelson said.

Laberge sees more opportunity for expansion in the south and southwest because the industrial corridor in the north limits the amount the city can expand in that direction, he said.

Infrastructure developments, such as the ring road connecting outlying neighborhoods to downtown, will improve real estate values. Communities in northeast, southeast and southwest Edmonton are being built out to meet the ring road, Millar said.

There is also "interest in building along the existing commuter train line and on the planned commuter train line that's heading south," Goatcher said. Properties within walking distance of the lines will benefit, he said.

Outlying towns

The small towns surrounding Edmonton have suddenly become boom towns straining to support the growing population.

"Many communities are struggling to cope with the influx of people," Winters said. "It's not just housing, but all of the support services and community services and infrastructure that have to be developed to support that kind of growth."

"Basically all towns in this region are expanding," Michaelson said. "The towns are looking for more land to bring on stream to build more housing. And basically the whole province is completely taxed out. This is almost the same as in the 1800s up in the gold rush in the Yukon...the fervor is just unbelievable."

"This is almost the same as in the 1800s up in the gold rush in the Yukon...the fervor is just unbelievable."

Les Michaelson, president of the Edmonton Revenue Property Investors Association

"Virtually all of the communities within 30, 40 minutes of Edmonton are getting a lot of attention," Winters said.

Navratil recommended looking toward towns with established services and infrastructure, including schools, recreation centers and shopping.

Some towns, such as Redwater, Leduc and Devon, market themselves as bedroom communities to Fort McMurray, Hall said.

Fort McMurray is about five hours north of Edmonton, in the heart of the oil sands. Its convenient location means intense competition for housing, with limited availability and exorbitant prices.

"There's no housing in Fort McMurray at all. People are living in holiday trailers and backs of trucks," Hall said. "There's tens of thousands of people living in camps."

Bedroom communities encourage families to settle in town and commute to the oil sands. In addition, Redwater has industrial development in progress that will generate local jobs. A $5.9 billion USD refinery is in the works.

Investment strategies

Rapid price increases mean Alberta is "not really a cash flow market, so that should be something that investors going into Alberta realize," Millar, who specializes in small residential properties, said.

It will generally take about two years to "pump up the cash flow" on a single family home, Millar said. "It's a capital gains market...I think long term appreciation is what investors need to look at."

Single family homes may currently be "a little undervalued," Navratil said, because "there's not enough of a gap" between single family home and condominium prices.

Average House Prices in Q1 of 2007

City	Detached bungalow	Standard two-story	Standard condo
Calgary	$402,933	$411,456	$261,336
Edmonton	$350,000	$384,750	$261,600
Montreal	$221,583	$338,857	$204,929
Ottawa	$298,083	$294,667	$187,333
Toronto	$387,744	$489,889	$269,210
Vancouver	$758,000	$837,500	$403,500
National	$316,993	$378,148	$230,146

Source: Royal LePage

Because single family home prices have outpaced rental rates, Michaelson said multi-family properties offer more cash flow potential. When investing, "I would be looking for areas that have had a fairly low vacancy rate even in times when the vacancy rate has been high," he said.

For rehabs and flips, Millar recommended "inner city areas that are already in transition...it's always good if you can buy a few properties on one street and start that trend." Labor and building material shortages can delay rehabs, so those who prepare a crew in advance have an advantage, he said.

Opportunities for flips are hard to find, Navratil said. She sees opportunity in buying a single family home with suite potential and converting the basement into a suite or multiple suites, if the zoning allows for it.

Common mistakes

One of the biggest dangers for Edmonton investors may be the fact that nearly all investors succeeded in 2006—even those who made what would normally be bad purchases.

For example, Navratil had a client who purchased a property that she thought was "just awful," yet the property sold a year later for $110,000 more. "Everything went up, so it just didn't matter."

"You don't get really punished for mistakes in this market too badly" because of the rapid appreciation, Rolheiser said. "But you can overpay for a property. You can buy a property that requires too much work" or can select the wrong tenants, he said.

"I would very strongly recommend working with people that are here, professionals that are here," Winters said. "It's just really easy to overpay...if you come in on your own and look for something to put your money down on."

Boom town lessons

Edmonton's growth has followed a classic boom town pattern, and the increases of 2006 may scare off investors who consider that rate unsustainable.

