It's the economy, stupid! So the now famous James Carville quote goes as he bantered with commentators during the last Bill Clinton election campaign. The same goes when it comes to real estate investments. It's a numbers business; it's about economics. More specifically, it's about creating value in a property by generally achieving two things:

Investment success begins with purchasing a property in an acceptable location at a great price, which will be in good demand and generate an excellent cash flow and good appreciation. See, isn't that easy? The general formula is not difficult to memorize or even difficult to master and implement, but it does take more than a prima fascia understanding.

The value of most investment is driven by yield and/or potential appreciation. Yield is the current return on an investment generally reflected as a return on capital invested. A bond the produces a $10 annual return on $100 investment yields 10%. Like wise an investment property that provides you a $5,000 net return (net of interest, taxes, insurance & maintenance) is only worth $50,000 if you require a 10% yield on your investments or worth $25,000 if you demand a 20% return on capital. That stated, return is often called the cap rate, and real estate investments often are priced (particular commercial ones with long term tenants) based on their cap rates.

It is important to remember that the total returns on an investment and particularly real estate investments are significantly influenced by their appreciation which is reflected in their sales price sometime in the future. So the current yield and the appreciation (which is captured only on sale or refinancing) ultimately constitute the net profit and true returns on an investment. Both facets can be important. To sacrifice current cash flow and yield and focus exclusively on potential appreciation generally makes an investment more speculative and higher risk. This characteristic is more common in land plays and development projects but can be very lucrative but likely requires both an investor and a financier with a longer investment horizon and a greater tolerance for risk.

Many novice real estate investors, however, have been blinded by the promise of higher yields at the expense of quality properties in better locations. There is often a trade off but seldom is it wise to buy common assets in undesirable locations based purely on the promise of high yields and fat profits. Too often those cheap properties are not cheap enough, and the high yields come from low grade tenants who make the property high maintenance and very expensive to keep up. Most often better quality neighborhoods attract better quality tenants who have higher personal standards and values. The qualities of the residents are in turn reflected in the greater long term value of the properties they inhabit.

It is particularly important during weakness in the real estate market to avoid the lease desirable neighborhoods. In the most recent market bubble the excess money flowing into the real estate market lifted many of those inner city property values to unsustainable levels. The extensive defaults in subprime loans and the resulting foreclosures prominent in such areas will quickly deflate such prices and those neighborhoods will be slowest to recover from the market bubble. Avoid them. Double digit yields are available in better communities where property values will stabilize sooner and recover more quickly when the market turns north again.

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