Real Estate Investing

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Introduction

"More money has been made in real estate than in all industrial investments combined."
—Andrew Carnegie

It's true (before the advent of computers and the Internet anyway). For decades—even centuries—more millionaires have been made through real estate than any other investment vehicle. Real estate investing is one of the keys to wealth building and preservation. Many middle-class Americans, unable to capitalize more costly business ventures, have turned to real estate as a means to substantially increase their net worth. Congratulations on making a wise choice to improve your financial future by investing in real estate.

Owning a successful business is the dream of many Americans. But the large amount of money it usually takes to start a business, coupled with the very real possibility of losing all of that money, keeps many would-be entrepreneurs on the sidelines. But what if you could start a business with minimal capital that could make you independently wealthy, and in a relatively short period of time, with very little risk involved? You're right. It does sound too good to be true. But it is true. Of course, there will always be people who say, "you can't do this" or "you can't do that" or "this won't work." The irrefutable fact remains, though, as you're reading this, people just like you are making substantial amounts of money buying and selling real estate and enjoying the fruits of their labor: financial freedom. Some have even gone on to become millionaires or multi-millionaires. Why can't you?

It would be easy to read over the above question and move on to the next topic, but it's a very important question. Why can't you be a successful real estate investor? The most common answers to that question are "I don't have the time" and/or "I don't have the money." In-and-of-themselves, a lack of time and money cannot prevent you from becoming a successful real estate investor. Through our program, you will learn proven strategies for securing property with little or even no money down. Many successful real estate investors had less free time and less disposable income than you currently possess when they started investing in real estate. No, what will keep you from investing in real estate isn't a lack of time or a lack of money. *You* are the only thing that can stop you from investing in real estate. A lack of desire and commitment is usually what separates those who are successful in a given field from those who'd like to be.

You obviously have the desire to improve your financial future, or you wouldn't be reading this right now, but are you really committed to improving your financial future? Do you really want to be a successful real estate investor? Will you take the time to learn our program and follow through by securing your first investment property? (All it takes is that first good deal to get the snowball rolling down hill). If you answered yes to the three questions you were just asked, you should have no problem making money buying and selling real estate. In short, there are dreamers, doers, and then there are the dreamers and doers. Real estate investors, and all other entrepreneurs, are dreamers *and* doers.

I bargained with life for a penny,
And life would pay no more,
However, I begged at evening
When I counted my scanty store
For life is a just employer,
He gives you what you ask
But once you have set the wages,
Why, you must bear the task.
I worked for a menial's hire,
Only to learn, dismayed,
That any wage I had asked of life,
Life would have willingly paid

—Author unknown

What is Real Estate?

According to Dictionary.com, *real estate* is "land, including all the natural resources and permanent buildings on it." Real estate is also a versatile and powerful investment vehicle. It will help a great deal if you think of real estate as simply another investment option, one that has many advantages and comparatively few disadvantages.

Entrepreneurship

There are two kinds of failures: those who thought and never did, and those who did and never thought. —Laurence J. Peter

The preceding quote clearly indicates what it takes to be successful in any worthwhile endeavor. You must <u>take action</u>, but not act rashly, which means learning as much as possible about the business you're in or considering getting into—as quickly as possible—and setting goals, a crucially important topic, which will be addressed a little later.

People who invest in real estate as a business are entrepreneurs. What, exactly, is an entrepreneur? Good question. Webster's defines an entrepreneur as "a person who organizes and manages a business, assuming the risk for the sake of profit." Key words in Webster's definition are *risk* and *profit*. Let's look at these two key words a little more closely.

Risk

Entrepreneurs are said to be risk takers, a characterization that isn't quite complete. Most entrepreneurs are calculated risk takers, and the two main factors in their calculations are risk and reward. What separates entrepreneurs from the crowd is the way in which they view risk, money that could potentially be lost in a business venture, and reward, money that could potentially be gained (profit). While entrepreneurs have a healthy respect for risk, entrepreneurs typically do not fear risk, especially when the potential rewards are great. Entrepreneurs would rather risk what others might consider failure than have to look back and ask "what if." Many successful real estate investors, looking back on their accomplishments, have asked themselves the same question: *Why didn't I invest in real estate sooner?*

The rewards associated with real estate investing far outweigh the risks involved. Comparatively speaking, real estate is a low-risk investment vehicle. Real estate typically appreciates at around 4% to 5% annually, and it's uncommon for property to rent for less than what's referred to in the industry as PITI: **p**rincipal & **i**nterest (mortgage payment), **t**axes, and **i**nsurance. Even if you barely break even renting a property, it will still likely appreciate at around 5% annually, which for a $100,000 property, is some $5,000.00 a year. Yes, there are occasional downturns in the real estate market, but in most areas of the country, property values have increased for decades and decades. And as long as people need shelter, this trend should continue. Even if the market is slightly depressed, there are still great opportunities for making money investing in real estate. Often, it does not come down to what the market is doing, but how well armed we are with knowledge and negotiating skills. Real estate knowledge can make you money in almost any market. Inflation appears to have leveled off in recent years, but the overall trend has been for inflation to increase. Inflation should continue to force higher real estate prices. In fact, those of us who own real estate, *real property* as it's commonly referred to, may even look forward to inflation increasing, because it bumps up the price of the property we are holding.

Why invest in real estate?

Any investment carries with it some degree of risk. One of the most appealing aspects of real estate investing as a business is that it is far less risky than most other business ventures. Why is real estate investing inherently less risky? That's another good question. First, the market (group of potential customers) for residential real estate is huge. After all, everyone needs a place to live, helping you avoid a major problem many other entrepreneurs face: a limited market for a product or service. Another problem many entrepreneurs face is high business-startup costs. A real estate investing concern is one of the few businesses that can be started with minimal capital and generate substantial revenue, perhaps a million dollars or more. And with other types of businesses, there exists the possibility of losing <u>everything</u> if things go awry. While real property may decrease in value, which is the exception rather than the norm, you are pretty much assured that the underlying asset (land and any improvements to the land) will always be there. Insurance will even protect your investments against loss, an option not available on many other investments.

Leverage, the ability to use OPM (**o**ther **p**eople's **m**oney) to secure large assets (properties), is perhaps the most appealing aspect of real estate investing. For example, with a little strategic knowledge, you can secure a $100,000 asset with a minimal down payment—for the purposes of our discussion, let's say $10,000. We already know that real estate typically appreciates at between 4% and 5% annually. Better still, this rate of appreciation applies to the full value of the property ($100,000) and its appreciated value (see: compounding), not just the original $10,000 investment. In addition, you can maximize a property's wealth-building potential by renting it out, another way to use other people's money to make <u>you</u> money. Through the rent you charge, other people will pay your mortgage, taxes, insurance, and other homeowner's costs; thus, someone else is paying for *your* equity growth in the property, while it appreciates in value and you derive positive monthly cash flow. Also, at any given time, there will be numerous opportunities to buy property far below market value, providing immediate equity. *Outstanding!*

There are other advantages to investing in real estate. Real estate has been and continues to be an effective means of tax reduction for many Americans, although the Tax Reform Act of 1986 diluted tax advantages associated with real estate investing. There are a number of tax-sheltering advantages for the real estate investor, most notably *depreciation*, a loss in value of business or income-producing property over time, which helps the owners of rental property save money at tax time. Speaking of saving money at tax time, many of the costs associated with running a business are tax deductible. (Ask your accountant for details.) While reduced tax liability is certainly an important consideration for the real estate investor, what makes a property a good or not so good investment is its ability, or lack thereof, to generate positive cash flow (rental property) and appreciate significantly in value over time.

Risk Management

Knowledge is one of the most effective risk-limiters, as is a levelheaded approach to real estate investing. One of the best ways to manage risk is being able to tell a good deal from a not so good deal, a skill you'll develop by reading this book, and keeping your emotions in check. There's certainly nothing wrong with falling in love, but one of the downsides is that it can cloud the judgment of even the most clear-thinking individuals. You must be willing to walk away from a property, even if you've "fallen in love with it," when things aren't going your way. Savvy entrepreneurs are always prepared to nix deals, even when they really want them to go through, to avoid potentially adverse consequences. There will always be other opportunities to fall in love and even better deals down the road.

Reward

The key to success for any business venture is <u>maximizing profits</u> and <u>minimizing expenditures</u>. To be successful at real estate investing, or any other business venture, you must be profit- oriented. To underscore this point, let's briefly look at a popular real estate investing strategy known as "flipping." This is basically how it works: You buy an average 3-bedroom 2-bath single-family home located in a nice neighborhood, a home that most first-time homebuyers could afford, for at least 20% below market value. Then you fix it up—quickly. And then you sell it near, at, or above fair market value—quickly. For a $100,000 property purchased 20% below market value, you would be looking at a gross profit somewhere in the neighborhood of $20,000. The property will likely need some work to bring it to move-in condition, which will reduce your profit margin. You will also be responsible for paying the mortgage while searching for a qualified buyer, further reducing your profit margin.

"Profit-oriented" means spending as little as possible bringing properties to move-in condition and selling them as quickly as possible (if your investment strategy is short-term). "Spending as little as possible" doesn't mean cutting corners though. You must find people who do quality work, quickly and economically, and businesses that sell quality products at fair prices. Obviously, the more tasks you and your helpers are able to accomplish, the more profit you'll make, but sometimes it pays to pay professionals. "Profit-oriented" also means finding qualified buyers as quickly as possible, which is why beginning investors should focus on 3-bedroom 2-bath single-family homes in nice neighborhoods. There are many more potential buyers for these types of homes than for any other properties, significantly increasing the prospects of quickly finding qualified buyers.

To be a successful real estate investor, you absolutely must know the fair market value of properties similar to the ones you're considering placing bids, and you must also know the projected (post fix-up) value of properties you're considering bidding on. You must also have a good idea what it's going to cost to bring a property to move-in condition (see: FHA standards), hold it until you find a qualified buyer, and actually sell it. Professionals who can help include real estate salespeople and brokers, who can provide you with helpful advice and a free CMA (**C**omparative **M**arket **A**nalysis) for properties you're interested in; professional property appraisers, who can provide you with much more detailed information than found in CMAs; and professional home inspectors, who can tell you what needs to be fixed or replaced and how much it's going to cost you.

Profit Margin

Only when you know how much a property will sell for after it's rehabbed, and how much it's going to cost to rehab it, can you make an informed decision as to whether or not to proceed (place a bid). If a property's post-rehabilitation value is $100,000, you can purchase it for $80,000, and it's going to cost $5,000 to bring it to move-in condition, you're looking at a net profit of $15,000. But that doesn't take into consideration costs associated with holding and selling the property, which could take the final net profit down to around $10,000 or even lower. "Profit-oriented" means launching preemptive strikes against anything that has the potential to significantly reduce your profit margins: mortgage payments (try to sell quickly, by lining up potential buyers before rehab work is complete or maintaining a database of potential buyers), real estate commissions (try to negotiate lower commissions before you list, or work directly with sellers), closing costs (try to pay none or half), etc.

Another, longer-term investment strategy is to secure properties and rent them out or offer lease-to-buy options, a strategy that will be addressed a little later. One of your main profit objectives is the same: spending as little as possible bringing a property to move-in condition (or bringing it to move-in condition again). But instead of quickly finding qualified buyers, you must quickly find qualified/responsible renters, charge as much for rent as the market will bear, keep it occupied, and spend as little as possible maintaining the property, while still keeping it in good condition. <u>Note</u>: "Slum lords" are a little too profit-oriented.

Let's say you purchased a 1-bedroom/1-bath condominium five years ago from someone whose property was in jeopardy of being taken away. The owner wanted $26,000.00, almost 15% below fair market value, but you managed to negotiate the price down even further to $23,000.00 cash on the barrelhead. (In the world of foreclosures, money talks—loudly.) A new air conditioning unit, carpet, and minor repairs ended up costing around $4,000.00, but you still got a great deal. Let's further assume that you lived in this condo for one year prior to renting it out, which you did for the past four years, but now you want to sell it. Your tenant, who lived there all four years and took good care of your property, is moving, and you discovered that yours is the only 1-bedroom/1-bath unit in the entire complex that would be available for purchase, creating an ideal selling situation (high demand and low supply).

In year one of the four years your condo was used as rental property, you charged $450.00 for rent; in year two, you charged $465; in year three, you charged $480.00; and in year four, you charged 495.00. Your monthly maintenance fee in the first year your condo was used as rental property was $60. The next year it went up to $63. The following year it rose to $67. And in year-four you were paying $70 a month. During the four years your condo was used as rental property, you also incurred two special assessments: $230 to repair the stairs and $335 for balcony repairs. Taxes during this four-year period amounted to approximately $3,000.00. Maintenance fees, special assessments, and taxes subtracted, you would've made almost $16,000.00 in rental income, recouping close to 60% of your initial $27,000.00 investment! And that's not even taking into consideration the money you would've saved through income tax deductions. Now let's say, after five years of ownership, you sold your condo for $36,500.00, a reasonable projection. All told, you would've made over $25,000.00, nearly a 20% annual return on your investment. You also lived rent-free during the first year of ownership and paid no property taxes because of homestead exemption. Using your condo for comparative purposes, you would've saved $5,000.00 in rent alone during the first year of ownership! Of course, not everyone has $23,000.00 to invest in one lump sum and another $4,000 for necessary improvements, but this example, albeit simplified, does illustrate nicely the value of real estate as a personal asset and investment vehicle.

A 20% return on any investment is certainly nothing to sneeze at, but let's take it to the next level and witness the true power of real estate investing through *leverage*, *appreciation*, and another friend of the real estate investor: *compounding*. Let's say you purchase a $100,000.00 house for only $2,000.00 out-of-pocket. Nationally, real estate appreciates at around 5% annually. After just one year of ownership, your $2,000.00 investment would likely have doubled in value! After ten years of ownership, the house you purchased for $100,000.00 could quite conceivably be worth in the neighborhood of $180,000.00. Let's see now, control of property worth $180,000.00 for an initial investment of $2,000.00. *Amazing!*

If real estate investing is something you really want to pursue, and you're the type of person who doesn't want to face the prospect of looking back and asking *what if* I had invested in real estate years ago, you stand a very good chance of making and saving substantial amounts of money with our program. Real estate investing isn't for everyone, though. That's why everyone isn't doing it, which is good news for the people who do want to stick their hands into the cookie jar.

Chapter 1. Real Estate Basics

Real Estate is the IDEAL business

As previously mentioned, there are many advantages and comparatively few disadvantages to investing in real estate. In many ways, real estate is the ideal business. In this case, however, ideal isn't just a suitable adjective; it's also a helpful acronym, which stands for **I**ncome, **D**epreciation, **E**quity, **A**ppreciation, and **L**everage.

Income

One of the most attractive aspects of real estate is its ability to generate income when used as rental property—while appreciating in value at an average rate of around 5% annually.
In the vast majority of cases, the amount charged for renting a residence exceeds monthly mortgage payments, insurance, taxes, maintenance fees or homeowners' association dues, property management fees, utilities, etc., thus earning a profit for the homeowner and a steady (monthly) stream of income. Of course the owner has to keep the property rented, make sure tenants pay rent on time, and hope that they don't decide to reenact the gunfight at the OK Corral with paintball guns before they vacate, but every silver ling has a cloud. Most tenants, however, pay what they owe relatively on time and take pretty good care of rental property. To protect yourself, there are services you can use to determine the credit worthiness of would-be renters. Another form of protection is asking for the first and last month's rent upfront and a security deposit someone wouldn't want to forfeit upon moving.

Depreciation

For tax purposes, income-producing (rental) property may be depreciated. *Depreciation* is an allowance made for a loss in value of business or rental property over time. Depreciation makes certain types of properties appealing to investors, thus spurring economic growth. Many of the costs associated with the upkeep of rental property may be used as tax deductions as well. The interest portion of mortgage payments is also tax deductible, which is a big incentive to buy rather then rent. Let's say you purchased a home for around $100,000.00 six years ago; it has appreciated at 5%; and you've just sold it. You would've made and saved tens of thousands of dollars! Now imagine if you'd rented for those six years. Not a pleasant thought. Through appreciation, tax deductions, and profit from the sale of your home, you can live virtually rent-free. Real estate investing isn't just about building wealth; it's also about preserving it.

Equity

Equity is simply the fair market value of a property, which is the price an informed buyer would likely pay, less any debt against said property—for example, a mortgage, second mortgage, or other lien. As the value of a property increases (through inflation, appreciation and compounding) and the mortgage debt decreases (mortgage payments are made), equity builds.

Equity is akin to profit. Real estate investors—smart ones anyway—try to pay as little as possible for a property (purchase price) and to secure said property (down payment). Like all investors, they hope their investments/assets (properties) will substantially increase in value. Painting, carpeting, cleanup, minor repairs, a new air conditioning unit or appliances, lawn work, etc. boost and accelerate this appreciation process, hopefully to the point at which a big profit is eventually realized. Not exactly rocket science is it? Of course, a property in need of paint, carpet, cleanup, lawn work, minor repairs, a new air conditioner, appliances, etc. should be discounted accordingly.

It's often said that people who rent rather than buy are "throwing their money away," which really isn't true. After all, they're paying for a place to live. What is true, though, is that they are missing out on lucrative benefits associated with homeownership. The rent payments they make every month build no equity. Actually, that's not true. They do build equity—for other people! It's great that the interest portion of mortgage payments is tax deductible; however, the biggest advantage to buying rather than renting is that the monthly payments build *equity*. In other words, if you buy a home and then decide to sell it years later, if there are no encumbrances upon the property (additional mortgages or other liens), chances are you'll make a healthy profit. Pride of ownership is another major benefit, albeit a less tangible one.

People who rent often pay more and get less for their money than people who buy. Many people who could buy property, though, primarily those who aren't planning to reside for a number of years in the same area, simply are not interested in buying. One of the main reasons is that they don't want to deal with "all the hassles," although some people who move around quite a bit prefer to buy and then sell when they move or use their former residences as rental property. If you can buy a residential property, are willing to deal with some hassles when it comes time to selling or renting it, and have a keen eye for real estate bargains, you will save and make a considerable amount of money. If you're going to be in the same area for a number of years and you don't own your own home, you should seriously consider buying rather than renting. As you will learn, the benefits are just too great not to. The bottom line is that you're going to have to pay someone's mortgage, so why not pay yours?

Appreciation

It's hard to beat an investment vehicle that can save you money on your taxes, appreciate at rate of around 5% annually, and generate a steady stream of (rental) income. The best part of the equation is that the appreciation applies to the <u>value of the property</u> and the increased value of the property, not just the initial investment (down payment). Another appealing aspect of real estate investing is appreciation's compounding effect. Let's say you purchased a $90,000 home. During the first year of ownership, it appreciated 4%, or $3,600. During the second year of ownership, your home will appreciate on the appreciated value of $93,600. Over the years, the effect can be dramatic.

Leverage

The ability to use *leverage*, or OPM (other people's money) as it's commonly referred to, to secure valuable property is another factor that makes real estate such an attractive investment. In many cases, for little or sometimes even no money down, property can be secured that not only will likely appreciate in value—substantially—but also has the potential to generate a steady stream of income through rentals.

Archimedes said, "Give me a lever long enough, and a fulcrum strong enough, and I can move the world." Leverage is a method that allows you to control large assets (properties) with little or no money out of your own pocket. The following example illustrates the power of leverage, appreciation, and the compounding effect. We will take a $100,000 property and assume a 6% rate of inflation. The return of initial cash is expressed as a percent of the amount borrowed.

Property Value		**Amount Borrowed:**			
After:		0%	50%	75%	90%
		Return:			
1 Year	$106,000	6%	12%	24%	60%
5 Years	$133,820	79%	68%	135%	338%
10 Years	$179,000	79%	158%	316%	791%

To take advantage of leverage, you do not have to have high income or assets. You just need credit and the ability to correctly evaluate risks. Economist David Baxter highlights a distinct advantage of real estate as an investment: Monopolistic or oligopolistic power does not exist within real property markets. Property ownership, and especially home ownership, is widely distributed. So is the demand for ownership. While much has been made of the concentration of the developable land, and the supposed monopoly profits it entails, new building accounts for less than 3% of the total." In layman's terms, the small investor is on an even footing with larger investors. Real estate wealth based on capital appreciation is likely to continue, because investors are allowed to use and profit from the continuing availability of leverage, special opportunities common to real estate due to its highly open nature, the money making power of creativity in negotiations and financing, the purchase and sale of real estate, and the conversion of real estate from less efficient to more efficient uses.

Let's look at a ($100,000) real estate investment with only a 2.5% increase in inflation compounded yearly. You will see that it is still a good investment.

Property Value		**Amount Borrowed:**			
After:		0%	50%	75%	90%
		Return:			
1 Year	$102,500	2.5%	5%	10%	25%
5 Years	$110,381	10%	21%	42%	104%
10 Years	$124,886	25%	50%	100%	249%

The federal government is running on an annual deficit. It is only a matter of time before the government will run out of politically acceptable alternatives and start printing money like crazy. When that happens, even with collapsing oil prices, inflation will flare up. And when it does flare up, it is going to do so in a major way. The bottom line is that as long as the dollar's value continues to go down, people will continue to resort to real estate as a hedge against inflation. This will contribute significantly to future demand for real estate, and consequently, real estate prices will increase. If inflation is at 2%, at the end of one year, a $100,000 property (purchased with $10,000 down) will increase by $2,000, a 2% increase on the value of the property but a 20% increase on the cash down payment used to secure the property. This is an example of the power of leverage in helping you obtain financial independence. Leverage is the most important tool in your bag.

Leverage:

Makes your money work harder.
Makes compounding work in your favor.
Makes it possible to control a lot of money with a little money.

With the wise use of leverage, your money will work ten times harder than you can. Even if you have small sums to invest, you can increase your average annual return dramatically. Use as little of your own money as possible when buying real estate. You've probably been told that the more money you put down on a property, the lower the payments will be. But remember, the more you put down, the less your return on your investment when you resell. In addition, the more you put down on investment properties, the sooner you'll run out of your investment capital.

Compounding

If I were to hire you for 30 days and give you two methods of payment to choose from: $1,000 per day or one penny the first day and double your daily pay each day, which method would you opt for? The first option would pay you $30,000, not a bad take at all, but you’d be kicking yourself from here to Timbuktu, because the second option would’ve paid you $339,456,652.80. This is the effect of 100% compounding.

It would screw up the IDEAL acronym, making it IDEALC, but compounding is another one of the things that make real estate the ideal business. Applied to real estate, compounding is appreciation upon appreciation. At 4% annual appreciation, a $100,000 property would be worth $104,000 after the first year of ownership. If the property appreciates at 5% the following year, the property would be worth $109,200, because it appreciated on the already appreciated value. Needless to say, over an extended period of time, the effect of appreciation and compounding can be quite dramatic.

What does it take to be a successful real estate investor?

What you need to have and do in order to be successful at real estate investing can be summed up using the acronym STAMP, which stands for **S**pecialized knowledge, **T**ime, **A**ttitude, **M**oney (capital), and **P**rofessional tools.

Specialized knowledge

Most successful real estate investors are not geniuses. They are, however, adept at ferreting out good deals. In other words, they know good deals when they see them and also know where to find them, two critical keys to successful real estate investing. The ability to act (buy property on short notice) completes the circuit.

To be successful in any field, you must acquire specialized knowledge. Successful real estate investors didn't become successful overnight. They first had to acquire the requisite knowledge and skills, knowledge and skills you must acquire.

Time

"We haven't the time to take our time."—Eugène Ionesco

If you want to be successful investing in real estate, or any entrepreneurial endeavor for that matter, you must not waste time. Time and money are your two most valuable resources. Of the two, time is much more valuable. You can replace money, but you can't replace time. What makes real estate such an attractive field, besides all the money that's floating around out there, is that you can keep your current job and work on real estate during the day if you have a night job or during evening hours if you have a day job and on the weekends, which is when many real estate professionals put in the bulk of their time. Of course, it's going to take time away from your other activities, but the rewards will be well worth it.

Attitude

Anything new can be a little intimidating at first, but you can do this! Every day, people with no real estate background and no specialized knowledge make hefty profits buying and selling real estate. Imagine what you will be capable of accomplishing using the knowledge you'll possess.

While confidence is an essential attribute, cockiness isn't. The homeowners you'll be dealing with, literally, oftentimes are not in very good financial positions. (Feel free not to feel sorry for financial institutions that are trying to sell-off the property they own.) If you're in this business just to profit from other people's misfortune, chances are you won't go far. If you're in this business to help people out of jams and hopefully make a nice living doing it, that's a winning attitude.

Empathy and an unassuming manner, not haughtiness, is what will win people over. Strolling up to someone's door in a designer suit, wearing expensive jewelry, and driving a fancy car, will certainly make an impression—the wrong one. The message you're sending is that you enjoy flaunting wealth, not exactly what people in tough financial positions are apt to appreciate, and can afford to pay more than you're offering. By the same token, you don't want to waltz up to someone's house or meet with bank officials wearing a baseball cap, an old T-shirt, and equally old jeans. The message you're sending this time is that you can't afford to dress professionally and therefore cannot afford to buy houses. In other words, dress professionally, but don't overdo it.

Money

The amount of money generated by real estate is absolutely staggering. With so much money floating around out there, getting your "piece of the pie" shouldn't be a problem. That is, if you have some money to get started investing in real estate, good credit, or both. "It takes money to make money" didn't become a cliché for nothing.

Let's discuss credit worthiness for just a moment. People with less than stellar credit have achieved success investing in real estate, but poor credit certainly doesn't help matters. Using other people's money (leverage) is one of the keys to successful real estate investing, and if after pulling your credit report, the people you're asking to give you money come to the conclusion that you might have a problem paying it back, they're going to say thanks, but no thanks to your request for a loan. Due in large part to the Savings & Loan debacle of the 1980's, which we are still paying for and will for many years to come, investment capital is much harder to come by. Financial institutions have become so strict about lending money that most people who start their own businesses must do so by investing their own assets, money from friends and loved ones, or using credit cards to finance or partially finance their business ventures. (Later, you'll be shown helpful strategies for rehabilitating your credit.)

Sure, it's great if you have stellar credit and thousands of dollars in your bank account, but most people don't when they first get started investing in real estate. But that hasn't stopped many of them from achieving success—some are even millionaires. All it takes is that first successful investment property or turnaround sale (see: "flipping") to get that snowball started downhill.

Professional Tools

A carpenter without tools is someone who knows how to work with wood; a carpenter with tools can build things. While chimps, gorillas, and otters might beg to differ, the ability to use tools is what separates us humans from the rest of the animal kingdom crowd, and our real estate investing materials are the best in the business. Heck, a chimp could even make money buying and selling real estate using our materials and software. Well … almost. Seriously, though, no matter what business you're considering going into, you will need proper tools if you are to succeed. Here is a list of essential tools.

1. Capital

Capital is simply wealth used to create more wealth. Money is actually a tool, a tool that can be used to buy other tools (office equipment, software, books and instructional materials, etc.) and generate more money. One of the biggest challenges would-be entrepreneurs face is raising sufficient capital. Through real estate investing, there is the real possibility of becoming wealthy within five to ten years. But during this time, you will need money to support yourself and your family and capitalize (fund) your real estate investment activities. As previously mentioned, one of the most appealing aspects of real estate is that you can keep your "day job" and work on real estate in your spare time. In addition, a real estate investing concern requires far less capital than most business ventures.

2. A Small Business

There are many advantages to owning your own business, especially in the area tax reduction. It can also make it easier for you to obtain credit and project credibility to agents, other contacts, and vendors.

The first step in organizing a business is deciding how to structure it (sole proprietorship, partnership, corporation). A sole proprietorship, a business arrangement in which an individual and his or her company are deemed a single entity for tax and liability purposes, is the simplest way to structure a business. Let's take a closer look at two key words in the previous sentence: *tax* and *liability*. There are many advantages to owning a business. One of the most appealing characteristics of a small business is its tax sheltering capability. Many of the costs associated with starting and operating a business are <u>tax deductible</u>. When tax deductions exceed business income (see: "paper loss"), a tax shelter is created. Personal taxable income is reduced by the amount of the business loss. If you look at a 1040 tax form, you will see a space for business income or loss. One of the downsides to a sole proprietorship is personal liability exposure, a situation that can be remedied by a small business liability insurance policy.

Other options for structuring a business are a partnership or corporation, which are more complicated business entities. Starting out, a sole proprietorship is probably the way to go. For tax purposes and opening a business bank account, your Social Security Number can be used as your tax ID number. About all that's left to do is registering your fictitious name (the name of your business) and obtaining a city and/or county business license. Oh yeah, and making money!

3. Home office

You may already have a fully equipped home office, but if you don't, this is a good time to start thinking about setting one up. You'll need a computer with Internet access and e-mail capability), real estate and contract-preparation software (optional, but highly suggested), a printer, fax machine, and other items commonly found in most offices. Certainly, you can invest in real estate without using a computer, but this tool can make investing much simpler. In addition to helping you communicate infinitely more effectively, a computer can create professional looking correspondences, documents, and contracts; store a buyer's database and other important contacts and other critical information; help you analyze cash flow and project profits, and track target properties.

In order to conserve cash, time, and effort, you must be organized. A day-planner or electronic organizer may be just the ticket. There are also some really great software programs on the market that will help you get and stay organized. Stationery is another consideration. One of the best ways to project a professional image, a must for the real estate professional, is with professional looking business cards and letterhead.

Among items commonly found in most offices, a simple filing cabinet is one of the most useful. You must be able to locate important documents—sometimes in a hurry—making a filing cabinet and properly labeled folders (capable of handling legal size documents) a must. In the filing cabinet, filed in an organized manner, you will have legal forms, records of properties you have visited, rental studies, people who can assist you, articles concerning real estate, receipts for expenses, rental records etc. All of this information will be very useful to you and will assist you in your wealth-building endeavors. A fireproof container for your most important documents is another important consideration. Also, you should consider storing backup computer discs in a separate location.

4. Real estate contracts and other legal forms

You should have copies of all types of real estate contracts and legal forms you may need: agreements for purchase and sale, standard lease forms, small claims court forms, etc. You can buy them from most office supply or business stationery stores. (Some real estate brokers will even give them to you.) By having these forms available at all times, you will be able to take advantage of opportunities on short notice. Since the forms are standard, the seller and his/her/their legal representative will readily accept them. You should amend them to suit your needs and the particular purchase/situation (see: addendums), but all of the basic real estate forms are pretty much the same. You should also have relevant legislation for your state. Although you will probably be using a lawyer, there will be times when you will need an answer and a lawyer is unavailable. It is also good business to have some knowledge of the law affecting your business.

Hint: If you have a computer, printer, and contract-preparation software, you will find the task of preparing contracts far easier and much less time-consuming. Your contracts will also look more professional. Remember: Work smarter, not harder.

5. Amortization Table
This is a small, but powerful tool (book), which you will probably carry around with you often. In this book, you will find information you need to calculate mortgage payments, once you know the interest rate and the length of the amortization of the mortgage.

6. Real Estate Calculator
Invest in a real estate calculator. A basic real estate calculator is an inexpensive tool, one that will make your job much easier, eliminating the need for an amortization table.

7. Books/Instructional Materials
It's often been said, "Knowledge is power." Increasing your real estate knowledge will, in turn, increase your investing power. But you do not need a real estate license, and in fact, it is probably not in your best interest. As a licensed real estate agent, you must declare your interest as an agent when buying a property. The seller will wonder why a real estate agent is interested in buying his/her/their property. The owner will suspect that you have some special knowledge and may be reluctant to sell to you. You will make more money as an astute investor than most real estate agents ever make.

The best way to increase your knowledge, thereby increasing your investing power, is by taking a field trip to a large bookstore or by visiting a large online bookseller, like Amazon.com. Take your time browsing. Select books that specifically address *your* needs and wants and are best suited to helping you achieve *your* particular objectives and goals. Don't just stop at one book, though; buy several. Why not visit a library, you ask? That's not such a bad idea, but the selection will not be as complete as the selection found at larger bookstores or online booksellers, and the information will likely not be as current. You will also not be able to keep the books you checkout, limiting future reference and forcing you to make photocopies, that is, if you can find a copier that's actually working properly, which isn't being used by someone else. Why limit yourself to books a library thinks you'd like to read? Decide for yourself. Instead of visiting a library, start your own real estate investing library! A $100 or so investment in this area could pay huge dividends down the road. (Magazines are yet another source of practical information. Power-up by compiling a scrapbook of interesting and informative articles and stories you come across.)

Chapter 2. Goals and Planning

Planning is crucial because it turns desire into action, the key to success for any worthwhile endeavor. Webster's defines *planning* as "a means for the attainment of some object." Oftentimes, the difference between attaining an object and not attaining it is following through on a workable plan. What object or objects do you wish to attain? Most of us have dreamed about being wealthy, going on exotic vacations every year, living in a large house, driving a fancy sports car, having thousands of dollars in our bank accounts to do with as we choose, etc. Maybe you just want to make a good living working for yourself, spend more time with your family, or send your kids to college. Maybe one of your goals is becoming debt free and then building wealth. Perhaps you'd like to augment income from your present job or start a new career after retirement. Maybe you'd simply like to become a more informed consumer and get an awesome deal on your next home. These are all examples of goals. What are your goals? In order to plan effectively, it's imperative that you <u>set goals</u> and <u>write them down</u>. It would be hard to overstate the importance of setting goals and writing them down.

Once you've set a goal and written it down, the next thing to do is set a date for attaining it, a deadline if you will, which will create a sense of urgency: *I will secure my first investment property <u>within six months</u>*. The next step is making a list of action steps related to attaining your goal. These action steps will, in turn, have action-steps, and some of them may even have action-steps. Since there are some really good deals in the FSBO (For Sale By Owner) market, let's use it for a couple examples.

<u>Action</u> Steps:

1. Make list of available "For Sale By Owner" properties within a ___mile radius.

A) Drive around looking for "For Sale By Owner" signs in yards.

a) Get a clipboard & pen. b) Make information sheets. c) Obtain a city street map.

B) Take down addresses and phone numbers. List properties on map.

2. Pare down FSBO list

A) Call homeowners, and ask pertinent questions.

a) Make a list of pertinent questions in order to determine if property is ideal real estate investment candidate: 3-bedroom/2-bath home in need of minor repairs/cosmetic enhancements, located in nice neighborhood and priced below (minimum 10% below) fair market value. How many bedrooms and bathrooms are there? What else can you tell me about the property? How much work is needed? What is the asking price? How did you arrive at that price? How flexible is your asking price?

B) Trim list (based on initial conversations with homeowners).

C) Visit properties.

a) Get clipboard, pen, and flashlight. b) Make property inspection sheets. c) Take a good look around, and take good notes during initial visits.

D) Trim list (based on initial visits).

E) Have ideal investment property inspected by a professional home inspector.

a) Find property inspection expert. b) Ask real estate agent or broker for referral.
Action steps related to your goals are so named for a reason: You must take action if you are to attain your goals. It would wise to also add a timed element to your action steps and action steps related to your action steps.

Goals and *objectives* are terms that are often used interchangeably, but it would help if you think of goals as long-term and objectives as short-term. Rehabilitating your credit is an objective. Increasing your existing credit limits is an objective. Learning as much as possible about real estate investing program is an objective. In some cases, though, goals and objectives overlap. Buying your first investment property can be both an objective and a goal. Buying your next investment property, on the other hand, would be an objective. Attained objectives and goals have been described as milestones to success, but they are really milestones *of* success. What's the difference? Have you ever heard the saying, "Success isn't a destination, but rather a journey"? That's the difference. Keep in mind that objectives, like goals, require action steps. For example, a number of action steps are required to rehabilitate challenged credit, steps outlined in an upcoming section.

While it seems to give many people fits, planning is a fairly simple process. The reason many people, even organized people, get hung-up on planning is that they fail to write down their goals, objectives, and action steps related to their goals and objectives. One of the biggest differences between people who are successful and those who aspire to be is something ever*yone* can do. Successful people write down their goals & objectives and plan accordingly (see: action steps). Writing down your goals validates them, giving you something concrete to shoot for, making you more target-oriented. The game of golf provides a great example of target-orientation in action. You don't just put the ball down and swing away—well, some golfers seem to, but that isn't exactly the way the game is supposed to be played, not to mention potentially dangerous. The object is to execute, to the best of your ability, shots that will get you closer to your intended targets and eventually in the hole. Before each shot they take, professional golfers select a target and then visualize the type of shot they want to play. The process of seeing in your mind's eye where you want to go and how you're going to get there is known as *visualization*, one of the keys to superior athletic and business performance. Once you determine where you want to go and how you're going to get there, all that's left to do is execute (take action). If you don't know where you're going, or you don't know how to get to wherever it is you'd like to go, you're basically lost. The following quote from Laurence J. Peter, educator, author, and management theorist, sums up nicely the importance of setting goals: "If you don't know where you're going, you'll probably end up somewhere else."

To plan effectively, you must:

1. Set goals and objectives related to attaining your goals.
2. Write them down.
3. Give your objectives and goals a timed element (deadline).
4. List action-steps for achieving your objectives and attaining your goals.

Set goals. Write them down. And take action!
A simple, yet very powerful, formula for success

Desire and commitment are terms that are often used interchangeably, but there are fundamental differences. Desire sets goals; commitment attains them. To be successful, you must want to be successful, and you must take action, which you did by choosing our real estate investing program. Way to go! But if you want to be successful, you're going to have to get it in gear. If you've already got it in gear, shift gears!

Before moving along to our next topic, it should be pointed out that goals should be lofty, yet realistic. Buying your first investment property is a lofty goal (many people who consider investing in real estate as a business never get to this point), yet a very realistic one. Nike hit the nail on the head years ago with one of the most effective advertising slogans of all time: *Just do it!* Once you attain your goals, it's time to set new ones. If you've just purchased your first investment property, go for number two!

Goal/Objective Sheet

Goal/Objective (be specific): ____

____

____

____

Deadline: ____

<u>Action</u> Steps:

1. ____

____

____

2. ____

____

____

3. ____

____

____

4. ____

____

____

5. ____

____

____

If you are truly going to become a master of real estate investing, you must dedicate a specific amount of time to investing each week—perhaps every Saturday morning or some weekday evening. The investment in time will pay off handsomely in the long run.

Make the commitment now to improve your financial future!

Exercise:

In the space provided, commit to a specific amount of time per day or week to work just on real estate investing. The more time you can set aside, the faster you'll secure your first investment property.

____

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Now *go for it!*

Success Strategies

"If we all did the things we are capable of doing, we would literally astound ourselves."
—Thomas Edison

So, you'd like to start a business, but you have very little capital. This is one of the most common problems would-be entrepreneurs must address. Another common problem for would-be entrepreneurs is deciding which business to go into, a problem you've already addressed. Since you've already decided which wealth-building strategy to go with, let's move on to the next step: funding your business. How do you go about starting a business with very little capital? It's simple: You plan how you are going to create wealth—in this case, by investing in real estate—and how you are going to meet your capital requirements. Once you have adequate capital, you move on to the third step, which is investing your capital. Then, you let appreciation, compounding, and rental income (if income-producing properties are part of your investment strategy) work in your favor as your real estate investments create wealth for you. There is an old adage related to real estate investing: *Do not wait to invest. Invest; then wait*. This is a direct reference to the power of AC: appreciation and compounding.

Capital

"Average people, people able to raise five to ten thousand dollars, have it within their power to become millionaires." —Marvin Naiman

How much capital do you really need in order to start a real estate investing company? Fortunately, the answer is very little. Sure, it would be great if you had fifty or a hundred thousand dollars to invest in real estate, which would prove especially helpful in the foreclosure market, but one of the best things about real estate investing as a business is that you don't have to expose a large portion of your own money to risk. You can use other people's money (borrowed funds) to make *you* money: Leverage. Most real estate investors didn't have tens of thousands of dollars (the minimum amount of capital most other start-up businesses require) when they started building wealth by investing in real property. They got the ball rolling with their first successful deal and used the profits to fund more real estate purchases.

There's nothing wrong with paying yourself from proceeds derived from your business; however, it would be wise to keep in mind that money you take out of your business is no longer available to make you more money. It sounds simple, but many people seem to lose sight of this capital-saving strategy once the money starts rolling in.

Follow through

Oftentimes, what will determine success or failure is whether or not a viable plan is followed through on. To put it another way, you must have a plan, <u>take action</u> based on your plan, and continue taking action. A short time ago, you were provided with a simple plan for starting a small business: Decide which business to go into (real estate investing); fund your business (real estate investment company); invest your capital (buy and sell/rent properties). The goal is rather obvious: growing your business and your bank account. The first step of this simple, 3-step plan is the easiest. The second and third steps are much more challenging, as they require not only considerable effort (and some money to work with), but follow through as well. Whether or not you become a successful real estate investor will largely be determined by whether or not you are willing and able to follow through on this simple plan by securing your first investment property. Unfortunately, there are few guarantees in life. Following through on a viable business plan will not guarantee your success. It does, however, make you eligible.

"The greatest results in life are usually attained by simple means and the exercise of ordinary qualities."—Owen Feltham

There is likely very little to differentiate you from those who've built substantial wealth investing in real estate. You're probably just as intelligent, if not more so. You likely have as much or more common sense. And you probably have as much or more time and money to invest in entrepreneurial pursuits as many of them had when they first started investing in real estate. What differentiates you from those who are making money right now buying and selling real estate is that they followed through on a plan that brought them to where they are today, and you haven't done that yet. You can either follow through or not follow through on your plan to build wealth investing in real property. The choice is yours.

What does it take to follow through on a wealth-building plan? One word: Commitment. Desire, in and of itself, isn't enough. For example, you may really want to get in shape, but if you don't exercise on a regular basis, it's not going to happen. You must take action and continue taking action. It could be argued, though, that those who want something bad enough will do whatever it takes to get it, a point that would be difficult to debate. Motivation is arguably the most important element of success. Without motivation, all of the information contained in this manual or any other real estate investing material isn't worth a nickel.

What is *commitment*? That's a very good question. Three words, all of which happen to begin with the letter P (defined below) are what commitment is all about:
Persistence, **P**erseverance, and **P**atience.

Persistence: refusing to give up or let go.
Perseverance: persistence in adhering to a course of action (steadfastness).
Patience: calmly awaiting an outcome or result; not hasty or impulsive.
(Source: Dictionary.com)

"A journey of a thousand miles must begin with a single step."—Chinese proverb

Persistence and perseverance, although often used interchangeably, do not mean the same thing. *Persistence* is the act of refusing to give up or let go; *perseverance* relates to how long or how short a period of time one refuses to give up or let go (adheres to a course of action), which is a very important distinction. You can be persistent, but lack perseverance. Perseverance requires *patience*, the ability or willingness to tolerate delay. Rome wasn't built in a day, and the same holds true for building wealth.

Not coincidentally, people who lack persistence, perseverance, and patience tend to make poor entrepreneurs, especially those who lack persistence and perseverance. Few things can beat working for yourself and the satisfaction of watching your business grow, but there will be setbacks along the way. Persistence, perseverance, and patience will help you overcome many obstacles; however, without technical and practical moneymaking knowledge, one can work hard and still be unproductive. The objective of our program is to provide both the stimulus and the means to succeed in real estate investing. If you want to be successful, are committed to being successful, and know how to be successful, success is simply a byproduct. But you must have a plan and follow through on your plan (take action and continue taking action for as long as it takes to get to wherever it is you want to go).

"You have to dream."—Conrad Hilton

Planning is said to be a dream with the addition of action. If you do not dream big, you likely will not achieve much. Unless you can visualize whatever it is you would like to attain, you cannot attain it. Project your financial future.

