

The **ENTREPRENEUR'S** Guidebook Series™

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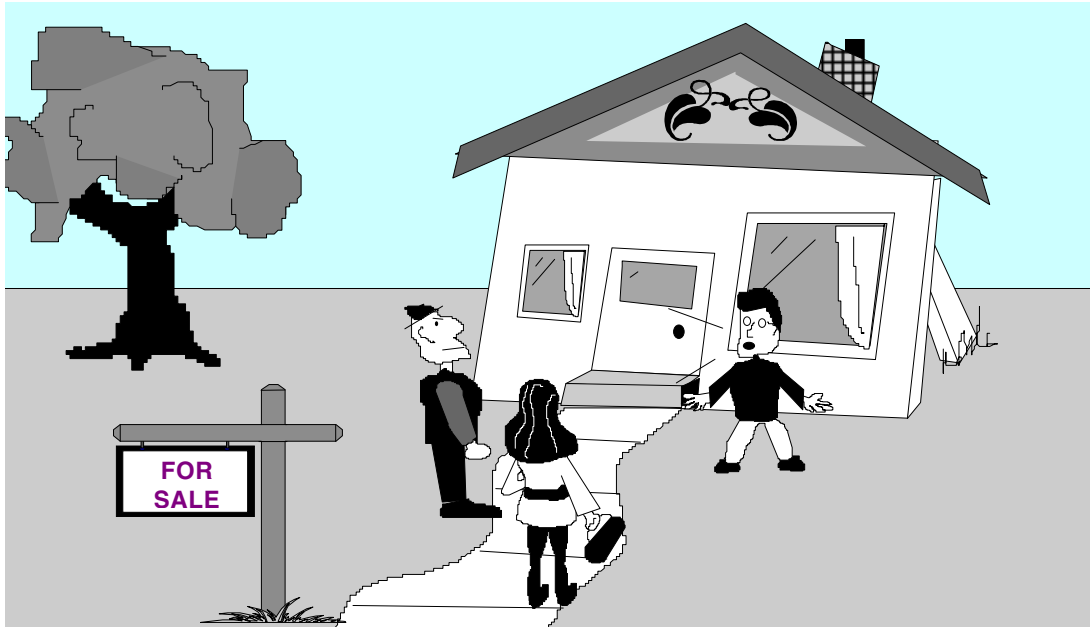
PERSONAL PLANNING

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*“All I can say is . . . WOW what a steal.
By the way are you handy with a hammer!”*

DJD

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*“What’da you mean TOO much?
I haven’t even told you the price yet!”*

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INVESTING IN REAL ESTATE

CERTAIN areas in New York, Washington, California, Florida, Toronto and Vancouver, as well as various resort properties located throughout North America, have proven to be hot properties in the past and speculation in such properties has made many millionaires.

No wonder many entrepreneurs consider real estate the supreme get-quick-rich field. However, the future of real estate as an investment is clouded because of tax reforms, decentralization, and the aging of North American populations. You can no longer assume that properties that increased in value in the past will automatically increase in value in the future.

Real estate investors of today must be more calculating and patient than those of the past. There is less room for speculation.

STRATEGIES FOR BUYING A HOUSE

AS AN investor, your first concern when buying a house is its potential for capital appreciation and income potential as well as its capacity to meet your personal and family needs. However, as a budding entrepreneur, your house must also be adaptable to function as a computer consultant's office, architects design studio, or even a beauty salon.

Other strategies for buying and owning a house include:

BUY a house close to where you work. That way you can walk to work or ride a bike. Not only is this of benefit to your health, but will save you considerable

A house should always be an investment first and a home second.
SUPERTIP

money over the years. If you can't quite picture this, imagine buying a house in the country and driving to work each day. You will consume gas, oil and occasionally your car will break down. Not only that, your spouse will need a car. And when your children get older, they too will need cars. Considering that autos are a depreciating asset, and cost a considerable amount of money to purchase and maintain, wouldn't it be better to put your money into a non-depreciating asset, for example, by increasing the principal amount of your monthly mortgage payment?

BUY a second home in the name of an adult child to claim a second principal residence exemption. Since 1981, the principal-residence exemption has basically been restricted to one resi-

dence per family. However, it may be possible to claim a principal-residence exemption if your second home is owned by a child 18 or older in the year, or a younger child if he or she is married. In Canada, it is possible for the child to claim his or her own lifetime capital-gains exemptions on the home's appreciation if the home is sold while the child is still a minor.

BUY a house for its utility. A house should be looked at like any investment. The more useful it is

Why Buy a House?

OWNING your own home makes sense **emotionally** because it can make you feel secure and it show others how successful you have become. Buying a house can also make sense **financially** because:

- It's a great forced savings plan, every month in the form of a repayment of capital, you increase your net worth
- you have insured tenancy; no one can kick you out
- you can arrange the dwelling to suit your style and taste
- you have an automatic inflation hedge and
- you have an asset which you can collateralize at inflated values i.e., take a 2nd mortgage to invest in stocks

NOTE Owning your own home can easily become your worst nightmare if you let your emotional needs color your financial limitations.

to your life, the more you can afford to pay.

BUY a house for the long term. To lessen the capital losses caused by moving, lawyer fees and real estate commissions, as well as give your house a chance to appreciate, choose a house that is suitable for you and your family for the next five to ten years, and preferably twenty. Avoid trading or upgrading. And never buy frivolously so that a few years after you get settled in, you have to sell again. Real estate can easily become a major cash drain.

BUY a house for the rent it can produce. Buy a single family home or a condo that can be rented out for a reasonable return.

