
The Book on

**INVESTING
IN REAL ESTATE
WITH NO
(and low)
MONEY DOWN**

*Creative Strategies for Investing in Real Estate
Using Other People's Money*

BRANDON TURNER

*Author of THE BOOK ON RENTAL PROPERTY INVESTING
& Host of THE BIGGERPOCKETS PODCAST*

The Book on Investing in Real Estate with No (and Low) Money Down

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THE BOOK ON
INVESTING IN REAL ESTATE WITH
NO (AND LOW) MONEY DOWN
REVISED EDITION

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REVISED EDITION

*Real-Life Strategies for Investing in Real
Estate Using Other People's Money.*

BRANDON TURNER



BiggerPockets®
PUBLISHING
Denver, Colorado

Praise for Brandon Turner's Books

“An insider’s perspective, full of encouragement and resources for newcomers... Interested readers will find the book substantially useful as a starting point.”

—**Kirkus Review on *How to Invest in Real Estate***

“I only wish this book had been written in 2005 when I was starting my real estate investing journey!”

—**Ken Corsini, Real estate investor
and star of HGTV’s *Flip or Flop Atlanta***

“I think this should be required reading for anyone considering real estate investing... Countless hours, months, and—frankly—years this book would have saved me!”

—**Ben Leybovich, Real estate investor,
syndicator, and founder of JustAskBenWhy.com**

“There are very few books that provide a detailed, step-by-step framework for accomplishing real estate success. Brandon Turner’s *The Book on Rental Property Investing* does that, and does it in a way that puts financial freedom through real estate within reach of anyone who wants it.”

—**J Scott, Bestselling author of
*The Book on Flipping Houses***

“I have not read a more comprehensive discussion in my 20 years of investing. This is a great reference for beginners and experienced rental owners!”

—**Al Williamson, LeadingLandlord.com**

“This book is an A-to-Z guide for the real estate investor—not just buying and selling, but also strategic planning, which is all too often forgotten. The real-world examples really drive it home.”

—**Brian Burke, CEO of Praxis Capital**

“*The Book on Rental Property Investing* fuses passion with a system-driven, business-mindedness that provides a very big resource to help establish and achieve your personal investment goals.”

—**Bill Syrios, Owner of Stewardship Properties**

“I wish I had *The Book on Managing Rental Properties* before I made all of my expensive property management mistakes! Brandon and Heather Turner have covered the biggest challenges for landlords and solved each one with step-by-step systems. I literally gave the information in Chapter 6 on tenant pre-screening to my own team and said, ‘Use this!’ It’s that good.”

—**Chad Carson, CoachCarson.com**

“It’s practical, real, and comes across very open and unbiased... This is great for beginners as well as anyone who is in another field of real estate investing looking to cross over.”

—**Lisa Phillips, AffordableRealEstateInvestments.com**

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**The Book on Investing in Real Estate with No (and Low) Money Down
Revised Edition**

Brandon Turner

Published by BiggerPockets Publishing LLC, Denver, CO

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Publisher's Cataloging-in-Publication Data

Names: Turner, Brandon, author.

Title: The book on investing in real estate with no (and low) money down : creative strategies for investing in real estate using other people's money , revised edition / by Brandon Turner.

Series: BiggerPockets Starter Kit

Description: Includes bibliographical references. | Denver, CO: BiggerPockets Publishing, 2020.

Identifiers: LCCN: 2020935321 | ISBN 9781947200975 (pbk.) | 9781947200968 (ebook)

Subjects: LCSH Real estate investment. | Investments. | Real estate investment -- Finance. | Real estate business -- Finance. | BISAC BUSINESS & ECONOMICS / Real Estate / General | BUSINESS & ECONOMICS / Investments & Securities / Real Estate.

Classification: LCC HD1382.5 .T868 2020 | DDC 332.63/24--dc23

Printed in the United States of America on recycled paper

10 9 8 7 6 5 4 3 2 1

Dedication

They say it takes a village to raise a child. I also believe it takes a village to raise a book from concept to print.

To that village I owe a great debt.

Thank you to the BiggerPockets community for your wisdom and advice, and thank you to all my family and friends who have offered support and encouragement through this crazy journey.

Finally, thank you to my Papa, for blessing me more than any man should ever be blessed.

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FOREWORD

By David Greene, Co-host of *The BiggerPockets Podcast* and bestselling author of *Long-Distance Real Estate Investing*

Like you, I love real estate.

I love looking at it, analyzing it, talking about it, and owning it. I love it so much that I've written detailed books so I can teach the art of real estate to others. I co-host *The BiggerPockets Podcast* so I can talk about it. I became a real estate agent so I can make my living selling it.

When I first started buying rental property, I did so with my own money that I saved while waiting tables throughout college. When I moved on to my law enforcement career, I started working 100 hours a week to make the money I needed to fund real estate deals. Seven days a week, often working twenty-hour days, I would drag myself through shifts as a police officer, always striving for that elusive goal of financial freedom through real estate.

To be free, it was worth the cost.

Was I dogged, determined, and focused? Yes. In fact, I think I worked harder than anyone. Was I unhealthy, unbalanced, out of shape, worn out, and depressed? Also, yes. It wasn't until later in my career that I realized I was doing it all wrong. I found there were investing techniques, strategies, and principles that I wasn't aware of, and I had missed opportunities while I worked with my head down.

While I was sacrificing some of the best years of my life *for* real estate, Brandon Turner was living some of the best years of his life *through* real estate. I was laboring away with a handsaw while Brandon had discovered

power tools. I wish I had a book like this back then—it would literally have changed my life, my health, and given me back many years of freedom.

I met Brandon when I was first interviewed on *The BiggerPockets Podcast*. I had listened to every single episode of the podcast and knew all of Brandon's investing stories, interview quirks, and hilarious jokes. What I didn't know, however, was how wicked smart he is.

Behind his goofball persona lives a mad scientist with a brain that never stops churning. Anyone who spends five minutes with Brandon in person will be instantly blown away by the whirlwind of thoughts that his mind produces. This book is a collection of some of those thoughts, organized so you can comprehend them, written so you can make them your own, and structured so you can use them yourself!

The biggest difference I noticed between Brandon and I was how *happy* the dude always was. We were both buying real estate, but he never seemed as stressed as I was about it. We were both building our portfolios, but he was doing it with ease while I was working like a madman. It wasn't until later that I learned why this was the case: Brandon had discovered how to build wealth creatively. He found a way around the brick wall that I was steadily bashing my head into. Did I knock the wall down? Eventually, yes, and with pride. Brandon, however, walked around it with much less stress.

It was through my friendship with Brandon—and by learning how to see the investing world through his perspective—that my own investing methods changed. I learned to look at deals creatively and to see financing, title, rehabs, offer prices, zoning, and square footage as individual pieces of a bigger puzzle. Before Brandon, I saw one path: save money and dump it into real estate. It was Brandon's creative approach that helped open my mind to new possibilities, and then my real estate investing took off.

This book will show you what Brandon was doing differently and how you can do the same. More important than that, it will teach you how to think about and see real estate in a new way. The truth is, there are myriad ways the average investor can make a deal work, find the next property, or structure pieces so they fit together in a way that works for both the buyer and the seller. You don't have to make the same mistakes I did—you can be like Brandon and make real estate work for you.

As the host of the world's largest real estate podcast, Brandon has interviewed *hundreds* of successful real estate investors and pulled back the curtain to see exactly how they built their business. He knows the

mistakes they've made, the successes they've had, and the techniques they discovered at the end of the day that moved their business forward.

What better way to learn than from the collective wisdom of hundreds of successful investors? What better person to learn from than the one who not only does it himself, but has also learned from a collective group of the worlds' best?

Today, thanks to Brandon's influence, I have a portfolio of over 35 cash-flowing properties all over the country. I've written two books on different investing strategies, *Long-Distance Real Estate Investing* and *Buy, Rehab, Rent, Refinance, Repeat*. The BRRRR strategy alone took me from buying two properties a year to two properties a month, all with the same capital. Brandon taught BRRRR before it was popular, and this book is the foundation for it and many other financially creative concepts.

We believe in the wealth-building power of real estate because it's available to everyone. You don't need rich parents, a six-figure job, or an ivy league degree. While you don't need fancy credentials, you *do* need a firm resolve, a strong understanding of the fundamentals, and the ability to creatively structure deals in a way that allows you to have big success without big money.

This book is written to show you exactly how to do just that. Expect to be blown away by strategies you haven't heard of, pathways you've never seen, ideas you've never had, and concepts you never knew existed. The creative ways to buy property are virtually limitless and the combinations countless—if you know how!

Read this book. Memorize the strategies. Share them with your friends, and practice how you would deploy them as you begin analyzing mock deals and looking for opportunities. Share this with anyone you know and love who has similar goals. Do not sell yourself short by taking the hard road when you don't have to! The truth is, you don't *have* to work 100-hour weeks like I did to build a portfolio. Instead, you can be smarter, more creative, and enjoy your life while you build massive wealth and passive income that can last for generations.

Your Friend,

David Greene

Award-winning Keller Williams real estate agent and co-host of
The BiggerPockets Podcast



INTRODUCTION TO THE 2ND EDITION

When I speak to people who have read the first edition of this book, I am usually told one of two things:

1. This book has the longest title in the history of titles.
2. This book changed my life and helped me invest in real estate.

Since I like long titles, I want to focus on the latter. Why did this simple book make such an impact, selling more than 120,000 copies, when the typical business book sells fewer than 5,000 in its lifetime? Why did this book stand out?

Obviously, it's not from the talented writing (you'll realize quickly that I'm not a professional author, but an actual real estate investor who often struggles putting words together!). Nor is it from brilliant marketing (most purchases seem driven by word-of-mouth). In fact, I don't believe this book's success had anything to do with me. It had everything to do with YOU.

You see, we've conducted many polls of our members and visitors at BiggerPockets and found, time and time again, that there is one problem above all others that keeps people from investing. It's the same complaint I hear from strangers standing in line at Starbucks while I wait to order my peppermint hot chocolate after I tell them what I do for a living. It's the same objection I hear when I attend local real estate meetups around the country. It's the same issue I hear weekly when I host live online

webinars for BiggerPockets. Nearly everyone new to real estate struggles with the same thing:

Money. Or, more precisely, the lack thereof.

You see, as I discuss in Chapter One of this book, it doesn't matter how rich or poor you might be, how loaded your bank account is, or the size of your vault. You'll likely always need *more capital* when it comes to your real estate ambitions. Even billionaires borrow money on their real estate deals.

Therefore, the reason the first edition became such a hit had little (or nothing) to do with me, and everything to do with the nerve that was struck. People want to learn how to invest in real estate with low (and no) money down! That's exactly why you're reading this book right now—and in the pages to follow, that's exactly what you're going to learn.

So—why the need for the 2nd edition?

Several reasons.

First, when I wrote the first edition, I decided to include examples that would illustrate my point for each of the many no- and low-money down strategies in the book. These examples were designed to be clear-cut, simple explanations of the strategy. But as more and more individuals read this book and began doing their own deals with no- and low-money down, I noticed that these real-life stories were just as compelling, if not more-so, than the original stories. So, in addition to the simple illustrations from the first edition, here you're going to read more than thirty real-life stories from all around the world from investors just like you doing real deals in real situations.

From the story of Tim in Southern California who bought a property with less than \$15,000 down to Luke in Louisville, KY who not only purchased a fourplex for no money down but actually received \$10,000 at closing—these stories are designed to educate you, inspire you, and hopefully spur you to action. At the end of the book, as a bonus, we also included a dozen additional real-life stories to give you even more ideas on how to finance real estate with no- and low-money down.

Secondly, I make it a goal when I write books not to write about topics I have not personally experienced. When the first edition of this book was released, I had never performed a syndication (the powerful strategy of buying big deals by raising money from a variety of passive investors) but since that time, I've jumped fully into this strategy. Therefore, this edition includes an entirely new Chapter Ten—more than 5,000 words—not

found in the first edition. This chapter will walk through the exact strategies I've used to buy millions of dollars in real estate with almost no money out of pocket. This chapter alone may change the future course of your real estate investments, forever.

Finally, this second edition includes some updated numbers based on where the real estate market is today and a fresh new design.

Without further suspense, I invite you to begin reading and truly hope that this book delivers exactly what the incredibly long title suggests.

Yours,

A handwritten signature in black ink that reads "Brandon Turner". The signature is fluid and cursive, with the first name "Brandon" being more prominent than the last name "Turner".

Brandon Turner

Maui, Hawaii

January 2020



Chapter One

THE ART OF CREATIVE REAL ESTATE INVESTING

Allow me to start this book talking about one of my favorite things: pizza. Bear with me a moment and it will all make sense.

When I go to the pizza store to pick up a pepperoni pizza with extra cheese, I have one choice: to pay for it with my hard-earned money. I suppose I have other choices, but I'd rather avoid the orange jumpsuit and forced community service involved in theft.

However, the rules for real estate investing are actually not as hard and demanding as those for buying pizza or other consumer goods, so you'll have many more options. Better yet, those options are not only legal, they are also a lot of fun to learn and apply. I call this process "creative real estate investing."

One of my favorite aspects of real estate investing is the ability to trade cash for creativity. In my world, this is the truest definition of creative real estate investing.

You can't easily do this with stocks, mutual funds, gold, or most other kinds of investments. If you wanted to buy gold but had only \$1,000 to spend, you would probably buy just \$1,000 worth of gold. If the price of gold then doubled over the next decade, you would make only another \$1,000 in that ten-year time frame. If it doubled again the following decade, you would then have \$4,000 in your portfolio.

You can imagine how long building serious wealth might take with

this method, especially with the market fluctuating so greatly. In fact, gold has done tremendous things over the past decade, climbing from \$282 per ounce in February of 2000 to over \$1,300 per ounce in February of 2014. While that rise may seem incredible, it's only incredible for those who had a significant amount of money to invest to begin with. After all, if you had bought that \$1,000 worth of gold in 2000, today you'd have approximately \$4,600—hardly anything to quit your job over.

The same applies to the stock market. And mutual funds. And fine wine. And nearly all other investments.

Now, there's nothing wrong with investing in those other things (and in fact, I recommend a “balanced diet” with respect to investments), but if you have little or no money, getting started can take a *long* time.

Frustrating, isn't it?

However, with real estate, you can leverage your knowledge, time, and creativity to essentially make money from *nothing*. This is what creative finance is all about: replacing cash with creativity, money with motivation, and dollars with determination.

Do you have that creativity, that motivation, and that determination? If so, you can do some amazing things to improve your family's financial future. If not, don't worry. This book will show you the way.

Who Am I?

My name is Brandon, and I'm addicted to creative real estate investing.

I started investing in real estate at the age of 21 with no credit, no cash, and—honestly—no idea what I was doing. However, I had decided that I was going to be a real estate investor, come hell or high water, so that's what I set out to do. I read every book the regional library system had on real estate investing, spoke with every real estate investor I could find in my area, attended landlord meetings to network, and continued to work my day job making barely above minimum wage for the first few years. Fast forward thirteen years and I'm not a billionaire, I don't drive a Lamborghini (though I did just buy a Tesla, using a rental property that I acquired with low money down to fund the entire payment!) and I've made more mistakes in real estate than I'd like to admit. However, I've also amassed a portfolio of nearly 300 rental units and flipped or wholesaled a variety of properties that have provided me with enough income to support my family whether I maintain a day job or not, and

I've purchased every property using little or no money of my own.

I don't say this to brag. The truth is, I didn't jump into creative finance because I was some super genius or because I was trying to achieve some astronomical return on investment. I jumped into the world of creative finance because, frankly, I was broke. I acquired nearly all my properties while I was either self-employed or working for less than \$15 per hour. I simply had no choice: be creative or don't invest at all. Along the way, I've made a lot of mistakes, wasted a lot of time, and made more than a few bad investments. However, the many lessons I've learned from it all have made me the investor I am today, so my hope is that I can now share those lessons with you.

All that said, this book is not about me. This book is about **you and your future**, no matter what your past has been or how much money is in your checking account. This book is about giving you the educational tools you need to start investing in real estate, whether you have a million dollars in the bank or six bucks to your name.

It's Not About Being Broke or Irresponsible

I realize that creative real estate investing holds a special appeal for people who have absolutely no money in their checking account, but I want to be clear that I don't equate creative real estate investing with having no money. Yes, the two often go together, but that's not what this book is about.

After all, no matter how much money you have in your bank account or IRA, there will always be real estate that you cannot afford. There is always another level, and getting to that level requires a strong commitment to creative real estate investing. Even the most wealthy and successful real estate investors use a heavy amount of creative finance to continue their business; I would even argue that their skills at buying real estate with no or little money down are what have contributed most to their success.

Therefore, this book is for **YOU** if you are interested in doing more deals, enjoying more cash flow, and increasing your income through creative real estate investing.

This Book Is Not About Getting Rich Quick

Yes, fortunes have been made in real estate, and some of those fortunes

have been made rather quickly. However, for the vast majority of real estate investors, this is simply not going to happen, and I am not promising anything different.

This book is about applying creativity as leverage to acquire real estate, and this doesn't happen overnight. Building up a portfolio can take years, and the speed at which that portfolio grows depends heavily on a healthy dose of luck, location, and timing. That said, please don't be discouraged. Creative real estate investing truly is an amazing vocation that can transform your future and the financial destiny of your family forever, and I'm excited to share with you the strategies I've used throughout my career.

Who Is This Book For?

There are hundreds of ways to make money in real estate and hundreds of books written about each of the various strategies. Therefore, I think we should discuss *who* this book is for before we jump headfirst into the content.

This book is for anyone interested in investing in real estate using other people's money. Whatever strategy you expect to use or niche you plan to enter, I believe the lessons in this book can help you find greater success.

Although I am primarily a buy-and-hold real estate investor—interested in the extra monthly income (cash flow) that owning numerous rental properties can provide—and even though I tend to mix in the occasional flip or wholesale deal just to keep things interesting, rental properties are my bread and butter and my area of expertise. That said, the lessons in this book *will* apply for those looking to engage in all types of real estate investing. In fact, Chapter Nine of this book deals exclusively with the concept of real estate wholesaling and finding amazing deals, so be sure to stick around for that.

You CAN Afford It

Each week, David Greene and I have the honor of sitting down with successful real-life real estate investors on the BiggerPockets Podcast and asking them about how they've built their business, the successes they've had, the failures they've faced, and more. Perhaps the most popular segment of the show comes at the end, during the "Famous Four"—four

questions we ask each and every guest. The first question is simple but powerful: What is your favorite real estate book?

The number one answer given by 80 percent of our guests thus far has been the same: *Rich Dad Poor Dad: What the Rich Teach Their Kids About Money That the Poor and Middle Class Do Not!* by Robert T. Kiyosaki¹.

I am amazed by the sheer number of investors out there who credit this one simple book as the inspiration for their investing career, and I'm right there with them. This book was a huge turning point for me and motivated me to start thinking about my financial future in a new light. Although not a textbook for real estate in any way, *Rich Dad Poor Dad* was foundational in the lives of many real estate investors because it changed the mindset of everyone who read it. Personally, it completely blew my mind wide open with new possibilities and ways of thinking.

Perhaps the greatest mindset-expanding revelation in this book comes when Kiyosaki tells a story about the two men who had a hand in raising him: his real dad and his best friend's dad. Each had a different way of guiding his family financially, which led to the author's dual perspective on financial matters.

In the book, Kiyosaki states, "Rich dad forbade the words 'I can't afford it'... Instead, rich dad required his children to say, 'How can I afford it?' His reasoning, the words 'I can't afford it' shut down your brain. It didn't have to think anymore. 'How can I afford it?' opened up the brain. Forced it to think and search for answers."

I still remember the day I read that; my entire world seemed to turn upside down. I had been raised in a household of "we can or we can't afford that" and so was accustomed to turning my brain off as soon as I reached the point of "no." When I suddenly realized that there was a different way of thinking, something ignited inside me, and my quest for creative finance began.

At that point, I stopped saying, "I can't afford it" and "I can't do it" and began asking, "How can I afford it?" and "How can I do it?" I realized people were making money with real estate investing and were not using any of their own money. I was going to do the same, and I hope this book will help you do so as well.

However, before we go too far down the "let's invest with no money" road, we need to ask one fundamental question...

¹ Robert T. Kiyosaki and Sharon L. Lechter, *Rich Dad Poor Dad: What the Rich Teach Their Kids About Money That the Poor and Middle Class Do Not!* Warner Books, New York, NY, 1997.

Should You Really Invest with No Money Down?

A lot of people out there would advise you not to invest in real estate if you don't have significant financial resources of your own to use as a large down payment. Others, such as popular financial radio talk show host and author Dave Ramsey, have even stricter views and argue that you should *only* invest in real estate if you can pay 100 percent cash for the property you want.

At the other end of the spectrum are those who would advise you to get into real estate no matter what, however you can. Scam, steal, and squeeze your way in to make a buck. After all, what is important is getting rich as quickly as possible so you can start driving that convertible, lying on that beach, and watching your money grow.

So, what's the truth? Should you really try to invest in real estate using creative methods? Should you put this book down immediately and go get a second job working at a fast food joint?

I can only speak for myself and my own risk tolerance, but I believe that a happy medium can be found. I believe all investments are risky to some degree. However, as the great hockey player Wayne Gretzky once said, "You miss 100 percent of the shots you don't take." In other words, had I not taken that first step toward investing in real estate without any money, I would not be where I am today.

Have I struggled? Yes!

Have I lost money? Of course!

Would I change any of it? Not a chance!

I love the freedom that real estate investing offers, and I was willing to use my creativity in place of the cash needed to get started. I had more time and creativity than money, and I leveraged that into a profitable career—and I wouldn't hesitate to do it again.

If you are someone who advocates being content with a traditional job and saving up for that first cash purchase, more power to you. I wish you well, and I'm fully convinced that's the best route for you to take. However, for me, working 40 years behind a desk so I can be a millionaire when I retire at 65 is hardly a worthy goal.

I want to live today *and* when I retire.

That is what motivated me to start creative real estate investing, and that is what continues to motivate me today. That said, I want to make a few things very clear about creative finance. I like to think of real estate as a game, and as such, certain rules must be followed. I call these the Four Rules of Creative Investing.

The Four Rules of Creative Investing

I like to speed.

Traveling down the freeway, something just seems wrong about going the speed limit. I have to push the limits just a little. This is what intrigues me about the Autobahn in Germany. This federal highway has no federally mandated blanket speed limit, which makes it a dream for people like me.

However, just because the highway has no speed limits, that doesn't mean a driver can afford to be stupid.

In fact, Autobahn drivers are mandated to control their speed during adverse weather conditions and in urban areas of the road. Additionally, an "advisory speed limit" of 81 mph applies to the entire freeway system to protect drivers.

What does this have to do with creative real estate investing? Creativity in real estate is a kind of open road that often appears to be "rule free." However, the same conditions that make it so exhilarating can also lead to the greatest crashes. Therefore, investing in creative real estate has its own "advisory speed limits" in the form of four important guidelines.

These are the four primary rules and advisory limits of creative real estate investing. These have been passed down from one established investor to another with the goal of keeping aspiring investors from crashing and burning.

1. When investing creatively, you need to find even better deals than those who invest normally.

Let me explain what I mean. Let's say a certain home is worth \$100,000. A traditional investor might pay \$100,000 for that home, put a 30 percent down payment (\$30,000) on the property, and make a nice return on investment from the cash flow (the extra money left after all the expenses are paid).

However, if I were to purchase that same house for \$60,000 because I took the extra steps necessary to get a great deal, which of us is in the better position? The traditional investor, who has \$30,000 of their cash tied up in their property and no real equity, or me, who has nothing invested but owes less?

Because of the deal I obtained, I have far greater potential for profit and for a better return on investment than the normal investor, but less of my cash is at risk because I have no cash invested at all.

However, what if I decided to be just a “normal” investor and pay full price for that \$100,000 property, with no money down? Most likely, my mortgage payment would be so high that good cash flow would be out of reach, and I would not have the equity necessary to be able to sell the property. In this case, the “good” investor would be in a better position because they owed only \$70,000. Hopefully, you are following my argument here: Creative investing means you must invest in incredible deals, or it’s simply not worth doing.

There are exceptions to this rule, of course. Sometimes the method of financing can sweeten a deal enough to entice you to jump in. We’ll talk more about those strategies later in this book.

2. When investing creatively, you must be extremely conservative.

I’m not talking politics here; I’m talking about planning for the future. This means assuming the worst when buying property. Take as a given that taxes will go up, your unit will sit vacant for a certain percentage of each year (higher than the average for your area), repairs will be numerous and expensive, and you will need to evict deadbeat tenants. Plan for these costs and only buy property that proves to still be a good deal even after a conservative estimate of potential revenues.

Although the analysis side of the real estate transaction is beyond the scope of this book on creative real estate investing, I encourage you to spend some time on this subject by studying how to analyze an investment property on BiggerPockets. For a video tutorial on exactly how I analyze potential rental properties, check out “How to Analyze Real Estate Investments.”² Also, I go into significant detail about how to analyze a property, including estimating repairs, so stick around for that.

3. Creative finance requires sacrifice.

Remember my definition of creative finance: the ability to *trade* cash for creativity. Notice there is a trade-off involved—one you need to accept. Most of the methods I’ve discovered for acquiring real estate creatively weren’t found in books. Instead, I discovered the methods at 4:00 a.m. after an eight-hour brainstorming session with my wife, my pen, and my paper, desperately trying to figure out the missing puzzle piece that would enable

² <http://www.biggerpockets.com/analyzeinvestments>

me to close a deal. This is often the trade. It requires jumping through a lot of mental hoops, numerous conversations with others, and the ability to ask for help. Creative real estate investing is a puzzle that takes significant mental (and sometimes physical) effort to put together.

If you want easy, then stick with a job, a sizable down payment, and average returns. There is nothing wrong with that, and I'd have chosen the same if I'd had enough money and income when I started. But I didn't, so I chose creativity. I chose to sacrifice. Will you?

4. Creative finance does not mean investing without a cushion.

A wise man and mentor once told me, "You can go broke buying good deals." Even though you need to get killer good deals if you are going to invest with no or little money down, you still need to understand that bad stuff happens. Murphy *will* show up on your doorstep and start knocking. He might even move his whole family in. (If you don't understand the reference, Google "Murphy's Law.")

Therefore, maintaining a financial cushion to deal with problems is imperative. You don't need \$50,000 in the bank to buy a small rental house, but you *do* need to be able to weather the storms that will come, relative to the size of the property you are buying and that property's risk for loss.

For example, if you needed to evict a tenant, could you handle several months of lost rent, more than \$2,000 in eviction costs, and several thousands of dollars to repair the property? What if you had to do this twice in the same year? These are important questions you must be able to answer—or at least discuss. Many of the strategies in this book will deal with solutions for issues like this, so don't give up on this book quite yet if you are down to your last dollar. These questions do have answers, so hang in there and keep your brain turning.

I can't tell you exactly how much money you'll need to save, because that depends largely on a number of factors, including the following:

1. The strength of your target real estate market
2. Your ability to manage properties effectively
3. Your ability and desire to repair things yourself, if needed
4. How difficult and lengthy evictions are in your state
5. How good your credit is
6. How much cash flow you can get

7. The average purchase price of your target properties
8. The niche you enter
9. The strategy you use
10. And a whole lot more

The point is: be conservative, buy great deals, and have a financial backup plan. If this means spending six months working a second job to save up \$5,000 to put into a savings account, then start that second job tomorrow. Maybe it means asking your boss for a raise or lowering your living expenses (remember... sacrifice!). Whatever you need to do, get started as soon as possible. Stop wasting time on excuses and start planning for how you are going to get there.

Furthermore, even though having a large financial cushion to weather storms can help you significantly offset risk, you cannot simply throw money at real estate investments and hope they turn out well. Education is key. Will you read the books, study the material, ask the right questions, and insist on becoming the best? I hope so.

No Money Down: Myth, Scam, or Secret?

I don't really like the phrase "no money down."

Not because the approach is not possible, but because the phrase has been so worn and used by the late-night TV gurus who drive up in their red convertible with two hot bikini-clad babes in the back seat. Big cars, big hair, big promises. "No money down" conveys a sense of "easy money" and a "get rich quick" mentality that is not only flawed and silly—it's dangerous.

As I mentioned earlier, wealth built through real estate investing is definitely not easy money, nor is it quick. However, does the widespread overuse of the phrase mean that the concept is impossible to achieve? Does investing in real estate with no money down really work? If you've made it this far into this book, you should know that it is possible. I've personally done it time and time again, and so have thousands of other, far more successful investors around the world.

Investing in real estate without any money is not a scam or a myth, and it's not a secret that you need to pay thousands of dollars to unlock. It's simply the process of generating the needed cash with the creativity you have. There is a method to the madness of "no money down" real

estate, and this book will outline numerous tips for buying property without using your own cash. Thousands of investors, including me, have used these strategies and tips for years.

Obviously, real estate is not free; investing in it requires money. However, when we talk about investing with “no money down,” we mean investing with none of *your* money down. In other words, we’re talking about using other people’s money to buy real estate.

Creative investing is about shifting the source of any needed cash, depending on the strategy. You can do this in numerous ways, and this will all make much more sense as we start examining the different strategies. For now, though, just understand that buying real estate with no money out of pocket (or very little) is a very real and possible thing if you are committed to learning the art. And yes, it is as much an art as it is a science. This book will show you both.

Having the Right Tool for the Right Job

Have you ever hired a handyman to do a job for you?

When a handyman goes to a job site, they don’t always know what they are going to need when they get there, so they bring a number of common tools (hammer, saw, drill, etc.). This way, they’ll be prepared for whatever they encounter. If the job requires that something be nailed, they can pull out their hammer. If the job requires a hole to be drilled, they can pull out the drill. A good handyman is prepared with a toolbox full of tools to be able to address whatever is in front of them.

In the same way, a good investor also has a toolbox, and you can fill yours with whichever tools you want. As you work your way through this book, you will learn a number of different strategies. Some of these are relatively easy to understand and apply, while others are high-level concepts that you may need to go over a few times (or just jump into) to fully grasp. Each of these strategies and concepts is a “tool” for your investor toolbox. You may not need each strategy today and some you may never employ, but by having them all in your toolbox, you will be a more prepared investor—one who can tackle more jobs and will have more success. After all, just like a handyman, the more tools you have, the more types of projects you can master.

What to Expect in This Book

This book will examine a number of very different strategies for creative finance with real estate investing, but realize that these are only a small fraction of what could be possible when you start using your brain and adopt a “how can I afford it?” mentality. I encourage you to take as many notes as you can so you can revisit the concepts when needed.

Each chapter in this book will cover a different strategy you can use to invest in real estate with little or no money out of pocket. Each chapter will also include a thorough discussion of the risks, downsides, and potential problems involved. Additionally, numerous examples throughout each chapter will help break down the concepts into real-life, actionable plans.

If you have any questions as you work your way through this, I encourage you to visit the *BiggerPockets Forums*³ and start asking them there. I can guarantee you that investors are hanging out in the forums right now who have experience in each and every one of the strategies I am about to present, so learn from them by leaning on them! Ask them about their experiences, their mistakes, their successes, and fill your toolbox with the highest quality tools you can acquire.

Will All These Strategies Work for Me?

The short answer is *no*.

Think of this book not as a textbook but as a piece of literature, one whose lessons can be applied to individual situations, but not necessarily used as exact formulas. This book is about learning to think creatively and is filled with stories of individuals who have done exactly this. Your ability to carry out certain strategies will rely heavily on a number of factors, including your location, your personal place in life (family commitments, free time, willingness to sacrifice, etc.), your finances, your personality, and more.

For example, I might mention a rental house that an investor purchased for \$120,000. Some of you might scream, “\$120,000 for a rental house? That’s highway robbery!” while others would shout, “\$120,000 for a rental house? That wouldn’t buy a parking spot in my area!”

Real estate investing and the strategies for creative finance are heavily defined by location. Does this mean the strategies outlined will not

3 <http://www.biggerpockets.com/forums>

work for your area? Not necessarily. You may be able to tweak a specific strategy to work wonders in your area. The point is to open your mind, learn what works in other markets, and train yourself to think creatively and apply those strategies to your own local market.

If you are ready to get started—to open your mind to the possibilities of buying real estate for little or no money down—turn the page, and we’ll begin by talking about how I got started: with an *owner-occupied investment property*.



Chapter Two

OWNER-OCCUPIED INVESTMENT PROPERTIES

At first you might be a little confused.

After all, aren't we supposed to be talking about investing, not buying a personal home? If so, why am I using the term "owner-occupied" in this chapter title? I wanted to begin this section by discussing this special kind of real estate investment for two reasons:

1. This is the way thousands of other investors and I started our careers.
2. This can be one of the absolute cheapest ways to get started investing in real estate.

This chapter will focus on the strategy of combining your own home with sound investment principles to create a powerful method of getting started without much (or any) cash of your own.

What Exactly Are We Talking About?

First, let's all get on the same page. An owner-occupied investment property is real estate that has been purchased as an investment but that also doubles as a primary residence for the investor. In other words, the property is both your home *and* an investment property.

Why would you want to do this? Because America loves homeowners! Owning a home is the American dream, and as a result, our society has

created some excellent incentives for those who want to buy a primary residence. When you combine those benefits with the knowledge needed to profit at real estate investing, you can skyrocket your chances for success while lowering the threshold for getting started. For example:

- Homeowners can purchase a home with a mortgage that requires as little as 0 percent down.
- Homeowners get lower, fixed-interest rates.
- Homeowners can qualify with lower credit scores.
- Homeowners are often given the first option to buy foreclosures (especially HUD homes, which are properties that have been foreclosed upon by the U.S. Department of Housing and Urban Development).
- Homeowners can often negotiate better deals with sellers.

We'll go into the specifics on how to do all this later in the chapter, but first let's look at the two primary ways of applying this strategy: single-family homes and small multifamily homes.

Owner-Occupied Single-Family Home

Let me tell you a tale of two college grads.

Both graduated college with the usual amount of student loan debt, got married, found great jobs paying \$5,000 per month, and decided to buy a house for their families.

The first buys a McMansion in the suburbs. The home has everything a family could want: manicured lawn, granite countertops, Brazilian cherry hardwood floors, and more. The family is very happy but spends roughly \$2,000 per month just to pay the mortgage—and this is on top of their car payments, student loans, private preschool for their kids, and other middle-class expenses.

The second college grad buys a house knowing it will not be the family's "final home." They purchase a three-bedroom, two-bath home in a working-class neighborhood and put a little sweat equity into painting and landscaping, making it a great house to start out in. The best part? Their total mortgage payment is just \$850 per month.

After a year, both college grads, for whatever reason, want to move and decide to rent their homes. College grad #1 quickly learns that the most rent he can get for his home is \$1,800 per month. Given that his mortgage payment is \$2,000, not counting maintenance and repairs,

etc., he can't sell the house because what he owes on it is the same as its current value. This means that by selling, he would actually lose money because he would have to pay the real estate agent's fees and closing costs.

College grad #2, however, finds that his home will rent for \$1,500. Given his mortgage payment of only \$850, he will end up netting significant extra cash flow each month that he can use to rent or make mortgage payments on his family's next dwelling.

As Kiyosaki explains in *Rich Dad Poor Dad*, buying a single-family home to live in is not an "investment," it's a liability. It costs you money each and every month, takes a significant amount of money to maintain each year, and is probably your single biggest expense. Far too many Americans treat their home as some holy investment, when really, it's putting them in financial hell.

So why do I refer to it here as an "investment"? As the story of the two college grads illustrates, you can consider a single-family home an investment if you purchase it with the intention of using it as a real estate investment in the future or if you can build substantial equity by doing some light rehab and then transferring that equity into greater investments later.

Generally, banks assume that you will stay in the home for a period of time (and sometimes contractually require you to commit to living in it as your primary residence for at least a year,), but if you move out, you do not need to obtain a new loan. Your loan will stick with the property no matter where you move. Therefore, you can buy a home to live in, move out some time later, and continue to use this home as an investment property. This is how I acquired several of my early properties.

The same principle in the story of the two college grads relates to house flipping—and this is how I got into real estate at the very beginning.

My No Money Down Beginning

I had just graduated from college and was working a barely-more-than-minimum-wage job, when a friend's sister (who was a real estate agent) said that for me, buying a house would be cheaper than renting one. I looked into the numbers and discovered that she was right.

Although I had no idea what I was doing, I decided to purchase a four-bedroom, one-bath home that was downright ugly. I rented out the

extra bedrooms to some friends (this paid the mortgage so I could live there for free), slowly fixed the place up, and nine months later, sold the property for a \$20,000 profit. During this time, I used none of my own money, but relied on a 100 percent mortgage to purchase the property and used mostly credit cards to fix it up.

Note: I don't necessarily recommend using credit cards, but doing so did help me bridge the gap I needed to move my plan forward. Although I believe credit cards are exceptionally dangerous,

I have a hard time vilifying something that helped me get to where I am. If you plan to use credit cards in your investing strategy, be sure to have a rock-solid way to repay the money quickly, and never borrow more than you can afford to pay the minimum payment on.

While most of my friends were busy playing video games and chasing girls, I was turning thin air into a \$20,000 profit and was ultimately able to pay for a dream wedding and honeymoon with my new wife. Yes, I could have purchased a beautiful home that needed no work, but instead I chose to buy something that could double as both an investment and a primary residence—and it paid off well for me.

Could you do the same? You tell me! This is just one simple example, but the possibilities are endless when you use your head and start thinking creatively.

Let's move on to another popular form of owner-occupied investment: the small multifamily home.

Owner-Occupied Multifamily Homes

Chances are good that you've rented a unit in one of these places in the past or know someone who has. They exist in every market, in every neighborhood, and at every price point, and purchasing a small multifamily property can have a tremendous impact on your financial future, especially when combined with the power of being an owner-occupant.

A small multifamily property is a two- to four-unit residential property, so an owner-occupied multifamily property is one where the owner lives in one of the units.

The neat part is this: duplexes, triplexes, and fourplexes are all considered "residential," so if you live in one of the units, even for a short time, you will reap the same rewards as any other American homeowner. In other words, most banks view small multifamily properties exactly the same as single-family homes. This is good news for you!

Once a property reaches five units, you enter a whole new ball game of “commercial real estate,” which is ineligible for the benefits related to owner-occupied properties that we are talking about here. There are still ways to buy properties with five or more units without using your own cash, but this chapter on owner-occupied investments won’t explain those techniques. We’ll cover them in later chapters instead.

Because small multifamily properties are considered residential, they come with low rates, easy(ish) financing, and a smaller required down payment. Additionally, when you buy smart and get a great deal, you might be able to live for free and get paid for doing so—the rent your tenants pay each month can cover all the property’s expenses, and more.⁴ This has become known as “house hacking.” For example, if you buy a fourplex, live in one unit, and rent each of the other units for \$500 per month, you could be making \$1,500 per month in income. If your loan, taxes, insurance, utilities, and other expenses total just \$1,200, you could essentially be getting paid \$300 a month just to live in the home, while you also build equity in the property (using *other people’s money*).

Even better, when the time comes to move out and into your future home, renting that fourth unit will yield even greater monthly income on that property. Let me break these numbers down again in an easier-to-understand table:

	3 UNITS RENTED	4 UNITS RENTED
Total Monthly Rental Income	\$1,500 (\$500 × 3)	\$2,000 (\$500 × 4)
Total Monthly Expenses	\$1,200	\$1,200
Cash Flow	\$300	\$800

Expenses include an average of all possible expenses, such as the mortgage payment, property taxes, insurance, flood insurance (if needed), property management, utilities, repairs, capital expenditures (the big items you’ll need to save up for, like a new roof, appliances, etc.), and any other costs that might come up. To help estimate these expenses, be sure

⁴ Keep in mind that banks will not consider projected rental income on multifamily properties when assessing your income level as they process your mortgage. You will need to be able to demonstrate a steady, regular income stream that doesn't factor in this future cash flow, even if your eventual rental income will be making your mortgage payments for you!

to check out the article “How to Estimate Expenses on a Rental Property.”⁵

Again, the success of your owner-occupied multifamily home depends almost entirely on your ability to find a great deal, so don’t skip that part of your education. There are numerous great resources across the BiggerPockets website that can help you learn how to find great deals, and in Chapter Nine of this book we’ll spend a lot of time on the subject as well. Study up on the best methods for finding and analyzing properties so you’ll recognize a good deal when you see one.

Single-Family or Multifamily?

Whether you plan to buy a single-family home and turn it into an investment someday or buy a small multifamily property to use as an investment property right now, you can see how important this stage of your investment career can be.

The choice is yours as to which type of property to buy: single-family or multifamily. In many ways, the decision comes down to your position in life. Do you have a large family? If so, you may want to focus on a single-family property. Are single-family homes too expensive in your area? If so, you may want to focus on a small multifamily property instead.

Obviously, investing in an owner-occupied single-family home is more about appreciation in value than cash flow, and because I’m a cash flow investor, I am pretty strongly in favor of the multifamily idea. However, once again, it all comes down to your lifestyle and which strategy will work best for you.

Why Buy an Owner-Occupied Investment?

What does any of this have to do with creative finance and buying real estate for little or no money down? Owner-occupied properties are a great place to start because they provide benefits to the investor that other real estate investments do not.

The fact is, there are low money down lending opportunities that exist for homeowners—people who intend to live on the property as their primary residence—that simply do not exist for other types of real estate deals. By taking advantage of these opportunities, you can start building your rental portfolio with very little out-of-pocket cash and get started sooner than you might have imagined.

⁵ <http://www.biggerpockets.com/estimateexpenses>

The rest of this chapter will deal with the “creative” side of buying an owner-occupied investment property. We’ll explore how you can get into a home for less money than you think and consider a few specific loan products you can use to get into your first property.

However, before we begin discussing those techniques, let’s quickly address one important fundamental question...

Should You Even Buy a Home?

When I bought my first house, I took a hammer and smashed a hole in the wall—just because I could. You see, buying my first home was exciting because it was mine. I could do what I wanted, when I wanted, and no landlord could tell me “no.” For me, owning a home is one of the greatest feelings on Earth. That said, homeownership is not for everyone.

If you are flat broke, up to your eyelids in debt, without steady employment (inconsistent freelancing and side hustles don’t count—banks want to see paystubs documenting regular income) or can’t seem to get a handle on your spending, maybe you should focus on getting your life and budget in order first. Or, if the average home price is \$995,000 where you live and you can’t move to a lower cost area, buying a home might not be the right move just now (unless you can find a screaming good deal). Or, if you have a credit score of 550 because of some past mistakes, buying a home simply might need to wait until you can get your credit in better shape to qualify for financing.

Investing in real estate by purchasing an owner-occupied home is not a lighthearted, impulsive decision. It requires a plan, stability, and moderately good credit. However, I also believe that buying a home is not meant just for boring old folks who have 2.1 kids, a dog, and a career at a Fortune 500 company. If you have decent credit, a stable job, and a modest balance in your savings, you can enter the world of homeownership. What’s more, if you are smart about it, you can simultaneously enter the world of real estate investing and live for cheap—or free!—while getting firsthand, on-the-job training to be a landlord.

Now, let’s move on to specifics. The programs outlined in the following sections are the ones used most often by owner-occupied investors to obtain properties with no or little money down. (Keep in mind that I am not a mortgage professional. Loan requirements and details change often, so always check with a qualified mortgage professional (or several—it’s a good idea to shop around) before moving forward with any of this information.)

FHA Insured Loans

One of the most popular methods of buying a home today, especially for lower-income borrowers, is through the use of a Federal Housing Authority insured loan, generally just referred to as an FHA loan. The Federal Housing Authority is a United States Federal agency under the Department of Housing and Urban Development (HUD) that performs a number of housing- and mortgage-related activities to encourage homeownership and market stability.

