RICH DAD

HOW TO BUY YOUR FIRST INVESTMENT PROPERTY

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Best-selling Books
by Robert T. Kiyosaki

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A LETTER FROM ROBERT KIYOSAKI

Dear Friend,
Congratulations and welcome to "How To Buy Your First Investment Property!

Invest for Value

This ebook is all about Rich Dad's fundamental formula: Look for properties with cash flow AND with a potential for capital gains. People always ask, "What about foreclosures? What about nothing-down deals?" These are certainly valid real estate approaches to investing, and we'll discuss them briefly in this ebook.

It's really about "value investing." What's the true value of the property? That value includes both cash flow and potential capital gains—and a number of other factors we'll examine. For now, keep this in mind about the difference between a value investor and a speculator. A value investor buys a property based on its overall value, both today and in the future. A speculator buys with one hope in mind: that the price of the property will increase.

Seek an Area Close to Home

Especially if you're a beginner, it's important to concentrate on an area close to home—one that you can get to know really well. Drive, walk, or bicycle around that area regularly. Is it growing or dying? Are there many "For Sale" or "For Rent" signs? Also, find two or three brokers who operate in that area. You can find this out simply by seeing who has the most "For Sale" signs posted. Call these brokers and ask them about the area. What has sold recently and for how much? What do properties rent for, and who rents here? How long are properties typically on the market before selling?

Why do you want to do this? Because when a property comes on the market, you'll know very quickly whether it's a good deal or not, and you'll be able to move quickly. In fact, if you really get to know an area well, you may even hear about a new property before it comes on the market and get a real jump on the competition.

My wife, Kim's, first real estate investment was in an area close enough to our home that we could jog there. She'd walk, run or drive through the area at least three times a week to pick up any changes happening in the neighborhood.

Start Small

I can't emphasize this enough—when you're starting out, start small. Invest a lot of time and a little money in your first deal. Most people do just the opposite—they invest very little time and a lot of money and wonder why they lose! You want to keep your risk small, because you're on a learning curve. Why risk a lot when you know there's a lot to learn?

> ***"The difference between rich people and poor people is which way their cash is flowing."***

Expect to Make Mistakes

You're bound to make mistakes—everybody does! Just remember that mistakes aren't setbacks: They're really forward steps in the learning process. The fact that mistakes happen is one reason that positive cash flow is important right from the start, because it can help buffer those mistakes.

For example, two friends recently purchased their first investment property—a 4-plex. Within a month of taking ownership, the city issued a citation that demanded they pave their driveway. They were able to pay for this unexpected expense out of their cash flow. This meant that their property paid for their education, not themselves personally.

Know What You Can Afford

First of all, this means finding out how much it's going to cost you for the amount of cash flow you want. In other words, what will it cost you to get 15%, 20%, or 30% return on your cash investment? You'll learn how to figure this out in the workbook, but you'll also need to know the specifics for your own area.

Secondly, remember that your primary investment goal is to improve your personal financial statement. So ask yourself these questions about a potential purchase:

- If the tenant moves out and the property sits vacant, how long can I afford it?
- If there's a costly maintenance problem, can I afford it?
- This is another reason to start small. If my friends with the 4-plex had started with a 12-unit apartment building, that driveway would have cost them much more and would probably have caused them a much bigger financial problem.
- Remember, the purpose of real estate investing is to solve your financial problems, not give yourself bigger ones.

Look for Properties with Problems

It's really true: One of the best things to look for is a property that someone else has walked away from because of a problem. Figure out how to fix that problem, and you can instantly increase the value of that property.

One of my favorite examples is when my wife, Kim, and I came across an apartment building in Phoenix, Arizona, with a 37% vacancy rate—a pretty high number. Nobody else would touch it. But we asked ourselves the following question: "How can we solve this problem?" It turned out the property was being run as a hotel: People could rent a fully furnished apartment for anywhere from a week to a year. One not-so-small problem—no one wants to be in Phoenix in the summer, so most of the units sat vacant during those months. To make a long story short, we did our research and converted the property from short-term hotel rentals to regular long-term rental apartments. The vacancy rate went from 37% to 3%—and the property's value soared. We were winning on both cash flow and capital gains!

Your job as a real estate investor is to seek out properties with problems—and solve them.

Always Remember to Look at the Numbers

As Rich Dad often said, "Think with your calculator, not your heart." So once you understand the area you've chosen to invest in and you know what it is you're looking for, be sure to follow through by looking closely at the numbers on your chosen properties. The numbers will almost always tell you whether you've found a good deal. The workbook has lots of valuable information about analyzing the numbers.

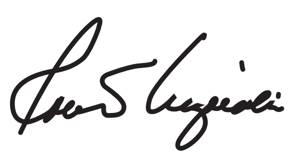
One Final Word of Advice

Remember that price isn't everything, so don't be led away from your principles by what seems an attractively low price.

Does the property meet your criteria? Does it have positive cash flow? Is there a good chance of appreciation? Rich Dad said it best: "Just because a property is cheap doesn't mean it's a good deal. In fact, if it's cheap but has no value, it could be the most expensive property you can buy."

Remember Rich Dad's fundamental formula: Look for properties with cash flow AND with a potential for capital gains. Okay, now it's time to really get started. Get ready to begin your successful journey to Investing in Real Estate!

Thank you and all the best,



Robert Kiyosaki

Introduction

HOW REAL ESTATE BUILDS WEALTH

Real estate investments offer both tax advantages and the advantage of appreciation, the tendency of a property to increase in value over time. But the biggest advantage is leverage—using other people's money (OPM) to purchase an investment worth many times what it costs you to buy. Using OPM in the form of a loan, you can buy a property that generates passive income for you even though you've invested very little.

What Are My Choices?

You can build wealth through real estate in several different ways. Below are what those choices are—and which ones Rich Dad recommends.

1. **Cash flow or capital gains?**
   Long-term cash flow, with the potential for future capital gains. Cash flow assumes you're going to hold on to a property to reap the benefits of ongoing passive income; capital gains result from selling a property at a higher price than the price at which you bought it. Some investors buy a property only to turn around and sell it for the capital gains. Both cash flow and capital gains are good ways of realizing profits from your real estate investment and both have a place in an investor's real estate portfolio. But for the investor who wants to realize the goal of financial freedom by living off passive income, cash flow is definitely Rich Dad's way to go.

2. **Buy and hold or buy and flip?**
   Buy and hold. This is a tried-and-true way to become infinitely wealthy. If you buy well, hold on to the property, and manage it wisely, buying and holding can provide a good, steady passive income every month. Plus, if the property appreciates in value over time, it not only gives you a monthly stream of cash flow but also still allows you to realize capital gains if you sell. On top of that, your tenants pay off your loan! Buying and flipping can also be a good practice because sometimes you don't even have to put any of your own money down in order to make a profit on the property. But remember, you then have to get that profit working again to create cash flow. Please consult your tax accountant for the best investment strategy for you.

3. **No money down or money down?**
   Remember the magic words—cash flow. It's really a balancing act. You want the greatest return on your money and you want to leverage your money well. For example, if you're just starting out and only have a small amount of money to invest, then the most highly leveraged investment (the least money down) that still gives you positive cash flow may be best for you at that time. If you have a large sum of money to invest, you still want to leverage your money effectively, but you may be willing to put down more money in order to get a healthier monthly cash flow on your investment. It all depends upon your personal investment plan.