Though price increases of 52 percent a year are unlikely to continue for the long term, most experts on the ground feel increases will settle to a steadily climbing, sustainable pace. Whether or not an investor sees opportunities in Edmonton, the area provides a useful example for identifying future opportunities in areas with similar fundamentals and similar potential for rapid growth. ■

Photo courtesy of Shell.

Rocky Mountain Oil

The area houses the largest oil shale deposits in the world

Although they prefer not to publicize it too loudly just yet, Shell Oil Company and the U.S. government have taken steps toward tapping into the world's largest known oil shale deposits using an innovative in-ground heating method.

The Green River Formation of Colorado, Utah and Wyoming "holds the equivalent of 800 billion barrels of recoverable oil—as much as the U.S. would use in 110 years, at current consumption levels, and three times the proven oil reserves of Saudi Arabia," according to a Nov. 13 press release from the Bureau of Land Management.

"More than 70 percent of the Formation, including the richest and thickest oil shale deposits, lies under federally managed lands," the release said. The federal government has a critical role in determining the future of the U.S. oil shale reserve, and it has quietly taken steps to support oil companies in accessing this resource.

In 2005, the Energy Policy Act "liberalized the lease ownership provisions of the Minerals Leasing Act of 1920, thereby removing a major deterrent to private-sector investment in oil shale development," according to a 2005 study produced by the RAND think tank for the Department of Energy.

In 2006, the Bureau of Land Management granted approval for five 160-acre leases for oil shale research, development and demonstration in Colorado. Three of the leases went to Shell, one to Chevron and one to EGL Resources.

Of the three companies, Shell has the technological advantage, with successful tests already completed that offer promise of an economically competitive way of accessing the resource.

Shell successfully tested in situ (in-ground) methods that involve heating the shale with massive electric heaters below ground for a few years and pumping the oil out after conversion.

"On only a 30 x 40-foot testing area, Shell successfully recovered 1,700 barrels of high quality light oil plus associated gas from shallower, less-concentrated oil shale layers, thus determining our technological design works," Shell's website said.

Production of a barrel of oil requires approximately a ton of oil shale, and it creates byproducts that are potentially hazardous to the surrounding environment.

To contain those byproducts, Shell is testing an underground "freeze wall," made of ice, that will separate the production zone's possible contaminants from the groundwater. Early tests of the freeze wall approach have been successful.

This complex approach should be profitable as long as oil costs at least $25 to $30 per barrel, Shell predicted. This represents a huge economical improvement over past methods, which used an expensive and environmentally-damaging open-ground mining and surface retorting (heating) process.

Oil companies implementing the costly surface retorting approach poured billions of dollars into Colorado's Piecance Basin in the late 1970s and early 1980s, creating jobs, spurring the local economy and straining the local infrastructure. Real estate prices jumped as towns expanded. New businesses cropped up to service the many new residents employed by the oil companies.

In order for surface retorting to be profitable, oil barrel prices had to stay in the range of $70 to $95. When barrel prices dropped in the early 1980s, oil shale was deemed unprofitable and abandoned. On May 2, 1982, a day locally known as "Black Sunday," Exxon shut down its $5 billion project in Colorado.

The negative impact on the local economy has not been forgotten, and nobody wants to repeat that scenario—least of all Shell.

It is no surprise then that Shell and the U.S. government have been cautious with publicizing recent developments. It remains to be seen whether Shell's in situ approach will be successful on a larger scale, so Shell has not yet committed to a commercial venture.

According to the 2005 RAND study, "A firm decision to commit funds to such a venture is at least six years away." Even then, "at least an additional six to eight years will be required to permit, design, construct, shake down, and confirm performance of that initial commercial operation."

Ultimately, the study concluded, "Under high growth assumptions, an oil shale production level of 1 million barrels per day is probably more than 20 years in the future, and 3 million barrels per day is probably more than 30 years into the future." This means that any investments based on oil shale's future are significantly speculative and long-term.

The government supports oil shale as a way for the U.S. to achieve energy independence. The Department of Energy compares shale oil to the Alberta tar sands, saying that "Oil shale in the United States, which is as rich as tar sand, could similarly be developed and become a vital component in America's future energy security."

The process for production could eventually prove cheaper and more environmentally friendly than extraction from tar sands, also known as oil sands.

The oil produced from oil shale is a similar product to that produced from oil sands, according to the Department of Energy.

