REAL ESTATE AND WARREN BUFFETT

Warren Buffett's investment acumen is legendary and his annual shareholder letter to Berkshire Hathaway investors should be required reading for us all. In one of his letters, Buffet discussed two real estate investments he once made and his comments regarding them are illuminating – not just for real estate, but for any investment.

In 1986 Buffett bought a farm near Omaha and in 1993 he invested in a retail property adjacent to New York University. In both instances he bought property after a bubble had burst and the price had declined dramatically. In addition, both properties were delivering an unleveraged current yield of about 10% and a relatively simple analysis indicated a good prospect for rising future income. Like many Buffett investments, these two also turned out well.

He used those two experiences to illustrate certain fundamentals:

- **You don't need to be an expert to get satisfactory returns** (this is great news for all of us "average" folks!). Now, you must learn to recognize your limitations and follow a sensible course of action. Buffett admits that he knew little about operating a farm – but one of his sons loves farming. With the New York property, he invested with a group of people that included an experienced real estate investor and property manager.
- **Keep things simple and don't swing for the fences.** Buffett's analysis was not that complex or sophisticated. He focused on the cash the farm and retail property could generate and did some best case/worst case planning. If the properties could survive a worst case scenario, then anything above that was icing on the cake.
- **Focus on the future productivity of the asset you are buying.** If you can't make a rough estimate of the future earnings, then move on to something else. You don't have the time or expertise to evaluate every potential investment, but you do need to understand enough to make an intelligent decision
- **Focusing on future productivity makes it an investment.** Focusing on future price change makes it speculation. Be an investor, not a speculator.
- **Keep your eyes on the playing field and not on the scoreboard.** Buffett only thought about what the two real estate properties could generate in future cash flow and cared nothing about their potential future value.
- **It is a waste of time to try and form macro opinions or focus on market predictions.** You don't have that ability, and neither does anyone else. Concentrate on what is in front of you – the important facts about your contemplated investment. Buffett said he couldn't remember what the headlines were at the time of his real estate purchases or what the pundits were saying – but he did have the conviction that corn would keep growing in Nebraska and that students would keep coming to NYU.

Buffett points out a big difference between his real estate investments and stock investments. Stocks provide minute-by-minute valuations causing us to frantically overreact to the daily commentators and their implied message of "don't just sit there – do something." Interestingly, Buffett notes that this should be an advantage to stock investors, as the wildly fluctuating values placed on their holdings by the irrational "market" gives the rational, long-term investor an opportunity. He observes that if his farm was bordered by a moody fellow who knew and yelled out the daily price swings of both Buffett's farm and his own, Buffett could either buy the guy's farm (if prices were low and the guy was depressed about it), sell his own farm to his neighbor (if prices were absurdly high and the neighboring farmer was overly optimistic), or do nothing and just go on farming.

Good advice for us to apply to real estate, stocks or any other investment.

Gerald A. Townsend, CPA/PFS/ABV, CFP®, CFA®, CMT is president of Townsend Asset Management Corp., a registered investment advisory firm. Email:Gerald@AssetMgr.com