Definitions: You'll Need to Know

Fixer-upper: A property that needs renovation.

FSBO: For Sale by Owner—a property being sold by its owner without a real estate professional's services.

Vacancy rate: A figure representing the annual percentage of units unrented or the percentage of time a single unit remains unrented during the year.

Zoning laws: Regulations governing land use, population density, and building size and use. Set by local governments, zoning laws typically change as communities develop; you can also request changes or exemptions.

Chapter One

FINDING PROPERTIES

Where Do I Begin?

Now you're ready to start looking for properties. But what exactly are you looking for? And where do you find it? In this chapter, you'll learn how to answer those questions for yourself just as rich dad would.

First, you'll learn how to figure out what types of property fit your plan. You'll learn rich dad's most important guidelines that apply to any situation, but you'll also learn how to set other criteria based on your own particular circumstances and goals.

Then you'll get some very practical advice on where to find those properties you've targeted. You'll walk through some basic tips, then, Dolf de Roos, about the methods he uses to find properties.

Along the way, keep in mind that cardinal 100-10-3-1 rule.

For every single property you end up buying, you should expect to:

Look at **100**

Make offers on **10**

Have **3** accepted

Buy **1**

At the end of this chapter, you'll take a big step toward buying that first real estate investment—you'll start your first list of 100 properties!

> **"Every man who invests in well-selected real estate in a growing section of a prosperous community adopts the surest method of becoming independent, for real estate is the basis of wealth."** ***—Theodore Roosevelt***

What am I Looking For? Establishing Your Criteria

Two of the most important things to keep in mind about properties are cash flow and appreciation. No matter what your level of experience, these should always be your two primary criteria.

Keep your eyes peeled for areas that are up-and-coming. Real estate in general tends to appreciate over time, but you want to find areas that are appreciating even more. A good idea is to look not just at the residential area, but nearby commercial areas as well. Are there new or high-end stores opening in the area? Are there new office buildings being built or companies moving in? These could be signs that the neighborhood is improving or in demand, and you may be able to get in on the ground floor of a booming market.

Read the following questions and answers, then fill in the Basic Criteria worksheet.

What Type of Property is Right for Me?

Start small.
Start with a small property—a single family home, a duplex, or 3-plex. Mistakes are part of the process, and you should expect to make them. With each mistake, you become smarter and your next investment easier. So make your mistakes on small properties, learn from the mistakes, then move on to larger properties. This is also why you want positive cash flow properties: The cash flow can buffer the mistakes you'll make along the way.

Stay close to home.
Ideally, look for rental properties that are near where you live.

That makes it easy to drive around the neighborhood and see what new properties are on the market, watch the selling prices and purchase prices, talk with the neighbors, and keep a pulse on your particular market.

Establish cash flow as soon as possible.
Your goal is positive cash flow, ideally from day one. Sometimes you'll need to take a few steps before the cash starts flowing, but make positive cash flow your top priority.

Hold on to the property as long as it produces a reasonable income stream.
Or hold on until it appreciates and you can sell it, moving the gain to a larger property with an even stronger cash flow. As far as rich dad is concerned, the best investments are those that keep the cash flowing year after year.

So What Types of Property Can Help Me Meet These Goals?

If you're a beginner, you'll want to look primarily for residential real estate up to about a 3-plex at most. If you've already begun investing and are ready to increase your holdings, it might be time to move on to 4-plexes or maybe even a small apartment building. As you become more confident in your plan, you'll quickly graduate to larger properties.

MY REAL ESTATE CRITERIA

I am looking for ______________________________ type of property.

I plan to invest about $__________ as a down payment.

My price range is $__________ - $__________.
(Multiply down payment by 10, then subtract 20% to 30% for the low end, and add 20% to 30% for the high end of your range.)

I plan to invest about $__________ for renovations and fixing up.

I am considering the following types of financing:

____

____

____

____

How Much Can I Afford?

First, decide how much you have available as a down payment. For a rough estimate of price range, multiply this by 10, which assumes putting 10% down. You may very well ultimately put more or less than 10% down, but it's a good way to estimate your target. Now calculate 20% to 30% above and below that target to establish your range.

> **Rich dad said:** "When buying investment properties, look for cash-flow potential and areas that are up-and-coming."

Note: Don't limit yourself exclusively because of price. Never turn a good investment down because "I can't afford it." You'll be amazed at how creative you'll become about finding the money if the deal is very good. Not having the money often makes you smarter because you have to think of alternative ways to come up with what you need.

How Much of A "Fixer-Upper" Can I Tolerate?

To find a good bargain, learn to see beyond the obvious. Sometimes properties in obvious need of work can become wonderful opportunities—if the price is right, that is. However, when you first start out in real estate investing, you may not have the time, or the up-front funds, to take on major renovations. What you're looking for are properties that need small, inexpensive, cosmetic fixes: yard clean-up, decorative painting, a new refrigerator. Sometimes a small investment—less then $1,000—can add significantly to the potential value and rental rate of a property. Also, consider the age of the property when thinking about renovations. Often, older properties need more work.

How Will I Pay for This Property?

It's not too soon to start thinking about how you'll finance this investment. For now you just need to start considering potential sources of funds. Take note of the following financing sources:

- Local banks, mortgage companies, and savings and loans.
- Private funds.
- Assumable mortgages.
- Owner financing.

Where Do I Look? Finding Properties and Bargains

Especially when you're starting out in real estate, there's just no substitute for going out and looking at properties. It's the best way to get a realistic feel for the market you're entering and to spot trends you might be able to take advantage of. It's also a good way to find a broker. As you look at For Sale signs, take note of the broker names that appear most frequently—they'll know the most about the area you're interested in. Start with your own neighborhood or one close by, so you can go there again and again.

As you start your search, keep the following tips in mind. They'll help you narrow your focus.

Explore the Area

It's important that you personally inspect the area. Jog, walk, or drive around the neighborhoods you're considering regularly.

Note any changes, and pay particular attention to For Sale signs. How fast do they go up—and come down? Who are the most popular agents? Talk to people who live in the area and ask them about it. You might be surprised at the answers.

Scan the Internet

There are hundred of sites full of real estate deals. Compare the price ranges and rental rates in different neighborhoods. This comparison will help you identify an area or neighborhood that shows promise.

Talk to Real Estate Professionals

Once you've identified a market, make appointments with several real estate professionals who do business in the area and discuss the market with them. They not only know what's available, they can also give you a good idea on price and current market conditions.

Talk to the Local Chamber of Commerce
All chambers of commerce produce studies that provide information on planned future developments, both public and private. This information can be valuable when looking at the potential growth and change in a neighborhood.

Identify Useful Governmental Agencies and Officials
Governmental bureaucratic red tape can be maddening, but you do need to know something about the laws affecting the rental market in your chosen area and the real estate laws in general. Take the time to find out which state and local governmental agencies regulate the real estate and housing industries in your area. Always consult a lawyer if you have doubts or questions.

Seek Out Local Real Estate Investment Clubs and Associations

Research Zoning Laws
Contact your local zoning and planning commission. They can provide you with the most up-to-date information on current and future plans for the area in which you wish to invest.

Chapter Two

HOW DO I KNOW A GOOD DEAL FROM A BAD DEAL?