BUY a house in an area with low overhead costs. This includes low prop-

Real Estate Values

| | Most Expensive | Least Expensive |
|----|-----------------------------------|---|
| 1 | Honolulu \$368,000 | Waterloo / Cedar Falls, IA \$55,500 |
| 2 | San Francisco 250,200 | Saginaw / Bay City / Midland, 60,400 |
| 3 | Orange county, CA 217,000 | South Bend / Mishawaka, IN 60,900 |
| 4 | Los Angeles 189,000 | Youngstown / Warren, OH 62,100 |
| 5 | Boston 188,200 | Topeka, KS 62,300 |
| 6 | New York (metro) 177,400 | Ocala, FL 62,800 |
| 7 | San Diego 175,400 | Amarillo, TX 63,900 |
| 8 | Washington (VA/MD) 160,000 | Beaumont / Port Arthur, TX 65,400 |
| 9 | Seattle 158,400 | Oklahoma City, OK 66,500 |
| 10 | Chicago 150,200 | Mobile, AL 68,300 |

Median cost of a house, 1994

Source: National Association of Realtors

erty taxes, low utilities and close to low cost grocery stores.

BUY a house that has at least one strong selling point. A large corner lot, or a wooded lot, or handy access to shipping or recreation, or a school that has the best reputation in the area, makes a good selling point when you need to sell.

BUY a house with a developed basement, preferably a full basement. A basement doubles the house space, saves on fuel, and keeps the rest of the house drier. A house with a developed basement can also be rented out or leased to another entrepreneur if zoning laws permit.

NOTE Don't buy a house with a full basement in an area with a high water table like

Florida or next to a body of water.

BUY a house with a quiet work area. Your house needs to have a private quiet work area that can function as your home office.

BUY a house with a solid foundation. A hole in the roof can be easily fixed. But a damaged foundation requires extensive and costly repairs.

BUY a house you can fix up. But only if you a genuine handy man. Don't try and fool yourself into thinking you'll become one.

BUY a modest home in a nice neighborhood. Whenever you buy a house, you also buy the neighborhood that comes with it. So look to buy a home in a superb

Buy a house you can fix up. But only if you a genuine handy man. Don't try and fool yourself into thinking you'll become one.

superb neighborhood. A bad house can be torn down in a day. However, a bad neighborhood can take years to turn around.

BUY a two or three-bedroom single family home large enough for an average sized family. Buying a house that's too large or small limits the size of market you have access to when it comes time to sell.

BUY from a person who needs to sell. In this way, you will be able to negotiate a selling price below the market price.

NOTE Remember, when shopping to buy a house, it's just a house until you have paid for it. In other words, you can walk away from the deal at anytime.

When it comes time to sell, try to make the sale before you buy and move into another house. Empty houses seldom command their asking prices.

SUPERTIP

BUY in a transition area on the way up. Look for old areas being redeveloped into yuppie areas. Avoid buying houses in areas on the way down.

BUY the worst house on the best block. Look to buy a home in a superb neighborhood with superb schools and one that has been on the market for a while. Never buy the most expensive house in a neighborhood. A house and property can always be improved in time.

BUY when the supply of houses is greater than the demand. Don't buy in an overheated market.

PAY your mortgage off as soon possible. The sooner your house is paid off, the sooner you will have low cost accommodation. You can use the equity to get a business or investment loan – of which interest payments are tax deductible.

REFINANCE your mortgage when rates go down by more than one and a half percent. Less than that however, is not worth your while.

WHENEVER you spend money on the house, upgrade. Don't replace a cheap fence with another

Over the long run, in present market conditions, it is often cheaper to rent than to buy. Buying a house is not the great investment it was after World War II and into the sixties and seventies. You should buy sensibly, and not put too much of your wealth into a house, because it costs you more than renting.

SUPERTIP

cheap fence. Make a substantial capital investment in your asset so that you don't have to continue pouring money into it. Put the very best of fixtures and appliances to avoid the continual need to replace or repair. An \$800 dishwasher, over the long haul, is cheaper than the \$400 one.



SHOULD YOU INVEST IN REAL ESTATE?

INVESTING in real estate is never a matter that should be taken lightly. Consider the following:

Why You Shouldn't Invest in Real Estate?

Real estate speculation is risky, takes time, and not every entrepreneur has the patience nor skills to find and recognize good buys. Furthermore, it is predicted that inflation rates will be low for the next few years, maybe even well after the year 2000, making capital gains unspectacular. To make matters even grimmer, as baby boomers age and increasingly seek low maintenance living life-

The Canadian housing market is being blitzed by the aging of baby boomers – despite government policies to promote home ownership.
EDMONTON JOURNAL

styles, there will likely be a surplus of single family homes. Already sales and prices have fallen across Canada and the U.S. In fact, people are spending more on home renovations than on new homes. Are you prepared to beat these odds?

According to the chart on the following page, if your great grandma had bought a single family house in 1885, priced at \$3,000 and it was passed down from generation to generation, in 1980, priced at \$50,000 without any adjustment for commissions or property taxes, your 95-year average annual return would have been only 3.0 percent.

