MONEY GOALS SRL

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Stupid plan to get rich with real estate, uncovered (15-18 ott. 2023)

Introduction

I like real estate, or at least I really like to think about real estate as a way to generate recurring income or capital appreciation, using a market which has only really one kind of a barrier to entry: money.

If you do not have enough money, you could find all the deals in the world, but you are not going to purchase those investments. Sometimes I have heard "you can invest in real estate without money", what that usually means is that you CAN invest in real estate with other people's money (OPM), and that also means that you will incur in a lot more troubles if you screw up your first investment (or maybe your second).

Money is not the problem; in fact, the problem is: what do you want from your real estate investment?

3 are the main reasons you could want to invest in real estate:

1) Capital appreciation (short term strategy): you buy some kind of property which you know is worth more than you paid, then you eventually resell the property. In between the buying and the selling, you will often find that you could purchase some furniture, or you could create new spaces or change the existing ones. Usually, it depends on the market demand from a particular set up of the property.
2) Buy at market price to get pure rental income, and here, in my opinion, there is a ton of shit you can read or hear online (I hope you'll never get a taste of it!). What for the next strategy to know why, but relying purely on the income generated from a property is really not a way to achieve the old (but still very good) margin of safety which Benjamin Graham depicted in chapter 20 of The Intelligent Investor. What about a real estate market crisis? How do you deal with it? What about a depressed economy that could impede your long-term host to pay the next rent? Could you really resell the property at a sufficient price to cover at the very least your initial total purchase cost? If any of these questions has a "no" answer, then you do not have a margin of safety in your investment.
3) Buy low, keep high the rental yield. This is the approach that COULD give you a margin of safety in the purchase price, and also could give you an edge in the long run. The catch is that you will not really find too many deals maintaining the requested standard, oftentimes you will find yourself frustrated for not finding any deal, or worse you could find a deal which seems to be good on the surface, but then reveals itself for the Damocles' Sword that the ex-owner had very much desired to let you inherit.

The margin of safety concept

If you are not a Benjamin Graham or a Warren Buffett reader, you could have missed the most important general concept about investing: the margin of safety.

I would like to keep things short, and give you two descriptions of the same concept to better understand the margin of safety approach.

1) When you buy an investment, you should always be able to resell the assets you purchased at the price you initially paid. This is the concept of keeping the principal, or the money you invested, and not risking losing it for any reason at all ("A bird in the hand is worth two in the bush").
2) You should evaluate an investment with this frame of mind: in the worst-case scenario, ideally you should not even lose money at all, and realistically speaking you should at the very least contain the maximum loss to a minimum (if it makes sense, but it should be to you). In the best-case scenario, you reward for the investment should be very high. This way, you create a situation where there is a misalignment between the risk (capital loss) and the reward (capital appreciation).

Still, if things shouldn't be clear to you by now, I really suggest you read The Intelligent Investor by Benjamin Graham. It is not about real estate investing; it is about investing and the global principles of a sound investment.

Why this document?

So, why am I writing this long text? Well, it is just a remainder to me, about what I planned, why I planned it and how I wanted it to be executed. In case I screw things up, I will reference back to this document, maybe to have some kind of guidance, but realistically to say to the old failing me "I told you so". Which one will it be? Only time will tell.

Why and in which way I want to make money

I am going to start with stating my end goal: money from my investments should cover for everything I do, aka passive income. To do what I want most of the time.

I selected two ways to make money, both of which have little in common if not some basic investment principles and common sense:

1) Financial instruments with value investing
2) Real estate investing

In this document, I will focus on my strategy to make money with real estate, knowing that I am not going to get rich quick, but eventually, in the future.

Why real estate?

I choose real estate as one of the means to make money because it is a really straightforward method to generate income, and banks really want to help you do it (I do not know why, but so is the game): buy at a low price to keep the margin of safety high, in an area which can generate more income than the expenses owed with the ownership of the piece of real estate. So, I have to:

- Find an apartment or a building costing less than the fair market price
- Also, that apartment should be able to generate an income which would cover all the expenses, the mortgage and leave you with a positive cashflow month to month.

The devil is in the details: both are no easy tasks, if you want to buy real estate below market price, you will be surprised by how many people you will compete with; those people will also make crazy offers with cash money, no mortgage or strange financing ways to have the money. I, with my only-after-mortgage-approval offer, would not stand a chance against them. And, if I want to find an apartment which will yield a good rental return, I will have to search for a long time: those rare opportunities have a short life, someone else will soon jump at them.

Core features of the search

Finally, before jumping in the core section of this document, I would like to remind myself two main features I must have to get ahead in the game:

- Patience: the search will require months or even years to complete, and the first couple of deals will be the slowest to complete, because I have not so much money, I have less experience and I have less connections.
- Long-term vision: this really is the key component of the mindset required to succeed; having a long term vision means have patience and means to be able to postpone short-term easy choices to arrive at the main goal, financial independence.

My strategy to make money

There are a number of steps that I have thought of completing, most of them in sequence but that is not a guarantee.

1) **Have a plan**: the first step is get started and having a plan, and I think that what you are reading is the creation of the first basic step, to define what I am going to do in real estate.

I should say that at this point in time I have already purchased my first real estate investment, of which I will write in other documents, but it does not mean I will not follow this plan, it means that maybe I am ahead of the schedule (do not confuse it with being relaxed).

I have thought a lot about this plan, I have tried a lot of experiments and extravagant investments in the past, just to reduce my strategy to the two most known investment markets. This is to let you know that as I write this, I have my plan in mind but I think for clarity it should be also written in stones (or paper, or even more precisely, in bits).