As you look at properties, you'll be forming opinions based on what you see. But to pick out the good deals from the not so good, you also need to look deeper. You need to look at the numbers.

In this chapter, you'll learn how to review a pro forma—a good tool for evaluating properties in terms of the return they might generate on your investment. You'll look at several examples and learn how to get a better fix on a property's potential by completing an upside checklist. And to prevent "analysis paralysis," you'll also learn about taking shortcuts to a deal. By the end of this chapter, you might be well on your way to your first successful deal!

What is a Pro Forma?

A pro forma is a type of financial statement for an investment property. But unlike a cash flow statement representing current income and expenses, a pro forma is a projection of anticipated income and expenses. Most pro formas don't show actual operating numbers.

Where do you get pro formas? Ask the agent, whose job it is to gather the information on a pro forma in order to market the property to potential buyers. You can even ask a real estate broker for pro formas for the general types of property you're interested in. You'll soon see that they come in all shapes and sizes, but if you understand the basic elements, you'll always be able to get to the information you need.

Remember, pro formas are selling tools, and they typically paint a rosy picture. They may assume an increase in rents, as well as decreases in the vacancy rate and in expenses. On the next three pages we will discuss the components of a pro forma, look at a sample pro forma, and analyze it.

Rich dad said, "You can't tell from the building alone whether an investment is good or bad. You've got to look at the numbers. The numbers tell the story."

What's on a Pro Forma?

The definitions that follow will help you understand the information on just about any pro forma. Real estate brokers typically don't generate pro formas for single family rental properties. But as you'll see in the following example you can easily use the same format for any type of investment property—even a single family home.

The Numbers

The numbers on a pro forma will tell you whether a property qualifies for further review. If you decide to pursue the property you will then use the pro forma numbers as a starting point for the financial analysis you will do with Rich Dad's Real Estate Evaluator™.

What Do All the Terms Mean?

Many of the individual items on a pro forma are self-explanatory. A few are defined more thoroughly below.

Price: Either the seller's asking price, or what you expect the purchase price to be.

Cash on Cash Return: The annual cash flow divided by the down payment assumed by the seller. On a pro forma this is simply an indicator.

CAP Rate (capitalization rate): The net operating income divided by the purchase price, expressed as a percentage. The CAP rate, which excludes the amount of debt, is an indicator of the value of the property.

Unit Mix: The number of units on a property. Unit type includes studio, 1 bedroom 1 bath, 2 bedroom 1 bath, and so on. From the figures for number of units, square footage per unit, and monthly rent, you can calculate the rent per square foot and the total monthly income from all the units of each type.

Gross Income: The total of all income from all units whether actually rented or not.

Vacancy Rate: The percentage of rent you will not collect because of unrented units. If your gross income is $1,000 and your vacancy rate is 10%, you'll subtract $100 from the income.

Other Income: Other sources of income such as parking fees, laundry service, etc.

Operating Expenses: All the expenses of operating the property.

Reserves: Money set aside for repairs and improvements to a property.

Net Operating Income (NOI): The total operating income less total expenses.

Debt Service: The amount of principal and interest, based on the financing proposed on the pro forma.

Cash Flow: What's left over after all cash expenses—including the mortgage principal and interest payment—have been made.

Assumable or Owner Financing: Either the amount and terms of a loan that the buyer can take over or the amount of debt the seller is willing to carry, which means you'll be borrowing money from the seller at an agreed-upon interest rate.

SAMPLE

PRO FORMA

Name	Arizona Apartments	Price $	1,150,000
Address	Phoenix, AZ	Price per unit $	46,000
		Total square footage	18,150
No. of units	25	Year built	1986
Price per square foot $	63		
Down payment $	478,000		
CAP rate	8.7 %		
Cash on cash return	9.8 %		

UNIT MIX

Unit type	No. of units	Sq. ft. per unit	Monthly rent per unit	Rent per sq. foot	Total monthly income
1bd / ba	10	615	508		5,080
2bd / 2ba	15	800	630		9,450

INCOME

	Monthly	Annual
Gross Rental Income	14,530	174,360
(-) Vacancy Rate (8 %)	1,162	13,949
(+) Other Income	653	7,846
(=) Total Operating Income	$ 14,021	$ 168,257

OPERATING EXPENSES

	Monthly	Annual	Per unit
Maintenance and Repairs (Building)	917	11,000	
Maintenance (Yard)			
Management Fee	631	7,572	
Contracted Services			
Advertising	327	3,925	
Utilities	1,000	12,000	
Salaries	958	11,500	
Miscellaneous	544	6,525	
Real Estate Taxes	675	8,100	
Insurance	156	1,875	
Reserves	417	5,000	
Total Operating Expenses	$ 5,625	$ 67,497	$
Net Operating Income (NOI)	$ 8,396	$ 100,760	$
(-) Debt Service	$ 4,471	$ 53,652	$
(=) Cash Flow	$ 3,925	$ 47,108	$

CASH FLOW *(Annual)*

Net Operating Income	$ 100,760
(-) Debt Service	$ 53,652
(=) Cash Flow	$ 47,108

CASH ON CASH RETURN

Cash Flow (A)	$ 47,108
Down Payment (B)	$ 478,000
A÷B=Cash on Cash Return	9.8 %

ASSUMABLE OR OWNER FINANCING

Type	Interest Rate	Amount	Monthly Payment	Due date
HUD-Assumable	% 7% fixed	$ 672,000	$ 4,471	2044

How Do I Analyze the Pro Forma?

Now that we've defined several of the terms on a pro forma, let's take the next step—interpreting the information on the pro forma to determine whether the property is a potential investment for you. After you've reviewed many pro formas, the process will become much easier as certain properties will be quickly eliminated and others will stand out as potential winners. Your skills as a real estate investor improve with every property you analyze. Kim and I, after reviewing thousands of pro formas, are able to assess within seconds whether a property is worth pursuing.

Location: A property's location can help determine if the price is a good deal. Upscale neighborhoods will naturally carry a higher price tag, but remember to think in relative terms, and look especially for prices that may be lower than the average for the area. Also, is the neighborhood up-and-coming or deteriorating?

Price per unit, price per square foot: For multiple unit properties, these are good figures to look at for comparisons. You might find a property with a high price per unit (price divided by number of units), but if the units are larger than average, with greater square footage, the price per square foot might be competitive. As you become more familiar with a given area, these figures will become key indicators.

Unit mix: Look for a mix of unit types that matches the needs of the area. Studios might do well in a college town, but two bedroom apartments might be a bigger draw in a downtown location.

Age of the property: The older the property, the greater the likelihood that you'll be facing deferred maintenance—in which case you might want to increase the reserves you set aside for repairs.

Vacancy rate: Always assume some sort of vacancy rate; ask your broker what the average is in the area. A high vacancy rate may actually represent an opportunity: It can justify asking for a lower price, and if you can see ways to turn the situation around, you can greatly increase the value of the property and the cash flow to you.

Expenses: This is where some knowledge and experience can improve your bottom line. A poorly managed property will reveal itself in high expenses. For example, a high electricity bill may mean that the owner pays for the tenants' electricity; you might be able to improve cash flow by having the tenants pay for their own electricity. Note that in the preceding example, expenses are only broken down annually. You can divide by 12 to get a monthly figure if you want.