Oil sands and oil shale require massive amounts of water to produce oil, and the Alberta oil sands and the Green River Formation are both located in areas where water is a limited and precious resource.

Shell's in situ oil shale process would also require electricity that exceeds the capacity of the existing local infrastructure. At least one huge new power plant would be needed of unprecedented size in the area.

However, Shell expects that it would

Map of the oil shale deposits

Map courtesy of the Oil Shale & Tar Sands Leasing Programmatic EIS Information Center.

extract 3.5 units of energy in return for each unit used in production.

Oil shale towns that suffered from the 1980s bust went through a boom process similar to the one currently occurring in Fort McMurray, Alberta.

Oil sand production has brought money flowing into Fort McMurray, a city that increased in population by 67.2 percent between the years 1999 and 2005, from 36,452 to 60,983, according to Syncrude, a major oil company in the area.

Property values in the Fort McMurray area have skyrocketed during the past few years as oil sand production became more profitable and more oil companies and their many employees moved into the area. Property is scarce, and prices have risen so high that it's hard for investors to justify investments in Fort McMurray now.

Local infrastructure is taxed to its limit with the sudden population influx and the needs of the large oil companies. For example, the city is now dealing with a homeless problem and heavy traffic along the two-lane highway connecting Fort McMurray with the oil sands and with Edmonton.

In light of the Fort McMurray example, investors will do well to keep an eye on U.S. oil shale development. If it follows a path at all similar to oil sands development in Alberta, properties in the Green River Formation area and nearby towns could offer a compelling opportunity for investors looking to get in on the ground floor of a boom.

Southwestern Wyoming and northeastern Utah would be particularly appealing, since prices in those areas are currently very low.

Northwestern Colorado would also be attractive, although it would be starting at higher property values because it is already home to more industries.

Oil companies and the U.S. government are currently taking a slow and cautious approach to oil shale, but the development process could likely be expedited if global factors made it politically and/or economically advantageous to put more money and energy into accessing this resource. If oil shale were to become commercially profitable, its impact on surrounding towns would be immense. ■

Timber: A Renewable Resource

How timber can balance out a portfolio

Since 1987, the timber industry has outperformed the S&P, according to the National Council of Real Estate Investment Fiduciaries (NCREIF). The timber index produced average annual returns of more than 15 percent during the past 20 years, compared with less than 12 percent for the S&P.

Timber's increasing popularity means that these impressive returns may not last forever. As more investors move into timber, many experts predict that the industry returns will settle in the 7 to 9 percent range. Many of timber's new enthusiasts view it as a low risk, high return investment. They believe it will produce capital growth comparable to equities while only requiring bond-level risk.

That may be slightly ambitious, but timber does have significant advantages that lower its risk. Timber is both a hard asset and a renewable resource. Its value increases over time "on the stump," even if investors wait around and do nothing.

In fact, the longer investors wait to cut down and sell the trees, the more valuable their investments grow. This enables many timber organizations to wait out downturns and sell their timber later when prices are more favorable.

The world has a limited supply of both land and timber, and global demand for timber is increasing as the global population increases. The long-term global market is solid; the U.S. may encounter short-term housing market downturns, but China, India and other booming populations show no sign of slowing in demand.

Timber prices are not correlated with stock market trends, even though some timber companies are publicly traded on the market. Timber tends to do well during stock downturn periods when investors shift from riskier stocks to safer investments.

Publicly-traded timber companies can provide strong and reliable dividends, particularly those in the form of Real Estate Investment Trusts (REITs). REITs are not considered corporations and do not pay corporate income tax. REITs are required to pay out 90 percent of their profits as dividends, so timberland REIT investors have the confidence of knowing that even if their REIT's stocks drop, dividends should remain steady.

Private timber companies and those which are publicly traded in non-REIT form aren't required to offer dividends, although they can do so at their discretion. This gives non-REIT public corporations and private institutional timber investment management organizations (TIMOs) the advantage of being able to wait out downturns. REITs, on the other hand, may feel pressured to sell their timber even during low market conditions to produce dividends.

Timber trends

Ownership of timberland has shifted dramatically in recent decades as industrial, publicly-owned forest product companies sell to institutional investors.

In 1981, forest product companies owned approximately 58 million acres of U.S. commercial timberland, but that number dropped to less than 21 million acres by 2005, according to a study produced by

Seneca Creek Associates for the American Forest and Paper Association.