Before the late 2007 real estate crash, FHA loans were mostly ignored because anyone with a pulse seemed to be able to qualify for a mortgage using no or little money down. (Remember the story I told earlier of my first live-in flip? Yep, I was able to pay no money down as a college grad with a low-paying job. Don't expect that anymore!) In fact, in 2005, less than 5 percent of purchases used an FHA loan, but FHA market share reached 28.1 percent of all purchases in 2009 during the height of the mortgage crisis.⁶

The term “FHA loan” is a bit of a misnomer, though, because the FHA does not actually provide loans. Instead, it simply insures the loan against loss. In other words, the U.S. Government tells the banks (please read the following in a New Jersey mobster accent):

“Look, fellas, we know these people don’t have enough of a down payment to get a regular loan from yous guys. So, I’ll tell you what we’re gonna do. You scratch our back, we’ll scratch yours. Go ahead and offer the loan anyway, and good ol’ Uncle Sam will make sure you’re taken care of should something bad happen and the homeowners stop paying.”

FHA Loan Specifics

To offset the risk the government takes when insuring these loans, the FHA passes some additional costs on to the borrowers through the use of two special fees (when the loan-to-value⁷ is greater than 78 percent). These fees are known as the Mortgage Insurance Premium (MIP) and must be used in your calculations when considering using an FHA loan

⁶ Source: FHA-Insured Single-Family Mortgage Originations Market Share Report: 2013 – Q3.

⁷ *Loan to Value (LTV)*: The ratio of the mortgage amount to the total appraised worth of a property. For example, a home with an \$80,000 mortgage that is worth \$100,000 would have an 80 percent LTV.

for a property. The MIP is charged both upfront, in the form of a one-time fee that is usually wrapped into the loan, and monthly, in the form of a monthly fee that is added to your loan. Both fees are based on a percentage of the purchase price and typically result in an extra 1–2 percent fee upfront and an additional monthly fee of roughly \$100 per month for each \$100,000 financed.

FHA loans stand out in the lending world because of their extremely low down payment requirements—just 3.5 percent of the purchase price at the time of this writing. This means that an individual could use an FHA loan to purchase a single-family home or small multifamily property with considerably less than the 20 percent down payment normally required as long as they plan to initially live on the property. This makes the FHA loan very attractive to first-time homebuyers and first-time investors.

Let's look at a few quick examples to see how you might use an FHA loan to get started investing in real estate.

Lindsay found a triplex in a good neighborhood listed for \$100,000 that currently brings in \$500 per month per unit in income. She is able to negotiate with the seller a purchase price of \$90,000 for the property, and they will pay \$2,700 toward her closing costs, which covers about half of her costs. Lindsay then uses an FHA loan to get a mortgage on the property, needing to put down 3.5 percent of the \$90,000 (\$3,150 down) plus another \$2,700 in miscellaneous loan fees and pre-paid insurance/tax amounts.

Lindsay's monthly mortgage payment is approximately \$530, including the MIP we discussed earlier, plus \$150 for taxes and insurance, for a total payment of \$680 per month. She rents the other two units out for a total of \$1,000 per month and manages the property herself, collecting the difference in cash flow each month (after paying expenses and saving for maintenance issues). After several years, Lindsay moves on to buy her dream house, renting out the unit she had been living in, thereby earning more cash flow while simultaneously building her wealth.

Joseph Williams in Richmond, Virginia was looking to get his start in real estate investing by purchasing a small multifamily unit in which he also planned to live. He found a great realtor in his area with a focus on investing and was knowledgeable about the type of listings that he

was looking for. His realtor even had a few off-market listings to show him. This led him to find his very first triplex. It was listed at \$375,000 and was currently bringing in \$2,650 in total rents for all three units.

Since he planned to live on the property, he decided to finance this first investment by using an owner-occupied FHA loan and paid only 3.5 percent down. This low down payment was what really made this type of loan perfect for his situation. Joseph moved into one unit and raised the rents of the other two units up to market rate. These two units then brought in a combined \$2,950. His monthly mortgage payment plus his MIP (which we discussed earlier) and taxes put his total expenses at \$2,800. Subtract that total from the \$2,950 in rent that he now brings in and Joseph has brought his own housing costs to \$0 while also generating \$150 in cash flow each month.

After Joseph moved out, he was able to rent out the third unit for an additional \$1,950, bringing the new monthly cash flow to \$2,100.

Risks and Drawbacks to the FHA Loan

While the FHA loan program seems to be a great one (and it can be), you should be aware of some major issues and drawbacks before jumping into an FHA deal. I do not want to scare you away from these loans, but I feel that understanding all the risks and dangers before engaging in any real estate investment is vitally important.

1. **MIP.** As mentioned earlier, the Mortgage Insurance Premium can be a real cash flow killer, so be sure to only buy amazing deals when using the FHA loan to purchase property. In the example of Lindsay and the triplex above, Lindsay would have almost \$1,200 per year in extra cash flow if her loan had not included that MIP.
2. **One Time Use Only.** For those of you who are thinking, “Great! I’ll use this FHA trick every year and get a dozen properties in the next 12 years,” I have some bad news: the FHA allows you to have only one FHA loan in your name at a time. Bummer. However, if you have sufficient equity in your property and the credit score and income to justify it, you can refinance⁸ your loan into a conventional (normal) mortgage and pursue another FHA loan.
3. **Red Tape.** Additionally, dealing with the government in any way

⁸ *Refinancing:* Obtaining a new loan to pay off a previous one.

always seems to involve more hassle, more red tape, and more waiting than dealing with private banks. Once you secure the loan, it might be a great option, but actually getting the loan might take a little extra time and fancy footwork.

Summary of the FHA Loan

Should you use the FHA loan? Obviously, every situation is different, but I am a strong proponent of using this kind of loan when the deal makes sense. The FHA loan is ideal for first-time real estate investors and those who have minimal cash but decent credit and job stability. Although it isn't a technique to obtain real estate for no money down, it can get you pretty darn close with a 3.5 percent down payment plus closing costs, which is doable for most people, even if you have to save up for a few months.

I believe the FHA loan, when used correctly, can be a powerful tool for new investors to acquire their first deal with minimal cash out of pocket.

Again, the MIP and low down payment requirements demand that you get an even better deal than the typical homeowner, so shop around, be selective, and claim a great property.

Most banks and lending institutions offer FHA-insured loans, so ask your mortgage professional about your options, and be sure to look into any policy changes since the publishing of this book.

The 203k Loan

This next loan I'm going to talk about gets me really excited because of the potential it has for helping new investors get started building serious equity without a lot of cash out of pocket. After reading about the FHA loan just moments ago, this should be fairly easy to comprehend. Let's get into it!

One of the subsets of the FHA loan is called a 203k loan, so named because it's based on section 203(k) of the National Housing Act from the Department of Housing and Urban Development (we'll stick with calling it the 203k loan).

Although the 203k loan is part of the FHA-insured loan program, and thus adheres to the main rules and requirements already discussed, I decided to dedicate a separate section of this chapter to this loan because of some major benefits it offers and the power it can have for a real estate

investor looking to maximize their live-in investments.

At its core, the 203k loan is a two-part loan that includes funds to both purchase *and* rehab a home to the specifics you desire. In other words, you can buy a property that is in desperate need of new paint, carpet, smell removal, or other cosmetic (or structural) attention, and the 203k loan allows you to roll all those costs into the loan so you don't need to pay for them out of pocket.

For example, let's go back to the story I shared earlier about **Lindsay** with her regular FHA loan and the \$90,000 triplex. Let's say that the triplex had just gone through foreclosure and was in desperate need of some new interior paint, carpet, and cabinets. Normally, getting a bank to lend at all on a property in such a condition might be impossible, but with the 203k loan, Lindsay can make this work.

After her offer is accepted, during the due diligence period, Lindsay hires an FHA-approved contractor (recommended to her by her lender) to give her a bid on the repairs needed. It comes in at \$10,000. Lindsay's purchase price on the property was \$90,000, so the total cost of the project ends up being \$100,000. This is the number on which the FHA bases its 3.5 percent down payment requirement, so Lindsay must pay just \$3,500 down plus part of the closing costs to buy the property. After the property sale closes and Lindsay takes possession of the home, the FHA-approved contractor goes in and replaces the carpet, paints the interior, and adds the new kitchen cabinets. The FHA then inspects the property to make sure the work was done correctly, and it pays the contractor directly.

Lindsay was able to secure the now-rehabbed triplex for less than \$5,000 out of pocket and will make that money back from the cash flow the property will generate in less than a year.

As you can probably see, the 203k loan holds tremendous potential for a smart investor. Adding value to a property through rehabbing is one of the fastest ways to build wealth quickly, and with this opportunity the government is willing to lend you money to pay for those repairs!

The 203k loan allows you to avoid the competition for already beautiful homes and instead focus on properties that most other homebuyers are too afraid to consider. Rather than offering \$90,000 in our triplex example, could Lindsay have offered \$80,000? \$70,000? \$60,000? Those discounts

are not outside the realm of possibility when one is dealing with distressed properties, and it's one of the reasons I personally focus almost entirely on properties where I can get great deals and "force" the value higher through rehabs. Let's look at another example of how you could use a 203k loan to invest in real estate with little money out of pocket.

Eddie lives in an expensive part of Boston where the cost of a single-family home is far beyond his comfort level, with prices ranging from \$400,000 to \$600,000 for a nice home. This translates to \$2,000 to \$3,000 per month for a mortgage payment, not including any expenses.

However, Eddie finds a vacant duplex that has recently been foreclosed on by a national bank, and the place is trashed. Eddie and his contractor estimate that to completely clean up and renovate the property would cost approximately \$34,000. So, Eddie makes an offer on the duplex for \$315,000, and after some negotiations, the sellers accept his offer.

After all the closing costs and other charges are added into the equation, Eddie is required to bring about \$12,000 to the closing table. He gets a 203k loan for \$349,000, which covers the agreed-upon purchase price and the \$34,000 needed for repairs. After all is said and done, his mortgage payment is \$2,600 per month with taxes and insurance, and he rents out one-half of the duplex for \$2,900, leaving extra money each month to save up for repairs, maintenance, and more. In two years, Eddie moves out and rents his unit out for \$2,900 per month as well, making huge cash flow each and every month.

Additionally, after the repairs are finished, Eddie has the property reappraised and finds it is worth nearly \$500,000, meaning Eddie has built up \$150,000 in equity. Not a bad way to start.

Tim Gordon in Oceanside, California, lived in an extremely competitive buyer's market where many buyers were making cash offers. He was struggling just to get his foot in the door of the real estate game. His "lucky" break came when he got the inside scoop on an off-market fourplex. The sellers didn't want to list it and the property was in significant disrepair and had some major tenant issues (i.e. heroin dealers). In addition to being in a notoriously crime-ridden neighborhood, the immediate area had not had any multifamily sales in several years so there were no other properties to use for price comparison.

For most investors, this would raise huge red flags but for Tim, this was finally his chance to outmaneuver all of the career investors unwilling to even look at a deal like this. Through sheer boldness of will, Tim was determined to make this one opportunity work for him.

He spoke with the problem tenants (drug dealers) and assured them that if they moved out, they would receive their deposits back in full, and they agreed. With this one major problem now a non-issue, Tim had the confidence he needed to move forward and pull the trigger on the property. However, because Tim did not have the cash on hand to purchase and do all of the necessary rehabs, he had to get creative with his financing, all while outbidding any cash offer that might arise.

203k loan to the rescue!

When Tim first heard about the 203k loan, he thought it had to be too good to be true. With the 203k, Tim was able to borrow the \$322,500 to purchase the property in addition to the necessary \$30,000 for rehab repairs. This put his total loan amount at \$352,500 making his 3.5 percent down payment only \$15,000.

Tim moved into one of the four units and after renovations and renting out the other three units, he was bringing in \$3,600 in monthly rents. His monthly mortgage payment plus his MIP (or PMI) was \$2,800—giving Tim a cash flow of \$800.

After living in the property for one year, Tim was able to refinance the property to eliminate the monthly MIP making his new mortgage payment only \$2,500. He was also then able to rent out the fourth unit to increase his cash flow on the property!

Six years later, the property that Tim purchased for only \$15,000 out of pocket is now valued at more than \$700,000 and provides him with a monthly cash flow of \$2,200.

203k Loan Specifics

There are actually two types of 203k loans, depending on the type of work you plan on doing:

- the 203k
- the 203k *streamline*

The difference lies in the extent of the rehab involved. The 203k streamline loan can be used for smaller cosmetic problems, like painting,

carpet, and odor removal, while the regular 203k loan can be used for structural changes, like moving walls or building additions. Contractors that work on the property rehab must be FHA approved. However, most licensed/bonded contractors can become FHA approved by simply submitting the correct paperwork to the bank, and your mortgage professional can help them do this.

Also, at the time of this writing, FHA-approved contractors are required to do the work only if the total cost of renovations exceeds \$15,000, so if the property just needs some basic repairs that you can and will do yourself, you can save even more. Finally, all work on a property purchased with a 203k loan must be completed within six months of the loan's closing, though lenders do reserve the right to shorten this timeline.

Risks and Drawbacks to the 203k Loan

As with any loan, the 203k loan has both benefits and pitfalls. We've already mentioned some of the downsides of using an FHA loan, and because this product is also part of the FHA program, the same dangers exist. However, you need to note some additional concerns before you venture out to buy a property with a 203k loan.

1. **Even More Red Tape.** Speaking from experience, I can tell you that the 203k loan involves even more red tape than the regular FHA loan, so be prepared for a heap of paperwork, mainly because there are many more moving parts in the machine (contractors, lenders, reimbursements, etc.).

This can also affect the speed of the lending process, so be sure to give yourself ample time to close when making an offer on a property for which you'll be using a 203k loan. Also, I recommend finding a great mortgage professional who specializes in the 203k loan program to help you navigate these cumbersome details. These experts can be difficult to find, given that most mortgage professionals have never done or cannot do a 203k loan, so make a lot of phone calls and interview to find the best!

2. **Rehabs Are Risky Business.** If you've ever been involved in a rehab, you already know that it can be a significant undertaking with numerous risks and dangers. Besides trying to manage contractors and deal with the drama that accompanies any rehab, you'll have recognize the possibility that something could go wrong on the project that would require more money than you had anticipated spending, and HUD

won't cover those items. For example, if your contractor opens up the walls and discovers bad wiring or asbestos, you may be forced to cover the cost of the corresponding remedies out of pocket.

3. **MIP.** Again, because the 203k loan is part of the FHA program, you'll be required to pay the up-front MIP, as well as the monthly MIP payment, if the loan to value ratio is greater than 78 percent. This can add hundreds of dollars to your monthly payment, depending on the size of the loan. Therefore, if you are investing for monthly cash flow, be sure to consider the MIP payment when running your numbers.

Summary of the 203k Loan

I truly believe that when used correctly, the 203k loan might just be the most perfect loan product for a new investor trying to break into the investing game. The key, however, is in the phrase “when used correctly.”

The ideal scenario is finding a property with basic cosmetic issues—like peeling paint, old carpet, and unpleasant odors—that can be acquired for far below value and with significant potential for cash flow or quick appreciation after purchase. Whether the house in question is a single-family or multifamily (two to four units) property, the savvy homeowner-investor can use the 203k loan to add immediate benefit with minimal out of pocket expense.

The VA Loan

Another popular loan option for many homebuyers is the VA loan. This loan product was created by the U.S. Department of Veterans Affairs and operates in a very similar fashion to the FHA-insured loan—with a few notable differences.

1. VA loans are designed exclusively for U.S. military service members, veterans, and eligible surviving spouses.
2. VA loans can be funded with no money down. No, that's not a typo—you can really get a home for zero down.
3. Unlike FHA loans, VA loans require no private mortgage insurance, meaning your payment will be lower than if you used an FHA loan.
4. The VA loan allows the seller to pay 100 percent of the buyer's closing costs, unlike the FHA loans, which limits the seller to just 3 percent. This means a VA loan can truly be 100 percent no money down.

Like the FHA loans, the VA loan is an “insured” loan that the government provides to protect the majority of the lender’s capital in case the borrower defaults. Also, like the FHA and other residential loans, a VA loan can be used to purchase single-family homes or small multifamily properties with up to four units, but only for individuals purchasing a primary residence.

I won’t go into a lot of detail on using a VA loan to invest in real estate, because the principles are almost identical to those of the FHA loan, and any differences can be explained to you by your VA lender.⁹

Bryan Carlton of Rockland, Maine, served almost ten years in the U.S. military. He had always assumed that real estate investing was something that only rich people could do. He never saw it as a possibility for himself and had assumed that if he wanted to get started in real estate, he would need to save for a big down payment. After Bryan finished with the military, he learned that veterans could buy property with almost no money down by utilizing the VA loan. This was exactly what he needed to get started.

Bryan found a duplex priced at \$125,000. Using the VA loan, his down payment was 0 percent and his closing costs were \$2,500. That means that for only \$2,500 out of pocket, Bryan now had a new home plus one rental unit bringing in \$1,100 monthly. Bryan’s mortgage payment plus expenses came only to \$927. Subtract this number from his monthly rental income and you get a cash flow of \$173.

Bryan was off to the races. He saw the power of real estate and looked to duplicate his successes by quickly purchasing his next deal using an FHA loan. Utilizing both the VA and FHA loans simultaneously, Bryan was able to vastly expedite his position in his real estate investment journey.

USDA Loans

Though it is perhaps the least well-known of the government-insured loan programs, the U.S. Department of Agriculture offers one that works very similarly to the FHA and VA loan programs.

⁹ If you are a member (former or active) of a U.S. military service or a family member of one, learn more about VA loans by visiting benefits.va.gov.

Now, you are probably thinking, “Isn’t that the same government department that certifies my hamburger meat?”

Yep!

Although commonly referred to as simply the “USDA loan,” the full name of the program discussed here is the USDA Rural Development Single Family Housing Guaranteed Loan Program (though the USDA does offer several different loan programs from which to choose). You can see why calling this a “USDA loan” is simpler for this discussion.

USDA Loan Specifics

The USDA loan is similar to the other programs we’ve discussed already (the FHA, 203k, and VA loans), but in many ways it takes the benefits from each and combines them into a really great loan product, which includes the following advantages:

- 100 percent loan financing
- No monthly private mortgage insurance (an added monthly charge for low-down payment mortgages) or MIP (as seen with the FHA Loan)
- No maximum purchase price
- Certain repairs and upgrades can be financed into the loan
- Seller can pay up to 6 percent toward the buyer’s closing costs

In other words, the USDA loan includes a lot of really great features than can help you get into a home with almost nothing out of pocket. So why doesn’t everyone do a USDA loan?

Just as the VA loan is only for veterans, the USDA loan has a strict qualifier as well: rural single-family homes only, for low- to moderate-income homebuyers. But what exactly is “rural” and what qualifies as “low to moderate income”? You might actually be surprised, and chances are good that you could qualify for a USDA loan if you live outside a major city by any small distance—you don’t need to live 500 miles into the desert or deep in the Midwest farmland.

To check your location’s eligibility, the USDA actually has a nice map feature you can use to check your status on their website.¹⁰ As for income eligibility, the USDA loan requirements change depending on the county in which you live, but if your household income hovers near the average

¹⁰ <http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do>

income of most Americans, there is a good chance you do qualify. To qualify currently, your income can't exceed 115 percent of the median income for the area in which the property is listed. For example, in my county, the threshold is \$75,000 per year.

Risks and Drawbacks to the USDA Loan

Let's look at a few of the specific negative characteristics of the USDA loan so you'll have a better understanding of whether this option has advantages for you.

1. **Location Specific.** Perhaps the biggest drawback of the USDA loan is that many homes, because of their location, simply will not qualify, though a surprising number still will. Be sure to check the USDA website to determine if your location would qualify for a USDA loan.
2. **More Red Tape and Waiting.** Just like the other loan programs we've discussed thus far, you may have to deal with significant waiting, red tape, and other obnoxious paperwork issues when obtaining a USDA loan. I sold a home recently to a woman who used a USDA loan, and the loan took nearly four months to close because of a "backlog" at the USDA. Be prepared for possibilities like this.
3. **Single Family Only.** As the name of the loan would suggest, the USDA loan is available for use only on single-family homes, which means small multifamily properties such as duplexes, triplexes, and four-plexes are out of consideration. With that said, the USDA does offer a 10 percent down payment loan on multifamily investment properties in rural areas (whether you live there or not). If you want more information on the Guaranteed Rural Rental Housing Program, visit [USDA.gov](https://www.usda.gov).
4. **High Leverage.** Obtaining a 0 percent down payment loan requires leveraging yourself to an exceptionally high degree, which could be a negative for some. We've talked about this already, but leverage is not necessarily a bad thing if the deal is good enough. However, a 100 percent loan on a mediocre deal may result in a bad deal. Use caution any time you use a highly leveraged loan.

Pre-Approvals; What's the Deal?

No one likes wasting time. This is especially true with real estate. Whether you're buying a property or selling one, it's a big undertaking and if the other side ends up bailing later in the process. To help give

evidence to the seller of a property that the buyer isn't going to waste everyone's time, the buyer oftentimes gives what is called a "Pre-Approval Letter." This is a document issued by a lender that basically says, "We've looked at the buyer's financials and are comfortable lending to them." It isn't a guarantee that the loan is going to go through, but it at least shows that the bank is happy enough with the buyer's financial position, so if everything else like the appraisal and price are good to go, the loan should go through just fine.

Now, how do pre-approvals come into play when we're talking about investing in real estate with no (and low) money down?

Well, keep in mind a few things:

First, if a property is listed by a real estate agent, chances are, the real estate agent is going to want to see a pre-approval from you before they let their client accept your offer because they don't want you wasting their client's time and end up not being able to fund the deal. So, if you're pursuing a listed property, then you're going to want to make sure you get that pre-approval.

Also, if you plan to use a loan like those we talked about in this chapter, such as an FHA Loan, a 203(k) loan, a USDA Loan, or a VA Loan, you also want to make sure that you're not wasting your own time. Go get a pre-approval from a bank for one of these types of loans. And of course, if you can't get pre-approval, then that's just a sign that you'll need to use another one of the strategies in this book.

Now, let's say you are dealing with a private seller, someone who is not listing their home through a real estate agent. Maybe you found them through a direct mail marketing campaign. Maybe you found them through Craigslist. Whatever the reason, do you need a pre-approval for this?

Probably not. Most private sellers aren't going to ask to see proof. And, if you plan to do one of the other strategies in this book that don't require you to get a loan, then a pre-approval wouldn't do you that good anyway. However, it's still a good idea to know how you plan to finance a deal before putting it under contract. You don't necessarily need to know with certainty, but I'd recommend having a solid plan in place ahead of time. As you go through the rest of this book, you'll be able to make that plan happen with confidence.

WRAPPING IT UP

Owner-Occupied Investment Properties

Investing in owner-occupied properties can be a great way to jump-start your real estate portfolio and give you a solid foundation upon which to build your wealth. It's the way thousands of other real estate investors have started because it can be done with little to no money out of pocket.

Let me emphasize this one final time: The key to a successful owner-occupied investment strategy is getting a great deal, something that can serve as a great buy-and-hold investment for the future or that can gain significant equity right off the bat.

If you are interested in buying your first owner-occupied investment, I recommend reading through the rest of this book to get a solid grasp of what makes a great deal and apply that to your process of home shopping. You may need to be more selective, and the process may take longer than it would take the average homebuyer but, if done correctly, the results could be amazing and set you on a path toward financial success.

Owner-occupied investments can be one of the easiest and most streamlined ways to start your real estate investing journey for little to no money down. As I mentioned earlier, this is the way I started my investing career, and I recommend that most people do the same because you can gain significant education through “on the job” training and hopefully build up some serious equity or cash flow in the process.

The biggest drawback to owner-occupied investment properties is that you have to live on the property. This is a deal killer for many people who, for whatever reason, are not in a position to move or to qualify for financing. Perhaps they live in their dream home already or don't have the credit score to qualify for a mortgage. This is okay. This is only one chapter out of ten!

The rest of this book will deal with strategies outside the owner-occupied realm and dig into techniques you can use without needing to live in your investment property. Let's move on and look at some other ways you can get involved with real estate investing creatively and without a lot of cash. We'll begin with one of my favorites: *partnerships*.



Chapter Three

PARTNERSHIPS

I'm a huge fan of superhero movies.

You know the type: big Hollywood budget, star-studded cast, and over-the-top special effects, and judging by the recent success of these films, I'm not the only one who loves them. People connect with these films in a unique way, largely because of the connection we feel to the powerful yet emotionally damaged lead characters.

No matter how cool or super these heroes are, they all have one thing in common: partners. Whether that partner is another superhero, a government agent, or a wise butler, it's clear that even superheroes need a partner.

Why? Because everyone has weaknesses. Yes, even you. No matter how smart, talented, rich, good looking, strong, or wise you are, you still have needs that can be better met by someone else. Partners can compensate for those weaknesses in a powerful way. When investing in real estate, your greatest weakness may be your lack of cash, but you may excel in other areas like:

- knowledge
- creativity
- having a flexible schedule
- the ability to do your own labor
- having a great deal or the ability to find one

As a result, using partners to invest in real estate can be a powerful way to move forward without a lot of cash. This chapter covers the

concept of partnerships extensively and explains a few strategies for cultivating partnerships to creatively invest in real estate without a significant amount of money out of pocket.

I hope this chapter will open your eyes to the many possibilities that partners can bring to your real estate deals. Whether you have done zero deals or 100, I believe the information in this chapter will help you invest in more real estate, build more wealth, and have more fun doing it.

Although I will share several specific techniques and strategies for investing in real estate using partners, recognize that these are not the *only* ways to invest with partners—just a few strategies I’ve used. As I’ve mentioned, the purpose of this book is to get your mind thinking creatively, so let’s get creative with partners...

Let Me Introduce You to “Bob”

Bob is responsible. Bob pays his bills. Bob has a good job, good credit, and a nice smile—and he smells terrific. Bob is a banker’s best friend. Bob also has some extra cash lying around. There’s only one problem: Bob is not a real estate investor. But he is an excellent potential partner.

Bob doesn’t find deals, Bob doesn’t read the books, Bob doesn’t hang out on BiggerPockets.com, and Bob doesn’t even know the difference between a lease option and seller financing! (Don’t worry; we’ll get to both of those later in this book.)

You, on the other hand, find the deals, read the books, hang out on BiggerPockets.com, and can tell the difference between lease options and seller financing (or, at least, you will soon). Together, your skill and Bob’s money could form a superhero team that could take on Batman and Robin—or better yet, yield profitable results for both of you in Gotham City’s real estate market.

Why Bob?

Let’s face it, real estate investing is cool. If the world were a junior high school playground, investors would be the kids with the Air Jordans. Although the definition of what’s cool may change as we all get older, the basic concept remains the same. Everyone wants to be cool.

Even “Bob.”

Bob looks at you, the investor (or soon-to-be investor), and sees “cool.” He sees that you are out there, wheeling and dealing, making things

happen. You are going places. You are generating immediate cash flow (so that one day working for “the man” might become optional) and building some serious wealth in the process.

Bob wants to be cool, but for any number of reasons, he does not have the time or the inclination to do the research and to make the deals. Bob wants to invest his money in real estate, to see his money making money, but he simply cannot do the leg work. Or will not. By joining forces, you and Bob can become unstoppable.

How Do You Find Bob?

Bob is everywhere. Chances are, many of your family members and friends are potential investment partners. Many of the people you run into at the grocery store or the gym or the kids’ soccer game are “Bobs.” Your doctor might be a “Bob.”

Now before you run out and ask all your family members and friends for money, wait to hear what I have to say next. I don’t actually recommend ever directly asking your Bob for money—at least not at first. After all, when you go to the grocery store, you don’t see the cashiers begging for cash, yet your money still ends up in their registers.

Why is this?

Because you trust the store; you trust its brand. Additionally, the store has something you want. It is known for carrying the kinds of products that satisfy your needs, and as a result, you will willingly hand over your hard-earned money.

The same is true when you are raising money for real estate investment. From my experience, it helps to begin by shifting your perspective from being an individual investor to being a real estate investment company, and presenting yourself as such. Developing yourself as a recognizable brand is the number one way to attract money to your real estate deals. I’m not suggesting you build a national brand (like Coca-Cola or Starbucks) but rather a personal brand, and a solid reputation for success, within your community and network.

Building Your Brand

What is a brand? It’s more than just a company name; it’s what your prospective partner/investor thinks and feels when they think about you in

relation to their desire to make money in real estate.¹¹

In this case, your brand consists of two parts: yourself and your product. They are two sides of the same coin, and you need both to develop your real estate brand. For example, you might buy Oreo cookies because you trust and like the name Oreo and believe they have a good quality product, but also because you were in the mood for a sugary chocolate cookie. Obviously, both parts played a role in your choosing to purchase Oreos. The same applies with your real estate investing if you are looking for partners. You must develop a brand for yourself personally, as well as for the product you are offering.

Let's dive into this topic a little deeper and separate these two halves so we can look at each one individually.

1. Your Personal Brand

The first half of your "brand" involves *you*, the lead investor. What do people immediately think when they see you and talk with you? Do you project confidence and intelligence, and inspire trust?

I believe your personal brand is developed in three primary areas: reputation, knowledge, and experience. Let's talk about each of these, one at a time.

Reputation. Our reputation is a fragile extension of yourself that must be handled with care at all times, extending far beyond just your business life.

- Do you do what you say you'll do?
- Do people know you as honest?
- Do you go out of your way to help others?
- How do you treat your family and friends in public?
- What does your Facebook wall say about you?
- What do your clothes say about you?
- What does your choice of friends say about you?
- What does your appearance say about you?
- What does your car say about you?

Your reputation extends to every area of your life, and when you're building a creative real estate business, it matters. I'm not suggesting you dump your wardrobe and your Prius in exchange for an Armani suit and

¹¹ McLaughlin, Jerry. 2011. "What is a Brand, Anyway?" Forbes.com. <https://www.forbes.com/sites/jerrymclaughlin/2011/12/21/what-is-a-brand-anyway/#94510742a1b1>

a limo. However, recognize that with every move you make, people are watching. They are looking for someone to look up to, respect, invest with, and partner with. Start building your reputation right now as someone who is serious about success.

Knowledge. Your personal brand is developed through knowledge. I'm sure you know someone in your life who talks a big game but clearly doesn't know what they are talking about half the time. (Admit it, you are thinking about someone right now.) People can smell "that guy" coming from a mile away.

Never pretend to know more than you do—use your gaps in knowledge as motivation to grow. Don't be afraid to say, "I don't know the answer to that question, but let me get back to you on it." Knowledge can be gained in various ways, and with this book, you are using one of the best methods: reading. You can also attend real estate meetups, sit down with local real estate investors for coffee, listen to real estate podcasts, get involved in online forums, or work (or volunteer) under an experienced real estate investor.

Experience. Finally, your personal brand is strengthened through your experience. Perhaps the most difficult to build for new investors, your track record is your greatest ally in establishing your personal brand. What have you done that will help people trust you?

If you are experienced with real estate or business, this should speak for itself. However, if you are just getting started in this field, building your experience without ever doing a deal is not impossible. Experience can be gained through close proximity to other investors or can be conveyed by a large dose of education and a good reputation. In other words, if you lack experience, strengthening your knowledge and reputation can go a long way.

2. Your Product

The other side of the "branding coin" is your *product*. It has to be good, and it has to be worth selling. Nabisco did not become the monster company it is because Oreos tasted bad. No, Oreos are probably the best-tasting treat ever invented on planet Earth. (Feel free to disagree, but deep down, we both know I'm right!).

Your real estate deals need to be the same—incredible. If you are having difficulty raising funds from partners, you need to ask yourself, "Is this *really* a good deal?" You need to be sure it is able to explain it

convincingly to your investors. In case you didn't realize it, you are now in sales!

Although this is beyond the scope of this book, you really need to have a solid grasp on the math behind real estate investing. Do you truly know what makes a deal a deal, or are you just throwing out wild numbers and hoping for the best? If people are going to trust your brand, they have to trust the quality and profitability of the product you represent.

Additionally, and just as important, you need to present your deals in a manner that reflects their strengths. In other words, presentation matters! Do you just talk about how great you hope a deal will be, or are you prepared with a three-page detailed analysis packet, complete with repair estimates, color photos, and recent sales comps to justify your claims?

Building Your Brand Will Help You Succeed

If you build yourself into a trustworthy brand, the money will follow. When real estate investing becomes your passion, you will find that you can't help but talk to everyone about it. In turn, the people you talk to about it will talk to their friends about you. Brand loyalty can spread like wildfire if you proactively fan the flame.

Remember Bob? When you build your brand and develop both sides of the coin, you won't need to go searching for Bob. Bob will find you—and when he does, you'll be ready to help him feel cool.

How to Work with Bob: Four Strategies

Perhaps a neighbor overheard you talking about a recent deal, or your sister's boyfriend's aunt's doctor heard about your skills and wants to get involved. There are many ways I work with Bob to benefit us both, and the type of business relationship you have with your Bob will depend significantly on the case-by-case situation you are in. That said, here are four ways I've worked with Bob to build a mutually beneficial relationship:

1. **Full Equity Partnership.** The first strategy is an equity partnership in which Bob funds the deal using cash. In this scenario, Bob funds the purchase and the repairs needed, in exchange for a certain split. This works especially well for house flippers. Bob can fund the entire purchase and repair amount while you manage the rehab, and in the end, you split net revenues 50/50 after selling the house for more than the initial investment. Mike Simmons explains how he uses this

strategy to flip houses with no money of his own on Episode 50 of the BiggerPockets podcast.¹² Let's look at two examples:

Real estate investor **Cheryl** really wants to purchase, rehab, and sell a certain three-bedroom, two-bath townhouse, but she has none of the \$250,000 the sellers are asking for the property. She knows that with \$50,000 worth of work, she could sell the property for \$400,000, so she is eager to put the deal together. She decides to get creative. Cheryl meets with her local real estate mentor, John, and shows him the full deal. He's impressed by the due diligence she's put into it and the solid deal that she presents.

John agrees to become a full equity partner of Cheryl's by funding the entire purchase price and the repairs in exchange for 50 percent of the net profits when they resell the property. John pays for 100 percent of the expenses and holding costs while Cheryl diligently manages the rehab. After 90 days, the home is sold for \$400,000 and Cheryl and John split the \$100,000 profit 50/50. Cheryl clears \$35,000 after paying the closing costs and fees—with not a penny out of her pocket.

Duc Ong from Honolulu, Hawaii, wanted to expand his portfolio by purchasing properties on the mainland but thousands of miles of ocean can make that difficult. Luckily, he met his business partner, Tony, through BiggerPockets. Tony lives in the Pittsburgh, PA area where he is also a realtor. Tony heard about an off-market deal from a former colleague and after a couple of BRRRR (buy, rehab, rent, refinance, repeat) partnerships with Duc on single-family properties, this seemed like a huge opportunity for both of them. With Tony's growing track record of success, they were ready to make the jump to bigger and better properties.

The deal was a 10-unit building in Natrona Heights, right outside of Pittsburgh, that needed a little work. The property was listed at \$300,000 but since the seller had a solid working relationship with Tony, they were able to negotiate down to \$250,000. Furthermore, in order to lower their required down payment amount for their commercial loan, the seller agreed to finance \$50,000 of the purchase price at 11 percent APR. This brought their required commercial

¹² <http://www.biggerpockets.com/show50>

loan amount to \$200,000—making their 20 percent down payment amount only \$40,000.

As part of their agreed-upon terms for their 50/50 equity split, Duc would bring the \$40,000 to the table for their down payment using a personal line of credit that their partnership entity would later pay back. For Tony's part, he would manage the repairs to and operations of the property in person and receive 5 percent of monthly rents as his fee.

After renovations and fully renting all 10 units, the property now brings in \$6,000 of monthly rent. Their mortgage payment is \$1,100 and, after taxes and other expenses, they have around \$4,000 in monthly cash flow.

2. **Down Payment Equity Partnership.** Although many “Bobs” have hundreds of thousands of dollars in the bank, not all potential partners will. However, you can still use Bob to invest with none of your own cash, even if Bob can't come up with the whole purchase price and repairs.

In a Down Payment Equity Partnership, Bob funds the down payment needed, typically 20–30 percent. Bob gets the entire mortgage in his name alone (or you can get it in both names, if you prefer), but the legal title is in both names (although most lenders do allow this, yours may not, so always check with your banker). You divide the cash flow and/or equity in whatever split you agree upon. I like 50/50, but as in any partnership, it all comes down to what you negotiate.

Here are two examples of this type of arrangement:

Brian, a relatively new investor, located a triplex in his neighborhood listed at \$120,000. He knows the property will make an excellent rental but has no cash to purchase the property. Brian's bank told him he would need to have 25 percent for the down payment. Brian also knows he will need about \$10,000 to cover minor repairs and closing costs to make the deal come together.

Thinking creatively, Brian talks with his aunt, Samantha, who has been interested in investing in real estate for some time but has been too busy with her day job to jump in. Samantha agrees to pay the \$40,000 needed to purchase the triplex and gets the loan for the property in her name, but both Brian and Samantha put their names on the property's title. They obtain a mortgage for \$90,000, and all the monthly expenses (mortgage, utilities, management, vacancy, capital expen-

ditures, repairs, etc.) come to \$1,400 per month. The triplex is rented for \$2,400 per month, so each month, the two make around \$1,000 in positive cash flow, which they split 50/50. Brian will take care of managing the property and dealing with the day to day operations, while Samantha does relatively nothing because she fronted the money.

Someday, when they sell, they'll split the proceeds 50/50 as well and trade up to a larger deal together. Brian was able to generate \$500 per month using no money of his own—just his time, labor, and creativity.

Daniel Deitz of Reedsburg, Wisconsin owned 26 rental properties and was well on his way to building a strong portfolio. This was until he ran out of money to continue buying properties. However, when a fourplex hit the market that was located right next to one of his existing properties, he knew that he had to find a way to make it work.

Daniel was sure that if he could raise enough cash for the 20 percent down payment, the deal would close and the property would be his. This is when he began brainstorming. His goal was to identify anybody with \$52,000 who might be looking to make a stable return in a safer place than the stock market.

With these criteria in mind, Daniel was able to come up with a list of about 50 people. Out of the first four people he reached out to on his list, three of them were interested.

Daniel met with an interested investor and drew up terms for an equity split on the property between his LLC and the LLC of his “down payment partner.” In exchange for the cash needed for the down payment and some reserve funds, Daniel's partner would receive a 50 percent stake and Daniel, for his finding and management of the deal would retain a 50 percent stake. Both equity and all future earnings from the property would be split 50/50.

Daniel and his partner bought the property for \$260,000. His partner paid the \$52,000 down payment and Daniel managed the tenants in the property, which brought in \$2,600 a month in rents. Their monthly expenses are \$1,225 for the mortgage, \$525 in taxes, \$150 for insurance, and \$100 miscellaneous. This brings total monthly expenses to \$2,000, meaning the property nets \$600 in monthly cash flow. At the end of the year, all collected revenues are split 50/50 and, when they eventually sell it, the proceeds (after paying back the money his partner put into the deal) will also be evenly split.

3. **Private Lending Partnership.** In this strategy, you offer Bob a solid interest rate on his money for a fixed interest rate and fixed term. This is commonly referred to as a “private lender” arrangement, which we’ll cover in more depth in Chapter Six. Bob protects his interest with a lien on the property, and you are able to buy it and do what you wish with it. In this case, Bob may decide to fund 100 percent of the purchase price and repairs, or he might fund just part of it, while you use another source (hard money, a mortgage, a line of credit, etc.) to cover the rest. Again, this depends on your strategy. Let’s look at a strategy that utilizes a private lending partnership:

The house was halfway across the country, but that didn’t stop **Kevin** from moving forward on the four-bedroom home located 2,000 miles away. The only problem was this: Kevin had very little money to work with and he could not obtain a mortgage from the bank because he already had too many loans. The home was listed at just \$45,000 and was already rented for \$800 per month.

Kevin had been building a relationship with a local retired real estate investor, Donald, for several months, so he decided to propose a deal. Donald agreed to loan Kevin \$45,000 at an interest rate of 8 percent, spread out over 30 years. The payment to Donald of \$330, plus \$120 for taxes and insurance, brought Kevin’s total monthly payment to \$450. Setting aside \$150 per month for vacancies, repairs, management, and capital expenditures, Kevin cleared roughly \$200 per month in cash flow on this property with no money out of pocket.

Daniel Karbownik was a real estate agent who was eager to get started buying properties of his own. For over a year and a half, in addition to selling properties, he was managing construction rehabs for a developer while also scouring BiggerPockets, reading books, and telling everyone he knew that he wanted to invest in real estate. His only problem—he had very little money to get started.

One day, while chatting with an old childhood friend, the subject of his real estate investment goals came up. His friend mentioned that his dad had been interested in investing in real estate as well and that maybe Daniel should call him. Daniel scheduled a meeting, told his friend’s father all about what he had been doing to prepare, both as a real estate agent and in managing renovation projects. Through his ex-

perience, knowledge, and relationship, Daniel was able to build enough trust for his friend's dad to invest with him.

They went into business together and found a property on the MLS listed for \$199,000. Daniel was able to negotiate the purchase price down to \$149,500. His partner loaned Daniel \$167,500, which was transferred into an LLC for 30 years at 5 percent with a 15-year balloon payment. With this 112 percent loan, Daniel was able to purchase the property and then use the remaining funds for upgrades and improvements. He installed a new septic tank, painted the interior and exterior, bought new appliances, fixtures, backsplash, etc.

The property is now worth \$205,000 and rents for \$1,700 each month. His mortgage payment to his partner is \$1,500. This leaves Daniel around \$200 in cash flow each month. It might not seem like a lot, but each property he now adds to his portfolio gets him a bit closer to his goal of early financial independence. Each year his portfolio values increases, his loans are paid down a bit more, his cash flow increases, and his wealth grows.

4. **Credit Partnership.** In a credit partnership, Bob lends his ability to get a loan but doesn't supply any down payment. To accomplish this, you would use a hard money lender (see Chapter Five) or another private lender (see Chapter Six) to purchase a property, including repair costs. If the deal is good enough, this should be feasible; however, it is the most expensive option by far. After the home is rehabbed, rented, and producing good month-after-month cash flow, Bob refinances the home into a fixed-rate, long-term mortgage using his great credit, but both you and Bob remain on the legal title for the property.

Heather had never purchased a multifamily property before, but the duplex—listed at just \$85,000 because of a bad smell inside—was too good to pass up. She knew it would rent for \$1,000 per side after the \$15,000 worth of necessary repairs were completed. However, without the ability to get a mortgage because of her bad credit related to a recent divorce, she felt stuck. Luckily, she didn't let the roadblock stop her. Heather contacted a local hard money lender (again, we'll talk more about hard money in Chapter Five) about the deal and explained her plan. At the same time, she mentioned the deal to her brother, Maurice, who didn't have a lot of money either but had excellent credit.

The hard money lender agreed to fund the entire \$100,000 needed as long as the loan was for a maximum of one year. Heather brought just the closing costs (\$3,000) to the table, and she and her brother bought the property and quickly fixed it up. After the property was rented out, they waited a required six months (banks require a period between refinances, typically 6–12 months) and approached a local bank. The bank agreed to finance up to 75 percent of the appraised value of the property, which came in at \$140,000. This allowed Maurice, with his good credit, to obtain a loan for \$105,000, enough to cover the hard money loan fees and closing costs.

Heather was able to put this deal together for little money out of her own pocket (and none out of Maurice's) while gaining significant equity and great monthly cash flow, all because she didn't say, "I can't."

Greg Fazio from Basking Ridge, NJ credits BiggerPockets with helping him quit the rat race, get his real estate license, and join a team of realtors.

Greg hit a roadblock early on in his real estate journey, however—he was unable to qualify for a loan. Luckily through his new profession as an agent, Greg was able to develop a great network of colleagues and connections. One particularly helpful connection he made was with the man who would become his mentor. After developing a strong working relationship through apprenticeship, they decided to go into business together.