If you were leaving for a long trip to somewhere you'd never been before, one of the first things you'd probably do is get a map. Think of wealth-building similarly. You need a map (plan) that will guide you from Point-A (where you are now) to Point B (where you'd like to be). Guess what. You have the map. It's right here in front of you! Once you arrive at Point-B, which then becomes Point-A, it's time for another Point-B. If your current Point-A is a financial nightmare and Point-B is financial freedom, you have your work cut out for you, but at least you know where you're going!

Think of this manual as your map to financial freedom through real estate investing. There will be many twists and turns in the road, perhaps even a few potholes along the way, but if you keep putting one foot in front of the other, you'll eventually get to wherever it is you wish to be. In preparing for your journey from Point-A to point-B, remember to map out waypoints—literally, points along the way: your first investment property, your tenth investment property, $20,00 in your bank account, etc.). Don't forget to include in your plan ETAs (estimated times of arrival) for arriving at Point-B and waypoints in between.

You probably realize that we've made our way back to the topic of goal setting. Point-B is simply your long-term goal and the waypoints in between are your objectives (short-term goals). You must set goals and objectives related to attaining your goals, write them down, plan, <u>take action</u>, and follow through by securing your first investment property.

Do you have what it takes to be a Millionaire?

After 40 years of hard work, only 1 of out of 100 people is really rich, and 44% are broke. To avoid a similar fate, set 10% of your gross earnings aside for investment purposes. Do not spend it; it is for investing only. Put this money to work for you. Speaking of putting your money to work, your capital must work as hard or harder than you work for yourself. Whether your income is $25,000 or $50,000 or more, the 10% rule can still be applied and help you work toward financial independence. Some financial experts suggest simply saving 10% of your gross income, which is better than not saving it, but it would be far better to put that money to work for you generating more money. With so many investments taking beatings in recent times, beatings that only seem to be getting worse, real estate has become an even more attractive investment vehicle.

Your primary concern related to growing your net worth should be <u>return on equity</u>, the return you get from investing whatever dollars you have available for investment purposes. Real estate is a very solid investment, because historically it has not only increased in value as quickly as inflation, but has on average increased in value more than the rate of inflation. It is therefore a good hedge against inflation, helping you maintain or increase your standard of living by maintaining or increasing your money's buying power. The federal government is running an annual deficit.

Real estate will also continue to go up in value because of high interest rates, as well as deficit financing and the increased printing of money. In addition, although some planning is necessary in the housing market, red tape delays in approving new subdivisions, lot levies, and financing costs involved in bringing raw land to the building stage will constantly cause a cost increase for individual lots. In turn, this leads to an increase in the cost of new housing, which filters down to the resale housing market. Increased labor and material costs contribute significantly to the cost of new housing and "the Three R's," which in this case are **R**epairs, **R**eplacements, and **R**enovations.

At the risk of drifting slightly off topic, it would be wise to keep the Three R's in mind when evaluating a potential investment property. It will help keep you organized and help keep you from missing something. If you are seriously considering submitting an offer, have the property inspected by an <u>expert</u>.

What needs to be **repaired**? (Ask your property inspector.)
What needs to be **replaced**? (Ask your property inspector.)
What should be **renovated**? (Ask your property inspector.)
And <u>how much is it going to cost</u>? (Ask your property inspector.)

The Three R's fall into to the broad category of "improvements," changes or additions that improve property, thus <u>increasing its value</u>. "Renovation" has somewhat of a pricey connotation; however, the Latin translation is simply *to make new again*, as in *new* paint or *new* carpet. Indeed, it would prove costly to make an entire house "new again;" however, you do not need to completely renovate a property to significantly increase its value. You must constantly guard against the urge to overimprove (invest more money in a property than you can reasonably expect to recoup when sold). Webster's uses three key words, which also begin with the letter R, in its definition for *renovate*: "renew," "refresh," "reinvigorate." There's nothing in Webster's definition about spending a fortune. Stick with necessary (cosmetic and functional) improvements, making sure everything looks good and is in good working order.

Advantages to Investing in Real Estate

1. Cash flow

One of the most appealing aspects of real estate investing is incoming cash flow from income-producing (rental) properties. One of the downsides to real estate as an investment is a lack of *liquidity* (you have to find a buyer before you can sell your house), the ability to quickly convert an asset into cash or cash equivalent. However, rental income creates a steady (monthly) stream of incoming cash, as long as a property is occupied and rent is being paid on time. Let's say that a property you own is bringing in $175 a month net rental income. That's more than $2,000 a year, and someone else is paying the cost of the mortgage, taxes, and insurance, while the property likely appreciates substantially, bringing us to our next real estate advantage.

2. Hedge against inflation

While there are divergent viewpoints regarding what causes *inflation*, a persistent rise in the prices consumers pay for goods & services, the consensus is that it's here to stay. Inflation is measured using the CPI (Consumer Price Index), often referred to as the cost of living index, which uses changes in the prices of over 400 products in 50 cities across the United States as a gauge. As the CPI rises, as it tends to do (regularly), the purchasing power of the dollar falls. As long as inflation eats up the purchasing power of the dollar, people will continue to invest in real estate as a hedge against inflation, adding to the future demand for property, therefore causing real estate prices to increase. Money does not disappear; it just flows toward the area of greater attractiveness.

The best defense against inflation is a good offense: real estate. Obviously, the prices of all consumer products don't rise (or fall) at the same rate. Real estate continually outperforms the CPI, keeping owners of real property ahead of the game so to speak. Bear in mind, though, that staying ahead of inflation, while preserving the purchasing power of your money, isn't exactly going to make you wealthy. That's the job of appreciation, priority #1 for the real estate investor.

3. Equity buildup

Over time, as mortgage payments are made, inflation increases, and appreciation and compounding work their magic, substantial equity can build in a property. There are, however, quicker ways to increase the value of a property than simply the passing of time, thus increasing the profit margin when it comes time to sell. Basic property improvements: fresh paint, new carpet, general cleanup, lawn work, minor repairs, etc. force equity buildup and increase profit margins. Forced equity buildup is commonly referred to as "sweat equity," since the increase in value often comes from manual labor.

4. Tax breaks

As mentioned previously, real estate provides effective tax breaks for many Americans. The interest portion of mortgage payments is tax deductible, a big inventive to buy rather than rent. There are a number of other tax-sheltering advantages for the real estate investor, most notably *depreciation*, a loss in value of business or income-producing property over time, which helps the owners of rental property save money at tax time.

Rental income produces substantial periodical payments for use, increasing the net worth of owners of income-producing property. Caution: If an individual is found to be in the business of buying and selling real estate, then the increase is not a capital gain, but income, and is fully taxable. That said, investing in real estate provides you with a great business opportunity, and many of the costs associated with running a business are also tax deductible, saving you additional money at tax time.

Credit Rehabilitation

Good credit is a major plus for the real estate investor. Below you will find contact information for the three major credit reporting agencies. When it comes to rehabilitating your credit, you must be thorough and aggressive. It's easy to become frustrated, but remember that the people you'll be speaking with at the credit reporting agencies did not put inaccurate or derogatory information on your credit report; other parties did. Getting upset and yelling will not get results any quicker; it will only raise your blood pressure.

Pull your credit report from each of the three major credit reporting agencies (Equifax, Trans Union, and Experian) and pull out all the stops trying to get inaccurate, derogatory information removed. **Do not assume that the information on your credit reports is accurate**.

Equifax
P.O. Box 740256
Atlanta, GA 30374
1-800-685-1111
www.equifax.com

TransUnion
PO Box 2000
Chester, PA 19022
1-800-888-4213
www.tuc.com

Experian (formerly TRW)
PO Box 949
Allen, TX 75013
1-888-397-3742
www.experian.com

Before speaking with a representative from one of the credit reporting agencies, you must first have a copy of your credit report. You can obtain copies of your credit reports by calling the credit reporting agencies' toll-free numbers, which can be a thoroughly frustrating experience (speaking with a human being doesn't seem to be an option), sending request letters, requesting your credit reports via their web sites, or using an online company that specializes in obtaining credit reports. One such company is Creditreport.com. It's more expensive than ordering directly from the source, but the savings in time (and aggravation) may be worth the extra cost. The Internet can be a valuable resource for rehabilitating your credit. Enter the key words *credit report* into a search engine, and that should do the trick. There is a lot of good, free credit information on the Web.

If you have been denied credit, insurance, or employment, or are currently unemployed, on welfare, or think you may be a victim of fraud, you may be entitled to a free copy of your credit report. If you are not entitled to a free report, the credit reporting agencies will provide you with a copy for a nominal fee. Once you have a copy of your credit report, you should immediately get started disputing inaccurate information. While you can launch an investigation by explaining over the phone the information you wish to dispute, resist the urge and take the time to put it in writing. Make your dispute letters brief and to the point, giving logical and compelling reasons why a particular entry or entries should be amended or deleted. Your credit reports will list contact information for each of your creditors. Try working thinks out. It may prove well worth the effort.

Your dispute letters should contain the following information: the date, your name, mailing address, telephone number, social security number, credit report number, date of birth, name of the party whose information you're disputing, the reason or reasons you're disputing the information (with documentation if possible), and the changes you'd like made to your credit. You should receive a response within 30 days. If you do not receive a response within 30 days, send another letter (attach a copy of your original dispute letter) stating that since you did not receive a response within 30 days, the disputed information should be amended or deleted from your credit report. You may also request that a brief written statement (your side of the story) be added to your credit report.

If a dispute letter does not achieve the desired outcome, ask a representative at the credit reporting agency what your options are, and be prepared to take your dispute to the next level if need be: small claims court, consumer reporters (most companies hate bad publicity), state agencies, and consumer advocacy groups. Don't be intimidated. Go on the offensive. After all, it's *your* credit!

One of the best ways to improve your credit is by asking for secured credit cards and retail store cards. The purpose of requesting these credit cards is not to get into more debt! Do not even consider running up substantial charges or being late paying. If you're not prepared to be a model cardholder, do not attempt this rehabilitation strategy. A record of paying on time will go along way toward rehabbing your credit. Make sure that this positive credit information, and any other positive information that should be part of your credit report but isn't, is included on your credit report. If you have derogatory information on your credit report, positive entries will start balancing things out.

Once you become a property management pro, you will be way ahead of the rest of the field and well on the road to wealth. Talk to real estate professionals, and get their input. Ask property managers for advice. Landlord associations are excellent places to obtain information. You should seriously consider joining. There are also a number of property management books. Consider adding one to your real estate investing library. Above all, do not be afraid to manage your own property. A little common sense is all that's required. By the same token, don't be afraid to seek professional property management services if the task of managing your properties has become overwhelming.

Chapter 3: Areas You Must Master

The Real Estate Market

To get a feel for property values, go out into the market, and checkout properties. Go to open houses. Talk to real estate agents and brokers. Obtain surveys of areas. Read the newspaper. Make offers. (No matter the results of your first few offers, remember that you are gaining knowledge and valuable experience). Speaking of experience, experience is more important than a large bank account. With the proper knowledge and experience, nothing can stop you from becoming a successful real estate investor.

The Rental Market

Even if you have no plans to be a tenant or landlord, you should still know how much rent you could charge for properties you're interested in acquiring, knowledge that will help you decide whether or not a particular property is a good buy. Whether or not a property is a good investment depends to a large degree on the rent it can command and the expenses associated with renting it. If you do not know have a clear idea regarding how much a particular property should rent for, you lack critical information for determining how much you should pay for the property. How are you going to obtain this knowledge? Look at rental advertisements in the newspaper for areas in which you're considering investing. In addition, you must go to the properties and inspect them. Check out the area in which they are located. Find out as much as you can about each area. How close are schools and shopping? Is the area improving or decaying? Look at as many properties as possible. What are their conditions? What is included in the rent? Washers & dryers? Utilities? Ask your real estate agent for rental rates in the area. Talk to property managers who are looking after properties in the area.

Property Management

While you may only be interested in buying property at a substantial discount, fixing it up, and selling it as quickly as possible, you should still try to learn all you can about property management, knowledge that may come in handy in the future.

When you first start out, it is probably a good idea for you to manage your own property. It will save you money, at a time when saving money is crucially important, and it will also teach you much about the new business you are engaged in, including how to know whether or not property managers you hire are competent and the importance/priority of suggested repairs. Once you have accumulated several properties, it's wise to consider professional property management. At this point, your time would be better spent on other tasks, securing additional properties, for example. A smaller property management company may be the best choice. The larger ones are usually staffed by hourly employees and have so many properties to look after that yours might become neglected. Murphy's Law definitely applies to property management. If something can go wrong, it usually will go wrong, usually outside normal business hours.

Many people balk at investing in real estate and renting it out because they are apprehensive about dealing with difficult tenants, nonpayment and collection problems, and other property management issues. Many landlords bring these problems upon themselves by not checking potential tenants out thoroughly enough. There are companies out there that will conduct tenant background checks for you, helping you avoid one of the most common problems landlords face: deadbeat tenants. A meaningful security deposit, one that a tenant(s) would not want to walk away from, first and last month's rent in advance, and late-payment fees are other ways to limit potential problems, that and being receptive to the needs of tenants and taking care of legitimate problems as quickly as possible. Good will is another thing that can foster a positive landlord/tenant situation. Just because you have a late-payment fee provision in your lease/rental agreements, doesn't mean that you have to enforce it every time someone is late paying rent. Of course, you can't let people walk all over you, but a little good will can go a long way.

Caution: All rental/lease agreements should be <u>in writing</u>.

The landlord/tenant relationship is a two-way street. If both parties do what's expected of them, there should be few problems, making the fear of renting-out property largely an irrational one. But if you still don't want to deal with property management issues, or if your rental property is located in another city or state, there is certainly the option of paying someone to manage property for you. Of course, that will cut into your profits, but it can also save you much time and effort, not to mention headaches. Just make sure that you do your homework and find a dependable property management company, one that charges reasonable fees for competent work.

The following are strategies for helping you manage property effectively.

1. Select the right tenant. Go overboard to qualify tenants. Do your homework, and conduct background checks on all prospective tenants (or have background checks performed by an outside agency). Unfortunately, many property owners have experienced damaged property, recurring late payments, difficulty evicting tenants, and the threat of physical harm, situations that thorough background checks help avoid. The best way to deal with tenant problems is not to let them happen in the first place.

2. Play the numbers game. Make sure you have multiple applicants. Select one out of your group of applicants, not the first person who happens to come to you with money. If you don't have the applicants, spend time cultivating a market.

3. Create strong leases/rental agreements. Don't be taken advantage of by tenants. After all, it's *your* property, not theirs. They are just borrowing it for a while. Draw clear lines of acceptable behavior and rules, perhaps even establishing penalties if they step over the line. Keep you tenants in tow.

4. Maintain control of the cash and security. Security deposits are <u>mandatory</u>. In fact, ask for a security deposit and first month's rent and last month's rent upfront. The more money you collect, the better. Obviously, you need to be competitive in the rental marketplace, but deposits ensure payment and repair of damaged property or at least some of it. Also, immediate follow-up on late rent payments are a must. Give a few days leeway, but no more. Offer an incentive for paying early or a discount for regular, on time payments.

5. Invest the time and effort required to keep good tenants. Reward them with a discount or a party. Build the relationship.

6. Get help if you need it. A professional property management company can be a great help if you have several or more rental properties, especially properties in other cities or states, and can afford the cost.

7. Use lease option contracts to make the tenant responsible for the property. Pride of ownership will make costly property damage a far less likely scenario.

8. Evict when necessary. The eviction process takes three weeks to three months. Every state has different rules. Make sure you know the regulations in your area. Even if you like the tenant(s), begin the process at the intervals specified by law. After all, this is business.

If tenants are selected carefully, it will probably never be necessary for you to evict one. The secret is to interview a large number of prospective tenants, and select only those who checkout okay. You will turn down about six applicants for every one you select. If there is any doubt, reject that candidate. If you become desperate, the likelihood of your making bad decisions increases, thus increasing exponentially the likelihood of having to deal with a bad tenant. If you are having difficulty in obtaining sufficient numbers of applicants, consider the following.

1) You may not be spending enough money on advertising. A small “For Rent” sign is not enough. Make sure that your ads are eye-catching and in the right newspaper/publication. This is no place to try to economize. You must advertise in all major and college newspapers, at local community colleges and universities, and list with rental agencies. Try this strategy: Put your ad in for Wednesday, Friday or Saturday. Give details of the property: location, rent, and date & time of open house. No phone number. Make sure you ask market rent for the unit or just a little less

2) Your property may be priced above what the rental market in your area will bear. Consider asking slightly less. If anyone should rent an inferior unit from you at an inflated rent, it will be someone whom no one else will accept as a tenant. During a group show, ask different questions to justify if that client will qualify to rent. Build a list of renters.

3) The telephone number people are calling may be wrong. Always check you ads for accuracy. Perhaps people are trying to call, but the number is busy. Not good. If you or someone else can’t field calls personally, make sure callers can leave a message. Always ask callers to leave the best time for you to return their calls, and return their calls promptly. You should seriously consider hiring someone to answer the phone for you, freeing you up for more important tasks and possibly saving you from a nervous breakdown.

4) You may simply not be showing the property enough times, which calls into question the effectiveness of your advertising. You can save yourself the trouble of many trips back and forth to rental properties by organizing group showings (showing a property to several prospective tenants at the same time), a strategy we touched on earlier. Why make

many trips to a property when several will suffice? Avoid unnecessary stress. Group showings are like an Open House. The only difference is that you're renting the property, not selling it, or are you? You can instill pride of ownership (the desire to keep your property in good condition) in your tenants by offering purchase options. Properly structured, purchase options can be effective moneymakers. Most of the time, purchase options are not exercised. If a purchase option isn't exercised, the homeowner can then pocket the money that was accumulating for a future down payment. Options are not free; they must be paid for. Let's say that rent on a particular property is $900, $100 of which is going toward a future down payment on the property. An extra $100 a month is pretty good. The money forfeited by tenants when a purchase option isn't exercised is the cost of the option. What if the option is exercised? This is where you have to be careful. You must structure a deal that will be favorable three years down the road if that's the length of the option. If you offer a purchase option, you would be wise to include future appreciation into the purchase price agreed upon at the inception of the option agreement.

5) Your property may be in need of repairs or just some cosmetic work to increase its showing power. If the unit needs cleaning or cosmetic touchup then do it. If you want good tenants you do not want people who are satisfied to live in a dump. If it is too bad, they may not even stop to inspect the interior. It's better to decorate the property so that it shows well, and have many tenants attend at one time so they know they are competing for the unit. This also allows you to practice conservation of time. Again, this involves your ability to stay in emotionally if the unit needs redecorating or cleaning, then spend the time and money to do this. It will pay big dividends.

How to select good tenants

If you do not feel good about a prospect tenant(s), even after he/she/they have filled out an application, then do not rent to that person or persons. Just make sure that your reasoning behind turning down him/her/them is in line with state and federal housing laws. It is better to keep out a bad tenant than to lose an occasional good tenant because of strict application guidelines. If you are charging reasonable rent and your unit is clean, don't worry if you don't secure a good tenant today. You will soon get a dozen new rental applications. All you have to do is advertise effectively. As long as your pool of potential tenants is sufficiently large, there should be fairly smooth sailing.

Always check a prospective tenant's references. If he/she/they lie, they're out of consideration. Settle for only the very best tenants. And once they're in, do everything within your power to meet their needs. They deserve it. After all, they're the ones who are going to make you wealthy!

Take your time selecting tenants. Don't be in such a big hurry that you go against your better judgment. It is always better to have one month's vacancy than a tenant who is not paying rent and/or damaging your property. The type of tenants no one wants will often show at the end of the month, because they know they have a chance of renting the unit for the coming month. These people always seem to have believable reasons (unless you’ve heard them a hundred times) why they are unable to pay rent when requested. Six months later, when you have finally been successful evicting one of them, he/she/they will just look for another sucker landlord to take advantage of. This problem must be nipped in the bud: the tenant selection process.

Always obtain full details from prospect tenants, and confirm these details. Do just accept someone’s word, no matter how nice he or she may seem. Nice doesn’t pay the rent. Cut deadbeats off at the pass by gathering as much information as possible and checking it out thoroughly. Always have rental applications with you, and have them filled out while you conduct interviews. Obtain the current and prior landlords' names and addresses. The current landlord might not be completely forthright in his or her answers, because he or she may be trying to get rid of a problem tenant. The prior landlord is not in the same position and is therefore more likely to be honest with you. Remember, when checking out tenant references, if there are any serious inconsistencies (see: lies), look for another prospective tenant. If any item does not checkout, ask about it. If the prospect says that he or she does not have to answer that question, remember that you are under no obligation to rent. If your intuition tells you not to rent to someone, listen. If there are any doubts, turn applicants down.

Here is a nifty tactic designed to ensure that tenants pay rent on time. If the normal rent is $500 per month, ask for $550, and then give a $50 discount provided that the tenants pay on or before the first of the month. (Any future rent increases will be based on a starting figure of $550 and not on $500.) Or you could tell them you want to see how the first six months go, and then offer the rebate. Ask for and get first and last months rent. Cash the certified checks as soon as possible. Put in a right to inspect the property from time to time. Have the tenants pay for utilities and to cut the lawn and remove snow and ice. Have a clause requiring the tenants to promptly notify you of any major problems with plumbing or heating. Do not allow painting or decorating without permission. You supply the paint, even if the tenant does the painting.

Tenant Application (must be in writing)

<u>Key information</u>:

• Name, current address, and phone numbers (work & home) of prospective tenants
• Present and prior landlord (the latter being the key to accurate information)
• Rent
• Length of tenancy
• Current employer, salary, position, length of service (Check information with employer.)
• Spouse and children (names of <u>all</u> people who will be residing at property)
• Credit and banking references (Be sure to check this out.)
• Tag number(s) and driver's license number(s) (helpful for tracking down deadbeats)
• Personal references
• Social Security number(s)
• Written permission to check credit (Actually look at current residence.)
• Signature verifying information is accurate

Handling tenant concerns

Handling tenant concerns in a timely manner is one of the keys to a positive landlord/tenant relationship. Keep tenants apprised of all repair work and notify every time it is necessary to turn off utilities in order to have repair work done.

The 8 most urgent complaints from tenants

Complaint #1 "There's no heat."
Solution: If the house is heated with oil, have the tenant check to see if there is oil in the tank. If the tank is empty, the tenant should call the service company to deliver more oil. If the house is heated with gas, perhaps the pilot light has gone out. Since the tenant has been taught how to relight it (hint hint), have him or her do so. Another possibility is that the tenant hasn't paid his bills. In this case, he will have to organize a cash payment with the gas company so that it will turn the gas back on.

Complaint #2 "Half of the lights are out."
Solution: Whether the house uses fuses or circuit breakers, have the tenant remove the plugged-in appliances that seemed to cause the problem in the first place. If fuses are in use, have the tenant check to see if any of the fuses are black in the back. If so, replace the fuse with one that the tenant has already been told to always have on hand. If the house uses circuit breakers, have the tenant check to see if any of the circuits have been tripped. If so, have the tenant push it all the way off and then back to on.

Complaint #3 "There's no hot water."
Solution: If the system is gas, have the tenant check to see of the pilot light for the water heater has gone out. If so, have him or her relight it the way you taught him/her when he/she first moved in. If the system is run by electricity, have the tenant check to see if a fuse has been blown or circuit breaker tripped. If so, have the tenant either replace the fuse or flip the circuit breaker back to the on-position (after flipping it all the way to off). Another possibility is that too many people are taking baths and showers for the capacity of the water heater. If there still isn't enough hot water, order a higher capacity heater. Since more hot water is required than is being produced, have the tenant turn the setting higher on the water heater.

Complaint #4 "There's no running water."
Solution: This usually only happens when it's particularly cold outside. Have the tenant open up the doors below the kitchen sink in order to let the warm air from the house heat the pipes. Then tell him or her to take a space heater into the basement, put it close to the pipes running into the kitchen sink, and let it run for an hour or so. This will melt the ice in the pipes, and water flow should resume.

Complaint #5 "Some rooms are cold all the time."
Solution: First, have the tenant check to make sure that all of the louvers are open on all of the heat registers if it's a forced-air system. While looking for that, have tenant check to

see if there are any objects stuck in the ductwork, by actually lifting the register out. If radiators heat the house, tell the tenant to make sure that the main valve of that room's radiator is turned fully open. Also, have him or her check to see that all air has been let out of the radiator by opening the small valve at the top. Next, have the tenant check the filter on the furnace. If it's dirty, he/she should replace it with one of the filters you instructed him/her to have on hand. While in the basement, the tenant should check the levers on the ducts from the furnace that heats that particular room. This is only true for a forced-air system. If the lever is turned so that the duct is closed, have the tenant open it. If all else fails, either have the tenant buy a space heater for that particular room or provide one.

Complaint #6 “I'm locked out of the house."
<u>Solution</u>: Suggest that the tenant leave a key with a trusted neighbor. The tenant could also consider hiding a key somewhere on the property. If neither of these options is available, then have the tenant come to you (if possible). Do not make a special trip out to the property unless it is absolutely necessary. You should have an extra key to the property at your place to lend tenants. (Consider adding a section to your lease agreement that covers this scenario, including a charge for coming out.)

Complaint #7 "Our toilet is broken."
<u>Solution</u>: First, tell the tenant not to flush the toilet again. Then, tell him or her to use the toilet plunger you provided when he/she first moved in. Get the strongest person in the house to use it. If necessary, water should be added before plunging.

Complaint #8 "There's water dripping from the ceiling."
<u>Solution</u>: Tell the tenant to put buckets below the drip to catch all the water. Then call a roofing contractor to do the work as soon as it stops raining. This will require a phone call by you, but at least you won't have to go over to the house at 11:30 Saturday night!

Developing strong leases, rules & regulations, and move-in/move-out procedures

Your greatest ally can be your lease/rental agreement and rules & regulations governing the use of your property. They should be clear, specific, in writing, and furnished to all tenants upon move-in—nothing should be left to chance. Here is a partial list of important considerations:

• Security deposit and first month’s payment <u>mandatory</u> (Consider collecting last month’s payment too.)
• Lease/rental agreement should contain a penalty for late rent payments
• First $50 of repairs each month should be responsibility of the renter
• Periodic inspection privileges (Use them.)
• Disallow subleases and subletting
• Penalties for most infractions and vacating early
• Move-in checklist should be filled out (with signatures)
• Credit check
• Alternative contacts (friends, employers, family) to help you track tenants who skip
• Names of all residents

• List of tenant obligations (keep equipment in working order, repair damage, pay for small maintenance items, etc.)
• Disclaimer for the landlord
• Written permission only to alter property, otherwise penalty clause in effect

Lease option strategy

The lease option strategy is an excellent way of instilling pride of ownership in tenants, saving you management problems and limiting potential property damage. We suggest you use this strategy at every opportunity. Most lease-to-buy options are not exercised and provide extra income for homeowners.

Apartment rules & regulations

1. No birds, cats, dogs or other animals shall be maintained in or about the premises without the written consent of the owner or his/her agent.
2. Ashes, garbage, sweepings, dirt, litter or other refuse shall be wrapped and deposited in proper waste receptacles.
3. Water shall not be left running in bathroom, kitchen or elsewhere in the demised premises. All leaks shall be immediately reported to homeowner or his/her agent.
4. Signs or placards shall not be posted in or about demised premises or building.
5. Toilets, sinks, and washbasins are to be used for the purpose for which they are intended. No dust, rubbish, litter, coffee grounds, tealeaves, eggshells, parings, or garbage are to be put into same, unless a waste disposal system for such purposes has been installed.
6. No musical instruments shall be permitted to be played later than 9:00 PM or before 9:00 AM, nor shall music be taught or permitted to be taught—either vocal or instrumental. No practicing whatever shall be permitted.
7. Brooms, mops, toys, and other articles shall not be left in any area other than the proper storage area for such items.
8. Tenants must not drive nails into walls.
9. Tenants must keep that part of the premises they occupy and use as clean and sanitary as the conditions of the premises permit.
10. Laundry washing and maintenance of washing machines within the apartment units are prohibited Tenant shall not use bathtubs, basins, nor kitchen sink for laundry purposes. Damage to the plumbing equipment resulting from this or any other abnormal use of the equipment must be repaired at the expense of the tenant.
11. When individual heating equipment, electric range, refrigerator, or other automatic equipment is included in the rental unit for the sole use of the occupant, such equipment shall be kept in a state comparable to that which it was in at the time of occupancy by tenant, except for reasonable wear and tear.

Use of halls, roof, etc:

1. Children positively are not allowed to play in corridors, entrance halls, on the roof, or in the basement.
2. No windowsills, fire escapes, ledges or light shafts shall be used for storage purposes. No public halls or passageways shall, in any way, be obstructed by packages, boxes, or any other items.
3. All furniture, provisions, supplies, carts, material, etc. shall be received and delivered via the rear, basement, or other entrance designated for such purpose.
4. Tenants are not permitted access to the roof, except in case of emergency or by permission of manager.

Use of laundry facilities

1. Use of laundry includes the facilities only. Hot water is supplied for laundry purposes only during the regular heating hours.
2. Laundry room may be used only during the time allotted the tenant by the manager, and laundry must be removed before closing time in the evening.
3. Management reserves the right to refuse the tenant the use of the laundry and storeroom and all other building facilities for failure to comply with laws and ordinances governing safety, health, and sanitation or for disregarding the rules pertaining to such facilities.
4. Use of the laundry and its facilities shall be limited to the washing of the usual personal and household articles. No cleaning with inflammable materials, nor dyeing, will be permitted.

The owners or agents will not be responsible for any articles lost, stolen, or damaged on these premises. The owner and agent reserve the right to make such additional rules and regulations as they may deem necessary.

Move-in/ Move-out Forms

One of the recurring issues in landlord/tenant relationships is whether a tenant should or should not get his/her/their security deposit back at move-out. Landlords often think they shouldn't; tenants almost always think they should. The best way to address this issue is with detailed move-in/move-out forms.

At move-in, provide a tenant with a move-in form. Ask the tenant to take the time to walk through the property and make notes regarding the condition of said property. Also ask the tenant to print his/her/their name(s) on the form and sign it. Add a provision to your lease/rental agreement stating that this form must be turned in to you or your rental agent within a reasonable period of time (several days after signing the lease/rental agreement. Another provision should state that the tenant agrees to walk through the property with you or your rental agent a week prior to vacating the premises. If the tenant does not comply with this request, it should be stated on your move-in/move-out form that the tenant agrees to your or your agent's report on the condition of your property at move-out. Make a photocopy of this form; keep the original; and send the tenant a copy. (Sign the form before photocopying it and sending it back to your tenant.) The goal is getting everyone on the same page with regard to the condition of your property prior to move-in and at move-out.

Keep your move-in/move-out forms in a safe place. If you lose one, your claim to retain all or a portion of the security deposit will be significantly weakened. It would be wise to take pictures of your property before moves-ins and after move-outs. As further protection, consider asking your tenants to look at before move-in photos and sign them. Also, reiterate on your move-in/move-out forms the amount of the security deposit and conditions for losing it or getting it back. Be reasonable, though. If your property is in good condition at move-out, return the security deposit. Homeowners looking for ways to keep security deposits that aren't rightfully theirs have caused some nasty altercations. Sure, you have every right to retain all or a portion of a security deposit to pay for repairs or reconditioning costs, but if your property is in approximately the same condition as it was when it was rented, call it a winner, and return the security deposit. If you feel that withholding all or a portion of a security deposit is warranted and decide to do so, make sure you can justify your claims via receipts for repair/reconditioning work. Be sure to photograph the damage to compare to your before-photos.

Move-in/Move-out Form

Rental Property Address: ____

Date lease/rental agreement executed: ______________________________________

I/We agree that this is the condition of the dwelling at the beginning of my residency. I/We understand that this form must be returned within three (3) days (excluding weekends and legal holidays) after executing the Lease/Rental Agreement. I/We also agree to conduct a joint checkout with the Owner/Agent at least seven (7) days prior to the date I/We plan to vacate the dwelling and also agree to schedule a checkout time with the Owner/Agent. Failure to so contact the Owner/Agent obligates the Resident(s) to accept the Owner, Agent, or other authorized person's checkout evaluation.

RESIDENT-1 (Print) ____

(Sign) ____

RESIDENT-2 (Print) ____

(Sign) ____

RESIDENT-3 (Print) ____

(Sign) ____

Date move-in/move-out form received by Owner/Agent: ___________________________

Date move-out checkout requested by resident: ________________________________

Vacating-notice: None Thirty (30) Days Sixty (60) Days

Security Deposit: $ _________________

Pet Deposit: $ _________________

Damage and/or penalty: $ _________________
Unpaid rent: $____________
Amount of deposit(s) forfeited (if any): $ _________________

Refund Amount: $ _________________

Resident's forwarding address: ____
Date returned: __________________
Check number: _________________
Owner/Agent: ____

Foyer	Move-in comments	Move-out comments	Cost
Ceiling	___________________	___________________	______
Walls	___________________	___________________	______
Floor/Carpet	___________________	___________________	______
Doors	___________________	___________________	______
Drapes/Rods	___________________	___________________	______
Windows	___________________	___________________	______
Screens	___________________	___________________	______
Elec. outlets/switches	___________________	___________________	______
Light fixtures	___________________	___________________	______
Closet	___________________	___________________	______

Additional comments (**Foyer**): ____

Living Room	Move-in comments	Move-out comments	Cost
Ceiling	___________________	___________________	______
Walls	___________________	___________________	______
Floor/Carpet	___________________	___________________	______
Doors	___________________	___________________	______
Drapes/Rods	___________________	___________________	______
Windows	___________________	___________________	______
Screens	___________________	___________________	______
Elec. outlets/switches	___________________	___________________	______
Light fixtures	___________________	___________________	______
Closet	___________________	___________________	______

Additional comments (**Living Room**): ____

Dining Room	Move-in comments	Move-out comments	Cost
Ceiling	___________________	___________________	______
Walls	___________________	___________________	______
Floor/Carpet	___________________	___________________	______
Doors	___________________	___________________	______
Drapes/Rods	___________________	___________________	______
Windows	___________________	___________________	______
Screens	___________________	___________________	______
Elec. outlets/switches	___________________	___________________	______
Light fixtures	___________________	___________________	______
Closet	___________________	___________________	______

Additional comments (**Dining Room**): ____

Den/Family Room	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____

Additional comments (**Den/Family Room)**): ____

Master Bedroom	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____

Additional comments (**Master Bedroom**): ____

Bedroom #2	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____

Additional comments (**Bedroom #2**): ____

Bedroom #3	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____

Additional comments (**Bedroom #3**): ____

Master Bath	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____
Tub/Shower	________________	________________	_____
Toilet	________________	________________	_____
Sink/Cabinet	________________	________________	_____
Mirrors	________________	________________	_____

Additional comments (**Master Bath**): ____

Bathroom #2	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Closet	________________	________________	_____
Tub/Shower	________________	________________	_____
Toilet	________________	________________	_____
Sink/Cabinet	________________	________________	_____
Mirrors	________________	________________	_____

Additional comments (**Bathroom #2**): ____

Bathroom #3/ Half-bath	Move-in comments	Move-out comments	Cost
Ceiling	___________________	___________________	_____
Walls	___________________	___________________	_____
Floor/Carpet	___________________	___________________	_____
Doors	___________________	___________________	_____
Drapes/Rods	___________________	___________________	_____
Windows	___________________	___________________	_____
Screens	___________________	___________________	_____
Elec. outlets/switches	___________________	___________________	_____
Light fixtures	___________________	___________________	_____
Closet	___________________	___________________	_____
Tub/Shower	___________________	___________________	_____
Toilet	___________________	___________________	_____
Sink/Cabinet	___________________	___________________	_____
Mirrors	___________________	___________________	_____

Additional comments (**Bathroom #3**): ____

Kitchen	Move-in comments	Move-out comments	Cost
Ceiling	___________________	___________________	_____
Walls	___________________	___________________	_____
Floor/Carpet	___________________	___________________	_____
Doors	___________________	___________________	_____
Drapes/Rods	___________________	___________________	_____
Windows	___________________	___________________	_____
Screens	___________________	___________________	_____
Elec. outlets/switches	___________________	___________________	_____
Light fixtures	___________________	___________________	_____
Closet	___________________	___________________	_____
Cabinets/ Cupboards	___________________	___________________	_____
Pantry	___________________	___________________	_____
Counters	___________________	___________________	_____
Sink	___________________	___________________	_____
Garbage disposal	___________________	___________________	_____
Refrigerator	___________________	___________________	_____
Range/Stove	___________________	___________________	_____
Dishwasher	___________________	___________________	_____
Microwave	___________________	___________________	_____

Additional comments (**Kitchen**): ____

Utility Room	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor/Carpet	________________	________________	_____
Doors	________________	________________	_____
Drapes/Rods	________________	________________	_____
Windows	________________	________________	_____
Screens	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Shelves/Cabinets	________________	________________	_____
Washer	________________	________________	_____
Dryer	________________	________________	_____
Water Heater	________________	________________	_____
Washbasin	________________	________________	_____

Additional comments (**Utility Room**): ____

Garage/Carport	Move-in comments	Move-out comments	Cost
Ceiling	________________	________________	_____
Walls	________________	________________	_____
Floor	________________	________________	_____
Doors	________________	________________	_____
Garage Door	________________	________________	_____
Windows	________________	________________	_____
Elec. outlets/switches	________________	________________	_____
Light fixtures	________________	________________	_____
Attic	________________	________________	_____

Additional comments (**Garage/Carport**): ____

Exterior:			
Roof	________________	________________	_____
Fascia	________________	________________	_____
Soffit	________________	________________	_____
Walls	________________	________________	_____
Front Door	________________	________________	_____
Back Door	________________	________________	_____
Exterior Doors	________________	________________	_____
Screen Doors	________________	________________	_____
Patio	________________	________________	_____
Porch/Lanai	________________	________________	_____
Deck	________________	________________	_____
Pool	________________	________________	_____
Spa	________________	________________	_____

Additional comments (**Exterior**): ____

Yard/Landscaping	Move-in comments	Move-out comments	Cost
Front Yard	___________________	___________________	_____
Back Yard	___________________	___________________	_____
Fence	___________________	___________________	_____
Driveway	___________________	___________________	_____
Trees	___________________	___________________	_____
Shrubs	___________________	___________________	_____
Walkways	___________________	___________________	_____

Additional comments (**Yard/Landscaping**): ____

ADDITIONAL COMMENTS:

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Hopefully, you found the tenant move-in/move-out form a helpful template. This template would also be helpful for initial inspections of prospective investment properties. Consider making your own customized move-in/move-out and/or initial property inspection report templates. They can really come in handy.

Groom your superintendent

When you own a building that has more than four units, it is convenient to have a resident superintendent. A common practice is offering this person free or discounted rent. Avoid offering rent discounts as a form of payment. After a few months, the superintendent forgets about the discount and remembers only that the rent is due every month, causing discontentment and resentment on the part of the superintendent, who does not want to do the chores on top of paying rent. In addition, purchasers of rental buildings usually look at gross rent receipts to figure out how much they should pay for the building. So by not charging full rent, you have reduced the price that the buyer is willing to pay. If there were an identical property, and the owner collected full rent and paid the superintendent separately, the property would demand a higher price.

Consider charging full rent, and giving your superintendent a check for services rendered. If the super’s pay is $250 per month, instead of giving your superintendent one check, cut two: one for $200 and a $50 bonus if all rent checks are deposited by a certain date. In fact, you should designate the second check a "bonus," so that the superintendent will have a feeling of pride in doing such a good job and having earned a bonus. Then, when it comes time for you to sell the property, you will show the super's fees as an expense, which will reduce net income, but it will not reduce gross rental income (what most buyers are concerned with).

You will need a dedicated property manager to help you in your trip to financial independence. One of the best ways to foster such dedication is by offering your property manager an equity position in the property. He or she will participate with you in the increase in value of the property, through a document stating that he/she will receive a portion of the increase in the value of the property between the time he or she started managing the property for you and the time you sell it, as long as he or she is still working for you at the time. You may pay a salary and add the equity participation or pay via a straight equity-sharing plan. (The two of you must negotiate this.) By doing so, you ensure that the manager will look after the property as if it were his or her own, because it is in fact partially his or her property. The manager will also look for ways to improve the property, thus increasing its value and his or her potential income. You can become a property manager and, instead of paying yourself, give yourself part of the equity.

Remember, charge superintendents full rent, and offer a check of refund. (Never arrange it so that it's cheap rent or no rent.) The super's apartment will be counted toward gross income when he or she pays full rent. Consider offering supers part ownership (equity). To receive it (the equity), he or she must stay for X number of years or until you sell. Offer incentive equity as of the day the superintendent first works the property, not the day you bought it.

7 Maintenance Do’s and Don’ts

Do:

1. Refinish the floors.
2. Paint the walls light colors.
3. Replace old light fixtures with less expensive, simpler ones.
4. Replace old heat registers with new ones.
5. Consider replacing kitchen countertops.
6. Spruce up the bathrooms.
7. Change the covers on light switches and electrical plugs.

Don’t:

1. Upgrade the basement at great expense.
2. Renovate the front of a house (until you're ready to sell) or landscape the back.
3. Add a pool, a serious overimprovement error.
4. Convert three smaller bedrooms into two larger ones.
5. Replace kitchen cupboards. (Paint them and replace the knobs with nicer ones.)
6. Totally renovate.
7. Buy used appliances from people's garages or basements.

Stay in the Game!

Almost everyone is capable of creating wealth and achieving financial independence through real estate investing, yet many people who have considered investing in real estate will not do so. What happens to all the good intentions? Why would people pay good money for real estate programs like ours, learn all of the advantages associated with real estate investing, and then fail to follow through to the finish (their first investment property)? Why do people let go of their dreams so easily? Often, it comes down to a shortage of the three P-words that earlier we associated with commitment:

Persistence (refusing to give up or let go)
Perseverance (persistence in adhering to a course of action)
Patience (calmly awaiting an outcome or result)

Desire is powerless without commitment. Those who lack commitment rarely achieve wealth, unless of course they inherit it. The problem is that many people do not have goals—much less write them down—only dreams and wishes. That isn't to say that some of them are not highly motivated. But without direction, all the motivation in the world will not help you succeed. You must channel your motivation, which means setting goals, writing them down, and taking action. Some people, however, do lack motivation—in a major way. They wish they could get out of bed one day and magically discover that they owned ten ideal investment properties and that enough time had passed that they could now collect their million dollars. All in all, not a bad dream, but that's all it is, just a dream.

If you get anything out of this book, let it be the following advice: TAKE ACTION, action based on lofty, yet attainable goals. Securing your first investment property is one such goal. Remember that it's hard to make a mistake investing in real estate. Even if you mess up, the property is still going to be there. Even better, you get to use other people's money (leverage) to make you money! It's not like investing all of your money in a far riskier business venture and facing the prospect of watching it all go bye-bye if things start to unravel, as they often do. Also remember that people with no specialized knowledge and no real estate background make money everyday in the real estate market. What have you got to worry about? What are you waiting for!

Some people who've enrolled in real estate investing courses have gone on to become millionaires or even multi-millionaires, while some don't even try to apply the things they've learned. Still others make half-hearted attempts to secure investment property, and then when the first obstacle arises, they throw in the towel. Why do people give up so easily on their dreams? Perhaps they have goals, maybe even written them down, but don't firmly believe that they can achieve their goals. Maybe their goals just don't seem real. Try taking pictures of the type of available properties you want to own and putting these pictures up in your den. Visualize yourself actually owning these potential gems. Walk around them. Inspect them. Talk to the owners. Study constantly about real estate, goal setting, and the power of your subconscious mind.