The American Forest and Paper Association also reports that of the 504 million acres of U.S. timberland, private investors hold 356 million acres, more than 70 percent of that total. These private investors consist of individuals, trusts and corporations. In contrast, just 146 million acres, or 29 percent, are owned by federal, state and local governments.

Institutional investors now own approximately $22 billion in timberland, according to *The National Real Estate Investor*. Most of that money—$15 to $17 billion—is managed by private institutional investors in the form of TIMOs, while REITs hold the rest.

This shift toward institutional investors owes much to the tax advantages they have over publicly-traded companies. Institutional investors are motivated to achieve the highest possible returns with the least amount of risk.

Environmental impact

Although the timber industry may have some lingering stigma for cutting down forests, many of today's timber organizations see the importance of preserving timber as a sustainable and renewable resource into the future. Government policies reward timber organizations in the U.S. for sustainable practices.

Timber companies also have their own financial sustainability at stake; if the forests were destroyed, the timber companies would go down along with them. This provides a strong incentive to practice renewable and sustainable timber growth and harvesting.

Many investors seeking "green" investments are turning to timber because of its renewable quality.

Timber companies in the U.S. today have little motivation to cut down old growth forests. The approval process is complex and does not inspire public approval. In addition, once old growth has been cut down, timber companies would have to plant new growth anyway.

Today's timber organizations find it more practical to buy land and turn it into timber plantations rather than cut down old growth forests.

To maintain a steady stream of profits, some timber holders harvest a different timber plantation or section of a plantation each year. This way, there is always new timber ready for harvesting each year. If the year is not a favorable one for prices, the organization can cut and sell less timber (or none at all) and wait for prices to improve.

Most growth cycles are approximately 10 to 40 years. In areas with favorable climates, the growth timetable may happen slightly faster; in less favorable conditions, it may take a few more years.

Timber companies have historically encountered cases where their land would have greater value if used for suburban development, and that phenomenon has increased significantly in recent years with the global population boom.

Some timber organizations allocate a certain amount of land to sell each year. They select the most valuable land that could have a more profitable use in suburban development and sell that land to developers. The timber companies can then reinvest that money into cheaper land in other locations for growing timber.

Ways to invest

There are currently three main ways for investors to gain exposure to timber:

1. Publicly-traded companies, including Real Estate Investment Trusts (REITs)

Publicly-traded companies are the most affordable and accessible timber investments, since shares are traded on the stock exchange. They currently take the form of either traditionally-structured companies or REITs.

Traditionally structured companies pay out dividends at their discretion;

these dividends are typically substantially higher than dividends from standard stock investments. These companies have the flexibility to decide when to sell and when to hold their timber; they have more freedom to wait out low markets and sell later when prices are higher.

A new trend in publicly-traded timberland companies is conversion to REIT status. This provides huge tax advantages by exempting the REIT from corporate income tax on earnings from land holdings, but it requires they pay out 90 percent of their profits in dividends to shareholders. This is a big attraction for investors seeking regular, reliable dividends.

Most timberland REITs are currently paying out around 4 percent in annual dividends, compared with around 3 percent for regular REITs and 1.8 percent for the S&P 500 overall.

Timberland REIT investments also provide tax advantages for investors; dividends are considered capital gains, so they are taxed at the 15 percent maximum capital gains rate. This is an advantage compared with regular REIT dividends, which are taxed at a higher rate based on income tax minimums.

Some REITs diversify into commodities other than timber, such as mining, depending on the most profitable use for the land owned by the REIT.

The most notable downside to REITs is that pressure to provide dividends to shareholders can force them to sell even during low markets.

Although the results of timberland REITs and traditional publicly-traded companies are not entirely correlated to the general stock market trends, their inclusion in the stock market makes them somewhat volatile and subject to fast changes.

2. Timber Investment Management Organizations (TIMOs)

Higher net worth individuals and institutional investors have the option of investing in TIMOs rather than REITs. TIMOs are privately-held organizations that manage timberland with the intention of producing the greatest long-term returns possible with minimal risk.

TIMOs are not traded on the stock exchange, and they can generally afford to wait out market downturns. TIMOs are strictly timberland; they don't own manufacturing operations.