Furthermore, considering that mortgages can easily wipe you out like they

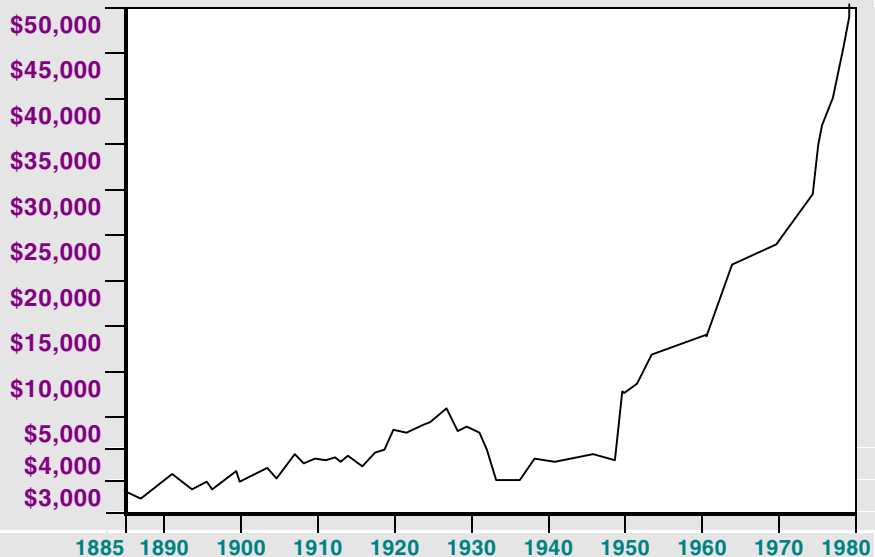
wiped out scores of people in the 1930s, and the fact that real estate prices offered no appreciation from 1890 until 1935 and that it could happen again – or worse – you really should think twice about real estate as an investment vehicle.

NOTE In most areas in North America, home prices are high compared to rents (if you think of them as a yield relative to the home's market value). Rents don't rise to match real estate prices (in general prices fall to match rents).

Why You Should Invest in Real Estate?

They're not making any more!

Investment Return on a Single Family Home



It should be noted that the seemingly huge move from **\$3,000** to **\$50,000** between 1935 and 1980 yielded a compound return of less than **6.5%** per year. Far less than the rate of return you would have received had you invested the same \$3,000 in the stock market.

Source: Above chart based on Douglas Casey's, "Single Family House Price Index 1890-1980" from his book *Strategic Investing*.

How Real Estate Can Make Your Money Grow

There are four ways real estate can make your money grow:

- equity buildup
- appreciation
- tax savings
- income

Equity Buildup – Mortgage payments include both interest and principle payments. Over-time, your principle will be reduced and equity built up.

Tax Savings – In the U.S., real estate is one of the few genuine tax shelters left. Interest paid on the mortgage for investment property is tax deductible.

*Everyone needs food.
Everyone needs
clothes. And everyone
needs a place to live.
But does anyone really
need a mortgage?
POWERPOINT*

Also, buildings on property that is part of your business can be depreciated. Other favorable tax advantages may also be available depending and where you buy and what type of property you invest in.

Appreciation – Real estate can be improved or developed and thus appreciate in value. Real estate also increases in value over time.

Income – A well-selected real estate rental property will have a positive cash flow. That is, after all expenses and mortgage payments have been made, there will still be money left over at the end of the year (this will be dealt with in more detail later on).



TYPES OF REAL ESTATE

REAL ESTATE is a term that includes property – such as vacant land, residential houses, condominiums and commercial or industrial buildings – as well as all activities concerned with the ownership and transfer of ownership of properties.

This section however, is concerned with identifying those types of real estate, which can produce income. For the beginning and advanced investor, these types of investments are the safest.

Income producing properties include: rental homes, apartment buildings, condos, mobile home parks, office buildings, shop-

Single family residential properties are easier to handle than most real estate investments.

ping centers, retail and wholesale buildings, warehouses, industrial parks, hotels, motels, rest homes, and certain kinds of vacant land that can be used for recreation or agriculture.

Of the properties listed above, rental homes, apartment buildings and condos offer the least risk and require the least amount of expertise.

Rental Homes – Single family residential properties are easier to handle than most real estate investments. Depending on how well you choose your locations, your skills and time, they also have a great potential for appreciation.

NOTE Hire rental agents to collect rents. For an owner with a full-time job or a business to run, rent collection is a life-

complicating chore. You might consider hiring a rental agent to collect rents.

Apartment Buildings – Buy apartments near universities. You'll always have students to fill them up.

Condos – Condos tend to be more risky than single family homes. However, they have one advantage that makes them worth considering. Condos having the same square footage as single family homes, can often be purchased for less, yet rented for the same amount. Thus, it is possible for them to be good income producers.

Mobile Home Parks – Mobile home parks were once the sign of low-income

housing. But, times are changing and new mobile home parks are offering better living conditions. Keep your eyes open for cheap vacant land. Mobile home parks require only a bit of maintenance.

A fairly large number of Canadians reside in large homes they no longer need.

There is now and will likely remain a large unsold inventory of these types of properties largely located in the suburbs.

WAYNE MOEN

Mow the lawn, plow some snow, maybe do a bit of repaving, collect the rent, and pay property taxes. Once the park is full, there isn't much to do but pick up the monthly checks. Contrast that with apartment buildings where landlords are expected to do continuous maintenance on the paint, the elevators, the plumbing . . . an endless list.

Commercial Properties –

Commercial properties such as office buildings, shopping centers, retail and wholesale buildings, warehouse and industrial

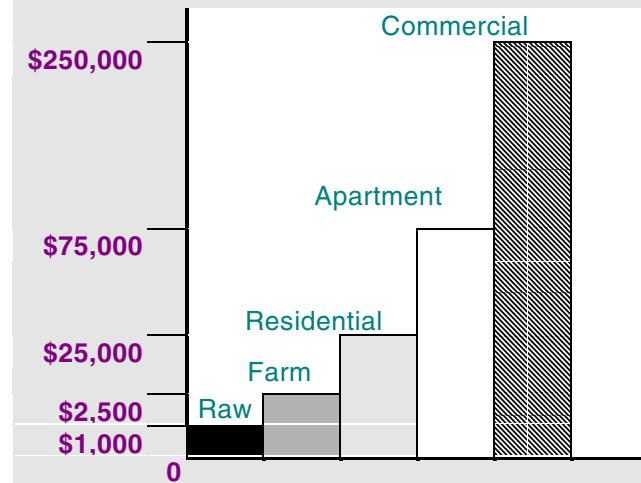
parks require expert management. Try and buy in stable downtown areas.

