A true story about a 20,000% gain in real estate

A 20,000% Gain in Real Estate; A True Story About the Ups and Down from Wall Street to Real Estate Leading to Phenomenal Returns

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Chapter Five
Here we go again

"The Internet is the Viagra of big business."
– Jack Welch, Chairman and CEO, General Electric

"The effect of these technologies could rival and arguably even surpass the impact the telegraph had prior to, and just after, the Civil War."
—Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, U.S. News & World Report, *June 19, 2000*

All of the previous ups and downs, as dramatic as they were, turned out to be just a warm-up for what was about to explode and completely sweep me away, then unravel and knock my lights out. This time things were going to be different. (Whenever you hear these words, look out!) I had been reading dozens of trading books, such as:

- *Reminiscences of a Stock Operator* by Edwin Lefevre
- *Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay
- *More Extraordinary Popular Delusions and the Madness of Crowds* by Joseph Bulgatz
- *Trade Your Way to Financial Freedom* by Van Tharp
- *Stock Market Logic* by Norman Fosback
- *The Market Wizards* by Jack Schwager
- *The New Market Wizards* by Jack Schwager
- *Pit Bull, Lessons from Wall Street's Champion Trader* by Martin Swartz

Armed with the knowledge from these books and dozens more, plus the training from Freddie Ballou on The Program, as he called it, I was able to handle things much better this time around. Now I used stop loss orders; I didn't put more than 10 percent of the account in any one position; I looked for stocks that fit a certain criteria, such as having good earnings and breaking out of a trading range; I paid close attention to volume, especially when there was a spike with no news; and I watched for unusual option activity or unusual premiums in the options. The 18-day rule was another trading technique, which is, simply, after 18 trading days of a new offering, the firm that brought them public will put a buy rating on the stock and you usually get a nice pop in the stock price. This happened almost all the time because of the quiet-period regulation. I would look for a stock that was bouncing off a double bottom or, even better, a triple bottom or, even better yet, bouncing off a triple bottom with over two or three times normal volume, on no news. These would give you a nice trade.

A double or triple bottom is when a stock bounces off a support level two or three times without falling below it. A trading range is simply the range a stock would trade between for a week or even a month. Let's say the stock trades between $10 and $14 per share for four weeks. Then all of a sudden it blows through $14 on large volume. This is usually a very good sign, and in good markets it should send the stock higher in the near term.

In 1998 the market started to really heat up and Internet stocks started exploding. My goal was to find a stock that was not discovered yet, such as a company that had an Internet component that was not priced into the market capitalization yet. I found one and got real excited about it: Data Broadcast (DBCC). They had a popular website called Marketwatch.com that they were going to spin off. Right before the spin-off of an Internet company that everyone wants to own, the parent company gets bid up big time. I dumped most of Conseco and plowed into DBCC. It was a good thing I was able to sell most of the shares, because Conseco ran into some problems and went into bankruptcy protection a few years later. Within a few months, DBCC flew from the single digits to the twenties, then thirties. Needless to say, my commissions for that month were huge. That was it; people thought I was a genius. My buddy Artie Buisson had originally brought DBCC to my attention but unfortunately did not load up on it like I did. Artie is now a trader on the floor of the NYSE.

The next idea may not have worked so well, but that was okay because I did not give it much room on the downside. I was using tight stop losses. I had created a lot of wealth for my accounts, and I wanted to protect it. I also knew that these assets would generate a ton of commissions. I had close to 100,000 shares of DBCC in my book, all under $16 to $18 per share, with some purchased as low as $7. This move gave my book new life. I was back!

The years 1998 and 1999 were an insane time to be a stockbroker! I mean a real stockbroker—those who made a living buying and selling stocks, as most of the brokers at Gruntal at the time did. Not bond brokers, financial planners, or insurance salesman, I mean honest-to-goodness stockbrokers. All the brokerage firms these days are trying their hardest to convert this group to become salesman of other products, like money managers or mutual funds. Real stockbrokers are becoming scarce, and with the Internet and the deep discount brokers, it will be hard for them to survive. This is an extremely challenging profession. I often heard from broker buddies how often they were just about ready to call it quits. Then it hits them: What else could I do? The answer to this question keeps most of them grounded. The ups and downs are almost unbearable, but the options may seem limited**.** That's because life as a stockbroker is a unique experience. When times are good, the money that can be earned is mind-boggling, but when things turn, it's like torture. It's often hard to switch careers to what would most likely be less exciting, more structured, and a reduction in earnings. Then there are also the lingering memories of the good old days and the hopes that they'll return. The memories of how much money can be made in a good market pulls them through the bear markets.