Financing terms: In the preceding example there's existing financing locked in at 7% that you may assume with very little qualifying. That could be a major plus depending on the state of the economy. You might also be able to finance through the current owner to avoid going to a bank for a loan.

Cash on cash return: Simply put, the higher the cash on cash return, the better. But a low return isn't always bad news: It might just mean there are opportunities to be found in the other numbers.

Running the Numbers

Now it's time to analyze the property based on the numbers offered on the pro forma. To do this, use Rich Dad's Real Estate Evaluator™. There is a hard copy of this worksheet on the next pages, or you can use the online worksheet on the rich dad web site at www.richdad.com.

To Analyze a Property's Numbers

1. Transfer the numbers from the pro forma to the Real Estate Evaluator.
2. Make adjustments to the various numbers to give you several scenarios for the property. For example:

   Income: Are the rents competitive? Can you increase the rents? If so, how much can you increase them and still be competitive in the market?

   Vacancy: Is the vacancy rate realistic? If it's high, what can be done to reduce it? If you are confident that the rate can be reduced, you may want to calculate the numbers based on a lower rate. If it's low, you may want to increase it to be comparable with vacancy rates in the area and get a more realistic picture.

   Other Income: Is there opportunity to add other income to the property (vending machines, laundry, etc.)?

   Expenses: As you gain more experience it will become easier to assess the expenses of a property. Which expenses seem high and which seem low? Make adjustments.

   Financing: Put in the purchase price you want to offer. What is the down payment you may be paying? What are the loan terms—amount, term of loan, interest rate, closing costs?

   Investment Analysis: Rich Dad's Real Estate Evaluator™ calculates cash on cash return for two different financing scenarios: with settlement fees paid by the buyer at settlement, and with settlement fees added into the loan amount. Is there a significant difference? If so, keep this in mind as you arrange financing.

You will see that as you change any or all of these numbers, your analysis will also change. On the electronic worksheet at the rich dad web site, the cash flow and cash on cash return will be automatically calculated for you.

So work the numbers, be creative, and create a financial strategy that makes the investment work for you.

Have fun with it and learn!

Definitions: You'll Need to Know

Pro forma: A projected financial statement based on anticipated, not actual, income and expenses.

Cash on cash return: A percentage figure determined by dividing the annual cash flow for a property by the actual cash you invested. (This could include down payment, closing costs, and fix-up expenses.)

Deferred maintenance: Necessary repairs and upkeep that have been left undone by the seller. Maintenance that has been deferred can represent an opportunity in a deal, allowing you to negotiate a lower price.

SAMPLE 1

RICH DAD'S REAL ESTATE EVALUATOR *(front)*

You can access this evaluator on line at www.richdad.com/realestate
Many numbers are automatically calculated for you in the electronic version.

PROPERTY INFORMATION

Property Name	House No. 1	Asking Price	$ 139,900
Property Address		Total Units	1
		Cost Per Unit	$ 139,900
Area/Cross Streets		Total Square Footage	1130
Listing #		Cost per Square Foot	$ 124

INCOME

Unit Information:

# of Units	Unit Type	Square Feet	Rent	Monthly	Yearly
1	3 bed / 2 bath	1,130	$ 1,350	$ 1,350	$ 16,200
			$	$	$
			$	$	$
			$	$	$
			$	$	$

		Monthly	Yearly
Gross Rental Income		**$** 1,350	**$** 16,200
Other Income		**$**	**$**
Vacancy Loss	5 %	**$** 68	**$** 816
Total Operating Income		**$** 1,282	**$** 15,384

EXPENSES

	Monthly	Yearly
Accounting	$	$
Advertising	$	$
Bank Charges	$	$
Electricity	$	$
Gas	$	$
HOA (Homeowners Association)	$	$
Insurance - Hazard (Normal)	$ 33	$ 396
Insurance - Mortgage	$	$
Landscape Maintenance	$ 10	$ 120
Legal	$	$
Maintenance (Handyman)	$ 30	$ 360
Manager Salary/Management Fee	$	$
Miscellaneous	$	$
Permits & Fees	$	$
Pest/Termite Control	$	$
Phone	$	$
Postage/Shipping	$	$
Referrals or Commissions	$	$
Reserves	$ 50	$ 600
Supplies (Maintenance)	$ 10	$ 120
Supplies (Office)	$	$
Taxes (Property)	$ 51	$ 612
Trash Pick Up	$	$
Warranties	$	$
Water/Sewer	$	$
Total Operating Expenses	**$** 184	**$** 2,208
% Operating Expenses to Income	14 %	
Net Operating Income	**$** 1,098	**$** 13,176

SAMPLE 1

(*back*)

FINANCING

Purchase Price	$ 135,000	
Down Payment	10 %	$ 13,500
Loan Amount	$ 121,500	
Interest Rate (% per year)	8.0 %	
Term of Loan (years)	30	
Settlement Fees		
Origination Fee	1.0 %	$ 1,215
Discount Fee	$ %	
Closing Costs & Misc. Fees	0.5 %	$ 608
Total Cash Outlay		**$** 15,323
The Loan		
Monthly payment (principal & interest)*	$ 892	
PITI (principal, interest, tax, insurance)	$ 975	

INVESTMENT ANALYSIS - Settlement Fees paid by Buyer

	Monthly	**Annual**
Cash Outlay	$ 15,323	
Total Operating Income	$ 1,282	$ 15,384
Less: Total Operating Expenses	$ 184	$ 2,208
Net Operating Income	$ 1,098	$ 13,176
Less: Loan Payment (principal & interest)	$ 892	$ 10,704
CASH FLOW	**$** 206	**$** 2,472
CASH ON CASH ROI**		16.1 **%**

INVESTMENT ANALYSIS - Settlement Fees added into loan amount

	Monthly	**Annual**
Cash Outlay	$ 13,500	
Total Operating Income	$ 1,282	$ 15,384
Less: Total Operating Expenses	$ 184	$ 2,208
Net Operating Income	$ 1,098	$ 13,176
Less: Loan Payment (principal & interest)	$ 905	$ 10,860
CASH FLOW	**$** 193	**$** 2,316
CASH ON CASH ROI**		17.1 **%**

* To calculate your monthly loan payment, please use your mortgage calculater included in this program.

** Cash on Cash ROI is cash on cash return on investment. The calculation for cash on cash ROI is your annual cash flow divided by the actual cash you will pay at closing.

Rich Dad's Real Estate Evaluator™ is a guideline for analyzing investment properties. Rich Dad® recommends performing a thorough due diligence on each investment property you are considering. Please consult a tax advisor regarding the tax and depreciation components of your real estate investment.

What's the Potential? Rating Opportunities

Now that you've done an analysis with Rich Dad's Real Estate Evaluator™, you can begin looking for what can be done to increase the value of a given property. Where is the "win," or the upside, in this property for you as the buyer? Can you increase the income? lower the expenses? Can you improve the value with some simple fixing up? Can you build additional units on the property? This is where you can get very creative. How can you best optimize this property? If you have some answers, then you may have a deal in the making.

Use the following checklist to evaluate potential opportunities; refer to the explanations below for more information. Rate each opportunity—and any others you can think of—as to whether it will have a positive, negative, or neutral effect on the property's cash on cash return. The more positive check marks, the better. In some cases, you'll want to calculate the actual dollar amount and factor it into a revised analysis to see if the opportunity is financially worthwhile.