After the Employee Retirement Income Security Act (ERISA) in 1974, TIMOs became popular with institutional investors. Pension funds in particular began investing in TIMOs in their move toward diversification.

TIMO investments usually require a large minimum investment. According to *The National Real Estate Investor*, a separate account usually runs an investor $20 to $100 million. Commingled funds are usually around $2 to $5 million; a few require as little as $250,000. Many require 10 year commitments with options to extend.

TIMOs require management fees of approximately 1 percent of assets, and managers sometimes also receive a percentage of profits.

Like REITs, investments in TIMOs are not hands-on investments. The organization makes the official business decisions and handles the practical management of timber growth and maintenance.

3. Purchasing land directly

Investors can also buy raw land directly and develop it for timber. Investors buying land that they anticipate will be in the path of progress can add value by planting trees on the land and then holding it for 20 years or more. The land can then be sold to a TIMO, REIT or lumber investor along with the timber, or the investor can harvest the trees and sell the land to a land developer.

> Raw land investors can add value to their land by planting trees.

Land investors interested in growing timber should research areas likely to produce well and provide easy transport, since timber transport can be costly. The investor must then decide what sort of trees to grow and determine how to plant and cultivate them.

Unless the investor already has expertise in this field, a manager may be needed to plant, maintain, oversee and harvest the timber growth. Some areas will require more maintenance than others, depending on climate and environmental factors.

This approach tends to appeal more to hands-on investors who like direct control over their investments. Many investors interested in timber will prefer to have a large institution manage the practical aspects of timber production, but for those who are not afraid of getting their hands dirty, this can be a great way to add value to land purchases.

Raw land investors already interested in areas favorable to timber growth may want to consider planting timber while waiting for the underlying land value to increase. ■

New Zealand Forests: Opportunities for Small Investors

Few American companies offer economically feasible opportunities for small investors seeking private timberland ownership, but some New Zealand companies are attracting investors with such opportunities.

Roger Dickie and Greenplan are two New Zealand companies offering partnerships in which small investors can own shares of a corporation that owns forestland. Investors own an undivided share of the forest, not a particular plot of land.

"It's like if you owned a share in a commercial building; you wouldn't own any particular rooms. You would own an undivided share of the whole thing," Richard Bourne, marketing manager with Roger Dickie, said.

These companies offer hands-off investments; they handle the management, pruning, insurance and maintenance. In the U.S., a small-time timberland owner would have to manage the land or pay large management costs. Roger Dickie and Greenplan keep costs lower by spreading them over a large amount of timber and many investors.

Co-owning a large plot of land is also less risky than owning one piece of land directly; if some of the timber is damaged, all investors share in the remaining profits.

Greenplan offers units equivalent to one hectare, or approximately 2.5 acres, for $NZ 7,500. Minimum investments in Roger Dickie partnerships range from 1 percent to 4 percent shares of forests, with costs of approximately $NZ 10,000 to $NZ 40,000. A 1 percent share normally equates to about 3 hectares, or 7.5 acres, according to Bourne.

For an investment of as little as $NZ 100,000, Roger Dickie will help investors purchase an entire private forest, Bourne said. Typical investments span from $NZ 500,000 to $NZ 45 million, according to the company's website.

Neither company requires that all money be paid up front for partnership investments. Costs are spread out over a number of years, with ongoing maintenance fees.

A recent Roger Dickie partnership project predicted returns of 7.11 percent pre-tax. A 4 percent share in that project required an investment of $NZ 120,940 and was forecast to produce $NZ 545,782 in returns after the first harvest.

New Zealand's climate facilitates fast growth; growth cycles for Radiata pine are about 30 years. "We can grow trees a lot quicker than many other places in the world," Bourne said. Native to California, Radiata pine has a natural cycle of 25 to 40 years, according to the New Zealand Forestry Insights website.

Roger Dickie's standard rotation is 28 years for Radiata pine and 50 years for Douglas fir. Radiata pine is normally harvested at 25 to 28 years, at whatever time will maximize returns. Greenplan forecasts for a 30-year Radiata pine cycle, but they often harvest after 22 to 25 years to maximize returns.

Investors who want to sell mid-term can do so. Greenplan and Roger Dickie facilitate the process. Shares are offered to the other partners first before becoming available on the secondary market.