Greg's mentor was looking to increase his overall ROI with a low money down deal and Greg needed his mentor for his guidance, income, and credit score to get the loan approved. Together they qualified for a 5 percent down 30-year conventional mortgage. They purchased a single-family property for \$315,000. Each partner paid 2.5 percent or \$7,875 upfront for the down payment. Their monthly mortgage payment is \$2,288 and their MIP is \$120 making total expenses just over \$2,400. The monthly rent is \$2,500 which provides a little cash flow. Although it might not be much, this partnership allowed Greg to purchase his first house and begin building equity and experience with low money down investing.

Greg and his mentor are now looking for further ways to expand their partnership and have even found investors for future projects who are willing to put 20 percent down in exchange for Greg and his partner managing the purchase and property. For Greg, a partnership was exactly what he needed in order to get started playing the game.

I have personally used all four of these Bob strategies to invest in real estate, and all four have worked out well. Yes, I am giving up part of my profit and cash flow to someone else. However, I believe 50 percent of a great deal is better than 100 percent of no deal.

Without Bob, I often find myself up a creek without a paddle. Bob gives me the security I need to sleep at night, keep moving forward, and do what I do best—put deals together. These partnerships also help teach other people how to “be cool” and gain a huge foothold in getting ahead financially. It’s truly a win-win.

That said, before you invest in real estate using these partnership models, you absolutely must speak with an attorney who specializes in this kind of thing, as well as a CPA who does the same. I’m not just saying this to protect myself as the author of this book—there are ways of structuring a partnership that can have *huge* implications on both your tax bill and your liability. Even something as simple as having your partner put in money at the wrong stage of the process can cost *you* thousands of dollars at tax time. So please, go speak with a knowledgeable CPA and a lawyer. Doing so will cost a couple hundred bucks, but I promise it will be well worth it.

Dangers and Pitfalls of Using Partners

If you just finished reading about Bob and thought “Perfect! This is so easy!” I’ve got some bad news for you: explaining the process in theory is always easier than the reality. In this book, Bob is hypothetical. In real life, Bob is a real person, with his (or her) own goals, dreams, fears, agendas, timeframes, creativity, and personality. As with any venture, once you insert the “human element” into the picture, things can drastically change (for better or worse). Let’s talk about some of the pitfalls of working with a partner when creatively investing in real estate.

1. **Personality Conflicts.** Partnerships can be difficult because of the possibility of vast differences in personalities. When you are relying on another person to get things done and you don’t mesh perfectly, conflict can easily arise. For example, what if Bob ended up being controlling, irritating, and domineering? If you are investing in buy-and-hold real estate with Bob, you may need to spend the next 30 years tied to him and his personality problems. This is why picking the right partner is so important.

2. **Differences of Opinion.** Everyone has an opinion on how things should be done. If you are in a partnership, you are forced to compromise on many aspects of your business deals. From paint color to investment type to deciding when to sell, differing opinions can cause friction. It's helpful to think about ways you plan to resolve disagreements in your partnership at the outset.
3. **Suspicion/Trust.** As in any close relationship, suspicion and trust issues can easily arise—especially when things aren't going well. Trust can be hard to gain and quick to lose. Fraud also plays a role in the demise of many businesses and partnerships. This is why keeping impeccable records is so important to any partnership. You may also want to plan on using a third-party bookkeeper to limit any suspicion of wrongdoing.
4. **Delayed Decision Making.** When you are acting alone, you have the ability to quickly make decisions based on your own needs and desires. In a partnership, you are often forced to discuss every decision—no matter how trivial—with your partner, which can add a lot of time to your dealings. This is why I generally prefer Bob to be a “silent partner” and to have a clear understanding with him (or her) from the beginning that I am the primary decision maker.

Of course, I want to discuss critical business issues with Bob, but I don't want Bob demanding that I talk with him before picking a tenant, a paint color, or the rental price. This conversation needs to happen very early in the partnership, before any money is spent, and must be written down and signed by both parties. I know my strengths, and I've been in the business long enough to generally know what I'm doing. That's not to say I don't value input, but I simply need the freedom to act quickly and decisively on non-major issues. If your partner cannot accept this, you may need to find a different partner.

5. **Smaller Profits.** When you form a partnership, your profits, by nature of the agreement, are split. In other words, you will make a lot less money per deal than if you were working alone. In most of the scenarios mentioned above, the deal would not have been possible for the investor acting alone.

The same is true for Bob. People may ask Bob why he would give me (or you) 50 percent of a deal when he could do it all himself, given that he is funding the total purchase. The simple truth is that Bob would not buy the property himself. Bob would continue going the way

Bob has been going and would do nothing different—and Bob knows it. So for him, 50 percent of a deal I (or you) put together is better than 100 percent of sitting on the sidelines and buying nothing. Besides, Bob doesn't have to do much work for his part, and he gets front-row training from an experienced investor.

6. **Mixing Business/Friendship.** When people get into business with friends or family, it's a very real possibility that the business partnership (due to potential pitfalls mentioned above) can jeopardize a good relationship. Partnerships don't always work out, and when they don't, the relationship is often destroyed. A partnership is very much like a marriage: don't go into it blindly assuming nothing can go wrong! Again, this is why setting your business up right from the start is key.

As I mentioned earlier, don't be afraid to sit down with a lawyer for an hour or two to review your partnership agreement. Your partnership agreement is there to protect you from the things you don't think will happen, because something always will. When you have a plan for how to deal with problems, the risk of the relationship ending badly diminishes greatly because both parties have already agreed on what to do.

For example, what if five years down the road, you and Bob jointly own a triplex, and you have a "hell month" when you have to evict one tenant, completely remodel her cockroach-infested unit, and remodel a second unit at the same time? This is exactly what happened to me recently. We had \$10,000 saved up in an account for problems in business, and *poof!* just like that, a "hell month" drained our account. An eviction, a paint job, and a trashed unit cleaned us out. However, because we had agreed ahead of time, in writing, that we would split all such future losses (and that I would manage the situation), I simply talked with my partner, and we each wrote a check for half of the overages. No one was upset; no one was confused.

If you don't prepare for issues like this, you might end up with some very awkward conversations, angry friends, and a sour business relationship.

7. **Unrealistic Expectations.** When you rely on someone else, setting expectations as to how something should be done is easy. However, when your partner doesn't live up to your expectations, it's easy to grow bitter and to blame him or her. One thing I do to curtail this is

to *consistently underpromise and overdeliver*. In fact, I generally don't promise anything at all. All I can do is show them what I've done in the past and give my best guess for what the future will look like. In reality, that's all real estate investing is: an educated guess. I will show them how I determined the potential cash flow or equity for a property, planning for the worst-case scenario, and make sure they understand I'm not promising that the deal will work out a certain way.

The only time this does not apply is in a pure lending partnership, when I am simply borrowing money at a fixed interest rate for a fixed term. In that case, I do promise to pay a certain rate for a certain time through a promissory note.

8. **Legal Responsibility for a Partner.** While the legal ramifications depend largely on the entity structure you establish and the choices you make at the beginning, you and your partner are still in business together, which means you are responsible for that person, at least as far as the business is concerned. If he or she skips town, you are still responsible for the whole business, and its obligations. Once again, this is another reason you must make sure your real estate attorney helps you draft any partnership agreements to help protect your interests and your financial future.
9. **More Complicated Taxes.** When you alone are running your business, the taxes and accounting requirements are much simpler than when you're working with partners. The more members you bring on as owners, however, the more complicated the bookwork becomes—and the more time consuming (and costly) tax season is. Consider this part of the “cost of doing business” and prepare for it. While you may have been accustomed to having your taxes done for \$100 before, you should expect to spend \$2,000 or more for this service once you start adding properties and partnerships.

WRAPPING IT UP

Is a Partnership Right for You?

Partners are not for everyone, and not everyone will make a good partner. However, when you can use partners to move your business forward and close more deals, they are invaluable. Real estate investing is a relationship business, and without others, success will be hard to come by.

As I've demonstrated thus far, there are multiple ways to buy property

using a partner with no or little money down. However, each technique involves its own trials and tribulations. Only you can decide for yourself the best way to put together each deal. No two deals are identical, so no two financing structures will likely be the same either. Creative finance is a puzzle, and the right partner can be just the piece you need.

Finally, keep in mind that a great partnership cannot make a bad deal into a great one; you still need to find great deals and do your homework. Doing so will ensure a long-lasting and profitable relationship between you and Bob.

As we move on with more strategies for investing in real estate with no or little money down, I want you to always keep the partnership strategy in the back of your mind. Partners can play a role in any of the strategies outlined in this book, and a creative real estate investor's job is to find ways of putting together deals by mixing and matching strategies. The point of creative finance is to open your mind to new possibilities, and partners can open a whole new world of investing possibilities when combined with other methods. Let's move on to one of those strategies now: tapping into *home equity*.



Chapter Four

HOME EQUITY LOANS/ LINES OF CREDIT

If you already own your own home, and you owe significantly less than its current market value, you may have an incredibly cheap source of financing right at your fingertips. However, even if you don't own your own home yet, I encourage you to read this chapter in full because it will equip you with the tools you'll need to invest with others in the future.

Let's start at the beginning. What is "equity"?

Equity is the difference between what you owe on your property and what it could sell for. For example, if you owe \$50,000 on your home and it is worth \$150,000, you have approximately \$100,000 in equity.

A home equity loan is a loan you can take out from a lender that is secured by the equity in your home. In other words, if you don't pay the loan back, the lender can take your personal home and resell it to pay the debt. A home equity loan is also known as a "second mortgage" because it is generally subservient to your primary mortgage. This means that in the case of a foreclosure, the primary mortgage would get paid off first, followed by the second. Before we get too deep into how to use a home equity loan, let's talk about the difference between the two types of equity products:

1. **Home Equity Loan.** A home equity loan is a mortgage product wherein all funds are disbursed at the beginning of the loan, with a definitive term length and equal monthly payments. For example, you may take

out a \$50,000 home equity loan at 3.75 percent payable for 15 years. The payment would be roughly \$363 per month for the entire 15 years, or until you paid the loan off. You might think of a home equity loan as similar to a car loan or a normal home mortgage. These loans can have either a fixed (unchanging) interest rate or one that is variable (subject to change with the economy).

2. **Home Equity Line of Credit.** A home equity line of credit, or HELOC, is similar to a home equity loan, but the amount of money you borrow (determined by the amount of equity you have in your home) is not necessarily dispersed at the start of the loan. Instead, it is available for you to borrow and pay back with flexibility. If this is a bit confusing for you, think of it like a credit card. You can borrow money up to a certain amount and pay it back at will, though you are required to make at least a minimum payment each month based on the amount you have used. The minimum payment is often simply the interest that accrued during that month, but some lines of credit require a higher payment than just the interest. For example, you may have a \$50,000 limit on your home equity line of credit, but you only use \$20,000 of it. If your interest rate on the line of credit is 10 percent, your monthly interest payment would be \$166.67 ($\$20,000 \times 10\% / 12$). If you paid only the interest each month, your loan balance would never go down, because you would never be paying back the principal. A HELOC typically has a variable interest rate, though fixed rate versions are available.

Where Do I Get a Home Equity Loan?

Most banks and credit unions offer a loan or line of credit that can tap into your equity in your home, though these offerings may go by different names. Simply call up your local bank or credit union and ask to speak to someone in the lending department; ask if they do second mortgages and what kinds they currently provide.

As of this writing, typical rates on a home equity loan hover around 4.8 percent, and adjustable rates on a line of credit hover around 4 percent. As you can see, a loan typically has a slightly higher rate, because you are paying for the security of never having your loan payment increase (as long as you get a fixed rate loan). Also keep in mind that not all home equity loans are “fixed,” so be sure to clarify the terms of any loan you are considering with your lender.

Equity: How Do I Find Out How Much I Have?

As the name would imply, a home equity loan or line of credit will require you to have equity to qualify. Therefore, let's take a few minutes to explore what equity is and why it matters. As mentioned earlier, equity is the difference between what you currently owe on your home and the fair market value of that home. For example, if you owe \$50,000 on a home whose current value is \$80,000, you have approximately \$30,000 in equity (not including the costs required to sell the property if you wanted to).

In math terms, the equation would look like this:

$$\text{Fair Market Value} - \text{Your Total Mortgage Balance(s)} = \text{Your Equity}$$

When determining your ability to obtain a home equity line of credit, the most important number to clearly understand is known as "loan to value," or LTV. The LTV is a percentage that shows the ratio between what you owe and what the property is worth. The higher the percentage, the less equity you have. LTV is determined using the following formula:

$$\text{LTV} = \text{Loan Amount} / \text{Fair Market Value}$$

So, revisiting the example I just used, if you owed \$50,000 on a home worth \$80,000, the calculations would look like:

$$\text{LTV} = \$50,000 / \$80,000 = 62.5\%$$

So, what is a good LTV and what is a bad LTV? In the crazy lending world of the mid-2000s, lenders were offering home equity loans and lines based on 125 percent of the value of a person's home, a 125 percent LTV. In other words, back then, if your home was worth \$100,000, you could borrow as much as \$125,000 in a home equity loan or line of credit. Lenders did this because they believed, foolishly, that prices would continue to rise and values would eventually increase enough to cover the loan.

I'm sure you can see the problem with this. In late 2007, the market began to change fast. Home prices began to drop, and millions of borrowers who had borrowed far more than their houses were worth

were suddenly underwater.¹³ Even those who didn't borrow too much but obtained low or no down payment loans on their houses found themselves underwater. Consider also that many of these loans were adjustable rate mortgages and were offered to people who were not very good at handling their finances; you can see why America nearly melted down.

Today, lenders have learned from the mistakes of the past, and the days of getting 125 percent LTV loans and lines of credit are gone. More typically, the highest you'll probably see is around 90 percent LTV, but even that may be difficult to find. In other words, if your home is currently worth \$100,000, the bank will likely cap the total amount you can borrow across all loans at \$90,000. So, if you have a first mortgage with a balance of \$70,000, and the lender will allow you to borrow 90 percent (or \$90,000 total), you could potentially obtain a loan or line of credit for a maximum of \$20,000.

Keep in mind that, as with nearly all loans, you will need to meet certain credit and income minimums to obtain financing, and rates and terms will differ based on your LTV, amount of debt, credit score, income, and other factors. You may have a ton of equity in your property, but if you are rocking a 520 credit score, obtaining a home equity loan or line of credit will be nearly impossible.

Be sure to shop around with various banks when considering a home equity line of credit. In my small town, rates can vary by as much as 10 percent between banks. I feel sorry for all those people who are paying 13.5 percent at X Bank while I'm paying just 3.5 percent at Y Bank. Don't be like them. Get out there, make some phone calls, and shop around to get the best rate possible on your home equity loan or line of credit.

How to Use a Home Equity Loan or Line of Credit to Creatively Invest in Real Estate

I want to share some strategies for using your home's equity to invest in real estate creatively without needing to come up with much cash out of pocket. As with all the lessons in this book, this may or may not work for you, but understanding the concepts is key in becoming a proficient creative real estate investor.

The following are two of the most common techniques you could use if you have equity in your home. Rather than trying to explain what they

¹³ *Underwater*: When the balance owed on a home mortgage is more than the home is worth, making it almost impossible to sell to a typical buyer without coming up with the difference out of pocket.

are, I'll tell you two stories of investors who used their home equity to invest in real estate.

THE SUBSTITUTION: **Shawn** and **Lynne** were looking to buy a cash flow-friendly duplex that came on the market for \$70,000. They also owned their primary residence free and clear, which means they owed nothing on their home (so their LTV was 0 percent).

Although they could have gone to a bank and taken out a mortgage on the investment property, they would have had to come up with approximately \$21,000 out of pocket as a down payment (since their bank would lend them only 75 percent of the value (\$49,000), the remaining would need to be provided as a down payment).

Instead, because they owed nothing on their home, they talked to the bank and obtained a home equity loan tied to the value of their primary residence (not based on the new rental purchase) for \$80,000, enough to pay for the cost of the entire purchase of the duplex and to cover the repairs the property needed!

They ended up with a fixed rate loan at 5.25 percent amortized over 15 years for a monthly payment of \$643. They are currently paying down the loan quickly, using the cash flow from the property, and plan to have the duplex paid off in less than seven years with absolutely no money out of pocket.

Kelly Skeval of Ithaca, New York owned and lived in a single-family home that had been turned into a duplex. Having acquired the piece of land directly next door, Kelly wanted to build a new, larger duplex directly adjacent to her current home. The total project would cost \$235,000 and in order to accomplish this, Kelly would need to get very creative with her financing.

To fund the construction of her new duplex, Kelly initially sought out several residential building lenders. Unfortunately, for one reason or another, none were willing to lend to her to build on the land. Undeterred by this setback, she finally met a commercial construction lender who was willing to loan \$188,000 for 20 percent down.

Kelly's cash on hand could only cover part of the \$58,750 needed for the down payment. She knew that she had built up a sizeable amount of equity in her primary home so Kelly took out a \$25,000 Home Equity loan to complete the 20 percent down payment amount

needed for her commercial building loan.

Her home equity loan was fixed for five years at only 2.9 percent interest. With this relatively smaller loan borrowed against the equity in her own house, Kelly was able to leverage and fund a much larger deal that otherwise would not have been possible.

In the story of Shawn and Lynne, they used the equity in their home to purchase a property “free and clear,” meaning the investment property was paid for without a loan on that property (because the home equity loan was on their primary residence, not the rental property).

Another neat strategy Shawn and Lynne could add to this would be to go to the bank after all the repairs have been completed and after the proper “seasoning” (the time a bank requires between refinances, typically 6–12 months) has passed and refinance the loan, putting the lien on the rental property and freeing up their personal residence’s home equity. For example, they purchased the home originally for \$70,000 and used an \$80,000 home equity loan (tied to their primary residence) to buy it. If they could get an appraisal to show a new value of \$110,000, they could get their bank to refinance the property for 75 percent LTV and get a standalone mortgage on the rental property for \$82,500. This would allow them to pay back their home equity loan—the one for \$80,000 on their primary residence—and free up that equity to “rinse and repeat” the process, repeating the same strategy over and over as long as they could qualify for new loans, never using their own money. Obviously, this strategy is contingent on getting incredible deals for which you can “force” the appreciation higher through a rehab. If this is a strategy you plan to use, I would recommend using a home equity line of credit, rather than a home equity loan, so you will be able to keep using the same line of credit over and over without having to get a new home equity loan each time.

Let’s move on and talk about another strategy for using your home equity, because, frankly, most people looking to invest in real estate don’t have as much equity in their homes as Shawn and Lynne did in the story I just told. In that case, is investing with a home equity loan or line still possible? Definitely. Let’s look at another example of how an investor could use creativity and a *small* bit of home equity to invest without any cash of their own.

THE DOWN PAYMENT ASSISTANCE: Jessica was an experienced investor who owned a few properties but had most of her cash tied up in other ventures. However, when she received a lead for a killer deal, she knew she couldn't pass it up. Jessica would be able to buy a single-family home worth around \$90,000 for just under \$60,000. Unlike Shawn and Lynne and their free-and-clear home, Jessica already had a loan on her primary residence. She owned a home valued at \$190,000 and held a mortgage for \$125,000. Her local bank would lend up to 80 percent of the value of her home on a second mortgage, a home equity line of credit, meaning she could obtain a total of \$152,000 in loans on her property. Because she owed \$125,000, she was able to get a home equity loan for \$27,000—definitely not enough to buy the rental property she wants, but enough to be creative with.

Jessica spoke with a different bank, and they offered her an investment property loan that required a down payment of 30 percent of the purchase price. This meant Jessica needed \$18,000 down to buy the house. She didn't have that money in her bank account, but she did have it in equity in her home. So Jessica tapped into her home equity using the home equity line of credit she had taken out. Although she had approximately \$27,000 in the line of credit, she used \$18,000 of it to fund the down payment on the new investment property at 4 percent variable interest. Her new investment property loan was for \$42,000 on a 5.25 percent APR, 30-year fixed mortgage (for a monthly payment of \$231), while her line of credit required a monthly interest-only payment of \$60, for a combined total monthly payment of about \$291. The home now rents for \$1,000 a month, providing significant cash flow so Jessica can pay off the line of credit first (because it's variable), then pay off the loan on the investment property.

Jim Morgan from Wichita Kansas was looking to purchase a fully-rented triplex listed for \$150,000. Not wanting to spend any money directly out of pocket, he decided to get creative for his down payment.

First, he was able to negotiate with the seller to reduce the purchase price by \$10,000. This then allowed Tom to pull the \$21,000 needed for the down payment out of the equity from his own personal residence. Instead of allowing the equity tied up in his home to sit passively, Tom was able to leverage that money to purchase a new investment property.

After all expenses, this property now pays Tom \$700 per month in

cash flow in addition to paying down the mortgage and building up his equity. Tom is able to recoup the amount he pulled from his HELOC for the down payment which means he will be free to replicate this process again and again—steadily building his portfolio and growing his wealth.

In this example, Jessica did not have enough equity to fund the whole deal, but she did have some. This allowed her to use several mortgage products to purchase the investment property.

If you ask most creative real estate investors, you'll find that one loan is seldom enough to get a deal done. Often, a creative combination of two or more loans will achieve your objective, just as in Jessica's story. Yes, it is more complicated than the typical 20 percent down payment conventional loan that most people think of, but the end result can put you years ahead in the real estate investing game.

Let's move on and talk about a question many people have regarding home equity loans...

Can I Get a Loan or Line of Credit on the Equity in an Investment Property?

The question is often asked: "Can I get a home equity loan or line of credit based on the equity in one of my rental properties?" After all, if you own a rental property worth \$200,000 but only owe \$100,000 on it, shouldn't tapping into this equity be easy?

These kinds of loans were common in the past, but today they are not as easy to find (due to the continuously-changing world of banking regulations and requirements) though some portfolio lenders and hard money lenders may still allow you to obtain a second mortgage on a rental property. Just don't expect to walk into any bank and get one. It may take a lot of phone calls to secure this kind of financing, and it may turn out to be a dead end.

Instead, many investors prefer a different strategy, wherein they use the combined equity from multiple properties they own to obtain a business line of credit they can use for further investing, or for other business needs that may arise.

For example, let's say you own five rental properties, and each has a significant amount of equity:

	AMOUNT OWED	PROPERTY VALUE	TOTAL EQUITY
Property 1	\$67,000	\$89,000	\$22,000
Property 2	\$42,000	\$97,000	\$55,000
Property 3	\$98,000	\$155,000	\$57,000
Property 4	\$14,000	\$80,000	\$66,000
Property 5	\$105,000	\$200,000	\$95,000
Totals:	\$326,000	\$621,000	\$295,000

In this scenario, you would have a good chance of approaching a commercial bank or portfolio lender with a solid business plan and could potentially tap into the majority of this equity through a commercial or business equity loan or line of credit. To learn more about these kinds of loans, definitely call around and talk to various lenders, because each lender will have different requirements and programs that may or may not fit your business model.

Additionally, the rules for commercial and portfolio lending are very different, and much less strict, than for the residential world. Even if you don't plan on taking a loan out right away, it doesn't hurt to start the conversation with a lender today and begin building that relationship in preparation for your future needs.

Risks and Drawbacks to Using Home Equity

Life isn't all peaches and cream when you are dealing with home equity loans and lines. They sound great, but you need to understand the risks inherent in such loan products. If the funds are misused, tapping into your home equity can be disastrous to both your real estate investing business *and* your personal finances. Because a home equity loan is based on the equity in your primary residence, the lender can place a lien on *your home*. If you don't pay the money back, the lender will then foreclose on your home and kick you out on the street, severely damaging your credit in the process.

The obvious solution is to simply pay your bills. If you do, you don't need to worry, right? It's not quite that simple, actually. You need to be

aware of a few more dangers and pitfalls. Don't let this information scare you, but you need to know about these risks so you can prevent yourself from making the same mistakes other investors have made.

1. **Overleveraging.** As you learned earlier, during the mid-2000s, banks were allowing homeowners to risk far too much equity in their home, a condition known as "overleveraging." Although banks are no longer providing 125 percent loans, many will still allow you to take out up to 90 percent of your home's value.

Is 90 percent too much?

That is a matter of personal opinion and comfort level, but understand that values go up and values go down. As of the writing of this book, values are increasing around the country at a rapid pace. As a result, we may see a decline in values in the future (what goes up must come down!), though there is no certainty as to what the future holds.

If you obtain a 90 percent LTV loan on your primary residence and property prices drop 20 percent, you'll quickly find yourself underwater and will be unable to sell your home without coming to the closing table with a significant amount of cash or doing a short sale.¹⁴

Leverage can be a great thing, but over-leveraging can be dangerous because it limits your options. If you don't plan on selling, and you have a fixed rate mortgage, being underwater may not be a big deal to you, because your payment won't change. However, overleveraging does remove options, and having options is key to success in real estate. The more options you have, the more opportunities you'll have for success.

2. **Less Cash Flow.** Additionally, by using your home's equity to fund a down payment or the entire purchase price of a property, you are decreasing the amount of cash flow you would normally receive. For example, when we talked about Jessica and her use of \$18,000 of her home equity line of credit to fund her real estate down payment, note that her monthly interest-only payment on that \$18,000 was \$60 ($\$18,000 \times 4\% / 12$ months). Although this is not a huge number, it is \$60 less per month that Jessica gets to keep.

Therefore, if you plan on using your home equity to fund your real estate purchase (or even just the down payment), getting a killer deal on the property is even more imperative in order to make up the difference.

¹⁴ *Short Sale:* A sale of real estate in which the lender agrees to accept less than what they are owed to allow the homeowner to sell. A short sale typically hurts the homeowner's credit.

3. **Adjustable Rates.** A third danger of home equity loans and lines is something I've touched on a few times already: the potential for an adjustable rate. Each lender will have different terms, rates, fees, and requirements for their loan products, but if you end up with a lender who offers only an adjustable rate loan, it's extremely important that you fully understand what you are getting into and the potential for what could happen. I call this Worst-Case Scenario Analysis, and it's helpful to use when considering an adjustable rate loan. Essentially, I like to look at what the worst-case payment would be for that loan, and if it would still make the deal work, I'll consider doing it.

Let's look again at the example of Jessica, who used an \$18,000 home equity line of credit to fund her down payment. Because the loan's interest rate was not fixed, her interest-only payment could change. If you were to look into the fine print of her line of credit (which Jessica did), you would discover that the line of credit was capped at increasing by no more than 2 percent per year, for a maximum interest rate of 24 percent. So, let's do a Worst-Case Scenario Analysis on this deal and see how it pencils out:

- Current loan amount: \$18,000
- Current interest: 4 percent
- Current minimum payment: \$60
- Worst-Case Scenario loan amount: still \$18,000
- Worst-Case Scenario interest: 24 percent
- Worst-Case Scenario minimum payment: \$360 per month

Wow! You can clearly see the danger of an adjustable rate loan or line of credit in this example. Jessica's initial payment was just \$60, but if interest rates were to go crazy, she could end up paying closer to \$360 per month for that money!

So the question is: Is it worth it?

For Jessica, the answer was yes. She knew that the loan could only increase by 2 percent per year, so it would take a decade to reach its max, and as I mentioned earlier, Jessica planned on snowballing that debt and paying it off in just a few years. Additionally, Jessica bought a deal with an incredible amount of monthly cash flow, so she knew that even if the worst-case scenario happened, she would still be able to make the payment using nothing but the cash flow.

The key to using the Worst-Case Scenario Analysis is fully understanding the worst case scenario. Dig into the fine print from your potential lender and find out how bad things really could be. On a recent variable rate mortgage I received, I learned that the interest rate was capped at 11 percent, meaning it could never climb higher than 11 percent, no matter how high the market rates might rise. When I looked at the numbers and ran it through a Worst-Case Scenario Analysis, I discovered that at worst, my payment would increase from \$600 per month to \$800. However, because I'd be receiving almost \$2,000 a month in rental revenue, I could handle the worst-case scenario and receive slightly less cash flow if everything went sour.

WRAPPING IT UP

Home Equity Loans and Lines of Credit

A primary home's equity can be a powerful tool for a real estate investor, but it isn't without some potential dangers. The key to successfully using a home equity loan or line of credit is in comprehending exactly how it works, knowing the details of your particular loan/line product, and clearly understanding the risks of the particular loan product.

If you want to check out the latest home equity loans and lines, be sure to visit the *BiggerPockets Mortgage Center*,¹⁵ which contains up-to-date rates for lenders across the country.

Home equity loans and lines can be great, but they depend on you (or a partner) having equity *and* the ability to get the loan. However, a traditional bank is not the only choice for obtaining a loan. In the next chapter, we'll look at a nontraditional method of financing that many real estate investors use and/or fear: *hard money*.

¹⁵ <http://www.biggerpockets.com/mortgage>



Chapter Five

STRATEGIES FOR USING HARD MONEY

Imagine a world where you have all the funds you need, an unblemished credit record, and banks are pounding at your door to give you large sums of money for low interest.

That would be nice, wouldn't it?

The real world, however, is a much darker place. In reality, trying to get financing from a bank is often like trying to shave Chuck Norris's beard while he sleeps. It's just not going to happen (because he doesn't sleep). As they say, *necessity is the mother of invention*, and hard money (an alternative to bank loans) is the invention birthed by the need for quick, uncomplicated financing. Although it is most popular among house flippers, hard money can also play an interesting role for any creative real estate investor willing to take the risk.

This chapter will explain what hard money is and how you can use hard money lending in your real estate investment business to do more deals and propel your business forward.

What Is Hard Money?

Hard money is financing obtained from private individuals or businesses for the purpose of real estate investment. While terms and styles change often, hard money has several defining characteristics:

- Based primarily on the strength of the deal
- Short term (typically 6–36 months)
- High interest (typically 8–15 percent)
- Involves a high number of loan points¹⁶
- Often does not require income verification
- Often does not require credit references
- Much faster than traditional loans
- Property condition is not important

If hard money is a new concept to you, you are probably reading the interest rates in that list, thinking there must be some kind of typo. After all, compared to typical bank financing, hard money is *ridiculously* expensive! So why would anyone use it?

As I mentioned early on—the reasons are necessity and simplicity. Hard money may be an expensive way to do business, but if those costs are factored into the final equation, it just might work for some people, especially given the simplicity with which an investor can obtain a hard money loan.

How Do I Find a Hard Money Lender (HML)?

Hard money lenders generally exist in every market, but tracking them down can be a little tough. To help, BiggerPockets has created the Web’s largest directory of hard money lenders, with leads to lenders in all 50 states. To find this information, check out the *BiggerPockets Hard Money Lenders Directory*.¹⁷ You can also find hard money lenders by searching the Internet. For example, a search of “Seattle Hard Money Lender” turns up numerous good results.

Another good source for finding hard money lenders is by speaking with other investors, agents, and mortgage brokers in your local market. Networking is a huge part of being a real estate investor, so don’t be afraid to get out there and start building relationships and asking around for hard money referrals. You’ll likely find that most real estate investors are eager to share their lenders with you, since this makes them look good in their lenders’ eyes as well.

¹⁶ *Loan Points*: Fees added by a lender to the cost of a loan that equal 1 percent of the loan amount per point. For example, if a lender required 2 points on a \$80,000 loan, the fee would be \$1,600 (\$80,000 × .02).

¹⁷ www.BiggerPockets.com/hardmoneylenders

How Does Hard Money Work?

Often, house flippers will use hard money to buy a property, fix it up, and resell it. When this approach works, it works well. The lender may charge 4 points (4 percent of the loan) and a 12 percent interest rate, but if that is figured into the total cost of the project, this number is just part of the price of doing business.

A major advantage of hard money is that a borrower can obtain financing in just a few days with minimal paperwork, no credit checks, and a lack of other formalities usually found in conventional lending. In other words, hard money can be very easy money if your deal is strong.

Let me walk you through a typical scenario of how hard money works in the house flipping world:

Jane gets a really great deal on a three-bedroom home in rough condition, with her offer accepted at just \$45,000. Her contractor gives her a bid of \$35,000 to fully remodel the home, and Jane believes she can resell the house for around \$130,000. However, Jane doesn't have the \$80,000 needed to buy and renovate the home, and no bank will lend her the money on a home in such bad condition. Jane decides to pursue the deal using hard money.

Jane finds a local hard money lender who charges 4 points and 12 percent interest on a loan, for a maximum of one year. The hard money lender agrees to fund the full \$80,000 for Jane, and the 4 points are added to the loan (remember, 1 point is equal to 1 percent of the loan; thus, $\$80,000 \times .04 = \$3,200$), for a total loan amount of \$83,200 and interest-only payments of \$832 per month. Jane's contractor goes to work fixing up the property, and within six months, the home is sold for \$130,000. Jane pays off the hard money loan and the closing costs, and she's left with roughly \$30,000 in pretax profit on the flip.

Sam K from San Ramon, California found a recently renovated turnkey house from a seller asking only \$65,000. However, the seller was only considering all-cash offers, and Sam only had \$15,000 in cash. He had a very limited amount of time to make his move and finance his \$50,000 budget gap.

Sam began looking for any means of borrowing \$50,000. After much searching, he finally found an institution willing to extend him a personal loan to cover the amount he needed. Combined with his

cash position, Sam was able to close on the house and pay the loan back over 10 years. The rent provided from the house covers all of his expenses and creates additional cash flow.

It's a small start, but now Sam is in the game. After one year of owning that first property, Sam was able to refinance and withdraw his initial \$15,000 in order to buy a second property that generates more cash flow than the first. Sam is currently working on acquiring his fifth unit using the same \$15,000 he invested in the first property.

Hard Money lending isn't always ideal due to how expensive it can be, but sometimes it is precisely what is needed to close the gap and get the ball rolling.

(Keep in mind, this is not an in-depth discussion of the math regarding house flipping. For a much more thorough discussion on house flipping, check out *The Book on Flipping Houses: How to Buy, Rehab, and Resell Residential Properties*¹⁸ by J Scott, published by BiggerPockets Publishing.)

The example of Jane above represents an ideal scenario when using a hard money lender for a flip, and many investors have similar stories. However, obtaining 100 percent financing, as Jane did in our example, can be very difficult for a new investor, though if the deal is strong enough, anything is possible. That's the beauty of hard money: there are few hard rules. We'll talk more about that in a moment, but first, what about individuals investing in rental properties? Let's explore how **buy-and-hold** investors can use hard money to invest in real estate with little or no money down.

Can a Buy-and-Hold Investor Use Hard Money?

No doubt you see the benefit of using hard money when flipping a house, but what about landlords and buy-and-hold investors? Should they ignore hard money?

By now, I'm sure you've caught on to a few major roadblocks for buy-and-hold investors in using hard money. The two biggest issues are:

1. The short term of the loan
2. The high interest rate

¹⁸ <http://www.biggerpockets.com/flippingbook>

After all, if you borrow \$100,000 with a 15 percent interest-only payment from a hard money lender, you could be looking at a \$1,250 monthly payment, compared with a 30-year bank loan at 5 percent for \$536.82 per month—not to mention that the hard money loan probably needs to be paid back within a year or less. Talk about a cash flow killer!

Clearly, there are some issues to work through, but does this mean all is lost? Is hard money only for house flippers? No!

Buy-and-hold investors can definitely take advantage of certain strategies for using hard money in the right situations. This brings me to the story of my first flip, which accidentally taught me how to use hard money for a rental property. Let me explain...

Trouble on the Horizon

The house I found to flip was located on a nice street but had some serious problems, especially since the home had not been updated in nearly 50 years. Ugly wallpaper covered every surface, the floors were damaged and smelly, the roof leaked, the kitchen needed to be gutted, and the plumbing and electrical were a mess. This is not the kind of project I recommend for new investors. However, I was optimistic from watching the flipping shows on TV and thought I could handle the project. Even worse, I decided I would quit my job to work on the property full-time.

Worst of all, I was broke.

So, I made some calls and discovered a hard money lender who would fund the entire purchase price and the total cost of repairs so I could flip this house with nothing out of pocket. The loan would be a two-year loan at 10 percent interest. This isn't something I'd be able to use long-term, but perfect for a quick fix-and-flip. Although the money was expensive, I decided to do the deal anyway and jumped into the flip. Nine months later (ouch!), I wrapped up work on the project and listed the property for sale. (There are about a thousand other lessons to be learned here, but because this is a book about creative real estate investing, I won't go into them now. Just understand that this was a very challenging and "educational" flip!)

I now had a problem: the market had changed. Prices were plummeting faster than I could drop my price, and I soon discovered I was going to have some major issues selling. The house sat on the market for months, and I finally realized I needed to do something. I didn't want to just sell it and make nothing, so I decided to get creative.

I decided I would become a buy-and-hold investor and rent the property out. I found tenants who loved the home and moved in. However, I still had the expensive hard money loan to deal with. I was in a tight spot, and I needed help, which brings me to the solution I've used a number of times since: I refinanced the hard money loan through a conventional bank. In other words, I was able to pay off the original hard money loan with a brand-new long-term loan from a traditional lender.

I was able to obtain an 80 percent LTV mortgage on the property, which was enough to pay the hard money lender off in full. In the end, I ended up with a 4 percent, 30-year fixed loan, stable tenants, a beautiful house, and absolutely no money out of pocket. Furthermore, I now had time on my side; I could wait for the market to return rather than settle for making no profit.

Keep in mind that most banks will require at least six months (sometimes up to a year) of “seasoning” before they will allow a refinance to take place. In other words, even if you complete the repairs in two weeks, you will be stuck paying the high rates to the hard money lender for at least six months, but probably an entire year. Be sure to plan accordingly for this.

Since this can get a little confusing, let me give a quick, simple recap of what I did to make this project profitable. (Just keep in mind that this is only an *example* of something that worked for me in responding to the particular circumstances of this deal—don't assume you can do this exact same thing. Remember to think of this as an art book, not a recipe book!) So, to summarize, I

- Found an incredible deal on a house I intended to flip,
- Used hard money to fund the purchase and rehab costs,
- Fixed up the home, adding more value than the repairs cost,
- Was unable to sell for a profit due to market fluctuations,
- Changed tack to a buy-and-hold strategy,
- Rented out the home for significant monthly cash flow, then
- Refinanced the home, paying off the hard money loan.

Will a Hard Money Lender Fund the Entire Purchase Price?

One question a lot of people ask is “Will a hard money lender really fund the entire purchase price *plus* repairs?”

Sure, it worked for me with my first almost flip—but will it work

today, for you? That depends. Most hard money lenders want to see “skin in the game.” In other words, they want to see that the borrower has some vested interest in the property’s success. They want to know that the borrower has something of monetary value to lose. When you have nothing to lose, very little exists to keep you from walking away, and that scares hard money lenders.

However, 100 percent financing can still happen with the right deal. Remember, hard money lending has very few hard and fast rules, so everything is up for negotiation between the borrower and the lender.

In the story of my first failed flip, I was able to secure 100 percent financing, including the repairs, because I had (what we thought was) an incredible deal. You see, a hard money lender cares about one thing above all else: security. A hard money lender wants to know that, no matter what, they are going to make money and win. If I had sold the house, the lender would have received all their money back and had a successful investment. Had I defaulted on the loan, they would have been forced to foreclose and take the property for themselves, which they could then sell and recover their investment from the sale proceeds. Again, another win (or at least hopefully not a loss) for them.

So, the amount of cash you need to come up with to make the “hard-money-to-refinance” strategy work depends largely on the deal you find. In general, most hard money lenders have a certain LTV they will lend on, which is usually between 50 and 70 percent of the after-repair value (ARV).

In other words, if the home, in good condition, would appraise for \$100,000, the hard money lender would typically not lend more than \$60,000 on the deal. So, if you found a property for \$60,000, you might be able to get the entire purchase price covered, but you would have to come up with the closing costs and repair costs out of pocket. However, if you were to negotiate the same deal down from \$60,000 and get the home under contract for \$35,000, your chances are better that your lender will still fund \$60,000, giving you the extra \$25,000 for repairs needed.

Typically, this extra money would be given out in “draws” as the work was completed. So, you might replace the roof for \$6,000, submit the receipt, and be reimbursed for the work (or the lender might pay the contractor directly, though this is uncommon). Again, this is designed so the lender has maximum security and feels they will win no matter what happens.

What If the Hard Money Lender Doesn't Fund the Whole Price?

If the lender will not fund the entire price, you have a few options:

- You can refuse to buy the property, forget this strategy, and move on.
- You can use your own saved cash to fund the rest.
- You can use money borrowed from another source, such as a partnership, home equity line, credit cards, etc. Again, thinking creatively is important.

For example, if you can get a hard money lender to fund \$50,000 of a \$60,000 purchase, and you need an additional \$10,000 for repairs, you are going to be short by about \$20,000. Could you borrow that money from a line of credit on your home? How about using a partner to fund that portion? What about partial seller financing (see Chapter Eight)?

As you can see, a *lot* of different options are available for using a hard money lender to get into buy-and-hold real estate with little or no money down. However, as I've mentioned several times, you need to be careful when using this strategy. The next section will discuss four important risks and how to handle them.

Risks and Drawbacks to Using Hard Money

Let's get this out of the way right now: hard money can be risky because of the high costs (both the one-time and monthly fees) and short time-frames associated with the loan. However, understanding these risks is key to knowing how and when to use a hard money loan in your investment business. Let's look at the top four risks associated with using hard money...

1. **Hard Money is Expensive.** Although obtaining hard money is fairly simple if you find a great deal, the monthly payment can be prohibitively expensive. With rates ranging from 10 to 20 percent, your monthly payment will be double or triple what your normal monthly payment would be with a bank loan. This will almost guarantee a negative cash flow situation while you are holding the hard money loan.

This is why you should view hard money only as a very short-term solution and factor the extra costs and monthly charges into the deal before making an offer on any property. Let's say you borrowed a total of \$100,000 from a hard money lender at 15 percent for 12 months

using this strategy, and let's say the lender charged 5 points (5 percent of the loan amount) as an added fee:

$\$100,000 \times .15 = \$15,000$ interest payments
+ \$5,000 in loan fees (closing costs and points) =
\$20,000 total cost of using the HML for one year.

Compare that to a conventional bank, borrowing \$100,000 at 5 percent with only \$3,000 in loan charges:

$\$100,000 \times .05 = \$5,000$
+ \$3,000 in loan fees (closing costs and points) =
\$8,000 total cost of using a loan from a bank for year one

As you can see, using hard money in this case could cost you more than double what borrowing from a traditional bank would cost. Clearly, hard money is not a good option if you don't need it, but chances are, your bank financing will eventually dry up, and you may find hard money to be the best way to quickly close more deals with less money out of pocket—especially if you are a house flipper.

After all, if you can get \$50,000 in equity on a property, is it worth paying \$10,000 extra to do so? As with all creative methods of investing in real estate, you just need to get a significantly better deal on the property to compensate for the extra costs.

2. **You Can't Sell.** If you are using a hard money lender to flip a property, the most dangerous outcome is the inability to sell, which is exactly what happened in the story I told earlier about my first attempt at flipping. If you can't sell and can't refinance, you may have a significant problem on your hands. This is why clearly understanding your ARV is so important, so you know how much the home will sell for. Additionally, this is why speed is so crucial when flipping, because you don't want to give the market time to drop significantly (one of my many mistakes!). Finally, the easiest solution is to get such a great deal on the property that you can drop your price until it does sell and still make a profit.
3. **You Can't Refinance for the Full Amount.** If you are looking to use a hard money lender to buy a property, fix it up, and then refinance it into a rental property, the key is adding significantly more value than

the cost of the repairs. For example, if you bought a home for \$50,000 and put \$20,000 into repairs, the home would need to appraise for *far more* than \$70,000 for you to get your money back (because remember, banks lend only a portion of the value, probably between 70 to 80 percent of the ARV). So, for you to fully pay off the hard money lender, the property you paid \$50,000 for and put \$20,000 into would probably need to appraise for at least \$100,000 to get the full refinance.