Like I was saying, the years 1998, 1999, and the beginning of 2000 are years that will be compared to the tulip mania in Holland throughout the 1620s, the South Sea Bubble in England from 1711 to 1720, and even the Roaring Twenties. It was a time that no stockbroker or investor will ever forget. They say an investment or speculative bubble comes along once in a generation, and this was ours!

The market had heated up so fast and out of nowhere that by the time we were halfway into it, we still did not fully realize what was going on. The commissions that brokers were earning exploded as prices rocketed upward. I went from doing under $10,000 a month to around $100,000 a month. My best month was around $180,000 in commission. After taxes and what I owed the firm (payment toward a negative balance in my margin account), I took home around $37,000 for that month. Lina applied the whole check to pay down our debt. This was my biggest month, and I didn't see a penny of it. I handed the check over, and that was the end of it.

I was totally absorbed by the market. I would do research on my home computer until almost midnight and then wake up in the morning and reach for the remote to see what the futures were doing. The pre-market trades would continuously go by on CNBC, and I'd be glued to the ticker. Then I would grab a cup of coffee and head to the computer to see once again where the stocks I was trading were in the pre-market and check for news. Because of the Internet, information had become more widely disseminated than in any other time in history. It was as if things were upside down. Twentysomething's were starting companies that were going to change the world, and they were raising millions—sometimes hundreds of millions, and some even valued in the billions. A good portion of these companies were losing money, with a few hundred million dollars' of market capitalization and no profits to show for itself. This was the first time in history that companies losing money were going public. And going public at a rapid-fire pace. But you had to see the big picture. As the pioneers and spokesman for the new digital economy would say, "You either get it or you don't."

I got it. I really did. I was a believer, especially because I was doing $5,000, $10,000, and sometimes even $20,000 a day in commissions because of these companies and the runaway market. It seemed like all a company had to do was add a "dot com" to their name and the stock would take off. The thinner the float—meaning the fewer shares available for purchase—the greater the news affected the share price. The market was valuing Internet companies based on the future.

The thought was that if you could create a niche, get people interested, and lure them to the website, you'll eventually figure out how to generate revenue from them. Everyone seemed to accept this as gospel and thus price the companies accordingly. The few naysayers would practically be stoned.

The main transformation of the world economy, via the Internet, had to do with the ability for information to be widely disseminated at light speed. There was no place a transformation of this magnitude would be felt more than the U.S. securities markets. Information is the pivotal point for action. There is no real action without information. Think of the Battle of Waterloo. Nathan Rothschild had an agent who, as soon as victory was certain, set off to London to inform Rothschild, who in turn loaded up on British government shares. He unloaded, at huge profits, as everyone else got the news. He acted on information.

Truly insightful entrepreneurs who are bright enough to understand what is happening and act swiftly have the ability to make a fortune. TokyoJoe is an excellent case in point. Because of this stock trader's clever wit, outspoken manner, and stock-picking ability, he created a following from chat rooms and message-board crowds. He then started the website Tokyojoe.com and charges an arm and a leg for membership. His mere mention of a stock would increase the volume exponentially and send the price substantially higher.