Most failures can be traced to lack of determination. Once you have made up your mind to stay in mentally and emotionally to your dream, financial success will follow. If you have enough determination, there will always be enough money to stay in financially. Here's some advice on staying in financially. Keep your job or take a different job if the present one does not pay enough or you do not enjoy what you're doing. Do not over extend yourself. Set up a reserve if possible, keeping several thousand dollars in cash or credit per property, guarding against possibility emergencies. Obtain all the credit you can, but watch how you spend it. (Use it to make you more money, not more in debt.) Accomplish this through credit cards and personal lines of credit. Available credit can mean the difference between success and failure, buying you valuable time to extricate yourself from any tight money situation that might arise.

Do not move too fast

Don't rush out and buy every property you see. It is always better to build slowly, but surely, rather than building fast and shakily. If at any time you are having difficulty staying in financially, then sell one or two of your properties. It is better to stay in to the end of the game and end up a winner than to hang on stubbornly and lose everything. The bottom line, though, is that you must have a job, and you must have credit.

Establish contacts people who have money to invest, but not the time, knowledge, nor the inclination to invest on their own. When seeking to borrow from banks, tell them that you don't need the money right away. You must come from a point of view of want, not need.
Your goal is to have $1 million of net worth real estate in four to 10 years from now. Put in very simple terms, you will be a millionaire if you secure $1 million of real estate and wait four to ten years for it to grow in value. To do this, you must be prepared to stay in the game. If you can do it by holding the goal firmly in your mind and in your thoughts, then you can do it in the outside world. It is achievable by setting your goal firmly in your mind and absolutely refusing to give up. Are you committed? Do you have …? three P's again

Assembling a Winning Team

In order to succeed, you will need to work with others; the purpose of this section is to assist you in selecting the best ones for your team. Don't try to do all the work yourself. Seek professional help and support.

Teammates:

Lawyer

This is one of the most important members of your team. Your lawyer must be in full-time real estate practice. Real estate purchases are far too complicated to attempt without a lawyer; the results can be economically disastrous. Make sure that the lawyer is familiar with rent review and tenant's protection legislation. Lawyers can give certification of good title, yet most will only give you their opinions, so insist that they issue title insurance with each closing they perform.

Real Estate Agent or Broker

Must be knowledgeable, creative, positive, and hard working. You must be loyal to your agents if you expect loyalty and hard work in return. (Don't say "nothing down" to any Realtor you just meet; they will fear there won't be a commission.)

Two important questions to ask potential agents:

1. What is your commission?
2. Is your commission negotiable? (If the answer is yes, that’s a sign that he or she may be creative and willing to work with you.)

In order to sell fast or get more for a property, tell her or him that you will pay 8% commission on the higher price or within a limited period of time. In different areas, use the same agent (from that area). The seller pays anyway, so why not use an agent with whom you have an ongoing working relationship?

Professional Home Inspector

Develop a working relationship with an expert home inspector. Ask a real estate agent, broker, or other trusted contact for recommendations. Also, try looking in the yellow pages. You should learn to do this yourself, so always attend the inspection and ask lots of questions. Often, it is possible to use a contractor or home renovator to do the inspection. (Have the contractor perform the inspection for a fee, not for promises of future work.)

Accountant/Tax Expert

Real estate tax law can be very complicated. Make sure you get professional advice.

Mentors

Education, books & tapes, strategies and knowledge are great, but there is no better help than a sounding board — a coach or someone to mentor you.

Tenants

Tenants may seem slightly out of place on your list of teammates, but good tenants, tenants who pay in full and on time, take good care of rental property, and don’t cause problems, are one of the most important pieces of the puzzle for the owners of rental property. The rent they pay usually covers the cost of mortgages, taxes, and insurance, often with money left over, providing owners of rental property with a monthly source of income, while their property significantly appreciates in value (in most cases).

Ask for and confirm full details from prospective tenants upfront (name, phone number, current address, address of parents (for student renters), employer, references and bank references; current and previous landlords, driver's license number, Social Security number, and date of birth). Be sure you have rental application forms at the ready. Get permission to do a credit check. (With student renters, ask the parent to guarantee the rent with a signed letter.) Obtain security deposit and first and last month's rent immediately, and make sure a tenant’s deposit and rent checks clear before issuing keys.

As mentioned previously, there are companies that will conduct background checks on potential tenants for you, but don’t be afraid to use gut feelings. Use your intuition in assessing prospective tenants. If you do not feel good about them, from a financial perspective that is (they seem more like potential deadbeats than potential tenants), then do not rent to them. Keep in mind, though, that discrimination on the basis of race, color, religion, sex, national origin, handicap, or familial status with regard to the purchase, sale, leasing, or rental of real estate is a violation of federal law. It is essential that you know, and strictly adhere to, all state and federal housing laws.

Be prepared to carry a property for a month or so until you find a good tenant. If there’s a purchase option accompanying the lease, qualify potential tenants as if they will be buying at 90%, financing the loan as a bank would. If a potential tenant can't qualify, then have someone guarantee the rent, so you are protected. Once you have good tenants, look after them. They will likely stay for some time if treated properly.

Chapter 4: General Real Estate Strategies

Real Estate Investing—a <u>Repeatable Process</u>

While some legal aspects of real estate investing, contracts and tax regulations in particular, can be complicated and confusing, especially for newcomers, the overall process is actually quite simple and varies little from transaction to transaction. (Seek professional advice from a qualified professional when venturing into important areas you're not familiar with.)

To be successful investing in real estate, you must:

- Know how to locate potentially profitable ("ideal") properties
- Understand what is and what isn't a good deal (research & evaluate)
- Negotiate the best price possible
- Have the means to quickly secure the property (cash, financing)
- Prepare and present the contract/offer

While going through this 6-step process, keep in mind the objective:
How can I <u>make money</u> on this property?
Usually the answer will fall into one of three basic categories:

1. Buy, Hold, and <u>Rent</u>
(Long-term perspective)
2. Buy, Hold, and <u>Sell</u>
(Medium-term perspective)
3.Buy, Assign (contract/option to buy), or <u>Sell ASAP</u> (see: "flipping" properties)
(Short-term perspective)

Note: Chapter-10 addresses long-term, medium-term, and short-term investing strategies.

There are many real estate strategies and offers. The structure of the real estate deal is a function of the property, the owner's motivation, financing, the type of loan, the market, and your own creativity. Remember that you are looking for the ideal investment property: a moderately priced, 3/2 (3-bedroom/2-bath) single-family home, preferably for sale by owner—a motivated one—located in a nice neighborhood. To bring to move-in condition, it should be in need of only TLC (general cleanup, lawn work, etc.) and minor repairs or improvements (new carpet, paint, etc.). After you have qualified the property by these basic characteristics, focus on the following strategies:

1. VA or FHA

Ease of financing and lack of credit qualifications (if the property qualifies) make VA or FHA properties attractive investment properties. (Check the date of the original loan to see if the property is a good choice.)

2. Wraparound Mortgages

Use the existing owner's financing and qualifications to keep the mortgage on a property. The owner could establish a new mortgage on the property, take in monthly payments, and pay the original mortgage.

3. Cash Discounts

If you have cash to acquire a property quickly, expect a great deal.

4. Contract Assignments

A contract assignment is a good way to get started investing in real estate—with no money. Negotiate a favorable deal, and simply assign your rights for cash.

5. Lease Options

No money for a down payment? A lease option is a wonderful way to acquire property with as little down as possible. Consider selling or buying using lease options.

6. Options Contracts.

Establish an option on the contract. You can sell the contract or hold onto the contract and exercise the right later.

7. Foreclosures.

The foreclosure market is large. Selling prices are oftentimes 30% to 40% below fair market value. Occasionally, a 50% or greater discount can be realized. An understanding of the foreclosure process (and readily available cash) can help you profit.

If you focus on these strategies, you can make your investments in real estate very profitable ones.

VA and FHA properties

If credit is an obstacle or you just want to reduce the turnaround time financing a property, VA or FHA properties may be the ideal investment. Nowadays, they are rare. So when you find one, feel free to get excited. There are all kinds of opportunities surrounding these types of homes. To fully understand the benefit of finding these gems, you must understand a little about their financing and obligations.

VA (Veterans Administration) Loans

The government has made lending a little easier for our nation's veterans. VA Loans are guaranteed by the government in case of default and usually have a limited or no money down payment (on the original note/property). A veteran must initially live in the property but can move later. Loans made prior to March 1, 1988 had the additional distinction of being easy to transfer. Transfer of a VA loan involves assuming the mortgage non-qualifying (loans prior to Mar. 1, 1988), paying a $45 assumption fee, and making the payments. Loans originated after Mar. 1, 1988 require the new homeowner to qualify for financing.

For individuals who can search out, find, and negotiate a good deal, VA properties can be a gold mine.

FHA Loans

The Federal Housing Administration is an agency of the United States Government that helps new homeowners acquire property. The government essentially assures the various lending institutions that if the homeowners default, it will make good on the loans. There are limitations on the amount of funds insured, and the process is time consuming, but there are some interesting benefits, including the potential for a very low down payment.

Prior to Dec. 15, 1989, FHA property and loans were assumable and non-qualifying. (Loans originated after this date require the new owner to qualify for financing.) Again, there is an outstanding opportunity for acquiring a property with minimal qualifying and easy financing options. Assuming you can find them, VA or FHA properties that are non-qualifying and assumable provide outstanding opportunities to acquire real property with no financial qualifications. Let's look at a couple of examples to get a feel for some of the ways to structure VA or FHA property purchases.

VA assumable and non-qualifying
Asking price: $128,000
(First mortgage has $102,000 left, 30 years original, 10% interest, 21 years 9 months left.)
The homeowners want $26,000 cash because they want to retire and move into a beach apartment.

<u>Option-1</u>

You could pay $26,000 and simply assume the first loan for $45. The homeowner will send away to the mortgage company for the assumption package. You would start making payments on the first mortgage. The only major negotiation is who pays the closing costs, anywhere from $1,200 to $2,000. You could split the costs, ask that the owner to pay, or you could pay. This option is quick and easy. Simply send the information to the title company with a copy of the purchase offer and/or agreement and you have a new home.

<u>Option-2</u>

The first mortgage is assumable and non-qualifying. The $26,000 is negotiable. One option may be to ask the homeowner to take back a second mortgage for $26,000 or whatever you can negotiate. The interest rate is negotiable. The term (number of years or months) is negotiable. For example, you make a $1,000 down payment and finance the balance for 10 years at 8% interest. It is really up to you and the homeowner to work out an equitable arrangement.

<u>Option-3</u>

Cut the best deal you can for the down payment, interest rate, and length of the mortgage. You might even ask the homeowner to throw in some extras: refrigerator, stove, washer/dryer, drapes, furniture, television, or whatever else you want. Then make sure you have the words "and/or assigns" after your name on the paperwork. This will allow you to sell the rights to the purchase of the home to another party for cash (the same as an assignment of contract). Perhaps you'll assign the contract without the television—a bonus for your den!

Wraparound Mortgages

Inquire about a *wraparound mortgage* on a property to eliminate the need to qualify for financing. To help you better understand this strategy and how it can facilitate the buying or selling of a property, let's go through an example. The seller has a home with a fair market value of $100,000, with $60,000 in an assumable mortgage (qualifying) at 8% interest and $40,000 in equity. You may try to discount the property by 20% and ask the owner to take back a second mortgage for the balance of the equity. This would keep your out-of-pocket cash to a minimum—a sound objective. It would be great if the first mortgage was assumable non-qualifying, but what would happen if you couldn't qualify? Perhaps you have poor credit, not enough credit history, or too many properties already leveraged to qualify. A solution could be a wraparound mortgage. In this case, the owner of the property could establish a wraparound mortgage on the property at your recommendation.

The wraparound mortgage, sometimes called an all inclusive trust deed (AITD), is a mortgage on the property at whatever terms you agree too. Perhaps you can negotiate an $80,000 mortgage at 8% for the next 30 years. The homeowner would receive the monthly mortgage payment on the wraparound mortgage ($587.01). In turn, the owner would pay the first mortgage ($440.26). The homeowner now has regular monthly income of $146.75 and is actually receiving 8% on the investment. Not too bad considering what the owner would get at a bank. Since the seller actually finances the deal, there is no qualifying, with the exception of what the seller asks the buyer for in terms of references, accounts and checks. If you were the seller, you would want a responsible buyer. Do your homework; check references and bank accounts; get guarantees. If you have a trustworthy buyer lined up, because there is essentially no qualifying for bank financing, you might ask said buyer for a larger down payment or an interest rate above the norm, thus getting a better return on your money. When it comes to wraparound mortgages, there is little risk from the seller's perspective. The worst that might happen is that you have to foreclose on the property and take it back.

Wraparound mortgage example:

FMV (Fair Market Value): $100,000
First mortgage—qualifying: $60,000
Owner has lost a job and wants to move back home. His credit is still good, but he's worried about what could happen in the near future.

Note: To implement the following strategies, consult a real estate lawyer. You may have to write a contract for deed, and you must review the existing mortgage on the property for any infringement of rights. For example, the initial mortgage may not allow a wraparound mortgage and could be in jeopardy if the wraparound mortgage is discovered.

<u>Option-1</u>

A key to using a wraparound mortgage is understanding what the owner is going to do with the money or what is motivating the owner to sell the property. Perhaps the owner needs the money, perhaps not. If the property has a fair amount of equity and the owner is prepared to hold a wrap mortgage, you have an outstanding opportunity to pick up a property with limited qualifying. Certainly, go for the 20% discount from the beginning of the negotiation. Ask the owner to hold the wrap mortgage at a fair interest rate. If the owner is concerned about being able to make the mortgage payment and credit problems, a wrap mortgage may be the answer. They homeowner gets some cash upfront, relief from the mortgage payments, and positive monthly cash flow. Essentially, the owner is lending you the money to buy the property.

<u>Option-2</u>

It's time to be more aggressive. Consider developing a wraparound mortgage that will look after the first mortgage payment: $440.26 a month ($60,000 at 8%), and insert a balloon payment of $20,000 in five years, at an acceptable interest, perhaps 10% simple interest. If the owner needs cash, you may consider a small down payment or even some sort of trade for goods or services.

Cash Discounts

If you have a readily available supply of <u>cash</u>, or have a partner who does, you can buy property at a substantial discount. Many homeowners are in situations requiring them to sell quickly, sometimes within a few days or a week or so, which puts you in the catbird seat. Expect a steep discount. Start negotiations at 50%, and don't accept less than a 25% discount off fair market value. Don't fall prey to the mindset that it's a "once in a lifetime deal." It's not. There will be many other great investment opportunities down the road.

Once you buy a property at a substantial discount, try to turn it around quickly. (This strategy works best when you have a list of potential buyers to work from.) You may also want to consider trying to borrow against the property. You may even be able to borrow more than you paid for it in the first place, which could come in handy for repairs and/or cosmetic enhancements to the property.

Cash is King!

Negotiate a deal at the lowest possible price (at least a 25% discount off market value).
Don't risk your own money, unless you can afford to and have lots of it.
Do your homework! (Know the fair market value, research ownership, liens, etc.)
Go for a quick sale. Keep you cash liquid. (Better to have 10–15 properties working for you than one big score.) Another option is to hold onto the property and attempt to take the cash back out in the form of a mortgage. Go to banks attempting to acquire regular financing. Normally, a bank will only fund 70% of an investment property, but if it's priced and appraised properly, you may get all the money back, perhaps more than you expected.

Contract Assignments

A contract assignment is a simple and powerful moneymaker and an excellent real estate investment strategy, especially when funds are tight. All it takes is a little contract knowledge and good negotiating skills.

<u>Contract assignment process</u>:

Step-1: Negotiate a deal at 80% of fair market value (a 20% discount off FMV), securing an even larger discount if possible.

Step-2: Set a long closing date (minimum 90–120 days out).

Step-3: Include the phrase "and/or assigns" after your name on the purchase offer/contract.

Step-4: Be sure to include a clause or clauses ("escape clause" or "out clause") that can get you out of the contract if need be—for example: "Subject to partner's approval."

Step-5: Find a buyer for the property

Step-6: Assign for cash your right to purchase the property and charge an assignment fee.

Step-7: Inform the seller of the change via an assignment form.

Including the phrase "and/or assigns" after your name on the purchase offer/contract gives you the right to transfer your right to purchase a property to another party for cash, an interesting technique for generating profit. You don't need any money to buy the property—your escape clause(s) give you a way out of the contract if it comes to that—the person you assign the contract to buys the property. You just sell the contract for cash, profiting from your superior contract knowledge and negotiating skills.

Note: You may want to pre-qualify the new buyer, the party you assigned the contract to, and you may also want to consider checking to ensure everything is moving ahead as planned or attending the closing.

Lease Options

With a lease option, a home can be purchased for little or even no money down, which makes this strategy particularly attractive for first-time homebuyers, especially those who have little or no money for a down payment. Basically, this is how it works. There are two separate contracts: a standard lease or rental agreement and an option contract, which gives the person or persons who are leasing the property the *option* to purchase it at a fixed price anytime within the specified term of the option contract. A portion of the monthly payment goes toward the future down payment.

<u>Lease Option example</u>:

Contract Term: 48 months
Purchase Price: $100,000
Rent: $1,000/month, $100 of which goes toward the future down payment.

(It's important to point out that potential buyers must *pay* for options. This $100 monthly payment is the cost of the option to purchase the property at a specified price sometime in the future. At the end of the 48-month option period, $4,800 dollars would be accrued toward the down payment. [Terms of the contract could provide that this money be deposited into an interest-bearing escrow account, which could benefit either the buyer or the seller, depending upon whether or not the option is exercised.] If the option isn't exercised (the person or persons who are leasing the property decide not to buy it), the homeowner pockets an extra $5,000 or thereabouts.)
(Future) Down Payment: $5,000
Balance: $95,000

It's important to note that at an average rate of appreciation, this property would be worth $120,000 at the end of the option period, but the purchase price was locked in at $100,000 four years prior. Many times, though, options are not exercised (a bonus for homeowners who rent their properties with options to buy).

Option Contracts

An option contract on a property basically provides the right to purchase it at a specific price and with specific terms, a right that must somehow be paid for. Options must be <u>in writing</u> to preserve the legal rights of the buyer or rights owner. Option contracts are usually unilateral. (The buyer can option the contract, but is not obligated to do so. The owner is obligated to sell the property under the contract for the period specified.)

There are several ways to take advantage of options:

1. Locate potential commercial sites (if you are a good judge of future development). Perhaps you can sign up a variety of commercial land development sites. Simply put an option on the land with the owner for a few hundred or thousand dollars. Then locate a developer or come up with a commercial application.
2. Tie up the rights to land or property with an option of a few dollars. When cellular phones were first starting out, people looked for tall buildings to set up the cell sites (antennas). A few wise people optioned the roofs of buildings and then sold the rights to the cellular phone companies. The options were for a few hundred dollars and sold for thousands.
3. If someone has a prime property but does not want to sell, offer an option. You can option some cash now for a future right. Perhaps the person needs cash now in exchange for a right you may exercise in the future.
4. If you believe that in the future the price of a property is going to increase dramatically, perhaps you can inflate the purchase price. Knowing that in one or two years the price will increase, you can tie up a purchase price that would be considered high now but low in the future. For example, the fair market value of a property is $100,000. You know the price is going to increase dramatically, so you suggest a purchase price of $110,000 within the next three years, with an annual renewal option of $1,000. In 2 ½ years, you exercise your option of $110,000, when the fair market value of the property is over $120,000. You enjoy immediate equity, or you can sell your rights for cash.

Foreclosures

Foreclosures are a fact of life. Any time a debtor breaches an obligation of a security document (i.e. mortgage, deeds or trust), the lender will take the steps to foreclose on the property. The grantor most likely does not want to acquire the property, but does want to be repaid the funds owed. There is an orderly process to foreclosures, including the opportunity to remedy the situation; however, many homeowners are not in a position to do so. Foreclosure actions are initiated for a number of reasons:

- Loss of job by one or more of the homeowners or other financial crisis
- Health or family problems
- Business failure or market downturn/sluggish economy
- Divorce (property liquidation)
- Death of a property owner
- Adjustable rate mortgage increases that cause property owners to fall behind on payments
- Balloon payments (single, large payments due at the maturity of a partially amortized mortgage to satisfy the debt)
- Job transfers (the two mortgage payment syndrome)
- Temporary negative cash flow situations
- Out-of-town/state owners

The key to making money in the foreclosure market is understanding why the property went into foreclosure in the first place. Perhaps the owner just has a temporary cash shortage. You may be able to help out and take an equity position in the property in return for remedying the situation. Or the owner may be financial devastated and just wants to dump the property before his/her/their credit is destroyed. You could help him/her/them make a brand-new start.

Finding foreclosures

There are many resources you can use for finding foreclosures. Hopefully, you can find a foreclosure before it has gone too far into the foreclosure process. Find below a few locations to begin the search:

- Classified ads
- Legal newspapers
- Attorneys
- FSBO (For Sale By Owner) properties
- Realtors
- Auction companies
- Banks (REO departments)
- U.S. Marshal Service
- Listing Services
- IRS auctions
- Bankruptcies
- Probate court

• Your own advertising
• County courthouse or town hall or registry of deeds (Check for new cases or sale file)

All of these resources are useless, unless you have a ready-made sales market. From the minute you begin the process of negotiating, making offers, and acquiring property, you must begin marketing the property to the public. The sooner you have a number of individuals asking you to find them properties, the better. Consider these four starting points:

1. Review your list of potential buyers

Begin by asking yourself, “Who do I know that might be interested in buying or investing in real estate?” This group of potential buyers may include the following:

• Fellow real estate investors (most have a list of applicants)
• Property management firms (may have access to investors/potential buyers)
• Realtors or brokers
• Business associates, accountants/CPAs, attorneys, doctors, engineers, stockbrokers, investment counselors, corporate executives, and other successful professionals
• “Nothing down” investors
• “Fix-up” investors
• First-time homebuyers
• Coworkers, friends, or relatives

2. Secondary sources

Consider using real estate publications to find individuals who are actively investing. They may know buyers or invest themselves.

3. Generating new sources

• Civil and social activities
• Banking contacts
• Advertising
• Newspaper advertising
• Bulletin boards
• Penny saver publications (FREE)
• “Bird Dogs” (A bird dog is anyone who can help you find investors or buyers. You may create a system for rewarding people who bring you qualified buyers, such as a free dinner, cash, or a percentage of the deal.

One of the best markets to target for purchasing your awesome real estate finds is first-time homebuyers. Most first-time homebuyers have limited funds for a down payment and closing costs. Also, they typically are not that familiar with the real estate process and need help. As you build your database of individuals interested in purchasing property, take the time to gather their personal information and pre-qualify them with a lender.
Qualification criteria for potential buyers:
• Down payment (minimum 3% of purchase price)
• Income and job stability (two year’s employment in same industry)

- PITI (**P**rincipal, **I**nterest, **T**axes, **I**nsurance) Payment = 28% of gross income
- Acceptable credit
- No Bankruptcies
- No Foreclosures
- Total debts, inclusive of mortgage payments and secured and unsecured debt, not over 30% of gross income
- Satisfactory rental history
- Additional cash needed for closing costs (5% to 6% of mortgage amount)

Investing Tips

How to become a Millionaire:
Buy a million dollars worth of real estate.
Wait seven to ten years.
Your real estate doubles in value.
You are now worth one million dollars or more.
Go and have some fun!

To be successful in the stock market, you must be quick and nimble—and knowledgeable. You must buy low, and sell high. Timing is crucial. You'd better watch the market. And watch. And watch. You'd better be sharp—all the time. If you don't sell today, your stock may be worth 50% less tomorrow. If you don't buy a stock today, it may cost 50% more tomorrow. The Stock Market: Fun … Adventure … Excitement … Keep away from it!

Real estate is a much different type of animal. Investing in real estate is a long-term affair. (Most worthwhile pursuits are.) To make a substantial amount of money investing in real estate using short-term investment strategies, you must be skillful—and somewhat lucky. Yes, you can make money by flipping properties, but many short-term real estate investors don't make it. They may make $5,000 or $10,000 here but lose $5,000 or $10,000 there. Big efforts. But oftentimes, small results. The people who really make it big in real estate play it dumb. They buy a property and hang onto it for seven to ten years. Then they sell it. They may not even be sure if it's the right time to buy. They may even overpay a bit. Seven to ten years later, though, when the property has doubled in value, they sell it and end up looking like geniuses. They may not even be sure if it's the right time to sell. They may even sell a bit too cheap. Not very sophisticated. Doesn't require great knowledge or skill. It just creates millionaires! An earlier quote said it best. "The greatest results in life are usually attained by simple means and the exercise of ordinary qualities." What this quote is basically saying is that you can be a millionaire and not have to reinvent the wheel. For some businesses, a sports bar for example, capital is a barrier to entry. Not so with real estate. Leverage, the ability to use other people's money to make you money, evens the playing field considerably. True, you may not have as much money to invest as the next guy, but the next guy may be a dummy!

Let's go back to our sports bar analogy. Think of everything you'd need to do and buy to open a nice one. What are we talking here? $50,000? $100,000? $200,000? More? Who's going to lend that kind of money? Even if you have a great business plan, you'd better have some major collateral or investors with deep pockets. The interest rates on your business loan are going to be high, because the risk to the lender is high—if you can get a loan that is. And if your sports bar goes belly up, bon voyage collateral (house, car, boat). Everyone will be sad if your sports bar goes the way of the dinosaur: you, your friends & family members who loaned you money, your investors, the bank that gave you the high-interest loan … everybody. The risk lenders face when financing real estate transactions is significantly less than the risk associated with new business loans. That's why, comparatively speaking, money to secure real property is a whole lot easier to come by. When things go downhill (payments fall behind), a property will always be there to secure the loan. Lenders like that part. Sure, real estate investors and lenders sometimes lose money, but they usually don't lose their shirts in the process. In real estate, even when things go bad, they usually don't go that bad. As a matter of fact, protecting the credit of the owners of distressed properties and helping them make things right again is one of the valuable services real estate investors provide. It's not all about making money; it's about helping people too. Real estate investors with that mindset are often more successful than investors who are just looking to take advantage of the misfortune of others.

Be patient

Patience is definitely a virtue for the real estate investor. The patient investor's attitude toward investing in real estate is "so what." So what if the market is up. So what if it's down. So what if it's sideways. Savvy investors don't care. They just go out, find really great deals, and buy them. Then they wait … and wait … and wait … then they sell and celebrate! But isn't one supposed to sell at the peak of a boom and buy when things quiet down a bit? Yes, it is better to buy when things are quiet. But then again, it was better to buy one year ago. It was even better to buy in 1990. And better still to buy in 1980. But you cannot turn the clock backwards. You cannot change the past. You can only plan for the future.

Wouldn't it be great, though, if you could determine when is a good or bad time to buy or sell? Sure it would. Guess what? You can. When you cannot find any duplexes or triplexes with break-even cash flow, and all you can find are properties showing a heavy negative cash flow, don't buy. The market will eventually correct itself. Conversely, if someone is willing to pay for your property a price so high that it will produce a heavy negative cash flow for the new owner, sell. If you can secure, with a minimal down payment, what you consider to be an ideal investment property, a property priced significantly below fair market value, which could easily rent for more than the costs associated with owning it (PITI: **p**rincipal & **i**nterest [mortgage payment], **t**axes, **i**nsurance, homeowner's association dues, maintenance fees, etc., buy it! Let's assume that the fair market value of this ideal investment property is around $100,000 (but you bought it for around $85,000). With steady occupancy, you have a $100,000 asset sitting out there likely appreciating at around 4% annually and appreciating on the appreciated value over the years (remember compounding?). And it isn't costing you a thing! Actually, the property is making you a little money, a portion of which you would be wise to set aside for expected or unexpected maintenance & repairs. This example is oversimplified to be sure, but while we're at it, let's further assume that you have ten such ideal investment properties out there working for you, and because you are using professional property management services, about breaking even. After five or ten years of ownership, proceeds from the sale of these properties could make you wealthy. Simple, isn't it?

What type of real estate to buy

Duplexes, triplexes, and quads can be excellent buys. They sell for less than comparable single-family dwellings, and the people who live there usually look upon them as their own property and take good care of them. They usually have their own back yards and the feel of a single-family residence. Condominiums and townhouses can also be a good buy and for all the same reasons. Generally speaking, they are easy to maintain and have comparatively low maintenance costs, as the tenants do most of the work on their own. High-rise condominiums, on the other hand, are more expensive to maintain as they have elevators, underground parking, security, swimming pools, exercise rooms, and expensive garbage pickup.

Raw land is only for the experienced investor. It is expensive to develop and can result in substantial negative cash flow while being developed. The expenses are usually accumulated and only written off as the property is developed and sold, breaching our rules regarding hanging in financially and emotionally, the conservation of cash, and the ability to repeat. A far better strategy, especially for the less experienced investor, is investing in single-family homes. That said, when held for a long time, there is excellent potential for an increase in the value of raw land. The major challenge for raw land is negative cash flow, which is counter to the conservation of cash principle and limits the ability to duplicate the process many times over.

Timesharing is not the way to become a millionaire, unless you are the person who sets up the timesharing plan. Stay away from this type of investment.

Industrial properties should be considered an investment option only if you have the requisite experience and expertise. It’s a very specialized field, and industrial properties can be adversely affected by economic downswings. You will need reserves of capital to protect you and allow you to hold on during downturns. Industrial property purchases also go against being able to repeat the process and stay in financially.

Retail/office: Again, it takes experience and know-how. It, too, is affected by downturns in the economy. Units can remain vacant for long periods of time, but your expenses will continue. Always test against being able to staying in and repeat the process.

Apartments are not for the beginner. There is the potential problem of having to face a tenants' association, which can act against your interests and cause severe depreciation in the price of your building. Pride of ownership and respect for the property is often lacking on the part of the tenants, which can result in vandalism, indifference, and property management problems. Definitely not for the inexperienced investor, large buildings have garbage disposal problems and expensive items, such as elevators, underground parking, and security personal.

Rooming houses offer good cash flow opportunities, but the people who gravitate toward these properties are usually harder to deal with than average everyday tenants. It requires almost a drill sergeant's personality, and if you possess this, you will have an investment that generates lots of cash. But for the majority of us, it would cause a problem staying in emotionally, meaning that we would not be able to repeat the process. It also goes against our principles of conservation of time and effort.

Summary:

Duplex/triplex/quad.	Excellent profit potential
Condominiums, townhouses	Usually good prices and easy to manage
High-rise condominium	High maintenance fees, may dramatically increase
Raw land	Negative cash flow for extended period of time
Single-family homes	High demand, excellent potential for profit
Timesharing	Avoid
Industrial	Requires specialized knowledge
Retail/office	Ditto
Apartments	Vandalism, indifference, management issues
Rooming houses	Difficult to manage

Chapter 5. Locating Ideal Properties

Obviously, you must locate property before you can invest in it. Successful real estate investors excel at ferreting out good deals. They're like detectives trying to track down elusive criminals—for the purpose of our discussion, ideal properties. But first they had to acquire the requisite knowledge and skills it takes to locate ideal properties and profit from them, knowledge and skills you will acquire through our real estate investing program.

Knowledge is certainly important, but there's no substitute for "real world" experience, which is why we suggest getting your feet wet as soon as possible. Drive around your neighborhood looking for "For Sale by Owner" signs. Look in the real estate section of the newspaper each week. Pick up a "For Sale by Owner" publication the next time you're at the grocery store. Place calls, and obtain asking prices. Drop by a realty office, and ask to look at the latest MLS (multiple listing service) book. Go online. Many property appraiser offices now have web sites. Go to the courthouse, and ask how to look for foreclosed-on properties. Call banks, and ask if they currently own properties that meet your search criteria. Don't be afraid to ask questions. Most people will try to be helpful. That's what they get paid for!

Even if you're not quite ready to buy your first property, the practical experience you'll gain by nosing around beforehand will give you a great head start. Who knows, maybe you'll find a gem and start investing a little sooner than planned.

Targeting properties

Our program will teach you much of what you need to know to become a successful real estate investor, but experience is the best teacher. You have to get out there and take a few steps. Find below a list of activities that will get you up and running. As you take action, you will learn what you know and what you don't know. Refer back to this manual often, and don't be afraid to ask questions. Dedicate a specific amount of time each day or week for investing in real estate. If you get into the habit of looking at real estate every week, sooner or later you will find an ideal investment property, a gem if you will. Here are some suggestions for getting started.

1. Start reviewing classified ads in the newspaper and circling ads containing motivated-seller phrases ("motivated seller," "price reduced," "must sell," "sacrifice," "TLC," "transferred," "below market value," "owner financing," "assumable," "non-qualifying," etc.) Focus on FSBO (For Sale By Owner) properties. Reviewing the ads will give you a feel for the marketplace, and you will begin to see opportunities. (Keep a file of properties.)

2. Pick up real estate magazines and FSBO publications to get a feel for prices and markets.

3. Drive through local neighborhoods. Look for FSBO signs, and take down phone numbers.

4. Make copies of the Call Sheet included in this chapter. You will make dozens of phone calls and taking notes on many properties in the upcoming weeks.

5. Review the telephone scripts included in this chapter. Say them out loud a couple of times. Make some phone calls to homeowners. See how much information you can get over the phone. Don't try to schedule an appointment. Try to get the forms filled out as best you can. Don't worry if you don't say it right the first time or if you miss something. You will get it all in time.

6. Once you have called 10 to 20 homeowners, make an appointment to see a property.

7. Obtain contracts for the purchase of real estate. Check with an office supply company or the board of Realtors. Also make sure you have addendum forms. (Real estate contract-preparation software will come in very handy.)

8. Grab a clipboard and a legal pad & pen (or notebook) and a flashlight, and go out to look at properties. Don't attempt to negotiate. Just get used to viewing and evaluating. Check out the property thoroughly; ask pertinent questions; and complete the Property Information/Evaluation Sheet included in this chapter.

9. Now look for the opportunities. Could you assign the right to purchase the property to another party? Structure a limited money-down deal? Acquire the property through assumption of the financing? Consider touching base with a professional and having the situation reviewed for opportunities.

10. Draft a contract. Double-check the figures and clauses. Make sure you have a couple "out clauses" ("subject to partner's approval"). Submit the offer to the homeowner, and see what happens. Will the owner ignore the offer or let the deadline expire? Will he/she/they submit a counteroffer? Time will tell. If they don't respond to your contract/offer, simply put them in a database with a note to call back in 30, 60, or 90 days. Situations change over time.

11. Examine your credit reports and increase your available credit.

12. Drop by a title company or visit with a real estate attorney. Ask about their fees and services. Also ask about volume discounts and the process in general.

13. You may want to invest in some letterhead and business cards to let people know you are a serious investor.

14. Take your banker to lunch. Let him or her know that you are beginning investing in real estate. Ask for timely information about interest rate changes, areas to invest in the local market, bank owned properties, and potential investors they may know. The rapport you build with bankers is as important as the information they possess.

15. Contact local real estate brokers, brokers who seem willing to work with you, brokers who specialize in distressed property. Establish solid contacts. They come in handy.

16. Call some rental properties in the newspaper. Ask the owners why they are renting. If the answer is “I couldn’t sell the property,” you have an excellent prospect. Ask this question: “Would you sell the property?”

17. Drop by the courthouse. It is not a scary place. Research a property. (Yours or a friend’s may be a good starting point.) The clerks will help you the first time or two with your research or point you in the right direction. Check out the Recorder’s Office, and inquire about the office that handles tax and mortgage foreclosures.

18. Attend an auction.

19. Tell associates, friends, and peers that you are looking for properties. Provide an incentive.

20. Start developing a database of buyers. Spread the word among your contacts. You may even post flyers or ads to acquire a buyers’ database.

21. Check out the “Money Available” section of the newspaper. A number of the individuals offering cash invest in real estate and may be a good source of capital, contacts, and properties. The same is true of the money for mortgages section. (“We buy mortgages.”)

22. Review your materials at regular intervals. Keep you goals in mind. Most of all, keep the commitment to spend a specific amount of time looking for ideal properties, studying investment strategies, and learning more about the industry.

By taking these simple but important steps, you will be well on your way to a successful career buying and selling real estate.

Call Sheet

PHONE: ____

CONTACT: ____

PROPERTY STREET ADDRESS: ____

CITY, STATE & ZIP: ____

ASKING PRICE: $ ____

______ BEDROOMS ______ BATH

______ GAR ______ FAM ______ FLA

OTHER FEATURES:

____

____

____

(IF INCOME PROPERTY)

NUMBER OF UNITS: ______ ______ BR _____ BA ______GAR

______ ______ BR _____ BA ______GAR

______ ______ BR _____ BA ______GAR

TYPE OF FINANCING ____

ASSUMABLE? Y N

INTEREST RATE? __________ TERM __________ YRS __________ BALLOON _________

CURRENT LOAN BALANCE: ____

CURRENT RATES

MONTHLY PAYMNET: $ ______________ TAXES ______________ INS _______________

ADDITIONAL MORTGAGES AGAINST THE HOUSE:

2ND __________ AMT __________ % __________ PAYMENT __________ YRS LEFT

3RD __________ AMT __________ % __________ PAYMENT __________ YRS LEFT

IS THERE A TRANSFER FEE TO ASSUME? YES NO $ _________________

OTHER LIENS AGAINST PROPERTY: ____

HOW OLD IS THE HOUSE? ____

WHAT IS THE ZONING? ____

ALL-CASH PRICE? ____

SQUARE FOOTAGE: ____

(INCOME PROPERTY) _____________ PER UNIT

WHAT APPLIANCES ARE INCLUDED? ____

____

IS THERE ANY FIX-UP NEEDED? Y N

____

WILL OWNER CARRY BACK ANY FINANCING? Y N AMOUNT $ ____________

AND AT WHAT % ___________ FOR WHAT TERM ___________

CONSTRUCTION: CBS FRAME

ROOF: SHINGLE TILE BUILT UP ROCK

WHY ARE YOU SELLING THE HOUSE?

____

HOW LONG HAS IT BEEN ON THE MARKET? ____________________________________

ANY CONTRACTS YET? Y N

IF SO, WHY DIDN'T IT GO THROUGH? ____

____

HOW WOULD YOU COMPARE YOUR HOME TO OTHERS IN THE NEIGHBORHOOD, SOLD IN RECENT MONTHS?

____

____

(INCOME PROPERTY ONLY) MONTHLY RENT PER UNIT:

W/UTILITIES $ ______________________ W/O UTILITIES: $_____________________

HOW MANY UNITS ARE THERE? ____

HOW MANY UNITS ARE OCCUPIED? _________ _______ LEASED ________ M to M

IS IT A GOOD RENTAL NEIGHBORHOOD? YES NO

NOTES:

____

____

____

____

REAL ESTATE OFFICE: ____

SALESMAN: ____

PHONE: ____

Key <u>Resources</u>:

1. Car, phone/cellular phone, and clipboard & pen. Make easy to use information sheets (Address, Telephone #, Comments). Never try to take notes while driving. Find a safe place to pull over, and then take down information and place calls.
2. Newspapers (check classifieds every day and the weekly Real Estate section)
3. Real estate magazines (Check the supermarket.)
4. Realtors (Start with small, “mom & pop” companies; they’re more flexible)
5. Builders
6. Telephone book. Search for financial institutions that have real estate to sell. (Ask for the REO [Real Estate Owned] department.)
7. Property management companies
8. Investment companies
9. Attorneys, estates/trusts
10. Courthouse/Town Hall (Registry of Deeds, Lis Pendens Files [Foreclosures] legal advertisements)
11. IRS auctions and sales
12. HUD, VA, FHA, FNMA, FHMC local offices

And, of course, the Internet

Locating potential investment properties

There are a number of ways to locate potential investment property. Begin your search with the newspaper. The best properties to negotiate are FSBO (**F**or **S**ale **B**y **O**wner). Begin your search for the ideal investment property with this group of sellers. Specifically, search the classifieds for ads that give you hints to an owner’s motivation. You are looking for motivated sellers. Perhaps they have been transferred or just need cash quickly. Literally hundreds of distressed properties are advertised for sale. You can’t afford to not use this resource!

The second place to search is the “Homes for Rent” section of your newspaper. In a number of cases, these properties are being rented because the owners could not sell the property and need cash to pay the mortgage. If you keep asking the question, “Would you considering selling,” you will likely hear a lot of “yes” answers.

The third place to look is in specific neighborhoods. Simply drive through the neighborhood, and look for “For Sale By Owner” signs. You will find many.

You can also call on properties that are being offered by Realtors, but you must realize that Realtors will complicate negotiations and want a healthy commission for their efforts.

7 Important Questions to Ask Realtors

Working directly with homeowners ensures that you will be represented in the manner you wish to be represented and takes commissions out of the equation, commissions that can inflate asking prices. That said, a real estate professional can be a valuable asset if he or she understands what you are looking for and is prepared to work with you in the acquisition of investment property. Finding a good Realtor can take time. It may take a few attempts before you find one you can count on, one who understands your plan and is prepared to work with you in carrying it out. Consider making one or two real estate professionals a part of your team (or consider becoming one yourself).

Find below a list of questions that can assist in developing Realtor relationships.

1. We buy properties at 30%–40% below fair market value for cash and are prepared to close quickly. Do you handle properties that can be purchased below market value, from motivated owners who wish to sell quickly?

2. Do you know of any properties that can be bought below market right now?

3. How about if we re-list the property with you ("double dipping")?

4. Do you know of anyone who has property of this type for sale?

5. How about properties with FHA or VA mortgages? Can you locate any?
Fully assumable?

6. We want to assume no-qualify mortgages; however, an all cash deal is okay. We are prepared to close quickly at the right price.
No? How about other associates?
No? May I speak with your office manager?

7. Can you call me back with some good deals in a few hours?

Let's make some money!

Single-family homes vs. other real estate investments

The material in this program applies to most real estate ventures; however, we suggest you begin your real estate investing career in single-family homes. Single-family homes have distinct advantages for the beginning investor:

1. The market (group of potential buyers) is exceptionally large. There are many single-family homes for sale in the marketplace. At any given time, critical events are happening in homeowners' lives, which create opportunities for real estate investors—for example, individuals being transferred or moving, losing a job or other financial problems, divorce, illness, or a death in the family. These, oftentimes unfortunate, situations can give rise to property discounts.
2. The demand for single-family homes is growing; therefore, you can usually turn around a good deal and in a short period of time, especially if the sale is well structured and at a reduced price.
3. Investing in single-family dwellings can reduce the need for property management. In most cases, the property will be sold, assigned immediately, or rented using a lease option contract, thus reducing or eliminating tenant problems.

4. You may not know much about apartment complexes or commercial real estate, but chances are you know about homes. Start with what you know. There will be other opportunities later, after you have more experience and capital to work with.
5. The home market is the easiest to borrow against. Home equity loans are common in the single-family property market, affording outstanding opportunities for financing and pulling equity out of properties.

Ideal investment properties

Before hitting the market, you should have a reasonable idea of what you're looking for. Keeping in mind the need to sell property within a reasonable amount of time, stay away from the high end of the market. Also, stay away from the low end of the market and houses located in less than desirable neighborhoods. Fixer-uppers are great if you have the time and expertise to do the fixing yourself, or have friends who do, but middle-range homes move the fastest, because there are more potential buyers, helping you turn properties around more quickly and therefore make bigger profits. It should be pointed out that homes in "fringe areas," formerly less than desirable neighborhoods that are becoming more desirable, sometimes make good investments, largely due to rising property values and community improvement. As buyers jump on the bandwagon, though, good deals become harder to find in fringe areas. Although fringe areas often become "we care" neighborhoods, you should still consider this type of investing more risky than the type outlined below. Homes in fringe areas also tend to be older and typically require more and costlier repairs.

Quick target property coding:

The quick appraisal system codes property using a simple ABC rating system (A-property: 70K to 170K, B-property: 170K+, C-property: less than 70K). A-properties are moderately priced, single-family homes—ideal investment properties.