After harvest, investors decide as a group what to do with the land. Often, a second rotation of timber is planted for future harvest. Many investors reinvest some of their profits from the first harvest into the second, Bourne said. Second rotation costs are significantly lower, since the initial cost of purchasing the land no longer applies.

New Zealand's forests also have potential as carbon offset forests and in generating carbon credits. The New Zealand government currently appropriates all carbon credits generated by the country's forests, but the Kyoto Forestry Association is petitioning the government to allow forestland investors to keep the carbon credits generated by their forests.

The government is seeking "direct feedback from farmers and foresters on ways to deal with climate change issues," according to a press release from the Ministry of Agriculture and Forestry. Discussion forums were held in February and March, and submissions on the discussion document closed March 30.

Meanwhile, the government has created a Permanent Forest Sink Initiative to enable landowners to establish permanent carbon sinks and obtain tradable Kyoto Protocol compliant emission units. Because the carbon market is so new, it is difficult to project carbon credit yields, Bourne said, but the offset market has already produced strong interest. Roger Dickie hopes to offer a carbon offset forest project in the next year, he said.

New Zealand timber investments are increasingly popular with investors worldwide, so new partnerships are not always available. Those who are interested in timber investments should visit www.rogerdickie.co.nz or www.greenplan.co.nz to learn about opportunities and register interest.

** We could not reach anyone at Greenplan; all information about Greenplan is derived from their website.*

** As of April 9, 2007, a New Zealand dollar was worth 0.7207 U.S. dollars.*

Investor Highlight

This month's investor highlight, mortgage broker and investor Katherine Swanberg, is a family friend of our executive editor. She is vice president of the Real Estate Association of Puget Sound and has experience in lease options, multi-family construction, raw land and foreign real estate.

In the past six years, Swanberg has acquired 20 properties throughout Washington state, New York and Nicaragua. Swanberg is also an expert in credit management and has taught credit repair courses to disadvantaged women for the state of Washington.

NuWire: What first led you to real estate investing?

Swanberg: I read *Rich Dad, Poor Dad* by Robert Kiyosaki. I think that book has probably done the most for me.

When I read that book I was an employee. I was working for somebody. I had no investments. I hadn't started saving money yet. Since I've read that book I have become self-employed, purchased a business and am very active in real estate investing.

NuWire: What kind of investment transactions have you done?

Swanberg: Most common is buy and hold. I've actually never sold a property. I have 20 houses right now in my portfolio that are single family up to fourplexes.

I'd probably say half the homes I have are single family; the rest are multi-family....The majority of those are rented out or I have lease option tenants living there with the intent to sell them the home after 12 to 24 months.

I've done a couple of new construction deals where I've purchased land and got construction financing and built multi-family and then those I've kept. So that's been the most common strategy for me.

NuWire: What have been your most profitable projects?

Swanberg: There [are] a couple deals I've done that have been new construction. The properties that performed the best are the ones that were brand new, that I built myself. They have the best cash flow and they also are turn-key. There's zero maintenance and I'm able to ask for the highest amount of rent in the neighborhood because I've got the nicest-looking property in the neighborhood.

As far as my lease options, actually buying used products or used homes, I've structured several different lease options where my tenants have actually put 10 percent down up front when they moved in.

I know you've heard a lot of people will say you make money in real estate when you buy; not when you sell.

Those were the first two deals where I'd really been paid my profit up front before I'd even purchased the home.

"The properties that performed the best are the ones that were brand new, that I built myself. They have the best cash flow and they also are turn-key."

So those are really exciting for me because I had fully vested tenants that have a massive incentive to perform, keep the house in good shape and get their credit in a position where they [can] buy. And whether they did or didn't was okay with me because I'd already made my 10 percent up front.

NuWire: Can you tell me about the hardest lesson you've learned so far?

Swanberg: I'm going through an eviction right now, and I realize that I have a desire to make my tenants happy, and to be able to be compassionate when they can't pay their rent on time, and to be able to bend the rules that I've actually put in place with a really solid lease agreement, and honor certain things that make it maybe easier for my tenants to pay rent on time.

And I've learned the hard way that that is not a way to run a business. I have to follow my contracts to a tee and I have to enforce them.

NuWire: What would you say is your biggest accomplishment?

Swanberg: I'm really proud of the number of properties I've been able to buy with an extremely small amount of money. It feels really good to understand the concepts of leverage and also systemizing my business.