In my office I had four phone lines and a cell phone. At least two lines were going at all times during market hours, and sometimes I would have a phone on each ear. My junior broker, Anthony, a sixtyish-year-old ex–Wall Street wire operator who was laid off from Shearson in a downsizing, could barely keep up. He would help my assistant, Lisa, answer the phones and give people quotes all day. Some of the new accounts I had opened during my account-opening spree turned out to be super-active accounts when the market heated up. Two in particular were Morris and Rahul. They alone would keep Anthony on the phone all day long. Anthony would go from one to the other entering orders nonstop. Clients would wait on hold for as long as fifteen minutes to ask my opinion on a stock or to put in an order. My office was like Grand Central Station, with phone lights blinking all day, CNBC on the TV, the squawk box blaring in the background, and faxes and mail being dropped on my desk. Then there were the other brokers in the office, running around full of enthusiasm with a tale or two of the next big trade. You would hear a roar when a particular stock the office was trading had a big move. At the end of the day, I would count the pages of orders entered. There would be eight or ten trades on each page. By this time, we had on-line order entry, where you could enter the orders from your computer. Some days I would have more than twenty pages of orders. It would take me an hour just to give them a quick check to make sure there were no mistakes.

Most days I would grab a few beers for the train ride home to help me unwind. On the extremely wild days, I would head to our office's bar of choice—Saga on Lexington Avenue, located around the corner. There would always be a group of brokers from our office there having a few drinks. Whenever one of us would walk in, the rest of the brokers would cheer and the bartenders would change the TV station to CNBC so we would feel right at home.

When the market was really moving, it would be tough to keep track of everything, and every now and then there was a mistake. One broker, who meant to buy 10,000 shares of some stock, sold it instead. The error generated a \$100,000 loss by the time he found it a few hours later. The firm let him pay it off over two years. Whenever anything really good or really bad happened, it circulated through the office like wildfire. If John LaBarka, a broker and buddy who sat in the office next to mine, traded the same stock as I did and it started to move, we would bang on the wall so hard we thought it would collapse. If it was a real move, say 5 to 10 points, my whole side of the office would start banging on the walls. The cheering and moaning that went along with the rises and dips in the market was like being at some crazy sporting event. Everyone always knew what everyone else was trading, and when someone got clobbered, everyone knew about it.

At Gruntal the top producers were treated well, as with most of the larger firms. Each month one of the managers, Al Palladino, would take the top five producers to the Sky Club on the 56^{th} floor of 200 Park Avenue. This posh members-only club was directly across the street from our office. The Third Avenue branch had moved to 777 Lexington Avenue, on the corner of Lexington and 42^{nd} Street. The building had two addresses. Being on the corner, the other address was 150 East 42nd Street—the old Mobile headquarters. Everything in the Sky Club is dark wood and brown leather. The chairs seemed to have extra cushion and were ultra-comfortable. It was at one of these meetings that Al told us about some type of business-club meeting in which both he and Donald Trump were members. I remember him telling me about having listened to Donald talk about his future plans and thinking he was nuts because his ideas were so inconceivable. This was before Donald became The Donald. I was very interested and wanted to drill him on the subject, but being the aspiring stockbroker, I resisted the urge to linger on the topic once the conversation returned to the business at hand. Besides these extra perks in the city, the top producers were awarded annual trips similar to PaineWebber's. One such all-expense-paid extravaganza was to Amelia Island in Florida. Lina and I had an unforgettable time**.** In the morning the brokers would attend a presentation of some sort while the spouses would enjoy a massage or just lounge around in the sun. The rest of the day was spent sailing, golfing, tennis, swimming, dining and networking.

In the meantime, my trading system was working out fabulously. Most of the other brokers would ask me to explain "The Program" to them. I was earning huge commissions, while the values of my customer accounts were increasing as well. It truly felt great, and I was glad to be paying down my debt from the last time around. It seems like each cycle got more vicious. The ups were greater and the downs more severe. These swings were amplified by me having more on the line each time with more accounts, larger accounts, and more money in my personal account.

After the 1997 wipeout, when my account went negative, my manager asked me to close my account and concentrate on building my business, which I did for a while. Once it was paid off and the slate was cleaned, there was no stopping me from opening it back up and letting it rip all over again—especially when the market caught fire and stocks that were all coiled up ready for a moon shot were exploding through their old highs like a blow torch through blotting paper. A company would be mentioned during CNBC's power lunch, and I would own a thousand shares before they could finish their sentence and then have sold before the commercial break. Everyone had a tip, and everyone wanted to get a tip. If a stock had anything to do with the Internet or broke out of a lengthy trading range, it could move as much as 50 percent in a week or so. It was a wild time. The volatility and the valuations were unprecedented and could send even the coolest-mannered trader home at the end of the day with the shakes.