Ideally what you're looking for, especially if you're new to real estate investing, is an awesome deal on an average 3-bedroom 2-bath home in need of some good old-fashioned TLC: cleanup, minor repairs, cosmetic enhancements (paint, carpet, etc.), lawn work, etc. It should be located in a "we care" neighborhood, meaning that the people who live there care about their neighborhood and take pride in their homes. Schools, churches, parks and recreation areas, and nearby shopping further enhance the value of property.

Basic search characteristics:

- Typical 3/2 (3-bedroom/2-bath) home, ideal for the average family of two adults and two to three children.
- Moderately priced—not the top of the market, not the bottom.
- No construction, unless you're pretty handy with tools.
- Minor repairs and cosmetic enhancements only (cleanup, paint, carpet, lawn work, etc.). The property should be free of costly damage and need no major repairs, unless of course you are capable of tackling such repairs.

• “We Care” neighbors.

Focus on neighborhoods where a growing family would like to live. Remember that churches, parks, recreation centers, public playgrounds and swimming pools, schools and desirable school districts, convenient shopping, and crime watch programs all enhance the value of property. “We care” neighborhoods are easy to spot; just look for kids playing in the yards, clean streets, and well-tended lawns and gardens.

The beginning real estate investor can easily become distracted from the ideal property to buy and resell. The low price of a fixer-upper or the potential killing on a high-priced property may seem very attractive, and you can make money in the low end and high end of the market, but the easiest place to make money is in the middle range of the real estate market. The challenge with the low end of the market is the time it may take to resell the property. First, if it is a true fixer-upper, the time and money it may take to repair the property (two to four months) may prove costlier than you anticipated. Then you have to try to sell potential buyers on the location, perhaps another three to six months. At the high end of the market, there is also a longer sales cycle, perhaps requiring six to twelve months of marketing. Remember, there are more buyers for moderately priced homes in “we care” neighborhoods. There are more buyers for moderately priced homes in desirable neighborhoods than for any other segment of the real estate market, which is why they tend to sell considerably more quickly than other properties.

Again, one of the best places to start looking for investment property is the newspaper or “for sale by owner” real estate publications. A great many properties are sold through classified ads. They are a readily available resource, and with a few insights, you can focus on the most desirable potential investment properties. Look for the following key words in ads that indicate a motivated seller.

Price reduced	For Sale By Owner (FSBO)	TLC
Non-qualifying loan	Nothing Down	
Must sell	Out-of-town owner	
Desperate	Moving	
Motivated seller	Seller anxious	
Transferred	Will sacrifice	
Illness forces sale	Repossession	
Bankruptcy	Estate Sale	
Foreclosure	Ideal investment property	
Below market value	Distressed property	
Below Appraisal	Divorce forces sale	
Buying another home	Owner financing	

Stay away from these words in classified ads:

Gorgeous
Oversized den
Ceiling fans
Wall-to-wall carpeting

Walk-in closets
Custom cabinets
Tiled foyer
Gorgeous fireplace
Great view
Large bedrooms

They are trying to sell you a home at full price.

Be First or Be Last

Realize that the best negotiators are usually the individuals who tie up property by contract first or last. Try to be the first person to see a property. If it fits your search criteria (you consider it to be an ideal investment property), submit an offer immediately. Tie it up so it is off the market. Since you will have clauses in your contract that will give you an out, there is no risk in putting an offer in immediately. By doing so up front, you will eliminate a bidding war.

If you can't be first, be last. You might even consider putting classified ads aside for six months. Then call the owners. If a property didn't sell, or a previous deal fell through, the seller should be fairly motivated. Automate the process by keeping a database older classifieds.

Telephone Strategies

If you were to call on all the property available in your market and visit every home for sale, you'd go crazy. It would take forever, and likely you would never find the real gems that are out there. A telephone and a quick survey form are your best tools for saving time and maximizing your search for ideal investment properties. Find below a sample survey script and questions you can ask to get the ball rolling.

<u>Script #1</u>:

"Hi, my name is ____________________. I'm a real estate investor and would like to discuss your property for sale. Is now a good time? (If not, ask for an appropriate time to call back.) I'm looking at several properties and just need to take a few minutes of your time to determine if your property would be of interest to me. If it is, I would submit an offer within 24 hours."

<u>Script #2</u>:

"Hi, my name is ____________________. I'm a real estate investor. I try to solve problems many sellers face. Maybe I can be of service to you.

It can take a considerable amount of time to sell a home, time that could drag on for months or even years. As time goes on, you must continue paying the mortgage, and because of real estate commissions, you end up getting less for your property than you should. Even if you take a chance with a Realtor and find a buyer, the buyer may not qualify for a mortgage loan, which means more wasted time and mortgage payments you'll have to make waiting for the right buyer to come along, not to mention the hefty interest you'll have to pay while waiting for a qualified buyer, when you could be earning interest on the proceeds from the sale of your home. If a buyer does eventually qualify for a loan, you'll still end up waiting and paying a real estate commission of around 7%. You'll also likely end up paying around 3% closing costs. Your total expenses could add up to 20% or more. What we do is simplify the process by immediately paying you a fair cash price for your home, helping you avoid costly delays selling your home. Do you feel we can work together?"

Key Questions:

Where is your house located?
How long have you lived there?
Why are you selling?
Are you in a hurry to sell? (Any deadlines?)
How long has the house been for sale?
How much do you think your house is worth? How did you arrive at that figure?
How quickly do you want to close?
How flexible is your price if we make a cash offer?
Do you have plans for the money?
Are you flexible on terms?
Would you carry back financing: OTB (owner take back) or SB (second mortgage)?
What is the balance on your mortgage? (Equity should be minimum 30%.)
What type of mortgage? Interest rate? Assumable? FHA or VA?

Answers to these important questions will give you a good indication whether or not a particular property meets your search criteria and whether or not the owner will work with you. Don't be in such a hurry to ask these questions that you don't let the homeowner get a word in edgewise, and be sure to take good notes. Seem genuinely concerned about the needs and wants of the homeowners you speak with. Imagine that you're having a conversation with a friend of yours.

If the homeowner seems evasive or unwilling to answer your questions:
"I don't want to waste your time or mine. I'd like to submit an offer as soon as possible, but I need more information to go on. I just have a few more questions."

If homeowner wants you to come see the property:
"I would love to, after I get some answers to a few more questions."

Your time is valuable. Don't waste it!

Property Information/Evaluation Sheet

PHONE: ______________________

NAME OF CONTACT: ____

ADDRESS ____

____

PRICE $ __________________BR _____ BA _____ GAR _____FAM _____FLA RM _____

Notes:

____

____

____

IF INCOME PROPERTY, HOW MANY UNITS ________ BR _____ BA _____ GAR _____

WHAT IS THE EXISTING FINANCING ON THE HOUSE?

A. INTEREST RATE? ______ TERM ______ YRS ______ BALLOON ______

B. PRIVATE VA/FHA CONVENTIONAL

C. CURRENT LOAN BALANCE: ____________________ASSUME? YES NO

CURRENT RATES ____

D. PAYMENTS PER MONTH $ ___________ TAXES _________ INS

E. ANY ADDITIONAL MORTGAGES AGAINST THE HOUSE?

2ND ____ AMT _____________ % ________ PAYMENT __________ YRS LEFT ___

3RD ____ AMT _____________ % ________ PAYMENT __________ YRS LEFT ___

F. IS THERE A TRANSFER FEE TO ASSUME: YES NO $ ______________

Notes:

____

____

____

HOW OLD IS THE HOUSE? ____

WHAT IS THE ZONING? _________________ ALL CASH PRICE? _____________________

SQUARE FOOTAGE:

INCOME PROPERTY? _______________ $ PER UNIT _______________________________

WHAT APPLIANCES ARE INCLUDED: REF ST D/W W/D

IS THERE ANY FIX-UP NEEDED?

____

____

WILL THE OWNER CARRY BACKFINANCING? _________HOW MUCH $ _____________

AND AT WHAT % ___________FOR WHAT TERM _________________________________

CONSTRUCTION: ________________________CONCRETE BLOCK _____ FRAME _____

ROOF: ________________________SHINGLE TILE______BUILT UP______ROCK ______

WHY ARE YOU SELLING? ____

____

____

HOW LONG HAS IT BEEN ON THE MARKET?

ANY CONTRACTS YET? _________ IF SO, WHY DIDN'T IT GO THROUGH? __________

____

HOW WOULD YOU COMPARE YOUR HOME TO OTHERS IN THE NEIGHBORHOOD, WHICH HAVE SOLD IN RECENT MONTHS?

____

____

INCOME PROPERTY ONLY:

MONTHLY RENT PER UNIT $ ____________________

W/O UTILITIES ________________ W/UTILITIES ________________

HOW MANY UNITS ARE PRESENTLY OCCUPIED: ______ _____ LEASED ____ M to M

IS IT A GOOD RENTAL NEIGHBORHOOD? YES NO

NOTES:

____

____

REAL ESTATE OFFICE ____

SALESMAN____ PHONE_________________

Foreclosures

In the United States, there are approximately twelve ways to foreclose on real property. Each state has its own procedure and method of execution, which fall into these major groups:

1. Mortgage Lien and Judicial
2. Mortgage Lien and Power of Sale
3. Trust Deed Lien and Power of Sale
4. Trust Mortgage Title and Power of Sale
5. Mortgage Intermediate and Judicial
6. Trust Deed Intermediate and Power of Sale
7. Mortgage Intermediate and Power of Sale
8. Mortgage Intermediate Strict Foreclosure
9. Trust Deed Lien Judicial
10. Mortgage Title Judicial
11. Security Deed and Power of Sale
12. Mortgage Title Entry and Possession

Each state has a specific foreclosure process — step-by-step procedures for lenders and owners to follow. You should understand the specifics of your state's process and the minor nuances.

How property is held

Generally, real estate is secured by either a debt or a lien, often called title theory or lien theory. Title theory states classify the mortgages or trust deeds for properties as contracts, and contract law applies. The contract conveys the title to the property secured by the underlying debt. In lien theory states, the mortgage or trust deed is a lien against the property. A lien just means an entitle (usually a bank) has a claim or hold on a property as security for a debt. Liens are an encumbrance to the property and recorded against the property. There may be more than just one lien (debt) against a particular property.

The foreclosure process

The lender follows a specific procedure for repossessing property or facilitating the satisfaction of the debt. The states are split approximately 50/50 on the process.
First, there is Power of Sale. Many of the trust deed states use Power of Sale. Power of sale tends to be a less expensive and quicker way to foreclose on a property. Under Power of Sale, the lender (trustee) informs the property owner that the debt has not been paid and specifies a due date. In a few weeks, if payment is not processed, a stronger demand for the payment is issued, often an immediate demand for payment. States regulate the period of time prior to public auction (approximately four weeks).

The process is sometimes complicated by FHA and VA properties. The federal government guarantees these properties, and its programs have their own regulations and procedures for rectifying debt obligations and listing properties. A deeper understanding of the FHA and VA process is encouraged. There are some outstanding opportunities in the FHA and VA foreclosure market. Contact your local branch office for more information.

Judicial Foreclosure, which is governed by the courts, accounts for half of our nation's foreclosures. Note that Power of Sale states usually have some form of judicial procedure.

Although slightly different in approach, both systems have essentially seven steps:

1. Non-Payment

Almost everyone has been late paying bills, mortgages included. The penalty for being two weeks late may be a nominal late fee and perhaps a mention on our credit report. Beyond two weeks, lenders start to get a little anxious. They may let a month slide, with notice of non-payment, but very quickly they begin to take non-payment seriously. The second month they will send a past-due notification, and approximately six to eight weeks after the non-payment, you can expect the phone to start ringing. The lender will try to solve the problem and work out a plan for repayment.

2. Default

If a mortgage continues to go unpaid, the note is moved to a default setting. Legal action is initiated. There is a demand letter, asking for full and immediate restitution of the debt owed, or a foreclose suit will be filed.

3 Lis Pendens

After default, a Lis Pendens is filed against the property. This legal notice will include the following: case number (assigned by the court), lender (plaintiff), owner(s) (defendants), property, legal description, notice of foreclosure, and attorney for the plaintiff.

4. Complaint

A complaint lists the events that took place to force foreclosure. Also included is a detailed listing of the mortgage amounts owed, timeframe of nonpayment, listing of the parties and property, a complete history of the mortgage, and reference to the official documents. At this point, the note is accelerated. The entire amount of the mortgage and related costs is due.

5. Judgment

Final judgment occurs after a set period of time determined by state law. The defendant can still rectify the situation by paying the default. All fees must be paid, including court fees and legal costs. That does not mean, though, that negotiations can no longer take place (by the owner or an investor). The lender will file a motion for judgment. When final judgment is granted, the plaintiff has the right to sell the property.

6. Sale

After judgment, the motion of sale is put into action. An order for the sale is processed, and a specific date for public auction is set.

7. Redemption Period

The process of foreclosure can take anywhere from three months to a year from start to finish. During this time, legal fees and costs are escalating and being attached to the property; however an investor can acquire the property at any point during this period. Obviously, earlier would be more favorable than later, because of mounting costs. It varies by state, but investors can usually intervene up to the day of the sale. On the day of the sale, a bidding war can erupt.

Visit the courthouse

In mortgage-theory states, the sale (auction) of property that has been foreclosed on takes place at the courthouse. The foreclosure process is threatening to the homeowner and occasionally concerns may rise for the lender, but these factors should not scare you at all. The process is systematic and well defined. At regular times of the day and week, the court auctions off property (the sale). Simply call the office, and ask the clerk for the times. It's sometimes said that property is sold "at the courthouse steps." Actually, it is typically sold in the lobby, foyer, or other specified location. A typical procedure (sale) would involve:

- A scheduled time for properties to be sold
- A clerk announcing file/case numbers and their status (solved, available, etc.)
- Announcement of the case and/or property description and asking for bids
- Bidding starts
- Winner emerges
- Property is bought and paid for at the courthouse

There will usually be at least one bidder. The lender wants to make sure the property is sold for at least what is owed on it; therefore, the lender or their designate starts the bidding at the amount being foreclosed on. If that is the only bid, the auction is over. The lender will actually receive the money, so there is no real cost. There have been the occasional errors in which the lender did not protect its debt and a bidder other than the lender received the property for a song. If there are multiple bidders, the process can be quite entertaining. It is strongly suggested that you visit the courthouse and watch several auctions. You will learn much about the process. You may even try to get to know some of the other individuals at the foreclosures. Bankers, lawyers, agents, investors, and title company representatives will sometimes be in attendance, all excellent contacts for the investor.

If you own a property, check the documents while you are at the courthouse. Just ask the clerks. It will help if you have the legal description. Get it from your mortgage documents. Also review the bulletin boards in the offices, and pick up any publications and notices in the offices. Check the Lis Pendens list (legal notice of foreclosures). In deed-of-trust states, the process is a little different. The trustees controlling title of the property can control the location of the sale, which may or may not be at the courthouse. Usually, the trustees publish sale locations.

The foreclosure market offers many opportunities for profit. Certainly, you can buy a property during the foreclosure process prior to sale at a discount, but as the foreclosure clock counts down to the time of sale, opportunities abound. Here are some examples and foreclosure strategies:

1. Joint venture with the owner. The owner may be experiencing a temporary financial setback and have substantial equity in the property. Perhaps you can approach the owner and attempt to solve his/her/their problem by getting the payments back on track, saving his/her/their personal credit profile. In return, you might agree to 50% ownership of the property. Alternatively, you could agree to sell the property and get cash out for both you and the owner. In this case, you would want to get to the owner early in the foreclosure process.
2. Look for properties with substantial equity. Usually the lender is going to make a bid just over the loan value to ensure the debt is paid. There may, however, be substantial equity in the property. You could pick up a property at a major discount and make a big profit reselling it.
3. Approach auction winners, and inquire if they would like to sell their property, perhaps on a lease option or installment sale.

The Foreclosure Clock:

Foreclosure process begins
Demand letter
Lis Pendens
Complaint
Default
Final judgment
Sale date set
Right of redemption period

Foreclosure Terminology

Foreclosure: *Foreclosure* is a legal proceeding instituted by a lienholder to enforce the lien against the debtor when he or she is in default of the debt or charge or fails to perform some act to which he or she is bound. Foreclosure results in a public sale of the property covered by the lien, with the proceeds of the sale used to pay (satisfy) the lienholder's claim. Foreclosure also terminates all rights of the debtor in the property, including the debtor's right of equity of redemption (in most states).

Equity of redemption: *Equity of redemption* is the right of the debtor during the foreclosure proceeding, and before the public sale, to redeem his or her interest in the property after it has been defaulted by paying the full debt plus interest and costs. Some states have statutory redemption, which gives the debtor equity of redemption for a certain period of time after a public foreclosure sale. The foreclosed debtor must pay the full sales price plus interests and costs to redeem interest in the property.

Types of foreclosure proceedings: The three general types of foreclosure proceedings are:

1. **Judicial foreclosure**
   A judicial foreclosure is the process of enforcing a lien by filing a foreclosure suit in court.
2. **Non-judicial foreclosure**
   A *non-judicial foreclosure* is the process used in some states of enforcing a lien through a power of sale, which is a clause in the lien giving the lienholder the right to conduct the foreclosure and sell the property without filing a foreclosure suit in court. Under this type of foreclosure, the lienholder advertises the property and holds a public sale to sell the property.

3. **Strict Foreclosure**
   A *strict foreclosure* is the process used in some states of enforcing a lien. Under this process, the lienholder gives the delinquent debtor notice of default and files the appropriate documents in court. The court then establishes the amount due on the lien and orders the debtor to pay the defaulted debt in full within a certain time. If full payment is not made within this time, the debtor's equity of redemption is foreclosed (terminated) without a sale of the property and title to the property is awarded to the lienholder by the court.

Liens defined

A *lien* is an encumbrance on the title to real property. It is a legal right that a creditor or government (city, county, state, or federal) has over specific real and personal property of a debtor as security for repayment of a debt, charge, or for performance of some act to which the debtor is bound.

A property owner may voluntarily create a lien, such as pledging the property on a mortgage lien in order to secure a loan. Liens may also be involuntarily created, such as a judgment lien arising out of a legal proceeding against the debtor to enforce a debt on which he has defaulted, or the placing of a tax lien against the property by a governmental agency. A lien does not transfer title to the property from the owner to the lienholder.

Five common types of liens:

1. Tax and Special Assessment Liens:

Real estate tax liens

(Real estate tax liens are filed against real property.)

Special assessment liens

Special assessment liens [municipal improvement liens] are filed against real property for improvements such as street paving, sidewalks, sewers, etc. A lien for an improvement not completed is a pending special assessment lien; a lien for a completed improvement is a certified special assessment lien. Generally, special assessment liens are levied only against those properties that will benefit from the improvement and in an amount apportioned according to the cost of the benefits received, rather than by the assessed tax value of the property.

Federal estate tax liens and state inheritance tax liens

Federal estate tax liens and state inheritance tax liens accrue against real and personal property at the time of death of the owner.

Note: Real estate tax liens, special assessment liens, and federal estate tax liens are imposed by law <u>without the consent of the owner</u>. They are superior liens because, when they are filed with the Clerk of the Circuit Court, they take precedence over all other types of liens.

Federal income tax liens

Federal income tax liens may be filed against real and personal property for nonpayment of federal income taxes.

State corporate income tax liens

State corporate income tax liens may be filed against corporate real and personal property for nonpayment of state corporate income taxes.

State intangible tax liens

State intangible tax liens may be filed against real and personal property for nonpayment of the state intangible tax on such items as stocks, bonds and mortgages.

Note: Federal income tax liens, state corporate income tax liens, and state intangible tax liens are imposed by law <u>without the consent of the owner</u>, but take precedence only from the date of filing with the Clerk of the Circuit Court.

2. Judgment Liens

A *judgment lien* is a lien rendered by a court in lieu of monetary compensation awarded to a plaintiff against a defendant as a result of a suit.

3. Mortgage Liens

A *mortgage lien* is a lien placed on real property voluntarily by a mortgagor (owner of real estate) as security for repayment of debt.

4. Vendor Liens

A *vendor lien* is a right of a vendor (seller of real estate) to place a lien against a sold property as security for any unpaid balance of the purchase price. A vendor's lien right is waived if any other form of security for the debt has been received.

Note: Judgment, mortgage and vendor's liens take precedence only from the date of filing with the Clerk of the Circuit Court.

5. Mechanic's Lien

A *mechanic's lien* is a lien for labor, materials, supplies or repairs to construct or improve property.

Note: Mechanic's liens filed with the Clerk of the Circuit Court date back and take precedence over mortgages given after the date the first supplies or materials were delivered to or repairs or labor were performed on the property, mortgages given during the progress of construction, or mortgages given within 90 days after the last supplies or materials were delivered to or repairs or labor were performed on the property.

Notice of Default

The foreclosure process begins with a *notice of default* being filed by the lienholder. The Notice of Default names as defendants the debtor and anyone else who may have any rights or interest in the property covered by the lien. The Notice of Default identifies the debt and the lien securing it and states that it is in default.

Lis Pendens

Concurrent with the filing of the Notice of Default, a *lis pendens* is filed on the public records in the county in which the property is located, for the purpose of giving notice to all persons that the title to the affected property is in litigation and may become subject to foreclosure.

Public Sale

The public sale is usually a sale at auction upon notice to the public of the sale. The sale is usually conducted at the county courthouse. If the proceeds from the public sale exceed the lienholder's claim, and any junior liens, the debtor receives the excess, less any unpaid property tax liens and expenses of the sale. However, if the proceeds are less than the lienholder's claim, a deficiency exists. In this case, the lienholder may request the court to enter a deficiency judgment against the debtor for the balance due. A deficiency judgment gives the lienholder (creditor) the right to attach the judgment as a lien on the debtor's other real and personal property, and if necessary, foreclose on the judgment lien to obtain the balance owed. (Deficiency judgments are not available in some states.)

Deed in lieu of foreclosure

To avoid the trouble and expense of a foreclosure proceeding, a debtor who is in default on a lien may voluntarily deed his property covered by the lien to the lienholder (creditor) if the lienholder agrees to accept the title. The debtor should receive a letter from the lienholder cancelling the unpaid debt. A deed in lieu of foreclosure does not extinguish the rights of any lienholder whose lien is senior or junior to the lien in default.

Priority of liens

In a foreclosure situation, a lien may be superior (senior) or inferior (junior) to the lien on which the foreclosure action is based, depending on provisions of law or the recording date of the liens. The example below illustrates the priority of liens in foreclosure situations.

A vacant residential lot was purchased for $20,000 cash on January 15. On February 20, the owner entered into a contract with a builder for $80,000 to construct a home on the lot. Construction on the home started on March 1. On April 12 the owner obtained a construction loan and a permanent loan from a savings and loan association in the amount of $75,000, secured by a mortgage lien on the property. On May 5, a special assessment lien of $1,000 for sidewalks was certified by the city. Construction was completed on August 10, and $16,000 was due the builder, because of changes and the addition of an enclosed swimming pool. On September 1, a judgment lien was filed against the property for $12,000, based on a delinquent credit card account debt of the owner. On September 8, the special assessment lien was foreclosed because of nonpayment. None of the liens have been paid. The proceeds of the sale are $90,000, and are distributed according to lien priority:

1. Special Assessment Lien (May 5)	$1,000
2. Mechanic's Lien (Dates Back)	$16,000
3. Mortgage Lien (April 12)	$75,000
4. Judgment Lien (September 1)	$12,000

The sale proceeds of $90,000 are sufficient to pay off the special assessment lien of $1,000, the mechanic's lien of $16,000, and $73,000 toward the mortgage lien of $75,000. No money will be paid toward the judgment lien. The mortgage lienholder (the lender) and the judgment lienholder (the credit card company) must now look to other real and personal assets of the owner to satisfy their claims.

Trust Deed foreclosure process

Note is the same (a promise to pay lender)
Third party is now in the picture:
Beneficiary: lending institution or person who lends the money.
Trustor or *Grantor*: person who owns the property.
Trustee: person to whom the beneficiary and trustor have entrusted the title of the property (until the debt has been paid).

When the mortgage is paid in full, the Trustee conveys the title to the Trustor who then owns the property free and clear. If the trustor fails to make the payments, the beneficiary notifies the trustee that the payments have not been made and is to put the property into default. The beneficiary is the person who decides when to ask for a Notice of Default. It could be one day, but usually is 60–90 days. Once 90 days have passed, the beneficiary notifies the trustee that the note is in default, and the trustee files the Notice of Default with the county recorder's office. This triggers a three calendar month period—not 120 days—three exact calendar months. Then the process moves to stage two: the publication period. This is when they really get serious about the auction of the property. The trustee must publish, for three consecutive weeks, in a paper of general circulation (21 days). At the end of the 21st day, a sale date is set, an auction is scheduled, and the property will be sold to the highest bidder. All cash is required at the sale. There is no catching up payments. The lender is entitled to all cash.

The auction may be held at the courthouse or another location convenient for potential buyers (attorney's office, title company, etc.). Sale locations are published in the notice of sale in the newspaper. Bidders must bring a cashier's check in the amount of the final judgment or default amount or larger, depending upon the bid.

Winning in the foreclosure process

There are basically three ways that you as a real estate investor can effectively work with property that is in foreclosure or property that has been foreclosed upon and has been retained by the lender.
1. Bid successfully on a piece of property at the foreclosure sale.
2. Negotiate a contract on a property with the owner prior to the pending foreclosure sale.
3. Negotiate a contract with the lender retaining a property after the foreclosure sale.

Note: Oftentimes, properties are turned over to real estate brokerage firms for resell.

Each of the three approaches outlined above can prove successful. Is one better than the others? That will depend on several key factors:
1. Are you going to assign your contract rights?
2. Are you going to "joint venture" the property?
3. Are you going to hold title to the property?
4. How much cash do you have available (yours or OPM)?
5. If you hold title to the property, what is your intent?
Sell quickly (short-term holding)?
Hold for short-term rental (2–5 years) and sell?
Hold for long-term rental (5–15 years) and sell, enjoying long-term market appreciation?

Each area of foreclosure has excellent profit potential. The area or areas you choose to work will be determined by what best suits your own individual investment needs. Let's look at some basic foreclosure examples.

Joe owns a property worth $100,000

Joe owes the bank a first mortgage ($60,000)
$500/month principal & interest

Joe owes Bob a second mortgage ($10,000)
$100/month principal & interest

The bank (first mortgage holder) is foreclosing, and the property goes to public sale. The highest bidder will own the property. The proceeds of the sale will be paid to the first mortgage holder (bank) first, to the second mortgage holder (Bob) second, and then to other lienholders (if any). The remaining proceeds will go to the owner (Joe)

QUIZ

Mary, an investor, bids $65,000 on what will soon be Joe's former property.

1. How much will the bank receive?
2. How much will Bob receive?
3. How much will Joe receive?
4. What happens to the second mortgage?
5. What happens to the first mortgage?

Answers:
1. $60,000
2. $5,000
3. $0
4. It's eliminated
5. It's paid in full

Let's look at another example.

Joe owns a property worth $100,000
Joe owes the Bank a first mortgage ($60,000)
$500/month principal & interest
Joe owes Bob a second mortgage ($10,000)
$100/month principal & interest

This time, Bob (second mortgage holder) is foreclosing, and the property goes to public sale. The highest bidder will own the property. The proceeds of the sale will be used to satisfy the second mortgage holder (Bob) first and then other lienholders (if any). The remaining proceeds, if there are any, will go to the owner (Joe). The high bidder now must make the mortgage payments.

QUIZ

Mary, an investor, bids $15,000

1. How much will Bob receive? ____________________
2. How much will Joe receive? ____________________
3. How much is Mary paying for the property? ____________________
4. What happens to the second mortgage? ____________________
5. What happens to the first mortgage? ____________________

Partial release of lien

If the lien is recorded against more than one property, try to obtain a “Partial Release of Lien” for the property you are buying.
1. Negotiate with the lienholder
2. Offer a cash incentive
3. Paperwork prepared by attorney or a title company

Example:

Lienholder has a lien against Joe
Joe owns three properties
Lien is against all three

You are interested in buying property-1. You pay lienholder $500 to release property-1. Lien still exists against properties 2 and 3. Lienholder is now $500 richer.

1. Buy the property “subject to” the lien.
2. Validity (Some liens are not valid. Ask a real estate attorney or a title company for advice.)
3. Statute of Limitations (Laws vary from state to state.)
4. IRS Liens

Strategy: Profit before the bank foreclosure sale

Joe owns a property worth $100,000
Bank holds first mortgage ($60,000)
$500/month P & I (ten months behind)
Bob holds a second mortgage ($10,000)
The Bank is foreclosing

1. Contact Bob (second mortgage holder).
2. Negotiate with Bob to purchase the $10,000 second mortgage for a discounted price ($1,000).
3. An “Assignment of Mortgage” will be prepared by attorney or title company.
4. You are now the second mortgage holder.

Options:

1.Negotiate with Joe and buy the property.
• Reinstate the first mortgage ($5,000 plus lender’s expenses).
• Satisfy your second mortgage (“Satisfaction of Mortgage”).
• Now *you* own the property.
• Reinstate the first mortgage, and foreclose on your second mortgage.

Possibility #1: Joe, the owner, reinstates the second mortgage (pays $5,000 plus your foreclosure expenses). You now hold a $10,000 second mortgage for which you paid $1,000. You can hold for the monthly income or discount and sell the second mortgage for cash.

Possibility #2: Joe, the owner, gives you a “Deed In Lieu of Foreclosure.” You now own the property.

Possibility #3: The Property goes to a public sale.

If no one else bids, you will own the property.
If anyone else bids, you receive cash.

FORECLOSURE EVALUATION FORM

PICTURE OF PROPERTY:

DATE: ______________________________

TELEPHONE # _______________________________________

OWNER: ____

ADDRESS: ____

CITY, STATE, ZIP ____

FILE INFORMATION:

LOAN TYPE: FHA VA CONV. OTHER _____________ CASE NUMBER ___________

PROPERTY ADDRESS: ____

PLAINTIFF ATTY & PHONE: ____

BALANCE OWING $ __________________________LAST PAYMENT: ____________________

INT RATE ______ % MTHLY PMT $ ________ ORIG. LOAN DATE & AMT _____________

____________________ ____

FOLIO # ___________________________________ TAXES $ ______________________________

LEGAL DESCRIPTION:

____

____

LIENS: ____

M FJ L B ______ P ______

M FJ L B ______ P ______

M FJ L B ______ P ______

M FJ L B ______ P ______

GRADING OF HOME: 1 2 3 4 5 ROOF: REPAIR? REPLACE? GOOD?

BDRMS _______ BATH _______ SQ FOOTAGE ___________ CENTRAL HEAT & AIR Y/N

POOL Y/N OTHER EXTRAS____

NOTES: ____

Motivated Sellers

Your best buys will always come from motivated sellers. A motivated seller is a person who wants to sell so bad that you can taste it. Talk to sellers. Ask them what they intend to do with the proceeds from the sale of their property. Find out their financial and tax situations. Take time to check expenses, including taxes, and scheduled rent. Make your offers conditional, so that you will have time to check things out.

Bypass real estate agents who will not let you speak with sellers. Make a low-ball offer with a condition that you must be present when the offer is presented. You are not serious with this offer, but want to get to talk with the sellers and find out what they really want, so that you can structure a real good deal. Do not show your hand to anyone, especially real estate agents or brokers. Take time to think through exactly what you are going to say and how you are going to say it before speaking to the seller or the seller's agent. The more motivated the seller, the better the deal, because sellers will make big concessions that under normal circumstances they would not. So be sure to seek those kinds of sellers. Your checkbook will thank you for it.

It may actually be wise to offer more than a property is worth to get attractive terms. By paying more than the property is worth, but getting it with a low down payment, the low interest cash flow could be very high.

Condition of the Property

To protect yourself, it is usually necessary to make an offer subject to certain conditions:

"Offer subject to the buyer inspecting and accepting the financial records and data of the seller." (This gives you a chance to verify the financial data without risk.)

"Offer subject to a complete inspection and acceptance by the buyer. Such inspection is to be at purchaser's expense." (This allows you to do a physical inspection without risk.)

"Vendor warrants that all appliances, electrical fixtures, plumbing, heating and air conditioning devices will be operative at the time of closing."

If the rents are collected on the first of the month, always try to close as soon after the first as possible. The adjustment in your favor will reduce the amount of money you will need on closing. A dollar increase in rents or a dollar decrease in expenses per month is worth an average of a hundred dollars added value to the property.

You must concentrate your energy and power. Anyone who wants to be successful should absorb the numbers game into his or her life. If you want to be a success, you must be willing to make the necessary investment. Real estate is a basic need. People always need a place to live, a place to work, a place to farm. Improved real estate is especially in demand, apartment units, single-family homes, duplexes, etc. If you do not like rentals, there are lots of other real estate investments.

Real estate is an imperfect market. It is unique in that there is no one central place of exchange where all properties are bought and sold. It is this very uniqueness that makes it a good place for you to invest.

Four key steps to buying real estate

There are four key steps to be followed in purchasing real estate:

1. Determine if the seller is motivated to sell.
2. Perform a cash flow analysis on the property.
3. Decide whether or not to bid on the property.
4. Get the story.

The reason for the first contact is to find out whether the seller is motivated to sell. The reasons for selling generally are not profit oriented. They are usually not logical; they are often emotional and sometimes irrational. Oftentimes, sellers are anxious to sell because of temporary circumstances (financial problems), which cause them to be more flexible. The seller might take an airline ticket, a car, a boat, your personal note, or just your handshake for the property. The seller will take whatever relieves the anxiety in his or her life. This is the time for you to begin problem solving.

What makes a seller motivated to sell? Perhaps a divorce, but it may be as simple as a transfer to another city or as traumatic as a loss of a job and a struggle to carry on. Health problems could be a factor, or maybe the owner needs money to pay the IRS or property tax liens. Maybe the owner is tired of managing the property or has problems with partners. Perhaps the house has been for sale for a year, or maybe the mortgage is in default and the foreclosure process has been initiated. Make sure that the problem is unique to the seller and within your ability to solve when *you* own the property.

Once you find a motivated seller, you also have likely found a good deal. You will find far more ideal properties than motivated sellers. In order to practice conservation of time and effort, do not waste your time looking at thousands of attractive properties for which you will never find the key to a profitable purchase: a motivated seller. Make offers only on their properties. Pick a seller before you pick a property. How do you do this? It may be by telephone, by answering an ad in the paper, by driving through neighborhoods looking for FSBO properties, or you may just stumble onto a motivated seller. Whatever the method, remember to be friendly and encourage him or her to open up to you. Do not ask questions that could put him/her on the defensive. Find some feature of the house that you like, and comment on how much you like it. You could ask, “Why would anyone want to sell this house?” The best strategy is to ask suitable questions that will lead you to an understanding of the seller’s situation and motivation. Relax him or her by asking, "What is the MOST you will take?” "How long have you lived in the house?” “If I were to give you cash, what is the least you will take?" "What is the reason for selling?” “Why are you moving?” "What is your new home like?" (If this seller is only thinking of moving, then he or she is not likely to be all that motivated. On the other hand, if the owner has purchased another home and moved there three months ago, he or she could be highly motivated.)

“Has the property been rented?” If not, this is probably a motivated seller. "Do you have any other property for sale?” This question could help uncover other opportunities or problems the seller may be having). "How soon can you move?" If the seller says “yesterday,” then you have found a motivated one. "How long does the mortgage have to run?" If it expired last week, you are on the right track. "Can I pay you full price?" Of course the seller will agree, but this opens the negotiations up for further possibilities. "Have you tried to sell the property privately? How much did you ask?" (The answer may indicate that the price is too high.”) "Would you invest the 25% down payment?" "Which is more important to you: a large down payment or full price with large monthly payments? Why?" "Under what terms are you selling your property?"

Benefits of seller financing

- Possible tax savings through an installment sale or possible combination of trade and seller financing.
- Property sells quicker with flexible financing.
- Seller might have specific, future money needs, which could be structured into a no-pay note (college or retirement).
- Seller could be assured of a specific yield on equity exceeding many savings plans.
- The loan is secured by a piece of property the seller knows well.
- The seller is turning an equity interest into a possible higher cash flow.
- Generally, a lower interest rate.
- Longer period of constant payments.
- Opportunity to insert clause beneficial to the buyer subordination.
- Prepay, discount.
- Generally no credit check or income restrictions.
- More flexible repayment plans.
- Negotiable financing.
- Defer the down payment by the amount of money required.
- For remedial work or use it as a rebate.

Set the Closing Date as Far into the Future as Possible

The closing date is when the buyer(s), the seller(s), and their representatives meet at the closing agent's office (attorney’s office or the title company). Whether you close at a title company or an attorney's office is determined by the accepted practice in your state or area. The closing is when the transfer of deed takes place. This is where all the paperwork is completed and the signing of the documents takes place. If there is a first or second mortgage company involved, these companies will need a representative at the closing. A check is necessary for the closing agent to close the transaction. Closing agents with title companies, although not attorneys, are sometimes more knowledgeable and effective. These agents spend the majority of their working hours helping buyers and sellers close on properties.

The Seller's objective

Sellers want to put the real estate transaction behind them and collect the money. Their main objective will usually be to close as soon as possible.

The Buyer's objective

The buyer's objective is to defer the closing as long as possible. Once you have fixed the price and terms, you want the closing date to be far into the future, thus delaying having to come up with the money and take possession of the property. This defers your cost of the upkeep of the property and defers the payments associated with the mortgage. The exception to this rule is if the property is to be your personal residence and you are moving from an apartment to your new home. Under the closing date in the contract, you will usually find two dates. One indicates the date of settlement; the second indicates the possession date. There are also provisions as to how and when the seller will allow the buyer possession of the property. (Possession is given at settlement.) There are occasions, if you are buying a property for your personal use, when you can ask to occupy the property before settlement by paying rent. Or you may be able to negotiate free rent until settlement. This is even more important when moving from an apartment to a home. If the property you are buying is a rental, the possession will be at or after closing, which gives the tenants time to find another apartment or house to rent. The sellers may require more time to give possession if they need a place to live.

If you cannot get a long closing because the seller requires the money to close on another property or is having one built, you may consider closing and taking possession later. In this case, you can allow the seller to occupy and pay rent until vacant possession (called a *sale leaseback*). Give the seller all the time needed to vacate, as long as they pay you fair rent. Who better to have as a tenant than the seller?

Normally, whoever pays for title insurance chooses the place where the closing will occur and who the closing agent will be. Under "evidence of title," the sellers furnish proof that they are the real and total owners of the property. A title search to verify the owners of the property will be done by the closing agent. Be sure to obtain a title insurance policy. It will guarantee that there are no encumbrances or liens on the property that you don't already know about. Evidence of title must be provided to the buyer by the seller within 10 days of acceptance of the offer. Since the seller must provide this evidence of title, you can use it as a way to back out of the contract legally. This is called the back door. If there is a lease on the property, the buyer may, depending on state law, be required to honor the terms of that lease. Be sure to request a copy of the current lease as a condition in the offer to purchase. Give the seller a timeframe. Also make sure that the security deposit is assigned to you at time of closing. In the event the copy of the lease is not forthcoming, you can use this as yet another back door exit. (Under restrictions and easements the buyer agrees to take title subject to zoning and other restrictions that apply to the use of property.)

Chapter 6. Researching & Evaluating Properties

After locating a property, you must conduct research and evaluate your findings. There are two basic considerations: The condition of the property itself and the condition of the title (evidence of ownership) to the property. It rather goes without saying that the more you know about the condition of a property and its title, the better off you are.

Hint: If you really like a feature of a house, condominium, duplex, etc. and you're seriously considering making an offer, keep your feelings on the inside. You can explode later. Try to maintain a poker face while looking over a property, even when you spot potential problems. Oftentimes, simply taking an extended look at something will cause someone to start explaining what's wrong. It's human nature. While he or she is explaining, simply nod agreeably. Later, if you decide to make an offer, ask for a price reduction. But before you do, have an inspector—one who really knows what he or she is doing—come out and estimate the cost of repairs. Another aspect of human nature is defensiveness. Criticizing someone's home in his or her presence is not a very good way to break the ice. Dear old uncle Mortimer may have chosen that wallpaper.

When it comes to buying foreclosures or other distressed properties, you must be able to act quickly, but that does not mean hastily. Hire a qualified home inspector—one who really knows what he or she is doing—to conduct a thorough inspection of any property you're seriously considering buying. A $300 inspection may end up saving you considerably more. And if everything checks out okay, the piece of mind that comes with knowing a property has been thoroughly inspected should be worth at least $300. You should also leave no stone unturned when researching the title for encumbrances (liens). Surprises can sometimes be good, but not when it comes to a property's title. Do your homework!

Maximizing the return on your investments

Your objective is to spend as little money as possible bringing a home to move-in condition. To achieve this objective, you need at your disposal a competent (and affordable) electrician, plumber, or handyman to make minor repairs. You also need the lowest possible price on appliances, carpet and installation, air conditioning service/repair/replacement, painting, cleaning, and landscaping. Of course, the more work you and your family and friends put in, the more profit you'll earn (see: sweat equity), but sometimes it's better to pay to have a job done right the first time. Document every penny you spend improving a property, and save all receipts.

You may come across a deal that's way too good to pass up, even though it needs more than just minor repairs and cosmetic work. Let's say you find a great 3-bedroom 2-bath home in a "we care" neighborhood—just what you're looking for—however, the homeowner held off on expensive repairs. Although the house is structurally sound and has no termite damage, the inspection you wisely paid for turned up a badly leaking roof and a central heat & air unit that's shot. Major appliances also need to be replaced. We're talking a deep discount here. If the price is right, you can afford to replace the above-mentioned items, and you anticipate a big profit, go for it. Just remember that your goal is bringing the home to move-in condition, not move-in condition for Donald Trump.

After thoroughly researching and evaluating a property, it's time to decide whether or not to move on to the next step.

What is a good deal?

Realize that real estate is the same as any other investment. There is an essential investment amount (down payment), a return on investment (appreciation and/or rental cash flow) and some risk involved. Your objective is to maximize the return on your investments and minimize risk. Here are a few basic strategies for maximizing the return on your investments.

Fair Market Value (FMV)

A key to investing in real estate and structuring a good deal is your ability to know the fair market value of properties that interest you. Do not confuse the asking price with fair market value. The asking price is what an owner is *asking* for a property, which should be viewed as simply a starting point for negotiations. There are, however, times when motivated sellers will discount properties to near rock-bottom prices, already taking into account repairs and improvements a new owner would likely want to make. There may not be much room for negotiating in situations like this, but if the asking price is below fair market value, it may be time to act. But what is fair market value? Fair market value is the most probable price a property will sell for under normal circumstances and market conditions. Some people will pay too much for a property, and some people will pay too little, but the majority will pay a fair price (what a property should probably sell for).

Determining Fair Market Value

It is absolutely imperative that you have an accurate fair market value to work from. This is no time to guess. There are a number of methods for determining a property's fair market value.

1. Contact a Realtor. Ask for some "comps" (comparable properties) in the same neighborhood or area similar to the one in which your target property (the one you're interested in) is located. This will give you a general idea of the fair market value for homes in the community. Comps are so named because they are used for *comp*arative purposes. The comparable method is one of the most commonly used methods for determining a property's FMV. When attempting to determine the fair market value for single-family homes, duplexes, and quads, use a minimum of three comparable properties, ideally, properties that have sold within the past three to six months in the area in which your target property is located.

Realtors will often provide potential buyers with a CMA report (comparative market analysis) free of charge, in the hopes of earning business, but a CMA is not an appraisal and should not be presented as such. Completed by a registered, licensed, or certified appraiser, an appraisal (estimate of what a property would sell for under normal market conditions) is a much more in-depth valuation of a property.