What would happen if that home appraised for only \$80,000 after the work was done? If the bank would lend 70 percent ARV, the most it would let you borrow would be \$56,000, leaving you \$14,000 short. You would then be required to pay that \$14,000 out of pocket at the loan closing, or you wouldn't be able to refinance—and we aren't even talking about the closing costs you'd have to pay during a refinance.

This is probably the most significant danger in using the “hard-money-to-refinance” strategy, and again, it comes back to truly understanding your ARV. How confident are you that the \$50,000 home you bought would actually appraise for \$100,000 after you put \$20,000 into it? Do you have multiple, recent, similar, sold comps (similar homes that have sold; see Chapter Nine for a more in-depth look at comps and valuing property) to back up your estimate? If not, don't even think about using this strategy.

4. **You Can't Refinance at All.** Another concern for those looking to use hard money to fund a future rental property is a complete inability to refinance at all. What if a bank turns you down for a loan because your debt is too high or your credit score is too low? Or what if the lending requirements change between the time you buy the property and the time you go to refinance it?

These are very real possibilities, so exploring all your options and having multiple exit strategies is important in case things don't work out. How little could you sell the property for and still get out okay? Could you add a partner onto the deal to refinance the property using that person's income/credit? For this reason, any time I use the “hard-money-to-refinance” strategy, I make sure the home could sell if I needed it to and that it could sell fast. This means buying a home that people would want to buy and getting it for the right price. If no one in your area wants to buy two-bedroom homes, I would not recommend pursuing this strategy with a two-bedroom home.

Additionally, you will need to speak with a bank ahead of time and

get preapproved for a loan, even though you'll be using hard money to buy the property. This means submitting all your paperwork to the bank and having it actually approve you for a loan. Things may change over the next six months, but this will give you a really good indication of your ability to get a loan.

WRAPPING IT UP

Should You Use Hard Money?

Hopefully, by now you have a good grasp on the role hard money can play in your creative real estate investment strategy. As I've mentioned numerous times, the success of these strategies hinges on your finding an incredible deal. Incredible deals give you options—and options help you build wealth. If you do decide to pursue this avenue, be sure you understand all the potential risks and that you adequately prepare for those dangers. Write your plan down carefully and be sure that everyone, including your hard money lender, is on the same page.

In the next chapter, we'll look at a close cousin of hard money—*private money*—and its potential role in funding your real estate deals with significantly fewer costs than hard money.



Chapter Six

RAISING PRIVATE MONEY TO FUND YOUR DEALS

Private money, the “holy grail” of real estate investing, is not only an incredibly powerful way to scale a real estate business, but it is also a terrific way to do so without using any of your own cash.

However, raising private money is not easy and you must follow numerous laws and complicated processes, or you could risk spending time in the slammer (yes, jail!). Therefore, this chapter will give you a general overview of how to raise private money and how to do so ethically and legally.

What Is Private Money?

Private money is money provided by nonprofessional lending individuals to fund your real estate deals. In other words, when “Rich Guy Gary” decides he wants to earn more interest on his cash than the 1 percent certificate of deposit his bank is offering, Rich Guy Gary may consider funding your next real estate investment.

This may sound similar to hard money lending (see Chapter Five) or partners (see Chapter Three), and the categories do overlap significantly. In fact, the terms “hard money” and “private money” are often used interchangeably (many hard money lenders refer to themselves as private lenders or private money lenders). Although the lines can be blurry, I believe there is a difference between private and hard money

and knowing that difference can save you thousands of dollars.

For the purpose of this book, I consider hard money lenders to be individuals who lend money as part of their business and charge higher rates and fees than a private lender might. For example, hundreds of hard money lending companies are listed in the *BiggerPockets Hard Money Lenders Directory*,¹⁹ but millions of individuals in America have enough cash stashed away to fund your next deal. These potential private lenders generally keep their money in the stock market, bank accounts, IRAs, and other low-maintenance investments, because these individuals are not professional lenders, as hard money lenders tend to be.

Additionally, hard money lenders generally establish their official rates as a part of their business, whereas private lending leaves much more to negotiation and works to find a solution that fits both parties. Hard money lenders, as discussed in Chapter Five, generally charge 3–10 points (1 point equals a 1 percent fee) and 12–15 percent interest, whereas most private lending is substantially cheaper and is often completely devoid of the points and fees.

The rate you pay your private lender and the length of your loan can depend on a number of factors but ultimately comes down to what the two of you agree to. Although no specific universal designations exist, the private money loans you will obtain typically involve three term ranges:

1. **Short Term.** Usually six months to two years; most commonly used for flips or refinances.
2. **Medium Term.** Two to ten years; most commonly used for repositioning (improving, leasing, and refinancing) properties or other shorter projects when the lender doesn't want their cash tied up for too long.
3. **Long Term.** More than ten years; most commonly used for buy-and-hold investments. Typically, these loans are the most difficult to obtain but can be the most beneficial for the buy-and-hold real estate investor. Rates are generally the lowest with long-term loans to make cash flow work on long-term investments.

Each lender has their own agenda and motivations, so you'll find that depending on the person you're dealing with, the term range preferred will vary.

¹⁹ <http://www.biggerpockets.com/hardmoneylenders>

Who Are Private Lenders?

Most Americans know that there is tremendous power in real estate, and many would love to diversify into an investment that they feel is safe and secure. Even better, many Americans have a significant nest egg sitting in a 401k or IRA that could be used to invest in real estate.

Clearly, the money is out there. Therefore, your job as a private money-raising investor is threefold:

1. Find those individuals.
2. Impress them with your personal brand.
3. Convince them of the deal's strength.

Each of these tasks takes work and knowledge, so the rest of this chapter will focus on maximizing your skills in all three areas. Let's first focus on the task that many investors find the most difficult: finding private lenders.

How to Find Private Money Lenders

Private money lenders are all around. A recent study showed that 22 percent of American workers have at least \$100,000 in their retirement fund.²⁰ With 154 million workers in America,²¹ that means more than 30 million Americans have more than

\$100,000 in their retirement account, either being shaken around by the stock market or accepting low fixed returns from CDs, annuities, savings accounts, or other investments.

There are numerous ways to find these individuals, perhaps more ways than we can list here, but allow me to go through the four most common methods for finding individuals willing to lend their money for your next deal.

1. Family and Friends

Borrowing money from family members or friends is probably the most common way for new investors to get started with private money. However, this "low hanging fruit" carries with it some emotional components that can make success much more difficult to obtain if things are not done correctly. Only borrow money from family members and friends

²⁰ 2010 study by the Employee Benefit Research Institute and Matthew Greenwald & Associates, Inc.

²¹ U.S. Department of Labor and Training.

who truly have money to invest (meaning, risk). Real estate is risky, and I'd hate to see you lose Grandma Betty's life savings because a deal went sour. Also consider the conversation we had back in Chapter Three about not asking for money. Especially with family, it's probably best to let them come to you as they become aware of your business, brand, and investment successes. Many investors simply refuse to mix business with family or friends, but the decision is ultimately yours.

2. Networking

As I mentioned earlier, 30 million Americans have \$100,000 or more in their retirement account. These are everyday people you know: your doctor, dentist, school janitor, librarian, accountant, garbage man, and others. The key to finding private lenders among the general public is constant networking. Networking involves putting yourself out there, letting people know what you do, and talking about your business (and their life/business as well). If you don't already have a stack of business cards in your back pocket at all times, get some!

Some of the best "official" places to network can be local real estate clubs, Chamber of Commerce meetings, BiggerPockets.com, and real estate-related conferences. However, your networking should not be limited only to official networking events; instead, networking should be a lifestyle. Let everyone know about your business and the great things you are in the process of doing or that you plan to do. Carry pictures with you of recent renovations and purchases. Don't brag, but don't shy away from talking about your real estate successes (or goals, if you are just getting started).

Another great way to network is to provide valuable information for free. If you have a local real estate club, ask to speak and share what you know (but please, don't pitch! Simply provide value). If you don't have a local club, consider starting one. As I mentioned earlier, there is a lot of power in being a "connector" of people, so by starting a networking group where real estate professionals can meet one another and grow, you will gain a reputation as someone to be trusted.

3. Blogging

The same effort you put into networking in the real world can be applied online by teaching what you know. You don't need to be an expert to start a blog and share your story, but if you know how to communicate well

online, a blog can be a great way to build up trust and gain a reputation. If the thought of starting a blog overwhelms you, understand that it can be done very simply, very quickly, and very cheaply.

While dozens of tutorials are available online that can teach you how to start a blog, I'd recommend starting by creating a BiggerPockets Member Blog.²² You can be up and running in just seconds and can instantly have a targeted audience at your fingertips.

4. Public Record Search

Not everyone will be convinced that real estate is a good investment to have in their portfolio, but do you know who are the easiest folks to convince?

Yep, people who are already private lenders! A lot of people out there are already lending on real estate deals and may be willing to lend on yours, too. Although you can find these people through the methods already mentioned, you can also take a more direct approach and identify them through public records.

Each time a mortgage is made, the mortgage document is publicly recorded at the local county government. This information can be invaluable to you as an investor because you can use it to find out who the lender is on any property. The majority of lenders will be listed with a bank name and address (Wells Fargo, U.S. Bank, Bank of America, etc.), but others will be presented differently, with either a person's name, an LLC name, or a trust. These are the individuals you are looking for.

In most counties, you can perform this search online through your local government's website, though this may involve a fee. If your county does not list this information online, you can simply go down to your county administrative offices and search manually (though this might take a lot longer).

Specifically, you are looking for the "grantee" (mortgage provider) line on the mortgage documents. You want to find grantee lines that have either a person's name or a corporate entity name (not the name of a bank).

These are potential lenders. Doing a reverse address-phone search or sending a letter can put you in touch with these lenders and open the conversation, but only use the contact information you find for relationship-building purposes. Soliciting others at random for money can be both illegal (for you) and annoying (for them).

²² <http://www.biggerpockets.com/blogs>

How to Talk with Potential Lenders

Step One: Open your mouth.

Step Two: Start talking!

Seriously, don't overthink the idea of networking. When you are talking to people about your passion, let that passion shine through! Talk about your goals, your dreams, and why you love real estate, but most of all, ask questions about the other person. Get them talking and sharing their goals. Listen for cues that they may be potential lenders for you.

Also, don't start throwing the term "private lending" around to impress anyone. Raising private money is like dating—you don't want to ask the person you've just met if they'd like to get married! Your goal is to build a relationship and see where that relationship leads.

When networking, remember this very basic idea: you are not a salesperson asking for money. You are a businessperson holding an opportunity. Repeat this to yourself and seek to maintain this attitude when talking with people. You'll find that 90 percent of the people you chat with will not be good candidates for lending, and that's fine. You don't need to sell people on the idea; let the other 10 percent come to you because you're offering a good opportunity to earn positive returns.

The Elevator Pitch

One of the most important techniques to use when talking with people is something anyone can and should adopt: *the elevator pitch*.

In conversations, one of the first questions to come up is "What do you do for a living?" This is the perfect opportunity to discuss your business goals and to open up the possibility of working together someday.

A simple answer like "I run an investment company that focuses on purchasing, renovating, and renting out homes for monthly cash flow, and I work with a lot of different partners to make it all happen" can initiate a whole conversation on the topic if the person is interested. If not? No harm, no foul. If they want to know more, they'll ask.

In the business world, this quick synopsis is known as an "elevator pitch," and it is extremely important for a real estate investor to have one. An elevator pitch is a quick, less than 30-second explanation of what your company is and why it matters (it's called an "elevator pitch" because you should be able to deliver it completely in the short span of an elevator ride).

Remember, real estate investing is "cool" to a lot of people, and almost

everyone is interested in earning more money. So let people come to you, and be prepared to answer any questions they may have. If they are extremely interested, they may ask you a lot of questions, which is great! This is all the more reason to take your real estate education seriously, because you never know when these conversations will occur.

When talking with people about your business, it's a good idea to say something like, "So, if you know anyone who's interested in lending on deals like this and working with me, definitely give them my number." This opens up the conversation so they can say, "You know, I might actually be interested in something like that" or "I know someone who very well might be interested." Either way, the seed has been planted, and you didn't come across as begging for money—and you may just find some really valuable partners.

An important note: I don't recommend using these "elevator pitch" conversations to explain your whole private money lending process. As I said earlier, this is like dating. You probably don't jump into marriage right after asking someone out, and you probably shouldn't be making serious commitments at a networking event while you're surrounded by all the lights, sounds, and distractions. Use this opportunity to set up a time to get together, perhaps at your office or at a local coffee shop.

Meeting with Your Potential Private Lender

At a more formal one-on-one meeting, you'll be able to more easily explain the benefits and inner workings of your business. I recommend creating an information packet about what your company is and what you are offering. This is not a time to skimp on quality, so if your design skills aren't strong enough for you to create a nice-looking informational packet, hire someone to do it for you through a site such as Upwork.com.

Your informational packet should include the following:

- Your business name/contact information
- Your business mission/goals
- A description of how your business operates
- An explanation of how you use private money to fund deals
- Your track record, including photos
- Referrals from others you've worked with
- Expectations for both parties in the deal
- Anything else you can include to strengthen your position

Put all this information in a nice binder and simply walk through it with your potential lender. Let them know up front that lending relationships *are* relationships, and the point of your conversation is to see if you might be a good match, not to pitch something or pressure them into anything.

As much as this discussion is their opportunity to learn about your business, it is also a time for you to learn about their goals, expectations, and personality. Is the individual a nervous person who will be calling you every day for an update? Is the potential lender domineering and Type-A, looking to push you around? Or will this person make a great lender with whom you can work multiple deals? Ask questions and get to know the person. Trust your gut, but also verify their information to the best of your ability.

Your potential lender may also have numerous objections to lending money to you, so you can either wait until these potential concerns come up or address them proactively. I'd recommend facing objections before they come up and including responses to them in your informational packet. After all, your potential lender may be thinking of those objections but never mention them to you—and will just simply disappear. By confronting those concerns up front, you can open up the conversation and enter more productive dialogues. Although the individual may have any number of concerns, the most common tend to be the following:

- What if the deal flops?
- What if the economy changes?
- What if you go bankrupt?

These are probably the most important questions you can answer for a potential lender. After all, they've heard the stories of real estate investments that crash and burn. No one wants to crash and burn. Therefore, you'll need to carefully explain the different ways and reasons their investment would be secure. For example, I might say the following to address most of these concerns:

“As you know, these are ‘investments’ that we’re talking about, so there is no guarantee of success. There is risk involved with any kind of investment, but as our successful track record testifies, the way we invest in real estate seeks to minimize the risk at every turn.

“Most importantly, we offer a first lien²³ position on any property we lend on, which means if I end up being a thug and break any of the terms in our agreement, you could foreclose on me and take the property.

“Also, because of this lien, you will get all your money back, plus interest, before I ever see a dime. I only make money if you make money. Additionally, we will sign a promissory note that clearly and legally spells out all the terms and conditions of our arrangement.

“Finally, we only invest in amazing real estate deals in which we will have significant equity right off the bat, so we are protected against a drop in the economy. Because we only buy good deals, there is significant monthly cash flow following conservative estimates, and we set aside money each month for future expenses.

“All these factors help limit risk and ensure that your investment is as solid as possible.”

By confronting potential objections up front, you help your prospective lender feel comfortable with you and your company.

I also think walking the potential lender through all the numbers on a particular deal is a wise move. Show them a printout of an example analysis you’ve done, indicating the cash flow and return on investment you expect. Demonstrate that you’ve done your homework, and you will build the trust needed to make a great lending partnership.

Getting Your Private Lender to Commit

Once your lender has committed to the deal, it’s time to get serious and make things happen. Many private lenders will feel passionate about the transaction right away, but if you let too much time pass, that passion will dissipate. They may decide against investing with you, leaving you holding the bag on a property.

For this reason, having a continuous pipeline of deals coming in is key so your private lender doesn’t have to wait too long for an opportunity. Asking the lender to commit with their wallet as soon as possible is also wise. In other words, the sooner they have money invested in the deal,

23 *Property Lien:* A legal notice connected to the recorded documents on a piece of real estate that lets the public know money is owed to the holder. All liens on properties must be paid off before a property can be sold.

the less chance they will walk away.

Several expenses occur on any real estate deal before the closing documents are signed (inspections, appraisals, insurance, etc.), so having the lender pay for this up front is a good way to lock them into a commitment, though this is optional.

Of course, you'll also want to get the agreement in writing, so plan on meeting with your private lender and an attorney at the beginning of your partnership.

How to Structure Your Private Loans: Interviews with Four Real Estate Investors

You can structure a private lending deal in numerous ways—far more than I could ever cover in this book—so rather than explain each one in theory, I want to introduce you to some other real-life investors who actually use private lending every day to run their real estate business. In this section, you'll meet four BiggerPockets members who have agreed to share how they have structured their private money relationships so you can gain some insight into how you might structure yours.

However, before I get to their stories, let me make a quick disclaimer: you can structure a lending arrangement in many different ways, but legalities can differ by state and even by county. The four investors featured here are all highly professional real estate investors who have sought legal counsel before devising their current fundraising methods. It is vitally important for you to do the same—sit down with an attorney to discuss your plans before you have an official meeting with your potential lender. Consider these interviews below descriptive, not prescriptive.

1. Will Barnard, Barnard Enterprises, Inc.

Will Barnard is a full-time professional real estate investor and developer in Southern California. He currently specializes in flipping luxury homes with values above \$1 million. Will has experience in almost every aspect of real estate investing, including spec building, rehabbing, wholesaling, landlording, short sales, land development, and notes. He conducts millions of dollars in real estate transactions each year, primarily using money raised from private lenders.

How do you use private money?

Typically, I will locate a great potential real estate opportunity and present it to my private lenders, explaining the deal in detail. I don't utilize a fund, but instead I treat each deal separately and utilize certain lenders for each specific deal. Sometimes I use multiple lenders on one property by fractionalizing the note (mortgage payment), which basically means the note is split between different lenders based on their contributions.

What kind of security do you offer your lenders?

Each property we purchase is secured by a note and deed of trust, which gives the lenders the right to foreclose if I don't fulfill my end of the relationship. Typically, I never borrow more than 70 percent of the total after-repair value, which gives the lenders a significant cushion against default. They are secured both by the deal and through the proper legal channels.

Additionally, I always list each of my lenders on the property insurance as 'additionally insured,' so if something were to happen to the home and the insurance money was to cover the loss, I couldn't simply run off with the insurance settlement check.

What kind of legal entity do you use?

My business is a legal corporation (Barnard Enterprises, Inc.), so the private lenders actually make the loan to my corporation.

Can you describe your money-raising process?

Through consistent networking, I come across a lot of individuals looking for a secure place to diversify their portfolio. Whether it's online in the BiggerPockets Forums or in the real world at a local real estate club, people with money are everywhere. My goal is to simply offer advice and tell my story, and the money usually finds me.

Once I have a deal under contract or am close to it, I send an email out to my private investor list and give them the entire rundown of the deal, including the ARV, comps, repair list, repair costs, and the purchase price. I also provide the math for the LTV and how much of my own cash will go into the deal.

I will also, on occasion, post a thread in the BiggerPockets Real Estate Marketplace as well.²⁴ Most of my private investors started out as family,

²⁴ <http://www.biggerpockets.com/marketplace>

friends, and people I had a relationship with. My web presence on BiggerPockets.com, my website, etc. also provided the opportunity to build new private investors.

My goal when raising money is to attract repeat lenders. I want my lenders to be happy with every part of the deal so they'll come back to me time and time again.

What kind of terms and rates do you offer?

Typically, the terms are 6–12 months and 10–12 percent annual interest, with interest and principal due in one balloon installment on maturity date.

What kind of problems have you run into, and how have you overcome them?

I have done a few loans over the past year that had interest-only payments rather than balloon payments. Due to longer holding times and holding costs, this has created cash flow and operating capital depletion at times.

I have had to borrow more money to complete rehabs to resolve this issue and, in the future, will likely not do any loans with payments. Other than that, I have had few problems, and all investors have been paid back their principal and interest every time.

Learn more about Will Barnard and his luxury house flipping model by listening to his full interview on the BiggerPockets podcast at BiggerPockets.com/show32 and BiggerPockets.com/show130. You can also connect with Will through his BiggerPockets Profile²⁵ or through his website at BarnardEnterprises.com.

2. Brian Burke, Praxis Capital, LLC

Brian Burke is co-founder and managing director of Praxis Capital, LLC, a real estate private equity investment firm created to provide high rates of return to his investors while tactically managing risk. He has been a real estate entrepreneur since 1989, purchasing more than 500 properties valued at over \$150 million, primarily from foreclosures.

How do you use private money?

I use private money in three different ways: I borrow it in the form of a

²⁵ <http://www.biggerpockets.com/users/BarnardINC>

private money loan (Loan); Blind Pool Funds (Blind Pool); and in identified asset funds (One Off). Both Blind Pools and One Off deals are considered a “fund,” but in the case of a Blind Pool, the money goes into a pot, and I buy whatever I want with it, as long as the parameters of the deal match the fund objective. In the case of a One Off, the asset is identified ahead of time, and the fund is assembled for the sole purpose of acquiring that asset and executing the predefined strategy.

On a Loan, we use one investor per loan per property. In the case of a fund, it could be funded by one person, but more often than not it is funded by multiple investors into a pool.²⁶

What kind of security do you offer your lenders?

In the case of Loans, the source of funds is truly a lender, and the security they receive is a first deed of trust on a single property. I use this strategy to leverage the equity in my Blind Pool funds with debt. In this case, the fund buys a property for cash, then borrows money from a private lender who gets a first deed of trust, and the cash goes back to the pool to purchase more assets. In the case of the Blind Pool and One Off, those investors are not lenders, they are limited partners, and they receive no security other than an ownership interest in the entity.

The entity will own all of the acquired assets, so there is real estate behind their investment, but no direct security, as there is in the case of a Loan. Hence, the Loans are not securities, and the investments into the funds are.

What kind of legal entity do you use?

For a Loan, my ownership entity—either a Limited Partnership (LP) or Limited Liability Company (LLC)—is the borrower, but no entity is formed for the purpose of the loan. The lender is either an individual, trust, LLC, corporation, or whatever the lender uses (that’s up to them, and it doesn’t matter to me).

In the case of the Blind Pool, I typically use an LP, but that is only because I’m in California, and the LLC fees are high for entities that make a lot of income. Outside of California, I use an LLC. My management entity is the general partner of the LP (or managing member, in the case of LLC), and the investors are limited partners or LLC members.

²⁶ A “pool” is when many different individuals or companies invest their money into one larger fund. That fund, then, goes out to invest in real estate.

Can you describe your money-raising process?

In the case of a Loan, they write a check or wire money to the title company, and when escrow closes, we receive the funds. In the case of a Blind Pool or One Off, the investor writes the check or wires the money to the LP or LLC, and the money goes into the bank account where properties are purchased out of.

We have control of the funds and use them to make purchases (Blind Pool) or close on the transaction (One Off).

What kind of terms and rates do you offer?

Loans are 8 percent with interest-only monthly payments, and the principal is due in one year. Funds vary by the deal. Terms range from 30 percent to 70 percent splits of the profits; some funds offer an 8 percent preferred return, some do not.

What kind of problems have you run into, and how have you overcome them?

The biggest problem is recruiting new investors. I have a full-time employee as my director of investor relations, and his job is to conduct outreach to current and future investors.

Deal structure is the one thing that most new investors seem to get hung up on, but deal structure is simple compared to recruitment. That said, they are directly related to one another. If your deal terms don't match the appetite of your audience, the project won't get off the ground.

I have one fund that offers investors 30 percent of the profits, and initially, there was a lot of resistance on behalf of the potential investors, because they thought they weren't getting a big enough share. I combated that in two ways: the first was to offer funds with different strategies that had richer profit splits (70 percent to the LP), and the second way was to show that despite the fact that one fund had a 30 percent split, the investors are earning over 20 percent return consistently.

Some investors don't care about the return, they just want a larger split, so we have something for them. Some don't care about the split, they just want high returns. We have something for them, too. Some investors don't want to tie their money up for longer than a year. We have a product that meets that criteria. It's about having a menu of options for investors so that they can choose the right fit for their situation.

To learn more about Brian Burke, listen to our full interview with him on the BiggerPockets podcast at BiggerPockets.com/show3, BiggerPockets.com/show76, and BiggerPockets.com/show152. You can also connect with Brian through his BiggerPockets profile²⁷ or on his website at Praxcap.com.

3. Glenn Schworm and Amber Higgins, Signature Home Buyers, Inc.

Glenn Schworm and Amber Higgins, a husband and wife team, are the owners of Signature Home Buyers, Inc., a real estate investing company based in upstate New York. Glenn and Amber's business focuses heavily on flipping houses. Over the past several years, they have successfully completed more than 100 deals using private money.

How do you use private money?

We have raised over \$2 million in private lending from average people, not lending institutions or savvy investors. We use the financing to fund our real estate flips. We finance 100 percent of the deal, including purchase, renovations, and some holding costs with the cash we raise.

What kind of security do you offer your lenders?

The lenders receive a note and mortgage for security on the loan. We also give the investors an insurance certificate made out to them so they know they are also protected with insurance in case of a total loss.

What kind of legal entity do you use?

We are a subchapter S Corp. It is how we started and still operate to this day.

Can you describe your money-raising process?

When someone shows interest in investing, we mail them a professional packet explaining who we are and what we do. If they are local, we suggest they come and spend a little time with us, touring some of our current projects. At the end of that tour, we ask them, "Are you ready to invest with us?"

We typically take a minimum of \$100,000 or more to start. If they have concerns, we suggest they start with one house and see how it goes for them. We tell them if they like the process, then they can do it again and again, as long as they would like. If they are ready, we put them in our

²⁷ <http://www.biggerpockets.com/users/cirrusav8or>

queue, and when the next house comes up that matches the money they are willing to invest, we let them know we are almost ready.

When we have a close date in place, we ask them to wire the money to our attorney's office to be held in escrow until the closing. At closing, our attorney uses the funds to make the purchase, then they wire us the difference with our closing statement. Remember, we borrow enough for the entire project up front. Then the investor gets their note and mortgage for their protection.

Each month, we send them a statement to show what their investment is accruing. At the end of the term, when we sell the house and close, we wire the principal and interest back to the investor, and we look for the next deal.

When we began, we did not have multiple investors on a project. However, once investors begin to grow their portfolio, we usually need to break it up on multiple houses in order to keep them fully invested. We try to not have more than three on any one deal. They are all individual mortgages, all in different positions.

What kind of terms and rates do you offer?

We pay from 8–14 percent annually. However, we only pay for the months we use the funds; if the money is not invested but is sitting in our account waiting to be used, no return is given yet. It is a fixed rate, so the investors get paid whether we make money or not. When we were new, we paid higher rates, as we were a riskier investment, but now that we have a long, solid track record, we can pay less, as we are a much more secure investment.

All investors are paid in full at the end of the term. Our mortgage with investors is set up for a maximum of one year; rarely have we gone over, but when we do, we make sure the investor knows our plan, and their interest gets compounded starting on day one of the second year. We ask for an extension if necessary.

What kind of problems have you run into, and how have you overcome them?

A few problems we've encountered are having to sell a house for less than expected, or holding it much longer than anticipated and having to bring money to the table in order to pay the investor. It is not fun, but it has happened.

Our advice to all who use private investors is simple: Always pay your investors, no matter how good or bad you do on the deal. They have a set

rate, and that is their investment. You have the risk of making it profitable, and if you do your homework up front and run the job efficiently, you should make more than the investors to make it a win-win.

However, if everything goes wrong, never screw your investors out of their money, or you will soon be out of business, and you will give us all a black eye! Treat your investors like gold, because they are the lifeblood of your business. Always send gifts at Christmas and birthdays. Make them feel special. Do what you say you will do, and you will build a huge base of investor money to grow your business as large as you want it.

To learn more about Glenn and Amber, be sure to listen to our full interview with them on the BiggerPockets podcast at BiggerPockets.com/show15. You can connect with Glenn on his BiggerPockets profile²⁸ or on his website at SignatureHomeBuyers.com.

4. Dave Van Horn, PPR The Note Co.

Dave Van Horn is the president of PPR The Note Co., an operating entity that manages several funds that buy/sell/hold residential mortgages, both performing and delinquent. Dave has been in the real estate business for 25 years, starting out as a realtor and contractor and moving on to everything from fix and flips to raising private money. Dave currently raises millions of dollars from private investors in the rather unique niche of real estate note investing.

How do you use private money?

I started by raising money from one investor for one property. Then I started doing private placements for real estate deals, and then I started doing them for notes. So for me, it was a natural progression. Although I started by doing one-offs, today, as a company, we use private money in our fund.

I suggest hosting Investor Open Houses (Q&As) to provide investors with the opportunity to see ‘under the hood’ of the business. We like to encourage transparency, and hosting these events is something that our investors have really shown an appreciation for.

We also attend a lot of events—self-directed IRA events, for example—and strive to teach people about raising money. Teaching people your

²⁸ <http://www.biggerpockets.com/users/glennschworm/>

business model and how you raise capital is actually a great way to raise money. Raising capital for charity is another great way to mingle with the accredited. Another great way is to join CEO and networking groups.

Developing a solid reputation is very important. With other people's money comes more responsibility, especially since it is their hard-earned money or retirement money. Even if you are a private offering, and reports aren't necessary, constant communication with investors (before, during, and after) is still the way to go, and it also keeps retention up.

Do the right thing, do what you say, and spend the money to hire a securities or real estate attorney to get the paperwork done right. I do the same paperwork regardless of who's lending to whom. If I'm lending money, I use the same paperwork that I require of my lenders.

What kind of security do you offer your lenders?

A property or a note is collateralized²⁹ through the recording process at the underlying asset's county courthouse. In other words, our investor's capital is collateralized by the assets of the LLC that's tied to the offering (i.e., they own shares of the company).

What kind of legal entity do you use?

We use an LLC structure as part of our private offering. The owners are Class A members who own more than 50 percent. All other classes of members are equity investors. We use a securities attorney to set up the private placement and register all the filings, including our blue-sky filings.

Can you describe your money-raising process?

If we're tying a lender to a property or an individual note, funding is wired at the time of closing when it's going to be recorded.

For an interested investor of our note fund, the process usually starts with an interview with our Investor Relations Department to see if there's a qualified fit. If so, we provide this accredited³⁰ individual with a link and secure access to our private placement documents, which includes the offering, operating agreement of the company, purchaser's questionnaire

29 Collateralized means to place a lien on a property so that in the case of non-payment, the lender can legally take ownership of the property.

30 An accredited individual is a person who meets certain financial qualifications as set forth by the United States government, primarily earning at least \$200,000 per year (\$300,000 if filing jointly with a spouse) or has a net worth greater than one million dollars (excluding their primary residence). For more on accredited investors, see <https://www.sec.gov/fast-answers/answers-accred.htm>

of eligibility, W9, ACH form, signature pages, etc. The offering includes risk disclosures, our business plan, and a descriptive use of proceeds. The offering explains how everything works...the fund, the company, etc. If they want to move forward, they fill this paperwork out and send it in (via mail, email, or fax).

They submit their subscription agreement and fund their involvement with certified check or wire. We pay our investors a flat return every month, whether the money is in use or not. We utilize capital from the fund to pursue deals as they come up.

What kind of terms and rates do you offer?

In our note fund (our fund that purchases mortgages and other loans), our current offering is for \$15 million. It's a three-year term with a set preferred return of 11 percent, which is paid monthly via ACH. The minimum investment is \$10,000, \$5,000 a share.

When we borrow against an individual note or lend on a property, our rates and terms vary.

What kind of problems have you run into, and how have you overcome them?

We once had an unforeseen expense, when we had to hire our securities attorney to review the investor content on our website in reference to our fund. To avoid this, be careful with the content you make available online for investors, especially if you have a private offering.

We've learned from other decisions we've made along the way as well. For example, we used to have higher minimums, but we learned that people usually prefer to have their money spread out, so we actually received more investor capital by lowering our minimums. We also tried to pay investors quarterly until we found out that they actually prefer a monthly payment.

Also, we used to have multiple rates and categories in each offering, but today, we keep it simple.

Learn more about Dave Van Horn by listening to the BiggerPockets podcast at BiggerPockets.com/show28 and BiggerPockets.com/show273, and by checking out Dave's BiggerPockets profile³¹ or visiting his website at www.PPRNoteCo.com.

³¹ <http://www.biggerpockets.com/users/davevanhorn/>

Legal Issues with Raising Money

Alright, it's time to talk about the legalities of raising private money. This is a highly regulated industry, and I am not a lawyer, so I strongly encourage you to speak with one before attempting to raise money.

The biggest legal issue you may encounter is that of “soliciting for money” (publicly asking for money). Over the past 80 years, some extremely strict laws have been passed that govern the advertising of money in the United States, but the laws are changing, and the legality of “general solicitation” is transforming almost daily because of the JOBS Act.³² However, even with the JOBS Act, you still need to follow numerous rules and conditions before you can advertise for money (such as only allowing verified accredited investors³³ to invest).

If you are just starting out, it would be wise to steer clear of the “general solicitation” game and just avoid publicly advertising that you are raising money. Once you get more experienced, you can jump into that game. Instead, raise money by allowing people to come to you, as we've discussed. If you network and let people know what you do, they will come to you if they want to invest. We've already covered this extensively—it's all about building relationships.

No matter how you plan to raise money, it's essential that you have your paperwork together in order to avoid legal problems. Sit down with a qualified attorney to discuss the correct legal entity, paperwork, and what you can and cannot do when raising funds.

Examples of Using Private Money for Investing in Real Estate

I love to step outside the theoretical and get into real world examples so, in this section, I will outline several scenarios of how private money can be used to fund your real estate investing business.

SHORT TERM: Ivan is a house flipper in Southern California, where the typical run-down house costs over \$300,000 (which Ivan doesn't have). Instead, Ivan networks at various SoCal real estate events and meets individuals looking to invest in real estate without getting their hands dirty.

On his newest flip, he talks with Dr. Jim, an anesthesiologist, who has over a million dollars in various investments and retirement accounts.

³² <https://www.sec.gov/spotlight/jobs-act.shtml>

³³ Accredited Investor: Someone who has \$1 million in net worth or makes \$200,000 per year (\$300,000 for a married couple).

Dr. Jim has no time to invest but is looking to diversify his portfolio. He lends Ivan \$370,000, enough to purchase Ivan's newest flip and fund 100 percent of the repairs. Dr. Jim obtains a first lien position on the home, and Ivan signs a two-year promissory note, paying Dr. Jim 9 percent and payments deferred (but interest accruing) until the home is sold.

The funds are disbursed, and Ivan gets to work managing the flip. Within nine months, the property is rehabbed and sold, and Dr. Jim receives his money back, Ivan makes his profit, and everyone is happy and ready for the next deal.

Rich O'Neill of Chadds Ford, PA was in the midst of negotiating on three different properties at the same time. The only problem was, he could only afford to pay for two of them. He managed to land two and got them under contract. However, the third property was still available. That's when Rich's friend mentioned to him that he had sold a few of his own rental properties and was looking to redeploy some of the cash for a little while.

Rich was able to secure a short-term loan from his friend, borrowing the \$75,000 needed to purchase the third property in addition to \$25,000 for renovations. They negotiated terms for 11 percent interest and 2 points. Two months after closing, the property appraised for \$155,000. Rich refinanced and paid his friend back the principal, interest, and points. On top of that, he was able to pocket \$5,000.

The property now brings in \$1,650 in monthly rent. Rich's monthly expenses total \$1,200 so the property generates over \$400 in cash flow every single month. Thanks to the short-term loan, Rich was able to purchase all three properties *and* offer his friend a great return on his investment in a very short time.

In the example of Ivan, a short-term private money loan is used to fund a real estate fix-and-flip. This is one of the easiest private loans to obtain because it gives the investor their money back in the shortest time possible. Ivan was able to avoid paying extremely high rates and fees from a hard money lender and could make more cash when the rehabbed property was sold.

While the flip in Ivan's example took just nine months from beginning to end, loans that short simply can't work for certain strategies. Let's look at an example of an investor who uses private money to invest in rental property:

MEDIUM TERM: **Sarah** is an investor in the Dallas area who is primarily interested in small multifamily properties. She is especially interested in finding properties that have been poorly run and poorly maintained, acquiring them for a low price, rehabbing them, and renting them out while she waits for the market to improve. Sarah finds the perfect property located near her home: a garden-style fourplex in a great neighborhood that needs some new paint, carpet, and better management. She gets the property under contract for \$110,000 and sets out to find funding.

She discusses the deal with an experienced investor, Wilson, who she met online through BiggerPockets.com. Wilson is tired of dealing with tenants and has been selling off his properties. As a result, he has a sizable chunk of cash in his bank account that he needs to “put to work.” Wilson lends Sarah \$130,000, enough for Sarah to buy and rehab the fourplex, for a five-year term at 8 percent, interest only, which comes out to \$866.66 per month.

Sarah immediately improves the property and rents out each unit for \$750. After all the expenses, including the loan payment to Wilson, she clears almost \$700 per month in cash flow. She then holds on to the property for several years, until the market improves, and then sells the property for \$190,000, clearing a huge profit.

Kyle Novak of Green, Ohio is proactive with his brand and tells everyone he is a real estate investor. Because of this, Kyle’s friends, family, private lenders, and business associates think of him first when a new deal arises. Kyle gets the scoop on a lot of deals from referrals within his network that most other investors never even get the chance to see.

For example, Kyle’s contractor approached him about a package deal of four houses. The couple who owned the properties were going through a divorce and were simply looking to offload them. Kyle called one of his private lenders to see if he had any money available to loan, and he was in luck. Kyle then went and looked at all four houses. Though all of the houses were rented out, only two of them were in good shape. The other two were in a part of town that Kyle did not want to be invested in.

Kyle is not the type of guy to let an opportunity pass him by, however. He decided he could buy all four, keep the two he liked, and then wholesale the other two (we’ll discuss wholesaling in Chapter Nine).

The sellers were asking \$65,000 for the package of all four houses. They also happened to owe \$8,000 in backed taxes and Kyle knew this. Kyle countered at \$45,000 for all four properties and offered that he would cover the back taxes for the couple. Because the couple simply wanted to be out and done with the properties, they accepted.

Kyle paid the \$45,000 for the properties by going through his private lender. The loan is fixed at 8 percent amortized over 10 years. This puts his monthly payment at \$266.92. His taxes for both houses are \$92, insurance \$70, and management is \$120. The two houses he kept rent for \$600 each, totaling \$1,200 in monthly income. He was also able to wholesale the other two properties which brought him \$8,000 in wholesale fees.

Let's look at two final examples that involve a much longer term. This is perhaps the most difficult type of private lending to obtain, but it can be golden to your investment strategy if you find it.

LONG TERM: Real estate investor **Robert** enjoys renting out single-family homes but has long since maxed out his "four property" limit from the banks. Instead, he uses private lending to buy cash flow-generating properties.

He gets his newest project—an older, rent-ready, three-bedroom, two-bath home outside of Milwaukee—under contract for \$50,000. He then talks with his newest private lender, a distant cousin named Cal, about the property. The cousin made a killing selling his tech business in the late 1990s and has been investing his money in the stock market ever since, averaging a 6 percent return over the past decade.

In an effort to diversify his portfolio, Cal mentioned at a recent family reunion that he'd love to get in on the real estate action. Robert and Cal agree to a 30-year fixed loan at 6 percent, but to sweeten the deal, Robert offers Cal 20 percent of whatever profit is made at the end. They close on the property, Cal makes his 6 percent, while Robert rents the home out for \$1,000 per month and sits back to wait for his wealth to build. Fifteen years later, Robert sells the home for an \$80,000 profit, and Cal receives \$16,000 of that profit.

I (Brandon Turner) once bought a house in Montesano, Washington for \$65,000. I then spent \$25,000 on fixing it up. I needed a loan for the entire amount because I didn't have money at the time. So I talked to a

real estate investor friend of mine and he connected me with his father.

His dad gave me a loan for \$85,000 and I only needed to put \$5,000 of my own money down, plus a few thousand in closing costs to purchase the property. I paid a 7 percent interest rate on the loan and lived in the house for a short while. Later, I rented it out for \$1,300 per month.

After a few years, I decided to refinance to a lower interest rate (under 5 percent) with a conventional bank loan. But, for the several years I had that private money, long-term loan, it was nice to not have to deal with the hassles of bank financing. I was able to purchase the property with only a few thousand dollars down, as well as make a new connection in the real estate investing arena.

As you can see, the examples above are diverse, but they all have one thing in common: a great deal. As I've said time and time again in this book, a great deal is the best foundation for creative investing. Because all six of these examples involved solid deals, the lending arrangements were win-win for all parties, thus solidifying those relationships for many future deals.

Risks and Drawbacks to Using Private Money

Although using private money is a smart way to invest in real estate without using your own cash, it's not a perfect solution. This section will explore some of the risks of using private money, so you'll get the full picture and decide if this is an avenue you want to pursue.

1. **Legality.** The legality of raising money is not easy to understand, and the laws can differ greatly depending on your location. Because of this, we advise using a lawyer and, as we all know, lawyers are not cheap. However, hiring a lawyer to set up your business correctly at the start is much better than not doing a deal at all or sitting in a federal jail cell for doing it incorrectly.
2. **Networking Required.** Networking is neither easy nor quick. As I have noted, networking is a lifestyle, and if you don't like that lifestyle, you may find the process of raising private money cumbersome and difficult.
3. **Higher Interest Rates.** Although the rates you and your private lender agree on may not be as high as rates you'd pay with a hard money lender, chances are the rates will be significantly higher than you'd see with a conventional bank. Typical private money interest rates I

have seen are between 6–12 percent, depending on term length and other circumstances. If these rates fit your business model, great!

4. **Personalities Are Involved.** When borrowing from a bank, you are typically dealing with a system where emotion plays no part in decision-making. However, borrowing from real people always involves the potential for drama, emotion, and problems. What if your lender suddenly needs his money back? What if they get into legal trouble? These scenarios are further evidence that you need strong written legal paperwork for any lending arrangement.

WRAPPING IT UP

Should You Use Private Money?

Private money is not for everyone, but if it's an avenue you want to pursue, it can be a terrific way to raise enough capital to really scale your business to new heights. Be sure you understand the risks involved and take the necessary steps up front (ahem, *lawyer*) so you don't get into trouble down the road.

Finally, just remember that raising private money is about having great deals, building relationships, and ultimately delivering on the promises you've made. If you can do those three things, you'll have a successful future as a private money-funded real estate investor.

Next, let's move on to a strategy that involves investing in real estate without actually ever owning any property: *lease options*.



Chapter Seven

LEASE OPTIONS

The purpose of this book thus far has been to show you ways of buying real estate without using much (or any) of your own money. However, you can also invest in real estate without actually owning any property, using a technique known as a *lease option*.

This section will provide an overview of what a lease option is, how it works, and how you, the creative investor, can use the lease option strategy to invest in properties that have significant cash flow potential with no (or low) money down. Keep in mind that a real estate investor could be on either side of the lease option arrangement, so getting a well-rounded education on what a lease option looks like from both sides is best.

Let's get started.

What Is a Lease Option?

A lease option involves leasing a home to someone with a legal agreement that stipulates that that person has the exclusive right to buy the home within a certain time period. The homeowner cannot legally sell the property to anyone else during the period defined by the lease option.

You may have also heard the term “rent to own” which is the more casual phrase used to refer to a lease option. I generally avoid using the term “rent to own” when talking with investors (I don’t want to get it confused with the rent-to-own furniture stores!) but when talking with potential renters, I will use the phrase “rent to own” because it’s more

well-known than “lease option.”