Motels and Hotels – Although hotels are often out of the league of the average investor, motels have possibilities. However, be prepared to have them take up a good portion of your time.

Rest Homes – Properly chosen sites for rest homes, or community living centers, along with well set-up management structures, can become very profitable.

Vacant Land – Raw land near cities and in cities can be utilized and developed in several different ways. The chart on the left shows how this can significantly impact on its value. However, although some kinds of recreational and agricultural land can be purchased and used to produce income,

Relative Value of Different Kinds of Land



The following chart shows the value of land as it moves from raw land, to farmland, to a subdivision, to an apartment, and to a shopping center.

NOTE Chart is based on a typical acre of raw undeveloped ground (43,460 feet) costing \$1,000.

most investors should stay away from straight vacant land. In most cases, raw land can not generate a cash flow. Mortgage payments will need to be made out of your pocket.

Straight Land – Straight land is located away from civilization centers and has no immediate development potential. It is the kind of ground that is only good for holding the earth together.

Recreational Land – Unless you can build a racetrack, shooting range or skiing hill, most recreational land has little value.

Agricultural Land – You can tell how much farmers are making from their land investment by the number of farmers who are selling out.

Urban & Suburban Land – This land is more valuable because it is near population centers and because of the various ways it can be developed. With this kind of land the law of supply and demand works to your advantage.

Urban & Suburban Land –
This land is more valuable because it is near population centers and because of the various ways it can be developed.



THE “FIVE BASIC ELEMENTS OF GOOD REAL ESTATE”

There are five basic elements needed to make a real estate property a good investment:

1. good location
2. growing market
3. eager seller
4. good income potential
5. favorable financing

The following real estate investment strategies are aimed at helping you recognize and capitalize on these five basic elements.

Apartments and homes need to be close to shopping centers, churches, schools and other services.

Element #1

Good Location

Find locations in good neighborhoods. When you buy a piece of property, you are also buying a neighborhood. Take a good look around. Is the neighborhood deteriorating or improving? If you are unfamiliar with the neighborhood, talk to city planning staff, local property management firms, and local real estate agents?

Find locations that are close to needed amenities. Apartments and homes need to be close to shopping centers, churches, schools and other services. If you're considering a commercial building, determine if there is adequate traffic flow or proximity to working establishments. Homes should also be

close to places of employment, shopping centers and churches. The further they are away, the worse their location.

Make a thorough study of the rental market in your area. Learn what is in demand and what is not.

Element #2 Growing Market

Become familiar with your own local real estate by studying properties on the market. Learn all about your particular city, its growth patterns, its depressed areas, where the direction of growth is likely to extend, and where you would like to live yourself. You can find this information by talking to real estate agents,

George Allen, author of "How to Find, Buy, Manage and Sell a Manufactured Home Community," estimates that owners of apartment buildings spend 52% of their rent roll on operating costs, versus 38% for mobile home park owners.

FUNFACT

as well as city or country planning departments.

NOTE Determine if there is a large community of mature people who may soon be looking to trade in their houses for easier condo lifestyles or perhaps homes in luxury mature communities?

Do a thorough study of prices in your city. To know what is a good deal and what is not, you must know what the going prices are i.e., How can you know what wholesale is if you don't know what retail is?

Look for changes in population. Populations of certain areas change with the economy. This means that if you buy houses in anticipation of growth you

will reap rewards. Likewise, you will be able to get better deals when people are leaving.

Look for conversion opportunities.

The key to making money on a conversion is to turn subdivisions or land on the lower scale to land higher up. For example, consider converting apartments into office space or condos and farm land into subdivisions. An apartment can be converted into an office if it is located in the downtown or central part of the city. Usually classic buildings with stately white balconies, adequate parking and in excellent locations, e.g., directly across from the country courthouse, make good conversions. You can also convert high rise buildings into condos. Profits are

The key to making money on a conversion is to turn subdivisions or land on the lower scale to land higher up.

created because people will pay more to own a condominium than they will to rent it.

Element #3

Eager Seller

Look for owners who are desperate to sell.

If you find someone who appears willingly to do anything to get rid of a property, you can be sure to get a good deal. However, approach the situation cautiously. Sometimes, people anxious to sell have very legitimate reasons and the problems that go with their property can't be solved easily.

Therefore, if you are not careful in analyzing what has made them want to sell, you could end up buying the property and then wanting to get rid of it for the very same reason.

Your objective is to determine the owner's problem and then determine if you can solve it.

NOTE Often an owner's problem is not as serious as it is perceived to be. You may be able to find a solution quite easily.

Look for owners who have personal problems. People who might be willing to sell their house more cheaply include people who are eager to retire, experiencing health problems, recently divorced, or transferred to a new work location.

NOTE Make your first offer a low one, even if it seems ridiculously low. You never know what motivates a seller to accept an offer. Your offer may be the only one re-

Make your first offer a low one, even if it seems ridiculously low. You never know what motivates a seller to accept an offer.

ceived.

Element #4 Income Potential

Calculate the income needed to cover all overhead expenses. Use the form on **page 42** to determine your annual property operating costs and thus get a better idea of the potential cash flow of a property.

Explanation of APOC Chart (see example on **page 41**)

1 Gross Rental Income – This is the amount of income the property would generate if the building were rented all year with no vacancies.

NOTE If projecting the amount of rental income needed to create a positive cash flow, remember to keep the rent reason-

able enough to attract good tenants who will stay a long time and perhaps even add to the improvement of the property. Good tenants might even become future purchasers (saving you 6 to 7% in Realty commissions).