2. Have your target property appraised if you're serious about submitting an offer. An appraisal is one of the best methods for determining a property's value, but unlike CMAs, appraisals aren't free. One of the main resources an appraiser draws upon while attempting to determine a property's value is comps, ideally properties located in the same neighborhood or area similar to the one in which the subject property is located, which have sold within the past twelve months, are currently on the market, or have been taken off the market within the past twelve months.

Although it would certainly be helpful, comparable properties do not have to be nearly identical to the subject property. For example, a comparable property may have a pool, while one of your target properties doesn't. An adjustment would be made to the comparable to bring it inline with your target property. Appraisers are capable of making many such adjustments, but appraising is not an exact science. It's been said that appraising is more art than science, because appraisers must often rely on intuition and their own judgment (common sense) to determine the value of real property.

3. Compare asking prices for like properties on the same street, in the same neighborhood, or in an area similar to the one in which your target property is located. Simply pick up the phone, and start calling the numbers listed on Realtor and For Sale By Owner signs. Remember that the prices you'll be provided with are *asking prices*, not fair market values, and that asking prices are simply starting points for negotiations. Sometimes you'll see a home for sale only a few doors down from your subject property (or at least in the same neighborhood).

4. Search public records. A public records search can help you find the selling prices from homes in a particular area. Look for homes that have been sold recently. Oftentimes, the information you're seeking can be found via the Internet. In many cases, you can obtain the price that your target property previously sold for and the previous selling prices of nearby properties, once you've pinpointed them and obtained their addresses. If a property was purchased years ago, you can at least compare the rate of appreciation against known averages. Remember that real property appreciates at between 4% and 5% annually.

5.Obtain the tax-assessed value of property that interests you. Every year, local governments (property appraisers' offices) track the value of real property to determine the amount each homeowner will pay in taxes for that year. Most properties, however, are appraised some 20% below market value. If you're going to try to use tax-assessed values to help determine the fair market value of one of your target properties, keep in mind that tax-assessed values are often 15% to 20% less than fair market value. Using that variance, for a home assessed at $65,000 for tax purposes, a range of $74, 750.00 to $78,000.00 might be a good starting point. Notice that I said “might.” Tax assessments vary widely from market to market.

6. Calculate Profit Margins. The profit margin of a property is the fair market value minus the purchase price and is quoted as a percentage. A 30% profit margin is a fair deal with room for error. Even if the property needs work, there still is room for profit.

<u>Example</u>:

Market Value:	$100,000
Purchase Price:	$70,000
Potential Gross Profit:	$30,000 (30%)

Margins of profit will vary depending upon the type of investment property. Shoot for at least 20% on single-family homes, preferably more. Aim for these minimum profit margins.

<u>Target Profit Margins</u>:

Single-family homes	20% or more
Condominiums:	30% or more
Multi-family properties:	30% or more
Mobile homes (with land)	30% or more
Raw land:	40% or more
Developed land:	30% or more
Commercial property:	30% or more

7. Calculate Conversion Ratios. A Conversion Ratio (equity divided by cash invested) is a simple system for determining whether or not an investment is worth considering, which takes into consideration the cash invested in a property and said property’s equity. Anytime you can find an investment that returns three times equity in the property, it is generally a good choice. Even if the market moves down, the equity is substantial.

<u>Example</u>:

Market Value: $100,000

Purchase Price: $70,000

Equity: $30,000

(Value of property in excess of mortgages or other liens)

Cash Invested: $10,000

Conversion Ratio: **3**

(Equity received [$30,000] divided by cash invested [$10,000])

Conversion Ratios of 3 or higher are desirable.

The Overimprovement Trap

Another way to maximize your real estate investing profits is not to fall into the trap that many real estate investors fall into, the "this is what I would want" trap. You may love designer colors, ceramic tile, and wood floors, but that doesn't mean everyone does. Some people actually prefer linoleum and carpet, and the use of neutral colors will ensure that everyone's furniture and accessories will match. Do not get carried away making unnecessary improvements to a property. It will quickly erode your profits. The most important consideration is what people see when they get out of the car and what they see when they enter a property and look up, down, and all around. It's amazing what lawn work and paint will do for a property. If everything is as it should be—nice (not expensive) carpet and flooring, nice (not expensive) appliances, nice (not expensive) fixtures—and everything works (toilets flush, climate control systems cool and heat, lights come on when switches are activated, doors open and close properly, etc.) you will hear few complaints.

80% of FMV (or less) Rule

Notice in my definition for fair market value the words "normal circumstances." Normal circumstances would include a home in move-in condition and a buyer and seller who are well informed, acting prudently, and under no undue pressure to buy or sell. That's not exactly what we're looking for, is it? We are looking for homes that may need a little work to bring to move-in condition and owners who are under undue pressure to sell or looking for a quick sale, situations that cause homes to be sold below fair market value, at least 20% below fair market value, preferably more than 20% below fair market value. (Homeowners experience undue pressure to sell for a number of reasons, the most common being financial problems.)

If you can buy a property for 80% of fair market value, you will probably be able to quickly sell it at 90% of fair market value. If you were able to achieve this objective on a $100,000 property, your gross profit on the deal would be $10,000, but you must sell quickly if that's you're strategy, which is another way to maximize your earnings. Quick turnaround time on your investments is important, especially in the beginning when you may be cash poor and can't afford to hold onto a property for an extended period of time.

10/10/10 Rule

A good rule of thumb is the 10/10/10 expectation. First, never put more than 10% down on property. In fact, the lower down payment you can negotiate, the better. It will increase the leverage value of the property. Tie up as many properties as you can with the least investment possible. Second, never get involved with a property that has over a 10% interest rate. The interest can kill you in the long term. Third, require a minimum of 10% discount off the fair market value, not the listing price.

20% Return Rule (rental properties)

If you are investing in rental properties, be sure the cash flow per year returns at least 20% of down payment, after mortgage, interest, taxes, insurance, and other homeowner's expenses (utilities, maintenance fees, homeowner association dues, anticipated repairs, etc.) have been factored into the equation.

Additional considerations:

• First mortgage and all other mortgages must all be assumable/no qualify (FHA or VA) or private mortgage (old or new seller take back).
• If the mortgage is not assumable, anticipate a greater discount.
• Property must be in good condition.
• If the property is not in good condition, deduct three month's payments and cost of fix-up from price.
• If anticipated market resell time is long, discount price 10% for every extra four months. Discount 15%-20% from price. For market time, check "solds" in last six months (available through a Realtor).
• Rent must cover PITI (**p**rincipal, **i**nterest, **t**axes, and **i**nsurance), utilities, maintenance fees, homeowners' association dues, and anticipated repairs. Money remaining must yield 20% on cash down; otherwise, price must be lowered.

<u>Example</u>: Purchase price: $100,000. Down payment: $10,000. Net cash flow must be $2,000 per year. Mortgage seller takes back $90,000—payment: $9,000/year. Total rent: $18,000, less property taxes: $2,000, less other expenses $5,000, net cash flow $2,000/yr). Property value $150,000, which makes the conversion ratio 6 (conversion ratio is explained on page 22). Margin of profit, 33.33% (A Good Deal!)

<u>Tip</u>: You could ask seller to take back mortgage to increase the leverage in the purchase.

Minimizing Risk

Now that we've covered ways to maximize the return on your real estate investments: calculating fair market value, trying to pay at least 20% below fair market value for single-family homes, The 10/10/10 Rule (never more than 10% down, a 10% or less interest rate, minimum 10% discount off fair market value), avoiding the Over-Improvement Trap, let's discuss ways of minimizing risk. One of the major reasons real estate investing is such an attractive business is limited risk. With other startup businesses, there is a far greater risk of losing your investment capital—all of it. If you invest in a property, that property isn't going anywhere, but something might happen to it (see: fire, floods, violent storms, earthquakes, mudslides, sinkholes) that could decrease its value, which brings us to our next topic: Insurance. Whatever insurance is recommended for your investment properties, GET IT! If you think it can't happen to you, you may end up sadly mistaken. Do not leave valuable real estate assets unprotected.

Liquidity

One of the few disadvantages to real estate as an investment vehicle is liquidity—namely, a lack thereof. *Liquidity* is the ability to quickly convert an investment into cash. Many homes are not on the market long (sometimes there's not even enough time to put a key-box on the door), but it may take some time to find a qualified buyer. That's why our program targets moderately priced, 3-bedroom 2-bath homes in "we care" neighborhoods. There are many more potential buyers for these types of homes than there are for larger, more expensive properties, thus significantly shortening the time it takes to sell them. This is an important consideration for the real estate investor whose objectives are finding a bargain, bringing it to move-in condition as soon as possible, and making a quick profit.

The lot, the lot … what about the lot?

Previously, you learned how to buy developed real estate property. You can apply the same strategy to vacant lots. One major difference between a developed property and a vacant lot is that the lot is a non-income generating piece of real estate. In fact, in most cases, a lot will generate negative cash flow, because even if the lot is free and clear, you must still pay property taxes.

Let's look at how you can exchange the lot for a profit-producing real estate property.

Option-1: Maximum financing

Take the lot and negotiate the maximum financing. Remember how you financed the real estate property in the earlier example? You can use the same strategy to buy the lot. If the vacant lot, like the paper in the first example, is worth $90,000, you have a potential profit of $30,000. By obtaining maximum financing, you can profit by no less than $5,000. Do some simple math.

With 75% financing, how much cash will you pull out?
$__________________

With 70% financing, how much cash will you pull out?
$__________________

With 65% financing, how much cash will you pull out?
$__________________

Did you figure out your breaking point, the point where you can only finance out the amount you put into it?

Option-2: Seller financing

You can also buy the lot and put it up for sale. Offer seller financing, where you take a down payment and carry part of the purchase price as a note or mortgage. Congratulations! You have just taken a non-income generating asset and turned it into an income-generating asset, and you now receive a cash flow from the note. The buyer likely will put up a house, in which case your lot becomes more valuable. If the buyer doesn't pay you, foreclose on the loan and take back the lot. Then you have something of more value than the lot itself. Here's how it works. The buyer builds a house partly financed by a lender. The lender will finance the new construction and pay off any underlying debt. If the lender doesn't do this, it could be faced with losing money. A second lender would be in position for payment if the buyer defaults. Thus, when the lending institution finances the construction and the underlying debt, you get paid off.

Option-3: Offer the Lot to a builder at a discounted price

Offer the lot to a builder at a discount—for cash. If the lot is valued at $90,000 and you bought it with the exchange of a note worth $60,000, you can sell it at a discounted price of $65,000 to $85,000. You keep the difference and regain your original capital.

Option-4: Joint venture with a builder

Rather than offering the lot to the builder at a discount, create a joint venture whereby you put up the lot, and the builder puts up the total construction cost. Then split the profits upon the sale of the property.

Yet another option is to buy a new home to live in. Of course, you would buy the new property at a discount. Pay off the construction loan with a small profit to the builder. Now you own a property for $30,000 less than the actual value. This $30,000 is a minimum. Remember, you now have a house on the lot, so the appraisal will come in at more than the $90,000. In addition, you bought the property from the builder at a discount.

Chapter 7. Winning Negotiations

Negotiating isn't about trying to get the best of people or pulling the wool over their eyes. People with that mindset tend to make poor negotiators. The goal of any negotiating situation should be a win-win outcome, one in which all parties are satisfied with the end-result.

Understanding the needs and wants of the person on the other side of negotiating table is one of the keys to successful negotiating. But even more important than knowing what someone else wants is knowing what *you* want. Your offers should have some leeway built into them, though. Going into negotiations with a "This is what I want, and I'll not take a penny less" ("or offer a penny more") mindset isn't exactly an ideal starting point for negotiations. Each party in a negotiating situation has a desired end-result in mind. Negotiating is all about bringing the desired end-results of both sides (the price the seller wants to get and the price the buyer wants to pay) to one satisfactory end-result (the purchase price). Sometimes, though, desired end-results are so far a field from one another that a satisfactory end-result, a situation in which both parties are satisfied with the eventual outcome, is highly unlikely, if not impossible.

What is a "reasonable offer"?

Let's say that a motivated seller is selling an FSBO (for sale by owner) property in need of minor repairs, cosmetic work, and some new appliances. The initial asking price is $88,500.00, slightly more than 10% less than fair market value, which is $98,000, but the owner is looking for a quick sale. (The seller's fallback position is $84,500.00). A potential buyer submits an offer of $80,900.00 (The potential buyer's fallback position is $83,500.00).

Note: "Fallback positions" are not verbalized. They are simply imaginary lines drawn in the sand. Few people know another party's fallback position, but they almost always exist. Going into negotiations, you should always have a fallback position established. Once expressed, a fallback position or any point between a fallback position and the original asking price or the original offer becomes a *counteroffer*.

The parties in the above example appear to be more than $7,500.00 apart, a fairly significant difference. However, splitting the difference between both fallback positions, a potentially satisfactory end-result is only $1,000 away. If both parties were willing to budge $500.00 from their fallback positions, a deal could eventually be reached. Knowing both fallback positions, one possible outcome would be a series of counteroffers leading to a selling price of around $84,000.00, or about 15% less than market value. Alas, technology has created no reliable crystal ball. What's important to keep in mind is that what may seem at first like an unreasonable offer may well lead to a sale if the parties are open-minded. Initial asking prices and initial offers should be viewed simply as starting points for negotiations.

Property inspection as a negotiating tool

All properties you are considering purchasing must be inspected. Use a professional, and make sure all of the contracts you use have a "subject to inspection report" clause. You never know what's above the ceiling or under the carpet. You should, however, also consider using informal inspection techniques to get a feel for a property and perhaps initiate the negotiation process. By kicking the tires a bit, you may be able to get the asking price lowered right off the bat. You will need some general knowledge, a clipboard, paper & pen, flashlight, ball bearing, and an inquisitive mindset. As you walk through the property, take detailed notes and investigate the entire property. Concentrate on the following areas:

Roof

Prior to entering the home, stop outside and examine the roof. Look for signs the roof may be damaged (dry rot, shingles curling up at the edges, etc.). Take detailed notes.

Ceiling

Once inside the property, examine the ceiling with your flashlight. Look for signs of water damage (bowing, stains, fresh paint on the ceiling, etc.). If you find a blemish, include it in your notes. Don't say anything. Just take an extra long look at the spot. Sooner or later, the homeowner will probably say something like "Oh, we just fixed that." ("Just fixed that = Discount.)

Cupboards

Check the cupboards. Look under the sink. You might even pause under the sink or look twice.

Ball Bearing Test

Inspectors will use a ball bearing to test the levelness of property. If you place a ball bearing or a marble on a countertop or other flat floor surface, the ball bearing will roll, indicating the levelness of the property. Take more notes.

Inspection Report

Once the inspection has been completed by a professional, use the information contained in the report for renegotiating purposes—specifically, lowering the asking price. As a general rule, look in every corner and cupboard in the property. The more problems you uncover, the more problem areas and concerns that are pointed out, the lower the price. Document all problems and potential problems, and use them to justify price discounts.
Consider submitting the list with repair estimates of, perhaps attaching it to the purchase offer.

Why should you have property inspected by a professional?

There are a number of reasons you should have potential investment property professionally inspected.

1. Most laypeople don't know what to look for when evaluating a property for problems or potential problems. Even people who do know what to look for will sometimes forget to ask important questions. A good cleanup and paintjob can hide lots of damage. There could be unseen termite damage, water leakage and infestations, outdated plumbing, a climate control system badly in need of repair or replacement, malfunctioning appliances,

or worse: fire hazards (faulty electrical, natural gas, or fuel oil systems), How do you know? Get professional help! (Ask around for the name of a competent property inspector, and ask the inspector for his or her qualifications and perhaps some references.)

2. Property inspection results can sometimes be used to justify requesting substantial discounts. As a matter of fact, inspection results may well determine whether or not you submit an offer. Upon receipt of an inspection report, estimate the cost of repairs and consider how it will affect your decision whether or not to purchase the property. If the damage is considerable and costly to repair, you may want to pass on the property. On the other hand, if the damage is minimal and relatively inexpensive to repair, you can use your inspection results to renegotiate a lower price for the property. Simply review the problem(s) with the owner or owners, and ask him/her/them to see that repairs are made *properly* or lower the price accordingly. Since the necessary repairs will likely take considerable time and effort on the part of the owner, not to mention money, he/she/they will most likely opt for dropping the purchase price.

Example:

"Hi, this is _______________. I just received the report from the professional inspector I had come out and take a look at your property. I'm still interested; however, he did raise some concerns. Apparently, the roof needs to be repaired, at an estimated cost of $2,000. The garage door is also in need of repair and will cost about $800 to fix." Also, the central heat & air unit will need to be replaced soon."

Option-1: "Did you want to make the necessary repairs and replace the A/C unit before we close on the property, or do you just want to reduce the cost of the property to offset the costs?"

Option-2: "What do you think we should do from here? (Wait for a response.) Perhaps you could reduce the price of the property. I'll take care of the repairs and replacing the A/C unit, saving you time and helping us close more quickly."

Negotiating with ease

Skillful negotiating can spell the difference between a small profit and a very large one. You must develop the skill of negotiation to be a successful real estate investor. Use body language and tactics to maximize effectiveness. The following checklist will help you in your negotiations.

Appointment:

1. Phone (be professional and casual).
2. In person (neat appearance, dress: business-casual).

Meeting:

1. Be on time (early).
2. Dress appropriately.
3. Have important documents with you and in good order.
4. Greet people politely.
5. Ask to look around the property.
6. Be friendly.

7. Seating arrangement (side-by-side).
8. Make sure all parties are present.
9. Inspect property thoroughly and take good notes.

Talking business (honesty is the best policy):

1. Inquire about the circumstances (Why are you selling?).
2. Listen and analyze the need.
3. Do not get involved with problems.
4. Find a way to meet the need.
5. Present the proposal.
6. Handle objections tactfully and creatively.
7. Explain the benefits (understand people and what motivates them).
8. Anticipate objections. Be ready to overcome them.
9. Maintain control over negotiations.
10. Reinforce the problem (timelines, deadlines, negative alternatives).
11. Stress limited alternatives.
12. Stress limited solutions.
13. Ask for a decision.
14. Wait.
15. Compromise.
16. Reaffirm credibility. (You are a professional investor.)
17. Review the agreement in detail.
18. Do the paperwork.
19. Check everything on paper (twice).
20. Sign documents.
21. Reaffirm credibility and reinforce that it's a good deal.

Your Attitude:

1. Be understanding (empathize).
2. Do not get involved with emotional problems.
3. Be honest and sincere in trying to help.
4. Use common sense.
5. Time is on *your* side.
6. Be prepared to walk away. There are lots of other deals.

Ask for everything, but be willing to settle for less

You must always negotiate for more than you want. Make a list of all the items you want, with the least important items at the top and the most important items at the bottom. For example, ask the seller to do everything to put the property in new condition and pay as many of the transfer fees as possible. Your goal is to get the seller focused on the non-important items. This way, the seller will try to get you to drop some of the items that are not that important to you and may be willing to settle on the items that are important to you. Financing, terms, price and down payment are items that make the purchase of the property more profitable for you.

When working with a real estate agent or broker, always be present at the presentation of the offer. This puts you in a position of power. Not only that, you can cut through the red tape, motivate the seller, clear up any questions, and put the seller at ease.

Make an offer!

One of the best ways to become proficient at negotiating and inspecting property is by making offers. Make a lot of offers, just to become good at it. Even if you make a bad offer, it's better than no offer at all, at least from the perspective of gaining experience.

The "bad offer"

A bad offer is half the asking price. Even if the seller doesn't accept, you did make an offer, but the seller might say yes, so be prepared. If this happens, you just bought a property.

Once you have seen a property, make an offer, even if it doesn't fit your buying criteria. Make an offer on every property you look at, even if your offer is extremely low. If you buy the property cheaply enough, you can resell quickly for a profit. Or with seller financing, you hold the note.

Your goal is to eliminate all unacceptable properties from your potential profit purchase list. You want to do this after initial telephone calls. There are, however, occasions when you will not know much about a property until you have actually seen it. Making offers will make you more efficient and proficient. You will quickly learn about neighborhoods and associated property values, giving you valuable experience for making buying decisions. The more experienced you become, the easier it will be to make instant decisions.

Chapter 8. Finance

Okay, you found the ideal property, conducted a thorough inspection of both the property and its title, and having negotiated the best deal possible, are ready to take the next step: Financing. Some real estate investors are able to pay cash in large lump sums to homeowners in need of money, which is especially helpful in the foreclosure market, but most real estate transactions are financed using OPM, which remember is other people's money. Your goal is to use as much OPM as possible securing investment property, keeping as much of your money as possible safe from risk and available for future investment.

Soon, you'll be provided with definitions and explanations of terms related to real estate finance and mortgages. Before you nod off, though, let's go back and look a quote that appeared earlier in this book: "Average people, people able to raise five to ten thousand dollars, have it within their power to become millionaires." Remember the 10/10/10 rule? Never settle for less than a 10% discount off the fair market value of a property. Never finance at an interest rate over 10%. And never put more than 10% down to secure a property. Using this rule of thumb, for a $100,000 property, you would be looking to use no more than $10,000 of your own money to secure the property. Let's say that you quickly fixed up this property, whose fair market value was $113,500 at the time of purchase, and resold it two months later for $114,900, making your gross profit on the deal almost $15,000. Let's further assume that you spent $5,000 holding the property and bringing it to move-in condition, making your net profit around $10,000. Now, not only do you have your original $10,000 back (the down payment), you have an additional $10,000 in your bank account. In other words, you just doubled your money, bringing into much sharper focus the relevance of the quote referenced earlier in this paragraph. Notice the first two words: "Average people …" Most real estate investors are just that, average people, an assertion reinforced by another salient quote, this one from Kiplinger's website: *"Money, lot's of money, is still being made in investment real estate. And a good percentage of that money is being made by middle-income Americans at a time when very few of us can start up an industrial investment, whether it be a steel mill or a computer company."* It bears repeating, most real estate investors didn't have tens of thousands of dollars (the minimum amount of capital most other start-up businesses require) when they started building wealth by investing in real estate. They got the ball rolling with their first successful deal and used the profits to fund additional real estate purchases.

Never lose sight of the fact that money is simply a tool you can use to make more money, hence the popular saying "it takes money to make money," an obvious reference to the importance of capital. It doesn't take a lot of money to make money in real estate, though; it just takes a little of your money and lots of OPM. Many real estate investing programs spend lots of time on low/no-money-down deals, and there are certainly opportunities out there to make money with little or no money down, but you should at least have some capital to work with, although far less than would probably be required for starting another type of business. If you don't have at least some capital to work with, you may want to question why you're going into business for yourself in the first place. Ditto if you're willing to let five or ten thousand dollars stand between you and your dreams.

Paying the Price

In order to achieve anything in life, you must be prepared to pay a price. To build wealth through real estate investing, you must be willing and able to invest your time (to learn how to invest in real estate) and your money (to invest in real estate). Always look for ways to save money and time, your two most valuable resources. It takes time to study real estate and learn how to invest in it, establish credit, inspect properties, evaluate properties, sign offers, arrange financing, take tenants through properties, rent properties, talk to contractors, and do the accounting work. No doubt you have a busy schedule—we all do—but building wealth takes time, time you must invest wisely. You must also be willing to bear the risk involved in investing money. There is always a possibility that you may lose it. If you aren't able, financially and emotionally, to cope with a loss of capital, you shouldn't invest in real estate or any other investment vehicle.

You must also be prepared to put forth the mental effort required to make proper investment decisions. You must have patience and be able to wait for property to increase in value. Many people are not prepared to wait as long as ten years for property to significantly increase in value. If you are one of these people, perhaps you are not ready to pay the price required to become a millionaire.

Mortgage Terminology

Property is seldom purchased in full with cash; therefore, the purchase of real estate is widely regarded as joint venture between an equity investor (you) and a lending institution. For most real estate transactions, a lender provides most of the financing, and the property is held as security for the debt. For a real estate transaction involving both debt and equity, there are two instruments: the note and the mortgage.

Promissory note

A *promissory note* is a signed document acknowledging the existence of a debt and a promise of payment. The chief function of the note is making the borrower personally liable for the payment of the outstanding debt. Once the note is signed, the terms and conditions for repayment of said debt must be met.

Mortgage

A *mortgage* is a pledge of security for the repayment of a debt. It is created by a formal written agreement in which the party signing the promissory note pledges the property being financed as security (collateral) for the debt, making the mortgage a lien, not evidence of a debt.

Parties to the mortgage

There are two parties in a mortgage: the *mortgagor* and the *mortgagee*. The mortgagor is the borrower, the one pledging the property as security for the debt, and the mortgagee is the lender, the one to whom the property is pledged. The mortgagor must sign a note, evidence of the debt. Without this evidence, a mortgage, the instrument that creates an interest in the property, cannot exist. The interest is a lien, or legal claim, on the mortgagor's property until the debt is paid.

Mortgage requirements

Since a mortgage conveys an interest in real estate, it must be in writing. While the guidelines for the actual wording of mortgages are rather broad, mortgages contain essentially the same elements as the deed. (Reference is usually made to the promissory note, in lieu of the amount of consideration, which is found in a typical deed.) A basic mortgage should contain the following elements:

- Legal name of mortgagor and mortgagee.
- Words of conveyance, or granting, from the mortgagor to the mortgagee.
- A legal description identifying the mortgaged property.
- Mortgagor's signature. (Although it is not essential for mortgagees to sign, they usually do.)

Mortgage Theory

In the past, a mortgage (property pledged to secure a debt) actually assigned ownership of the property to the lender. During the period of time the mortgagor still owed a portion of the original loan, the lender was entitled to physical use of the land and any rental income or other revenue generated by the property. Thus, in earlier forms of mortgages, title to the land pledged as security for a loan was truly transferred to the lender. Abuses on the part of lenders brought about more careful wording in mortgage instruments. Slight delays in repaying a loan often resulted in “legal default,” with borrowers forfeiting any right to recovery of title to their land. A change was clearly in order.

Lien Theory

Lien theory (now used in most states) represented a more modern approach to creating loan security. In lien theory states, a lender holds a *lien* (the right to have a property sold to satisfy a debt), not the title to a property, to secure the debt. In the event of default on the promissory note, foreclosure proceedings are initiated, and the title is conveyed to the lender from the borrower. The mortgage remains with the property until the debt is paid, even if ownership of the property changes.

Title Theory

In states using *title theory*, a mortgage is assumed to represent an actual conveyance of title to the mortgagee. The instrument of conveyance is usually referred to as a *mortgage deed*. While this method is similar to earlier mortgage procedures, all title theory states have taken measures to curb abuses. One such measure is known as *intermediate title theory*, which allows the mortgagee to assume possession of the property between the time of default and sale, but also protects the mortgagor from eviction without due process. Foreclosure proceedings must be held, as they are in lien theory states, making state laws very similar with respect to protecting the rights of borrowers. About the only meaningful difference is the actual wording of the instrument of conveyance.

Deeds of Trust

As previously mentioned, the typical mortgage involves two parties: the borrower (mortgagor) and the lender (mortgagee). However, with a *deed of trust*, also known as a *trust deed*, the borrower conveys ownership of the property to a third party, which holds the land in trust for the benefit of the holder of the note. The primary reason some states use this mortgage method is to minimize or eliminate court proceedings. A deed of trust can be foreclosed easily and quickly (through a trustee’s sale, using the “power of sale” clause).

Mortgage Clauses

For every mortgage loan, there are several clauses outlining the rights of the mortgagor and the mortgagee during the term of mortgage loan agreement. The following are various clauses, or provisions, found in the debt agreement.

1. Acceleration clause

Lenders usually insist that the instrument contain an acceleration clause that makes the entire debt due in the event of default. This clause precludes the necessity for the lender to bring separate lawsuits against the same mortgagor for each late payment. This clause usually states that if any covenants are breached, including the obligation to pay the sums secured by the mortgage when due, then the full amount is due immediately. This declaration of full payment due is at the option of the lender.

2. Renegotiable rate clause

A renegotiable rate mortgage (RRM) is a series of short-term loans secured by a long-term mortgage. The short-term loans are automatically renewable at equal intervals of three to five years each. The mortgage term may not exceed 40 years. The monthly payments are made in equal installments. However, at the end of the life of each short-term loan, the interest rate may be changed. Changes are based on the movement of an index such as the Federal Home Loan Bank Board's most recent monthly national average contract mortgage rate index. The interest rate is the only term that may be altered. An interest rate modification results in a change of the monthly payment. The new payment amount remains stable until the loan term has again expired.

3. Prepayment clause

To prepay means to pay off the indebtedness before the end of the loan term. Under traditional common law, the mortgagor has no right to prepay a mortgage unless the right is explicitly provided by a prepayment clause. In some states statutory law has reversed this. Now, any note that is silent as to the right of the obligor to prepay the note in advance of the stated maturity date may be prepaid in full by the obligor or his successor in interest without penalty.

In typical prepayment clauses a statement is made as to (1) whether there is penalty for prepayment; (2) whether extra payments directly reduce the principal upon which interest is computed or eliminates the last payment; and (3) whether the number and size of extra payments in any one year are restricted. Some lenders try to discourage a fast turnover of funds, which is costly to them, by imposing prepayment penalties during the early years.

These penalties are usually stated as a percentage of the unpaid balance, and the percentage charge is usually reduced in later years of the mortgage term. Typically it states that the borrower has the right to prepay the outstanding principal amount in whole or in part and that the outstanding amount of the extra payment is applied against the principal amount. In addition, such clauses usually state that any extra payment does not extend or postpone the due date of subsequent monthly installments, or change the amount of the installments.

4. Variable rate clause

The variable rate mortgage (VRM) ties the interest rate to some specified index of market interest rates. As market rates fluctuate, either the periodic (usually monthly)payment or the loan's maturity would increase or decrease depending on whether the rate went up or down. Until 1980, federally charted savings and loans were precluded from increasing a loan's monthly payments. However, financial deregulation during the early 1980s freed S&Ls from such restrictions, and they can now make many types of loans in which periodic payments may vary.

5. Defeasance clause

This clause "defeats" the right of the lender to foreclose on the property as long as the borrower lives up to the terms of the agreement. Thus, as long as the borrower makes periodic payments according to schedule and fulfills all other requirements, the lender may not seize the property or have it sold.

6. Exculpatory clause

An exculpatory clause relieves the borrower of personal liability to repay the loan. Thus, if the borrower defaults, the lender can look only to the property foreclosure for recovery of the debt. In effect, the lender may not sue the borrower on the note or obtain a deficiency judgment, if sale of the property at foreclosure does not provide sufficient funds to cover the loan's balance. Obviously, borrowers prefer to negotiate loans with exculpatory clauses, but lenders are usually unwilling to allow them.

Probably the most frequent use of this clause is with investment property involving limited partners. In order for limited partners to claim tax depreciation on the mortgaged portion of a property, the general partners must have no personal liability for the mortgaged loan. This means all partners are considered to be "at risk" for the mortgaged portion of the property, and that the limited partners can claim depreciation on the mortgaged portion. To achieve this arrangement, the mortgage will have an exculpatory clause to relieve the general partners of any personal liability.

7. Subordination clause

A lien holder may consent to place his or her interest in a property at a lower priority than another lien holder, through the use of a *subordination clause*. A subordination clause is often used when the seller of vacant land takes back a purchase money mortgage. In order to make the sale, the seller agrees to lower the priority of the lien to a position inferior to a construction or permanent loan. Sometimes, landowners who lease their land will also subordinate their fee position to a construction or permanent loan obtained by the lessee.

8. Release clause

An acquisition and development loan obtained by a developer may be used to develop a number of building lots. Many such loan agreements contain clauses that allow the developer to release developed lots as security for the loan. In addition, a specified amount is paid back to the lender. Usually the amount that must be paid to obtain a release is greater than the proportionate amount of the loan allocated to the lot. For example, if a developer borrows $100,000 to develop 10 lots, the release amount might be $12,000 per lot—$2,000 more than the amount of loan per lot.

9. Cognovit clause

This clause is considered to be a confession of judgment. If borrowers allow this clause to be included, they in effect give up their right to a day in court. It authorizes the lender's attorney to obtain a judgment lien against the debtor's real property. Without this clause, the lender must sue on the basis of the note and prove it to be in default.

10. Escalator clause

This clause allows the lender to increase the interest rate. Although an escalator clause in its most general sense could allow a lender to increase the rate for any reason, it is usually tied to an event or contingency. For example, if it is discovered that the mortgagor is an investor rather than an owner-occupant. Moreover, it could provide for the interest rate to escalate up to the legal maximum in the event of the borrower's default. An escalator clause does not create a *variable rate mortgage* in which the interest rate is tied to a market index. Escalator clauses in which the interest rate is at the discretion of the lender are very unpopular with borrowers. The potential for abuse and unfavorable public relations far outweigh any benefits.

11. Open end clause

Many institutions (particularly savings and loans) write loan agreements that allow a borrower to increase the amount of a loan after the loan balance has been paid down. The loan can usually be increased to the original amount borrowed. While closing costs and loan fees are avoided by using an open-end provision, the lender usually reserves the right to adjust the interest rate if the current market rate is higher than the rate of the loan being opened.

12. Redemption clause

Prior to foreclosure, a borrower has the right to pay the amount owed (plus interest) in order to retain the property or interest therein. This right is called the *equity of redemption* and is a matter of law, not negotiation. Nevertheless, the right is stated in most mortgages.

13. Due-on-sale clause

Traditional common law permits a buyer to purchase mortgaged property and preserve the existing mortgage, unless the mortgage contains a clause to accelerate the loan upon sale. In a world of volatile interest rates, due-on-sale clauses are especially important to lenders. Without them, buyers tend to preserve low interest rate mortgages as long as possible, by purchasing second mortgage financing rather than refinancing the existing loan.

The clauses discussed in this section are the principal variable positions found in mortgages or notes. Other provisions that are sometimes used include equity participation and late payment clauses. Depending on the type of lender, each will usually have a standard form that outlines the rights of the lender and the borrower. All borrowers should carefully read these documents before signing. They may contain clauses detrimental to their particular needs.

Fortunately for home mortgages, the influence of secondary mortgage market agencies has in recent years encouraged the widespread use of a standard home mortgage contract. This document, promulgated by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Loan Association (FNMA–Fannie Mae), is well crafted to protect the interest of both mortgagor and mortgagee in the typical home loan situation.

Types of Mortgages

Mortgages may be classified according to several criteria: whether or not they are underwritten by an agency of the U.S. Government, method of payment, priority of lien, or the purpose of payment for which they were made. The classifications are not mutually exclusive. For example, a package mortgage could be either conventional or underwritten by the government. Similarly, a participation mortgage could be either fully or partially amortized. Thus the classifications are simply different ways of looking at the same mortgages.

A. Government underwritten vs. Conventional mortgages

Government underwritten loans are insured, or guaranteed, by agencies of the U.S. Government. The Federal Housing Administration insures loans made by private lenders to qualified buyers of properties who meet minimum standards. The Veterans Affairs guarantees loans made by such vendors to veterans.

1. FHA-insured mortgages

The Federal Housing Administration was created under the National Housing Act of 1934 and granted the authority to insure mortgage loans made by private lenders. It is important to understand that the FHA issues insurance policies (the premiums are paid by borrowers), which insure that the lenders will receive their money if mortgagors fail to make their payments.

There are several types of FHA mortgage programs, including low-income housing, nursing homes, cooperative apartments, and condominium apartments. But the most common FHA program is for single-family homes, as authorized by Title 11, Section 203, of the National Housing Act. Under this program, the borrower pays a one-time insurance premium, which is based on several factors. The premium may be financed over the life of the loan if the seller pays the closing costs. The premiums for FHA insurance are deposited in the Mutual Mortgage Insurance Fund. The FHA reimburses a lender from this fund if a borrower defaults, the mortgagor's interest has been foreclosed, and the Secretary of HUD has taken title to the property. Then, the FHA must sell the property.

With an insured mortgage, lenders will generally loan a higher percentage of the appraised value of a property. There may be times when a potential homebuyer does not have a sufficient down payment for a conventional loan. In this case, an FHA-insured mortgage may be appropriate. However, the insurance premium is an added expense to the borrower.

2. VA-guaranteed mortgages

The Veterans Affairs (formerly the Veterans Administration) was created just after World War II, as part of the Servicemen's Readjustment Act and was authorized to guarantee a percentage of loans made to qualified veterans by qualified lenders.

Although the Veteran's Affairs does not normally make loans, in areas where there are no lending institutions, the VA will grant loans directly to veterans. Generally, the VA guarantees loans made by lending institutions to veterans. When a borrower defaults, the VA will pay up to 50% of the amount of the loan if the loan is for $45,000 or less. For larger loans, the VA will pay any loss up to a maximum of $22,500 plus $.40 for each dollar of the loan over $45,000 (limit: $36,000). Because VA loans are available up to 100% of the selling price, brokers are able to sell homes to veterans who otherwise could not afford to purchase a home. Veterans are only entitled to one VA loan; however, in some cases, the loan can be transferred to another eligible veteran, and the original borrower's right to a loan is restored.

3. Conventional mortgages

In recent years, the percentage of FHA and VA mortgages has been decreasing. Today, most mortgages are conventional. Conventional loans are preferred by lenders for two reasons. First, lenders have the flexibility to create loans that reflect their own requirements, facilitating individualized programs that are in the best interest of both parties. Second, more paperwork and red tape are required for loans for loans that are insured/guaranteed, and administrative costs are higher.

Generally, a conventional mortgage requires a larger down payment than an FHA or VA mortgage. In the VA program, the borrower is not allowed to pay points on a new loan; however, the borrower may be required to pay points when refinancing or rolling over. (Points are a discount from the face amount of the loan, which increases the yield to the lender.) For conventional and FHA mortgages, borrowers are allowed to, and in many cases do, pay loan fees, user fees, or discount points.

B. Mortgages by method of payment

1. Straight (or straight-term) mortgage

A loan for which only interest payments are made periodically, with the entire amount due at maturity, is called a *straight* or *straight-term* loan. Although such loans are not used frequently to finance the purchase of single-family homes, they are used quite often for land transactions. In these situations, developers will be able to pay for the land after development and sale. In the interim, they pay interest only.

2. Standard fixed-payment mortgages

A *standard fixed-payment mortgage* (SFPM) is a fully amortized loan, which is completely paid off through by equal, periodic payments. Today, this is the standard type of loan used to finance purchases of single-family homes. Sometimes, this type of mortgage is also used to for income-producing properties, although partially amortized loans are more frequently used. Payments on fully amortized mortgages are usually required monthly. At maturity, the loan balance is zero.

3. Partially amortized mortgages

If a loan is not paid off through equal, periodic payments, but periodic payments are required, it is a *partially amortized* loan. In other words, the loan will be only partially paid off via periodic payments, meaning that there will be a remaining balance due on the loan at maturity. The remaining balance on a partially amortized loan is known as a *balloon* and is satisfied by a *balloon payment*.

C. Mortgages by payment or yield variability (AMLs, GPMs, SAMs)

1. Adjustable Mortgage Loan (AML)

In 1981, the Federal Home Loan Bank Board issued regulations incorporating both variable and renegotiable rate mortgages into adjustable mortgage loan regulations. "An *adjustable mortgage loan* (AML) permits adjustments of the interest rate, which may be implemented through changes in the payment amount, the outstanding principal loan balance, the loan term, or any combination of these variables." (FHLBB Res. No. 8-120691981). As with VRMs and RRMs, interest rates must be decreased as the index decreases, and of course, may be increased as the index rises. The lender may increase the loan term up to 40 years to cover interest rate increases, although such an extension is not an option that must be offered to borrowers.

The interest rate may be tied to any index beyond the control of the lender and may be adjusted as often as monthly. Examples of indexes to which an AML may be tied:
The FHLB District cost of funds to FSLIC-insured savings and loans.
The national average contract mortgage rate for the purchase of existing homes.
The monthly average of weekly auction rates on 3-month or 6-month U.S. Treasury bills.
The monthly average yield on U.S. Treasury securities, adjusted to 1, 2, 3, or 5 years.
(All of these indexes are published in the *Federal Reserve Bulletin*.)

Notice of interest rate changes must be provided borrowers at least 30 days, but no more than 45 days, prior to the change. (Lenders may not charge a prepayment penalty or fee associated with interest rate changes.) Within these regulations and guidelines, lenders may establish their own AML plans. However, administrative costs, competition, and secondary market requirements limit flexibility for most lenders in this regard. Frequent adjustments are costly; competitors may limit the frequency and magnitude of adjustments; and secondary market lenders have established certain limitations regarding the AMLs they will purchase. For example, the Federal Housing Loan Mortgage Corporation will not purchase AMLs that allow rising balances or have a subsidized payment ("buy down") in the early months.

2. Graduated Payment Mortgage (GPM)

With a *graduated payment mortgage*, the payments begin at a lower level than for a comparable standard fixed-payment mortgage and gradually rise to an amount greater than the payments associated with a comparable standard fixed-payment mortgage. After the period for payment increases ends, the payments for the remaining term are fixed.

In the early years of a GPM loan, interest accrues at a higher rate than is actually paid. The unpaid interest is added to the principal balance. This is called *negative amortization*, because the remaining balance is increasing rather than decreasing.

There are several plans for FHA-insured GPMs, under Section 245 of the National Housing Act. Approved plans are:
Plan I: Payments rise 2.5% annually for 5 years.
Plan II: Payments rise 5% annually for 5 years.
Plan III: Payments rise 7.5% annually for 5 years.
Plan IV: Payments rise 2% annually for 10 years.
Plan V: Payments rise 3% annually for 10 years.

3. Shared Appreciation Mortgage (SAM)

A *shared appreciation mortgage* allows a lender to charge a below-market periodic interest rate, by sharing in the property's proceeds at the time of sale or upon maturity of the loan. The payment to the lender upon sale or maturity is known as *contingent deferred interest*. The percentage share of the property's appreciation the lender receives is established in the loan agreement.

While there have been numerous advocates of SAM home loans, no large-scale program has been implemented. One reason is that home appreciation is geographically correlated with income and ethnic/racial characteristics; therefore, loans could be inherently discriminatory. Another reason is that typical terms do not return a competitive yield to lenders. In income-property lending, however, the SAM idea is used as one form of a "participation" mortgage loan.

D. Mortgages by purpose

Mortgage forms vary in their payback provisions, terms of agreement, and the types of property used as security. Some are created to achieve specific purposes or to fit the need of the individual borrower. The following are types of mortgages, classified by purpose.

1. Purchase Money Mortgage

The distinguishing characteristic of a purchase money mortgage is that the title and the mortgage are conveyed in the same transaction. The loan involved could be from a third party, and it could be a first mortgage loan. However, typically the purchase money mortgage is a second mortgage given by the seller to the buyer to partially finance the purchase through installment payments.

Purchase money mortgages are common in all types of real estate purchases. In the purchases of raw land in large quantities by a developer, the landowner may accept a partial cash payment and take a mortgage for the remainder of the selling price. As the developer sells lots from the completed subdivision, the mortgage is paid off. In effect, the landowner is a partner with the developer, through the use of a purchase money mortgage.

Purchase money mortgages are also common in transactions involving residential properties, such as when the buyer does not have a sufficient down payment. The remainder may be obtained by assuming an existing mortgage or giving the seller a new mortgage. Either way, the seller is willing to take a mortgage as part of the payment.