> **Rich dad said:** "There are no absolute good or bad numbers on a pro forma. A pro forma is simply a forecast of the future."

Important Note: Solving the Problem

One of the keys to increasing the value of any property is to find the problem of the property and solve it. For example, if the vacancy rate is high, how can you reduce it? That will immediately increase the value of the property. There's a story of a property that no one would touch because it was infested with pigeons. Once someone figured out how to solve that problem and got rid of the pigeons for good, the value of that real estate jumped. It's not uncommon for properties to belong to out-of-state owners who are not paying adequate attention to such factors as needed repairs, poor vacancy rate, undesirable tenants, etc. By simply putting new and attentive management in place, you'd likely turn things around and end up with a very profitable asset. Remember, your job as a property owner is to uncover the problem and solve it.

Financial Issues

Income: Can the rents be increased? Can the vacancy rate be lowered? Are there other income-generating items that can be added, such as vending machines or laundry facilities? Is there an entertaining or meeting area that can be rented out to tenants? What if you were to set up several computers where tenants could get onto the internet for a fee? How can you increase the income of the property?

Expenses: How can you reduce the expenses of this property? Is the owner paying for the water usage? If so, you may be able to charge a portion of the water bill back to the tenants. This is known as sub-metering. The same holds true for the electric bill. Are the real estate taxes in line? It is a simple process to "protest" the property taxes and have them reduced if the taxes are higher than they should be. Shop around for insurance. Review the service and vendor contracts. How is the management of the property being handled? Is there a more efficient way to manage the property?

Financing: The plus here could be twofold. First, if there is existing financing on the property that you can take over or assume, you might be able to save a good deal of time compared with applying for a new loan. Typically the qualifying process is much simpler and faster. The same holds true if the seller is willing to carry some of the debt on the property. In this case the seller becomes the "bank" and you pay the seller the monthly loan amount with an agreed-upon interest rate. Secondly, the interest rate on the existing loan may be less than you can currently get for new financing.

Amenities: The checklist opposite will give you a sample of ideas to consider when evaluating a property. For example, although a pool may be a nice addition, how often is it actually used by the tenants? How much savings will you incur if you filled in the pool and replaced it with nice landscaping—or better yet, storage units that tenants could rent from you? By adding other amenities such as ceiling fans, new carpet, internet access, or a security system, you can justify a higher rent.

Physical Plant: What can be physically added or changed to the property itself to increase its value? Is there room to build additional rental units? Can you build storage units (as mentioned above) that could be rented out to tenants? Can the property be divided up (subdivided) and a portion sold off separately to put cash back in your pocket? Can you change the way the property is being operated to make it more profitable—for instance, change it from a vacation rental to a long-term rental? Change it from student housing (which typically is vacant during the summer months) to non-student housing?

The City: How is the property zoned? Zoning dictates what can and cannot be built on a piece of dirt. Become familiar with your local zoning process by attending local planning commission meetings. You may be able to have your property re-zoned (for example, from single family to multiple tenant, or from a two-story building to a three-story building), which could open up opportunities for increasing the value.

Take note of any future changes to the master plan of the community. Many cities are adding light-rail transportation. If your property has easy access to good public transportation, that could make the location attractive to your tenants. Is the area part of a city improvement project? If so, this could add tremendous value.

There are also numerous city programs that will lend at low interest rates or give property owners money to improve their properties. Check with your local city government for the programs available in your area that you may be able to take advantage of.

OPPORTUNITIES CHECKLIST

		Plus	Minus	Neutral
FINANCIAL ISSUES	Price—property is undervalued	☐	☐	☐
	Income:			
	Rents are below market	☐	☐	☐
	Additional income-generating items:			
	____________________	☐	☐	☐
	____________________	☐	☐	☐
	____________________	☐	☐	☐
	Expenses:			
	Items that can be lowered:			
	____________________	☐	☐	☐
	____________________	☐	☐	☐
	____________________	☐	☐	☐
	Financing Terms, available?	☐	☐	☐
AMENITIES	Improve or add security system	☐	☐	☐
	Improve signage for drive-by visibility	☐	☐	☐
	Exterior paint	☐	☐	☐
	Exterior lighting	☐	☐	☐
	Pool – fill in, add or improve	☐	☐	☐
	Additional landscape	☐	☐	☐
	Awnings	☐	☐	☐
	Add covered parking	☐	☐	☐
	Add driveway	☐	☐	☐
	Air conditioning units	☐	☐	☐
	Interior additions (paint, carpet, fans, etc.)	☐	☐	☐
	Other____________________	☐	☐	☐
PHYSICAL PLANT	Build additional units	☐	☐	☐
	Build storage units	☐	☐	☐
	Subdivide the property	☐	☐	☐
	Change how building is operating	☐	☐	☐
	Change the unit mix	☐	☐	☐
	Other____________________	☐	☐	☐
THE CITY	Change in zoning	☐	☐	☐
	Change in master plan	☐	☐	☐
	Future infrastructure	☐	☐	☐
	City improvement program area	☐	☐	☐
	Government programs available?	☐	☐	☐
	Other____________________	☐	☐	☐

THE NO. 1 PROBLEM TO SOLVE ON THIS PROPERTY IS:

____

____

____

Let's Make a Deal!

Once you've evaluated potential opportunities using Rich Dad's Real Estate Evaluator™, it's time to zero in on the properties that you want to pursue. You need to do a bit more research, but you've also got to avoid "analysis paralysis" and go for it.

It's often important to move fast or else while you're still checking out the deal, the deal will be picked up by another buyer. Plus, you'll function more efficiently overall, wasting less time over trivialities and honing your decision-making skills. You'll have more time to make more deals—and that means more money!

Best of all, as you'll learn in the next section, you won't be taking as much of a risk as you think.

So let's recap So far...

- You've received pro formas on many properties.
- You've eliminated some and decided to move forward on others.
- You've analyzed those properties using Rich Dad's Real Estate Evaluator™.
- You've identified opportunities on certain properties.

And Now...It's Time to Ask a Few Questions

Now that you have reviewed the numbers, you're bound to have questions. If you have access to the seller then ask the seller. Ask the broker. Ask the property manager if there is one. A good manager can provide a wealth of information. One word of warning: You don't need to know everything about the property at this stage. That will come in your "due diligence" period after you have an accepted offer with the seller. Again, don't get caught up in analysis paralysis.

Make an Offer and Tie Up the Property

Many people believe the next step is due diligence—before they make an offer. Due diligence, a detailed analysis of the property, takes time and effort. And if it's a really good deal, time may not be on your side. Instead, go ahead and call the broker or the seller and say you're ready to make an offer. It costs you nothing to make an offer. The purpose of an offer is to see if the seller is serious. Once you have an accepted offer, which must include escape clause contingencies, you've now successfully tied up the property and that has bought you time to look into the property in depth. That is when you begin your due diligence. If in the due diligence process you don't like what you see, you can cancel the contract based on the contingencies, or propose a change in the offer. You don't risk anything by making offers first. It saves you a lot of time—and avoids lost deals.

Reminder! Make copies first!