2 Other Income – This income may be from vending machines, furniture rental, pet fees, rental of parking spaces, or forfeited deposits.

4 Less Vacancy and Credit Losses – Unless you are in an extremely tight rental market, your building will always have some vacancy. Don't believe the seller, if he or she tells you that they haven't had a vacancy in three years.

NOTE Look in the Yellow Pages under

A cardinal rule to consider when buying property is to buy the worst property in the best neighborhood, not the best property in the worst neighborhood.

SUPERTIP

Real Estate Rental Services and property management firms. These people might be able to give you valuable and free information concerning current rental rates and current vacancy rates in various areas of your city.

8 Advertising – This expense will vary from State to State or Province to Province and will depend on the various laws and rental markets.

10 Property Insurance – When seeking insurance, it pays to get several insurance bids. You will be amazed at difference in rates. Remember that bids are free.

11 Property Management – If you plan to manage the property yourself, you will not have to include any fee here. Fees for

such services vary from city to city, but generally range from 5 to 10% of the gross operating income. If you own many units, your rates can be negotiated even lower.

12 Residential Manager – The larger the apartment building, the more people you will need on your staff. You may pay as little as \$25 a month off the rent or as much as free rent plus a small salary. This amount is NOT paid by the management company.

15, 16 Taxes – Depending on your area, you will have to pay both personal property taxes and real estate taxes. Don't rely on your seller's past year's taxes. In many cases, the taxes and insurance payments are paid monthly as part of the mortgage payment.

17 Repairs & Maintenance – On new build-

In many cases, the taxes and insurance payments are paid monthly as part of the mortgage payment.

ings, the figure will be closer to 5 percent. On older buildings, this figure could be more than 10 percent.

24 Supplies – There is always a need for small items such as tools, faucet rings, fertilizer and so on. Your resident manager may also need a small petty cash fund.

25-29 Utilities – Utilities can easily be projected from past bills.

31 Total Operating Expenses – Across the country this ratio normally varies from 30 to 50 percent. If the seller however gives you a projection for expenses that is lower than 30 percent, something is not right somewhere.

32 Net Operating Income – This figure is

calculated by subtracting your total operating expenses from your Gross operating income.

33 Mortgage Payments – Your mortgage payments or total annual debt service is calculated by multiplying your monthly payments by 12.

34 Cash Flow Before Taxes – This figure represents the amount of profit or loss you can expect from a property before you take into consideration depreciation, tax advantages of mortgages and taxes owed.

35 Capitalization Rate – The capitalization rate (CR) is calculating by dividing your net operating income (NOI) by the sale or purchase price of the real estate. This formula is also known as the Real Estate Value Formula which is equal

The capitalization rate (CR) is calculating by dividing your net operating income (NOI) by the sale or purchase price of the real estate.

to Income (net operating income) divided by the Capitalization Rate: $V = I/CR$ (e.g., \$200,000 = \$20,902/CR; CR = 10.45 percent). Generally, avoid all properties with a cap rate of less than 7 percent. Look for ones with a 10% capitalization rate. Consider properties with a low cap rate, only if you can immediately raise rents or lower expenses significantly.

NOTE It should be noted that many real estate investors will gamble on increased appreciation of a building and therefore will buy buildings with a capitalization rate of less than 5%.

It should also be noted that it is generally very difficult to find a home, duplex, or four-unit apartment building with an adequate capitalization rate.

36 Return on Down Payment – This is calculated by dividing your Annual Net Cash Flow by your Down Payment (e.g., $RDP = \$503/20,000 = 2.5$ percent). Remember that spectacular returns here are not important. You still have appreciation and equity built-up to factor into your rate of return.

Consider purchasing properties that have a potential for producing income. The safest kind of investment for any investor, whether a beginner or professional, is an income-producing property. Income-producing property is the kind of real estate that is rented out to a tenant: an apartment building, rental home, commercial retail space, office building, or industrial warehouse building. The tenant pays rent that should be adequate enough to cover mort-

Invest in land because they've stopped making it.

MARK TWAIN

gage payments, property taxes, utilities and other expenses, and produce a small positive cash flow as a return on your investment. You should invest only in real estate with a positive cash flow.

If the numbers you calculate suggest a negative cash flow, don't walk away from the deal right away. Try a few of the following strategies first:

- Suggest that the seller cut their price.
- Determine if you can raise the rent without losing good tenants.
- Try and increase your down payment to reduce the mortgage expense.
- Try and eliminate any unnecessary expenses.

- Try and structure your mortgage payments in a more favorable manor (this will be dealt with in more detail later one).
- Factor in tax concessions (remember that in the U.S. interest paid on mortgages for investment property is generally tax deductible).

You don't need to have money to make money. You only need to know how to find the money.

Element #5 Favorable Financing

Leverage your investment with other people's money. You don't need to have money to make money. You only need to know how to find the money. If you don't have it, somebody else does. This is the essence of leveraging and what makes investing in real estate so exciting (and dangerous).

More specifically, it works this way:

Find bargain income producing properties, with a positive cash flow, and then buy them (or rather get control of them) with little or no money down.

For example, find a break-even income producing property with a value of \$240,000 at 20% below market rate (\$192,000), and purchase it with a 10% down payment (\$19,200). Hold the property for one year. If the property increases in value by 7% during this period, and you were able to get its full value when you sold it, you would now have \$256,800 – a profit of \$64,800. This is equivalent to a whopping return on your investment of $\$64,800/\$19,200 = 338$ percent. If you would have put your money in the bank in-

stead and received 10% per year, you would have \$22,000. By leveraging your money, you have made it grow more than 3 times.

NOTE Leveraging can be very dangerous. You can easily lose everything you have invested if the markets go sour.