Similar to a lease option, a “lease purchase” is a more formalized agreement wherein the property owner and the tenant sign a legal purchase agreement with a far-off closing date. Therefore, a *lease option* gives the lessee the choice of buying the property if they so choose, but they don’t have to, whereas a *lease purchase* legally binds both the buyer (the lessee) and the seller to fulfill the terms of the contract. For the purpose of this chapter, I’ll focus primarily on the *lease option*, because it is far more widely used, though keep in mind that both possibilities do exist.

For years, investors have used lease options to sell property to tenants who could not quite qualify for a loan. This process allows the tenants time to save up the required down payment, build their credit, establish a longer job history, or repair whatever is prohibiting them from obtaining a mortgage. A lease option could allow a family to move into their dream house and give them time to save enough for a down payment to buy the home, without worrying that the homeowner will sell to someone else in the meantime.

Let me give you a few examples of how investors have traditionally used the lease option:

John and Sally are a hardworking young couple who desperately want to buy a home, but they don’t yet have enough money saved for the full down payment they would need. Additionally, John only recently started a new job, and the bank won’t give them a loan until he has been there for one full year.

So John and Sally decide to do a lease option on a nice house in the suburbs. Jacob, a real estate investor, offers the couple a lease for \$1,400 per month with the option to purchase the home anytime in the next three years for \$140,000. During this time, Jacob cannot sell to anyone else, and as soon as John and Sally are ready and able, they will obtain a mortgage and purchase the home for \$140,000, using a loan from the bank. Jacob will get his cash; John and Sally will get their home.

I (Brandon Turner) once had a friend who wanted to move but didn’t have the money or time needed to fix up his home in order to sell. He just wanted out.

So I took control of the property via a lease-option. I signed two documents; a lease for \$500 per month and an option to buy the home

for \$65,000 anytime within the next three years. I then turned around and rented the home to some tenants for \$850 per month, keeping the \$350 difference.

Several years into the deal, I was able to exercise my option to purchase the home for the pre-agreed price of \$65,000. I got a bank loan from a portfolio lender for that amount (at this point the property was worth over \$100,000) and paid my friend for the house. I still own that property today and get great cash flow from it every single month.

The Two Sides of a Lease Option

As you can see from the example of John and Sally, a successful lease option arrangement can be a win-win for all parties involved but setting up the lease option correctly from the start is imperative.

The term “lease option” can be a little confusing, because it’s not actually just one concept—it combines two independent real estate transactions:

1. A lease
2. An option to purchase

Although creating a lease option agreement using one document is possible, most investors choose to use two completely separate documents to create the agreement.

The lease portion is similar to any other lease that a landlord and a tenant might sign. The lease document would contain information such as the names of both parties, the property address, the monthly rental amount, rules and regulations, late fee information, due date, and more.

The option portion, however, involves a separate legal document in which the owner agrees to give the lessee the exclusive right to purchase the property within a specific time period and for a predetermined price.

Remember, however, that this option contract only gives the lessee the *option* to buy the property—it does not legally require them to. However, the option *does* legally obligate the seller to sell the property under the terms set forth in the option if the lessee does decide to move forward and purchase the property. In other words, the option is only “binding” for the owner.

In addition to the option paperwork, there is an option fee. When a lessee signs the lease and option agreements, typically, they will also be required to pay the rent, the security deposit, *and* the option fee. This fee

is an up-front charge, similar to a down payment, found in most lease option arrangements. By paying this fee, the lessee is essentially paying for the right of exclusivity on the home, so only they can buy the home, and the seller cannot sell to anyone else.

The option fee amount can be whatever the two parties agree on, but typically, the fee ranges from \$2,000 to \$5,000, depending on the value of the home. When you are the lessee in such an arrangement, negotiating the lowest fee possible, maybe even \$1, is obviously in your best interest.

This fee is generally nonrefundable but will be later applied toward the lessee's down payment when the time comes for them to get their mortgage. If the lessee never obtains a mortgage and decides not to carry out the purchase option, the homeowner keeps the fee.

Why Use Lease Options?

We haven't yet discussed the best way for investors to use a lease option to invest with little to no money out of pocket, but don't worry, I will get into that soon. I want to be absolutely sure you fully understand how a lease option works before we talk about how you can use one. Allow me to briefly lay out some reasons sellers or buyers would want to use a lease option rather than a simple sale. Whether you find yourself on the lessee or lessor side of a lease option, knowing the advantages of both sides is best.

Owner/Seller/Lessor Benefits of a Lease Option

1. **Lessee May Be Required to Perform Repairs.** If so desired, with a lease option, the landlord will often require minor maintenance repairs to be the responsibility of the lessee (the tenant). After all, they plan on owning the property someday, so this added responsibility will help prepare them for that day. However, keep in mind that by shifting this responsibility to the lessee, many repairs may not be done properly or even done at all. I'm not telling you that you should or shouldn't ask this of your lessee—just understand that noncompliance is a possibility. If you are negotiating with a motivated seller to lease option his home to you, the fact that you will take care of minor maintenance on the property can be a major benefit to explain to the seller.
2. **Lease Option Tenants Tend to Treat Houses Better.** Although this is not always 100 percent true, tenants who live in a home under the

assumption they will soon own it will treat the property with more care than they would a typical rental. This might include higher craftsmanship in repairs, better cleaning, and more responsible choices (removing shoes on carpet, no drinks in the living room, etc.).

3. **Incentive for Responsible Payments.** Because the tenant may have paid a fairly hefty option fee to move in, they have extra incentive for paying rent on time and eventually buying the home. This will typically translate to more diligence in the performance of their tenant responsibilities.
4. **No Agent Commission Upon Sale.** Normally when you sell a house, the real estate agent fees can cost 3–6 percent or more. However, when a seller finds the buyer themselves without using an agent—as is the case with most lease option deals—the seller can avoid paying this fee, thereby saving thousands of dollars.
5. **Less Turnover and Fewer Turnover Costs.** A lease option tenant typically has a different mindset than a traditional tenant: they want to be buyers. This means they are far less likely to suddenly move out, and this means you have fewer vacancy expenses in your business. Additionally, if the tenant does move away, you have a security deposit as well as the option fee they paid at the beginning, so you won't lose as much money.
6. **Possible Higher Sales Price.** When you sell to a lease option buyer, they are typically less concerned with achieving the rock bottom prices that many traditional buyers seek. For those looking for a rent-to-own house, the price is far less important than the terms offered.

Tenant/Buyer Benefits of a Lease Option

While a lease option agreement offers some clear benefits for the lessor (owner), there are also numerous benefits for the lessee. Let's look at those now.

1. **Ability to Lock-in a Sales Price.** If you recall, when a lease option is signed, part of the contract is an option to buy, which names a specific future purchase price on the property. This means that if a purchase price of \$100,000 is agreed upon by the lessee and lessor, this price is locked in and cannot be changed if the tenant/buyer abides by the terms of the agreement and ends up purchasing the home. Even if the value of the home rises to \$150,000, the tenant/buyer can purchase it for the pre-defined amount. Additionally, remember, the tenant/

buyer only has an “option” to buy the home, not a requirement. If the market were to suddenly drop and they no longer wanted to buy the home at the agreed upon price, they could simply not exercise their option and could move or attempt to renegotiate.

2. **A Home to Call Their Own.** Although the tenant may not be able to legally call the home their own, a lease option feels much more like a purchase than simply renting. This can give the tenant a feeling of security and pride of ownership.
3. **A Plan for Home Ownership.** Many tenants simply don’t know the right way to begin to buy a home. A lease option allows them to “test drive” a home while creating a plan to actually purchase the property. From allowing them to learn how much they’ll need for a down payment to giving them time to build their credit, a lease option can help guide a tenant into homeownership.
4. **Stability in the Home.** Finally, by signing a lease option with a seller, a tenant has the ability to lock in a number of years in which the owner cannot legally sell the property to anyone else. This relieves the tenant of the fear that the owner may sell and kick them out, which is a common concern among tenants.

No Money Down Investing with a Lease Option

In this section, I’ll explain some strategies for using a lease option to invest in real estate creatively. I hope you’ll forgive me for the time spent explaining the intricacies of the lease option, but lease option investing is a fairly advanced method of investing, and doing so with creativity is even more complicated, so it’s important to understand the fundamentals before branching out. If you don’t yet feel comfortable with the concept, I invite you to read the first part of this chapter once more before moving on.

As I mentioned earlier, as an investor, you may find yourself on either side of a lease option deal. In fact, there are at least four different strategies you could use as a creative investor. This section will cover all four and give examples of how they might work in the real world.

1. A Straight Lease Option (Lessor)

The most common way real estate investors use a lease option is by being the lessor, or owner, of the property. The investor finds a tenant-buyer and signs an agreement with them, giving them the right to buy the

property in a specified time period for a defined price. Then, the investor either sells the property to that tenant-buyer or cycles through different tenant/buyers until one of them ultimately purchases the home.

Because some lessees don't end up buying the home (for a variety of reasons), the owner may end up renting to two, three, four, or even more different tenant/buyers before someone obtains a mortgage and buys the property. However, if you do some great screening ahead of time, hopefully the first tenant you place will end up purchasing the property.

If more than one tenant/buyer is needed before the home actually sells, the benefit for the lessor, of course, is that each new tenant brings the opportunity to adjust the price to the house's current value as well as an additional option fee from the new tenant.

Although a lease option in this regard doesn't help you purchase the property creatively, this strategy can help provide you with an exit strategy to one of the other creative finance techniques discussed in this book. In Chapter Ten, we'll spend a lot more time talking about how to combine different strategies for maximum creativity, and the lease option is definitely a powerful tool to pair with other methods.

Let's look at an example of how a straight lease option might look in the real world to an investor:

Isaiah is just getting started with real estate investing and owns no properties except his primary residence. Isaiah decides to move, but rather than sell his home, he opts to carry out a lease option.

He places an ad in the local paper and ends up signing a lease option with Carrie, a young urban professional who would love to buy a home but whose credit score is just a bit too low to qualify her for a typical mortgage. Carrie signs the lease, which states that she'll pay \$900 per month in rent for the property, as well as the option agreement, which states that Carrie can choose to purchase the home for \$119,000 at any time in the next three years. Carrie pays a \$3,000 option fee plus a \$900 security deposit and \$900 for her first month's rent and moves in.

After two years, Carrie has improved her credit rating enough to obtain a loan, so she fulfills her option contract and buys the house from Isaiah for \$119,000. Isaiah thereby generated significant cash flow during those two years and was able to sell for top dollar with no sales commission to a real estate agent—a true win-win.

You may be thinking right now that an owner could use this strategy to take advantage of others by charging high fees to tenants who would never qualify anyway, churning through tenants with the full knowledge that they'll never end up buying. Yes, this does happen, but I am adamantly opposed to such action. We'll talk a bit more about this later in the "risks and downsides" section of this chapter, but understand that the lease option should be used only as a win-win solution for both parties, not as a method to collect more rent and put the tenant in a worse position than when they moved in. In addition to the ethical reasons for not doing this, there are some legal reasons, which I'll address shortly, why taking advantage of tenants is just a bad idea.

2. A Straight Lease Option (Lessee)

An investor can also acquire real estate using the lease option strategy by turning the tables and being on the other side of the deal—as the lessee. Although most owners probably would rather have cash, an owner may accept a lease option instead for a variety of reasons, especially if they are having a hard time selling their home. The investor and property owner would sign a lease option for the longest term and lowest rent possible and, as in my example above, the investor would then sublet the property to a tenant for the highest possible rent, keeping the cash flow difference.

When subletting property, such as in a lease option scenario like this, it is vital to let the lessor (owner) know what you plan to do. Don't try to hide anything—be open and honest about what you intend to do and explain the benefits for them in allowing you to do so. After all, the owner probably doesn't want to deal with tenants, drama, or any of the other issues that come with being a landlord, but as a real estate investor, this is your job! Essentially, you will act as a middleman, getting paid well without actually owning the property.

Additionally, because the investor has a signed legal option to purchase the property at a specific price, the investor can market that property and potentially sell it in the future without even owning the property because they can sell the option. (This is very similar to what a wholesaler does when they place a property under contract and then sell that contract to a cash buyer. I've dedicated Chapter Nine to wholesaling later in this book, so don't worry about it now.) Let me illustrate this scenario with another example:

Reginald and **Debbie** sign a lease option agreement so Reginald can take over the property and Debbie can move on with her life. Reginald agrees to pay \$875 per month in rent with an option to purchase the home for \$220,000 anytime within the next six years. He gives Debbie an option fee of \$100 and takes control of the property.

Reginald then finds a tenant to rent the home for \$1,475 per month, giving Reginald \$600 per month in cash flow. He saves most of this cash flow, making sure he has enough to cover any future vacancies or repairs.

The market then climbs about 3 percent per year for the next five years, and the home is now worth \$266,000, so Reginald finds a buyer to pay full price. This nets him close to \$40,000 profit (not counting the five years of cash flow he collected) after he pays the closing costs—all for a \$100 down deal that most investors would have passed up.

Micah Grafsgaard is a real estate agent in Honolulu, Hawaii. On Facebook, Micah noticed that one of his friends was interested in selling or renting his luxury condo on Waikiki. The photos looked nice, so Micah called to preview the property before showing it to a client who was looking in that area.

While the property was priced a bit beyond the client's price range, Micah himself became interested when the owner mentioned he was willing to offer seller financing. Because Micah knew this market very well, he was positive that this was a great deal.

He and his friend were able to come to terms on the property for a five-year lease with the option to purchase for \$615,000 and \$50,000 down as the option fee/down payment. Micah would then pay \$3,140 per month in rent with a clause stating that all lease payments would be applied to the outstanding balance of the purchase using the same amortization schedule as that of a traditional mortgage.

So not only was Micah able to lease the property with a purchase price locked in for five years, but he was also able to deduct all rent payments from the ultimate purchase price which means he was essentially building equity even before he owned it.

The seller (lessor) even included the condo's luxury furniture in the terms of the agreement. Micah was then able to rent the property out on Airbnb for about \$4,500–\$5,000, per month giving him a monthly cash flow of over \$1,000. On top of that, the property came with two

parking stalls (extremely rare commodities on Waikiki) which Micah was also able to rent out for \$300 each month.

In this deal, Micah is not only utilizing a lease option as the “lessee,” he is also executing a strategy often called “Airbnb Arbitrage” (where an individual rents a home, and then subleases the home out as a vacation rental, keeping the difference as profit.)

3. A Lease Option Sandwich

The lease option sandwich is so named because it places you in two separate transactions—one on each side of the deal—like the two slices of bread on your PB&J. First, you act as the lessee and find a property that you can lease option from the current owner. Next, you find a great tenant looking for a rent-to-own deal, and you sign a lease option with that tenant for the property. So there is a lease option on the front end of the deal and another lease option on the back end of the deal, and you are the peanut butter and jelly holding the “sandwich” together.

This strategy is very similar to the Reginald example above, but rather than finding any random buyer after five years, Reginald actively seeks to rent the home to the same person who will end up buying it. Let’s look at an example of how this lease option sandwich would work in the real world:

Jerry is a motivated seller who has been transferred to another city for work but can’t sell his current house, even though he has been trying for months. Real estate investor Kevin meets with Jerry and agrees to sign a five-year lease option agreement for a purchase price of \$70,000, in which Kevin will pay Jerry \$500 per month over those five years. Kevin gives Jerry an option fee of \$1,000 and takes control of the property.

Once the contract is signed, Kevin begins marketing for a tenant-buyer looking to sign a secondary lease option. After a few days and a couple of Craigslist ads, Kevin makes an arrangement with a local graphic designer, Rhoda. She pays a \$3,000 nonrefundable option fee, signs a two-year lease with a two-year option to buy the home for \$100,000, and agrees to pay a monthly rent of \$1,000.

At this point, Kevin is simply the middleman. Rhoda pays Kevin \$1,000 each and every month, while Kevin pays Jerry \$500 per month, giving Kevin a monthly cash flow of \$500. Additionally, Rhoda put down a \$3,000 option fee, whereas Kevin gave Jerry only \$1,000 for the op-

tion fee, which means Kevin is not only making significant monthly cash flow but he also made \$2,000 on the deal. (However, if Rhoda ends up buying the property, that \$2,000 will come off the top of what Kevin would get at closing. He is smart and saves that \$2,000 for a rainy day.)

Two years later, Rhoda decides *not* to buy the home. She moves out, forfeiting her \$3,000 option fee, and Kevin (with three years left on his five-year lease option contract) decides to look for another tenant/buyer. He finds Sam, a local bank teller, who pays a \$3,000 option fee and moves into the property, paying \$1,100 per month for rent and getting an option to purchase the home for \$110,000. After one year, Sam is able to qualify for a mortgage, completing his option and paying \$110,000 for the property. Kevin sends all the paperwork to the local title company who carries out the sale, and he walks away from the deal with almost \$40,000—in addition to the cash flow he had been receiving for months.

What Happens After the Contract Time Expires?

In this example, Kevin first signed a five-year lease option with the homeowner, Jerry. Luckily, Kevin's second tenant ultimately purchased the property at the end of year three. But what if he hadn't? After all, the majority of tenant-buyers never actually end up carrying out their option. So, what if Kevin's initial contract with Jerry runs out?

All is not lost; at this point, Kevin would have a few options:

1. Kevin could ask Jerry for an extension, perhaps another five years. Jerry has been renting the home to Kevin for five years anyway, so Kevin could simply request to continue the process. Perhaps Jerry is happy with the reliable rental income. You'll never know if you don't ask.
2. Kevin could sell the home to a retail buyer. Remember, Kevin had a lease option to purchase the home from Jerry for \$70,000. He could search out a buyer, perhaps even listing the property on the multiple listing service (MLS), and try to assign the contract to a retail home buyer. He could even do some cosmetic improvements to help the home sell faster.
3. Kevin could sell to an investor, even at a discount. If Kevin got a good deal on the home from Jerry, he may be able to sell the home to a cash buyer, like a local investor that wants to use the home as a rental. Even if Kevin doesn't get the full market value of the home, as long as he can sell it for more than his option price, he can make a profit.

4. Kevin could decline to purchase the property and split from Jerry. Remember, Kevin only has an option to buy the property, not an obligation. Jerry would get the home back, and because the market has probably improved over the five-year period, he may be able get much more than the \$70,000 he was planning to receive from Kevin. If not, at least Jerry's mortgage has been paid down, and he's no worse off than he was when he started the whole process.

One of the reasons I like the lease option sandwich so much is that it can truly be a win-win-win for everyone involved if it is set up correctly. To return to our example with Jerry and Kevin,

- Jerry was relieved of the burden of dealing with his property and the mortgage payment.
 - Jerry received the fair price he was comfortable with.
 - Kevin was able to make great monthly income and a significant profit with little to no money out of pocket.
 - Sam is able to buy his dream house and obtain long-term financing.
- Don't you just love win-win-win situations?

Tips for a Successful Lease Option Sandwich

Here are eight tips for making sure that your lease option sandwich succeeds without any major issues and that you are able to achieve the most security, income, and fairness for everyone possible.

1. The longer your contract is with the homeowner, the better. Three years is better than one, five is better than three, and ten is better than five. The more time you have, the more options you have. Also, ensure that your contract with your tenant/buyer is shorter than your contract with the owner/seller. You don't want to offer your tenant/buyer a five-year lease but sign just a three-year lease with the owner.
2. Always let the owner know what you are doing. This is not a strategy you should ever think of using without having everyone on the same page. Don't pretend you'll be living in the home just to get the contract, only to turn around and sublet it to a tenant. Be up front and honest and make everyone comfortable with the arrangement. Your job as a real estate investor is to solve problems, so do that!
3. Screen well! Screening your tenant is one of the most important steps you can take to ensure a positive landlord experience, especially with a lease option sandwich. Although tenant-screening practices are

beyond the scope of this book, the most important things you can do are as follows:

- **Always run a background check on your tenant.** Look for evictions, criminal activities, etc.
 - **Make sure the tenant/buyer has good enough credit.** Their credit score doesn't need to be 800 for them to qualify, but it needs to be reasonable/improvable for them to be able to get a mortgage to cash you out eventually.
 - **Look for stability.** A tenant who moves every six months without reason is probably not a great candidate.
 - **Don't discriminate.** Doing so could land you in jail, so know your local and federal discrimination laws and adhere to them.
4. Connect and qualify your tenant/buyer with a mortgage professional, also known as an RMLLO (short for Residential Mortgage Loan Originator). This individual can sit down with your potential tenant and explain what they need to do to qualify for a loan, making sure they can reasonably hope to qualify. A good mortgage professional can work with your tenant/buyer to create a credit road map to help guide them from where they are now to being able to qualify for a mortgage. Setting up a meeting between the tenant/buyer and your favorite mortgage professional is helpful for both the tenant/buyer and you. It can also help prove that you are not trying to take advantage of a tenant if you are ever accused of such.
 5. Arrange to pay the owner's mortgage. After all, you don't want to send the owner a payment each month and suddenly find out the bank is foreclosing on the property because the owner decided to pocket the money rather than pass it on to the bank.
 6. Legally record your option contract with the owner at your county administrative department. By legally recording the option contract, you will put a "cloud" on the title, and the owner will not be able to sell the property until it's cleared. If you do not record the contract, the owner might decide to sell to another investor or a retail buyer, and your only recourse would be a very expensive and stressful lawsuit. Recording can usually be done for less than
 7. \$100 and normally requires only that the agreement be signed and notarized.
 8. *Don't* apply any portion of the rent toward the tenant/buyer's future

down payment. This was a popular method of doing lease options in the past, but since the SAFE Act and Dodd-Frank legislation were passed, there has been legal concern on the part of many investors that portions of rent applied toward the tenant's future down payment constitutes a "security," which means many additional rules and regulations must be followed (ones you don't want to deal with). Additionally, most banks will not allow this credit anyway, so it's just best to make the rent the rent.

9. Don't be a jerk. Do you remember the scene from *Spider-Man* where Uncle Ben states, "With great power comes great responsibility?" By this point, you can probably see that there is a lot of potential power in the lease option sandwich, but this same advice that guides Spider-Man should guide you as well, because with lease options, one could very easily be a jerk and take advantage of tenants.

For me, this is one of the biggest concerns for someone looking to engage in a lease option agreement. Because the vast majority of lease option tenants never end up actually purchasing the home, the lessee may be set up for failure from the beginning. Many lease option investors know this and proactively take steps to make it nearly impossible for the lessee to ever close on the deal. They charge huge up-front fees for a totally unqualified tenant to move in, give them a short time frame in which to buy, kick them out, and then repeat the process. The tenant, on the other hand, ends up in a far worse financial position than they were in originally. I believe this kind of unethical behavior is what gives the real estate investing industry a bad name. Don't be part of the problem.

Treat your lease option agreements as a chance to create a win-win scenario and help others get what they want and need as well. Use your power for good, not evil. This means only entering a lease option with tenants who could very reasonably obtain a loan within several years, without charging an exorbitant option fee. I want to be fair and have all parties happy with how things turned out at the end of the transaction, whether the tenant officially buys the property or not.

Finally, the government knows this is a problem and frowns on landlords who take advantage of tenants. The SAFE Act and Dodd-Frank legislations were enacted, in part, to help deal with these problems. Not only does your unethical behavior give landlords a bad name, but you could wind up in prison.

4. A Master Lease Option

The fourth strategy I want to share with you is known as a master lease option, or MLO. An MLO takes the lease option concept to a whole new level, and its use can have a tremendous impact on your real estate investing, especially if you are trying to invest creatively.

An MLO works pretty much the same way as a regular lease option in that there is a lease, a lessor, a lessee, and an option fee. However, with an MLO, the lessee (the tenant/buyer) generally pays all the expenses associated with the property, including taxes, insurance, and any maintenance concerns—and then sublets the property out to tenants who live in the property.

Although an MLO can be used with any size property, it is most common with larger investments, such as apartment buildings and commercial real estate. It is very similar to seller financing, which we'll cover in the next chapter, but no title is actually transferred. Instead, the property is simply leased for a long period of time for a set monthly rental amount. The owner (the lessor) receives monthly payments but is no longer involved in managing the property. Instead, the investor who has the option (the lessee) takes care of the property, collecting rent, paying the bills, and acting as the proxy owner, keeping the cash flow difference.

An MLO can be a great way to buy a large multifamily or commercial property using very little money out of pocket. Because you are not actually purchasing the property, there is no change in title, but you are entitled to all the cash flow (positive or negative), as well as any appreciation benefits, because you lock in a future purchase price as part of the option contract.

Here's an example of how an MLO might work in the real world:

Marsha is a 20-something investor with a few house flips and rentals under her belt who is looking to invest in larger properties. After reading several books on the subject, she decides investing in apartment complexes is the path she will take in her investment career. She mentions her ambitions to a local investor, Phil, at church the following Sunday. "Actually," Phil says, "I'm looking to travel more and sell off my own apartment complex." This is networking at its finest!

After several conversations, Marsha and Phil agree to work together to accomplish both of their goals. Being a 20-something investor, Marsha has very little money, so giving Phil enough to even pay the closing costs is beyond her capabilities. Instead, they decide to start

with an MLO. Phil agrees to accept a monthly rent of \$2,500 and to give Marsha three years in which to purchase the property. Paperwork is signed, and Marsha takes over the property, cash-flowing from day one, with no cash out of pocket!

Marsha's job is then to manage the property, accept rent, manage any handymen, and pay all the bills. Meanwhile, Phil and his wife buy a camper and enjoy their retirement, driving around the United States and loving the steady MLO payment deposited in their account every month.

If this story seems too good to be true, I have a secret: this is the story of how I bought my 24-unit apartment building when I was just 25 years old. (I had to change the name, of course, to throw you off!) We later converted the master lease option to a full-blown seller-financed deal (we'll cover these in the next chapter). So these kinds of opportunities *do* exist and can be done for very little money out of pocket. Notice that the deal came to me because I simply learned about the concept and told other people about my passions. I had no idea that "Phil" owned an apartment complex; I just let my passion spill over into my day-to-day life.

As I've said before, networking is a lifestyle.

The same can happen for you, and amazing deals can fall into your lap if you take the time to educate yourself and share your dreams with others. You never know what you might find.

Risks and Drawbacks of the Lease Option

1. **The Due-on-Sale Clause.** You've probably heard about the dreaded due-on-sale clause before, but just so we're all on the same page, let me give you a brief description of what it is. In nearly all mortgage paperwork, there is a paragraph that sounds something like this:

If the trustor shall sell, convey, or alienate said property, or any part thereof, or any interest therein, or shall be divested of his title or any interest therein in any manner of way, whether voluntarily or involuntarily, without the written consent of the beneficiary being first had and obtained, beneficiary shall have the right, at its option, or declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note evidencing the same, immediately due and payable.

This clause declares that the mortgage holder—the lender—has the legal right to demand to be paid back in full if the property is sold. If this happens, and the borrower cannot pay back the entire loan in full, the lender could foreclose and reclaim the property. Not cool.

“But Brandon,” you say, “we never bought or sold the property! This is just a lease with an option to buy.” Very smart, and very true. Nevertheless, some people worry that a lease option could entice a bank to call the note due based on the due-on-sale clause. In the lender’s mind, they may argue that although the legal title was not transferred with the lease option, “equitable interest” in the property has been transferred.

Furthermore, many due-on-sale clauses specifically note “lease options” as a condition for the due-on-sale to be exercised, in which case it’s pretty black and white. I just took a look at my own primary residence mortgage, and sure enough, it states that a lease option can trigger the due-on-sale clause. I would wager most of my loans have something similar.

Is any of this likely? How fearful of the due-on-sale clause should you be? Will the bank really come and demand payment from you?

At least in the past, banks have generally ignored the issue, and I’ve never even heard of a case where a note was called due because of a lease option. However, the possibility does exist, so I must mention it and make sure you are aware of any potential problems.

There are additional concerns that by breaking the due-on-sale clause without notifying the bank, you are breaching an ethical code and possibly even breaking mortgage law.

So what can you do to prevent this kind of thing from happening? Make sure it’s actually a great deal. If there is a ton of equity in the deal, chances are good that you could sell quickly or try to work something out. Or simply don’t do a deal that involves a due-on-sale clause.

Furthermore, I recommend *never* going behind your lender’s back. Therefore, if the mortgage paperwork specifically forbids lease options, you probably shouldn’t do one with that property unless you are 100 percent comfortable with the risk—and you are not putting the seller at any undue risk. Plenty of other strategies in this book could work just as well. Creative finance is about finding solutions, not forcing them.

2. **Major Repairs the Owner Can't Cover.** A second problem that could arise is repairs, especially if you are the lessor in a lease option scenario and you are renting out a property to tenants. As I mentioned earlier, you could require the tenant to cover repairs under a certain amount, and in theory, this arrangement is great. However, certain issues could come up that you need to be aware of.

For example, what if a large repair is needed that your tenant can't afford, such as a furnace failure? Who will pay for that? Hopefully, your legal contract with the owner will spell out exactly who is responsible, and you could take legal action if absolutely necessary.

Additionally, a great suggestion from John Jackson,³⁴ a lease option expert on BiggerPockets.com, is to pay for a home warranty on the property (or have the tenants pay for one) at the start of the lease option, one that covers all major maintenance problems on the home. These policies tend to be less than \$500 and can be a life saver when the furnace does blow up.

3. **Changing Legislation.** Finally, the lease option world is changing, and it's severely unsettling as to where things are headed. Most of the changes and uncertainty have come about because of passing of the SAFE Act and the Dodd-Frank legislation since the housing collapse several years ago. These reforms were enacted to prevent a similar meltdown in our economy, but much of the language designed for big banks and huge corporations also seems to apply to small-time investors like you and me. No one is sure where things will end up or what actually applies to small investors, so the uncertainty also creates a degree of risk.

WRAPPING IT UP

Lease Options

I hope you can see the tremendous possibilities available with a lease option, especially for those with more creativity than cash. Entire books have been written on the subject of lease options, so the past several thousand words cannot be considered the only guide on how to successfully execute them. If this is a strategy you plan on using, I highly recommend you learn more and study up on how to make them work in your market.

³⁴ <http://www.biggerpockets.com/users/LeasingToBuy>

Find someone who currently works in the lease option niche and ask questions!

Lease options are not an easy beginner strategy, as many of the real estate gurus might have you believe, but they can work for you if you take the steps necessary to learn how to properly apply them. If you want to get into buy-and-hold landlording, it can be a great way to do so without needing to get bank financing, save up a huge down payment, or wait months for a loan to go through. However, there are risks involved and some ethical questions you need to fully understand before moving forward.

In the next chapter, we'll talk about a similar strategy—*seller financing*—and discuss how to use the owner of a property to invest in real estate with little to no money out of pocket.



Chapter Eight

SELLER FINANCING

One of the most popular methods of using little or no money down when investing in real estate is by taking advantage of *seller financing*.

Perhaps the oldest of the creative options outlined in this book, seller financing has become less and less popular in recent years because of the increase in availability of “easy credit” and record low mortgage rates. However, knowing how to effectively use seller financing in your business can help you get more deals done faster and for less money.

Additionally, mortgage rates are rising, so by learning how to master seller financing today, not only are you adding a tool to your toolbox of financing options, but you are also preparing yourself for the day when seller financing becomes more popular once again.

What Is Seller Financing?

Seller financing is just what it sounds like: the seller provides the financing. In other words, the owner of the property acts as the bank, and although legal ownership of the property changes hands, the payment is sent directly to the previous owner, rather than to a bank, for a specific duration and with a defined monthly payment.

For example, I may want to purchase a rental house, but I do not want or am unable to get traditional bank financing. The seller would like \$100,000 for the property but is willing to “carry the contract” (aka “carry paper”).

This is investor jargon for agreeing to finance a property (or part of the property) they currently own so the buyer doesn't need to get external financing from a lender. In this case, the owner would ask for \$5,000 down and a 10 percent interest rate on the remaining \$95,000 amortized over 30 years, for a monthly payment of \$833.69 before taxes and insurance. I'd agree to his or her terms and after doing my due diligence, I would close on the property through my local title company. I'd then look for a tenant who would rent the home for \$1,600 per month and collect the cash flow difference each month.

In this scenario, the seller gets a great interest rate on their money, I get to buy the house for just \$5,000 down, and I don't have to deal with a bank at all. Seller financing can be another great win-win for all parties involved. But what's the catch?

Why aren't these arrangements more popular?

The Problem with Seller Financing

One major problem with seller financing puts a wrench in the whole strategy for the millions of American homes that currently carry a mortgage: the due-on-sale clause. We talked about this clause in the previous chapter when I outlined the risks of a lease option, but allow me to repeat the gist of it: the due-on-sale clause is a legal part of nearly every mortgage document that gives the bank the right to demand that the loan be paid back in full, immediately, if the property is sold (hence the term "due on sale").

So you can see the core problem with seller financing: in such an arrangement, the property is being sold. In other words, if the seller has a mortgage on the property, and the property is sold using seller financing, then the bank could come and demand to be paid back in full that moment or it could foreclose.

Will That Actually Happen?

Well, remember that the due-on-sale clause gives the bank the *right* to demand full payment; it doesn't *require* the bank to do so. The bank may be amicable towards the arrangement and not exercise this right. However, the risk you carry is great when you buy a property with seller financing that has a due-on-sale clause in the seller's mortgage. If the bank does demand full payment immediately and you can't pay the bank the entire loan balance, the property may be foreclosed on. If you are

buying from a homeowner, the homeowner may get foreclosed on, and both of you would lose the property. Obviously, this is not a situation you want to find yourself in. There is one simple solution:

Only use seller financing when the seller owns the home free and clear (i.e. when the seller has no loans on the property).

In other words, if you truly want to eliminate the risk of being foreclosed on for violating the due-on-sale clause, don't use seller financing to buy a home unless the existing loan is first paid off. Your goal when using seller financing is to find sellers who don't have a mortgage. Although this may seem difficult, in fact, nearly one third of American homeowners do not have a mortgage on their property.³⁵ Therefore, *millions* of properties are prime for you to buy using seller financing.

Why Buy Using Seller Financing?

Seller financing offers numerous benefits, so let's look at a few of the most common:

1. **Ease of Financing.** As mentioned earlier, when you use pure seller financing to purchase a property, you avoid having to use a bank, which can mean the difference between a deal and no deal for many people. If you are tapped out on the number of mortgages you can get, seller financing can be a great tool to obtain additional rental property.
2. **Possible No or Low Down Payments.** Because you are dealing directly with a homeowner seller, there are no cut-and-dry rules regarding the down payment. You aren't dealing with rigid rules imposed by Fannie Mae or Freddie Mac, which require 20–30 percent down on an investment property. Instead, you get what you negotiate with the seller. The seller may want nothing down, or they may want 50 percent, but you won't know until you ask and negotiate.
3. **Option for Creativity in Structuring the Deal.** As I mentioned earlier, the rules when dealing with banks can be extremely rigid, but this is not the case with seller financing.

Seller financing allows you to get creative to solve a problem. Rates, terms, the payment amount, payment dates, and everything else is completely negotiable, which can turn a mediocre deal into a great deal.

4. **Purchase “Unfinanceable” Properties.** Sometimes, the condition of a property may be too poor to allow you to use traditional financing.

³⁵ <http://articles.latimes.com/2013/jan/10/business/la-fi-free-and-clear-20130110>

In these cases, seller financing can give the buyer a chance to own the property, begin fixing it up, and possibly refinance into a more traditional form of financing down the road (or never—the possibilities are numerous!).

5. **Doesn't Show on Your Credit Report.** Unless the seller of the home signs up with one of the credit reporting agencies to report the debt (very unlikely), chances are that your seller-financed deal will not end up on your credit report. This can make obtaining other loans and mortgages in the future much easier.

There are, no doubt, numerous other reasons you may want to use seller financing, so don't be afraid to seek out opportunities where you can apply this method. It truly can be a great way to finance properties of any size. However, if it's so good for the buyer, does a seller have good reasons to agree to it?

Why Use Seller Financing?

If I gave you the choice between getting \$100 today or \$1 per month for the next 30 years, which would you take? Most of you would want the \$100 right now, but if you do the math, \$1 per month for 30 years is \$360, which is more than three times the lump sum of \$100. Still want the \$100?

Perhaps.

Some of you reading would take the \$1 a month, whereas others would take the lump sum. It all comes down to personal choice.

The same principle this question demonstrates is true for home sellers. Many homeowners who own their house free and clear would rather take the cash and move on. However, for a large number of sellers, the value of getting monthly payments outweighs the need for a large lump-sum check. Let's look more closely at why owners might choose to sell via seller financing rather than just cashing out.

1. **Monthly Income.** Perhaps the most common reason sellers would prefer to sell via seller financing is to get monthly income. As in the \$100 or \$1 per month example I used, a lot of individuals would simply prefer to steadily receive money each month instead of in one lump sum. This is especially true for older sellers on a fixed income who need stable monthly income to pay the bills. A \$100,000 chunk of money would last only so long for a seller, but if that income were

financed over 30 years, the money would last them much further into retirement.

2. **Better ROI.** Many homeowners choose to sell with seller financing because the interest they get from the financing is greater than they would likely get elsewhere. For example, if a homeowner were to sell a home for \$100,000, they could put that money into a certificate of deposit at the bank and receive 1.5 percent annual percentage yield, or they could seller finance their home and get 6 percent, 8 percent, or more.

Many seasoned real estate investors understand this concept and eventually move their portfolio from a “holding” phase to a “selling” phase, using seller financing to avoid the hassle of being an owner while still collecting monthly income by carrying the contract. Therefore, some of the best possible candidates for seller financing are other real estate investors who are changing their strategy. (On a side note, this is another reason making friends with as many local real estate investors as you can is so important. When they are ready to get out of the landlord game, they may choose to sell to you and carry the contract in the process.)

3. **Spread Out Taxes.** Anytime you make money, the government wants its share, and when you sell real estate, it’s no different. This issue may not be as important for homeowners because of the IRS rule that allows homeowners to avoid paying taxes on up to \$500,000 in profit from selling their primary residence (as long as it meets certain specific criteria).

However, real estate investors are not so lucky and must pay taxes when they sell. For example, if an investor spends 30 years paying off a rental property mortgage of \$100,000, owns the home free and clear, and decides to sell the property for \$250,000, she would need to pay taxes on the gain of \$150,000, which could result in a hefty tax bill.

Therefore, many investors choose to sell using seller financing rather than getting a lump sum, to spread out most of those tax payments over the life of the loan on the seller-financed property. You see, the IRS has special tax rules for installment sales, such as ones using seller financing, so the seller may need to pay only a small portion of that tax bill each year while the loan is being paid off. Be sure to talk to a CPA for more details on this.

4. **Can’t Sell Otherwise.** As I mentioned in the previous section, many

properties simply are not sellable to a typical bank-financed borrower because they are in such poor condition. Seller financing can allow the seller to unload such a property without needing to fix it up first.

Example of a Seller-Financed Deal

So how does seller financing work in the real world? The following is an example of how you might structure a seller-financed deal to create a win-win for all parties involved. Keep in mind that this is not legal advice; this is just an example of how one investor structured a purchase.

Paul owned a nice triplex in the suburbs of Chicago. He purchased the property with cash ten years earlier and has now decided it's time to retire and began looking at his options. Paul knows the property is worth approximately \$250,000, and if he tries to sell it through a real estate agent, he'll spend \$15,000 in commissions and another \$10,000 in seller-assisted closing costs, netting him \$225,000. However, after paying taxes, he'd likely have only around \$150,000 remaining, which he may be able to invest for an 8 percent return in the stock market.

Instead, Paul talks with Samantha, an up-and-coming real estate investor excited to get her first property. Samantha had been learning from Paul for several months and has built a great relationship with him. Paul sells Samantha the property for \$250,000 with just \$3,000 down to cover closing costs and an 8 percent interest-only loan on that \$250,000. Paul now makes \$20,000 per year from the property, 100 percent passively, while Samantha owns and manages the property and collects the cash flow every month.

Josh Bauerle, a CPA in Willard, Ohio, got a call from a realtor friend who was trying to offload several rental properties. The friend remembered that Josh was interested in investing in rentals so he reached out to him with this opportunity—a 10-property deal with a total of 13 units. Josh let him know that he was interested but that he would need to get creative in order to fund such a large deal.

The property package was initially listed for \$440,000 but after a couple of months of back and forth negotiation and deliberation, Josh was able to convince the seller to knock almost \$100,000 off of the purchase price! This brought the new total to only \$341,000. Here is how he did it.

Josh, because he is an accountant extraordinaire, was not about to let a measly \$100,000 get between him and these properties. In the months of back and forth negotiations, meetings, and research, Josh ran the numbers on every single unit in the deal using the calculators on BiggerPockets.com. He then printed out all of the comps he could find that were relevant to these properties and realized he had the numbers and research to support an offer of \$100,000 below the asking price. Josh also made every effort to anticipate any objection the seller might have to reducing the price.

He compiled all of this information in a giant binder and then showed the seller, line by line, how he had formulated his price and why this deal would be good for him. Josh also explained to the seller all of the fantastic tax benefits he would get from financing the properties himself rather than taking it all as a lump sum.

To make the deal work, Josh borrowed \$30,000 via a personal loan to be used as a down payment to the seller. The other \$311,000 was seller-financed, amortized over ten years starting at 5 percent interest and jumping by 2 percent every three years that the loan was not paid in full. Josh also included a clause that he would owe \$15,000 in principal at the end of the first 18 months and then again at the end of every two years if he did not refinance. Josh clearly wanted to assure the seller of his intention to refinance as soon as possible in order to repay the loan.

Sixteen months after closing, the properties were appraised for \$550,000. He refinanced for \$347,000, paid back the remaining balance on both of the existing loans, and even walked away with \$17,000 in cash.

Partial Seller Financing

To this point, I've discussed seller financing mostly from an "entirety" position, meaning that the entire property is sold using seller financing. However, seller financing lets you get your creative juices flowing. One such creative way to use seller financing is known as *partial seller financing*.

What if a seller doesn't own their home free and clear but does have some good equity in it? What if the owner has 50 percent equity in his home, or 90 percent?

This kind of situation allows you to let the seller finance just part of

the deal, while a traditional lender finances the other part. This can get a little bit confusing, so let's look at an example.

Charlie owns his home, which is currently for sale for \$100,000, but he owes only \$50,000 to the bank on his mortgage.

Susan is a buy-and-hold investor who is looking to buy Charlie's property, but she doesn't have the large down payment needed for a conventional mortgage.

So, Susan works a partially seller-financed arrangement with Charlie and her lender in which the bank provides a \$65,000 first mortgage, Charlie agrees to "carryback" a second mortgage for \$30,000, and Susan can put just \$5,000 down. The \$65,000 goes to pay off the original \$50,000 loan of Charlie's, and he ends up with \$15,000 in cash plus a "note" (mortgage) for \$30,000, giving him some monthly income for the next X number of years.

Don't worry if that was confusing! The point is, seller financing allows for some creativity, and using a seller's equity to partially fund a real estate deal is a path you may want to take some day.

Keep in mind, however, that many banks and lending institutions do not allow sellers to carryback second mortgages anymore (this was much more common in the past) and may require you to still put a down payment into the deal, no matter how much the seller agrees to carry. However, you won't know until you pick up the phone and start asking different lenders what their rules are.

Luke Neubauer of Louisville, KY noticed a four-plex on the street where he lived that had a "For Rent" sign in the yard. Luke gave the owner a call to see if he might like to sell the property. The owner was interested in selling but was asking \$205,000 and would not part with it for any less. This was more than Luke was willing to pay but he kept in contact with the owner.

Over the course of several months, the owner experienced a couple of evictions and a tenant passing away, was now more ready to let go of the property. Luke was still very interested in buying, yet he did not want to use any of his own money. He offered to purchase the property at \$190,000 if the owner was willing to seller-finance his 25 percent down payment to the bank for a conventional loan on the remaining portion.