Consider the following example, which illustrates the use of a purchase money mortgage in the purchase of residential properties. Seller-A is asking $80,000 for a single-family residence. Buyer-B likes the house but only has $10,000 for the down payment. The lending institution will only loan $64,000 for the purchase. To be able to sell the house, Seller-A decides to take a purchase money mortgage for $6,000 from Buyer-B. In addition to taking this purchase money mortgage, Seller-A is willing to accept a lower priority of claim should Buyer-B default. In this case, the lending institution has the first claim, because it has a first mortgage. The purchase money mortgage is a second mortgage.

2. Participation Mortgage

A *participation mortgage* is a loan agreement, which provides for a lender to receive part of the income from an investment in addition to the interest payments. Participation mortgages became popular during periods of high interest rates and are used by lenders to increase their yields. The participation feature enables lenders to share in the expected success of income-producing (rental) properties. It also protects the borrower from abnormally high payments if income projections are not realized. The participation can be a specified percentage of gross or net income, a share of sale proceeds, or both.

A closely related term, *mortgage participation*, comes into play when two or more lending institutions combine their funds to finance a real estate project. The lenders do not wish to shoulder the entire risk of a project of the magnitude for which the investor is seeking a loan. In this case, the primary lender may call upon another lender to participate in the loan. For example, an investor needs $100 million in order to purchase a large hotel complex. The lending institution to which the developer applies for a loan may not be able to lend that much money. By securing one or more "participants," the original lender is able to obtain the money the investor needs to make the project fly. In return, all lenders receive evidence of the debt from the borrower, as well as an instrument pledging the property as security for each lender's note.

3. Blanket Mortgage

A *blanket mortgage* covers more than one parcel of land. Developers of subdivisions employ this type of mortgage, which permits small portions of the land (residential lots) to be paid off and released from the mortgage via a *release clause*. The remainder of the land continues to be held as security for the loan. The percentage of the original mortgage that is released is usually smaller than the pro rata dollar amount. For example, the developer has a note for $100,000 on a subdivision with 20 lots. The lender will usually require more than 1/20th of the mortgage dollar amount to be paid before one lots is released.

4. Reverse Annuity Mortgage (RAM)

The *reverse annuity mortgage* was conceived as a way to enable older homeowners to liquidate and consume the equity "locked up" in their homes. As the name suggests, in its simplest form, the homeowner would receive a regular disbursement from the lender, secured by a second mortgage. The regular disbursements and interest accruing against them eventually accumulate to some maximum loan balance. The major problem is that the homeowner may outlive the time when the maximum loan is reached. While various solutions to this risk are being explored, there is yet to be significant use of reverse annuity mortgages in the United States.

5. Package Mortgage

A *package mortgage* allows homebuyers to pledge household items, in addition to the real estate, as security for a loan. For instance, lending institutions may allow ranges, refrigerators, dishwashers, washers & dryers, air conditioners, etc. to serve as security, thereby allowing the homeowner to finance major appliances over the term of the loan at relatively low mortgage interest rates. This practice allows lenders to increase the amount of a loan, with no added administrative costs and little risk. It also allows buyers to purchase home appliances and other major items of equipment they may otherwise not be able to afford.

6. Home Equity Credit Lines

By far, the fastest growing form of mortgage loan in recent years has been the credit line home loan. It is a second mortgage loan, which permits any number of draws or balance reductions, subject to 75 to 80% of a homes value, including the first mortgage loan. The monthly payment typically is the greater of a fixed percentage of the current balance, usually 1½to 2% or a modest dollar minimum. The interest rate is variable, usually prime or another short-term interest rate plus 1½to 2 %. Draws against the mortgage are usually by check, although in some instances, a credit card is used to access the credit line.

E. Mortgages by Priority of Lien

1. First Mortgage

A first mortgage is the mortgage instrument that creates the first lien on a property. As explained in the purchase money mortgage example, the holder of the note secured by the first mortgage will have its claims satisfied before any subsequent mortgages.

2. Junior Mortgage

Any mortgage that is not a first mortgage is junior to the first mortgage. This means that in case of default, the claims of the holder of a note secured by a second mortgage or mortgage of lower priority will not be satisfied until the first mortgage is satisfied.

Because of the subordinated nature of these mortgages, they carry a higher level of risk. Generally, the higher the risk, the higher the interest rate will be.

Transferring mortgaged property

In the transfer of mortgaged property, two situations typically arise: The mortgagor sells the property, or the mortgagee sells the property. When the mortgagor sells the property, the buyer may take the property "subject to" the mortgage, or the buyer may assume the mortgage. When the mortgagee sells its mortgage interest, the sale must be by *assignment*.

1. Transfer of property subject to mortgage

When a buyer obtains property subject to mortgage, the buyer realizes the existence of the mortgage. As long as the buyer makes the mortgage payments, no problems arise. Suppose, however, that the buyer defaults. The seller is still liable for the debt and may elect to make payments. But if the seller does not make the payments, the lender will foreclose, and the property will be sold. If the sale price is not sufficient for paying off the debt, the seller, not the buyer, is responsible for the deficit.

2. Mortgage assumption

When a buyer assumes a mortgage, the buyer covenants and promises to pay any deficit that might occur as the result of default. Therefore, if the buyer goes into default, and after the foreclosure sale money is still owed on the debt, then both the buyer and the seller may be responsible for the deficit.

3. Mortgage assignment

A *mortgage assignment* occurs when a mortgagee sells a mortgage. The assignment is a brief form stating that the mortgagee ("assignor") transfers and assigns the mortgage and mortgage note to the purchaser ("assignee"). Prior to assignment, the assignee should give the mortgagor written notice of the assignment. Prior to assignment, the assignee should also obtain a *certificate of estoppel* from the mortgagor. A certificate of estoppel is a written document stating the balance due on a debt and all defenses or claims against the mortgage.

D. Default and Foreclosure

Default

Default is defined as the nonperformance of a duty or obligation, such as the failure to make payment called for by a note, whether arising under a contract or otherwise. Default can also occur if the mortgagor fails to pay taxes, insurance premiums, or otherwise breaches any of the covenants in the mortgage instrument.

Default does not necessarily lead to foreclosure. After default occurs, lenders usually try to avoid foreclosing. Foreclosure action usually arises only after default has occurred and the mortgagee determines that there is no hope of collecting, through normal negotiation with the borrower, the amount owed.

Foreclosure

If a borrower defaults on a secured loan, the mortgagee must bring foreclosure action to eliminate the mortgagor's interest in the property. In most states, the preferred method of foreclosure is by public sale, the proceeds from which are applied to the indebtedness. When a foreclosed property sells for more than the debt, the mortgagor receives the balance, saving at least some of the investment. When a foreclosed property sells for less than the debt, the mortgagee must look to the note for the remainder of the debt. The mortgagee obtains a deficiency judgment against the signatories to the note and then attempts to collect against their personal assets.

When foreclosures begin, all junior lien holders should join in the suit. If the property sells for less than the debt, the junior lien holders can sue the mortgagor on the note. If the property sells for more than the debt, the junior lien holders are paid off (in order of priority) out of the surplus, with the mortgagor receiving the balance. The purchaser than receives the property free and clear of the first lien, which was foreclosed, and all junior liens.

All real estate tax liens must be paid from foreclosure proceeds or the property passes to the purchaser subject to all unpaid taxes. The purchaser must then pay the taxes due or lose the property

Soldiers and Sailors Relief Act

The Soldiers and Sailors Relief Act affects mortgages in several ways. One provision states that the court in which foreclosure action appears has the right to stop proceedings in which a civilian mortgagor, after induction to the military, is unable to comply with a mortgage agreement. For example, after entering the military, a mortgagor might be unable to make payments, due to a reduction in income. Another of this act's provisions states that the mortgagee can collect a maximum of 6% interest while the mortgagor is in the military, unless the mortgagor's ability to pay is not affected by his or her military status.

Creative Financing

Financing is a broad topic (whole books have been devoted to the topic), but the underlying objective is simple: try to use as much OPM as possible to secure property. Again, one of the most attractive aspects of real estate as an investment vehicle is that you typically earn about 5% on the entire value of a property and not just the money you initially invest to secure the property (down payment).

Professional real estate investors know the power of investing sometimes is not finding the bargain but finding the best terms. Much personal and business wealth has been created by those who understand this concept. Let's say that you buy a car from a friend of yours who agrees to let you take possession of the vehicle with no money down and make monthly payments with no interest, assuming the price was reasonable, you're getting a great deal. After all, you did not have to go to the bank, establish credit, nor pay any interest. Purchasing real estate is no different. Some of the best real estate deals have or include creative terms. Low interest rates (below market), no interest for a specified period of time, balloon payments, interest only and principal only payments, and other favorable terms can significantly reduce costs associated with securing investment property.

Creative financing is a key to success in real estate investing. The cheaper you can borrow money, the longer you can extend payments, or the lower your down payments, the greater leverage you can build into your portfolio. Leverage (using other people's money) is key to wealth building. Tie up as many properties as possible with the least amount of out-of-pocket cash. The best sources of OPM are the bank, a partner, a tenant, the seller, anybody but you. Try to conserve your cash. Always look at how to structure the deal, purchasing with the least amount of cash and the most favorable terms.

Creative financing falls into two major categories:

1. Understanding payment patterns and how to use them to your advantage.
2. Creative sources of capital and creative structuring of the purchase.

In subsequent sections, we will review a number of creative offers and purchase options (case studies based on actual real estate purchases). Review them in detail to see just how creative you can get structuring purchases.

Understanding your options

It is important that you understand the format and pattern of a real estate loan. Most loans are for a set period of time, usually thirty or fifteen years, but a mortgage can be for any length of time: five, ten, twenty, or even fifty years, as long as the borrower and the lender agree. The payment of the mortgage is structured to proportionately pay off more of the interest in the early years and less of the principal, a trend that changes over time, as the following amortization schedule illustrates.

Amortization Schedule (Principal: $100,000.00)
Rate: 7.500%
Term: 30 Years, 0 Months
Payment: $699.21
Interest: $151,721.68

No.	Date		Payment	Interest/Principal	Balance
1	Jul	1, 1992	699.21	625.00/74.21	99925.79
2	Aug	1, 1992	699.21	624.54/74.67	99851.12
3	Sep	1, 1992	699.21	624.07/75.14	99775.98
4	Oct	1, 1992	699.21	623.60/75.61	99700.37
5	Nov	1, 1992	699.21	623.13/76.08	99624.28
6	Dec	1, 1992	699.21	622.65/76.56	99547.72
7	Jan	1, 1993	699.21	622.17/77.04	99470.69
8	Feb	1, 1993	699.21	621.69/77.52	99393.17
9	Mar	1, 1993	699.21	621.21/78.00	99315.17
10	Apr	1, 1993	699.21	620.72/78.49	99236.68
11	May	1, 1993	699.21	620.23/78.98	99157.70
12	Jun	1, 1993	699.21	619.74/79.47	99078.22
13	Jul	1, 1993	699.21	619.24/79.97	98998.25
14	Aug	1, 1993	699.21	618.74/80.97	98917.78
15	Sep	1, 1993	699.21	618.24/80.47	98836.81
16	Oct	1, 1993	699.21	617.73/81.48	98755.33
17	Nov	1, 1993	699.21	617.22/81.99	98673.34
18	Dec	1, 1993	699.21	616.71/82.50	98590.83
19	Jan	1, 1994	699.21	616.19/83.02	98507.82
20	Feb	1, 1994	699.21	615.67/83.54	98424.28
21	Mar	1, 1994	699.21	615.15/84.06	98340.22
22	Apr	1, 1994	699.21	614.63/84.58	98255.64
23	May	1, 1994	699.21	614.10/85.11	98170.53
24	Jun	1, 1994	699.21	613.57/85.64	98084.88
25	Jul	1, 1994	699.21	613.03/86.18	97998.70
26	Aug	1, 1994	699.21	612.49/86.72	97911.99
27	Sep	1, 1994	699.21	611.95/87.26	97824.73
28	Oct	1, 1994	699.21	611.40/87.81	97736.92
29	Nov	1, 1994	699.21	610.86/88.35	97648.57
30	Dec	1, 1994	699.21	610.30/88.91	97559.66
31	Jan	1, 1995	699.21	609.75/89.46	97470.20
32	Feb	1, 1995	699.21	609.19/90.02	97380.18
33	Mar	1, 1995	699.21	608.63/90.58	97289.59
34	Apr	1, 1995	699.21	608.06/91.15	97198.44
35	May	1, 1995	699.21	607.49/91.72	97106.72
36	Jun	1, 1995	699.21	606.92/92.29	97014.93
37	Jul	1, 1995	699.21	606.34/92.87	96921.56
38	Aug	1, 1995	699.21	605.76/93.45	96828.11

No.	Date		Payment	Interest/Principal	Balance
39	Sep	1, 1995	699.21	605.18/94.03	96734.07
40	Oct	1, 1995	699.21	604.59/94.62	96639.45
41	Nov	1, 1995	699.21	604.00/95.21	96544.29
42	Dec	1, 1995	699.21	603.40/95.81	96448.43
43	Jan	1, 1996	699.21	602.80/96.41	96352.02
44	Feb	1, 1996	699.21	602.20/97.01	96255.01
45	Mar	1, 1996	699.21	601.59/97.62	96157.40
46	Apr	1, 1996	699.21	600.98/98.23	96059.17
47	May	1, 1996	699.21	600.37/98.84	95960.33
48	Jun	1, 1996	699.21	599.75/99.46	95860.87
49	Jul	1, 1996	699.21	599.13/100.08	95760.79
50	Aug	1, 1996	699.21	598.50/100.71	95660.09
51	Sep	1, 1996	699.21	597.88/101.33	95558.75
52	Oct	1, 1996	699.21	597.24/101.97	95456.79
53	Nov	1, 1996	699.21	596.60/102.61	95354.18
54	Dec	1, 1996	699.21	595.96/103.25	95250.93
55	Jan	1, 1997	699.21	595.32/103.89	95147.09
56	Feb	1, 1997	699.21	594.67/104.54	95042.50
57	Mar	1, 1997	699.21	594.02/105.19	94937.31
58	Apr	1, 1997	699.21	593.36/105.85	94831.46
59	May	1, 1997	699.21	592.70/106.51	94724.99
60	Jun	1, 1997	699.21	592.03/107.18	94617.76
61	Jul	1, 1997	699.21	591.36/107.85	94509.91
62	Aug	1, 1997	699.21	590.64/108.52	94401.39
63	Sep	1, 1997	699.21	590.01/109.20	94292.19
64	Oct	1, 1997	699.21	589.33/109.88	94182.31
65	Nov	1, 1997	699.21	588.64/110.57	94071.74
66	Dec	1, 1997	699.21	587.95/111.26	93960.47
67	Jan	1, 1998	699.21	587.25/111.96	93848.52
68	Feb	1, 1998	699.21	586.55/112.66	93735.86
69	Mar	1, 1998	699.21	585.85/113.36	93622.50
70	Apr	1, 1998	699.21	585.14/114.07	93508.93
71	May	1, 1998	699.21	584.93/114.78	93393.65
72	Jun	1, 1998	699.21	583.71/115.50	93278.15
73	Jul	1, 1998	699.21	582.99/116.22	93161.93
74	Aug	1, 1998	699.21	582.26/116.95	93044.98
75	Sep	1, 1998	699.21	581.53/117.68	92927.30
76	Oct	1, 1998	699.21	580.80/118.41	92808.89
77	Nov	1, 1998	699.21	580.06/119.15	92689.73
78	Dec	1, 1998	699.21	579.31/119.90	92569.83
79	Jan	1, 1999	699.21	578.56/120.65	92449.18
80	Feb	1, 1999	699.21	577.81/121.40	92327.78
81	Mar	1, 1999	699.21	577.05/122.16	92205.62
82	Apr	1, 1999	699.21	576.29/122.92	92082.69

No.	Date			Payment	Interest/Principal	Balance
83	May	1,	1999	699.21	575.52/123.69	91959.00
84	Jun	1,	1999	699.21	574.74/124.47	91834.53
85	Jul	1,	1999	699.21	573.97 125.24	91709.29
86	Aug	1,	1999	699.21	573.18/126.03	91583.26
87	Sep	1,	1999	699.21	572.40/126.81	91456.45
88	Oct	1,	1999	699.21	571.60/127.61	91328.84
89	Nov	1,	1999	699.21	570.81/128.40	91200.44
90	Dec	1,	1999	699.21	570.00/129.21	91071.23
91	Jan	1,	2000	699.21	569.20/130.01	90941.22
92	Feb	1,	2000	699.21	568.38/130.83	90810.39
93	Mar	1,	2000	699.21	567.56/131.65	90678.74
94	Apr	1,	2000	699.21	566.74/132.47	90546.27
95	May	1,	2000	699.21	565.91/133.30	90412.98
96	Jun	1,	2000	699.21	565.08/134.13	90278.85
97	Jul	1,	2000	699.21	564.24/134.97	90143.88
98	Aug	1,	2000	699.21	563.40/135.81	90008.07
99	Sep	1,	2000	699.21	562.55/136.66	89871.41
100	Oct	1,	2000	699.21	561.70/137.51	89733.90
101	Nov	1,	2000	699.21	560.89/138.37	89595.53
102	Dec	1,	2000	699.21	559.97/139.24	89456.29
103	Jan	1,	2001	699.21	559.10/140.11	89316.18
104	Feb	1,	2001	699.21	558.23/140.98	89175.20
105	Mar	1,	2001	699.21	557.34/141.87	89033.33
106	Apr	1,	2001	699.21	556.46/142.75	88890.58
107	May	1,	2001	699.21	555.57/143.64	88746.94
108	Jun	1,	2001	699.21	554.67/144.54	88602.39
109	Jul	1,	2001	699.21	553.76/145.45	88456.95
110	Aug	1,	2001	699.21	552.86/146.35	88310.59
111	Sep	1,	2001	699.21	551.94/147.27	88163.33
112	Oct	1,	2001	699.21	551.02/148.19	88015.14
113	Nov	1,	2001	699.21	550.09/149.12	87866.02
114	Dec	1,	2001	699.21	549.16/150.05	87715.97
115	Jan	1,	2002	699.21	548.22/150.99	87564.99
116	Feb	1,	2002	699.21	547.28/151.93	87413.06
117	Mar	1,	2002	699.21	546.33/152.88	87260.18
118	Apr	1,	2002	699.21	545.38/153.83	87106.35
119	May	1,	2002	699.21	544.41/154.80	86951.55
120	Jun	1,	2002	699.21	543.45/155.76	86795.79
121	Jul	1,	2002	699.21	542.97/156.74	86639.05
122	Aug	1,	2002	699.21	541.49/157.72	86481.34
123	Sep	1,	2002	699.21	540.51/158.70	86322.64
124	Oct	1,	2002	699.21	539.52/159.69	86162.94
125	Nov	1,	2002	699.21	538.52/160.69	86002.25
126	Dec	1,	2002	699.21	537.51/161.70	85840.55

No.	Date			Payment	Interest/Principal	Balance
127	Jan	1,	2003	699.21	536.50/162.71	85677.85
128	Feb	1,	2003	699.21	535.49/163.72	85514.12
129	Mar	1,	2003	699.21	534.46/164.75	85349.38
130	Apr	1,	2003	699.21	533.43/165.78	85183.60
131	May	1,	2003	699.21	532.40/166.81	85016.79
132	Jun	1,	2003	699.21	531.35/167.86	84848.93
133	Jul	1,	2003	699.21	530.31/168.90	84680.03
134	Aug	1,	2003	699.21	529.25/169.96	84510.07
135	Sep	1,	2003	699.21	528.19/171.02	84339.05
136	Oct	1,	2003	699.21	527.12/172.09	84166.96
137	Nov	1,	2003	699.21	526.04/173.17	83993.79
138	Dec	1,	2003	699.21	524.96/174.25	83819.54
139	Jan	1,	2009	699.21	523.87/175.34	83644.20
140	Feb	1,	2004	699.21	522.78/176.43	83467.77
141	Mar	1,	2004	699.21	521.67/177.54	83290.23
142	Apr	1,	2004	699.21	520.56/178.65	83111.59
143	May	1,	2004	699.21	519.45/179.76	82931.82
144	Jun	1,	2004	699.21	518.32/180.89	82750.94
145	Jul	1,	2004	699.21	517.19/182.02	82568.92
146	Aug	1,	2004	699.21	516.06/183.15	82385.77
147	Sep	1,	2004	699.21	514.91/184.30	82201.47
148	Oct	1,	2004	699.21	513.76/185.45	82016.02
149	Nov	1,	2004	699.21	512.60/186.61	81829.41
150	Dec	1,	2004	699.21	511.43/187.78	81641.63
151	Jan	1,	2005	699.21	510.26/188.95	81452.68
152	Feb	1,	2005	699.21	509.08/190.13	81262.55
153	Mar	1,	2005	699.21	507.89/191.32	81071.23
154	Apr	1,	2005	699.21	506.70/192.51	80878.72
155	May	1,	2005	699.21	505.49/193.72	80685.00
156	Jun	1,	2005	699.21	504.28/194.93	80490.07
157	Jul	1,	2005	699.21	503.06/196.15	80293.92
158	Aug	1,	2005	699.21	501.84/197.37	80096.55
159	Sep	1,	2005	699.21	500.60/198.61	79897.94
160	Oct	1,	2005	699.21	499.36/199.85	79698.10
161	Nov	1,	2005	699.21	498.11/201.10	79497.00
162	Dec	1,	2005	699.21	496.86/202.35	79294.65
163	Jan	1,	2006	699.21	495.59/203.62	79091.03
164	Feb	1,	2006	699.21	494.32/204.89	78886.14
165	Mar	1,	2006	699.21	493.04/206.17	78679.96
166	Apr	1,	2006	699.21	491.75/207.96	78472.50
167	May	1,	2006	699.21	490.45/208.76	78263.75
168	Jun	1,	2006	699.21	489.15/210.06	78053.69
169	Jul	1,	2006	699.21	487.89/211.37	77842.31
170	Aug	1,	2006	699.21	486.51/212.70	77629.62

No.	Date		Payment	Interest/Principal	Balance
171	Sep	1, 2006	699.21	485.19/214.02	77415.59
172	Oct	1, 2006	699.21	483.85/215.36	77200.23
173	Nov	1, 2006	699.21	482.50/216.71	76983.52
174	Dec	1, 2006	699.21	481.15/218.06	76765.46
175	Jan	1, 2007	699.21	479.78/219.93	76546.03
176	Feb	1, 2007	699.21	478.91/220.80	76325.23
177	Mar	1, 2007	699.21	477.03/222.18	76103.06
178	Apr	1, 2007	699.21	475.64/223.57	75879.49
179	May	1, 2007	699.21	474.25/224.96	75654.53
180	Jun	1, 2007	699.21	472.84/226.37	75428.16
181	Jul	1, 2007	699.21	471.93/227.78	75200.37
182	Aug	1, 2007	699.21	470.00/229.21	74971.17
183	Sep	1, 2007	699.21	468.57/230.64	74740.53
184	Oct	1, 2007	699.21	467.13/232.08	79508.44
185	Nov	1, 2007	699.21	465.68/233.53	74274.91
186	Dec	1, 2007	699.21	464.22/234.99	74039.92
187	Jan	1, 2008	699.21	462.75/236.46	73803.46
188	Feb	1, 2008	699.21	461.27/237.94	73565.52
189	Mar	1, 2008	699.21	459.78/239.43	73326.10
190	Apr	1,2008	699.21	458.29/240.92	73085.17
191	May	1, 2008	699.21	456.78/242.93	72842.75
192	Jun	1, 2008	699.21	455.27/243.99	72598.80
193	Jul	1, 2008	699.21	453.74/245.47	72353.34
194	Aug	1, 2008	699.21	452.21/247.00	72106.33
195	Sep	1, 2008	699.21	450.66/248.55	71857.79
196	Oct	1, 2008	699.21	499.11/250.10	71607.69
197	Nov	1, 2008	699.21	447.55/251.66	71356.03
198	Dec	1, 2008	699.21	445.98/253.23	71102.79
199	Jan	1, 2009	699.21	444.39/254.82	70847.98
200	Feb	1, 2009	699.21	442.80/256.41	70591.57
201	Mar	1, 2009	699.21	441.20/258.01	70333.55
202	Apr	1, 2009	699.21	439.58/259.63	70073.93
203	May	1, 2009	699.21	437.96/261.25	69812.68
204	Jun	1, 2009	699.21	436.33/262.88	69549.80
205	Jul	1, 2009	699.21	434.69/264.52	69285.28
206	Aug	1, 2009	699.21	433.03/266.18	69019.10
207	Sep	1, 2009	699.21	431.37/267.84	68751.26
208	Oct	1, 2009	699.21	429.70/269.51	68481.74
209	Nov	1, 2009	699.21	428.01/271.20	68210.54
210	Dec	1, 2009	699.21	426.32/272.89	67937.65
211	Jan	1, 2010	699.21	429.61/274.60	67663.05
212	Feb	1, 2010	699.21	422.89/276.32	67386.73
213	Mar	1, 2010	699.21	421.17/278.04	67108.69
214	Apr	1, 2010	699.21	419.43/279.78	66828.91

No.	Date		Payment	Interest/Principal	Balance
215	May	1, 2010	699.21	417.68/281.53	66547.38
216	Jun	1, 2010	699.21	415.92/283.29	66264.09
217	Jul	1, 2010	699.21	414.15/285.06	65979.03
218	Aug	1, 2010	699.21	412.37/286.84	65692.19
219	Sep	1, 2010	699.21	410.58/288.63	65403.56
220	Oct	1, 2010	699.21	408.77/290.44	65113.12
221	Nov	1, 2010	699.21	406.96/292.25	64820.87
222	Dec	1, 2010	699.21	405.13/294.08	64526.79
223	Jan	1, 2011	699.21	403.29/295.92	64230.87
224	Feb	1, 2011	699.21	401.44/297.77	63933.10
225	Mar	1, 2011	699.21	399.58/299.63	63633.48
226	Apr	1, 2011	699.21	397.71/301.50	63331.97
227	May	1, 2011	699.21	395.82/303.39	63028.59
228	Jun	1, 2011	699.21	393.93/305.28	62723.31
229	Jul	1, 2011	699.21	392.02/307.19	62416.12
230	Aug	1, 2011	699.21	390.10/309.11	62107.01
231	Sep	1, 2011	699.21	388.17/311.04	61795.97
232	Oct	1, 2011	699.21	386.22/312.99	61482.98
233	Nov	1, 2011	699.21	384.27/314.99	61168.04
234	Dec	1, 2011	699.21	382.30/316.91	60851.13
235	Jan	1, 2012	699.21	380.32/318.89	60532.24
236	Feb	1, 2012	699.21	378.33/320.88	60211.36
237	Mar	1, 2012	699.21	376.32/322.89	59888.47
238	Apr	1, 2012	699.21	374.30/324.91	59563.56
239	May	1, 2012	699.21	372.27/326.94	59236.62
240	Jun	1, 2012	699.21	370.23/328.98	58907.64
241	Jul	1, 2012	699.21	368.17/331.04	58576.61
242	Aug	1, 2012	699.21	366.10/333.11	58243.50
243	Sep	1, 2012	699.21	364.02/335.19	57908.31
244	Oct	1, 2012	699.21	361.93/337.28	57571.03
245	Nov	1, 2012	699.21	359.82/339.39	57231.64
246	Dec	1, 2012	699.21	357.70/341.51	56890.12
247	Jan	1, 2013	699.21	355.56/343.65	56546.48
248	Feb	1, 2013	699.21	353.42/345.79	56200.68
249	Mar	1, 2013	699.21	351.25/347.96	55852.73
250	Apr	1, 2013	699.21	349.08/350.13	55502.60
251	May	1, 2013	699.21	346.89/352.32	55150.28
252	Jun	1, 2013	699.21	344.69/354.52	54795.76
253	Jul	1, 2013	699.21	342.47/356.74	54439.02
254	Aug	1, 2013	699.21	340.24/358.97	54080.06
255	Sep	1, 2013	699.21	338.00/361.21	53718.85
256	Oct	1, 2013	699.21	335.74/363.47	53355.38
257	Nov	1, 2013	699.21	333.47/365.74	52989.64
258	Dec	1, 2013	699.21	331.19/368.02	52621.61

No.	Date		Payment	Interest/Principal	Balance
259	Jan	1, 2014	699.21	328.89/370.32	52251.29
260	Feb	1, 2014	699.21	326.57/372.64	51878.65
261	Mar	1, 2014	699.21	324.24/374.97	51503.68
262	Apr	1, 2014	699.21	321.90/377.31	51126.37
263	May	1, 2014	699.21	319.54/379.67	50746.70
264	Jun	1, 2014	699.21	317.17/382.04	50364.66
265	Jul	1, 2014	699.21	314.78/384.43	49980.23
266	Aug	1, 2014	699.21	312.38/386.83	49593.39
267	Sep	1, 2014	699.21	309.96/389.25	49204.14
268	Oct	1, 2014	699.21	307.53/391.68	48812.46
269	Nov	1, 2014	699.21	305.08/394.13	48418.32
270	Dec	1,2014	699.21	302.61/396.60	48021.73
271	Jan	1, 2015	699.21	300.14/399.07	47622.66
272	Feb	1, 2015	699.21	297.64/401.57	47221.09
273	Mar	1, 2015	699.21	295.13/404.08	46817.01
274	Apr	1, 2015	699.21	292.61/406.60	46410.40
275	May	1, 2015	699.21	290.07/409.14	46001.26
276	Jun	1, 2015	699.21	287.51/411.70	45589.56
277	Jul	1, 2015	699.21	284.93/414.28	45175.28
278	Aug	1, 2015	699.21	282.35/416.86	44758.42
279	Sep	1, 2015	699.21	279.74/419.47	44338.95
280	Oct	1, 2015	699.21	277.12/422.09	43916.86
281	Nov	1, 2015	699.21	274.48/424.73	43492.13
282	Dec	1, 2015	699.21	271.83/427.38	43064.74
283	Jan	1, 2016	699.21	269.15/430.06	42634.69
284	Feb	1, 2016	699.21	266.47/432.74	42201.94
285	Mar	1, 2016	699.21	263.76/435.45	41766.50
286	Apr	1, 2016	699.21	261.04/438.17	41328.33
287	May	1, 2016	699.21	258.30/440.91	40887.42
288	Jun	1, 2016	699.21	255.55/443.66	40443.76
289	Jul	1, 2016	699.21	252.77/446.44	39997.32
290	Aug	1, 2016	699.21	249.98/449.23	39548.09
291	Sep	1, 2016	699.21	247.18/452.03	39096.06
292	Oct	1, 2016	699.21	244.35/454.86	38641.20
293	Nov	1, 2016	699.21	241.51/457.70	38183.50
294	Dec	1, 2016	699.21	238.65/460.56	37722.93
295	Jan	1, 2017	699.21	235.77/463.44	37259.49
296	Feb	1, 2017	699.21	232.87/466.34	36793.15
297	Mar	1, 2017	699.21	229.96/469.25	36323.90
298	Apr	1, 2017	699.21	227.02/472.19	35851.71
299	May	1, 2017	699.21	224.07/475.14	35376.58
300	Jun	1, 2017	699.21	221.10/478.11	34898.47
301	Jul	1, 2017	699.21	218.12/481.09	34417.38
302	Aug	1, 2017	699.21	215.11/484.10	33933.27

No.	Date		Payment	Interest/Principal	Balance
303	Sep	1, 2017	699.21	212.08/487.13	33446.15
304	Oct	1, 2017	699.21	209.04/490.17	32955.98
305	Nov	1, 2017	699.21	205.97/493.24	32462.74
306	Dec	1, 2017	699.21	202.89/496.32	31966.42
307	Jan	1, 2018	699.21	199.79/499.42	31467.00
308	Feb	1, 2018	699.21	196.67/502.54	30964.46
309	Mar	1, 2018	699.21	193.53/505.68	30458.78
310	Apr	1, 2018	699.21	190.37/508.84	29949.94
311	May	1, 2018	699.21	187.19/512.02	29437.91
312	Jun	1, 2018	699.21	183.99/515.22	28922.69
313	Jul	1, 2018	699.21	180.77/518.44	28404.25
314	Aug	1, 2018	699.21	177.53/521.68	27882.56
315	Sep	1, 2018	699.21	174.27/524.94	27357.62
316	Oct	1, 2018	699.21	170.99/528.22	26829.40
317	Nov	1, 2018	699.21	167.68/531.53	26297.87
318	Dec	1, 2018	699.21	164.36/534.85	25763.02
319	Jan	1, 2019	699.21	161.02/538.19	25224.83
320	Feb	1, 2019	699.21	157.66/541.55	24683.28
321	Mar	1, 2019	699.21	154.27/544.94	24138.34
322	Apr	1, 2019	699.21	150.86/548.35	23589.99
323	May	1, 2019	699.21	147.44/551.77	23038.22
324	Jun	1, 2019	699.21	143.99/555.22	22483.00
325	Jul	1, 2019	699.21	140.52/558.69	21924.31
326	Aug	1, 2019	699.21	137.03/562.18	21362.12
327	Sep	1, 2019	699.21	133.51/565.70	20796.43
328	Oct	1, 2019	699.21	129.98/569.23	20227.19
329	Nov	1, 2019	699.21	126.42/572.79	19654.40
330	Dec	1,2019	699.21	122.84/576.37	19078.03
331	Jan	1, 2020	699.21	119.24/579.97	18498.06
332	Feb	1, 2020	699.21	115.61/583.60	17914.46
333	Mar	1, 2020	699.21	111.97/587.24	17327.22
334	Apr	1, 2020	699.21	108.30/590.91	16736.30
335	May	1, 2020	699.21	104.60/594.61	16141.70
336	Jun	1, 2020	699.21	100.89/598.32	15543.37
337	Jul	1, 2020	699.21	97.15/602.06	14941.31
338	Aug	1, 2020	699.21	93.38/605.83	14335.48
339	Sep	1, 2020	699.21	89.60/609.61	13725.87
340	Oct	1, 2020	699.21	85.79/613.42	13112.44
341	Nov	1, 2020	699.21	81.95/617.26	12495.19
342	Dec	1, 2020	699.21	78.09/621.12	11874.07
343	Jan	1, 2021	699.21	74.21/625.00	11249.08
344	Feb	1, 2021	699.21	70.31/628.90	10620.17
345	Mar	1, 2021	699.21	66.38/632.83	9987.34
346	Apr	1, 2021	699.21	62.42/636.79	9350.55

No.	Date		Payment	Interest/Principal	Balance
347	May	1, 2021	699.21	58.44/640.77	8709.78
348	Jun	1, 2021	699.21	54.44/644.77	8065.01
349	Jul	1, 2021	699.21	50.41/648.80	7416.20
350	Aug	1, 2021	699.21	46.35/652.86	6763.34
351	Sep	1, 2021	699.21	42.27/656.94	6106.40
352	Oct	1, 2021	699.21	38.17/661.04	5445.36
353	Nov	1, 2021	699.21	34.03/665.18	4780.18
354	Dec	1, 2021	699.21	29.88/669.33	4110.85
355	Jan	1, 2022	699.21	25.69/673.52	3437.33
356	Feb	1, 2022	699.21	21.48/677.73	2759.61
357	Mar	1, 2022	699.21	17.25/681.96	2077.64
358	Apr	1, 2022	699.21	12.99/686.22	1391.42
359	May	1, 2022	699.21	8.70/690.51	700.90
360	Jun	1, 2022	700.90	4.38/694.83	0.00

Generating cash at closing

There are a number of ways to make money on one transaction. In the following transaction, you make use of three different contracts. Although the numbers used are from an actual transaction, this technique will work with any property and any numbers.
We will make several assumptions in these examples.

- The property is free and clear. (This strategy will work best with properties that are free, but if the property has a mortgage, it will still work.)
- The property has been owned by the same owner for several years.
- It has been a rental property.
- If the property is sold, the owner will have to pay capital gains tax.
- The property has been on the market for just a few days.
- The seller is asking $117,000 for this property. The market value is the same.

Your offer:	$116,000
Mortgage:	None
Down Payment:	$1,000
Buyer's additional payment at closing:	$55,000
Balance due at Closing:	$115,000

You negotiate with the seller for a carry-back mortgage for the $115,000 at 10% for 30 years. The monthly payment to the seller works out to $1,009.21 per month. Looking at the options, the seller says that he is not interested in monthly payments but would rather have a larger dollar amount now and wait for the balance. This is where you write a second contract. The first contract is the purchase offer. The second contract will be an assignment of payment. The $1,009 per month will be assigned to a third party. In the purchase contract, you add the clause that you have the right, as the buyer, to assign the payment of the mortgage that was taken back by the seller. The assignment of payment comes into effect at closing. The payment for the mortgage will now be paid to the third party. Let’s call this third party "I Buy Mortgages." (You can find mortgage buyers in the yellow pages, the newspaper, or through Realtors.) The assignment of payment is drawn up between you, the seller, and “I Buy Mortgages.” The payment will be assigned to “I Buy Mortgages” for the first 10 years of the 30-year amortization. Let's look at the concept of present and future values. Today's value is different from the future value, because time erodes the value of money. Today's dollar is worth more than the future dollar. One dollar will be worth less in ten years. Since the value of a dollar changes, the payment to “I Buy Mortgages” is affected. I Buy will receive $1,009 per month for 10 years. What amount will I Buy receive?

A. $121,105.20

B. $122,105.20 (includes $1,000 down payment)

C. $120,000 (interest included)

D. Have no idea!

The answer is A. Over a 10-year period, I Buy will receive $121,105.20 ($1,009.21 x 12 months x 10 years)

Now let's look at the effect of present and future value on the transaction. These values have no effect on what "I Buy Mortgages" will receive; it will have an effect on the amount of dollars "I Buy Mortgages" will advance in terms of today values. You assign the payment to "I Buy Mortgages" in the first place to provide the cash you need to complete the transaction. By assigning the payments to "I Buy Mortgages," you are in effect borrowing money, by collateralizing the seller-held first mortgage and shifting the payment to "I Buy Mortgages." Because "I Buy Mortgages" is receiving the monthly payments, it will advance monies that are valued at today's dollars.

The seller is holding a mortgage in the amount of $115,000 at 10% for 30 years. You secured the property with a $1,000 down payment. Through the assignment of payment, the payments are made to "I Buy Mortgages" in the amount of $1,009.21 per month. The amount that "I Buy Mortgages" will advance is based on the yield it expects. Yield is the discount rate, not interest percent on the mortgage. Most mortgage buyers expect a yield of 12% or higher. For this calculation, you will need to know the amount that "I Buy Mortgages" will receive: $121,105.20. Based on the concept of present vs. future values, "I Buy Mortgages" will advance no less than half of the future value. This means that the advance will be no more than $60,552.60. This is where you negotiate a higher yield to "I Buy Mortgages," say 14%. In this case, you would increase the advance to $65,000. This amount is sent to your closing agent’s trust account to complete the closing. The fact that it’s sent to your agent's trust account is one of the keys to the success of this strategy, as it allows you to direct where and how much money is released for the closing. Direct the funds in this way:

Total from “I Buy Mortgages”	$65,000
Send to seller:	$55,000
Sent to buyer (you):	$10,000

The total profit is $9,000 ($10,000 minus the down payment of $1,000)

Why the seller is happy

The seller sells the property for close to the asking price. Once you see the rest of the math, you will realize that the seller, in fact, sells the property for more than the asking price. The seller also receives a $55,000 down payment, and the best part is the fact that the seller does not have to pay tax on that money. Why? Because the money was advanced by way of assignment of payment, thereby a loan, and one does not have to pay tax on borrowed money.

There is a balance to be paid to the seller, because he took back a mortgage. This mortgage was a first mortgage in the amount of $115,000 at 10% for 30 years. The balance owed the seller is at least $115,000 minus the $55,000 down payment, which comes to $60,000. The problem is that the seller did not earn any interest on his money during the 10-year period. The balance will be based on the amortization of the $115,000 over 30 years. During the first 10 years of the amortization of the 30-year mortgage, the payments pay off the interest of the mortgage. The balance then owed will be the balance owed at the tenth year. That amounts to $76,367.89. This balance would be part of the SPM provision of the seller-held mortgage, due and payable at the tenth year. (A SPM mortgage provision means only one payment is made on the mortgage.) At the tenth year, the balance of $67,367.89 will be paid to the seller in one single payment. The balance is paid to the seller in many different ways.

Here are two ways in which you can make the SPM Mortgage. But you must answer these questions first. Who will make the payment of $1,009 per month? Who will live in the property? The answer to the first question is two-fold. If you are thinking of buying your first home, this strategy will afford you the opportunity to do so without a large down payment. There are no credit checks because the seller takes back the mortgage. The only thing you have to concern yourself with is the ability to pay $1,009 per month. Even this is not a big concern, because you would have at least $10,000 at closing. This would take care of nine month's worth of payments. If you already own your home, this might be an investment property for you. This would answer the next question: Who will live in the property? It could be you, or you could rent it out. The best strategy would be to lease option the property. Using this strategy you would be able to get $1,300 per month. You get to keep the difference every month, even if you credit $300 per month toward the purchase price or the down payment.

If you are going to live in the property, the property would be refinanced in the tenth year. If you use the lease option, in the tenth year, you sell the property to the lease option buyer. The price would be the value of the property in the tenth year. You can determine this by using the 5% per year increase rule of thumb.

Property Value Today	$116,000 (your purchase price)
Property Value Tenth Year:	$191,053.10 (at 5% per year increase over 10 years)
Property Value Tenth Year:	$172,936.59 (at 4% per year increase over 10 years)
Property Value Tenth Year:	$156,525.01 (at 3% per year increase over 10 years)
Property Value Tenth Year:	$141,659.13 (at 2% per year increase over 10 years)

Mathematics of the sale

The lease option is used in the tenth year. The lease option buyer pays $1,300 per month; you credit $300 every month toward the down payment for the purchase of the property. In the tenth year, the property is sold for $191,053.10.
Disbursement of cash ($1,300 per month):
"I Buy Mortgages" receives $1,000 per month.
You retain $300 per month.
Option buyer receives $300 credit per month for 10 years ($36,000).
Option buyer buys property for $191,053.10 (5% per year increase over 10 years).
In the tenth year, the option buyer would have to go to the bank. You would accompany him or her with an offer to purchase of $191,053.10. The buyer needs to have a down payment of at least 10% of the purchase price, which would be $19,105.31. The credit the buyer has accumulated is a little more than 20% of the purchase price. This makes it easier for the bank to provide the first mortgage in the amount of $155,053.10.

Sell price:	$191,053.10
Down payment	$36,000 (credit over 10 years)
New first mortgage	$155,053.10
Balance to original owner	$76,367.89
Balance at new closing	$78,685.21

So what is your true profit on this one deal?
A. $78,685.21
B. $88,685.21
C. $124,685.21
D. $36,000

C is the correct profit figure.

Renovate & Refinance

Strategy:
Buy a "fixer-upper."
Borrow down payment and the material costs.
Have a handyman/contractor as partner.
Refinance later to repay everything.

1. Buy a $50,000 property with $5,000 down payment and $45,000 in short-term OTB (owner take back) financing
2. Borrow $10,000 to renovate
3. If a mortgage company appraises it at $80,000, you've got a nicely renovated home with $20,000 equity and classy tenants. You also have a handyman/contractor partner to manage repairs/maintenance.

"Contrary" investing

Buy when everyone wants to sell (low prices and your terms), and sell when everyone is buying (high prices and your terms). It takes courage, but the reward is wealth. Suburban properties are the nicest to live in and usually the worst to rent out because of the severe negative cash flows. Rural properties may give you problems with mortgaging. Small towns (close enough that you can drive to within an hour) usually offer low real estate prices with excellent rental income. Since there are fewer buyers in smaller towns, sellers are often very motivated.