Try and meet the needs of the seller. The best and most satisfying negotiation to both parties concerned – you and the seller – are those in which you try to understand the needs of the seller, and then try to structure your offers to meet these needs.

Turn the seller into a partner. If you have difficulty in finding partners to invest in property, keep in mind that the partner

If you have difficulty in finding partners to invest in property, keep in mind that the partner can be the seller himself.

can be the seller himself. One of the ways you can do this is lease an under-rented property from the seller who is eager to meet their monthly mortgage payments, and then sublet it. You can make this deal even more attractive by asking the seller of the property for a lease with an option to buy.

Write up your own mortgage agreement – create a seller’s note. A “seller’s note” is a legal contractual agreement written up by you and the seller regarding how a piece of real estate will be paid for. It is essentially a mortgage carried by the seller. The advantage of this type of mortgage is the increased flexibility it can give you over bank mortgages, regarding when and how payments are made. For example, to help create a positive cash

flow property, and thus make it more favorable for purchase, you can try and structure a seller's note in the following four ways:

- Make mortgage payments that take into consideration seasonal demands e.g., pay more when your utilities are less and less when they are more.
- Structure a balloon mortgage i.e., pay no monthly sums until the end of the year where you pay a lump sum.
- Increase the length of the amortization i.e., make payments for a thirty-year period but have the option of making a lump sum payment after seven years.

Never pay more than seven times gross annual rental on a property or you're going to suffer negative cash flow.

SUPERTIP

- Have interest payments smaller the first year and larger in the later years.

NOTE One powerful financing technique lies in allowing sellers to borrow out 100 percent of their equity in the real estate holdings. For example, if a seller wants their \$15,000 in equity out of their investment right away, you can suggest to them that you will take out a \$15,000 mortgage on the property. You then pay the monthly mortgage payments to the bank, as well as the monthly payments to the seller less the \$15,000.



STRATEGIES FOR FINDING “GOOD REAL ESTATE”

THE PROBABILITY that you will find an inexpensive home that you can buy for 60 cents on the dollar, with a low down payment, low interest mortgage, deferred payments on the mortgage, high rent-to-value ratio, and positive cash flow, is not very good. However, if you are prepared to sift through a hundred properties before you find one that comes close to your needs, your chances will improve vastly. Remember that volume is the key.

To help you find “good real estate” consider the following **8** strategies:

1. Become an expert in foreclosures.

Join your apartment owner’s association, local investment groups, or exchange groups.

Visit every sale. Visit every saving and loan association, finance company, bank, or credit union in your area. Ask to study the bank’s portfolio or repossessed properties. Look for properties in lower price ranges, which could be purchases below market with below market financing offered by the lending institution.

2. Begin circulating in the right circles. Join your apartment owner’s association, local investment groups, or exchange groups. Develop a list of people who can give you good advice ranging from other investors (potential partners) to bankers and real estate agents.

3. Become friends with a Realtor.

Visit your local real estate offices. You need to let people know that you are in the market.

4. Look through the obituaries. Recently deceased property owners may have no heirs.

5. Read ads in the newspaper. The newspaper can be an excellent source of people who need to sell in a hurry.

6. Set a time each week for searching for new properties. Most people are so busy making a living that they don't have any time to make any real money. However, some people learn or have a unique way or routine system of handling their time more efficiently, and these people make money. They

Wait for a bargain. Try and create a bargain. However, never grow impatient and fool yourself into thinking you have found a bargain.

use discipline and consistency to achieve where others fail. As the saying goes, "routine brings perfection within the grasp of mediocrity." In other words, even a mediocre person with a modest daily routine will outperform a disorganized genius ninety-nine times out of a hundred.

NOTE Wait for a bargain. Try and create a bargain. However, never grow impatient and fool yourself into thinking you have found a bargain.

7. Use multiple-listing books.

Go into your local real estate office and ask to study a copy of the MLS book (Multiple Listing Services). Look for the clues in the remarks section of each advertised prop-

erty. Try to determine how flexible the seller might be.

- 8. Attract offers to you by placing an ad in a paper.** Place an ad in the paper in the Real Estate Wanted section of the classified advertising, stating that you are in the market to buy property at full price but on the condition of extremely flexible financing. Place your own ad in the paper. You may even want to post this ad on a billboard or bulletin board.

Classified Ad

I buy properties. Will pay fair price with small down. Quick Closings. Call Bob: 555-5555.



STRATEGIES FOR MANAGING REAL ESTATE

MANAGING A BUILDING can be very frustrating. Problems can include: low vacancies, bad tenants, too many expenses, extensive repairs, long distance travel, time constraints, and poor management skills.

A more detailed description of the above problems and possible solutions are outlined below:

Vacancy Problems – Vacancy problems can occur when your tenants move into a competitor's apartment. To solve this problem find out why tenants are moving and then try and beat the competition by offering lower rates, free utilities, satellite TV, or

*Buy the acre,
sell the lot.*

**JOHN JACOB
ASTOR**

*Real Estate
Magnate*

reduced damage deposits.

Tenant Problems – Tenant problems can occur when your tenant refuses to pay the rent. To prevent this problem, screen your tenants better.

Overhead Problems – Overhead problems can occur when you have difficulty controlling your expenses. To solve this problem, implement a budget and stick to it.

Repair Problems – Repair problems can occur when old water heaters need replacing. To solve this problem, get repairs done by a professional – unless your family business is home improvement, or you have special skills, or you take special pleasures in working on a building.

Commuting Problems – Commuting problems can occur when you have to travel a long distance to solve a problem. This becomes especially difficult if you live in another state or province. To solve this problem, hire someone to manage the property. To prevent this problem, don't buy property that is too far for you to manage.

Time Problems – Time problems can occur when you are extremely busy and your spouse tells you it is either your family or your apartment building. To solve this problem, get someone else to manage your properties.

