Mortgage Investing

An Attractive Option to Stock Market Investing

By David Grossman

Given the recent upheaval in the global stock market, many people who thought their investments were safe because they own *balanced* mutual funds and *blue chip* stocks, have of late found that a substantial amount of their life savings has eroded. If you're one of these people, what should you do? Should you cash in your mutual funds, sell your stocks and buy GICs? Selling low and locking in your losses is never a good strategy, but if you've been losing a lot of sleep at night, and if you find you're a bit frantic about checking out the daily financial reports, you may want to consider balancing out your portfolio with good quality income producing mortgages.

Let me explain how mortgage investing works, what the risks are, and what kind of returns you are likely to achieve. With mortgage investing you can see and touch the underlying security, and without a lot of training you can make your own assessment about the value of the property. Where is the property located and what is its use? In what condition is the property? How much income can the property generate? You will also want to know something about the borrower and his or her ability to repay.

Private first mortgages will usually generate a return of around 8-9%, while higher risk second mortgages usually give you a return of 10-12%.

There are risks associated with mortgage investing. If the borrower stops making his mortgage payments, and if in an economic downturn the value of the property drops below the sum of the mortgage(s) on the property, you could lose part or all of your investment. First mortgages are lower risk than second mortgages because the first mortgagee has first claim to the property. As a rule of thumb, you should not lend more than 75% of the value of the property. That way, even if the property drops in value by 20%, your investment is safe (allowing an additional 5% margin for legal and selling costs).

It's important to note that if the property owner stops paying the mortgage, the mortgagee (the investor) has a right to foreclose on the property. In the late 80's, when interest rates were as high as 18-20% and many property owners could not afford to pay their mortgages, a number of mortgage investors acquired substantial real estate holdings. When real estate values eventually started to go up, they made a nice profit on their holdings.

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