Buy your own home with nothing down (joint venture)

Find a home you really want to live in, in an area you like. Negotiate a low down payment Find an investor and offer the following deal, using a slight modification of the joint-venture agreement:
<u>Investor</u>:
Puts up small cash required (the down payment)
Owns 50% of a nice property in a nice neighborhood.
Never has a negative cash flow.
Has no property management duties (totally silent partner) and will either share in the capital appreciation on resale or will be bought out by you at say … 15% compounded interest on the investment.
<u>Occupant</u>:
Puts up one dollar.
Owns 50% of home, pays all bills, and does all improvements.
Has a buy-out privilege (the investor does not).
All t\you have to do is close on the property and move in and care for it like your own home, which it is!
Exercise buy-out privilege a few years later if you can. If you cannot, sell the property, and use your new cash and added knowledge to buy another property on your own.

Use discount mortgages to generate profit

The amortization schedule (repayment pattern) is a key to success. Note that in the later years more of the monthly payments go to pay off principal than interest. If you can change the repayment pattern to reduce the interest, eliminate the interest, or defer the interest, the cost of the property can be substantially reduced. In many cases, restructuring the financing can turn a marginal deal into a great deal. Yes, it is important to buy at a discount (90% or less of the fair market value), but realize that when you change the terms you actually get a discount, not to mention increase your leverage.

You probably know that a lower interest rate will save you money; however, you may not know how much you can save by a reduction in the interest rate. For example, assume a seller is ready to take back a mortgage on the property they are selling. They are prepared to give you a second mortgage of $30,000 over a 4-year period at 10% interest. Over that

4-year period, you will pay $6,522.24 in interest. It may be a fair rate, but what if you can negotiate a lower rate, perhaps 5%? The total interest paid will be $3,162.24. Therefore, you save $3,360.00. Always try to negotiate a lower interest rate with the bank or the seller.

If you lower the monthly mortgage payments and you rent the property out, you can immediately increase your cash flow each month. For example, a 5% rate equates to a $690.88 per month payment and a 10% rate a $760.88 payment. In this situation, the end result could be a $70.00 per month increase in cash flow or reduction in expenses or $840.00 over the course of a year. See the following two amortization-schedules, with a 5% and 10% rate of interest. With larger amounts, over time, the savings can be substantial.

Amortization Schedule

Principal:	30,000.00
Initial Interest Rate:	10%
Initial Term (periods):	48
Periods Per Year:	12
Payment:	$790.88

Pmt #	**Date**	**Rate**	**Payment**	**Principal/Interest**	**Balance**
1	2/1/1995	10.000%	760.88	510.88/250.00	29489.12
2	3/1/1995	10.000%	760.88	515.44/245.74	28973.98
3	4/1/1995	10.000%	760.88	519.43 241.45	28454.55
4	5/1/1995	10.000%	760.88	523.76 237.12	27930.79
5	6/1/1995	10.000%	760.88	528.12 232.76	27402.67
6	7/1/1995	10.000%	760.88	532.52 228.36	26870.15
7	8/1/1995	10.000%	760.88	536.96 223.92	26333.18
8	9/1/1995	10.000%	760.88	541.44 219.44	25791.75
9	10/1/1995	10.000%	760.88	545.95 214.93	25245.80
10	11/1/1995	10.000%	760.88	550.50 210.38	24695.30
11	12/1/1995	10.000%	760.88	555.09 205.79	24140.21
12	1/1/1996	10.000%	760.88	559.71 201.17	23580.50
13	2/1/1996	10.000%	760.88	564.38 196.50	23016.13
14	3/1/1996	10.000%	760.88	569.08 191.80	22447.05
15	4/1/1996	10.000%	760.88	573.82 187.06	21873.23
16	5/1/1996	10.000%	760.88	578.60 182.28	21294.62
17	6/1/1996	10.000%	760.88	583.42 177.46	20711.20
18	7/1/1996	10.000%	760.88	588.29 172.59	20122.91#
19	8/1/1996	10.000%	760.88	593.19 167.69	19529.72
20	9/1/1996	10.000%	760.88	598.13 162.75	18931.59
21	10/1/1996	10.000%	760.88	603.12 157.76	18328.47
22	11/1/1996	10.000%	760.88	608.14 152.74	17720.33
23	12/1/1996	10.000%	760.88	613.12 147.67	17107.12
24	1/1/1997	10.000%	760.88	618.32 142.56	16488.80
25	2/1/1997	10.000%	760.88	623.47 137.41	15865.33
26	3/1/1997	10.000%	760.88	628.67 132.21	15236.66
27	4/1/1997	10.000%	760.88	633.91 126.97	14602.75
28	5/1/1997	10.000%	760.88	639.19 121.69	13963.56
29	6/1/1997	10.000%	760.88	644.52 116.36	13319.04
30	7/1/1997	10.000%	760.88	649.89 110.99	12669.15
31	8/1/1997	10.000%	760.88	655.30 105.58	12013.85
32	9/1/1997	10.000%	760.88	660.76 100.12	11353.09
33	10/1/1997	10.000%	760.88	666.27 94.61	10686.82
34	11/1/1997	10.000%	760.88	671.82 89.06	10014.99
35	12/1/1997	10.000%	760.88	677.42 83.46	9337.57
36	1/1/1998	10.000%	760.88	683.07 77.81	8654.50

Pmt #	Date	Rate	Payment	Principal/Interest	Balance
37	2/1/1998	10.000%	760.88	688.76 72.12	7965.74
38	3/1/1998	10.000%	760.88	694.50 66.38	7271.25
39	4/1/1998	10.000%	760.88	700.29 60.59	6570.96
40	5/1/1998	10.000%	760.88	706.12 54.76	5864.84
41	6/1/1998	10.000%	760.88	712.01 48.87	5152.83
42	7/1/1998	10.000%	760.88	717.94 42.94	4434.89
43	8/1/1998	10.000%	760.88	723.92 36.96	3710.97
44	9/1/1998	10.000%	760.88	736.04 30.92	2981.01
45	10/1/1998	10.000%	760.88	736.04 24.84	2244.97
46	11/1/1998	10.000%	760.88	742.17 18.71	1502.80
47	12/1/1998	10.000%	760.88	748.36 12.52	754.45
48	1/1/1999	10.000%	760.88	754.45 6.29	0.00

Amortization Schedule

Principal: $30,000.00
Initial Interest Rate: 5.0%
Initial Term (periods): 48
Periods Per Year: 12
Payment: $690.88

Pmt #	Date	Rate	Payment	Principal/Interest	Balance
1	2/1/1995	5.000%	690.88	565.88 125.00	29434.12
2	3/1/1995	5.000%	690.88	568.24 122.64	28865.88
3	4/1/1995	5.000%	690.88	570.61 120.27	28295.28
4	5/1/1995	5.000%	690.88	572.98 117.90	27722.29
5	6/1/1995	5.000%	690.88	575.37 115.51	27146.92
6	7/1/1995	5.000%	690.88	577.77 113.11	26569.16
7	8/1/1995	5.000%	690.88	580.18 110.70	25988.98
8	9/1/1995	5.000%	690.88	582.59 108.29	25406.39
9	10/1/1995	5.000%	690.88	585.02 105.86	24821.37
10	11/1/1995	5.000%	690.88	587.46 103.42	24233.91
11	12/1/1995	5.000%	690.88	589.91 100.97	23644.00
12	1/1/1996	5.000%	690.88	592.36 98.52	23051.64
13	2/1/1996	5.000%	690.88	594.83 96.05	22456.81
14	3/1/1996	5.000%	690.88	597.31 93.57	21859.50
15	4/1/1996	5.000%	690.88	599.80 91.08	21259.70
16	5/1/1996	5.000%	690.88	602.30 88.58	20657.40
17	6/1/1996	5.000%	690.88	604.81 86.07	20052.60
18	7/1/1996	5.000%	690.88	607.33 83.55	19445.27
19	8/1/1996	5.000%	690.88	609.86 81.02	18835.41
20	9/1/1996	5.000%	690.88	612.40 78.48	18223.01
21	10/1/1996	5.000%	690.88	614.95 75.93	17608.06
22	11/1/1996	5.000%	690.88	617.51 73.37	16990.55
23	12/1/1996	5.000%	690.88	620.09 70.79	16370.46
24	1/1/1997	5.000%	690.88	622.67 68.21	15747.79
25	2/1/1997	5.000%	690.88	625.26 654.62	15122.53
26	3/1/1997	5.000%	690.88	627.87 63.01	14494.66
27	4/1/1997	5.000%	690.88	630.49 60.39	13864.17
28	5/1/1997	5.000%	690.88	633.11 57.77	13231.06
29	6/1/1997	5.000%	690.88	635.75 55.13	12595.31
30	7/1/1997	5.000%	690.88	638.40 52.48	11956.91
31	8/1/1997	5.000%	690.88	641.06 49.82	11315.85
32	9/1/1997	5.000%	690.88	643.73 47.15	10672.12
33	10/1/1997	5.000%	690.88	646.41 44.47	10025.71
34	11/1/1997	5.000%	690.88	649.11 41.77	9376.60
35	12/1/1997	5.000%	690.88	651.81 39.07	8724.79
36	1/1/1998	5.000%	690.88	654.53 36.35	8070.26

Pmt #	Date	Rate	Payment	Principal/Interest	Balance
37	2/1/1998	5.000%	690.88	657.25 33.63	7413.01
38	3/1/1998	5.000%	690.88	659.99 30.89	6753.02
39	4/1/1998	5.000%	690.88	662.74 28.14	6090.27
40	5/1/1998	5.000%	690.88	665.50 25.38	5424.77
41	6/1/1998	5.000%	690.88	668.28 22.60	4756.49
42	7/1/1998	5.000%	690.88	671.06 19.82	4085.43
43	8/1/1998	5.000%	690.88	673.86 17.02	3411.57
44	9/1/1998	5.000%	690.88	676.67 14.21	2734.91
45	10/1/1998	5.000%	690.88	679.48 11.40	2055.42
46	11/1/1998	5.000%	690.88	682.32 8.56	1373.11
47	12/1/1998	5.000%	690.88	685.16 5.72	687.95
48	1/1/1999	5.000%	690.88	687.65 2.87	0.00

Mortgage Strategies

Most mortgages are created by "professionals." Often a bank, title company, real estate lawyer, or Realtor will create a mortgage, deed of trust, or note on the property. The majority of mortgages in our nation are first mortgages; however, there are millions of second and third mortgages on properties.

Basically, a note is an agreement to borrow money at a certain rate of interest for a specific period of time. The lender or the borrower puts in writing the agreement and terms. The agreement or contract is legally binding and has a number of safeguards for both the borrower and lender.

Often, second or third mortgages are created when the seller cannot sell his/her/their property. For example, if a property is on the market for six months to a year, the seller may consider financing the property—loaning the buyer the money to purchase the property. There are dozens of legal templates (contracts) for the seller or buyer to use. The agreement will include:

- The amount of the loan (mortgage).
- Interest rate of the loan.
- Length of the note (5, 10, 15, or 30 years or whatever is agreed).
- Position of the note (first, second, or third mortgage).
- Any particular clauses or covenants (balloon payment, escrow amounts, assumable etc.)

Note: Ask a professional to review all mortgage documents. They can be complicated.

Negotiate mortgages at a discount

Most people do not understand that mortgages or notes are negotiable. They can be bought and sold. For example, the first mortgage on your property could be sold by the bank that owns the note to another bank or other lender. You will just be told to send your mortgage payments to the new owner. The payments stay the same, as does the term. Usually the note is bought by the new owner at a discount; hence the term "discount mortgage." Most first mortgages are bought and sold by large financial institutions (banks, saving and loans, trust companies, and mortgage companies).

In the second and third mortgage market, there are many players: homeowners who created a second mortgage to sell their home, private investors who are investing in notes to get a good interest rate (often 12% or higher), professional mortgage and investment companies speculating in the mortgage market, syndicates that are building profitable portfolios, and institutions that are looking for a better return on their investment, secured by property. These notes are also negotiable. They can be bought and sold, often at a discount.

When a note is sold at a discount the new owner starts to receive the payments, but also receives the discount, which is cash value that will be collected later from the note. Let's take a look at an example.

Characteristics:

- $100,000 property
- First mortgage was $60,000
- New buyer came up with $70,000 financing for the property and had to take a second mortgage
- The property owner sold the home and took back a second note for $30,000 over a 4-year period at 15% interest. (See amortization schedule.)
- The homeowner wants to get his money out of the property as soon as possible.

Since the second mortgage is a negotiable instrument, it can be sold. In fact, many individuals and groups would be willing to buy the note, especially if the owner is prepared to sell the mortgage document or note at a reduced rate. We could offer the owner of the note $25,000 for the $30,000 note. If the owner accepts, because he wants the cash now and not later, we have just made a great return on our investment. First, we will receive a good interest rate of 15% on the note, so the monthly payment of $834.92 is a solid investment. Second, we have made $5,000 on the note. We paid $25,000 for a $30,000 note and will receive the $30,000 over the next four years.

When notes are bought by individuals or institutions, they are evaluated by a number of factors, including how old the note is; what discount is available on the note, which will equate to a yield on investment; and the type of property the note is securing. (Certain properties are not acceptable.) Other factors are the Loan to value (the more equity in the property, the better, because it makes the note more secure), borrower credit rating and worthiness, and the amount. ($100,000 and less is very common. More than that amount is less common.)

Amortization Schedule

Principal:	$30,000.00
Initial Interest Rate:	15%
Initial Term (periods):	48
Periods Per Year:	12
Payment:	$834.92

Pmt #	**Date**	**Rate**	**Payment**	**Principal/Interest**	**Balance**
1	2/1/1995	15%	834.92	459.92/375.00	29540.08
2	3/1/1995	15%	834.92	465.67/369.25	29074.41
3	4/1/1995	15%	834.92	471.49/363.43	28602.92
4	5/1/1995	15%	834.92	477.38/357.54	28125.54
5	6/1/1995	15%	834.92	483.35/351.57	27642.19
6	7/1/1995	15%	834.92	489.39/345.53	27152.79

Pmt #	Date	Rate	Payment	Principal/Interest	Balance
7	8/1/1995	15%	834.92	495.51/339.41	26657.28
8	9/1/1995	15%	834.92	501.70/333.22	26155.58
9	10/1/1995	15%	834.92	507.98/326.94	25647.60
10	11/1/1995	15%	834.92	514.32/320.60	25133.28
11	12/1/1995	15%	834.92	520.75/314.17	24612.53
12	1/1/1996	15%	834.92	527.26/307.66	24085.26
13	2/1/1996	15%	834.92	533.85/301.07	23551.41
14	3/1/1996	15%	834.92	540.53/294.39	23010.88
15	4/1/1996	15%	834.92	547.28/287.64	22463.60
16	5/1/1996	15%	834.92	554.13/280.79	21909.47
17	6/1/1996	15%	834.92	561.05/273.87	21348.42
18	7/1/1996	15%	834.92	568.06/266.86	20780.36
19	8/1/1996	15%	834.92	575.17/259.75	20205.19
20	9/1/1996	15%	834.92	582.36/252.56	19622.83
21	10/1/1996	15%	834.92	589.63/245.29	19033.20
22	11/1/1996	15%	834.92	597.00/237.92	18436.20
23	12/1/1996	15%	834.92	604.47/230.45	17831.73
24	1/1/1997	15%	834.92	612.02/222.90	17219.70
25	2/1/1997	15%	834.92	619.67/215.25	16600.03
26	3/1/1997	15%	834.92	627.42/207.50	15972.61
27	4/1/1997	15%	834.92	635.26/199.66	15337.35
28	5/1/1997	15%	834.92	643.20/191.72	14694.15
29	6/1/1997	15%	834.92	651.24/183.68	14042.90
30	7/1/1997	15%	834.92	659.38/175.54	13383.52
31	8/1/1997	15%	834.92	667.63/167.29	12715.89
32	9/1/1997	15%	834.92	675.97/158.95	12039.92
33	10/1/1997	15%	834.92	684.42/150.50	11355.50
34	11/1/1997	15%	834.92	692.98/141.94	10662.52
35	12/1/1997	15%	834.92	701.64/133.28	9960.89
36	1/1/1998	15%	834.92	710.41/124.51	9250.48
37	2/1/1998	15%	834.92	719.29/115.63	8531.19
38	3/1/1998	15%	834.92	728.28/106.64	7802.91
39	4/1/1998	15%	834.92	737.38/97.54	7065.52
40	5/1/1998	15%	834.92	746.60/88.32	6318.92
41	6/1/1998	15%	834.92	755.93/78.99	5562.99
42	7/1/1998	15%	834.92	765.38/69.54	4797.61
43	8/1/1998	15%	834.92	774.95/59.97	3238.02
44	9/1/1998	15%	834.92	784.64/50.28	3238.02
45	10/1/1998	15%	834.92	794.44/40.48	2443.58
46	11/1/1998	15%	834.92	804.38/30.54	1639.20
47	12/1/1998	15%	834.92	814.14/20.49	824.77
48	1/1/1999	15%	834.92	824.77/10.31	0.00

Note Grading System

Notes are graded by professionals, who decide if said notes have the right purchase qualities.

	Particulars	Points
I.	Note Seller Motivation	
	Underwritten agreement to sell	20
	Expresses serious interest to sell	10
	No contact w/note seller made	-50
II.	Acceptable Property Types:	
	Single-Family, Detached	20
	2-4 Family	10
	Condo	5
	Residential/Office. Mixed use	5
	Multi-Family (More than four units)	5
	Mobile home with land	-10
	Building Lot	-15
	Acreage	-20
III.	Occupancy:	
	By Owner	20
	By Tenant	10
	Vacant -	20
IV.	Lien Position:	
	First mortgage	20
	Second mortgage	10
	Wrap Second -	10
	Other -	20
V.	Property Value:	
	Over $50,000	20
	Under $50,000	-20
VI.	Seasoning (age of mortgage):	
	More than 24 months	20
	12-23 months	10
	Less than 12 months	-10
	New/buy at closing	-20
VII.	Loan Balance:	
	Under $20,000	-10
	$20,001 to $100,000	20
	$100,001 to $150,000	10
VIII.	Geography:	
	Suburban	20
	Urban/inner city	-20
	Urban/suburban fringe	10
	Rural	-10

IX.	Loan to Value (Actual balance(s) vs. Market Value:)	
	Up to 65%	20
	65. 1% to 80. 0%	10
	80. 1% and higher	-20

Total Grade Score Is: _________________________

If total grade score is between 100-140: High Investor Appeal
If total grade score is between 70-99: Moderate Investor Appeal
If total grade score is lower than 70: Low Investor Appeal

Keys to discount mortgages

The keys to buying and selling discount mortgages fall into two major categories:

1. Finding Mortgages
2. Network of Buyers

Actually, selling the note if it matches the note guidelines and is graded correctly is not a challenge. Your greatest challenge is going to be finding the notes. They are not well advertised, and most people who are holding second mortgages don't know they can be sold. To find them:

• Market the fact that you buy notes: Put it in classified ads. Use flyers. Conduct seminars.
• Go to the courthouse, and research the properties to see who has second mortgages.
• Develop a network. Perhaps you can use Realtors or real estate lawyers as “bird dogs.”
• Examine programs supplying leads on a local or national basis.

The second challenge is that you most likely don't have millions of dollars in cash to buy all the notes you will find. You need a network or an individual with deep pockets. There are dozens of networks in the marketplace and thousands of note-buyers, both private and institutional. If you can find a seasoned note, there is usually a buyer around the corner that has the money. The professionals will look after all the paperwork and the exchange of money.

Obviously, if you buy a note, you can make money by discounting the note and receiving interest (income) from the note. If you find a note but don't have the money to buy into this great deal, you can often pass it on to the network, and it will pay you a commission or fee for finding the note. The payoff could be a couple hundred dollars or even thousands of dollars if the note is big enough and the deal is good enough. The real money in discount mortgages is your ability to negotiate discounts up to 20-50% and then hold onto the note. As it matures, you will make an excellent return on your initial investment.

Interest Only Payment

An interest only payment is a creative way of reducing the monthly out-of-pocket expenses of acquiring a property. The period can be a year, five years, or more. In this case, the principal remains the same for the period, and only the interest is paid on the note. Therefore, you still owe the principal amount. For example, a property could have a $30,000 mortgage for a period of five years with a 10% yearly interest. Each month, the payment would be $250.00. The principal would have to be paid in five years, but in the meantime, you have a low monthly payment. This is a great strategy if you are renting a property and are looking for increased monthly cash flow. Perhaps you can even get the renter to buy the property using a lease option. The buyer would have to come up with the full price of the property in five years, limiting your liability.

Balloon Payment

Balloon payments are not uncommon. Usually they are part of a complete package. A *balloon payment* is a deferment of the payment of the principal (the equity or value in the property) until some point in the future. For example, if a seller says he will give you a $30,000 note (second mortgage on the property), ask to structure it as a balloon payment due in five years. That way, you may have no payments for five years. That substantially reduces the ongoing cost of owning the property. Although balloon payments may have no interest, usually they have an annual interest rate or simple interest rate, which is paid along with the note at the time of payment. For example, the $30,000 note may have simple interest of 10% to be paid in five years; therefore, you would pay $33,000 in five years. The note could also be 10% simple interest accrued annually due in five years. You would pay $45,000 ($30,000 plus five $3,000 payments). Obviously, a simple interest pattern is more desirable.

No Interest

Another successful strategy is to ask for no interest for a period of time. Usually, this can be accomplished for several months. On rare occasions, you might be able to extend this perk for longer periods of time, one year or perhaps longer. (The longer the better.) The best example of this strategy in use is to buy someone's home from them over time and never pay them interest. This is a good strategy. It's even better if you do not have to use any of your credit to purchase the property and just have an agreement between you and seller to pay the principal off over a specific period of time. Does it happen? Not often, but yes, it does happen.

Multiple Patterns

Multiple patterns can help you finance a property with a low out-of-pocket expense. Let's say a homeowner wants to sell his property for $100,000 and owns it outright (no mortgages). A no-interest pattern and straight payment of principal over a 30-year period could be a great pattern. Or you could use a variety of patterns to reduce your out-of-pocket expenses. For instance, the first five years are a deferred payment pattern: simple interest on the $100,000 at 7.5% for five years—a payment of $7,500 in year five (average: $125 per month). Fifteen years of interest only payments at 7.5% paid monthly ($625 per month). Ten years of a regular amortization schedule.

Why would you do this? Well, your payments are low in the front-end of the purchase. Perhaps you just want to get low payments in the first several years and are going to rent the property. What kind of rent would be paid on a $100,000 property? $700? $800? $1,000 a month? With this kind of payment pattern, you will have a strong positive cash flow in the first several years. When you get to the later years, sell the property. For the most part, you will hold onto the property because you will have a lot of cash coming in if you've been investing in more properties with the positive cash flow.

Payment patterns and the ability to change the patterns are a true key to success in real estate. Real estate investors know the power of no interest, low interest, principal only, interest only, deferred payments, simple interest, and balloon payments. Be creative. Be aggressive. Many people are surprised what they can do in terms of creative financing.

Get a second mortgage from someone else

Assume we find a property a seller has some equity in, but not much. He wants to get his equity out of the property, and you want to buy the property with as little cash out-of-pocket as possible.

Characteristics:

Fair Market Value is $75,000
Owner is prepared to sell for $68,000
Assumable first mortgage of $58,000
Owner wants the $10,000 cash at closing

In this case, the seller has already declined a second mortgage, because he needs the cash. A sound strategy would be to offer the owner $10,000 down with assumption of the first mortgage. The qualifier you must have is "Payment of $10,000 subject to the location of a second mortgage." If you can't find the funds, the deal is off. If the seller goes for the offer, find a lender.

Remember that savings and loans or banks will not likely give you a second mortgage on an investment property that is highly leveraged, particularly if the loan to value ratio is above 75%. In this case, the loan to value would be 90.67% ($58,000 first plus $10,000 second equals $68,000 on a $78,000 property). Your best bet would be a private investor. Use part of the network you have developed or simply look in the newspaper. The classified section lists individuals prepared to invest in properties. Contact the individual to see how much of a note or second mortgage you can get on the property. Ensure you have backup on the fair market value of the property. You may even be able to get more of a mortgage or note than $10,000. Any extra funds go into you pocket. You may ask why would someone loan me $10,000? Well, they are going to get paid a regular interest on the $10,000, perhaps 15% a year. The worst case is that the property is foreclosed on and the note is secured by a property worth $75,000. A regular real estate investor would find this appealing. The property could be one that you plan on living in, and in this case, there was no down payment. Consider renting the property to maximize OPM. Make sure you perform a cash flow analysis, to see if the first and second mortgage payments and rent income are sufficient. In this case, you have a no-money-down, positive cash flow, equity building investment.

Trade services or assets for property

Most people don't realize that you don't have to pay cash for a property. Perhaps you trade your personal services in lieu of a down payment or ongoing payments. For example, a self-employed individual could trade lawn care services for the next year as part of the contract. If you have personal assets, barter them for a down payment or several months of mortgage payments. The key to trading goods or services in property transactions is understanding the wants and needs of the sellers (homeowners). If they have a need or want, try to supply, at a discount, whatever it is that will fulfill said need or want. An interesting deal might be struck that will benefit both parties. The end result is less money out of your pocket.

Find a private first mortgage, and move to a junior position

There are thousands of mortgages in the marketplace held by private investors. A visit to the courthouse and a little research will help you find them. If you find a property with a private first mortgage and there's a fair amount of equity in the property, it could be an outstanding opportunity.

Characteristics:

Fair market value:	$105,000
Negotiated price:	$100,000
First mortgage:	$50,000 (private mortgage)
Owner equity:	$50,000 (wants all the cash paid at closing)

In this situation, approach a private lender, and ask it to move from the first mortgage position to the second mortgage position. This will allow you to go to the bank for financing a first mortgage. You might even prime the pump a little by telling the private lender you will pay off $10,000 of the note at closing. Assuming the private lender will move to a junior position, you could pick this property up for no money down.

Arrange to have the first mortgage moved to the second position. The new second mortgage will be for $40,000, as you pay off $10,000 as an incentive for the private lender to move positions. You put a first mortgage on the property for $60,000. Your total mortgage on the property is $100,000 (a $60,000 first mortgage and a $40,000 second mortgage). The homeowner is going to get $50,000 cash at closing, and the second note holder $10,000. Everyone is happy, most of all you. A $100,000 property is yours just because you knew to move the private lender to a junior position.

Use the broker's money to finance the down payment

There are lots of good properties in the marketplace that are being sold by brokers. The challenge is that the property usually has a 10% down feature. This is usually a feature brokers are in favor of, because it guarantees their commissions. Most brokers receive a commission from the sale of a property of about 6%. A 10 % down feature ensures the commission pay out and the closing costs. Approach a broker, and offer a note in exchange for the commissions. Make the note a greater amount than they would have received with interest. Put the money toward payment of the house. Alternatively, ask the broker to take the commission in equity. In essence, you are making the broker a partner in the property, which may appeal to the broker’s long-term wealth-building outlook. It may be even more appealing if you guarantee the future listing of the property with the broker. If the broker is also the listing agent, ask for discounted commissions. Put the money you saved into the deal.

Checklist for financing a property:

___Look for seller take-back and second mortgage financing
___Find property that does not require a credit check
___Low down payment
___Balloon payment in 5 or 10 years, longer if possible
___No points to be paid by you
___Closing cost to be paid by the seller
___Principal payments only
___Low interest rates on notes
___No collateral or personal guarantees
___Deferred payments
___Interest only payments to increase rental property cash flow
___Subordination of debt
___Right to assign property
___Substitute collateral
___Trade of assets for property
___Discount commissions or extend payments
___No interest for several months
___Simple interest for a period of time
___Long closing period
___Right of first refusal
___Rearrange financing to reduce monthly payments or get another mortgage

Note: When it is your turn to sell, you will want to reverse this checklist (high interest rates, short closing, high down payment, lots of collateral and guarantees).

As part of creative financing, consider using existing real estate to finance new properties. There are dozens of ways to use existing real estate. Consider using home equity loans, the sale of your property to purchase multiple properties, a mortgage you own on a property (perhaps a discounted mortgage), existing property cash flow, or use your property as collateral for loans.

Use your own home to finance deals

Should I sell my home and use the money to buy more properties? Re-mortgage to get cash out and then buy more real estate? Take out a home equity loan? The answer is yes! Your home is an outstanding source of capital. As a new investor, it can be a good starting point for cash. In addition, most lenders will give low rates to homeowners. Often one or two percentage points above prime. Borrowing against your own home is often better than going out to get new financing. Oftentimes, lenders give up to 80% of the equity in property. The terms can vary from 3 to 15 years. When you are starting out, consider securing a line of credit secured by the equity in your property. That way, you will have pre-approved access to funds when the great opportunity presents itself.

Use an existing mortgage or discounted mortgage

Any existing mortgage you may own can be used as collateral or payments on properties you are considering purchasing. For example, find a $10,000 second mortgage that you can negotiate at a purchase price of $5,000. Make sure it has good property, the note is seasoned (one year or older), and there’s a good payment history. Put a contract on the note, essentially reserving it for 60 days (right of first refusal). Use it as a $10,000 down payment or as part of the financing. For example, the $10,000 could be given to the seller as part of the structured offer. "The seller will receive ownership of a $10,000 mortgage on XYZ property."

Build up positive cash flow, and use it as soon as possible to buy more property

If you own property, consider using the cash flow to fund additional investments. If one property has $300/month positive cash flow, either wait for a year and put $3,600 down on a new place, or borrow $3,000 now and use the $300/month positive cash flow on new property to repay the loan. The loan is secured by the cash flow of the other property, and you are putting the money to work immediately.

Sell one property to get another

Some people believe that trading is a good strategy for building wealth. They will constantly upgrade their positions by selling an existing property to finance a new property. Although it may improve your quality of life and standard of living over time, you would be better off taking the equity in the property and breaking it into several units, say $5,000 apiece, and then investing $5,000 in positive cash flow producing property.

Conservation Of Cash

As a professional investor, conservation of cash is an important element, because you may not have much cash starting out. Don't worry that you don't have large reserves of money; a great many millionaires started with little or no capital. Try to keep as much cash in your pocket as possible. Consider the following:

1. Realtors
Have agent take the commission back as a mortgage.
Structure a payment of the commission over a period of time.
Have the agent become a partner in the property.
Use agent's knowledge of cash sources to find help.
Ask for a discounted commission. Split the commission with the Realtor.

2. Investors
Structure limited partnerships.
Look for professional real estate investors. (They already have sources of cash.)
Do joint venture partnerships. You find the property; they put up the cash.
Develop a real estate investment club or syndicate.

Don't beg for money, and don't be afraid to take your share of the deal. Choose your partners very carefully. Define your agreement clearly and put it in writing (percentage of equity, cash flow, and liabilities). Make clear it is an equal partnership. Qualify investors upfront. Ask for deposits. Confirm cash available.

3. No money philosophy
Try not to invest any of your own money, even if you have lots of money lying around.
Cut all costs.
Negotiate tough on each contract.
Always ask for seller financing, second mortgages, promissory notes, and seller take-back notes.

Sources of Money:
• Family connections/friends.
• Borrow against an insurance policy
• Cash in your insurance policy
• Family syndicate
• Finance companies
• Credit unions
• Employer advance
• Advertise for cash
• Inheritance
• Personal note
• Credit cards
• Home improvements loans

- Compensating balances
- Personal property loans
- Collateralized loans
- Refinancing cash
- Loan brokers (costly)
- Buy at a discount and trade to full value
- Deep discounted bonds
- Borrow against 401(k)

Lines of Credit and Credit Cards

You have set your plan, obtained your education, and established your goal. Is it time to go out and buy your first property? Well … not yet. First you should establish as much credit as possible. Do this by obtaining personal lines of credit and as many credit cards as possible. Granted, this goes against conventional wisdom. In fact, improper use of credit cards can invite financial disaster. You must have credit, and you must use it judiciously to buy investment property and to help you through times of emergency. If a mortgagee refuses to renew a mortgage, you will have enough credit to hold together until you are able to arrange a replacement mortgage. If a roof needs major repairs, you will be able to do this immediately and avoid further damage.

If you find a highly motivated seller and need $25,000 to close the deal of a lifetime, you will be able to do so. Then you can convert the financing to a proper vehicle later. The credit that you have established may be just what you need to prevent you from becoming a motivated vendor. Credit must be used with judgment and not used for personal consumption. Credit cards are to be used strictly for short-term borrowing; long-term borrowing by this method is just expensive and will place your whole project in jeopardy. It is not worth the risk.

Seed money

You will need money to buy and run your properties. This is known in the industry as *seed money*. Creativity will help keep down payments as low as possible, but you will always need money. Always have some money set aside for emergencies. If you do not have seed money, you'll have to generate some by working or by finding an investor to work with. These people have money but do not have the time or inclination to search out properties or to manage them. If you treat them properly, they make very good partners in your search for wealth. You may even need to take a second job to create capital. In addition, examine your expenses and cut down on unnecessary expenditures.

You must negotiate with potential investors your share of equity. At first, you may have to give an investor(s) a large share, and then as you gain experience and establish a track record, you will attract more investors and get a bigger piece of the pie. Remember, you must always protect your investor/investors.

Strategies for increasing your credit and credit limits:

• Get several credit card application forms from each bank.
• Apply for a MasterCard, American Express card, and every Visa card available.
• Immediately use each card for gasoline or some other purchase you would have otherwise made anyway. When you pay your bill, enclose a written request for a higher credit limit. Two months later, withdraw in cash a little more than your entire credit limit, and go to a different branch of the same bank to repay it in full. Next month, request a higher credit limit when you pay your bill. Within six months, you should have several cards with a high credit limit.
• Reapply to the credit card companies that initially rejected your application, listing your new cards as credit references. Continue this process of withdrawing, repaying, and requesting a higher limit on all cards. Redo this whole procedure simultaneously with personal lines of credit from several banks and trust companies. (Interest rates are very low and repayment plans are very lenient).
• Redo this whole procedure for your company. Within a year, you should have access to about $40,000 cash—totally unsecured.

Banks

1. How to get started at banks:

• Go to a large bank.
• Request a small furniture loan (to be repaid in three months).
• Allow a guarantor, not a cosigner.
• Never allow collateral or security.
• Put money in a savings account across the street.
• One month later, close your savings account across the street, and repay early.
• Redo this process with larger and larger loans (ensuring that the purpose of each new loan is different and reasonable).

2. How to deal with your banker:

• Meet, write, or phone every month to announce good news (raise, promotion, new client, big sale, sale of something, purchase of something, etc.)
• Send a statement of assets quarterly (or more often if there is a major change).
• Drop in with large deposits.
• Invite banker to lunch and ask advice.
• Send a postcard.
• Send a semiannual letter of thanks.
• Send a letter of appreciation once every three years to your banker's boss.

3. How to request a loan:

• Do all homework in advance. Prepare a written proposal of how the funds will be used and how they will be repaid.
• Meet well in advance.
• Ask for more money than you'll need.
• Request a longer repayment period than you need.

• Make a big issue about how large and prompt your first repayment check is.

The 3-Mortgages Financing Tool

Here is a strategy you can use to buy property with very little down. You offer the seller of the property close to the asking price, and then negotiate the terms of the sale of the property. This strategy, combined with others you will learn, will give you enough financing tools to help you build a strong real estate portfolio. Remember these numbers are only examples. Don't get bogged down with the numbers. Dealing with a Realtor who understands financing, or buying property from another real estate investor, allows for the ease of creative financing. This is what the deal would look like:

Offer:	$105,000
Purchaser to take over first mortgage:	$60,000
Seller to take back a second mortgage:	$30,000 @ 12%
Seller to take back a third mortgage:	$15,000 @ 14%
Down payment by purchaser:	$100
Additional cash from purchaser at closing:	$1,000
Total Purchase Price:	$106,100

You're right. The numbers don't add up. But wait …

Offer: $105,000, even though the actual value is $100,000.00

Take over first mortgage: $60,000

(There are mortgages that can be assumed by the purchaser. The key is to look at the date of the mortgage, when it was originally taken out and the older the better. Try to find mortgages that are at least ten years old or older.)

Seller to take back $ 30,000 (Term of the mortgage would be 25 years)

Second mortgage: amortizing for five years or longer, interest only mortgage, when it is an interest only mortgage. The amortizing has no effect on the payment. The rate would be at 12%. This is where your negotiating skills come into play. The terms of the mortgage will be determined by what you want to do with the property.

Seller to take back $ 15,000

Third mortgage would be at 14% without any payments for the first year. This gives you control over the cash flow. The second year, the mortgage would call for interest payment only. The total mortgage could be paid off at any time during the term of the mortgage. The mortgage would, of course, be paid off at a discount. The financing strategy gives you more than twelve different possibilities for profit and/or cash flow. Notre that out of every three opportunities you come across, you will apply this strategy to probably only one.

Investor Seller

You can see the benefit to a seller who is an investor. This strategy would give the seller a way to sell his property with a minimum of effort. By structuring the purchase of the property as described, your seller would minimize the tax burden of selling the property. As an investor, upon the selling of an investment property, the seller would be hit with a capital gains tax based on his tax bracket. The 3-mortgages financing strategy eliminates the capital gains problem, so that your seller would not have to pay that large lump sum, as would be the case in the sale of an investment property. The seller would only have to pay tax on the income from the mortgage he carries. Since he is receiving interest payments only, there are several considerations and benefits to be examined.
1. The seller is receiving interest payments only; therefore, the pricing is still intact.
2. The seller would now be able to move from the property management standpoint to that of management of pure cash flow. This is an eventual goal you, too, will set for yourself.
3. The income the seller receives from the mortgage can be offset by expenses incurred during the tax year.
4. & 5. Have you figured out the next two yet?

Homeowner Seller

What are the benefits of this strategy to this type of seller? First of all, go back to the section where the mathematics of the financing was described. You probably noticed a peculiarity in the total sum. You will notice the vendor was able to sell the property for $5,000 above the actual value of the property, and in addition, the purchaser would pay $1,000 at closing and $100 as a deposit. The seller received an additional $6,100 in our example, CLOSER TO THE ASKING PRICE. The mathematics of your deal may be slightly different, but calculate your deal using percentages of this example, and you should be fine.

Note: The above example will provide you with a template for negotiating property acquisition of your own. You will be able to show your seller how much more money they are receiving by selling the deal to you. Reflected in a percentage, they are receiving 6% more. This would mean that you are offsetting the commission they have to pay in the event a Realtor is involved.

Let’s take a look at another angle. In addition to the 6% more you pay, the "true" rate of return in our example of the Investor Seller would be the 12% received on the second mortgage and the 14% received on the third mortgage, giving a total rate of 32% after the second year of the mortgage term. Where else can one get this type of return? It is amazing what you can do with numbers once you get the hang of it. There are many more strategies you will learn, which will expand your repertoire of financing techniques.

Buying property 20% to 30% below market value, while the seller gets the asking price!

You have come across a seller who wants to sell, and you want to buy. He is willing to sell and take back "paper," meaning that he is willing to finance the sale of the property, while agreeing to carry part of the equity back in the form of a note or a mortgage. Here is how you will be able to get the property at a discount. This technique will not always work, but it will work enough times to make you a lot of money. You negotiate the purchase with the seller, including how much cash he will require, how much "paper," at what interest rate, and the length of the mortgage. You start by inserting this type of clause within the contract, known by investors as *substitution of collateral*. This technique requires that you find and buy "paper" from another investor who has "paper" for sale. You can find these in your local newspaper under "Want To Buy" or "Want To Sell."
<u>Clause</u>:
"Seller agrees to accept paper on a property other then the property associated with this transaction, the property herein being sold by the seller. This substitution of financing shall take place only if the seller is in agreement of said substitution and the security of said financing is not in any way subordinated by said substitution."

All this clause does is help to put into black and white your position and your intent with the financing. Here is an example you can follow and learn from. There was an owner of a fourplex who was willing to accept "paper" and wanted some cash on the sale of this property. Here is how the transaction went: The offer was made to buy the fourplex with some cash and have the owner carry back paper with the understanding that the paper would be substituted for another paper of value on another piece of real estate. In addition, for the rest of the equity we exchanged, for some undeveloped lots that were bought in a bundle using this same technique, these lots were free and clear. We structured the deal in such a way that our offer included some free-and-clear lots at appraised value; some paper paying interest at 11% or more, interest only open (no due date); and some cash. Next step was to get this offer accepted. The seller did, in fact, accept. Now it was time to find paper, at least at 11%, either in first or second position that could be bought at a discount and then substituted for the "paper" that was created on the fourplex. This was very easy to do.

Here is a strategy that you will find profitable: There was a subdivider who had a lot of "paper" paying 9% to 16%. All these properties were in second position, second to a land improvement loan with a local bank. All these mortgages were due on the first construction draw or five years, whichever came first. An offer was made to buy the paper at the face value of $130,000 for the purchase price of $70,000 cash. The offer had a clause that this offer would be conditional if the seller of the fourplex would accept this paper as substitution. The fourplex seller agrees. The transaction was closed. In fact, two transactions took place. Here is how it all looks: The purchase of the fourplex was for $280,000 with 25% cash ($70,000), $130,000 in paper, and $40,000 in free and clear lots. By paying only $70,000 for paper that was worth $130,000, we save $60,000 off the purchase price. That is 21% off the market value.

Exchange paper for free and clear property

You can generate large sums of cash by using this strategy. In addition to putting cash in your pocket, you can exchange for other property, another way to buy property below market value while the seller gets his/her/their asking price. Here is how this strategy works. You exchange "paper" that you bought at a discount for a free-clear property or lots. You can frequently borrow more from a lender than you paid in cash for the "paper," which you bought at a discount. For example, you bought a second mortgage that was worth $90,000 at a discount for around $60,000. You now look for properties or lots that are free and clear. Once you find one, you negotiate the exchange of the paper you bought for the property or the lots. The key here is to find the lots or properties that are at least valued at $90,000.

So you have exchanged the "paper" you bought worth $90,000 for a property or lot at $60,000. (Remember the numbers used here are just examples. In your area, the numbers may be higher or lower. To better understand the concept, your consultants can always be of help.) You can now take that property or the lot and go to any lending institution and borrow against it. How much can you borrow? How does this strategy make you any money? With your lot or the property as collateral, if a lenders will only lend you 75% of the value of the lot or the property, what then? No problem. You will put in your pocket $7,500 cash. The property is valued at $90,000 with 75% of the value equaling $67,500. You paid $60,000, so you net $7,500—tax-free! What … tax-free? Yes … tax-free!! Why, you ask? The $67,500 is borrowed money. Not bad for two days worth of work.

Lease with the option to buy

If you had in your hands a property instead of a lot, this is how it works. You can lease this property with the option to buy to a buyer. Let's say your payments on the $67,500 you borrowed are $600 per month ($67,500 at 10% for 30 years equal $592.39). Enter into a lease with the option to buy for 10 years. With your qualified buyers, the buyers would buy the property at the future price, the value in 10 years. Lease this property for $900 per month. Take a small down payment of $1,000. For a qualified buyer (the key is qualified buyer), allow a credit of $100 each month of the payment they make toward the down payment of the purchase of the property. The third year of the lease, allow a credit of $150 per month; the fifth year, $175 credit per month; the seventh year, $225; the last remaining years, $300 per month per year. This credit would be credited to the buyer/lease option only if the monthly payment of $900 per month is on time. The total credit for the buyer at the end of the tenth year would be $23,700. Remember, this is only a credit, not cash to the buyer. The credit they are amounting can only apply toward the down payment of this property. That being the case, your property will be valued at $151,766. This is the value you would sell the property for. How much profit will you make from this deal?