Management Problems – Management problems can occur when you don't have the organizational skills or people skills to

manage a building. To solve this problem, hire someone else to manage your building.

For a fee – usually between 5 to 10 percent of the gross income – management professionals will take care of everything that has to do with operating the property.

For a fee – usually between 5 to 10 percent of the gross income – management professionals will take care of everything that has to do with operating the property, including the collection of rents, payments for expenses, handle minor and major problems, evict bad tenants, advertise the building, handle bookkeeping, and take responsibility for the maintenance.

You never have to worry about plugged toilets or leaking roofs; your management company will take care of everything and will only bother you for major decisions, if that's what you want. In

addition, they have paid maintenance men on their staff or have connections for the lowest rates in town. They can even purchase supplies at wholesale prices.

Furthermore, if requested, the firm will send you a check each month with an accounting of all expenses and income.

NOTE Every city has access to professional management. Services are listed in the Yellow Pages under Professional Property Management. However, not all management companies are as competent as they would like you to think. Do some in-depth checking before you decide on your company and to monitor their service monthly until you feel that they are honest, trustworthy, capable, and professional. For the

first while, it's a good idea to manage your own property so that you know first hand the problems of managing an apartment building. Whatever you do, don't walk away from your property after you have turned it over to a manager.

*Whatever you
do, don't walk
away from your
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manager.*



STRATEGIES FOR AVOIDING REAL ESTATE BLUNDERS

THE GREATEST BARRIERS to getting into real estate and the greatest reasons for getting out of real estate are usually the same.

To avoid making big real estate blunders, heed the advice contained in the following 6 investment strategies:

1. **Never buy a property which has a balloon mortgage of less than five years.** Balloon mortgages can come faster than you think. Unless the price is at least 10 percent below market the day you buy it, don't agree to it. If you're buying for the long

The best investment on earth is earth.

LOUIS J. GLICKMAN
Investment Banker

run, avoid balloons completely.

NOTE If you do agree to a balloon mortgage, it is a good idea to negotiate for a twelve-month extension beyond the balloon due date just in case you can't solve the problem in time. You may agree to pay a non-refundable fee of \$500 to \$1,000 for the privilege of extending.

2. **Never buy a property which has a high negative cash flow.** Unless the price is at least 10 percent below market the day you buy it or the property has the potential to appreciate well into the double digits, it won't be worth your time.
3. **Don't throw money into "condo time shares."** Time-sharing is a real

estate investment of usually one condominium unit, co-owned by as many as 25 investors. Each investor may personally use his unit during designated weeks, which are chosen as part of the transaction. Two “unit weeks” are usually sold for between \$8000 and \$25,000. However, realistically, it is unlikely that the condo is worth \$200,000 to \$600,000. Hence, it is almost always a bad investment (unless of course you’re the one selling them).

4. **Keep your money out of vacant land.** Undeveloped land, sometimes called vacant or raw land, will continue to be a less than optimal investment for the next few years. The lowered value is caused by the shift in

Undeveloped land, sometimes called vacant or raw land, will continue to be a less than optimal investment for the next few years.

agricultural production from small farms to major farming operations. In addition, land, unless leased, produces no income but does create negative cash flow through property taxes and loan interest.

NOTE A lot in an appreciating area, or one on which you eventually intend to build for yourself, is an exception and can be a good investment.

5. **Never buy a property that appears to be a “super deal” without doing your research.** **First**, hunt for serious physical problems. All buildings need to be repaired and maintained. However, some occasionally suffer irreparable or serious physical damage

and some just get plain old and become plagued with numerous upgrading problems. When buying a building make sure that it meets fire codes, the plumbing is not deteriorating, and the electrical system is not circa 1920.

Second, check for “function obsolesce.” Appraisers use this term to describe the particular faults of a building that will not be easily correct such as height of ceilings, lack of electrical outlets, small units or small parking lots.

Third, check out the competition. The competition next door may have just installed a new swimming pool that is attracting new tenants including yours.

The meek shall inherit the earth, but not the mineral rights.

*Attributed to
J. PAUL GETTY*

Fourth, research the age of the building. Structural elements and appliances may need replacing at great expense to the owner.

NOTE Buyer Beware: Physical problems are the most serious problem confronting the purchase of new real estate.

- 6. Stay away from investing in vacation property.** No one makes money in vacation property. First of all, there’s little chances for income, and second of all, equity capital appreciation is too speculative.



MAKING MONEY ON DISCOUNTED MORTGAGES

THE FIELD of discounted mortgages is one of the greatest opportunities for creating wealth in a real estate-related field. Billions of dollars of owner-carried-back financing has been created in the past ten years. That means that you will see a good portion of this paper flooding into the discounted paper market in the coming decade.

A discounted mortgage is essentially a seller's note that you buy at a discount, because the seller would rather have the

A discounted mortgage is essentially a seller's note that you buy at a discount, because the seller would rather have the cash instead of receiving monthly payments.

cash instead of receiving monthly payments.

Here's how it works. Suppose you find a holder of a seller's note with a face value of \$10,000 receiving monthly payments of \$143 per month at 12 percent interest (total value is \$17,160). It is completely amortized over a ten-year period. The owner of the note for some reason decides that he or she wants cash instead of a steady income.

Typically, the market would pay about 65 cents on the dollar. That means that you could likely buy the note for \$6,500 cash. Over ten years you would receive \$10,660 over and above your investment, giving you an annual rate of return of 16% on your original investment in

addition to the interest received as you re-invest the monthly payments. Overall this would create returns in the 25-30% range.

NOTE To make money in discounted mortgages, you have to hunt for bargains just like you do in real estate.



To make money in discounted mortgages, you have to hunt for bargains just like you do in real estate.