Ready to be done and have money in his pocket, the seller agreed. Luke would make interest-only payments for 2 years on the seller-financed portion, giving him time to make improvements, raise rents, and refinance the loan in order to pay back the seller.

The seller also agreed to credit Luke \$6,000 for a new roof rather than replace it himself before the sale. Because of the timing of the sale, Luke received \$2,000 of prorated rents, \$2,500 in tenant deposits, and on top of that, the lender covered the closing costs. All told, Luke walked away from the closing table with over \$10,000 cash.

With the location and versatility of the property, Luke had serious opportunities for improvements, rezoning, and even adding a fifth unit for more cash flow before refinancing. This deal, start to finish, took Luke 10 months to complete but his patience and cooperation with the seller paid off in a major way.

Three Ways to Find Seller-Financed Deals

You should now have a pretty good idea of how seller financing works and how you can use it in your real estate investing to get more deals. But how do you find owners who are willing to carry the contract and provide seller financing? Here are three simple ways to find these sellers:

1. **Ask.** It may seem obvious, but sometimes all it takes is a simple question. When talking with sellers, whether directly or through your real estate agent, simply ask the question, “Do you need to be 100 percent cashed out, or are you able to provide any seller financing?” As I hope I’ve made clear, seller financing is about creating a win-win situation, not trying to take advantage of someone. Therefore, never be afraid to ask about seller financing, and to explain the benefits, because the seller may turn out to be excited about it, but just never thought of it before. Besides, it never hurts to ask. What’s the worst they can say?
2. **Look for Keywords.** When scanning the MLS, Craigslist, and other sources for finding properties, keep an eye out for phrases such as “owner will carry,” “owc,” “flexible terms,” “seller financing,” and “motivated,” as well as any other indication that the seller is open to a conversation about seller financing.
3. **Direct Mail.** Although we will cover this later when we talk about wholesaling in Chapter Nine, understand that you can purchase lists of homeowners that specify how much equity the homeowner has

in their property. Although the list companies, such as ListSource,³⁶ don't always get the numbers correct, you can at least begin to market to individuals who probably have a good deal of equity in their properties. Significant equity is a good sign that seller financing may be a possibility, so when sending out direct mail, keep an eye out for high equity, and again, don't be afraid to ask.

Risks and Drawbacks of Seller Financing

Seller financing can provide some excellent options for you as a buyer, but the strategy is not without some risks and dangers. This section will outline three of the most common concerns when dealing with seller financing and offer some tips for overcoming those potential problems.

1. **The Due-on-Sale Clause.** We've covered this topic quite a bit already, but I can't help but rehash it here. It's vitally important that you understand what the due-on-sale clause is and why it matters. You don't want to endanger the seller's credit or your relationship with a seller by trying to circumvent this clause. Understand that if you buy a home using seller financing and the home has a mortgage with a due-on-sale clause, the bank may foreclose on the seller, leaving both of you in a financial mess.

Again, the simplest solution is to **use seller financing only on properties that are owned free and clear**. The one exception I would have to this rule (maybe, in certain situations) is for very short-term financing. Some investors out there use seller financing with existing mortgages (often called a "wrap," because you wrap one mortgage over another) despite the due-on-sale clause, because they believe they can quickly fix the property up and either sell or refinance before the bank finds out and has an issue. I won't tell you this is a great idea; I'll leave that for you to decide based on your risk tolerance level.

2. **Higher Interest Rates.** Although seller financing allows for incredible creativity, generally speaking, you will pay a higher than normal rate with seller financing. This has not always been the case, but in today's lending environment, with loan rates under 4 percent, getting a seller to accept an interest rate as low as that is difficult (though some investors do negotiate 0 percent interest seller financed loans).

³⁶ <http://www.listsource.com>

Just be sure to run the numbers with the interest rates you plan on obtaining, and make sure they work for the deal.

3. **Fewer Potential Properties.** Let's face it, even though seller financing can be a great win-win for both parties, the vast majority of homeowners are either unable (because of existing mortgages) or unwilling to carry a contract and provide seller financing. Therefore, the pool of potential deals is significantly smaller when you are looking to work with seller financing. But don't let this discourage you! As I mentioned earlier, approximately 30 percent of homeowners in America do not have a mortgage and could be great sources for seller financing.

Seller Financing Doesn't Mean "Buy a Bad Deal"

Before we move on from the topic of seller financing, I want to make something very clear: although seller financing allows you to obtain properties without using a bank, this does not give you an excuse to overpay for a property.

Many real estate investors like to sell using seller financing because they can charge a premium for the property. However, you should not pay a premium. Leverage is only leverage when used responsibly; otherwise, it simply becomes a liability.

So, add the seller financing tool to your toolbox, and go make some magic happen.

In the next chapter, we'll talk about the longest and perhaps most complicated method in this book: *wholesaling*. Although wholesaling is a completely different animal from the other methods discussed thus far, I believe learning to be an expert wholesaler will help you in every aspect of your real estate investing efforts. Whether or not you ever plan to wholesale a deal, pay close attention to the next chapter. Wholesaling could become a valuable tool in your investing toolbox.



Chapter Nine

REAL ESTATE WHOLESALING

I was reluctant to write this chapter.

Not because I don't like wholesaling—I do—but because I see so many people fail at it. Day after day, people come to us at BiggerPockets and say, “I want to be a wholesaler!” but two weeks later, they are gone, and I never hear from them again.

Why? Honestly, I don't know. But I have some guesses:

- “Experts” make it sound really easy—when it's not.
- People think it takes no money (well...)
- It's more complicated than they thought.
- It takes more time than they thought.
- They get bored.

For whatever reason, people interested in wholesaling tend to suddenly disappear from the real estate scene. However, the simple fact is that wholesaling is one of the most popular methods for newbies who want to get involved with real estate investing, and nothing I say or do will change that.

What I *can* do is make succeeding easier for those interested in this option by providing the best resource possible for being a real estate wholesaler. I believe that if more people realize what the whole picture looks like, they will stick with it and find success. If you are interested in

making money by wholesaling real estate, I encourage you to take your time and really dig into this chapter. Take notes, highlight sections, teach others what you are learning, and perhaps most importantly, head to the BiggerPockets Wholesaling Forums³⁷ and start interacting with some successful wholesalers.

I hope that this chapter will provide you with an exhaustive overview of wholesaling and that you'll be able to incorporate it into your strategy to invest in real estate with little to no money down.

Important: This chapter is about far more than just wholesaling. This chapter is first and foremost about marketing and finding great deals, so even if you *never* plan to wholesale a deal, I encourage you to read through it anyway. I believe wholesaling can be a valuable tool in an investor's toolbox, so learning the basics will serve you well in your quest to become a creative real estate investor.

With that said, let's get going. We'll start at the beginning, because as Julie Andrews tells me, "It's a very good place to start."

What Is Real Estate Wholesaling?

A few years ago, I wanted to start a jeans company. My plan was simple: create an online website that sold jeans for tall and thin men like me, because I can't find jeans that fit, and I know a lot of other tall/thin men have the same problem. In my efforts to start this venture, I realized that I would be the retailer—the "front end"—from whom customers would purchase the jeans. Hundreds of factory workers (the manufacturer) would stitch together the denim to make the jeans.

However, I didn't know a whole lot about jeans. I needed help. Enter the wholesaler. A wholesaler is the middleman who connects the retailer to the product source, collecting a fee for doing so.

Wholesalers typically buy in bulk, for cheap, and sell for a higher price to a retailer. This business process is the same in the clothing industry, the meat industry, the construction industry, and almost every other industry that sells to the general public. For example, Home Depot can't simply call up a factory in Bangladesh and order more toilets. You need a middleman, and the wholesaler is that middleman.

A real estate wholesaler finds deals and connects a retail buyer

³⁷ <https://www.biggerpockets.com/forums/93-wholesaling>

(typically an investor) with those deals, charging a fee for doing so. A wholesaler is trained to search for those good deals, negotiate the best discount, put together a solid contract, and then sell at a markup to someone else who is not trained or prepared to do this.

But I'm getting ahead of myself. Let me take a step back and walk you through how a wholesale deal typically plays out from start to finish, because the process can be a little confusing for someone not familiar with it. I find it helpful to see the terrain at an altitude of 20,000 feet before blazing through the jungle, so consider this your flyover. Also, keep in mind that there are many different techniques for wholesaling a property, and we will cover those in this chapter, but this example is just one of the more popular options:

- **Step One:** Find a great deal from a motivated seller.
- **Step Two:** Negotiate a great price that makes financial sense to both parties.
- **Step Three:** Sign a “purchase and sale agreement” with the seller.
- **Step Four:** Find a cash buyer (house flipper, landlord, etc.).
- **Step Five:** Legally connect the cash buyer to the motivated seller.
- **Step Six:** Collect the difference in price between what the seller's contract is for and what the cash buyer will pay.
- **Step Seven:** Rinse and repeat with more and more deals!

Example of a Wholesale Deal

Let me walk you through an example of a fairly typical wholesale deal. I'll use this same example throughout the chapter, so don't be concerned if you don't understand every aspect right away. This is the completed puzzle, but after I have presented the whole thing, I'll dive into the details of each piece.

Beth is a new wholesaler looking for her first deal and using a variety of smart marketing techniques. She gets a phone call about a three-bedroom, two-bath, 1,400 square-foot home at 123 Main Street in a fairly desirable neighborhood. The owner, Clarence, has been trying to sell on his own—with no luck. Beth talks with Clarence and discovers that he is making two house payments and cannot afford both, so he is getting very motivated to sell. However, the house is painted an ugly purple, has outdated carpet, and smells like the four German Shepherds

that have lived there for a decade. No one is interested in the house in its current condition. Clarence does not have the funds necessary to get the home into marketable condition. Besides, he's just tired of dealing with it and wants out; he feels stuck.

Beth knows the neighborhood well and has done her homework. There have been a dozen sales of similar homes (all fixed up) in the neighborhood in the previous six months, ranging from \$135,000 to \$175,000. Being conservative, Beth estimates the home's value, if the place is fixed up, at around \$143,000, but she knows it needs about \$20,000 worth of repairs. Clarence has been asking \$120,000, but because of the condition of the property, no one will even bother to look at it.

Beth builds a good rapport with Clarence, does the math, and offers him \$74,500 for the property. She lets Clarence know that either she or a business associate of hers will buy the home within six weeks, and Clarence will no longer have the double payment. After some minor negotiation, Clarence accepts the offer, and the two of them sign a contract for Beth (or her business associate) to purchase the property.

Beth thanks Clarence and immediately calls Jackson, a local house flipper she met via the BiggerPockets Forums. She tells Jackson about the deal and gives him the address. He and Beth go look at the house together, and Jackson agrees to pay \$84,500 for the home. Beth then "assigns" the contract to Jackson for a \$10,000 fee to be paid at closing, collecting a \$2,000 nonrefundable deposit up front from Jackson.

Several weeks later, Jackson and Clarence sign all the paperwork at their local title company. Clarence receives the \$74,500 Beth offered him, Jackson pays \$84,500 for the property, which he intends to rehab and resell for a profit, and Beth receives her \$10,000 wholesaling fee and moves on to the next deal—after enjoying a night out at the local steakhouse to celebrate!

Kyle Novak in Ohio, whom we met earlier, is primarily a buy-and-hold investor who buys rental houses. Two of the houses in the package of four he was considering met his standard for investing while the other two houses were in an area where he had no interest in owning and managing. He knew that if he only bid on two of them, he would likely be passed over in favor of a complete purchase of all four.

With this in mind, Kyle figured that his best shot was to purchase all four and keep the two that he liked. But what to do with the others?

He was not interested in holding them for any period of time to make upgrades and flip them. So, after giving it a little thought, he figured he could simply wholesale them.

Kyle went through his network and realized that he knew of another investor that already owned several other properties in the same neighborhood. Kyle had never done business with this other investor before and had only met him through networking. It just so happened that both parties were exactly what the other needed at the time. They came to an agreement and for an \$8,000 wholesale fee, Kyle was able to transfer the contract to this other investor.

It just goes to show the absolute necessity of meeting people and networking in real estate. You never know who the person will be you need most to make a deal work.

Real Estate Wholesaling

Wholesaling can be complex and while it may not be as easy as a late-night television guru might make it out to be, it's not an impossible task either. *Wholesaling, at its core, is about solving problems.* In the example above, the owner, Clarence, had a problem, and Beth made a fee by solving his problem, just as a real estate agent would do by solving a retail seller's problem.

Personally, I used to dislike wholesaling because I thought, "Well, isn't it wrong to try to steal properties from people?"

Yes, it is wrong to steal. Don't do it.

However, ethical wholesaling is not about stealing anything. Again, it's about solving problems and helping people by handling something that they don't want to or can't handle themselves. If someone doesn't want to sell, you are not going to make them do so. You are simply providing a way to solve their problem, if they consider your proposed solution the best option. Remember to be smart—and ethical.

Does Wholesaling Require Money?

Yes and no.

I decided to include this chapter on wholesaling because I believe wholesaling *can* be a legitimate way to get started investing in real estate, and there are tactics for wholesaling with no money, as we will discuss.

Furthermore, wholesaling can be an exceptional way of making enough cash to start buying your first rentals, flips, or commercial properties, so I do believe it fits nicely in a book about creative real estate investing.

Here's the truth about the money needed to wholesale real estate: it is possible to wholesale a deal or two without any money, but truly building a marketing system that consistently provides leads will probably require some cash. That's okay because you can start small and scale up, using your profits to reinvest into more and more marketing. So yes, you can wholesale with little to no money.

However, if you have no money and want to start wholesaling, it's going to take some additional hustle. Again, this is all about trading creativity for cash! You may need to start by driving for dollars and hand-writing a lot of letters (we'll talk about these tactics soon). You may need to work directly for a single cash buyer and accept very low margins on your first few deals. You may need to get out there and start knocking on doors. Hustle is the name of the no money down game. However, once you land your first deal, I encourage you to use that money to start testing out some of the "paid" ways of attracting motivated sellers to call you with a desire to sell, using strategies like direct mail marketing.

That said, wholesaling is probably never going to be 100 percent free. Even if you stick with "free" methods, such as driving for dollars, empowering others to find deals for you, or using an agent to make offers on HUD properties, you will likely still incur some costs, such as gas, business cards, stamps, or earnest money. However, these costs are nothing compared with what you could earn wholesaling—and nothing you can't save up by putting in a few extra shifts at work or selling some stuff from your garage!

Let's start with perhaps the most important aspect of the entire wholesaling process: finding a great deal. If you don't have a great deal, the best-looking business cards are just garbage. If you don't have a great deal, a list of 100 cash buyers is just a list of names. If you don't have a great deal, your ambitions as a wholesaler are just dreams.

A great deal is the foundation. Let's start building it now.

Marketing for Great Deals

The "secret" to making good money from wholesaling is being able to consistently find great deals. This also happens to be the most difficult part of

the wholesaling experience. The fact is this: *great deals are hard to find*. It takes work. It takes effort. It might even take a little bit of cash. However, finding great deals is possible, and you are about to learn how it's done.

The following are nine of the most common strategies for finding real estate deals. Keep in mind, you don't need to do all nine, or even most of them. Start with just one—whichever one your budget allows. Then, as deals start coming in, reinvest your profits to go bigger!

1. **Driving for Dollars.** “Driving for dollars” is the name investors give to the practice of simply driving around an area looking for potential good deals. The benefit of this strategy is that it costs very little to accomplish and is a true example of using creativity to replace cash when investing in real estate. However, I don't mean just driving aimlessly down random streets, hoping that someone comes out and asks you to buy their home. You will need to pick the right neighborhoods in which to wholesale, find properties that look prime for wholesaling (long grass, boarded-up windows, etc.), locate the property owner using public records, and get in touch with that owner. To read a great in-depth guide on driving for dollars, don't miss Chris Celtus' blog post, “Driving for Dollars Bible: Finding Distressed Properties and Marketing.”³⁸
2. **Direct Mail.** Direct mail is the practice of sending mail to a targeted list of people with the assumption that a very small percentage of them will respond to the campaign. Direct mail is not cheap, but most real estate investors who consistently use direct mail marketing find it to be the most scalable form of marketing, paying back many times more than it costs. For example, you may spend \$2,000 to print and mail 2,000 letters, receive 100 phone calls from motivated sellers, and actually find three properties worth wholesaling for \$5,000 each. Therefore, that \$2,000 could net you \$15,000 in revenue (\$13,000 in profit, after accounting for your marketing costs.) For a much more in-depth look at the world of direct mail marketing, don't miss the post “The Ultimate Guide to Using Direct Mail Advertising to Grow Your Real Estate Business.”³⁹
3. **Add SEO Tools to Your Website.** Whether it's figuring out how to keep their dog from “going potty” indoors, learning how to solve a

³⁸ <http://www.biggerpockets.com/driving-for-dollars>

³⁹ <http://www.biggerpockets.com/directmailadvertising>

Rubik's cube in ten minutes or less, or trying to identify that terrible noise coming from their car engine, people turn to the internet to find answers. As we've noted numerous times already, wholesaling is about solving problems, so it would make sense that people would search the internet for a cure to their home buying and selling difficulties. And they do—every day. Getting your website in front of these people can produce an incredible supply of motivated leads. However, getting the search engines to offer your website to searchers is an art form in itself. This practice is commonly known as SEO (search engine optimization). Although the search engine algorithms change constantly, the key to success in SEO is to make your website easy to read and to fill it with amazing content, centered on specific topics people are searching for. Remember, the search engine's job is to provide searchers with the best solution to their problem, so if you make your website the best, most obvious solution to their problem, it'll start to appear at the top of the search results.

4. **Online Marketing.** In addition to SEO, you can reach Internet searchers by paying to be at the top of the search results page (or on people's Facebook wall) by paying for ads, a practice known as pay-per-click advertising. For a few dollars per click (you typically only pay when someone clicks the ad), you can get targeted leads to your website.
5. **Signs.** Let's step away from the virtual world for a minute and talk about one of the most controversial methods of attracting leads: signs. The most common type of sign used by wholesalers is known as a "bandit sign." These are those ugly, yellow, often-handwritten "I want to buy your house for CA\$H" signs you see plastered all over street corners. At BiggerPockets, we recommend not using these. Although they may work, they are almost always illegal to post. Additionally, they make neighborhoods look terrible. As real estate investor Marty Boardman states in his article "Bandit Signs: The Ugly Way to Advertise Your Real Estate Business"⁴⁰ (this is a *must-read* article for anyone interested in using bandit signs), "As responsible real estate investors, we should be cleaning up our neighborhoods, not littering them with illegal signage." I couldn't have said it better myself.

There are other signs you can consider using, legally. For example, renting a billboard or a bus stop bench with an "I buy houses" message

⁴⁰ <http://www.biggerpockets.com/bandit-signs>

can get the phone ringing. Similarly, placing a magnetic sign on your car can get your name and number out there.

6. **The MLS.** The Multiple Listing Service (MLS) is where the majority of homes in the United States are listed for sale. (In reality, the MLS is not *one* thing, but rather dozens of small lists owned by real estate brokers that, when combined, we refer to as the MLS—but that’s getting a little too deep for this conversation.) Chances are, if you are searching Zillow.com, Trulia.com, or Realtor.com, you are actually searching (mostly) the MLS. When a home is listed on the MLS, that generally means a real estate agent is behind the listing and will get paid a commission by the seller (which means it is usually commission-free for the buyer to purchase real estate). This also means you can use a real estate agent on the deal, and that person also gets paid by the seller—so using an agent just makes sense.

I won’t say that finding wholesale deals on the MLS is impossible, but because of the exposure homes on the MLS have, competition is much greater, especially in a hot market, like much of the United States is experiencing today. However, hidden gems can be found on the MLS if you look carefully enough, act quickly, and negotiate intelligently.

7. **Craigslist.** Craigslist has truly taken the world by storm. This website, which unashamedly looks like the Internet circa 1995, is currently the country’s tenth largest website, with more than 60 million people using the site each month in the United States alone.⁴¹ Craigslist is essentially the world’s largest classified website, where people of all walks of life can post their needs, their wants, and what they have to offer. You can find, buy, sell, trade, or rent anything, ranging from cars to houses, chainsaws, and spouses. The best part is this: Craigslist is totally free (unless you are posting a job opening or rental in certain cities, which is where Craigslist makes its money). Every real estate investor should be using Craigslist on a daily basis. Because of the site’s popularity, posting “I buy houses” ads is a no-brainer. Additionally, looking there daily for owners who list their homes as for sale by owner (FSBO) is also a no-brainer—and you can do it in just a few minutes, or even automate it using a website such as www.ifttt.com.
8. **FSBO.** Many homeowners decide to sell their properties without listing on the MLS and simply stick a sign in the yard or post an ad in

⁴¹ <http://www.craigslist.org/about/factsheet>

the newspaper. These properties are known as FSBOs, or “for sale by owner” properties. Most FSBO homes are priced too high or have no equity, but wholesaling is a numbers game, so the more houses you look at, the better chance you have of finding a great deal.

9. **Empowering Others.** The final strategy I wanted to share might be the most powerful: leveraging other people’s talents, time, and skills to bring deals to you. After all, your circle of influence is relatively small, but the more people you work with, the larger your collective network is and the more potential deals you’ll be able to find. There are a variety of ways you can empower other people to find deals for you, including offering a finder’s fee to others, talking with your local mail carrier, working with other wholesalers, and just letting everyone you meet know what you are looking for.

I hope that these nine strategies will give you a good place to start in looking for deals. However, keep in mind that this is only a sampling of what’s possible. Get creative with your marketing. Talk to other real estate investors and discover what works for them. Continually test, continually tweak, and continually grow. Consistency is key when marketing for wholesaling leads and imperative when trying to build a sizable real estate wholesaling business. Spend the vast majority of your time on marketing, and you’ll have more deals than you’ll know what to do with—and that’s a great problem to have.

Is Wholesaling a Job or Investing?

Before we get too deep into the specifics of assembling a wholesale deal, I want to talk about the elephant in the room: is wholesaling *really* investing? Does it belong in a book about creative real estate investing?

Who cares?

Wholesaling is not passive, but neither is flipping or landlording. Nearly every worthwhile aspect of real estate investing involves some level of work, and the systems you create are what define how much work you will take on. Some wholesalers work far fewer hours than most landlords because they’ve established the proper systems to handle the majority of their business. This is where I want you to be—and this is where you *can* be. I believe that, at its core, wholesaling is a job. If you stop working, it stops producing.

However, it's a job that can help you raise cash for future investing while also giving you the skills you need to become a *great* real estate investor. By mastering the art of wholesaling, you master the art of marketing for deals, at which most real estate investors never excel.

Perhaps the greatest benefit of wholesaling is that you are able to cherry-pick the best deals (those that fit your long-term plan) while wholesaling the rest. If you can create a marketing machine that consistently churns out great leads, you can wholesale 90 percent of the properties you find, keeping 10 percent for flipping or long-term buy and hold. Because you'd be able to get such deep discounts, this would only accelerate your wealth-building activities and lead you to financial freedom that much more quickly.

So who cares if it's a job or investing?

If you love doing it, do it. If you don't, then don't.

How Much Money Can a Wholesaler Make?

Ah, so we come to the real reason you are reading this chapter!

Of course, no one is in the wholesaling game because it's just a fun hobby. Wholesalers work their tails off because they know good money can be made. But how much?

Defining a "typical" wholesale fee is hard, but most wholesalers I know try to make a minimum of \$5,000 per deal—and some make a lot more. In the end, it all comes down to how good of a deal you can get. The larger the spread between the price you pay for a property and the price you sell it for, the more money you make. The more deals you do, the more money you make.

One of the biggest mistakes most new wholesalers make is forgetting one simple fact: a wholesaler needs to sell at wholesale prices! Because the primary buyer for a wholesale deal is another real estate investor, a wholesaler must come to the table with a better deal than the investor can get on their own. For example, if a typical three-bedroom, two-bath house in Cougar Town sells for \$150,000, and an investor wants to get such a house for \$110,000, the wholesaler had better get it for even less than \$110,000. If they can get it for \$105,000 and sell it for \$110,000, they could make \$5,000 (less fees). If they can get it for \$90,000, they could make \$20,000 (less fees).

Your success as a wholesaler starts with finding a great deal. The old adage of "you make your money when you buy" rings especially true for

the wholesaler. So how do you know what a great deal is?

For this, it all comes down to the math.

Wholesaling Math

You don't have to be a nerd to understand math—at least, not wholesaling math. The process is not too difficult, and I believe anyone can get a firm grasp of it with just a little bit of practice, which is exactly what you'll be doing now! The next section will show you exactly how to determine the price you should offer a seller for a property and how much you can expect to make. For this, we'll return to the original story I used at the beginning of this chapter, with Beth the wholesaler, Clarence the owner, and Jackson the cash buyer.

The After-Repair Value

Let's start with the most important and fundamental number in real estate wholesaling, the ARV, which, as we first explained in Chapter Five, is short for after-repair value. As the name would suggest, the ARV is the property's estimated monetary worth if it were in good condition and comparable to other finished homes on the market. In other words, it's the value of the house after any necessary repairs have been done!





The ARV is the foundation on which most of our calculations are based. This is true because, in wholesale math, we need to start at the end and work backward, accounting for the different expenses that will come up along the way. When we are finished, we will have a specific price that we, the wholesaler, should offer.

Although ARV may be easy to understand as a concept, actually determining it for a specific piece of real estate is much more difficult—and nailing the ARV is the difference between success and failure in real estate wholesaling. So how does one figure out the ARV?

At least for residential properties, value is determined by comparing the property to other similar properties that have recently sold. This is known as the comparable sales approach and is often referred to as “comps.” However, there are several ways you can use comps to discover a property's ARV. First, let's look at how an appraiser would value a property.

Appraisers typically look for three properties within close proximity that have a similar size, layout, bedroom/bathroom mix, age, and other

similar attributes. The appraiser will then add or subtract values based on what the similar properties do or don't have, compared with the property being appraised. For example, check out the following image, which compares Clarence's house (the one Beth wants to wholesale) with similar homes in the area. The light-colored house on the left represents the home we'll be appraising. The dark-colored homes are the similar comps we will use to determine the light grey house's ARV. (Keep in mind, this is *very* simplified, and an actual appraiser uses many more factors than just these.)

Subject Property			
			
123 Main St. 3 bedrooms 2 bathrooms 1400 sq. ft. ARV: ???	875 Elm St. 4 bedrooms -\$15k 2 bathrooms 1500 sq. ft. -\$3K Old roof +\$5K Sold for \$156,000 Adjust: -\$13,000 Comp value: \$143,000	413 Oak St. 3 bedrooms 1 bathroom +\$13K 1500 sq. ft. -\$3K New roof Sold for: \$138,000 Adjust: +\$10,000 Comp value: \$148,000	77 First St. 3 bedrooms 3 Bathroom -\$11K 2000 sq. ft. -\$5K New roof Sold for \$167,000 Adjust: -\$16,000 Comp value: \$151,000
Average value of the three comps: \$147,333			

Notice that next to each feature that differs from that of our subject property, we add or subtract value based on how that difference would affect the price. The appraiser determines this value after knowing what certain items add to the cost of a home.

For example, 875 Elm Street has an extra bedroom that the subject property does not have. Therefore, we will subtract \$15,000 in value from the final sale price of 875 Elm Street because the appraiser has determined that the extra bedroom has historically been proven to add \$15,000 in that area. Also, 875 Elm Street has an extra 100 square feet of space, so we'll subtract \$3,000 from the final value since the appraiser has determined that adding 100 square feet is worth about \$3,000 in that area. However, that same Elm Street house has an old roof, whereas our subject property will have a new roof, so we'll *add* \$5,000, knowing that a

new roof on this home would add roughly \$5,000. In the end, an appraiser would likely come up with a relative value of \$143,000 for 875 Elm Street. This adjusted price reflects its value if its features were exactly the same as the 123 Main Street house, our subject property.

The appraiser would then do this for all three properties and average the results to get a fairly close estimate of what the ARV would be for 123 Main Street. In this case, the ARV average would ultimately be \$147,333.

What does this mean for the wholesaler?

I'm not suggesting you go out and become a real estate appraiser, and I'm also not suggesting you go out and hire an appraiser for every potential wholesale deal you consider.

However, by understanding the methodology an appraiser uses to determine value, you can get a ballpark estimate in just minutes, without doing as much work. In other words, if you were to do some research and discover the basic information presented in the comps image, you could look at those three properties and calculate that the value would be less than that of the most expensive comp but more than that of the cheapest. The most expensive was \$167,000, and the cheapest was \$138,000. Therefore, estimating an ARV in the mid-\$140s would probably be close enough for your purposes.

Another common method for wholesalers who want to estimate a property's ARV is to look at square footage, determine what the average price per square foot is for the comps, and apply that average to the property they are analyzing. I recommend using this strategy only when all three of the comparable sales are *very* similar to the subject property, because as we'll see in a moment, this practice can lead to some wild numbers.

Using the example of the three comps in the image, let's try to determine the subject property's ARV using just the square footage method. First, we need to figure out the price per square foot for each of the comps.

- 875 Elm Street: $\$156,000 / 1,500 \text{ sq. ft.} = \$104/\text{sq. ft.}$
- 413 Oak Street: $\$138,000 / 1,500 \text{ sq. ft.} = \$92/\text{sq. ft.}$
- 77 First Street: $\$167,000 / 2,000 \text{ sq. ft.} = \$83.50/\text{sq. ft.}$

Then, we just need to average out these price-per-square-foot numbers. To do this, simply add them together and divide by the number of comps (in this case, three).

$$\$104 + \$92 + \$83.50 = \$279.50$$

$$\$279.50 / 3 = \$93.17$$

Therefore, the average price per square foot for the comps is \$93.17. We'll now multiply that number by the square footage of our subject property, which is 1,400 square feet, to get the ARV.

$$\$93.17 \times 1,400 = \$130,438 \text{ ARV}$$

Whoa, that's quite a bit different from the number we determined earlier, isn't it?

Earlier, we calculated a price of \$147,333. Why did this value based on square footage come in at \$17,000 less? Because the comps were not similar enough! There were simply too many factors in those comps to use only square footage to determine value. For example, the formula didn't take into account that one of the homes had a new roof and that another one had an extra bedroom.

As I mentioned earlier, use the square footage approach only when the comps are very similar to the subject property.

Especially when you are first starting out, you should use several different methods to determine a property's ARV. Then, try to go with the most conservative one. Being too conservative and offering too little is better than over-offering and being unable to sell the property.

Because the ARV is such an important number (really, it's the *most* important number), it's vital that you get this part right. I'd highly recommend, at least when you are starting out, that you build a relationship with one or more competent real estate agents so they can offer their opinion on the ARV (we'll talk about this a bit more in a moment). The more opinions you can get, the better equipped you'll be to estimate an accurate ARV on a property.

Finding Comps

Finally, you may be wondering how to find the sale price of these properties for comp data. Here are a few ways to do so:

1. **The MLS and an Agent.** The MLS is a real estate agent-owned collection of data concerning all the listed, pending, and recently sold properties in a given area. Although this information is typically not available publicly, most real estate agents can print you a list of comps

in just seconds, for free. Even better, when starting out, you can work *with* an agent to help you figure out the ARV on a potential deal, even though the agent won't make any money on the transaction.

How do you get a real estate agent to volunteer their time helping you? By building a strong reciprocal relationship with that agent! Network, ask for referrals, and interview agents to find the best one in your area and then let them know who you are and what you do. Next, ask them if they would be willing to *occasionally* help you look at deals and determine an ARV in exchange for you referring all leads that you can't work with to them. Then, don't bother them very often, but maintain a professional working relationship based on mutually beneficial goals.

After all, when you are operating as a wholesaler, only a small percentage of the deals that come across your desk from your marketing will be worthy of your consideration, so you can refer all other leads to the agent. This is truly a win-win relationship that can benefit both parties greatly.

2. **Online Real Estate Portals.** Many of the online real estate portals, including Zillow.com, offer limited “sold” comps for *some* properties. Although this information is not as comprehensive as the MLS data, it may be more than enough for what you need. Additionally, you could use any free online real estate portal—such as Zillow.com, Trulia.com, Redfin.com, or Realtor.com—to look at all the homes currently for sale.

While you shouldn't use “for sale” prices in an appraisal, this can at least give you a ballpark of what homes are going for. You would then just deduct a little to come up with an estimated ARV.

3. **Public Records.** Finally, whenever a property is bought or sold, the transaction is recorded in the public records for anyone to see. However, even though you can search your county's online public records to find a property's most recent sale price and sale date, you will probably not discover any information on the condition or specifics of the property.

Still, you *can* use the public records in conjunction with online real estate portals such as Zillow.com, Trulia.com, and Realtor.com, which usually keep a record of old listings for a long time. Just Google the address of a property that has recently sold, and you'll likely find the original listing, complete with photos and other relevant information.

Finally, let me end the ARV discussion with this word of encouragement: it gets easier! It really does. The more time you spend analyzing properties, the better and faster you'll become. This is why I recommend setting aside a few moments every day to practice. Before long, you'll have a really firm grasp on the property values in your community, and you won't need to wonder—you'll just know.

This is also why it's important to keep your "farm area" (the area you work in) as tight as possible when you are first starting out. If you are trying to wholesale over an area of 10,000 square miles, you will run into a lot of problems. However, if you focus on several similar neighborhoods and property styles, you'll gain a much quicker grasp of the ARVs.

Let's move on and discuss how you can use ARV to determine your Maximum Allowable Offer (the most you should ever pay) and profit on a wholesale deal.

We'll start with a rule of thumb—the 70 Percent Rule.

The 70 Percent Rule

If you are a house flipper, you probably recognize the 70 Percent Rule and understand how it pertains to your trade. However, the 70 Percent Rule can also be extremely helpful for wholesalers, especially those who may be wholesaling deals to house flippers—as you might do.

Keep in mind, this is only a rule of thumb and one of several methods you will use to estimate what you should offer on a property. We'll look at another method in just a moment. The 70 Percent Rule states that you should pay no more than 70 percent of a property's ARV, minus any repairs.

A wholesaler also needs to subtract their fees from that number. Therefore, the 70 Percent Rule, as it applies to wholesalers, is as follows:

$$\text{Maximum Allowable Offer} = (\text{ARV} \times .70) - \text{Repairs} - \text{Your Fee}$$

Let's do some very quick math, and I'll show you how this would work in the real world.

Wholesaler Beth was considering making an offer on 123 Main Street, the property owned by Clarence that we looked at earlier. If you'll recall, we determined the ARV for that house to be approximately \$147,333, after comparing it with 875 Elm Street, 413 Oak Street, and 77 First Street.

To determine her offer price, Beth multiplies \$147,333 by .70 to get \$103,133. She then subtracts the cost of the necessary repairs, which she estimates at \$20,000, and her desired wholesale fee of \$10,000 to arrive at a maximum offer price of \$73,133.

$$\begin{aligned} & \$147,333 \text{ (ARV)} \\ & \quad \times .70 \text{ (70\%)} \\ & = \$103,133 \\ & - \$20,000 \text{ (Repairs)} \\ & - \$10,000 \text{ (Wholesale Fee)} \\ & = \mathbf{\$73,133 \text{ Maximum Allowable Offer}} \end{aligned}$$

Problems with the 70 Percent Rule

The 70 Percent Rule assumes that 30 percent of the ARV will be spent on holding costs, closing costs (on both the buyer's and seller's side, such as commissions, taxes, attorney fees, title company fees, and more), the flipper's profit, and any other charges that come up during the deal. This works well in many markets, but it has some severe limitations. For example, the 70 Percent Rule doesn't work as well for a property whose ARV is low, such as \$50,000. As mentioned earlier, the 30 percent deducted from the ARV includes the holding costs and closing costs, as well as the profit the investor or flipper wants to make. However, 30 percent of \$50,000 is \$15,000, so following the 70 Percent Rule, *all* the fees, costs, and profit add up to only \$15,000. If the fees and holding costs were to total \$10,000, that would leave just \$5,000 in profit for the house flipper—and I don't know any house flipper who will take on the risk of flipping for just \$5,000. So, following the 70 Percent Rule, a flipper or wholesaler would pay far too much for the property in this case.

A similar problem with the 70 Percent Rule exists for more expensive properties. The 70 Percent Rule would dictate that a home with an ARV of \$700,000 that needs \$50,000 worth of work should produce a Maximum Allowable Offer of \$440,000. However, in most markets, finding a \$700,000 property for \$440,000 is simply not feasible. A person who sticks exclusively to the 70 Percent Rule will likely never find a good enough deal to wholesale or flip a single property.

Furthermore, some investors may spend more or less on fees and

costs because of their particular life situation or location. For example, in some states, purchasing a home may require \$3,000 in closing costs, while in other states, it might be \$6,000. Some investors may have a real estate license, which saves them tens of thousands of dollars in commissions, whereas other investors may need to pay commissions when they sell.

Therefore, a different model may be needed to estimate the Maximum Allowable Offer. For this, we turn to the Fixed Cost Method.

The Fixed Cost Method

Another method, generally more accurate, for determining your Maximum Allowable Offer based on a property's ARV is known as the Fixed Cost Method.

The theory behind the Fixed Cost Method is that all the extra charges, such as holding costs, utilities, and closing costs, can be combined to form one number, known as the "fixed costs." To determine your Maximum Allowable Offer, you simply need to work backward from your ARV, subtracting out your fixed costs, the desired profit, the wholesale fee, and the rehab expenses to arrive at your offer. The formula looks like this:

$$\text{ARV} - \text{Fixed Costs} - \text{Investor's Profit} - \text{Wholesale Fee} - \text{Rehab Costs} = \text{Maximum Allowable Offer}$$

Of course, to do this calculation, you must understand how to determine your fixed costs. The profit, fee, and rehab expenses are fairly easy to determine, but discovering the fixed costs will take a little more effort.

The best explanation for determining fixed costs can be found in Author J Scott's *The Book on Flipping Houses*.⁴² He explains that "fixed costs are comprised of the various fees, commissions, and costs associated with all parts of the investment project (outside of the actual rehab costs)."

The author goes on to break out these expenses into more specific detail, adding up the total of the most typical fixed costs for his business:

- Inspection Costs: \$400
- Lender Fees: \$1,000
- Closing Costs: \$2,000
- Mortgage Payments: \$2,500

⁴² <http://www.biggerpockets.com/flipping-estimating>

- Property Taxes: \$600
- Utilities: \$1,000
- Insurance: \$200
- Commissions: \$4,000
- Selling Closing Costs: \$4,000
- Home Warranty: \$500
- Termite Letter: \$100
- MLS Fees: \$100

These costs, all added together, give an investor the fixed costs for a property. Keep in mind, these are just the rates that J Scott outlined in his book and that he has seen applied to his business—but *they may not be the same for you*. Every market is different, so spending some time determining what *your* costs would be on the listed items is important. For example, if you plan to sell to a landlord, you won't need to worry about the sales commissions, selling closing costs, home warranty, or MLS fees, because the landlord will be holding on to the property. However, if you sell to a house flipper, you would need to include these figures, because the flipper will be selling and will need to account for these numbers.

To determine your fixed costs, create a spreadsheet with the listed items, and spend some time researching what these figures would typically be for your area. You don't have to get them all precisely correct, but estimate conservatively. The nice thing is, after you do this once, you won't need to do it again for the same kind of property, as long as that property is in the same area. This is why we call them “fixed costs”—because we'll use the same (fixed) number every time. For J Scott, that number was \$16,400. What will yours be? Take an hour to figure it out once, and you won't need to do it again for that same property type and area.

Let's return to the ongoing story of wholesaler Beth and the 123 Main Street house, and we'll look at an example of how she used the Fixed Cost Method to determine her Maximum Allowable Offer.

Earlier we determined that the home's ARV was an estimated \$147,333. We also calculated, when discussing the 70 Percent Rule, that the rehab costs would be approximately \$20,000. This time, we'll use the Fixed Cost Method to come up with the Maximum Allowable Offer:

- Beth determines that the fixed costs would total \$19,000.

- The house flipper (Jackson) that Beth is planning to sell the home to likes to make \$20,000 minimum on any project, so we'll use that number for the desired profit.
- Beth is aiming for a \$10,000 wholesale fee.
- Beth estimates the rehab will cost approximately \$20,000 and gets a local contractor to agree.

Therefore,

\$147,333 (ARV)
 – \$19,000 (Fixed Costs)
 – \$20,000 (Profit)
 \$10,000 (Wholesale Fee)
 \$20,000 (Rehab Costs)
\$78,333 Maximum Allowable Offer

Beth has determined that the most she could pay for this property is \$78,333 using the Fixed Cost Method. If you'll recall, we determined earlier, using the 70 Percent Rule, that Beth could pay \$73,133. These numbers are fairly close, so they should give you a pretty good indication that we're approaching a good Maximum Allowable Offer for this property.

Which Method Should You Use?

The 70 Percent Rule is a good rule of thumb in a lot of markets, but many times it will not work because prices are much higher or much lower in different areas and it simply doesn't give you an accurate figure to work with. I recommend that you take some time to run a few hypothetical analyses to practice—especially using numbers that are realistic for your area. Use the 70 Percent Rule—if you can in *your* area—for a quick analysis but rely on the Fixed Cost Method to ensure you make the right offer.

At this point, you hopefully have a solid grasp on the math that goes into a wholesale deal. However, there is one sticky point in the math equations that we have not yet covered: estimating the rehab costs. Let's talk about that now.

Estimating Rehab Costs

One of the things investors complain about the most—with regard to buying from wholesalers—is the wholesalers’ inability to accurately estimate rehab costs.

“Dude, I’ve got this sweet deal that only needs like \$5,000 worth of work” is a lie—and every cash buyer knows it. The fact is, the better you can estimate rehab costs, the more successful you’ll be. Why? Here are a few reasons:

1. By understanding how much it will cost to rehab a property, you can arrive at an accurate Maximum Allowable Offer and avoid paying too much.
2. By understanding how much the rehab will cost, you can accurately present the information to your cash buyer in an easy-to-comprehend way.

Therefore, we’ll spend a little bit of time on the concept of estimating rehab costs. Keep in mind, this section will not be the end-all-be-all explanation of how to accurately estimate rehab costs. For that, you’ll want to get a copy of *The Book on Estimating Rehab Costs* by J Scott.⁴³ Every wholesaler should have a copy of this book and commit to fully understanding the concepts therein. In lieu of that book, however, I’ll present my six-step process for estimating rehab costs here.

1. **Understand your buyer and the neighborhood.** Before you start calculating how much it will cost to rehab the property, you need to understand what the final product will look like. There are high-end remodels that take months, and there are quick flips that take just days. Understanding the level of finishing to which your buyer plans to rehab the property is imperative. Also, looking at the neighborhood around the property will give you a good indication of how far the rehab will need to go. Typically, most investors do not want to go too far above and beyond the level of other properties in the neighborhood. Therefore, if the home is in a working-class neighborhood with mostly working-class rentals, you don’t need to spend hundreds of thousands on a rehab.
2. **Tour the property in detail.** Next, with a good understanding of how you want the finished product to look, walk through the property very slowly. Take a lot of photos or record a video so you can easily recall

⁴³ <http://www.biggerpockets.com/flipping-estimating>

the condition later (trust me, you won't remember it all). Furthermore, photos will help you sell the property later to the cash buyer. If the seller is home, be sure to let them know you will be taking pictures, that they're for analysis, and that you won't be making the photos public. Don't make them feel like you are invading their privacy.

- 3. **Write down the problems in each part of the property.** While you are still on-site at the property, go room by room and write down its condition, as well as any needed repairs that you notice. For example, if you walk into the living room and see carpet that looks and smells like dog urine, write down "replace carpet in living room." Also, write down a quick estimate of the size of the room (it doesn't need to be exact; just make your best guess). Be sure to take a look at the exterior of the home as well and pay attention to any big issues, such as the condition of the roof, siding, and any outbuildings.
- 4. **Condense your list into one of 25 categories.** Next, you'll want take your comprehensive list of repairs and classify each one into one of the following 25 categories. For example, if the living room needs carpet, the bedrooms need carpet, and the kitchen needs vinyl, group all of them together and include them under "flooring."