Here are some answers. Choose one.
A) $61,766.00
B) $91,766.00 + (plus the down payment)
C) $69,066.00
D) $82,677.00
E) $72,677.00 - (less the down payment)
F) $97,882.84 + (plus the down payment)

Sale of the property of the lease option

Here are the mathematics of the sale of the property of the lease option. Remember, you sold the property to the lease option buyer at the value in the tenth year of the option. In our example, the property would be valued at $151,766. You then sell the property at this value. You will take the lease option buyer to your bank, where you have good relationships with a banker. You will write an offer to sell to the option buyer. The option buyer will require a good payment. You will show a letter that you as the seller are satisfied with the down payment. In fact, you are, because the down payment will have come to you all throughout the lease. The amount you can show as the down payment is $23,700. This amount will be more than enough to qualify for a 10% down payment of the purchase price. Here is how it looks:

Purchase price:	$151,766.00
Down payment:	$23,700.00
Percent of purchase price:	16% (6% more then required)
Amount to finance:	$128,066.00
Mortgage to be paid off after 10 years:	$61,383.16 (the remaining balance
Balance paid to the seller:	$66,682,84 (this is paid to you)

So How Much Did You Make?
The Answer is F
($66,682.84 + $23,700 + $7,500 = $97,882,84 + $1,000 Down Payment = $98,882.84)

Keys for making the options work

Lock in the excessive price on the option in terms of today's value, so that you can control the benefits of future appreciation. Always have your option registered. Check title to verify information given by option. The key to making money with an option is leverage. Get the longest time period possible. Adequately address possible future problems in your option agreement, such as:

- Bankruptcy
- Insurance
- Eminent Domain
- Death of owner
- Defaults on loans
- Care of Property
- Lease option

You control the appreciation benefits of a property and also have the use the property

How to buy property without money

Let's assume you have a motivated seller. He’s been waiting to sell but has not had an offer and no longer wants to be liable for the mortgage. First, understand that a motivated seller has many reasons for selling, and cash in the form of a down payment is only one of them. There are many situations in which a seller will take other things as down payment. You can offer personal property, paper, art, stock, paintings, guns, or jewelry. You can offer to pay off a debt for the seller or settle a judgment. (If you pay off a judgment, be sure to pay it off at a discount, thereby reducing the net purchase price of the property by 15% to 20%.) You might exchange a note or a mortgage that you created on another piece of real estate you own. Offer one or more of the above in lieu of a down payment.

Let's say you want to buy a piece of property that is for sale for $120,000 (market value). You have good credit but don't have the down payment—in this case, 25% of the purchase price. There is also a non-assumable mortgage on the property in the amount of $80,000. You have three credit cards with credit lines of $5,000 each. The seller wants to sell because of a judgment for non-payment of a $30,000 debt. At first glance, this may not look like a viable deal, but there is a way to structure it. Offer to buy the property at $118,000 (never pay full price) and take over the judgment in the amount of $30,000. (Be sure you have a clause in your contract allowing you to back out of the deal just in case.)
Show on the contract a down payment of $30,000. (In an addendum to the contract, spell out how you will pay off the judgment on behalf of the seller.) Be sure to get a letter from the seller saying he is satisfied with the down payment. You will use this letter to get financing from the bank. Now that you have a contract, go to the judgment holder or lien holder and negotiate to pay off the judgment or lien (at a discount of course). Be sure you take cash with you. Where do you get the cash? From your credit cards. Then negotiate with the judgment holder or lien holder to pay off the $30,000 debt with $15,000 cash.

Okay, now you've bought the property for $118,000 and paid off the judgment of $30,000 for $15,000. Next, go to the bank and arrange a first mortgage for, say, 75% of the purchase price, or $88,500. You've just bought the property at a discount ($17,000 [14%} off the market value). Not bad for having no down payment (and a little creativity).

Mortgage Combining

When you buy a property, you must pay the seller one way or another, either now or later. Two questions you must keep in mind when buying real estate:
How am I going to structure the purchase to get the sellers what they are expecting?
How can I structure the purchase so the sellers get their money, but not out of my pocket?
Mortgage combinations can be used in a majority of situations. Combining makes use of first, second, and third mortgages. When you are familiar with this technique, you will be ready to make offers using combinations specifically suited to particular situations.

The terms first, second, and third mortgage are used to indicate a mortgage's position relative to other mortgages. The position of the mortgage is based on the order of registration or recording. This is important to know, as the mortgage that is first in line is the one that was registered first chronologically. In the event a property is foreclosed and sold for default of payments, the money from the foreclosure would not be split between the mortgages. Rather, the first mortgage would be paid off before any money would be paid to the second mortgage holder. The second mortgage would be completely paid off before any money would be paid to the third mortgage holder. The better the position of a mortgage the more secure (less risky) it is.

The traditional method of buying a property is a process of filling out the paperwork for a new mortgage. You would then have to pay the difference between the amount financed through a mortgage and the purchase price. To become wealthy using real estate, you must make use of creative methods to achieve your goals. The following information will help you put the creative method into perspective. When dealing with mortgages, these are some of the considerations. Purchase price equals the following combinations of mortgages. Either the whole purchase price is paid off through the creation of a first mortgage and a down payment, or by the combination of a first mortgage plus a second mortgage and a down payment, or by the combination of a first mortgage plus a second mortgage and plus a third mortgage and a down payment. Determine how to best combine the different types of financing to meet your goals.

<u>First Mortgage</u>

Type of Financing	Qualifying requirements?
Conventional	Yes
FHA	Yes (For most mortgages written before 12/15/89 no qualifying requirements are needed. On mortgages written after 12/15/89 there are qualifying requirements.)
VA	Yes (Special requirements after March '88. No requirements on VA loans before March '88.)
Owner Financing	No
Private Mortgage	No

<u>Second or Third mortgage</u>	Qualifying requirements?
Assume existing 2nd or 3rd	Maybe (This is determined by the type of second mortgage it was. Owner held may not require qualifying.)
"Subject to 2nd"	No (This clause is added to the purchase. Owner obtained equity loan agreement that allows the buyer to buy the property subject only to the existing

	financing, without providing any personal guarantee.)
<u>Single Payment Mortgage</u> (SPM)	No (This type of mortgage can reduce your down payment and reduce to even eliminate the monthly payment. This gives the purchaser a method of owning property with ease.)
<u>Owner Take Back</u> (amortized)	No (Owner take back amortized mortgage can be a very effective way to buy property, as the amortizing can stretch out to 30 years with payment being of different combination (i.e. interest only payment, therefore reduced payments, or principal payments only, therefore all payments reduce principal, or any combination thereof.)

The magic of using the debt dollar more than once

One of the most important tools you need to keep sharp is your credit standing and credit rating. Doing so will give you the edge over other investors, and moreover, an edge over your daily bills. Have you ever known anyone who was in a situation where they owed more than their income? Most people would say that this situation is one that is not winnable. This is true only if you look at the problem in a linear fashion. Here is how to win. You have accounts payable of $11,000 and accounts receivable of $4,000. This strategy requires you to regenerate cash to make use of constructive debt vs. destructive debt. Take all of your bills and sort them into three piles. The first pile is all of the bills where you borrow. These include credit cards, bank loans, credit unions, and finance companies. In this pile, your credit standing is important. These bills are revolving lines of credit that can be paid and then increased again. The second pile includes those bills that need to be paid on a regular pattern and could have an effect on your credit standing. These include the phone bill, car payment, house payments, investment payment, etc. The third pile is one that includes bills that can be paid in extensions of time of 30–60 days. This pile is similar to the second pile. The strategy is to pay those bills that can be paid, so the money can be generated again. It will keep your credit in good standing and lower your account with that creditor. Once the account has been lowered, the credit can be increased again. The credit amount can even be raised from the original amount. If you have $11,000 due and only $4,000 coming in, do the following. Pay off all of your pile-1 bills. Then borrow again from the same creditors with the $4,000. Then pay your pile-2 and make minimum payment to the pile-3 bills. If you pay off piles two and three first, you will be out of money. But if you pay off pile-1 bills first, you keep your credit in good standing. This allows you to regenerate the cash to pay off the final spending debt.

Chapter 9. Contract Basics

You don't have to be Matlock, but you should understand contract law fundamentals and the basic elements of the various types of real estate real estate contacts. A *contract* is a formal, legally binding document containing the terms of an agreement between two or more parties. Real estate contracts may seem complicated, and oftentimes they are, but the more you are exposed to them, the less complicated they will seem, especially if you use real estate contract-preparation software.

There are four essentials aspects of a contract:

1. Capacity of the parties (competent parties). For a contract to be enforceable, the parties must be competent. Insanity, intoxication, or an underage party may render a contract voidable.
2. Offer and acceptance. All of the terms of a contract must be agreed upon by all of the parties bound by the agreement, sometimes referred to as "a meeting of the minds." There must be an offer and acceptance of the offer. Communicated acceptance of an offer brings a contract into being. To be enforceable, real estate contracts must be <u>in writing</u> and signed by all parties bound by the agreement.
3. Legality. The purpose of a contract must be a lawful one.
4. Consideration. Legally speaking, consideration is the obligations each party makes to the other necessary to make a contract enforceable. For example, a buyer has the obligation to pay for a house that he/she/they agreed to buy, and the seller has the obligation to sell it to him/her/them. There are two types of consideration, and both are sufficient for making a contract enforceable. They are *valuable consideration* (money or something that can be measured monetarily) and *good consideration*, which cannot be measured monetarily. Love is an example of good consideration.

Most people are intimidated by real estate contracts and offers. Real estate contracts may seem complicated, and oftentimes they are, but the more you are exposed to them, the less complicated they will seem. Software is also available to make the task of contract preparation and preparation a breeze compared to the old way of doing things. Work smarter, not harder. Invest in real estate contract software.

Real Estate Contracts

Keep in mind the following contract considerations:

- Real estate contract software is available (a godsend).
- Adjust contracts to suit <u>your needs</u> via *addendums* (additions to contracts)
- "Out-clauses" give you a way out of contracts, significantly limiting risk
- Make contracts assignable. (You will want the option of assigning them to other parties—for cash.)

Buying a property will require a real estate contract or purchase offer agreement. Real estate contracts outline, in writing, the agreement between the buyer and the seller of a property. Contracts can be complicated, but it is important for you to understand some basic contract law, to ensure you limit your liabilities and capitalize on opportunities available to you. In this section, we will cover the basics of contract law, agreement and offers. If you have specific questions about a contract seek the help of a professional.

Not all contracts or agreements need to be in writing; however, real estate contracts must be in writing. A contract or offer is not legally binding upon the presentation of the contract, but after the contract is accepted in writing by the other party. Once the agreement is accepted in writing, all parties are bound by the agreement (terms and conditions of the contract). The person or entity that makes the offer can withdraw the offer at any time prior to acceptance.

Once a real estate contract is accepted in writing, the document becomes the instrument for handling of the sale of the property. The individual or entity facilitating the transfer of ownership will use the document as a guide. The transfer agent may be a title company, banker, or real estate attorney. The agreement will tell the transfer agent how to distribute funds, transfer the ownership (title), what stays with the property and what goes, what to do with the outstanding mortgages, and indicate rights of the parties. There are dozens of real estate contracts and agreements: Lease option contracts, options contracts, purchase and sale, sale and purchase, rental agreements, wraparound mortgages, and many more. You will want to review the various types of contracts and become familiar with them. Also, you can pick up sample contracts at most office supply companies, but you should seriously consider automating the process with software.

Addendums

Standard templates cover basic information contained in most real estate contracts; however, many transactions require additional conditions and terms. Extra information, conditions, and terms are included in contracts and agreed to via *addendums* (additions to contracts). Oftentimes, in the original agreement/contract/offer, you will see the notation "see addendum." An addendum may include a few agreements or many. In fact, it is not uncommon to see an original typed section of a contract crossed out and replaced with "see addendum." Addendums give contracts flexibility.

Out Clauses

Out clauses are designed to do exactly what the name implies, get you *out* of a contract if need be. Here are some examples of out clauses.

- Subject to inspection of property by buyer and written acceptance of condition of property within ______ days.
- Subject to inspection and acceptance by a qualified person.
- Subject to approval of my (accountant/spouse/partner/attorney) (select one).
- Subject to written acceptance by seller within 24 hours.
- Subject to seller purchasing another home.
- Seller to pay one-half of buyer's closing costs.
- Seller to paint the property inside and/or out.
- Escrows to be transferred to buyer at no charge.
- Seller to pay loan origination points (if any) for buyer's new loan.
- Seller guaranteed all appliances for 90 days from close of sale.
- Seller to pay recording fees.
- Seller to shampoo carpets.
- Seller to leave premises in "moving in" condition.
- Seller to do whatever repairs are needed; i.e., patch hole in utility room, caulk around tub, etc.
- Seller to leave premises free of all trash and debris.
- Subject to a satisfactory roof, plumbing and electrical inspection to be done within ______ days after the date of this contract. Inspection to be paid for by seller.
- Possession before settlement: "Buyer to receive key to property and right to enter for purposes of physical improvements to property and to show the property to prospective occupants."
- Cash credit to buyer for fix-up work: "Buyer to receive credit at settlement toward down payment for $__________ for painting, carpeting and general improvements to be made to the property."

Assingability

Make sure that the real estate contracts you use are assignable (they can be assigned to other parties—for cash). Whenever you see "and/or assigns" on a contract, the contract is assignable. Including the phrase "and/or assigns" after your name on a purchase offer/contract allows you to assign your right to purchase a property to another party, an interesting technique for generating profit without investing any money. You don't need any money; you just need strong negotiating skills and know how to use contracts to your advantage.

Chapter 10. Occupy/Sell/Rent?

Although this particular step of the real estate investing process is sixth—the other five steps being 1) Locating property, 2) Researching and evaluating property, 3) Negotiating, 4) Financing, and 5) Contract preparation/presentation—it would certainly be a good idea to have a clear idea regarding what you'd like to do with a property before actually purchasing it. What makes real estate such an attractive investment vehicle are all the things you can do with property after you invest in it. You can improve it (build a new home or renovate an existing one), live in it, rent it, sell it, or even assign to another party an option to buy it at a given price.

What you intend to do with a property will determine your perspective and vice-versa. Generally speaking, there are two main real estate investing perspectives/strategies: short-term and long-term.

Short-term and Long-term investing strategies

Short-term: You buy homes for significantly less than fair market value, make minor repairs and cosmetic enhancements, and then try to sell them at, near, or above fair market value—quickly. A $10,000 net profit per renovated property is not at all uncommon, and savvy short-term investors can make much more. One caveat, something we'll discuss in just a moment, many properties in need of only minor repairs and/or new paint and carpet will not have profit margins large enough to make this strategy profitable.

The short-term strategy can be used to enhance your lifestyle, deal with cash problems (pay down debt), and make you feel good while doing it. For some, short-term investing is a full-time business, a business they own! Buying, fixing, and selling residential properties is all they do, and they make very good money doing it. For others, real estate investing is a part-time pursuit, but part-time doesn't mean part-time money. Buying, refurbishing, and selling just two homes a year, a realistic goal for someone who has a full-time job and invests in real estate on the side, could earn you an extra $20,000 or more!

Long-term: You buy a home below fair market value, live in it and/or rent it out for a number of years, let appreciation and compounding work in your favor, and then sell. The long-term strategy, securing a number of properties, living in one and renting the rest out, and watching as your properties appreciate in value over the years, is perhaps the most satisfying and potentially lucrative. There's nothing better than waking up and not having to go to work, unless you really want to, which you probably will.

The word "long-term" is much more subjective than the word short-term. In the world of short-term real estate investing (flipping properties), "short-term" usually means ASAP. For short-term investors, many of whom are borrowing expensive money from private mortgage lenders, holding a property is a bad thing—very bad. That's why, if you're going to be using short-term investment strategies, you should follow this advice: *Sell before you buy*, by creating and maintaining a database of potential buyers, the objective being selling your property as quickly as is feasibly possible. How? Like any business owner, you must create awareness. Consider joining a real estate investing club. Networking is another great way to find potential buyers. The people you come into contact with on a daily basis should be made aware that you buy and sell real estate. Sure, you can wait for a real estate company to find a buyer for you, but the operative word is "wait." A more proactive approach is needed. Consider adding a *buyout clause* to your listing agreements, agreements with the real estate professionals you choose to work with in finding qualified buyers for your property. If you find a qualified buyer on your own, without any help from them, you will be able to buy your way out of the listing agreement for a specified sum. Also, as an incentive to push your properties, consider adding a *bonus clause* to your listing agreements, which pays a higher commission for fast results. These two clauses send clear messages, and both of them are designed to motivate:

A. You will not just sit around and wait for a qualified buyer. You're not going to place a full-page ad in the newspaper or anything, but if you find a qualified buyer through your network of contacts, before the real estate professionals who are working for you find one, oh well.

B. You pay for results (quick sales).

Also, don't wait until you're through rehabbing a property to let real estate professionals and your contacts know about it. Rehab time can be time spent finding qualified buyers.

For long-term investors, most of whom have favorable financing arrangements in place, holding a property is a good thing, as it gives inflation, appreciation, and appreciation on appreciation (compounding) time to work in their favor. But how long is long-term? For some investors, it's as short as two years, the period of time under new tax law that must elapse before you can sell your personal residence, move into one of your rental properties, convert it into your new personal residence, reside there for another two-year period, and then sell it tax-free (except for depreciation, upon which taxes must be paid). For the owners of multiple rental properties, the tax savings can be quite substantial. For other investors, "long-term" means just that—long-term—as in five, ten, fifteen, or twenty or more years. Inflation, appreciation, compounding, rental income, and tax savings can make the owners of multiple rental properties quite wealthy.

Let's briefly look at some basic short-term and long-term real estate investment strategies.

1. Contract assignment (short-term perspective)

One real estate strategy is to negotiate a favorable contract on a property and sell your right to buy said property to another party via an *option*. In other words, you're affording another party the option to buy a property at the price and under the terms you skillfully negotiated. How much you charge for this option is up to you and the party who's interested in the contract. You must, however, make sure that the contract is assignable, and that you can get out of a contract if you cannot find someone to purchase the option (see: *out clause*; see also *escape clause*). Obviously, to make this strategy work, you must find a purchaser for your option, making it a good idea to line potential option purchasers up ahead of time, which means finding people who are interested in a good deal. While this strategy does not require much money, it does require superior contract knowledge and strong negotiating skills. If you lack either, you would be well advised not to attempt this strategy.

2. Buy and sell ASAP (short-term perspective)

"Flipping" is the term for buying a property, fixing it up as quickly as possible, and then selling it as quickly as possible. Key to this strategy is finding property that can be purchased for significantly less than fair market value. Where can you find property that can be purchased for less than fair market value? Good question.

Real estate offices
One way to find property that can be purchased below fair market value is visiting real estate offices. MLS (Multiple Listing Service) books are full of bargain properties, many of which are owned by banks that are looking to unload them.

Bank REO (real estate owned) departments
Banks come into property via loans they made that didn't quite work out as planned. It takes time and it's sometimes difficult to reach the right party to speak with, but try to come up with a contact for every large lending institution in your area, and ask for a list of available properties. Some contacts will offer to put you on a mailing list, while others will require you to send a self-addressed stamped envelope every month. Banks often use real estate brokers to liquidate REO properties, so be sure to ask which real estate offices in your area handle REO properties. Real estate offices often offer lists of REO properties free of charge, in the hopes of earning business, and many also offer lists of government foreclosed properties (HUD, FHA, VA). The IRS also liquidates properties it has seized, yet another source of properties priced below market value. Leave no stone unturned in your search for ideal investment properties. (Another source of potential investment properties is Fannie May (Federal National Mortgage Association). Also keep in mind that repetition is one of the keys to successful bidding. Keep submitting bids until a property is sold to you or another party wins the bid.

One advantage to dealing with banks is, well, you're dealing with banks and not your fellow man. Some people worry about how other people will react to what they feel may be too low of an initial offer or feel bad about asking them to lower asking prices. In the REO market, you're not dealing with people; you're dealing with banks. Look at what they put loan applicants through! Take it to 'em baby! *Everything* is negotiable: price, down payment, closing costs—even financing. Speaking of which, banks have strict lending guidelines; however, these guidelines tend to be a little more flexible when it comes to financing REO properties. Banks want to get them off the books as quickly as possible, and being able to provide financing is an added bonus. (Look for a smaller down payment.) You may even be able to convince a bank that's financing a REO purchase to grant you a loan for repairs and renovation work.

While we're discussing where to find ideal investment property, let's not forget FSBO properties. They're easy to spot driving around neighborhoods. Just look for "For Sale by Owner" signs. Oftentimes, these owners are quite motivated. Also, if a property is in need of more than just minor repairs or cosmetic enhancements, the owner will know (or you can explain it) that he/she/they will have to provide some financing and be quite a bit more flexible. If a property doesn't meet government financing standards, a very large percentage of potential homebuyers, especially first-time homebuyers, will be excluded from consideration, severely limiting the seller's options. Sometimes, though, distressed properties do not have signs posted in front of them. How do you find them then? Look for other signs: an unkempt lawn, trash in the front yard, or other signs that some sort of financial intervention may eventually become necessary. Of course, you don't want to go up to the door and say, "Your property looks like hell. Want to sell it?" You probably don't want to go to the door at all, at least not initially. Take down the address, do some detective work (public records search), and try to see what's up with the property. Then make a phone call, and try to speak with the owner (if you can find the number and it's in service), a much safer strategy than trying to outrun some Cujo wannabe.

Foreclosures are a main source of potentially ideal investment properties. There are essentially three phases to foreclosures. Some people become experts at the first phase, the phase in which the profit potential is probably the highest, which is interacting with homeowners before their properties are foreclosed on. Some people are experts at the second phase, the phase in which the profit potential is the next highest, which is buying property at auction. Some people become experts at the third phase of the foreclosure process, the phase at which the profit potential is still high, but probably lower than the preceding two phases, which is buying property owned by banks or property being liquidated by government agencies (HUD/FHA/VA, IRS). Still others become experts at all three steps. Homeowners who fail to pay property taxes also risk losing their property, so be sure to check with county tax collectors' offices for listings and procedures.

Whole books have been written about buying foreclosures, books you should seriously consider adding to your real estate investing library. You should also consider adding books on 'flipping" and property rehabilitation to your library, since that's what you're likely going to be doing a lot of, rehabbing that is.

Property Rehab

This is probably a good time to discuss properties that may need more than just minor repairs or cosmetic enhancements. While our program stresses targeting residential properties in need of only minor repairs and/or cosmetic enhancements, many such homes will not have a profit margin large enough to make them viable short-term investment candidates. Oftentimes, the pricing strategy used by the owners of these homes is to list their properties at or near fair market value and then, during negotiations, deduct the anticipated cost of said minor repairs and cosmetic enhancements (paint, new carpet, etc.) from the initial asking price. Not much profit margin there. Owners who negotiate like this aren't even close to being as motivated as you need them to be, .so don't waste your time or theirs. The purpose of telling you this isn't to get you to abandon your search for the ideal investment property—on the contrary—it's to get you to try harder. You've got to look long and hard, using all available resources, to find prime wealth-building properties, which takes time and effort, time and effort you simply must be willing and able to invest. Real estate investing programs, like the one you've enrolled in, are often labeled "get rich quick schemes," which is a big misnomer. You can definitely get rich investing in real estate, but it's not going to be quick. You've got to dig deep to find gems, and often they don't look much like gems at first glance.

Some repossessed or soon-to-be repossessed properties are in surprisingly good condition, and some are actually in really good shape. But many others are not. That, however, should not automatically make them no-goes, especially if you have some money to work with. What makes a savvy real estate investor is the ability to see potential profit, not just potential problems. A house may be tacky. The lawn may look like the Gobi desert. The inside might be a complete mess. Appliances may be old or not even there anymore. It may not have central heat & air. The rooms may be dark, dank, and dusty. Heck, it may even need a new roof. But if the house is structurally sound, the wiring and plumbing checkout reasonably well, there are no major environmental issues (asbestos, lead paint, radon gas), it's located in a nice neighborhood, and the profit margin is great, it's certainly worth considering. You've got to look at the profit margin (the difference between fair market value and your planned bid). If the fair market value, the projected value of the property after rehab work is complete, is \$105,000 and your bid of \$70,000 is accepted, that's a \$35,000 gross profit margin. If it takes \$15,000 to rehab, hold, and sell the property, that's a \$20,000 net profit on the deal, which is a pretty big chunk of change. You absolutely must know the fair market (post rehab) value of a property you're considering placing a bid on, and you must also know the estimated cost of rehabilitating, holding, and selling the property. Only then can you determine whether or not it's a good deal. What's the use in spending \$5,000 to make a \$6,000 profit? Buying a property in need of some serious rehab work is definitely not a low-/no-money down strategy, but spent wisely, five or ten thousand dollars of rehab money can go a along way. But who lends money on dumps, sorry, diamonds in the rough? The answer is private mortgage lenders, and there are a lot of them out there willing to lend money when no one else will.

For private mortgage lenders, the risk is low and the returns are high, an ideal investment climate. The money isn't cheap to borrow, and most private lenders will finance only around 60% of purchase prices, if that much (the range is between 50 and 80 percent), but at least the money is available and with far fewer questions asked. It should be pointed out, however, that we're talking shorter-term strategy here: buy, rehab quickly, and sell quickly. The profit margin must be large enough to warrant more extensive repairs and renovation work. Avoid the urge to try to do everything yourself. As a matter of fact, with a true fixer-upper, you will not be able to. You're going to need to hire a contractor or a really good handyman. If you choose the latter, it will require more time and effort on your part, as you will be assuming the role of rehab supervisor, but probably less money. You will also have much more control. Probably good, could be bad.

What sells a property?

<u>Outside</u>:

“Curb appeal”—a nice lawn & landscaping, fresh exterior paint, attractive doors, nice windows & shutters, a deluxe mailbox, edged sidewalks, clean driveways, etc.—sells houses. If potential buyers react as though they’ve just pulled up to 1313 Mockingbird lane (obscure Munster’s reference), curb appeal may be lacking.

<u>Inside</u>:

A house you’re trying to sell can’t be too clean. We’re talking “Mr. Clean” and his entire family pitching in here, them and some “scrubbing bubbles” if that’s what it takes to get the job done. All things being equal, a really clean house—make that spotlessly clean—will sell much more quickly than one that should be but isn’t. Who wants to move into a house and then have to start a major cleaning project! After spending all day looking at less than clean houses, imagine how it feels to look at one that exudes clean.

Another thing that sells houses are electrical switches & sockets that work, plumbing that works, doors that work, windows & doors that open/close and lock properly, a working air conditioning unit (w/clean filters), a bathroom fan that works, clean or new toilets, bathtubs, and sinks—you get the picture. Extra emphasis should be placed on kitchens and bathrooms. Don’t skimp here. Use nice faucets and fixtures. They don’t cost that much more and add much perceived value. Newer appliances, refurbished countertops & cabinets, a microwave oven (costs next to nothing), they all significantly increase the value of a home. Light and openness/airiness also increases value. Do everything possible to increase natural and artificial light. We stopped living in caves long ago. Let everyone see how clean your house is! Chances are you’ve been in a house that’s dark and dank, with all the ambience of “The Pirates of the Caribbean” ride at Disney World. How did it make you feel? Did you feel more like buying it or singing *It’s a Pirate’s Life for Me*?

<u>Lawns</u>:

A nice lawn is a great way to improve curb appeal. Go to the nearest home improvement superstore; find someone in the lawn & garden department who knows what he or she is talking about; and <u>listen attentively</u>. Explain that you have a limited budget, and follow his or her advice and instructions to the letter. You *can* do this yourself, and no, it won’t cost a fortune, just some sweat. If there are homes in your neighborhood whose landscaping you like, snap some pictures. Be sure to explain what you’re doing, and ask permission first (see: Cujo wannabe).

Sorry, we got a little off track. Let’s get back to our investing strategies, shall we.

3. Buy, Hold, and <u>Sell</u> (Long-term perspective)

This strategy is fairly simple: You buy a property, live in it for a number of years, sell it, and make lots of money. This is the way much real wealth is created, by securing and holding onto properties while they increases in value due to appreciation and compounding. This builds equity, money that can be pulled from a property at the time of sale. No such perk is available to renters. Those who pay rent for years and years, all the while staying basically in the same area, truly are throwing money away.

4. Buy, Hold, and <u>Rent</u> (Long-term perspective)

Something that sets real estate apart from other investment options is that, in addition to an average rate of return of around four or five percent, it can generate monthly cash flow through rental income. Of course, there's a price to be paid, sometimes literally (professional property management), but if the amount charged for rent covers PITI—which remember is **p**rincipal, **i**nterest, **t**axes, and **i**nsurance—someone else is paying for your equity growth in the property. Quite likely, someone will even be paying you for growing equity in your property (if rent more than covers PITI). Rental property can be a significant hassle at times, especially if you manage the property yourself, but the advantages can also be significant.

Whether being aware of it or not, people commonly employ strategies two and three. They live in a house for some time, and then decide, rather than selling and cashing in, to rent it out, letting it appreciate even more. Then they end up selling sell it for even more. Isn't real estate great?

Glossary of Commonly Used Real Estate Terms

Abstract (of title):

A summary of the public records relating to the title to real property. An attorney or title insurance company reviews an abstract of title, examining it for defects that must be cleared before a buyer can purchase clear, marketable, and insurable title.

Acceleration Clause:

Clause in a mortgage that accelerates repayment of a loan, causing the balance of the loan to become due immediately in the event that regular mortgage payments are not made or other conditions of the mortgage are breached.

Ad Valorem Tax:

Term commonly used in reference to taxes based on assessed property value.

Agreement of Sale:

(Also known as *contract of purchase*, *purchase agreement*, or *sales agreement*.)

A contract that facilitates the sale of real property, with a seller agreeing to sell and a buyer agreeing to buy, under specific terms and conditions spelled out in writing and signed by both parties.

Agreement for Deed:

(Also known as a *contract for deed*, *land contract*, or *installment sales contract*)

A sales contract stipulating that the seller will deliver the deed on some future date. In the meantime, the buyer takes possession of the property, making agreed upon payments. The seller retains title until a certain number of payments are made, payments that may be forfeited in the event of default.

Amortization:

A loan repayment schedule, which enables a borrower to gradually reduce a debt through equal monthly payments of both the principal and interest.

Appraisal:

A detailed estimate (written report) of the value of real property at a certain point in time.

Appraised Value:

Estimated property worth.

Appreciation:

Increase in the value of a property, due to inflation, improvements made to the property, or prevailing market conditions (supply & demand).

Arrears:

State of being behind on the payment of a debt (mortgage payments). Also used in reference to payments made at the end of the period in which they were due (the opposite of "paid in advance").

Assessed Value:

Value of real property, as determined by a county property appraiser for tax purposes.

Assignee:

Party to whom a legal right is being transferred.

Assignor:

Person who transfers a legal right to another party

Assumption of Mortgage:

An obligation undertaken by the purchaser of real property to be personally liable for payment of an existing mortgage. In an assumption situation, the buyer is substituted for the original mortgagor in the mortgage instrument, and the original mortgagor is released from further liability. (The mortgagee's consent is usually required.) The original mortgagor should obtain a release (in writing) from any further liability. Failure to obtain said release renders the original mortgagor liable if the party assuming the mortgage fails to make monthly payments.

An "Assumption of Mortgage" is sometimes confused with "Purchasing subject to a mortgage." When one buys subject to a mortgage, he or she agrees to make monthly mortgage payments on an existing mortgage, while the original mortgagor remains personally liable if the buyer fails to make the monthly payments. Since the original mortgagor remains liable if default occurs, the mortgagee's consent is not required.

Both "Assumption of Mortgage" and "Purchasing Subject to a Mortgage" are used to facilitate (finance) the sale of real property and are often used when a mortgagor is experiencing financial difficulty and desires to sell the property to avoid foreclosure.

Balloon Payment:

A single, large payment made at the end (maturity) of a *partially amortized mortgage*.

Binder (purchase offer):

An initial agreement between a buyer and a seller, secured by the payment of *earnest money* (deposit), to sell/buy real estate. A binder secures the right to purchase real property at agreed upon terms and for a limited period of time. If the buyer has a change of heart, or is unable to purchase, the earnest money is forfeited, unless the binder contains a refund clause.

Certificate of Title:

A certificate issued by a title company or opinion (in writing) of an attorney that the seller has marketable and insurable title to property offered for sale. A certificate of title offers no protection against any hidden defects in the title that an examination of the records could not reveal. The issuer of a certificate of title is liable only for damages due to negligence. (The protection offered a homeowner under a certificate of title is not as great as that offered in a title insurance policy.)

Closing

Final settlement/statement between a seller and a buyer and the date title to real property passes from the owner (seller) to the new owner (buyer).

Closing Costs:

Expenses that buyers and sellers typically incur when transferring ownership of real property. These costs are in addition to the actual price of the property and prepaid at the closing day.

Typical Buyer's expenses	Typical Seller's expenses
• Documentary (Doc) Stamps on Notes	• Cost of Abstract
• Recording Deed and Mortgage	• Documentary Stamps on Deed
• Escrow Fees	• Real Estate Commission
• Attorney's Fee	• Recording Mortgage
• Title Insurance	• Survey Charge
• Appraisal and Inspection	• Escrow Fees
• Survey Charge	• Attorney's Fee

The *closing day* is the day on which the formalities of a real estate sale are concluded. Generally, the certificate of title, abstract, and deed are prepared for closing by an attorney, and this cost is charged to the buyer. The buyer signs the mortgage, and then closing costs are paid. The final closing simply reaffirms information included in the *agreement of sale*.

Cloud (on a title):

An outstanding claim or encumbrance adversely affecting the marketability of a title.

Collateral:

Personal property pledged as security for a loan.

Commission:

Money paid to a real estate agent or broker by the seller as compensation for finding a qualified buyer and completing the sale (usually expressed as a percentage of the sale price).

Comparables (Comparable Properties, “Comps”):

Recently sold properties that are used to help determine the value of a property a potential buyer has displayed an interest in (commonly referred to as the *subject property*). For valid comparison, comparable properties must have been sold in the same market as the subject property and must be similar, although adjustments may be made. (Adjustments are always applied to the comparable properties, not the subject property.)

Comparative Market Analysis (CMA):

A report prepared by real estate salespeople and brokers and presented to their clients, the purpose of which is to help them make more informed buying and selling decisions by helping them determine what they should ask/offer for a property. To generate business, potential buyers and sellers are usually provided with a free CMA. The major differences between a CMA and a certified appraisal is that the latter is far more detailed and usually isn’t free.

Condemnation:

The seizing of private property for public use, against the will of the owner, by a government entity (under the power of *eminent domain*) but with payment of what’s considered by said government entity as just compensation Condemnation may also be an official finding that a particular building is unsafe to occupy.

Consideration:

Anything (money, goods, services) given as an inducement to enter into a contract.

Contract:

A legally-binding written agreement between two or more competent parties.

Contractor:

In the construction industry, a contractor is one who contracts to erect buildings or portions thereof. There are also contractors for each phase of construction: heating & air conditioning, electrical, plumbing, etc.

Corporation:

A fictitious person (business entity) created by law to facilitate the transaction of business.

Counteroffer:

Rejection of an offer and the proposal of another.

Conventional Mortgage:

A mortgage loan not insured by HUD or guaranteed by the Veterans' Administration.

Conveyance:

Transfer of title (ownership) to real property from one party to another.

Deed:

A formal written instrument by which title to real property is transferred from one party to another. The deed should contain an accurate description of the property being conveyed, be signed and witnessed according to the laws of the state in which the property is located, and be delivered to the purchaser at the day of closing. There are two parties to a deed: the *grantor* and the *grantee*. (See also *deed of trust, general warranty deed, quitclaim deed*, and *special warranty deed*.)

Deed in Lieu:

Instrument that deeds property to a lender in order to avoid foreclosure action.

Deed of Trust:

Like a mortgage, a *deed of trust* is a security instrument whereby real property is given as security for a debt. However, in a deed of trust, there are three parties to the instrument: the borrower, the trustee, and the lender (or beneficiary). In such a transaction, the borrower transfers the legal title for the property to the trustee, who holds the property in trust as security for the payment of the debt to the lender or beneficiary. If the borrower pays the debt as agreed, the deed of trust becomes void. If, however, the borrower defaults in the payment of the debt, the trustee may sell the property at a public sale (under the terms of the deed of trust). In most jurisdictions where the deed of trust is in force, the borrower is subject to having his property sold without benefit of legal proceedings, although a few states have begun in recent years to treat the deed of trust like a mortgage.

Default:

Failure to make mortgage payments as agreed upon in a commitment based on the terms and at the designated time set forth in the mortgage or deed of trust. It is the mortgagor's responsibility to remember the due date and send the payment prior to the due date, not after. Generally, thirty days after the due date, if payment is not received, the mortgage is in default. In the event of default, the mortgage may give the lender the right to accelerate payments, take possession and receive rents, and start foreclosure. Defaults may also come about by the failure to observe other conditions in the mortgage or deed of trust.

Deficiency Judgment:

In a foreclosure action, a personal judgment against a borrower whose mortgage was foreclosed, which resulted from the proceeds of the sale of the loan's security (property) being insufficient to cover the unpaid mortgage balance, taxes, and costs associated with the sale. The borrower is liable for the balance due, unless the new owner has assumed responsibility for the debt.

Delinquency:

A condition arising from the failure to make agreed upon mortgage payments.

Depreciation:

Decline in value of real property, stemming from wear and tear, degradation of the neighborhood (reduced property values), or other reasons.

Documentary (Doc) Stamps:

A state tax in the form of stamps required on deeds and mortgages when title to real property passes from one party to another.

Down Payment:

The amount of money to be paid by the buyer to the seller upon the signing of the agreement of sale. The agreement of sale will list the down payment amount, which may be forfeited if the property is not purchased. If the down payment is to be refundable, a clause specifying the conditions under which the down payment will be refunded should be included in the sales agreement—for example, if a seller cannot deliver good title.

Due-on-sale Clause:

A provision in a conventional mortgage requiring the entire loan balance to be paid to the lender upon the sale of the property.

Earnest Money:

Deposit given to the seller (or his/her/their agent) to hold a property, tangible evidence that a potential buyer is serious about buying it. If the sale goes through, the earnest money deposit usually is applied to the down payment. If the sale does not go through, the earnest money deposit may well be forfeited, unless conditions stated in the purchase offer allow for a refund and said conditions apply.

Encumbrance:

A legal claim that may negatively affect the marketability of a title, such as zoning ordinances, liens, or unpaid taxes. A title search is usually sufficient for revealing encumbrances. Then it is up to the potential buyer to decide whether or not to purchase in spite of the encumbrance/encumbrances or find out what may be done about it/them.

Equity:

The value of a homeowner's unencumbered interest in his/her/their property, calculated by subtracting the property's market value from the mortgage balance and any outstanding liens or other encumbrances. A homeowner's equity increases over time as the mortgage is paid off and the property appreciates in value. 100% equity in a property is achieved when the mortgage is completely paid off and any and all liens are completely satisfied.

Escrow:

Funds paid by one party to another (escrow agent) to be held until the occurrence of a specified event, after which the funds are equitably distributed.

Exclusive Right to Sell Agreement:

An agreement between a seller and his/her/their real estate broker, giving the broker the exclusive right to sell his/her/their property during the agreed upon listing period. Regardless of who sells the property—even the owner—the broker is still entitled to the commission, unless there exists a *buyout clause* in the listing agreement.

FHA (Federal Housing Administration):

Insures mortgage loans offered by FHA-approved lenders, as long as the property (and the buyer) meets FHA standards.

Fixture:

Personal property that becomes real property when it is permanently attached to, or becomes a permanent part of, real property.

Foreclosure:

Legal term related to any of the various methods of enforcing the payment of a debt secured by real property, by seizing and selling said property and paying (in order of priority) parties owed money.

General Warranty Deed:

A deed conveying to the grantee all of the grantor's interest in, and title to, his/her/their property (ownership). It also warrants that if the title is “defective” and a *cloud* exists, the grantor may be held liable by the grantee.

Grantee:
One who is granted a right/rights (buyer in a deed).

Grantor:
One who grants a right/rights (seller in a deed).

Hazard Insurance:
Protects against damages to real property caused by common hazards.

HUD:
US Department of Housing and Urban Development. HUD's Federal Housing Administration insures home mortgage loans made by FHA-approved lenders to FHA-approved buyers and also sets minimum standards for homes for which it will insure mortgages.

Improvement:
Addition that increases the value of real property. (An *overimprovement* is an improvement that, financially speaking, does not warrant the cost, as it is unlikely the money expended will be recouped at the time of sale.)

Lease:
Contract granting use or occupation of real property during a specified period of time and in exchange for specified rent.

Lessee:
One who is granted a lease (tenant).

Lessor:
One who grants a lease (landlord).

Lien:
A legal right to have real property, which is held as security for payment of a debt or debts, seized and sold (see: *foreclosure*) to pay said debt or debts, debts that may include unpaid mortgages, judgments, unpaid taxes, labor & building materials, etc.

Lienee:
Party whose property is subject to a lien.

Lienor:

Party that has a claim on another party's real property.

Marketable Title:

A title devoid of "defects," one that allows the owner of real property to sell his/her/their property freely and others to freely accept.

Mortgage:

Lien against real property. Mortgages are offered to lenders (mortgagees) by buyers of real property (mortgagors) as security for borrowed funds.

Mortgage Commitment:

A written document from a lender stating that it will advance specified funds, enabling a buyer to purchase a home.

Mortgage Note:

Written agreement to repay a mortgage loan (proof of indebtedness), stipulating the way in which the debt will be paid. The note lists the amount of the debt secured by the mortgage and makes the mortgagor personally responsible for repayment.

Mortgage (Open-End):

A mortgage with a provision permitting future borrowing of additional money (without refinancing the loan or paying additional financing charges), as long as it doesn't exceed the original loan amount.

Mortgagee:

The lender in a mortgage agreement.

Mortgagor:

The borrower in a mortgage agreement.

Offeree:

Person to whom an offer is submitted (seller).

Offeror:

Person who submits a purchase offer (potential buyer).

Option:

Right to purchase or lease real property at a set price during a set time period.

Optionee:

Party to whom an option is offered in exchange for consideration.

Optionor:

Party offering an option in exchange for consideration.

Points:

(Often referred to as *discount points*) A *point* is 1% of the mortgage loan. (One point on a $40,000 loan would be $400.) Charged by lending institutions, points raise the *yield* (return on investment) on loans.

Prepayment Clause:

Clause allowing all or part of a mortgage loan to be paid ahead of schedule (before the due date) without penalty. Lenders often restrict prepayment by placing limits on the amount that can be prepaid each year or by charging prepayment penalties. FHA-insured mortgage loans have no such limitations.

Principal:

Amount owed on a mortgage loan (excluding interest and insurance).

Quitclaim Deed:

A deed that transfers interest in real property from one party (grantor) to another (grantee), making no warranties as to the quality or extent of the title being conveyed. Grantee accepts all risks.

Restrictive Covenants:

Restrictions, created by deed, that place limits on the use of real property. Some restrictive covenants affect potential buyers (run with the land), and as a result, may also affect the marketability of the title.

Special Warranty Deed:

Protects the grantee from title defects.

Title:

Rights associated with the ownership and possession of real property. *Title* also refers to the instruments or documents used to establish ownership rights.

Title Insurance:

Protects lenders and homeowners against title defects.

Title Search:

Ensures that a buyer is purchasing property from its rightful (legal) owner and that there exist no liens or other factors that could adversely affect the marketability of the title.

Trustee:

Party legally responsible for holding property for another party.

Department of Veterans Affairs (VA)

Guarantees mortgage loans made to veterans and their spouses, giving lending institutions an incentive to provide favorable mortgages by limiting potential loss.

Vendee:

Buyer in real estate transactions

Vendor:

Seller in real estate transactions