Annual Property Operating Costs

| | |
|---|------------------------------------|
| Name: <i>Jack Grandin</i> | Personal Property: <i>\$16,000</i> |
| Location: <i>1160 Chess Dr. Foster City, CA 94404</i> | Total: <i>\$251,000</i> |
| Type of Property: <i>6 unit apartment</i> | Date: <i>Jan. 1, 1995</i> |
| Building Appraised Value: <i>\$120,000</i> | Price: <i>\$200,000</i> |
| Land Value: <i>\$105,000</i> | Loans: <i>\$150,000</i> |
| Improvements: <i>\$10,000</i> | Equity: <i>\$50,000</i> |

Original Mortgage

1st Mortgage

| Balance | Payment | Period | Interest | Terms | Balance | Payment | Period | Interest | Terms |
|----------------|--------------|--------------|------------|-----------------|---------|---------|--------|----------|-------|
| <i>150,000</i> | <i>1,700</i> | <i>month</i> | <i>10%</i> | <i>25 years</i> | | | | | |

2nd

3rd

| Balance | Payment | Period | Interest | Terms | Balance | Payment | Period | Interest | Terms |
|---------------------------------------|---------|--------|------------------|-------|--|---------|--------|----------|------------------------|
| | | | | | | | | | |
| 1. Gross Scheduled Rental Income | | | <i>\$36,000</i> | | 19. Janitorial | | | | |
| 2. Plus: Other Income | | | <i>600</i> | | 20. Lawn | | | | |
| 3. Total Gross Income | | | <i>\$36,600</i> | | 21. Pool | | | | |
| 4. Less: Vacancy & Credit Losses (5%) | | | <i>1,830</i> | | 22. Rubbish | | | | |
| 5. Gross Operating Income | | | <i>\$34, 770</i> | | 23. Other | | | | |
| 6. Less Operating Expenses | | | | | 24. Supplies (1%) | | | | <i>350</i> |
| 7. Accounting & Legal | | | <i>750</i> | | 25. Utilities - Electricity | | | | |
| 8. Advertising (2%) | | | <i>695</i> | | 26. Gas & Oil | | | | |
| 9. Licenses & Permits | | | | | 27. Sewer & Water | | | | <i>2,000</i> |
| 10. Property Insurance | | | <i>1,000</i> | | 28. Telephone | | | | |
| 11. Property Management (7%) | | | <i>2,434</i> | | 29. Other | | | | |
| 12. Resident Manager (\$125/mth.) | | | <i>\$1,500</i> | | 30. Miscellaneous (4%) | | | | <i>1,400</i> |
| 13. Other | | | | | 31. Total Operating Expenses | | | | <i>\$13,867</i> |
| 14. Taxes - Workmen's Compensation | | | | | 32. Net Operating Income (34 - 31) | | | | <i>\$20,903</i> |
| 15. Personal Property Taxes | | | | | 33. Less: Mortgage Payments (\$1,700 x 12) | | | | <i>\$20,400</i> |
| 16. Real Estate Taxes | | | <i>2,000</i> | | 34. Cash Flow Before Taxes (32 - 33) | | | | <i>\$503</i> |
| 17. Repairs & Maintenance (5%) | | | <i>1,738</i> | | 35. Capitalization Rate | | | | <i>10.45%</i> |
| 18. Services - Elevator | | | | | 36. Return on Down Payment | | | | <i>2.5%</i> |

Annual Property Operating Costs

| | |
|---------------------------|--------------------|
| Name: | Personal Property: |
| Location: | Total: |
| Type of Property: | Date: |
| Building Appraised Value: | Price: |
| Land Value: | Loans: |
| Improvements: | Equity: |

Original Mortgage

1st Mortgage

| Balance | Payment | Period | Interest | Terms | Balance | Payment | Period | Interest | Terms |
|---------|---------|--------|----------|-------|---------|---------|--------|----------|-------|
| | | | | | | | | | |

2nd

3rd

| Balance | Payment | Period | Interest | Terms | Balance | Payment | Period | Interest | Terms |
|---------|---------|--------|----------|-------|---------|---------|--------|----------|-------|
| | | | | | | | | | |

| | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|--|
| 19. Gross Scheduled Rental Income | | | | | 37. Janitorial | | | | |
| 20. Plus: Other Income | | | | | 38. Lawn | | | | |
| 21. Total Gross Income | | | | | 39. Pool | | | | |
| 22. Less: Vacancy & Credit Losses (5%) | | | | | 40. Rubbish | | | | |
| 23. Gross Operating Income | | | | | 41. Other | | | | |
| 24. Less Operating Expenses | | | | | 42. Supplies (1%) | | | | |
| 25. Accounting & Legal | | | | | 43. Utilities - Electricity | | | | |
| 26. Advertising (2%) | | | | | 44. Gas & Oil | | | | |
| 27. Licenses & Permits | | | | | 45. Sewer & Water | | | | |
| 28. Property Insurance | | | | | 46. Telephone | | | | |
| 29. Property Management (7%) | | | | | 47. Other | | | | |
| 30. Resident Manager (\$_____) | | | | | 48. Miscellaneous (4%) | | | | |
| 31. Other | | | | | 49. Total Operating Expenses | | | | |
| 32. Taxes - Workmen's Compensation | | | | | 50. Net Operating Income (34 - 31) | | | | |
| 33. Personal Property Taxes | | | | | 51. Less: Mortgage Payments | | | | |
| 34. Real Estate Taxes | | | | | 52. Cash Flow Before Taxes (32 - 33) | | | | |
| 35. Repairs & Maintenance (5%) | | | | | 53. Capitalization Rate | | | | |
| 36. Services - Elevator | | | | | 54. Return on Down Payment | | | | |