EXTERIOR COMPONENTS	INTERIOR COMPONENTS	GENERAL COMPONENTS
1. Roof	11. Demo	22. Permits
2. Gutters/Soffit/Fascia	12. Plumbing	23. Mold
3. Siding	13. Electrical	24. Termites
4. Exterior Painting	14. HVAC	25. Miscellaneous
5. Decks/Porches	15. Framing	
6. Concrete	16. Insulation	
7. Garage	17. Sheetrock	
8. Landscaping	18. Carpentry	
9. Septic	19. Interior Painting	
10. Foundation	20. Cabinets/Countertops	
	21. Flooring	

From *The Book on Estimating Rehab Costs* by J Scott © 2019

5. **Determine a rehab price for each category.** Once you have your 25 categories spelled out, it's time for the most difficult part: estimating the rehab amount for each category. However, once everything has been broken down into these categories, calculating an accurate estimate is much easier, as opposed to looking at the entire project. Let's return to the example of the flooring estimate. We may determine we'll need approximately 1,000 square feet of carpet and another 500 square feet of vinyl.

With that information, we can call up a local flooring or big-box store and ask what they charge for the flooring we need. Speaking of big-box stores—I recommend spending a lot of time in them at the beginning. Learn how much material costs for the most common repairs, such as flooring, paint, cabinets, counters, appliances, etc. To get a really rough estimate on how much those items might cost in labor, double the price of the materials. Again, this provides just a rough estimate, but I find it to be fairly accurate. Additionally, you can go online and search sites like Craigslist or Thumbtack to see how much contractors are asking for certain jobs, such as replacing carpet or painting.

6. **When in doubt, ask for help.** Don't be afraid to ask for help. You can do this in a few different ways:
- Visit the BiggerPockets Forums⁴⁴ and ask people there what they are paying. This is an incredibly useful tool because you are able to get an inside look at what your potential cash buyers are spending.
 - Ask a local contractor for help. Although you may need to pay them for their time, the cost of an hour or two consulting with this professional at the house would be an investment that will help you for years to come. Many wholesalers actually include a detailed, line-by-line bid from a licensed contractor with their presentation to a cash buyer, and I highly recommend doing that. The contractor will likely offer the bid for free, because there is a good chance the cash buyer will end up using them on the job, and you will not have to do the work of estimating the project.
 - Ask a local real estate investor or another wholesaler to come with you. Learning to estimate rehab costs quickly is an important skill to have, so consider working on your first deal or two with someone who has been around the block and can share their knowledge.

⁴⁴ <http://www.biggerpockets.com/forums>

How Accurate Do You Need to Be in Your Rehab Estimates?

Your estimate needs to be close, but it doesn't have to be perfect.

After all, prices vary wildly on rehab jobs, depending on the contractor used, so you don't necessarily need to know the precise costs. As most house flippers and homeowners know, one contractor may bid \$20,000 on a rehab while another will bid \$40,000. You don't know what kind of contractor your cash buyer will use, so your number doesn't have to be exact.

The important thing is not to tarnish your reputation by estimating *way* too low or too high. If you tell a cash buyer that a home needs \$5,000 worth of work, and after their inspection they realize it needs a new roof, siding, foundation, paint, carpet, and cabinets, you *will* hurt your reputation and will likely never work with them again.

However, if you said that same job needed \$40,000 of work, and the cash buyer estimates \$50,000, this will not completely damage your reputation—though you may need to adjust your fee, renegotiate with the seller, or find another cash buyer who can get the work done for less.

Take the time needed to learn how to estimate the rehab costs and calculate a ballpark figure. Let the cash buyer count the nails while you move on to your next property.

It Gets Easier

Finally, one last tip about estimating rehab costs: *it gets easier*.

After several deals, you will be able to look at a property and within minutes offer a ballpark figure to your cash buyer. So don't sweat it too much at the beginning—just follow the six-step process I outlined, and you'll do just fine.

The Difficulty of Being a Wholesaler

As you may have noticed by now, the formulas that house flippers and landlords use to determine their Maximum Allowable Offer is similar to the formulas you'd use as a wholesaler, except you have to offer less than they do because you need to incorporate your fee into the offer to make sure you get paid. In this regard, a wholesaler's job of finding deals is much more difficult than that of a buy-and-hold investor or a house flipper. The wholesaler must identify a great deal and then get an even better deal to cover their fee.

A wholesaler is therefore competing not only against retail buyers, but

also against every other investor—and at a disadvantage because they need to get the properties for even lower prices. Don't let this discourage you, though, because this may not be as difficult as you think. Most landlords are not marketers. Most flippers are not marketers. Most retail buyers are not marketers. *Being a great wholesaler, therefore, comes down to your deal-finding skills*, which we covered earlier.

At this point, you should have a solid understanding of the math involved in a wholesale deal and be able to determine roughly how much you should pay for a property. Now the time has come to turn the theoretical into the practical and learn how to negotiate with sellers.

Making Your Offer and Negotiating with Sellers

At this point, you've met with a motivated seller, looked at the property, determined its ARV, estimated the repair costs, and figured out your Maximum Allowable Offer. Now you need to present your offer to the seller.

But how?

This section will walk you step-by-step through the process of presenting and negotiating deals with motivated sellers. I'll warn you right now: at the start, you may be terrible at this step, but that's okay!

Negotiation is an art form that takes a lot of practice to master, so consider every negotiation as practice for the one to follow and just do your best.

Presenting Your Offer

Once you have your Maximum Allowable Offer, you must present it to the sellers. This can be done in person or over the phone (or even via email/fax/snail mail)—whichever you feel will make the seller the most comfortable. Personally, I believe an in-person offer is best, but in time, you'll find what works best for you.

I think asking the seller, "What do you believe this home should sell for in its current condition?" is a wise way to start.

Then wait.

Likely, they will respond with a high "dream" number. Most sellers know that in a negotiation, you will talk them down, so they will probably start high. However, asking this question is key, because it will give you a point of reference. You can pose this question over the phone the first

time you talk with them (which is not a bad idea), but I also recommend asking them right before you make your offer. Get them to name a price. Maybe it will be completely reasonable, and you can simply shake hands and move on but, more likely, it will be high.

At this point, a great thing to say is something along the lines of, “Gee, Bob, that’s quite a bit higher than I can go. Is that the best you can do?” In almost every case, no matter what the negotiation, the person will drop their initial price and say something like, “Well, I can go to \$____, but no lower.”

At this point, you can begin the real negotiation. Of course, you may want to present an initial offer that is lower than your Maximum Allowable Offer, which will give you room to move up. However, if you offer too low to start, you risk insulting the seller and losing the deal altogether. This is the game of negotiation. Thousands of books have been written on the art of negotiation, so I can barely scratch the surface here. However, here are a few quick tips that have worked well for me and other investors when negotiating with sellers:

1. **Build rapport.** I don’t suggest that you be disingenuous, but try to build a solid relationship quickly with the motivated seller. You don’t need to come out swinging right away, but find some common ground and let your personality shine through.
2. **Look for their pain point.** Although your biggest motivator is probably price, it may not be the seller’s primary motivator. Discover *why* a seller wants to sell and find a solution that solves their problem while giving you the price you need. For example, if you are talking with a motivated seller who is overwhelmed with the management of the property, speed may be far more important than price. Look for cues that show you what their *true* motivation is, because what they say may not always be the real issue.
3. **Listen more than you speak.** Negotiations can be awkward, so your natural inclination will be to talk. Don’t. Listen and ask questions. Let the other party speak as much as they want, because every word they say can help you get a better deal.
4. **Blame it on the higher authority.** If a motivated seller sees you as a rich shark, they will have a hard time discounting the price to a reasonable one because, in their mind, “you can afford it.” However, if you can shift the blame for the low offer onto someone else, you become an advocate *for the seller*, and the higher authority becomes the “bad

guy.” For example, let the seller know that your partner/cash buyer needs to spend X amount or they won’t do the deal. This can keep you in the seller’s good graces while enabling you to negotiate strongly.

5. **Ask, “Is that unreasonable?”** This is one of my favorite negotiation strategies. No one likes to appear “unreasonable,” so when you ask, “Is that unreasonable?” the person typically feels compelled to say, “No, I don’t think so.”
6. **Be okay with walking away, but don’t.** Generally, the person who is more desperate in a negotiation is the one who loses, which is why you need to be okay with walking away. That said, just because you don’t *need* to get the deal, you should not walk away too easily. Negotiate, negotiate, negotiate as long as possible to get what you want.

One of two things will happen after negotiations: you will either come to an agreement or you won’t. If not, don’t consider it a loss, and continue to follow up with the person. Many wholesaling contracts have been won months after the initial negotiation when the seller comes to grips with the true value of their property.

If they do agree to your terms, it’s time to sign the contract.

Signing the Contract

A contract is a legal document that states the terms agreed upon by both parties in the transaction. Generally, I recommend that when you are going to meet with a seller, you fill the form out in its entirety so that once you have agreed on a price, you don’t need to hang around filling out paperwork—this gives the seller a chance to get cold feet. Simply leave the price line (or other negotiable terms) and the signature lines blank.

If you don’t already have a real estate contract, here are a few places you can obtain one:

1. The BiggerPockets FilePlace (free)⁴⁵
2. Title/Escrow Offices (usually free)
3. Office Supply Stores
4. Via a Lawyer
5. From Other Investors
6. Through Real Estate Clubs
7. From a Real Estate Agent (especially if offering on a bank foreclosure)

⁴⁵ <http://www.biggerpockets.com/files>

Real estate contracts are state-specific legal forms, so even though you can find these kinds of forms abundantly online for free, keep in mind that **these are just general samples, so spend a few dollars to have your attorney look over the form** you plan to use to make sure it is valid and applicable for your location. While your contract can be fairly short and simple, be sure that it states at least the following:

- Address and legal description of the property
- Seller's name
- Buyer's name
- "And/or assigns" on the buyer's name line, if you'll be assigning the property (I'll talk about this later)
- Price
- Closing date
- Today's date
- Earnest money amount (I'll cover this soon)
- Contingencies (I'll also talk about this)

Earnest Money

Your earnest money is a deposit paid to the seller showing your good faith to complete the contract as promised. Although you may or may not be required by law in your state to include earnest money, you will probably want to include some just to ensure the contract is fully legal (check with an attorney to see what contract law requires in your state). The amount of earnest money you put down depends on whatever the seller feels okay with, because you want to offer as little as possible. In fact, many wholesalers put down just \$1 as a technicality and leave it at that. Other wholesalers put nothing down. However, your seller may ask you for a little more, and you will have to decide if this is the right thing to do based on the situation.

No matter what the amount is, I recommend never giving the earnest money directly to the seller (though if it's an extremely small amount, such as \$1, feel free). Instead, a third party—usually the title company—should hold the earnest money. This way, the seller can't just steal your money and sell the property to someone else, thereby forcing you to take legal action—which likely wouldn't be worth it. Having a third party hold the earnest money protects you.

Contingencies

A contingency is a clause within a contract that states under what circumstance you are allowed to back out of the contract legally. Although you could put pretty much any contingency in your contract (e.g., “this contract is contingent upon the seller wearing a black shirt on the day of closing”), I recommend skipping anything weird and using only the minimum required to make sure you are safe. Many wholesalers use a contingency such as “This agreement is subject to finding a qualified buyer” or “This agreement is subject to approval from my partner” or “This agreement is subject to a thorough inspection of the premise and approval of its condition.” (Please understand, these are just examples. Your contingencies must be legal in your state, so be sure to have your contract reviewed by an attorney.)

You should never use a contingency to tie up properties only to later back out of the agreement because you hadn’t done your homework. Contingencies are meant to protect you legally in case something goes wrong; they are not to be used to compensate for your irresponsibility. This will only damage your reputation. If you’ve done your homework and the math correctly, you should not need to use your contingency.

Once you have your contract with the seller signed, it’s time to move on and get that property into the hands of someone who can purchase it. We call these people “cash buyers,” and the next section will dive into exactly what they are, how to find them, and the process for getting paid for your work in finding the great deal.

Finding and Working with Cash Buyers

At this point, you’ve found a great deal, negotiated with a seller, and signed a contract for a great price—now you need to get rid of that contract and get paid! This section will show you how to find real cash buyers for your next wholesale deal and explain what to do with them once you’ve found them.

Introduction to Cash Buyers

First of all, what do we mean by “cash buyer,” and why is it important?

A cash buyer is any person or business that can buy your wholesale deal from you without needing to use traditional financing. In other words, when you present the perfect deal, they do not need to run to the

bank and wait six weeks for a loan to close. In a wholesaling situation, that typically doesn't work.

However, this doesn't mean you need to find only wealthy people with millions of dollars in the bank (though that would be nice). Anyone with access to cash financing has the potential to be a great cash buyer.

Specifically, that could mean any of the following:

- Someone who uses a hard money lender to fund a deal (see Chapter Five)
- Someone who uses a line of credit that they already have access to (see Chapter Four)
- Someone who has a partner who can fund the deal with cash (see Chapter Three)

So how do you find a cash buyer? We'll get to that in just a moment, but let's first talk about one of the most common questions every new wholesaler seems to ask:

Which comes first, finding cash buyers or finding the deal?

The Chicken or the Egg?

It's a classic question.

In the wholesaling world, it's "which comes first, the cash buyer or the deal?" After all, the deal is what will attract the cash buyer, but without the cash buyer, you can't do anything with the deal. This question stops many new investors from ever taking action.

The problem is compounded because of all the wholesaling gurus out there. You sign up for a free seminar on wholesaling, get upsold to a weekend boot camp, and the only thing you get out of it is "how to build your cash buyers list."

Here's a little secret: finding cash buyers is the *easiest* part of the entire wholesaling process.

Seriously, you are about to be amazed at just how easy (and cheap) it is to find more cash buyers than you'll ever need in order to wholesale. I believe this is why the gurus use the phrase "cash buyers" so frequently: they know that if they can convince you that finding cash buyers is the solution to all your problems, you'll pay big money to find out that "secret," and you'll be convinced that you are a legitimate wholesaler—and that they are a god (they're not!).

Every day, newbie wholesalers straight from the latest and greatest

guru boot camp jump onto the BiggerPockets Real Estate Marketplace⁴⁶ and place an ad saying, “I’m looking to build my cash buyers list!”

However, after that initial post, we never hear from them again. They were duped into thinking that if they only had the cash buyers, everything else would fall into place. It’s very sad.

The truth is, cash buyers are everywhere, but cash buyers do not mean anything if you don’t know how to get a good deal.

So, we’re back to the original question: which comes first, the cash buyer or the deal?

It doesn’t matter. You can find the deal first and easily find a cash buyer for it later *or* you can easily find the cash buyer first and then go find the deal.

Either way, finding the deal is the hard part, and you need to understand that. Once you realize that locating cash buyers as a first step or last step doesn’t change your outcome, the issue becomes much less important. So, do both. Find cash buyers while you are marketing for good deals.

The one major benefit to finding cash buyers first is being able to gain some free education from them on what makes a good deal. Therefore, if you really need an answer to the question “which comes first?”, go find one cash buyer who is willing to train you on what they want from a deal. Then go out and find a perfect deal for them. You can build your business from there.

How Many Cash Buyers Do You Need?

For whatever reason, the phrase “cash buyers list” gets tossed around a lot in the guru circles. It sounds sexy, doesn’t it? “There are hundreds of investors on my list, fighting for all my good deals.”

You don’t need hundreds of cash buyers. You probably don’t need dozens. A great wholesaler only needs a small handful because their deals are good enough. They don’t need to shop their deal around to hundreds of potential cash buyers, hoping one of them is desperate enough to pay a ridiculous price for a worthless property. If you have a good enough deal, you won’t have a problem marketing that deal.

I *do* recommend having a small handful of cash buyers because every investor has their own niche, strategy, and location. Cash buyer Bob may be looking for single-family homes in Seattle that he can buy for \$150,000

⁴⁶ <http://www.biggerpockets.com/marketplace>

to \$175,000 that he can flip, while cash buyer Belinda may be looking for single-family homes in Tacoma that she can buy for \$80,000 to \$120,000 that she can rent out. Therefore, it is good to have cash buyers in multiple niches and strategies to cover all your bases and handle whatever legitimate deal comes across your plate.

Again, you don't need hundreds of buyers on a buyers' list. However, as long as you are not using the search for cash buyers as an excuse to think you are doing real work, you should always be updating your buyers' list.

When you are chatting with potential cash buyers, it's smart to "pre-qualify" them. Many people who claim to be cash buyers may just be newbies, fresh out of a guru boot camp and posing as someone who can make things happen. When wholesaling, you only want to deal with legitimate cash buyers who are experienced and trustworthy. I recommend interviewing all potential cash buyers and asking questions such as:

- How many deals have you purchased in the past six months?
- How quickly can you close?
- Are you working with other wholesalers?
- What kind of properties (specifically) are you looking for?
- What kind of LTV are you looking for?
- What kind of property condition will you accept?

These questions will help you distinguish legitimate cash buyers from wannabe tire kickers.

Let's get into the actual practice of finding cash buyers. As I said, I think you'll be surprised by just how easy this can be. In fact, let me give you ten different methods.

Ten Strategies for Finding Cash Buyers

1. **Landlords on Craigslist.** Head to your local Craigslist "houses/apartments for rent" section, and you'll instantly find a huge list of property owners, along with their phone numbers and property addresses! True, not all these owners will be cash buyers, but most investors with enough knowledge to buy multiple-unit properties could probably also pull off a cash deal.
2. **Real Estate Clubs.** At your local real estate investing club or landlord organization, you'll likely encounter a variety of cash buyers. Simply strike up conversations with everyone you can and ask what their

specialty is while letting them know what you do. Chances are you'll find some great business relationships this way!

3. **Real Estate Agents.** Real estate agents have some special tools at their fingertips that non-agents do not have, especially for searching recent sales. If you can build a solid relationship with an agent, they can easily supply you with a list of all recent cash sales in any nearby location. Although they may not be able to get you the property owners' names (though perhaps they can), they *can* easily give you the property addresses, and you can search the online public records for names and personal information.
4. **Online Lead Capture.** If you have a website, you can easily set up a "lead capture form" that allows potential cash buyers to submit their name and contact information if they'd like to be added to your buyers' list. You can drive traffic to your webpage through social media, online or traditional advertising, your BiggerPockets profile, or good ol' Craigslist.
5. **Public Record.** Your local public records office has information about every sale in your area and is perhaps the most comprehensive source of cash buyers. Although every county is different in the way this information can be accessed, you can begin by doing a Google search of your local county assessor's page or records office. When a house is purchased with financing (in a state that uses mortgages), two primary documents are recorded with the county: the deed (which shows the change in ownership) and the lien from the loan. On a cash sale, there will be no lien from the loan. Another good way to search the public record is through a local title company. They can provide (with or without a fee) a list of properties that have sold without a mortgage lien.
6. **Craigslist Ads.** Unlike a lot of real estate gurus, I don't recommend creating fake real estate listings just to get the phone ringing. However, creating ads on Craigslist for future wholesale deals is more than appropriate and should get people calling.

A simple subject line that states "Wholesale real estate deals at 70 percent ARV" and a short ad explaining how you wholesale deals should get people's interest and connect you with some serious cash buyers.

7. **Courthouse Steps.** When a person buys on the courthouse steps (a process where an investor can buy a foreclosed home from the government-held auction—often literally performed on the courthouse

steps) they must have all cash. Therefore, anyone bidding on a property at the courthouse is a cash buyer. Get to these auctions early and strike up some conversations, hand out business cards, and create some long-lasting business relationships.

8. **Hard Money Lenders.** Hard money lenders can be a terrific source of referrals to cash buyers because, as you recall, a cash buyer doesn't necessarily need to have all the cash in the bank and could use hard money to close with all cash. Connecting you with their clients is in a hard money lender's best interest because you, in turn, will provide them with additional business. It's a win-win-win.
9. **ListSource.com.** While Listsource.com is the most common place for wholesalers to create a list of potential motivated sellers, it can also be a great place to find cash buyers. Use the site to search for properties purchased within a specific period of time and focus on absentee owners who didn't record a deed of trust. This will give you a list of cash buyers for just pennies per item. (Special thanks to Michael Quarles from YellowLetters.com for that tip!)
10. **BiggerPockets.** Finally, our very own BiggerPockets.com is an incredible place to find and screen potential cash buyers. Among our more than 1.3 million members are thousands of cash buyers looking for deals on our site every day. Visit and use BiggerPockets.com/meet to find members in your area and start building relationships with those who appear to be big players in the real estate space. You can also use this space as a great opportunity to build your reputation by engaging with other members, answering questions, and getting involved.

Should You Present Your Deal to One Cash Buyer or Multiple?

At this point, you should have a solid list of potential cash buyers for your deals. But how do you present your latest deal to them—approach them all at once, or one at a time? Should you send out a large blast email to everyone on your list or pick up the phone and call each one individually?

Likely, you'll discover a strategy that works for you, and there is not one "right" way to do this. However, let me offer a few tips.

- An email is not as personal as a phone call, so I recommend using the phone when first starting. Once you have an established track record with your cash buyers, you can start sending them emails

or text messages. Also, find out which form of communication your various cash buyers prefer and cater to them as much as possible.

- If you send out your potential deal to everyone, you may get some interest, but you may also annoy those who would not be interested in that kind of deal. So consider pitching the deal only to those who seem most serious.
- If you have a great relationship with one of your cash buyers, consider offering the deal to them first, thereby providing them a limited moment of exclusivity. This might help deepen your relationship and show them you value their business.

How to Present the Deal to the Cash Buyer

Hopefully you've used your smart marketing and negotiation skills to snag a killer good deal so you don't need to pitch the property in desperation. However, you do need to adequately present the information to your cash buyer so they can make the best decision possible, which means you need to prepare. This is especially true when pitching a deal to a cash buyer for the first time, because you have not yet built up the trust needed for them to "take your word for it."

I recommend that when presenting to a cash buyer, you present your deal in the form of an easy-to-understand packet of information that the cash buyer can look through. The more work you do in advance means the less work they have to do, which means chances are greater that they will say yes. At a minimum, I'd recommend including the following:

- The property address and details
- Financial outlook (for either flip or rental)
- The property condition and repairs needed
- A bid from a contractor for the cost of repairs needed (optional, but very helpful!)
- Photos of the property, inside and out
- Comparable sales for the neighborhood to justify your assumed ARV

Remember, the less work you make your cash buyer do, the better chance you have of selling the deal to them and making your desired profit! Cash buyers will want to check out the property for themselves, so you will need to arrange a time for the buyer to do a walk-through. If they like what they see and agree to the terms you have offered, you have a deal and can move on. You may need to negotiate with the cash buyer,

so be prepared for the discussion and know exactly how low you can go and still make an acceptable profit.

Getting a Nonrefundable Fee from Your Cash Buyer

You've found the deal, negotiated a great price, found a cash buyer, and your cash buyer has agreed to work with you because of your fabulous marketing package. Now what?

Next, it's important that you receive a nonrefundable fee from your cash buyer to transfer the contract to them. Why? Because you don't want them to back out of the deal! You likely put down some earnest money on the deal yourself, so requiring this fee of your cash buyer is necessary to make sure you don't lose your money if they get cold feet.

The amount of the fee depends on the size of the deal, your relationship with the buyer, and your negotiation skills. I recommend asking for at least \$1,000 and potentially up to \$5,000, if not more. After all, your cash buyer has seen the property and inspected it to their satisfaction before handing over the deposit, and they are paying in cash, so they should have no major reason to back out. If they balk at the fee, consider finding a new cash buyer or lowering the amount, but make sure they understand that the only reason you require such a fee is to protect yourself from something going wrong at closing.

Finally, you'll sign the necessary paperwork and begin the process of closing. Let's discuss the different legal ways you can wholesale a property to a cash buyer.

Legally Putting Together a Wholesale Deal

A wholesale deal can be legally put together in many different ways, and the method you use will depend on the transaction, your state laws, and other circumstances. For this reason, I want to give you a thorough overview of the different ways to close a wholesale deal so you can choose the one that works best for you and your location.

The different strategies for putting together a wholesale deal can be a little confusing, so I want to return to the story I provided earlier in the chapter about wholesaler Beth and the deal she bought from Clarence and sold to Jackson. In that example, Beth used an *assignment*, so I'll talk about this method first.

Assignments

To “assign” a contract simply means “to give” the contract to someone else, which Beth can do because of the way she wrote up the contract.

Recall that Beth told Clarence that “either she or a business associate of hers will buy the home,” which she communicated on the official purchase and sale contract by writing ‘Beth and/or assigns’ in the blank space meant for the buyer’s name. In other words, the legal “buyer” of the property will be Beth and/or someone to whom she assigns the contract. Contract assignments are done every day in the business world, and there is nothing illegal or immoral about them—as long as you aren’t trying to deceive someone and pull the wool over their eyes.

Note that Beth clearly lets Clarence know that she may not be the one who actually buys the house. As for Clarence, he doesn’t care. He’s just happy to get out of the double payment he has been paying and move on with his life. To avoid complications later on and stay 100 percent ethical, you must let your buyer know if you plan on wholesaling the deal (though using terms such as “wholesaling” might just confuse them, so stick with “I or a business partner of mine will buy it” to keep things simple).

Many wholesalers do not use assignments when closing a wholesale deal, primarily for two reasons:

1. Most bank REOS (foreclosed properties being sold by a bank) do not allow “and/or assigns” to be written in the contract, so the assignment strategy is not an option.
2. When doing an assignment, the seller will likely see on their closing paperwork the assignment fee that the wholesaler will receive. Depending on the size of the fee, the wholesaler may prefer to keep that fee amount private so as to avoid “rocking the boat” with the seller.

In addition to assignments, two other strategies are commonly used by wholesalers: simultaneous closing and back-to-back closing. This is where things get a little confusing. You see, different real estate investors have different names for these strategies. No doubt, someone will read this and say, “That’s not a simultaneous closing” or “That’s not a back-to-back closing” or “that’s not a double closing!”

The fact is, there is no standard definition for either of these strategies but these are concepts you need to know, so keep reading!

Both techniques involve actually buying the property yourself, walking

(physically or just hypothetically) to another room at the title company (or attorney's office), and immediately selling the property to a buyer, often within just minutes (though it could be several days).

The difference between the two techniques (simultaneous and back-to-back) lies in the way the deal is funded. You see, purchasing real estate requires money, and even if you only own a property for ten minutes, you still need to pay for that property. So how do you come up with the funds?

The answer to that question is what differentiates these two techniques. Let's examine each one individually:

Simultaneous (Double) Closings

A simultaneous closing—also known as a double closing—uses the end buyer's cash to fund *both* purchases. In other words, the end buyer's cash will fund your purchase, and then that same cash will pay you for the property.

Confused yet? Let me try to explain by adapting the Beth, Clarence, and Jackson story from earlier in the chapter.

Clarence shows up at the title company to sign the documents to sell his home to Beth. In the next room, Jackson is waiting to buy the property. Jackson's bank sends a wire transfer of \$95,500 to the title company, and he signs the paperwork to buy the property from Beth. Beth then receives (on paper) \$95,500. She then goes back to Clarence in the adjacent room and buys the property from him for \$85,000. In other words, Beth simply sold the property at almost the same time as she bought it by using funds from the end buyer.

Do you see a problem here?

Simultaneous closings are fairly uncommon today because they involve someone selling a property before they even own it, as Beth does in our example. Yes, the title company can figure out the paperwork side of things (hopefully), but most are uncomfortable with this kind of arrangement. Furthermore, some states do not legally allow this kind of funding. Therefore, most wholesalers skip the simultaneous closing and instead rely on either an assignment or a back-to-back closing, which we'll explore next.

Back-to-Back Closings

A back-to-back closing is very similar to a simultaneous closing, but rather than using the buyer's funds for the purchase, the wholesaler uses other funds to make the deal happen.

Most people I know, however, don't have hundreds of thousands of dollars just sitting around, waiting to be used for a few hours to fund a quick wholesale deal. So if a wholesaler doesn't have such funds readily available, how can they come up with the cash needed for a back-to-back closing? Of course, the wholesaler only needs the funds for a few hours. Luckily, there is a simple solution: *transactional lenders*.

A transactional lender is a special kind of lender who funds back-to-back closings. They wire money to the title company for a short time (a few days max) and the title company uses that money to buy the property and then resell it a few minutes later. These lenders can be found nationwide, but I recommend starting with a local hard money lender who has experience with these kinds of transactions.

Because the transaction is almost risk free for the lender, finding transactional lending should not be too difficult. The fees for these transactions typically range from 1–3 percent of the total transaction, so be sure to figure those extra costs into your wholesaling math.

One negative aspect of the back-to-back closing involves the extra costs that must be incorporated into the deal. Because the wholesaler is actually legally purchasing the property (if only for a few minutes), charges can add up quickly in addition to the transactional lender's fee. These costs include additional document preparation fees, additional title company/attorney fees, and additional recording fees, among others. These can easily add an extra \$1,000 or more to your bottom line, so be sure to factor these costs into the deal. You don't want to wholesale a property for \$3,000, only to pay \$2,000 to a transactional lender and another \$1,000 in extra closing costs!

Whichever method you use to close the transaction, understand that you will really only need to figure this stuff out once. It may feel cumbersome and confusing in the beginning, but I encourage you to push through, and you'll find all the answers you'll ever need just by *doing*. And if you truly get stuck, visit the BiggerPockets Forums⁴⁷ and ask for help from others. There are plenty of wholesalers who would love to help you reach your goals, so don't be afraid to ask.

Getting Paid

Finally, the title company or attorney who closed the deal will issue a check

⁴⁷ <http://www.biggerpockets.com/forums>

for you, probably on the day of closing (though it may take a day or two). I'd encourage you to use this check to continue growing your real estate wholesaling business, reinvesting your profits into more marketing and potentially more help to manage the increased business. Remember, a single deal is not going to get you any closer to financial freedom. You need to develop a business that can consistently provide leads and generate a great income. Resist the temptation to buy that new car and reinvest the profits into your future instead.

WRAPPING IT UP

Wholesaling

In this chapter, we've walked through the entire wholesaling process from beginning to end. We've examined the details of a wholesale deal, from the basics of finding incredible deals to smart marketing tactics. We looked at two different methods of analyzing a potential wholesale deal. We covered negotiation and making an offer, as well as signing the contract with the seller. Finally, we talked about finding cash buyers for selling the deals, as well as the legal techniques you can use to make that transaction a smooth one.

At this point, I hope you have all the knowledge you need to begin wholesaling your first or next deal. Wholesaling requires dedication, hard work, smart marketing, and a commitment to success in order to build serious income from the business. If you feel up for the challenge and want to add wholesaling to your toolbox, you now have everything you need to make it happen.

Throughout this book, we've looked at almost a dozen different strategies for investing in real estate with little to no money of your own. Although wholesaling may not easily fit within the strict definition of "investing," I included it because it *does* fit the business of a real estate investor—and it can be done with little to nothing out of pocket. I want to make sure that when leads come in for your business, you have every opportunity to succeed with them, so I hope this chapter on wholesaling can help you earn more income in your business and live the life of your dreams.



Chapter Ten

SYNDICATION

Humans are *incredible*.

Think of the sheer magnitude of the Pyramids at Giza, the length of the Great Wall of China, and the expanse of the Panama Canal. What these incredible feats of human ingenuity show us is simple: when people band together, anything is possible.

In the same way, real estate syndications are all about bringing together people to do something amazing. People from different backgrounds, with different goals and different financial positions, can come together to invest in real estate *together* and everyone can win. And being that this is a book on investing with little or no money out of pocket, this chapter is going to focus on how to use syndications to do just that. Syndications are an advanced strategy for real estate investing, so take your time as you work through this chapter. Take notes. Underline. Read it multiple times. Because learning how to syndicate a real estate deal is learning how to scale a real estate empire. This is how millionaires are created from nothing.

A real estate syndication is a group of investors pooling their money for the purpose of buying a real estate investment. However, every syndication is unique and there are dozens of different approaches to putting one together. There could be three individuals in the syndication or there could be three thousand. They might buy an apartment complex, or they might buy a single-family home. They might plan to flip a property for a quick gain, or they might plan to hold onto the property for one hundred

years. However, the most common use of a syndication for the purposes of this book is to purchase expensive buy-and-hold rental properties, usually an apartment complex, which we'll use as our primary example throughout this chapter. But first, let's get on the same page as to exactly how a real estate syndication works.

The Organizational Structure Of A Syndication

Most real estate syndications are made up of two groups of individuals: general partners and limited partners.

General Partners, or GPs, are those who are “running” the operation. The general partners are those who are out there actively hunting for deals. They are the ones touring the properties, making offers, dealing with the paperwork, raising capital, and making all decisions involving the property—past, present, and future. The General Partners (or “Partner” if only one) is ultimately responsible for the success or failure of the investment, as well as legally responsible for managing the syndication.

Limited partners, or LPs, are those individuals who are strictly putting up the money for the investment. They are known as “limited” not only due to their limited role in guiding the day-to-day direction of the investment, but primarily because their legal liability in the deal is generally limited to the money they put in. Because they are not actively running the investment, they typically can't be sued if the investment goes south. They might lose their investment if things go wrong, but they aren't going to lose anything more than that. They are *limited* in their risk.

In most syndications, the limited partners are not putting *all* of the money in for the purchase of the property. Instead, they are usually providing only the down payment, closing costs, and rehab money needed, and the rest is purchased using a bank loan. For example, if a bank requires 30 percent down, the limited partners would supply that 30 percent plus any other costs associated with the acquisition of the property. A bank loan would supply the remaining 70 percent of the purchase price, but the bank would not usually take any “equity” in the deal.

Although every syndication gets to decide for themselves what the percentage “split” becomes between the LPs and GP, many syndications follow a 70/30 split, where the limited partners get 70 percent of the profits and the general partners receive 30 percent. That said, I've seen 80/20 splits, 50/50 splits, and everything in-between.

Now, let's take a look at how a syndication might play out in the real world:

Jonah is a real estate investor working on the purchase of a 60-unit apartment complex outside Orlando, Florida. Jonah knows this deal is going to be a homerun, but the property (which he can buy for \$3,000,000) needs almost \$1,000,000 in repairs. Because the bank is requiring a 30 percent down payment (\$900,000), the closing costs end up being \$50,000, and the total cash needed to make this deal work is going to be \$1,950,000.

Jonah, like most folks, doesn't have that kind of money. Therefore, he decides to syndicate. Jonah works with his attorney to create a syndication where he raises that entire \$1,950,000 (plus another \$100,000 in reserves and fees), for a total of \$2,150,000 from Limited Partners. He offers limited partners 75 percent of the deal and takes 25 percent as the sole GP. The bank supplies the remaining funds to purchase the property and Jonah begins the process of managing the remodel, securing a property manager, raising rents, and reducing expenses to make the property's value climb. Within six months, the property is producing \$10,000 per month in profit, which he splits with his investors, receiving \$2,500 himself and distributing the remaining \$7,500 to the limited partners.

This continues for the next several years until, after four years of owning the property, Jonah sells the apartment for \$6,000,000. After paying back the loan to the bank and paying back the initial investment to all his Limited Partners, there is almost \$1,500,000 in profit. This profit is then split along the same 75/25 parameters, and Jonah walks with a cool \$450,000, while his LPs walk with \$1,050,000 in profit. Within hours of wiring out the profits, his LPs are already blowing up his phone: *"Nice work, Jonah! When are we doing this again!?"*

Syndication Fees: Making Profit Before Profit Is Made?

In addition to sharing profits, the GP also typically earns additional income in the form of a variety of "fees." Fees for the General Partners serve a powerful role in the syndication, as they provide both an immediate reward as well as working capital for the general partners. In many

syndications, the vast majority of the profit is made at the end of the deal—sometimes a decade or more after the syndication was formed. Fees, therefore, allow the General Partner(s) to survive in the ongoing management of the investment. As with nearly every other aspect of a syndication, fees vary wildly between different investments, in terms of both the nature of the fees charged as well as the rate at which they are charged. Some investments have very few fees, while other investments have significant fees. Again, it all depends on the investment itself and what all parties agree to.

The most common fees seen in a syndication are:

1. **Acquisition Fee.** A lot of work goes into buying a real estate deal, sometimes months of work and countless failed offers. Therefore, an acquisition fee is typically given to the General Partner(s) when a property is purchased, often helping to cover company overhead and to reward the GP for their successful purchase. Typical acquisition fees paid to the GP are 1–3 percent of the property’s purchase price, with 2 percent being the most common.
2. **Asset Management Fee.** A great real estate deal is only as good as its ongoing management. This is why one of the primary roles inside the General Partnership is that of an “asset manager”—someone responsible for the ongoing supervision of the investment. An asset manager is different from a property manager. An asset manager is typically managing from a higher-level than the property manager. While the property manager (with their own sets of fees and costs) deals with issues like late rent, move-in and move-outs, and tenant complaints, the asset manager is looking at bigger-picture problems like financial reporting, market changes, and portfolio-wide policies. This asset management, of course, takes time, effort, and often has costs. Therefore, many syndications include an “asset management fee” paid to the GP (or the member of the GP who is responsible for the ongoing asset management of the property). This asset management fee is typically 1–3 percent of the revenue collected on the property each month, with 2 percent being the most common.
3. **Other Fees.** In addition to the two fees outlined above, some syndications have other fees paid to the GP including refinance fees (for when a property is refinanced), disposition fees (for when a property is sold), and more.

A Word about Fees: Fees sound great, don't they? Well, for the syndicator they do. In fact, some syndicators make hundreds of thousands of dollars per year just from fees— and it doesn't even matter if the investment pans out. Think about it: If you get a 2 percent acquisition fee just for buying a property, and you buy a \$10,000,000 property, that's \$200,000 in cash to you before the deal has even made a penny in profit. Furthermore, if that \$10,000,000 property brought in \$2,000,000 per year in rental income, that's another potential \$40,000 in profit right off the top, regardless of whether the investment actually makes money. While this might sound too good to be true, understand that if you charge too many fees, you run the risk of turning off Limited Partners, thus killing your ability to invest in the first place. Furthermore, the better your reputation is and the more experience you have, the more fees you could charge without offending Limited Partners. Limited Partners *expect* fees, but don't make them excessive or you may tarnish your reputation.

In addition to hurting your reputation, understand that fees paid out are not coming out of thin air; they are being taken from the potential profit in a real estate deal. Therefore, the more fees you add into a deal, the worse the investment is for LPs. Most LPs have an idea of what kind of overall return they want to see on their investment, which means the better deal you find, the higher fees you can potentially charge.

Can You Really Syndicate With No Money Down?

As you can probably see by now, because the very nature of a syndication involves one party (the GP) putting together the deal and the other party (the LPs) supplying the funds, a large apartment complex could be purchased for nothing down. In fact, because of the fees, an investor can actually *earn income* while putting no money down on a large real estate deal.

But is a “no money down” syndication really possible? Yes! As with anything, the devil is in the details. Although, technically, the Limited Partners are responsible for putting up all the money for the investment, many LPs are not comfortable investing in a deal where the GP is unwilling to invest any capital. The same concern is shared by many banks who would be lending on the deal. It's not that the investment *needs* cash from the GP, but banks and LPs are more comfortable knowing that the GP has something to lose. In this industry, this investment from the GP is known

as “skin in the game.” This skin in the game can really help alleviate any concern from the LPs and the bank that you, the syndicator, are just going to collect massive fees and walk away, letting the investment fail.

Now, does that mean you *must* put in your cash? Not necessarily. I personally know many syndicators who do not put any cash into the investments. Other syndicators put some or all of their “acquisition fee” into the deal, still making it a “no money down” investment for them. Or, perhaps you can bring in other individuals on the GP side of the deal, and they supply the desired *skin in the game*.

How To Find Limited Partners For Your Syndication

At this point, I hope you’re excited about the possibilities of investing in real estate with no and low money down via a Syndication. But perhaps there is a nagging question that keeps popping into your head: where do you find these Limited Partners?

Earlier in this book, I dedicated an entire chapter to Private Lending. The advice I give there could also be applied to the search for Limited Partners. Network. Build a personal brand online and in your local market. Get to know other investors. Hang out where other investors hang out. Go to local meetups. Go to conferences. And then *tell people you are (or are becoming) a real estate syndicator*.

This last bit is key. You’ve got to talk about your ambition. Because here’s the two-part secret truth about Limited Partners:

1. There are a LOT of them out there. According to *The New York Post*,⁴⁸ there are nearly twelve million millionaires in the United States alone. And your LPs don’t necessarily need to be millionaires.
2. They are looking for YOU. Think about it—being a limited partner is possibly the coolest way to invest. They get a great return on their investment and they have to do, basically, nothing.

But, as with a potential partner or private lender, just because you say you are raising money for a deal doesn’t mean people are going to throw money at you. Wealthy people didn’t become that way by accident. They are smart with their money. They need to be sure they are making a safe

⁴⁸ <https://nypost.com/2019/03/14/the-us-has-more-millionaires-than-greece-has-people/>

bet with the highest likelihood of paying them back. So, establishing trust is key. As I mentioned in the chapter on private lending, you must begin working on your reputation immediately. This is built through character (doing what you say you're going to do), experience (showing proof of what you've done), knowledge (do you know what you're doing?), and even *who* you are associating with (you can borrow other's credibility if they are part of your deal. Someone might not trust you yet, but maybe you can bring in a more-established partner who would have their trust?).

In the beginning, you may only be able to raise money from five investors, and those five are all family members or friends. That's ok! When you deliver great results to those investors, they will tell their friends (Do keep in mind my earlier cautions about doing business with family and friends—however, if you do right by them, they'll be amazing advocates for your business). You'll start building your track record. Your success will attract more success. The more deals you do, the greater the number of Limited Partners who will want to invest with you, and the greater amount of cash they'll be willing to invest. Therefore, in the beginning, getting your first syndication done is more important than what percentage of the deal you get, so don't be afraid to partner with other, more established, syndicators to get your feet wet. Learn from their experience while building your own track record and reputation.

Remember: trust is built slowly, but crumbles quickly. Be sure to give your investors solid returns when things are going well and reliable communication if things don't. Only buy great deals that will ensure your investors make a profit. And make sure to take care of your investors always, first and foremost. This is not an incredibly large industry, and people talk. It's incredibly important to build and protect a good reputation.

The Legal Side Of Syndications

The following is a high-level overview of the legal side of a real estate syndication. Keep in mind, these rules will differ entirely based on the country you live in, and this section is based on United States laws. Furthermore, I'm not an attorney and this is only my opinion of how the law reads. You **MUST** work with a syndication attorney if you plan to do a syndication. This section is merely designed to help give you a broad overview.

Imagine the day in your future when you've raised several million dollars for a large apartment complex. You've found the deal, negotiated

a great price, and raised money from forty-five different Limited Partners. You're really going to do it! You're going to invest in a large deal with no money down! You call up all forty-five investors from all around the country and ask them to head down to the title company at 3pm to sign documents. All forty-five of you crowd into the little 10 × 10-foot office. Someone is sitting in your lap. And someone is sitting in theirs. It's a little weird. You pass a single pen around the room and after six-hours of signing... you all leave together in your little car.

So—that's not really how this works, thank goodness! When putting together a real estate syndication, you don't need your LPs to sign documents because they are not actually investing in real estate. For that matter, neither are you. Instead, you are actually forming a business and your Limited Partners are purchasing shares of that company. That new company is investing in a real estate deal; therefore only you (and any other GPs running that company) need to sign to buy or sell the deal.

Besides explaining this technicality in a rather obnoxious way (sorry!), the point I'm trying to make is this: this ain't no regular real estate deal. A syndication is a *business* where you are selling shares of ownership. And anytime you start dealing with the buying or selling of shares in a business, the U.S. Government gets involved. Very involved. Enter the Securities and Exchange Commission (SEC).