When I called Arty, who was trading on the floor of the NYSE, and told him I was writing a book about the ups and downs of Wall Street in the '90s, he replied that he had the shakes all over again from just thinking about the craziness of 1999.

One day I turned to my buddy, Joe, and said, "Remember these times, Joe. You only go through this once in a lifetime." He still remembers that comment and is sort of spooked by it. It's hard to step back or step outside of a world that is so all-consuming. While going through it, it's hard to imagine anything different. I think the ability to remove oneself from the emotion of the moment is what separated the ordinary trader from the supertraders or even the geniuses. Believe me, it's next to impossible to ignore stocks as they go from 3 to 75 in a month, especially when it happens over and over. It was easy to get completely swept away. Everywhere you went, CNBC was on the TV, including the bars, restaurants, and barber shops, and the reporters made the market into a big game. CNBC had a half-time show midway through the trading day. The market became the new American pastime; everyone had an opinion and a story. At every party or social gathering, people would love to chat about their stocks and how much they were making and what the next big winner was going to be.

With the market devouring all my time, I hardly had time to focus on family life. Fortunately, Lina was very understanding and patient and was always great about planning our vacations. If it weren't for her persistence, we wouldn't have had too many trips outside the ones provided by the firms. But for all the many wonderful adventures she planned, the trips to Italy to visit her family were by far the most enjoyable.

On one such occasion, we flew into Rome and stayed there for three days. We stayed in a five-star hotel a few blocks from the Spanish

Steps in the center of the city. It was a summer trip, so Rome was warm day and night. I remember walking around and splashing my head in the fountains, including the Fontana Di Trevi. Lina could not get me out of the Sistine Chapel. We were in there for close to six hours. We got lost in the beauty and grandeur of the Vatican City. The sheer opulence, combined with knowing that its history dates back to antiquity and that people have been coming to the Vatican for almost two thousand years to pray over the tombs of the apostle Peter and more recent pontiffs, is almost too much to comprehend. Taking in the artwork and sculptures of the most famous artists in history can have a tremendously uplifting and inspirational effect. From Bernini to Michelangelo and Maderno, when you leave there, you take something more than just a memory.

The cafés in Greece were great, but the restaurants, cafés and trattorias in Rome were superb. It's something about the atmosphere and history in the surrounding buildings that just makes it feel as though it is a different time and place. The buildings are constructed with impressive stonework, and the inside of the bars and restaurants are overflowing with details. The roads and sidewalks are mostly cobblestone and brick, which adds to the beauty and ancient charm. Sitting in the cafés having an espresso and a panini or a pizza and a birra is truly unforgettable.

While in our hotel room in Rome, I would log on to the Internet and check stock prices. They were really moving right along, to borrow a phrase from Maggie Mahar, author of *Bull! (A History of the Boom 1982–1999:* "IPO's were popping like champagne corks."

After three days in Rome, we headed to the Abruzzi region, about two hours west. We took a local train and were met at the station by Lina's cousin Mossimo. They owned the most exclusive restaurant in Sulmona and resided above it. Our room had mountain views and a mural on the ceiling. Her grandfather, nonno Corradino, lives there as well. The days flew by. We did a lot of visiting, a lot of eating, and a fair amount of sightseeing. The center of the city was only a few blocks away. Her nonno would walk there daily to play cards, pick up the daily newspaper, and have espresso.

My brother- and sister-in-law, Anna and Joe DelPozzo, were there as well. They were staying on the other side of Sulmona with another one of Lina's aunts, Zia Adriana.

Sunday was great. The whole day was about getting ready for dinner. Joe and I ventured into town with Lina's uncle, Zio Celestino. First we went to the fish store, then to the butcher, was and, finally, to the cheese store and bakery. Everything had to be fresh. I was starving by the time we ate, at around two p.m., but after our ten-course meal, I could not see straight. We had dinner in the family restaurant downstairs, Ristorante Rigoletto. The walls are solid mahogany and the bar is marble. It really is like something in the movies. We can't wait until her cousins start getting married so we can go back!