The big picture of the plan is very simple: get a higher net worth and get an higher passive income figure. Using the word "higher" *per-se* has no meaning: to cite the best investor of all times, the "stick" of comparison of my results will be on a yearly basis with the main stocks index, the SP500. If I will get at least a 5% better result than the SP500 long term, I will be satisfied but most important of all I will have justified my fatigue and daily struggles. In this sense, I think that results of the first 3-5 years will not be this relevant in judging my long-term performance. At the moment, I have the luxury of having a job while starting ut with not so much capital, so that my overall returns including all my income should be pretty high (think of having 1€ in your wallet, and stumble over 5€ while walking: you would have achieved in one day a 400% return! Warren Buffet who?).

2) **Set some clear goals**: yeah, I know, I have just written that I want to have a lot of passive income. I have to set a clear goal, maybe with the SMART method, but let's keep it simple and define some basic realistic numbers:

   a. Number of houses: that is really more a vanity number than a cornerstone of a sound strategy: you could buy 100 houses, all of them bad, and you would not have made a single step forward. But, combined with other sound targets, the number of houses bought or operations completed could be a sign of going in a good path.

   b. Return as value over purchase price: is really difficult to be defining this global portfolio indicator, knowing that a big part of my portfolio will be devoted to stocks and financial instruments. Ideally, both parts of my portfolio would be yielding more than the SP500, by over 5% points over the long run. Yet, this value should be the highest possible, and good estimations during the analysis phase will have to be precise and conservative, to maximize yield. I am not stating a definite number, but a range, because depending on the level of uncertainty in the investment different expected yields could be tolerated. There are two main returns that should be evaluated, following the separation of the "buy low high yield concept": expected return calculated as market value over purchase price, and considering the prescribed 50% margin of safety would be asking practically too much for the investment to be found, at least a 20% margin should be achieved versus a market price calculated comparing similar houses' prices and market screeners. This margin should become a lot higher (35%-40%) in case of short-term investment, meaning the purchasing of a house to resell it in 12-24 months. That margin, although difficult to obtain, should give me a decent margin of safety in case of error.

   c. Return as rental yield over purchase price: the second condition to be fulfilled is an acceptable rental yield calculated over the purchase price or purchase total cost. There are different ways to calculate a yield: gross yield, pre-tax yield or net yield. I do not think that gross yield is that meaningful, often it is used as a raw indicator that things could go ok, but I do not think I am going to invest without deeply analyzing a potential investment so I am not going to use gross yield as a meaningful parameter. But it has to be considered with much more attention the usage of pre-tax yield and net yield, as there could be some hidden risks in both: in my opinion, pre-tax yield is more significant in comparing different purchases because the specific situation of the buyer or seller could greatly impact the net yield. So my strategy would be to consider a pre-tax yield of more than 15%, which would translate for a natural person in around a 11% net yield (considering the "*cedolare secca*" regime in Italy of 21% tax on gross rental income), and for a juridical person (corporation) if would be around 10% annual net yield (considering IRES tax of 24% on corporations). That just shows that using pre-tax yield is a much more stable approach, ignoring punctual effects of the different investor's situations. I will state here that I could invest as a physical person or with my company, so that should add a little degree of freedom in my strategy. But I should not ignore the final net result, and the choice of the investment method will also consider the net yield: if the difference in investing as a person will be huge against the results investing with my company, I would most likely invest in my name.

   d. Continue to do so: I will sound trivial, but the strategy will be to continue to achieve the 3 goals over the years, using compound interest.

3) **Start accumulating money for the down payment**: I will say that again: I actually own a house, I have a mortgage and currently I do not have enough income to cover a second mortgage so right now, a second rental investment is out of question, since I also am living in my to-be-rented apartment (slight error, but I will explain in another document). So, what is the first thing to do? Save money, and I now work full time to save most possible amount of money.

4) **Find the first house that meets the requirements**: this step will be the hardest and probably the most time consuming, as it will require a great amount of upfront money to cover the down payment and the purchase costs, and it will require to start the building of long-lasting networking with local agencies and investors. The first step could be easier if you have some co-investor (maybe more) with whom share the purchase price, so to split the initial cost in half or even in a lesser fraction in case of multiple partners. Of course, splitting the initial investments means to split the eventual reward in case of success, but the gain in experience, knowledge and hopefully lasting partners is going to have a lot more value to you. Right now, I was unable to find some partner to share my investment goals. I am really choosy and careful in the choice, and this comes with a great deal of difficulty in finding new partners. I am not going to specify every single step of the analysis of the real estate deal, but I will state that the finding-the-deal part will not be linear with the analyze-the-deal part, or the find-the-mortgage part, or every other part in between the search and the final sign in the deal contract.

   I do not know how much time I will need to find my first or second deal, ideally in my first year of search I should find at least 10 potential deals via direct contact with agencies or in foreclosures, or other ways. In my previous experience, 1-to-10 was the ratio purchased houses over offered houses, and that ratio was about 1-50 considering the in-detail analysis and a good 1000 houses screened, over a period of 12 month. That number could be seen as very large, but it means that on average I screened less than 3 houses per day. You could easily beat that number will little effort.

   The good thing is that I will have no rush in searching opportunities, and during the next months I am going to save money to invest. I will not have to be hasty in my decisions, as long as I can go forward with my goals and net worth.

5) **Continue**: as for the aforementioned targets, the next steps could be held inside the “eat-invest-sleep-repeat” motto.

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