QUESTIONS TO ASK

Who owns the property? an individual, or a corporate entity? ______________________

How long has the property been on the market? ______________________

Why is the owner selling? ______________________

Are there any liens or assessments on the property? ______________________

What can you tell me about the property? ______________________

What is the upside? ______________________

What is the downside? ______________________

Have offers been made on the property? If so, why were they not accepted? ______________________

Who are the tenants? singles, young families, older people? ______________________

Is there deferred maintenance? ______________________

Are you aware of problems with the property? Any environmental concerns? ______________________

What type of financing is available? ______________________

What do you know about the real estate market in this neighborhood? ______________________

What do you see happening in this area in the future? ______________________

If you, the broker, were going to buy this property, what would you do with it? ______________________

Definitions: You'll Need to Know

Appraisal: An estimate or opinion of the value of a property by an impartial person skilled in the analysis and valuation of real estate in a particular market.

Contingency: A condition in an offer sheet or contract that must be met before the deal can go forward.

Counter offer: A response to an offer to purchase a property that introduces new or different terms and conditions.

Due diligence: A research and verification process that provides accurate and in-depth information regarding the physical, financial, and legal attributes of a property.

Real estate purchase contract: Also known as an agreement of sale, a legally binding agreement between buyer and seller stipulating the terms and conditions of the sale of a property.

Chapter Three

DOING THE DEAL

How Do I Make Offers—and What Happens When They're Accepted?

If you've followed the rich dad process and the 100-10-3-1 Rule, you've now found at least 10 properties that look like good deals—if you can get the right price and terms. Now you're ready to make offers! If you're like most people starting out, you're probably nervous about this part of the process. Don't be. In real estate there are universally accepted written documents and procedures that outline the conditions and terms of any sale. These mechanisms make the offer process—including any back-and-forth negotiating with the seller—much easier than you might think.

In this section, you'll learn what constitutes "making an offer" and how offers are presented. You'll learn how to use a formal contract, which is a written offer to purchase a property at a specified price and under specific terms. The contract becomes legally binding when it is accepted in writing by both parties and all the stipulated conditions have been met. Consult your real estate advisory team to ensure that you are using the appropriate form.

This section also covers tips on negotiating if your first offer on a property isn't accepted, and what to do next when you do have an agreement. Due diligence is an all-important part of the process—your assurance that everything about the property and the numbers is as it seemed to be when you signed the contract.

If it isn't, properly drafted contingencies can get you out of the contract—or get you an even better deal!

> **Rich dad said:** "Negotiate with your calculator, not your heart."

How Do I Make an Offer?

Making offers on investment properties doesn't have to be complicated. In fact, it can be quite easy. Your real estate agent or broker's job is to complete the required paperwork and spearhead the process. If you're not using a broker or agent be sure you comply with all applicable real estate laws.

Remember, rich dad always said, "Investing is a team sport." If you intend to become a real estate investor you will want a strong team of real estate advisors.

Writing Up the Offer

Writing up a contract for purchase is, in essence, a fill-in-the-blanks exercise. Here are some key points to consider:

Who Is The Buyer?
As a real estate investor, you'll want to carefully consider how you hold the title to your property. Many are held in the name of limited partnerships (LPs) or limited liability corporations (LLCs).

Don't Make Assumptions.
That crystal chandelier may not come with the house. If you want it, be sure to put it in your offer.

Earnest Money.
When making an offer it's a good idea to attach a check for your deposit, or earnest money, to the offer. This lets the seller know that you're serious about the property.

Legal Description.
Make sure the legal description in your contract is accurate. (Make sure you know what you're buying.)

Financing.
Remember that just stating a proposed financing structure in your offer doesn't qualify as a contingency for securing financing.

Maintenance Warranty.
It is not uncommon for the seller to pay for a maintenance warranty. That may include coverage of major appliances, electrical, plumbing, and air conditioning, usually for one year from date of purchase.

> **Rich dad said:** "Your ability to write just about anything into a real estate contract is one of the most overlooked and underrated advantages of real estate investing."

What are Contingencies?

Contingencies should be clearly specified in every contract. They put the seller on notice that you will be looking carefully at specific items pertaining to the agreement and that your final decision to buy is based on those findings. Here are some examples of contingencies found in real estate purchase contracts.

This offer is subject to:

- Review and acceptance of all financial records.
- Examination and acceptance of existing leases.
- Obtaining clear title to the property.
- Satisfactory inspection of the property.
- Securing financing acceptable to buyer.
- Partner's approval.

You may also be more specific and tailor your contingencies to special circumstances, such as:

This offer is subject to:

- Inspection for cracks in the swimming pool.
- All units being rent-ready at the time of sale.
- Parking lot size is compliant with local regulations.

Remember: Contingencies are for your protection. They ensure that you get what you paid for. Remember to follow the release dates specified in the contract for contingencies to prevent jeopardizing the deal.

What's Next?

Now that you've submitted your offer, the seller can:

1. **Accept the offer:** If the seller accepts the offer, it's time to move on to the next phase—due diligence.
2. **Reject the offer:** If the seller rejects the offer, you may consider the deal to be dead or you can rewrite it to make your proposal more attractive.
3. **Come back with a counter offer:** If the seller counters your offer, you may take on further negotiations. You can do this either by writing and initialing your changes on the contract, or by adding a separate sheet, or addendum. If the buyer and seller negotiate an agreement through counter offers, the deal can then move forward to the due diligence stage.

Tips on Successful Negotiating

1. The best offers—and thus the best deals—are those that make both parties happy. Remember, the bottom line isn't what you buy the property for, but how good the property's cash flow is.
2. Have a maximum figure, a figure you will not go above, in mind before you begin negotiating. When you reach that figure you'll either need to pull out of the deal or get other concessions to make the purchase of this property economically feasible.
3. Find out what the seller paid for the property. An owner will be more inclined to negotiate the price of a property when it affects the profit only.
4. Round up when you make the offer. An offer of $200,000 may not seem much higher than $199,000, but psychologically it will appear higher and may make the seller look more favorably on your offer.
5. Be patient. Listen to what the seller is saying. You can learn a lot from just talking to the seller.
6. Be prepared to compromise. Instead of being adversarial, focus on your top priorities and don't let your emotions get in the way.
7. Don't fall in love with the property. You must be ready to walk away from the deal if you cannot come to a favorable understanding with the seller. You're in this deal to make money.
8. It's always a good idea to treat the seller with respect and dignity. You may be on opposite sides of the table now, but that seller may be the source of additional properties in the future.

Due Diligence Is This Property Really Worth the Price?

You've got the property under contract. Time to celebrate, right? Not so fast. It's time to examine the contingencies you added to the contract, as well as answer any other questions you may have. It's crucial to remember: You agreed to this purchase based on estimated operating data. In addition, you may not even have had a chance to carefully examine the property. You've signed the contract: Now you get the opportunity to study what you're buying.

To make sure that you've covered all your bases, and that you accomplish your due diligence in an organized and timely manner, you'll need a checklist. The checklist on the following pages is a guide—use it as it is, or modify it as needed. Remember, if you have questions about the property, call in your team—your lawyer, accountant, and building experts—and let them help you. Through proper due diligence, you can ensure that the deal you've made is a good one.

Two of the most important items included on the due diligence checklist are:

1. **Property Inspection**
   You can hire a professional property inspector, or you can do it yourself. Unless you're an expert in building construction and maintenance, however, you really should hire a professional. Ask for referrals from your broker, property manager or other real estate investors. Most local and state governments do not publish guidelines nor require licenses for property inspectors, but you can contact the American Society of Home Inspectors, Inc., at their web site: www.ashi.org.