Chapter Nine
Our Fifth Building: The Key that Opened the Golden Gate

"Now that we're out of our own money, how we do our fifth deal will be the key to opening the golden gate, whether it's a no-money-down deal, cross-collateralizing our other properties, or joining up with investors and silent partners."

– Kevin Kingston, discussing Delking's growth strategy

"It is common sense to take a method and try it; if it fails, admit it frankly and try another. But above all, try something."

—Franklin D. Roosevelt

Around the start of 2002, most of the Realtors in Dutchess County who specialized in investment property knew we were on the prowl for deals. I would call them weekly, if not more, to find out if anything new came on the market. One warm spring morning while Den and I were strategizing on my patio about the four buildings we owned, the phone rang. It was Stu, a go-getting energetic real estate broker for Re/Max. He said, "Kevin, I found you guys a deal. It just came on the market today." Without hesitation, I urged him to fax over the listing to my home fax. I also drilled him for the numbers: the number of units, gross income, expenses, and most important, the net income. Low and behold, the deal made sense.

When I got off the phone and told Den about it, I remember him being a little overwhelmed. His response was that he was all tapped out and had no money left for another deal. I told him not to worry and that we'd think of something. One thing I learned from my time on Wall

Street and from reading tons of books about real estate titans is, if the deal is good enough, finding the money is never a problem.

Let's take a look at the numbers:

Asking price: $389,000
Gross income: $ 67,740
Net income: $ 43,386
Cap rate: 11.15%

Down payment: $97,250 + $10,000 (closing cost) = $107,250

Net after mortgage: $19,206
Cash-on-cash return: 17.9%

The cap rate and cash-on-cash return did not quite fit our criteria, but the apartments were rented well below the market rate, and we knew with Super Den re-modeling each apartment, we could raise the rents by $100 to $200. Now the problem was where to find the $107,250. And adding a few bucks for repairs would realistically bring this number to $115,000.

I figured that with a starting net income of $21,309, we could do the improvements over time and increase the rents. On top of that, it was within a half mile from our four other buildings; this again would add to our economies of scale. So I showed the deal to a friend of mine and told him we would give him a preferential return of 12 percent on his money and half the equity. Without even taking a look at the property, he was in. He wrote a check for the $20,000 deposit on the spot. Stu, the broker, was elated because we were the first people to whom he had shown the property. He made his commission with one phone call. We got the price down to $355,000, or $29,500 a unit.

Here are the numbers based on the purchase price:

Asking price: $355,000
Gross income: $ 67,740
Net income: $ 43,386
Cap rate: 12.22%

Down payment: $97,250 + $10,000 (closing cost) + $7,750 (repairs) = $115,000
Net after mortgage: $21,309
Cash-on-cash return: 18.52%

When we closed on this deal, we knew we had the combination to the safe. We had our formula for growth. All we needed to do was find deals that came close to our criteria and show them to friends and family and give them a fair return on their money as well as a slice of the equity in the deal. This would let us grow, and make no mistake: We are builders, people that love the feeling from building a business. The deals, however, were getting harder to come by, and the returns were getting lower. The bottom line for us was the cash flow. We figured that appreciation would be an added benefit; as long as the deal had good cash flow, we wouldn't get hurt. This was a key concept for us, especially as we continued to grow on the fast track. As long as we had tenants paying rents, the cash flow would keep coming in. If we came across tough times and needed a cushion, meaning not be dependant on something, such as the sale of a property or completion of a development, in order to keep the business going. In reading about real estate giants of the past, most got into trouble because of overleveraging non-cash-flow properties. Take the Reichmann's and Olympia and York, for example. They built the largest real estate empire in the history of the world in the shortest amount of time imaginable. At their pinnacle they were worth over $10 billion and thus became one of the wealthiest families in the world, right behind the royal family in Britain. What defeated them in the end, even though it was comparable to the way they had initially gained their wealth, was betting it all on their latest development. Canary Wharf in London was a massive project, and they had to cross-collateralize most of their other holdings to keep the project going. The problem was, there was not enough cash flow to cover the massive debt they took on.