The SEC is responsible for the oversight of all stock trading in the United States, making sure everyone is playing by the right rules (or, in Jordan Belfort's case, tosses them in jail for their offenses.) Now, the SEC offers several different methods by which you can syndicate a real estate deal legally, with the two most common being the 506(b) and the 506(c). Although similar in nature, there are a few key differences that you'll need to decide between when choosing which avenue to pursue for your syndication. The primary difference involves *how* you find your private investors and *who* can participate in your deal.

Now, before I explain the vital difference between a 506(b) and a 506(c), there's one more term we need to define: the *Accredited Investor*.

An accredited investor is someone who the government has deemed rich enough to invest in a risky real estate deal. No, that's not the official language from the U.S. Government, but the point is the same. The government doesn't want poor Aunt Sally giving you her last dollar. Specifically, an accredited investor is someone who is either:

1. An individual with a net worth greater than \$1,000,000, not

- including their personal residence,
2. An individual whose annual income has exceeded \$200,000 in the last two years, or
 3. A married person who has had a joint income with a spouse exceeding \$300,000 the last two years.

Furthermore, the government mandates that this person has a “*reasonable expectation of reaching the same income level in the current year.*”⁴⁹

Now, why is this important? Because the government doesn’t really want non-accredited investors giving you money—though they do allow it in some cases. And that’s where the difference between 506(b) and 506(c) comes in.

With a 506(b) syndication, you may not “solicit” for LPs, which basically means you cannot advertise. You can’t put up a billboard letting everyone know you are raising money. You can’t put an ad on Craigslist. You can’t even post about it on the BiggerPockets Marketplace. The idea is simple: you must raise money from people you know—family, friends, neighbors, coworkers, etc. The good news, however, is that you are able to invest with up to 35 non-accredited investors. Which means, if your non-accredited mom wants to invest \$25,000 into your new deal, you can do it! Maybe. Because it gets a tad bit trickier than that. Although they don’t have to be “accredited,” they do have to be sophisticated. What does that mean? The government doesn’t really tell us, exactly. But the basic idea is simple: they have to be competent enough that they aren’t going to have the wool pulled over their eyes. Can they read a financial statement? Do they understand the risks behind the investment? Have they ever invested in another real estate deal? These questions, and many others, can help you decide if someone is “sophisticated” enough.

Now, a 506(c) syndication *does* allow you to market your syndication to the public. Buy the billboard, pop up that ad on Craigslist, and post on the BiggerPockets Marketplace to your heart’s content! But (there’s always a but, isn’t there?) unlike the 506(b), you may *not* take money from anyone other than an accredited investor (even your mom, unless she can prove she’s accredited). And that’s another thing: with the 506(c), the Limited Partner must **PROVE** they are accredited with documentation, like a tax return or a document from their CPA. With the 506(b), the Limited

⁴⁹ <https://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=8edfd12967d69c024485029d968ee737&r=SECTION&n=17y3.0.1.1.12.0.46.176>

Partner simply needs to “self-identify” as accredited.

So why would you choose one over the other? Well, here’s a good example. I have a fairly large Instagram following (what?! You’re not following me, @BeardyBrandon, on Instagram? You might want to go fix that.) I also have a large podcast following. Therefore, when I did my first syndication, I found it advantageous to open a 506(c) syndication because of my ability to market to my audience! If I had chosen 506(b), I would not have even been able to talk about my big deals, for fear that I would violate the rules of the SEC. So, I chose the 506(c). The downside, of course, is that there were a lot of folks who would have loved to invest with me, but I couldn’t take their money. You, on the other hand, might not care about advertising your syndication, and plan to rely on good old-fashioned networking to build your list of investors, giving you the ability to take investments from non-accredited investors.

Putting It All Together: Your Syndication

It’s time to put all this together. In this section, I want to walk you through the entire process, from beginning to end, so you can see all the pieces working together. To help with this, I want to tell your story in detail. Keep in mind, the story below includes the general order in which a typical apartment syndication process may occur, but every syndication is unique.

1. After doing some small real estate deals, including a few house flips and some small multifamily rentals, you decide you want to take your business to a whole new level. You commit to becoming a real estate syndicator. You begin reading books on the topic, listening to podcasts, and meeting with other syndicators to learn everything can about the topic.
2. You decide to focus your efforts on buying an apartment complex somewhere in the Houston, Texas market. You learn everything you can about the local market and begin chatting regularly with some local commercial real estate brokers who are prominent in that market. One of those brokers sends you a listing for a 100-unit apartment complex, listed at \$4.5 million. After an offer and some negotiation, you get it under contract for \$4.2 million.
3. Your list of potential private lenders is small at first—just a dozen potential investors. You know that you’re going to need more, but because this is your first syndication, you decide you need some

additional firepower to help. You decide to partner with one of the investors you met at a recent BiggerPockets Meetup. This partner has done a few smaller syndications and also is much better “connected” with more real estate investors. She’s confident she can raise the money. You offer her 50 percent of the General Partnership and divide up the roles. She also agrees to put in \$100,000 of her own money as skin in the game, so you don’t need to put in any. Really, this just means that your partner is 50 percent owner in the GP and she’s also part of the LP, because she’s putting in \$100,000.

4. The bank you decide to go with is requiring 30 percent down, or \$1,260,000. The loan will be for \$2,940,000. You also need \$150,000 for some various repairs around the property, \$30,000 for closing costs, \$100,000 for repairs, and you will be charging a 2 percent acquisition fee, which comes to an additional \$84,000 you’ll need to raise. All in all, you need to raise \$1,624,000.
5. You and your partner decide to follow the SEC guidelines and create a 506(b) fund, which allows you to accept funds from non-accredited investors but limits your ability to advertise. Because this is such a great deal and you have your partner’s experience and trust, you decide to split all profits 70 percent to the Limited Partners and 30 percent to you and include an 8 percent “preferred return” (“Pref”), meaning the LPs are guaranteed an 8 percent return before the GPs get their share. You’ve heard this preferred return is very common, and you know your potential Limited Partners will want that.
6. Your securities attorney drafts up a *PPM (Private Placement Memorandum)* which lists all the disclaimers and legal jargon for investors, as well as the description of the investment and the way your syndication will run. You also get an *Operating Agreement* documenting how the new company will run, as well as a *Subscription Agreement* which describes how the shares in the company will be divided. This costs you around \$15,000, which your partner funds for now, but will be paid back at closing out of the money raised for closing costs.
7. You and your partner put together a *Pitch Deck* to show potential investors. It’s a beautifully designed, 32-page document including photos of the property, detailed scope of work, projections for the future, market analysis, and more. You recognize the importance of utilizing the Five C’s of a perfect pitch deck: Clarity, conciseness, consistency in branding throughout, creativity, and projecting confidence. You and

your partner spend a lot of time talking with investors, walking them through the pitch deck you created, and even hosting a live webinar where investors can come and ask questions live while you explain the deal.

8. You're busy working through the due diligence and loan applications on the apartment complex while your partner is busy getting commitments from potential lenders. First, she gets verbal commitments and later has them begin filling out the *Accredited Investor Qualifier Form*, where they define how much they'll be investing as well as whether or not they are accredited or simply *sophisticated*. Your partner already has commitments for over \$2,000,000 from around 20 different investors, which is good. You've always heard that many people "flake out" when it comes to actually sending the money so you should raise 50 percent more than you think you'll need. Better to have too much, and have to turn people down, than to not raise enough.
9. Your due diligence is complete, and your loan is approved and ready to close. Your partner signs up for some investor-relations software to help manage the paperwork and communications among investors, and you open a bank account in the name of the new company that is being formed.
10. Investors are sent information on how to wire funds, and the syndication is opened up on a Monday, with closing set to be 10 days later. Within 48 hours, you've raised \$1,624,000. Papers are signed, money is wired from your holding account to the seller (through a local Title company), and at 3:00 pm on Wednesday, two-months after you first got the deal under contract, you close on your first large apartment complex.
11. At closing, you and your partner receive your Acquisition Fee of \$84,000, which you split. You walk to the bank, even though you could drive, just so you can hold onto that check a little longer and enjoy the moment. You are a syndicator.
12. The first few months are rough as you begin turning the property around. It's not always easy being a real estate syndicator, you decide, but it's worth it. You maintain good communication with your Limited Partners, explaining why things have been slower at the start than predicted but also illustrating your plan to improve things.
13. You go through three property managers before you find someone who is worth their weight in gold. Within six months, the property is producing more profit than you had estimated in your analysis and

Pitch Deck. Your investors are happy, and you are keeping 30 percent of the cash flow each month after your investors have earned their 8 percent preferred return on their money. Your investors are calling you almost weekly asking when you'll have another deal.

14. Three years later, after working your asset management plan and improving the property, reducing expenses, and doing a superb job managing the asset, you are approached by a national real estate investment firm who wants to buy your property. You and your partner agree on a sales price of \$6.0M.
15. After closing costs have been paid, the bank loan has been paid back, and the Limited Partners have received their initial investment back, you have \$1,200,000 remaining. This profit is split 70/30 between the Limited Partners and General Partners. You and your partner get a check for \$360,000 at closing, which you split 50/50. Once again, you take a long walk to the bank to deposit the check realizing that, not only are you a syndicator, you're a success story! Time to do it again.

At this point, you might be thinking, “that sure is a lot of work just to get 30 percent of a deal!” And you'd be right. But, of course, if you had millions of dollars, maybe you wouldn't need to syndicate, and you could keep all that beautiful money for yourself. There is a price to pay for using other people's money, and that price is giving up large chunks of the deal. But on a positive note, in this story of your first syndication, you earned a large check when you bought the property, received ongoing monthly checks for your work as the Asset Manager, and then walked away with nearly \$200,000. Maybe you even got a disposition fee at the end. It's not a bad gig. And imagine—if you could do this once... could you do it again? And again?

This is why, in the beginning of this chapter, I claimed that “learning how to syndicate a real estate deal is learning how to scale a real estate empire. This is how millionaires are created from nothing.” Because if you could do this once, you can do it many times. Imagine doing not just one syndication but doing several each year. Imagine owning 30 percent of 1,000 units. Or 30 percent of 10,000 units. This is possible. This is syndication. Is it passive? Not for the General Partner! It's work! It's effort! It's risk! But this is how you scale to thousands of units. This is how huge wealth is created.

Isn't it time you started creating your own?

Ben Leybovich in Phoenix, AZ got his start in real estate investing in 2006. Like many, he began by purchasing single-family homes. After buying a few of these, he realized that multi-family properties could yield better returns. With his eyes fixed on bigger and better milestones, he made the shift. From 2007 to 2013 he bought small multi-family buildings (2 to 10 units).

Ben still wasn't satisfied.

He became confident in his skills with smaller multi-family properties and knew he could still do better. He believed that in order for his business to survive, it would have to grow. He was ready for the next step.

But what is that next step? How do you go from doing deals worth a few hundred thousand dollars to deals worth well over 10 million dollars?

Enter the world of syndication.

Through syndicating, Ben is able to essentially crowdsource his deals to many parties of interested investors. Ben and his partners now purchase large commercial apartment complexes. They focus their business in the Phoenix area and specialize in properties constructed in the 1980s that have not yet had any major renovations or rehabs. From there, the goal is to find places where they can produce around \$300 per unit in additional monthly income after they complete all of their value-add improvements to the interior and exterior.

Ben and his many partners and investors are able to purchase properties listed between 10 and 20 million dollars. On top of that, it can cost anywhere between \$15,000 and \$30,000 per unit to complete the necessary renovations in order to get them to their target goal of \$300 per unit in added monthly revenue.

Syndication makes it possible for someone without millions of dollars in ready capital to begin purchasing massive properties and grow their portfolios exponentially while also helping many other investors who may not have the time or expertise to find, close, rehab, and manage properties.



Chapter Eleven

CREATIVE COMBINATIONS

The final strategy I want to talk about isn't actually a strategy at all, but a mindset, and I firmly believe this is the most important chapter in this book. It's important to understand that the approaches covered in these chapters are not the only methods for creatively investing in real estate. They represent just a sample of what's possible when you mix and match different methods.

In Chapter One, we talked about how creative real estate investing is similar to a handyman doing a construction job. The handyman could face a lot of different problems at a job site, so his having a fully stocked toolbox is essential. This is the theory behind this book and why I've spent the previous ten chapters exploring the various "tools" you can use in your creative real estate investing business. After all, the more tools you have at your disposal, the larger the projects you can tackle, and the more successful you can be.

However, as every handyman knows, seldom is one tool enough to finish a job. Instead, a combination of tools and creative thinking is needed to truly make something work. This chapter is, in my opinion, designed to help you see the big picture and change the way you think. Creative real estate investing is not about using one tool or another, it's about using whatever tool you need to make something amazing.

Therefore, the final strategy is one I like to call "creative combinations," because it involves mixing and matching the various approaches discussed in this book to fit your deal or property.

It's difficult to explain exactly what a creative combination is because there are millions of possibilities. Instead, let's look at a few brief examples that combine aspects from different strategies to close more deals with less (or no) money out of pocket:

Example 1: Partner/Hard Money to Refinance

Jillian found an incredible deal on a fourplex that she can get for just \$80,000, but she has very little cash to work with. Additionally, the fourplex is vacant and has some cosmetic issues that will need to be fixed before any units can be rented out. Jillian estimates these repairs will cost approximately \$20,000, but she has done her research and feels this fourplex will provide almost \$2,400 per month in income. She knows the cash flow will be amazing and she'll have a good amount of equity to work with.

To make the deal happen, Jillian reaches out to several local hard money lenders. However, she finds that even though the deal is incredible, because it is her very first deal, lenders are too nervous to cover the full purchase price *and* the repairs. Instead, they offer to fund just the purchase price if she can come up with the repair money.

Jillian doesn't have anywhere close to the \$20,000 she needs for this, but rather than saying, "I can't afford it," turning her brain off, and giving up on the deal, she starts to think creatively and asks herself, "How can I afford it?"

So Jillian draws up a solid business plan for renting the property that shows the potential rental income and includes bids from contractors. She takes the plan to a family friend, Grant, who has expressed some interest in real estate. When she explains the deal to him, Grant is impressed and convinced, so he and Jillian form a partnership to get the property together. Their partnership looks like this:

1. The hard money lender will fund the purchase price of the property for a one-year term.
2. Grant will fund the entire \$20,000 repair budget and holding costs until the property is rented, but he will be purely a "passive investor" in how the deal is run and the property is managed. Grant will also use his credit and income to help secure long-term financing once the property is fixed up and rented out. Both Grant and Jillian's name will be on the property's title, and they'll split all profits 50/50.

3. Jillian will manage the rehab, deal with the bills and contractor, and “manage the property manager” for the life of the partnership.

They end up closing on the property, and after all is said and done, they have roughly \$110,000 total into the property, including taxes and fees—though not a penny came from Jillian. Because of Grant’s strong income and credit, the two have no problem obtaining a refinance for 75 percent of the appraised value (it appraises for \$150,000) after six months, so their new loan ends up being for \$112,000. Now, not only does Jillian have no money invested, but Grant also has all his money back, so they can go out and repeat the process.

The property brings in \$2,400 per month in income, and after all expenses, there is over \$600 per month in positive cash flow (split between the two partners) all on a no money down deal for Jillian because she used a combination of creative financing methods. Remember, this is just one example of what’s possible. Do you see any other ways Jillian could have accomplished this deal? This is your chance to start thinking creatively!

Example 2: The Master Lease Option to Partial Seller Financing

Roland is interested in a 12-unit apartment complex that has been listed for several months. The owners seem motivated and have dropped their price several times, starting at \$650,000 and lowering it down to \$550,000. Roland has only a few thousand dollars to work with—clearly not enough for the 25 percent down payment his local bank would require.

So Roland decides to investigate further. He speaks with the property owners and discovers that they now live nearly 2,000 miles away after a job relocation. They love the income from the property, but because of the distance and trouble they are having with their resident manager, they decided to just get rid of the property.

Each of the 12 units rents for \$1,000 per month, but the property is currently only half-full and has been this way for quite some time; Roland knows that this is primarily because of the lack of good management.

Roland knows this is a great deal, so he presents an offer to the sellers, and they accept. The deal looks like this:

1. Roland offers to do an MLO on the property for the first three years, with an option to buy at \$500,000.

2. Roland and the couple agree to a monthly amount of \$3,000 for the master rent payment.
3. During the first year, Roland works hard to turn the property around. He manages the property locally, gets rid of the bad resident manager, increases occupancy, and even raises the average rent to \$1,200 per month per unit. The total gross income ends up at \$14,400. By the end of year one, after spending 50 percent in expenses, he is left with \$7,200 to pay the \$3,000 monthly rent to the owners, leaving him with \$4,200 every month in cash flow.
4. Roland saves half of the \$4,200 in cash flow for years two and three, saving up over \$50,000 just by managing effectively. At the end of year three, he approaches his local bank with a plan to purchase the property. The sellers agree to carry a 15 percent second mortgage for \$75,000, he puts up the \$50,000 he has saved, and the bank gives a 75 percent LTV mortgage for \$375,000. Perhaps best of all, the appraisal comes back at a value of just over \$1,000,000.

In this example, Roland successfully purchased a 12-unit apartment complex, built over \$500,000 in equity in three years, and created a substantial amount of cash flow income that comes in each and every month, using nothing but his creative thinking and management skills.

Example 3: 203k to Cash-Out Refinance to Partnership Flip

Adam has never purchased any real estate before in his life. He works a busy day job as a law clerk in Denver but has made plans to leave the job and become a full-time real estate investor as soon as possible.

Adam finds a home that is in severe need of updating, located about ten minutes from where he lives. It has two bedrooms and a “bonus” room, all painted bright green, with some outdated carpet, bad lighting, and other cosmetic issues. The home is listed at \$145,000, but he is able to get it under contract for just \$125,000 because of how long it has been on the market. Adam obtains a 203k FHA rehab loan (which he was pre-approved for before looking for his property—a great idea for any investor!) which allows him to include the \$35,000 of repairs into the cost of the loan for just 3.5 percent down (\$5,600) on the total loan amount. Because a 203k loan is only applicable for owner occupants, Adam and his family decide they will move into the property and make it their first home.

He navigates through the red tape, and after several months, he has a

fully remodeled home located in a great neighborhood that now has three bedrooms (he added a closet and a door to the “bonus” room to make it a legal bedroom).

Because he is paying the mortgage *and* the expensive MIP, Adam decides to refinance the home after one year into a conventional loan. Thanks to the work he has done and the addition of the third bedroom, the home now appraises for \$245,000, so Adam takes out an 80 percent LTV loan, obtaining a new mortgage for \$196,000, paying off the 203k completely, and taking out an extra \$38,000 from the cash-out refinance. Ironically, because Adam is no longer paying private mortgage insurance, his monthly payment increases by only \$24, despite the higher loan amount.

Adam then takes his \$38,000 and uses part of it to invest in a flip with a partner, using a hard money loan to fund the purchase price, while Adam and his partner each put in \$30,000 to fund the repairs. With this foray into flipping, Adam is able to leave his day job and jump full-time into real estate, and he did it all for just \$5,600—the down payment on the original 203k loan.

WRAPPING IT UP

Where to Go Next?

As you can see from these examples, buying real estate with little to no money down is possible, but it’s not always easy. It takes creativity and a combination of tactics and strategies to make a successful no- or low-money down deal come together. Always remember that real estate is not black and white; it’s a colorful tapestry made up of the experiences of millions of investors. The rules change daily, and new strategies are always emerging. No book, not even this one, could ever hope to compare to real-life conversation. Each of the techniques found in this book, along with many more, can be found in everyday conversations with the investors who live and breathe this stuff.

If at any point while reading this book you’ve felt confused or overwhelmed, that’s okay! These are not always easy concepts to fully understand, and there is a reason not everyone pursues creative real estate investing. There’s nothing wrong with investing in real estate through slow, conservative methods—in fact, I encourage it!

However, for many people, waiting five, ten, or 20 years to start

investing is simply not an option. As I mentioned at the beginning of this book, real estate offers you the ability to trade cash for creativity like no other wealth-building opportunity, so don't be afraid of trying out new creative strategies.

In your creative real estate journey, you will run into walls, doors, and dead ends. You will encounter problems, questions, and irritations. You'll face uphill battles, downhill coasting, and desert wandering. It's all part of the creative real estate investor's life. However, the way you respond to problems is what will define your future. Will you give up, shut down, and go back to what you are comfortable with? Or will you seek answers and press on?

Final Thoughts

I'm so honored that you've stuck around all the way to the end, and I hope that you now have a solid understanding of at least nine different methods an investor could use to invest in real estate without a lot of cash. I also hope that you finish this book with a larger toolbox than you started with and that you can use that toolbox to build your future.

Remember, the larger your toolbox, the more tools you can fit inside, and the greater your chance of being able to build something incredible with your future.

You have the tools. You have the toolbox.

Now go build something amazing!



Bonus Chapter

EVEN MORE INSPIRATION

Paul Savage

Paul Savage of Louisville, Kentucky found a duplex listed on the MLS with both sides rented. One tenant was planning to move out, which made this property a prime opportunity for Paul to house-hack (live in one unit, rent the other out). It was listed at \$189,000 and Paul was able to negotiate the seller down to \$180,000 in addition to covering closing costs because of some necessary repairs that needed to be made. Using an FHA loan meant that he would only have to put 3.5 percent down or \$6,750. Paul didn't want to spend any money out of pocket, however.

Enter the 401k loan.

Paul was able to borrow the money he needed for his house-hack down payment using a loan from his own personal 401k account. This loan allowed him to borrow against the assets in his retirement account and to then pay back that amount when he refinanced the property.

Only one month after closing and moving into the vacant unit, the other tenant moved out. This might sound like a nightmare in the making but it was actually an advantage for Paul. After his existing tenant moved out, Paul was able to raise the rent for his vacant unit up to the market rate and then fill it with his own new tenant.

Paul's second unit was now bringing in \$950 in rent. On top of that, he also decided to rent out one of the bedrooms in his own unit bringing his

total monthly rental income from the duplex to \$1,500. With his expenses including mortgage being \$1,603 this left him a small out-of-pocket payment of \$103 per month. After he moved out of the other side, the property now cash flows \$297 per month.

Miguel Palos

Miguel Palos of Los Angeles, California was trying to purchase a rental home in Long Beach. In this extremely hot market, it is common for a property to receive multiple cash offers so, in order to compete with any other would-be bidders, Miguel was determined to come to the table with an all-cash offer. The house was listed at \$430,000, however, and Miguel did not have that kind of cash liquid. For this, he would need the help of a private lender.

He turned to a private lender for funds, but that individual also did not have the necessary cash on hand and had to use his HELOC to cover the loan to Miguel. In return, Miguel agreed to pay 10 percent annual interest and to allow the lender to put a lean against another one of the properties he owned.

Because Miguel could now offer to pay in cash and guarantee a quick close, he was able to make an offer on the property for \$25,000 below the asking price and be accepted. None of this would have been possible without the creative use and combination of multiple low money down strategies.

Shawn Rea

Shawn Rea of Niagara Falls, Ontario was interested in a vacant small multi-family property that had been sitting on the market for a couple of months. The sellers were asking \$289,000 but Shawn ran the numbers on it and concluded that he could not offer more than \$170,000 for the property. He placed the offer but received no counter from the seller.

Shawn waited another month after his initial offer and then resubmitted the same offer of \$170,000. This time the sellers countered with \$230,000 and Shawn rejected it outright. At this point, the property had been sitting for several months with no buyers.

The sellers reached back out to Shawn's agent and said they were now willing to negotiate. Shawn responded by offering \$140,000.

Finally, Shawn and the sellers agreed to terms and closed on the property for \$153,000. He was able to buy it with only 20 percent down and then put \$30,000 into renovations and repairs. Only 45 days after closing, Shawn was able to do a complete cash-out refinance, meaning Shawn was able to get 100 percent of the money he invested back from the refinance. The property now generates \$1,400 per month with none of his money left in the deal, giving him an infinite return on investment!

Pete Osceola III

Pete Osceola III from Brighton, Florida was approached by a friend who was behind on her mortgage and feared the impact on her credit of a foreclosure. She knew that Pete rented out his own home, so she approached him with her dilemma. She owed \$500,000 on her home and needed a way out.

Pete knew she was in distress and offered to purchase the home for the \$500,000 she owed plus \$10,000 cash extra to help her out, knowing the property would appraise for over \$800,000. Pete was able to pay for the house in cash by utilizing the equity in his own home.

After purchasing his friend's house for only the \$500,000 she owed, he had the property appraised and it was valued at \$840,000. Pete had successfully added \$340,000 in equity to his net worth for almost no work simply by utilizing the equity in his own home.

Through refinancing, Pete was able to pull \$400,000 in equity out of his new property which he then used to purchase six more rental properties! This just goes to show how replicable this process can be.

Lauren Griffin

Lauren Griffin of Bristol, Virginia started buying rental properties and flipping homes in her early 20's after dropping out of college to work at her grandfather's carwash business. After three years of working there and saving money, she was finally able to finance her first small deal.

Now in her 30's, Lauren owns 40+ units and is flipping an average of 10–15 houses annually. She is also a real estate broker and has started her own firm. Because these two ventures align so closely with one another, Lauren has been able to develop a great amount of synergy between both her investing business and her brokerage firm.

In September of 2019, Lauren was able to purchase a 10-unit apartment building and is currently working on improvements for the property in order to cash-out refinance. The sellers of this 10-unit property then told the owners of a 48-unit property about Lauren and her business. The owners, three siblings who had just inherited the building and were unsure of how to properly operate and manage the asset, called Lauren.

Lauren was interested but hesitant—she had never done a deal nor managed a property this large. This would be a big leap for her and she'd need time to get up to speed on operations, so she reached an agreement with the owners to do a Master Lease Option.

Only, Lauren had not even heard of a Master Lease Option, so they simply came to terms on what she called a “seasoning period.” She would take possession of the property for 6 months—paying the mortgage and all expenses while simultaneously collecting and keeping all rent revenue. She also negotiated a \$3,000 fee to cover operating expenses with the sellers agreeing to pay any overages that exceeded the monthly revenue.

The property currently brings in \$25,000 in monthly rent and Lauren projects that it can yield an additional \$8,000 to \$9,500 a month. As it stands now, Lauren has identified a number of ways that the property is currently underperforming. The rents have not been raised in quite some time and they are paying way too much and too often for maintenance issues.

Already, Lauren has been able to define ways that she can improve the property's business performance and she is quite optimistic about what the future holds. She is putting \$180,000 down at the beginning of the lease which will be applied toward the sale price if she decides to close on the property at the end of the 6-month lease term.

Kelly Cook

Kelly Cook of San Luis Obispo, California is a young, first-generation American. She and her husband both work full time and are actively looking for ways they can create wealth. They come from humble beginnings with limited amounts of capital, but they are confident in the power of real estate and are eager to grow.

Kelly and her husband have already purchased a mobile home park and are excited to buy more property and build their portfolio. Because of their limited cash position, however, this has been difficult.

She knew that in order to really get things going, they were going to have to find creative ways for funding deals. That is when Kelly found her second mobile home park in Reno, Nevada and knew she couldn't pass it up.

Through her job at a bank, and in her handling of the first mobile home park deal, Kelly has proven herself reliable, responsible, and capable of managing real estate deals. Kelly's father saw this and when she approached him about the possibility of partnering, he didn't hesitate.

Kelly's dad became her private lending partner for the deal. Kelly borrowed all that she could from her 401k and her dad fronted the rest of the upfront capital needed to purchase their new mobile home park. They now each own 50 percent, Kelly manages the project, and they both get to enjoy the cash flow each month that the property produces.

David Pere

David Pere of Little Rock, Arkansas has experience mixing and matching several creative financing strategies. In fact, with the exception of a \$12,000 cash purchase (to flip) he has never paid more than 6 percent down on any of the 54 doors he's purchased since 2015.

Once, while sending out direct-mail advertising for 2–4-unit absentee properties, someone responded and said they weren't willing to sell their duplex, but that they had a 10-unit property they were thinking about selling.

Although David was currently stationed in Hawaii as active duty military, it just so happened that he would be in the seller's town the following week to visit. He looked over the building briefly with the seller before negotiating an offer of \$225,000. David then asked the owner if he would be willing to seller-finance any of the purchase. He agreed to carry back \$10,000 at 4 percent with a 5-year payoff.

The inspection showed about \$8,000 in repairs that needed to be done. However, David was reading *Never Split the Difference*⁵⁰ at the time and by using those negotiation tactics, was able to get the seller to agree to pay \$12,500 for the repairs. Instead of having the seller repair everything or cutting a check at closing, they decided to simply drop the purchase price by \$12,500.

⁵⁰ *Never Split the Difference: Negotiating as If Your Life Depended on It* by Christopher Voss and Tahl Raz

Here is how it all came together at closing: The bank loaned \$188,400, the seller loaned \$13,109.26 (which included deposits and closing costs). David's total down payment came to only \$10,990.74.

To recap, he bought a 10-unit apartment building with only a 5.17 percent down payment! Even more, the building also appraised for \$234,000 so David walked into the property with more than twice as much equity as he had invested out of pocket.

He purchased the property in February of 2018. In October of 2019, he refinanced his mortgage. He was able to keep the same low-interest rate but pushed the balloon payment out to five years and dropped it from a 16-year amortization to 15 years.

He was able to pay off the remaining seller-financing, receive a check for \$7,000, and shorten the loan by an entire year all while lowering his monthly payment by \$200 a month.

The property most recently appraised for \$252,000 which means he has built \$62,000 in equity in 20 months. As of this writing, the property cash flows around \$1,000 a month—not bad, considering how little he originally invested and the fact that he has already gotten all of his money back.

Christian Hall

Christian Hall of Warren, Michigan was introduced to the concept of syndication via BiggerPockets and decided to do some self-educating on the subject. After some research, his interest was piqued. He figured that he could apply the same principles he was reading about for large commercial deals on a much smaller scale simply by “slashing off some zeroes.”

In order to get started, he decided to get three of his friends to go in a single-family home. Together, they found a house that an investor had tried to flip but was having trouble selling due to its location.

Being very knowledgeable about his home market, Christian knew that he could make the property work as a rental property. He and his three friends obtained a conventional 30-year fixed rate mortgage for 20 percent down and each put in \$4,000 toward the down payment and closing costs to purchase the house for \$54,000.

The house rents for \$1,000 each month and generates \$382.29 in cash flow. Christian and his three partners are all named on both the loan and deed and each receive a monthly check of almost \$100 dollars. This is cash-on-cash return of almost 29 percent annually.

Cody Stegeman

Cody Stegeman and his wife of Mankato, Minnesota wanted to purchase their first rental property together but coming up with a large enough down payment was not feasible.

However, when they found an amazing deal on a value-add duplex with room for a third unit and a commercial space, they knew they could not remain on the sidelines. They found a family member who was looking to invest \$30,000 and presented them the deal. The family member lent them the \$30,000 which they used for the down payment and renovations.

The property closed for \$84,000 with the seller covering the closing costs. After repairs, the property rented for \$2,300 per month. Cody and his wife then cash-out refinanced the property and with the value add, received enough cash to cover the investor's \$30,000 plus the hard money rates they paid them.

They now own the property with none of their own money in it! This is the essence of BRRRR investing and they are well on their way.

James Baker

James Baker from Pittsburgh Pennsylvania was an extremely hungry, young, creative would-be investor. As an 18-year-old, all he wanted to do was house-hack using the FHA loan with 3 percent down he had learned about.

However, because of his age and the fact that James did not have either *two* W2's or a college degree, he could not qualify for an FHA loan—at least not in Pittsburgh.

Finally, after several other creative yet failed attempts at finding funding partners, an idea came to him and he could not believe it had not occurred to him sooner. He called his current bank where he holds his checking account. He didn't ask for a loan; instead, he asked if the mortgage director had any relatives that were real estate agents. It just so happened that she did. Her sister-in-law was an agent and, on top of that, she was the second-best agent in that market.

In effect, he now had the mortgage director on his side to get this loan signed so that her sister-in-law could get her commission and he had his real estate agent on his side in order to get this deal closed for *her* sister in law, the mortgage director. Basically, he made it so that it was in the best interest for everyone involved for the sale to go through.

With this “family chemistry” working in his favor, the bank ended up agreeing to give him a primary residence portfolio loan for 20 percent down. He was approved for \$210,000. James had no idea where he would come up with the down payment money, but he emphatically decided to move forward.

He had ten duplex/triplex units he was interested in seeing. They finally found the perfect triplex listed for \$130,000. They made an offer for \$120,000 with 6 percent seller financing and about \$2,000 in repairs. With the offer accepted, James then had two months to find his 20 percent down payment.

He began thinking though everyone he knew until it clicked. Every couple of weeks James would meet with an older friend who taught him about the stock market. He had successfully built enough wealth to retire early. Before James could even finish telling this friend about the deal, he offered to fund the down payment at 8 percent annually.

James now lives in the top floor unit of the triplex. His monthly payment to his friend is \$600 and will only last four years. The property itself generates \$300 after mortgage and expenses each month which means his out of pocket expense for the private loan is only \$300.

He’s not quite living for free but \$300 per month is an extremely small price to pay in living expenses—not to mention the equity he’s building each month from mortgage paydown. James is now 20 and has a great start on his path toward financial freedom.

Jon Huber

Jon Huber of Boca Raton, Florida, definitely proves that it is possible to purchase real estate for almost no money.

His city was having a “no minimum” silent real estate auction. It was not publicized, and only a few developers were “in the know.” There were 14 properties, and all were in very bad condition. Jon deemed four to be in relatively decent shape and submitted bids for \$2,000 toward each.

His agent then told him that an additional 4 properties (in slightly worse shape than his initial picks) were worth bidding on as well, so Jon decided to offer \$207 each for them.

Jon did not win any of his \$2,000 bids, but he was the top bidder on one property with a \$207 bid. After a \$30 filing fee to city hall, Jon had purchased a three-bedroom, two-bath house for \$237.00. You read that

correctly. \$237. Not \$237,000.

Believe it or not, Jon was able to pay cash for this house. After repairs to electrical, plumbing, and the interior, Jon had a viable rental property for under \$24,000. The home now rents for \$650 per month.

George Iliev

George Iliev of Columbus, Ohio is a BRRRR investor who also has his real estate license. This has given him a leg up when it comes to finding properties quickly when they hit the market. And, because George is a real estate agent and he is representing himself, when he purchases a property, he gets part of the commission from the sale.

George has also become an expert in his market so when he spotted a house that was significantly underpriced for the neighborhood, he was all over it. The house was listed at \$235,000 because it needed some exterior work. On the spot, he wrote up an offer for \$225,000. The owners countered at \$232,000 and they agreed to terms.

There was a seven-day inspection contingency and a two-day remedy period in the contract. Upon initial review, the home inspector saw signs of structural damage to the heavy concrete steps around the three exterior doors due to soft ground in this area.

The sellers agreed to extend the inspection period for another week so George could get a structural engineer to take a look. He determined that if the concrete steps were removed, rebuilt with wooden ones and the doors reframed, this would fix all of the structural damage as long as the foundation around the steps was still intact. However, it was impossible to tell since the steps were obstructing the view of the foundation and the basement was finished.

George decided to take a calculated gamble on this house and ask the sellers for a \$5,000 check made out to him directly at closing in lieu of having them do the repairs. Since he wanted to obtain conventional financing for this property and lenders usually don't like to see houses that need foundation repairs, this seemed to be the best course of action. The sellers agreed to this remedy request.

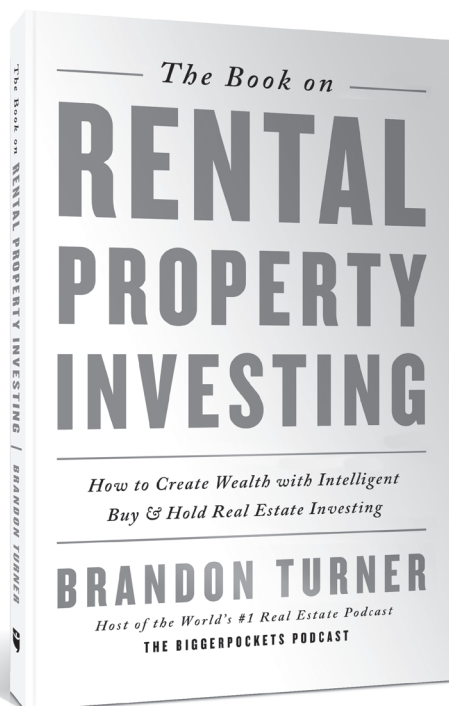
The appraisal on the house for "AS IS" condition came in at \$270,000. With a 5 percent down payment, Jon's PMI would be removed within 9 months due to the loan to value ratio. His total costs out of pocket at closing were \$13,000 (this included his down payment). George's commission

for the sale after taxes was \$5,600 and he received the \$5,000 repair check at closing. When all was said and done, he had turned \$2,400 cash into \$50,000 of real estate equity.

After removing the concrete steps, George was pleased to learn that the foundation was completely unaffected by the damage to the steps. He was able to repair the problem himself for only \$1,000 in material costs.

According to George's calculations from the nearby comps, this house should be valued at around \$300,000 and his extra \$10,000 spent in repairs/improvements should net him an additional \$20,000 in equity. The house, with 3 large bedrooms, 2 full baths, a 2-car garage, and a fully finished basement, can potentially yield \$2,500 per month in rent, which gives George an incredible cash on cash return for this investment.

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The Book on Rental Property Investing **by Brandon Turner**

If you've ever thought about using rental properties to build wealth or obtain financial freedom, this book is for you. In *The Book on Rental Property Investing*, real estate investor and host of the BiggerPockets Podcast, Brandon Turner, has one goal in mind: to give you every strategy, tool, tip, and technique needed to become a millionaire rental property investor—while helping you avoid the pitfalls encountered by so many wannabes!

Written for both new and experienced investors, this book will impart years of experience through the informative and

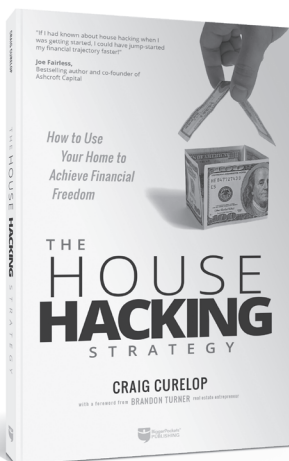
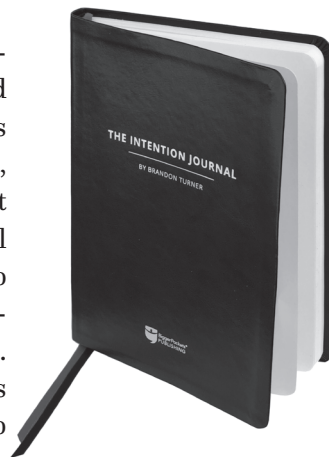
entertaining lessons contained within. You'll find practical, up-to-date, exciting strategies used by investors around the world to build wealth and significant cash flow through rental properties. You'll learn how to build an achievable plan, find incredible deals, finance your rentals, and much more!

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The Intention Journal

by Brandon Turner

Some people can achieve great wealth, rock-solid relationships, age-defying health, and remarkable happiness—and so many others struggle, fail, and give up on their dreams, goals, and ambitions. Could it simply be that those who find success are more intentional about it? Once you build intentionality into your daily routine, you can achieve the incredible success that sometimes seems out of reach. Backed by the latest research in psychology, this daily planner offers an effective framework to set, review, and accomplish your goals.



The House Hacking Strategy **by Craig Curelop**

Don't pay for your home. Hack it and live for free! When mastered, house hacking can save you thousands of dollars in monthly expenses, build tens of thousands of dollars in equity each year, and provide the financial means to retire early. Discover why so many successful investors support their investment careers with house hacking—and learn from a frugality expert who has “hacked” his way toward financial freedom.

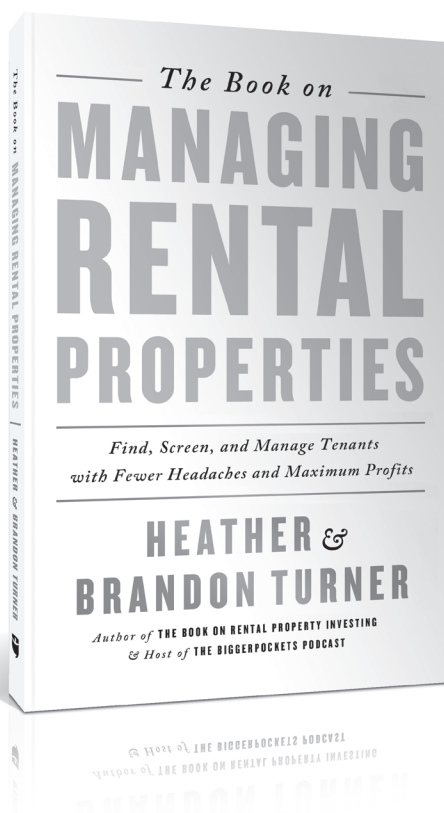
More from BiggerPockets Publishing

The Book on Managing Rental Properties

**By Brandon and
Heather Turner**

No matter how great you are at finding good rental property deals, you could lose everything if you don't manage your properties correctly! But being a landlord doesn't have to mean middle-of-the-night phone calls, costly evictions, or daily frustrations with ungrateful tenants. Being a landlord can actually be fun if you do it right.

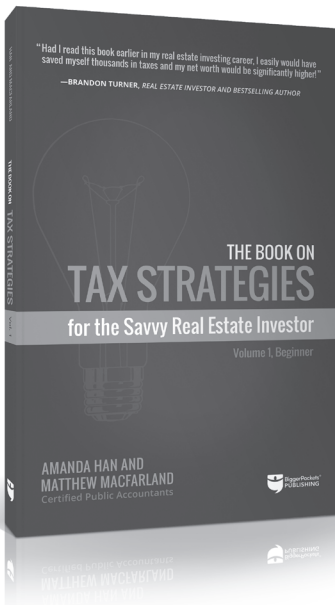
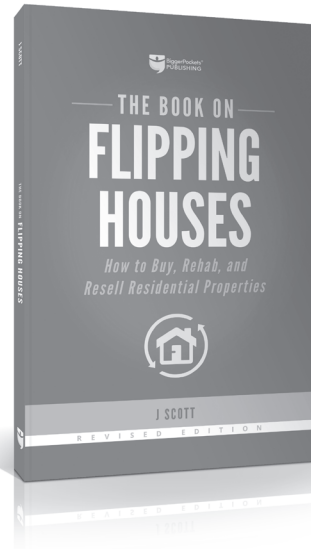
That's why Brandon and Heather Turner put together this comprehensive book that will change the way you think about being a landlord. Written with both new and experienced landlords in mind, *The Book on Managing Rental Properties* takes you on an insider tour of the Turners' management business, so you can discover exactly how they've been able to maximize their profit, minimize their stress, and have a blast doing it!



The Book on Flipping Houses, Revised Edition

By J Scott

Written by active real estate investor and fix-and-flipper J Scott, this book contains more than 300 pages of step-by-step training, perfect for both the complete newbie and the seasoned pro looking to build a house-flipping business. Whatever your skill level, this book will teach you everything you need to know to build a profitable business and start living the life of your dreams.



The Book on Tax Strategies for the Savvy Real Estate Investor

By Amanda Han and Matthew MacFarland

Taxes! Boring and irritating, right? Perhaps. But if you want to succeed in real estate, your tax strategy will play a huge role in how fast you grow. A great tax strategy can save you thousands of dollars a year. A bad strategy could land you in legal trouble. That's why BigPockets is excited to introduce *The Book on Tax Strategies for the Savvy Real Estate Investor*! You'll find ways to deduct more, invest smarter, and pay far less to the IRS!

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