   Note: This is a home inspection organization and does not include commercial inspectors. If the property you are buying is an apartment building, you'll need someone experienced in inspecting larger properties. Be sure that you ask any home inspector or home inspecting firm if they do inspections of larger properties, and if they do, at what level. If you cannot find an inspector with this qualification, find a local contractor with experience in the type of property you're buying.

2. **Appraisal for Financing**
   The seller may already have done an appraisal. However, you will want to do your own because you need to be sure that there are no hidden problems with the property that might affect its value. Also, your lender will want assurance that the selling price of the property is greater than the principal amount of the loan. The appraisal will accomplish both. Your lender will probably already have an appraisal firm that they use, but if you want to hire your own, be sure that they have attained, through formal study and examination, a designation awarded by the Appraisal Institute, 550 W. Van Buren St., at their web site: www.appraisalinstitute.org.

Rich dad said: "The words 'due diligence' are two of the most important words in a real estate investment."

Reminder! Make copies first!

DUE DILIGENCE CHECKLIST

Here's the due diligence checklist that Rich Dad uses:

- [ ] Property inspection report
- [ ] Appraisal for financing
- [ ] Current rent roster with paid to dates
- [ ] List of security deposits
- [ ] Mortgage payment information
- [ ] Personal property list
- [ ] Floor plans
- [ ] Insurance policies
- [ ] Maintenance/service agreements and copies of surviving guarantees and warranties
- [ ] Tenant information: leases, applications, profiles, or surveys
- [ ] Vendors and utilities with account numbers
- [ ] State of structural alterations to premises
- [ ] Surveys and engineering documents
- [ ] Commission agreements
- [ ] Rental or listing agreements
- [ ] Easement agreements
- [ ] Development plans: architectural, structural, mechanical, electrical, and civil drawings
- [ ] Governmental permits or zoning restrictions
- [ ] Management contracts
- [ ] Tax bills and property tax statements
- [ ] Utility bills
- [ ] Cash receipts and disbursements journals
- [ ] Capital expenditure records for the past five years
- [ ] Income and expense statements for two years prior to the submission date
- [ ] Financial statements and state and federal tax returns
- [ ] Termite inspection
- [ ] Seller/ownership information
- [ ] All seller's property records and documents pertinent to the ownership, operation, or maintenance
- [ ] Market surveys or studies of the area
- [ ] Construction budget or actuals
- [ ] Work-order files
- [ ] Bank statement for two years showing operating account for property
- [ ] Certificates of occupancy
- [ ] Title abstract
- [ ] Phase 1 Environmental Audit (if exists)

Reminder! Make copies first!

PROPERTY INSPECTION CHECKLIST

Address of Property:

____
____
____

Unit# (if apartments) ____________

Tenant Notes:

CONDITION		BAD	AVERAGE	GOOD
Exterior:	**Doors**	☐	☐	☐
	Carport/Garage/Driveway	☐	☐	☐
	Air Conditioner	☐	☐	☐
	Brick	☐	☐	☐
	Paint	☐	☐	☐
	Siding	☐	☐	☐
	Landscaping	☐	☐	☐
	Sidewalks	☐	☐	☐
	Windows	☐	☐	☐
	Storm Windows	☐	☐	☐
	Walls/Fences	☐	☐	☐
	Roof	☐	☐	☐
	Drainage	☐	☐	☐
Interior:	**Air Conditioning Unit(s)**	☐	☐	☐
	Heater	☐	☐	☐
	Electrical	☐	☐	☐
	Plumbing	☐	☐	☐
	Gas	☐	☐	☐
	Water Heater	☐	☐	☐
	Washer	☐	☐	☐
	Dryer	☐	☐	☐
	Drapes/Blinds	☐	☐	☐
	Smoke Detectors	☐	☐	☐
	Paint/Wallpaper	☐	☐	☐
	Doors	☐	☐	☐
Kitchen:	**Cabinets**	☐	☐	☐
	Counters	☐	☐	☐
	Stove	☐	☐	☐
	Refrigerator	☐	☐	☐
	Dishwasher	☐	☐	☐
	Garbage Disposal	☐	☐	☐
	Faucet	☐	☐	☐
	Sink/s	☐	☐	☐
	Flooring	☐	☐	☐
	Paint/Wallpaper	☐	☐	☐
Bathroom/s:	**Cabinets**	☐	☐	☐
	Floors	☐	☐	☐
	Shower/Tub	☐	☐	☐
	Toilet	☐	☐	☐
	Vanity	☐	☐	☐
	Shower Door/Curtain Rod	☐	☐	☐
Bedroom 1		☐	☐	☐
Bedroom 2		☐	☐	☐
Bedroom 3		☐	☐	☐
Living Room		☐	☐	☐
Other Rooms		☐	☐	☐

Chapter Four

FINANCING THE DEAL

How Do I Get a Loan?

One of the great advantages of real estate is, of course, leverage—using other people's money to make money for you. And it all starts with how you finance the deal on the property you've now got under contract. Financing investment real estate can seem like a daunting proposition: talking to lenders, comparing interest rates, getting together all the paperwork necessary to apply for a loan. But, if you break it down and take your time, it's pretty straightforward.

Sometimes in the world of loans and financing, it seems like jargon is king. So this section begins with two full pages of definitions that will help you understand the terminology. Then you'll learn where money for real estate financing comes from—it's not just banks! The section goes on to explain the different kinds of mortgage loans that are available and explains the advantages and disadvantages of each, according to rich dad's principles. You'll also learn what you need to do before you go in search of a loan, and how to evaluate the professionals—such as mortgage brokers—you'll be working with.

By the end of this section, you'll know exactly what you need to do to finance your deal, from preparing yourself and your paperwork, to finding the right lender and securing the best financing.

Rich dad said: "You want your money to work for you.
But even better is to have other people's money do the work!"

Definitions You'll Need to Know

Adjustable rate mortgage: a mortgage loan where the interest rate changes periodically over the period of the loan. The rate is usually lower than for fixed rate mortgages, so these loans are often initially more affordable. But they come with the risk that the interest rate will increase.

Amortization: gradual repayment of a debt by periodic installments that cover both the principal and interest.

Annual Percentage Rate (APR): the effective rate of interest for a loan. The APR reflects all the costs of financing—including points, origination fees, and other finance charges—and is usually higher than the interest rate alone.

Assumable loan: an existing loan on a property that the seller is able to pass on to the buyer. Interest rates on assumable loans are often lower than the going rate, making them an attractive feature of a deal.

Balloon loan: mortgage loan in which the remaining amount is fully due and payable at a specified, predetermined date. Balloon loans usually have a better interest rate, but you'll have to be prepared to pay the remaining balance of the loan in full at the specified time.

Cap: the limit on the amount of an increase (usually 2%) charged by a lender under the terms of an adjustable rate mortgage. Caps protect the borrower from large, unexpected interest rate increases.

Conforming loan: a mortgage loan that is eligible for purchase by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Conventional mortgage: a loan arranged between lender and borrower that is not covered by governmental guarantee or insurance.

Credit report: an assessment, provided by a local retail credit association, of an individual's ability to repay debt.

Department of Veterans Affairs: previously known as the Veterans Administration, the federal governmental agency that administers GI and VA loans.