Other examples include Donald Trump, whose Trump Hotels & Casino Resorts went into bankruptcy protection in the 1990s and had to reorganize the rest of his debt with the banks to avoid a full scaled meltdown. Then there is real estate magnate William Zeckendorf, who revamped the look of Long Island following the Civil War. Some of his properties included the Chrysler Building, Chase Manhattan Plaza, and Denver's Mile High Center. Under his leadership, Webb & Knapp in Manhattan built $3 billion worth of commercial projects. But in 1963 the bubble burst. Both men overleveraged their properties, and when the market went sour, they didn't have enough cash flow to carry the enormous debt.

There is nothing like the leverage available in the real estate market. If the market is going your way, the returns can blow your socks off. Let's say you buy a $1,000,000 building and it increases 50 percent. That's a $500,000 gain. If you put 20 percent down, or $200,000, that 50 percent gain in the value of the building is a 250 percent gain. It is even possible to negotiate a deal with 15 percent down or less on buildings with good cash flow. In the following example, with 10 percent down, you would be up 500 percent on your $100,000.

Purchase price: $1,000,000
Down payment: $ 100,000
50% appreciation: $ 500,000
Return: $500,000 / $100,000 = 500%

There is nothing better than having a leveraged property appreciate. And there is nothing worse than having a leveraged property, with no cash flow, depreciate. At least if you have the cash flow, you have income, even if times get so bad that the property is not profitable. It is better than not having any cash flow and being dependant on selling something in a soft market. With that said, our motto is, Leverage up! But do it with income properties that have a comfortable cushion in the cash flow or, even better, a property that has some sort of upside or way of increasing the cash flow.

As I've already mentioned, we were able to improve the properties and thus able to increase the rents. This added to the cash flow. Let me explain how I structure a typical deal. Here are the key points:

- Investor puts up all the money for the down payment.
- He gets a preferential return of between (6% and 12% on the investment).
- Then there is a fill-up, meaning we get the rest of the profit until our amount equals what the investor is getting.
- The rest is split in direct proportion to ownership.
- Upon sale, the investor gets their original investment back first.
- The rest is then split in direct proportion to ownership.

Let's walk through the structure of our fifth deal:

- Investor put up $115,000.
- Investor receives the first $13,800 of profit (called a preferential return).
- Delking receives the next $13,800 of profit (called the fill up).
- Any additional profit is split according to ownership (in this case, 50 / 50, but on future deals it changed to: 75% Delking / 25% investor)
- Profits are paid monthly.
- Delking manages the property.
- Investor is passive and has no involvement in the day-to-day decisions.
- Delking prefers keeping it to one investing partner per deal.

We call this the Delking Plan. Our investors are extremely pleased with how it has been working out. We can't do deals fast enough for them. They love the concept of owning real estate and getting a monthly check, yet not dealing with the day-to-day management. The deals are getting harder and harder to find, and the preferential return has come down a bit, but creating cash flow from real estate without much involvement is still the best deal in town (in our opinion).

For us it is the ultimate leverage. We are basically buying a piece of property with our reputation. We take great pride in our growing portfolio of properties and give them extra care. We believe if we put a little extra care into them, it goes a long way, as far as our reputation. Nothing pays better dividends than a good reputation. This saying sums up our feelings about dealing with investors as well as tenants. It's important to pay attention to detail and to do what you say you will do. This is the reason the seller of the first building we bought came back to us to sell us our second building and again, three years later, when he was selling his last building. On our third purchase from him, he was so confident in us and our reputation as a stand-up company, he offered to hold a second mortgage for $300,000, allowing us to purchase the building for $775,000 with as little as 10 percent down.

Another example of going the extra mile refers to our investor. Sometimes, for a month or two, the building may not have the cash flow to continue the payments. According to the operating agreement, we would be perfectly fine to skip a payment or two, because of a vacancy or an extra expense the property is incurring because of the cost of repairs or improvements. However, we eat the loss, carry a balance on the books and collect when the property is more profitable. As Charlie Munger says in his book, *Damn Right, Behind the Scenes with Berkshire Hathaway Billionaire Charlie Munger,* "Do the best you can do. Never tell a lie. If you say you're going to do it, get it done. Nobody gives a shit about an excuse. Leave for a meeting early. Don't be late, but if you are late, don't bother giving people excuses. Just apologize. They're due an apology, but they're not interested in an excuse."

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