It feels great to look at my assets and see all of the different kinds of homes that I've been able to acquire.

I love knowing that they're appreciating every year. I can use them to leverage. I can take money out of them to buy more properties, and it's an awesome feeling. I feel very much like I'm headed in the right direction.

> "I love understanding the financial ramifications of every choice I make. I like understanding the benefits of what I'm doing."

NuWire: What's your thought about people who are quitting their job to pursue investing full-time?

Swanberg: I think if you're set up in a way where your credit is strong and your assets are strong and you're in a good financial position for a couple of years and you don't need to have the cash flow from a job, that's awesome. That's fantastic.

But what I see a lot of times is that people do one deal and they turn a nice profit on that deal and they quit their job. But they haven't necessarily put into their life a system so that they have replaced their job with a new job of being a full-time investor, which comes with again managing your business like it should be managed.

So they do a deal and they have a great success, but then they quit their jobs and they haven't put systems in place to duplicate that success over and over and over again. Those are the people that I worry about the most.

NuWire: How do you define success?

Swanberg: I don't care what your goals are; if you've been conscious enough to write them down and have a clear idea of where it is you want to head and you can track that and see that you're heading in that direction, I think that's success right there.

I don't think there's any end result. I think it's a continuous process of constantly [being] accountable for yourself and being very clear what your intentions are. And not forgetting to dream because I think a lot of people get trapped into the rut of just earning income for their family every day and they've stopped paying attention to what it is they'd really want to do. So that is success for me, when I see people reaching that.

NuWire: What do you love most about investing?

Swanberg: I love understanding the financial ramifications of every choice I make. I love the tax consequences. I love the books. I don't like doing the books, but I like understanding the benefits of what I'm doing.

I like teaching. I like giving back to people the information that I have. It's...the most comprehensive, most positive thing I've ever done. I like learning and I like pushing the envelope. There's no other industry I've ever been [in] that's caused me to do that more than this.

NuWire: What's the most common investment mistake that you see investors make?

Swanberg: I have seen a lot of first-time people that want to fix and flip. They finance 100 percent of their rehab cost on high interest credit cards. It's maybe their first couple of deals so they haven't put together a budget. They haven't figured out what they can actually sell the home for when they're done. And they haven't factored in their profit margin very well. They just didn't analyze the deal all the way to the end.

So they are in a position when they finish fixing up the home where they go to sell it and they find out they can't sell it for what they need to get back out, what they need to be at a net of zero, let alone a profit. I see that a lot.

So they put themselves in a position where their credit's now suffering and their stress is really high and they're not in a position where they can make the minimum payments on their credit card and there's a spiral down from there.

NuWire: Do you think a lot of the interest in seminars and the reason that a lot of people are coming to you and wanting to do fix and flips is the fascination with making the quick buck, the easy money?

Swanberg: Absolutely. Real estate as an investment tool is super trendy right now. There was a time before real estate where network marketing was very trendy and very popular.

There was a time in the '60s where door-to-door sales were extremely popular and very in fashion and very accepted. Right now it's real estate as an investment tool.

So you've got people that hate their jobs and aren't making it financially and they're looking for a way to get rich quick. I don't look at real estate as an investment vehicle and getting rich quick as two things you should ever say in the same sentence.

“I don't look at real estate as an investment vehicle and getting rich quick as two things you should ever say in the same sentence.”

Swanberg's most recent multi-family project.

I'm planting seeds very deliberately and I'm going to reap the rewards later, but I don't look at it as a get rich quick scheme. But I do agree. I think there are a lot of people that are looking for something like that and they'll go anywhere and they'll buy anything if they can just do one deal and have the quality of their life changed.

NuWire: What do you think it is that separates those people that end up becoming successful investors from those that are unsuccessful?

Swanberg: If you're going to do real estate investing full-time or even part-time, you're going to be self-employed. So you're going to be responsible for all aspects of that business, not just one aspect.

That's not a really strong quality in everybody. There are a lot of people that have never worked for themselves before, that have always worked for an employer. So they've always had a job description and they've done the same thing every day.

But if left up to their own devices, without a boss or without a salary, do they have the ability to manage their time well and write their own business plan and follow their own direction?

If they don't, this isn't going to be a good fit for them. And if they do, they're going to excel far more than they ever would working for somebody else. ■