Down payment: cash paid by the buyer at settlement, representing a percentage of the purchase price. Different types of loans may require different percentages of down payment.

FHA (Federal Housing Authority): an agency of the U.S. Department of Housing and Urban Development that administers loan programs designed to make more housing available.

FHA mortgage: a loan made by a local lending institution that is insured by the FHA.

Fixed rate mortgage: a mortgage loan whose interest rate is fixed for the entire term of the loan. The most common are 15-year and 30-year fixed rate mortgages. The interest will usually be higher than that of an adjustable rate mortgage, but it won't ever go up.

Interest: the amount, expressed as a percentage of the total, that a lender charges a borrower for a loan.

Loan servicing: the paperwork involved in handling mortgage loans.

Loan-to-value ratio: the amount of a mortgage loan compared to the value of the property purchased. A $100,000 house with a loan of $80,000 has an 80% loan-to-value ratio.

Maturity: the date when a loan is due in full.

Mortgage: a written agreement that gives the lender an interest in the property as security for a loan.

Origination fees: charges to a borrower to cover costs associated with issuing the loan, including credit checks, title search expenses, and home appraisal.

PITI: abbreviation for principal, interest, taxes, and insurance. The acronym is used to describe what is included in the monthly repayment of a mortgage loan.

Point: one percent of a mortgage loan amount. A point is an additional charge by the lender at the time of loan origination as a placement or service fee.

Private mortgage insurance (PMI): insurance against default issued by a private company on conventional mortgage loans. Such insurance is usually required when the loan-to-value ratio is more than 80%.

Prepayment penalty: a fee charged to the borrower if the loan is paid off early.

Savings and Loan Associations (S & Ls): banking institutions specializing in originating, servicing, and holding mortgage loans.

Term: the period of time until a loan must be repaid.

Underwriting: the formal approval or denial of a loan based on the purchaser's ability to pay off the loan and the value of the property as collateral.

Going Conventional—The Most Common Types of Mortgage Loans

Later in this section you'll learn more about government-sponsored loan programs, as well as private party and seller financing. You'll understand these valuable alternatives better if you first get a good grip on conventional loans, the most common type of mortgage loan. Conventional loans are offered by banks, savings and loans, and mortgage companies. They come in two basic sizes: residential loans for up to four units, and commercial loans for five units and up. This section focuses on the residential variety, but as you expand your real estate portfolio, you'll soon move into the commercial category. Don't worry—you'll be an old hand by then!

Conventional loans at a glance—some pros and cons

Traditional 30-Year Mortgage
A loan instrument offering a fixed or unchanging interest and principal payment over the 30-year life of the loan.

PROS:

- Certainty of a set payment for 30 years.
- Ability to make extra payments whenever you like to reduce your principal.
- Ability to pay the loan off early without penalty.

CONS:

- Inability to take advantage of lower interest rates.
- Larger down payment required for investment loans.

15-Year Mortgage

A loan instrument offering a fixed interest and principal payment over the 15-year life of the loan. (There are also 10- and 12-year mortgages, but they're less common.)

PROS:

- Slightly lower interest rate than a 30-year fixed mortgage.
- About 50% less total interest paid over the life of the loan.
- Fixed interest and principal payment.

CONS:

- Higher monthly payment.
- Higher qualifying income than the 30-year fixed loan.

Adjustable Rate Mortgage

A loan in which the interest rate fluctuates periodically and payments may go up or down. Restrictive measures, or caps, are specified in the mortgage contract that prevent the payments from increasing or decreasing beyond a predetermined limit.

PROS:

- Usually lower qualifying income.
- If interest rates hold steady, the loan could be less expensive over time.
- Most are assumable.
- There is usually no prepayment penalty.

CONS:

- Interest rate and payments will probably go up sometime during the life of the loan.
- Predicting interest rates is difficult.

How Do I Find a Lender? Shopping for a Conventional Loan

Get ready to do some shopping. Shopping, for a mortgage? Yes, indeed. If you choose to get your financing through the conventional method—that is, finding a commercial bank, savings and loan, or mortgage banker—you'll have to take the time to carefully survey the market. Just as you shop for other services, you'll be shopping for your real estate loan.

Keep in mind these two important things as you begin your search:

1. **Compare for the best deal.** There can be a huge difference among lenders in interest rates and points charged. Comparison-shop and you can be certain you've found the right mortgage for your needs.
2. **Do research on mortgage companies.** As in any business deal, you're looking for partners with honesty and integrity who will provide good service—going the extra mile for you. Check with your broker or agent, friends, or colleagues with experience in this area. Also check your local Better Business Bureau to make sure you've found a reputable lender.

When do I begin my search?

You should start thinking about your lender when you begin to think about buying your investment property. You can't actually apply for your mortgage, but you can certainly begin gathering information. Do some basic research so that when it comes time to contact actual lenders, you're prepared to move, and move fast. Remember, the more knowledge you bring to your endeavor, the more likely you are to have a successful outcome. Learning about loans and the loan process is part of your overall financial literacy—take it seriously and start early!

Where should I look for lenders?

Here are a few ideas to help you get started in your search for the perfect lender:

Your real estate broker or agent.
It's always a good idea to ask someone you trust. But don't take their word for it—call and check out brokers or agents for yourself.

Mortgage brokers.
These licensed agents can be a great help and time saver for the busy real estate investor. They know the lenders—who has the best rates, who has the best loans, and who has the easiest qualifying standards. See the next page for more information on mortgage brokers.

Your local newspaper.
Every major metropolitan area has a section each week devoted to the real estate business. You'll find advertisements for mortgage lenders as well as a list of mortgage rates.

The yellow pages of your telephone book.
Look under banks, mortgages, and savings and loans, and be patient. You'll need to call between 15 and 20.

The internet.
Use your favorite search engine, type in the word "mortgage," and stand back—you'll get thousands of listings. Look through the categories for commercial banks (such as Citicorp/ Citibank: www.citi.com/mortgage) and mortgage bankers (such as the Mortgage Bankers Association of America: www.mbaa.org).

What's a Mortgage Broker? Your Loan Matchmaker

Mortgage brokers are matchmakers—they match financial institutions with money to lend to investors who want to borrow. They don't use their own money to originate loans; they represent lenders who do that. They can help you narrow your list of suitable mortgage lenders—simplifying the process and helping you understand and take advantage of the best deals on the market. In addition to knowing the conventional market, they should have a broad knowledge of all government-backed loan programs and which lenders participate in them.

A mortgage broker matches your specific needs with a specific lender. For example, if you have a credit problem, they find a lender who is willing to work with you. When you talk to a mortgage broker, be prepared to give him or her the same paperwork you'd give a mortgage banker.

How are mortgage brokers paid?

Mortgage brokers, like real estate brokers, are paid a commission by the lending institutions for each completed deal. The average brokerage commission is $1,500 to $5,000, or anywhere from .5% to 3% of the total loan.

Note: Never pay mortgage brokers a fee for their services (beyond a nominal amount for copying forms and other paperwork). Their job is to find you a loan, and that's when they get paid. Good mortgage brokers don't ask for up-front money.

How do I find a mortgage broker?

- Ask for a referral from your real estate professional or another investor.
- Check out what the National Association of Mortgage Brokers: www.namb.org
- The internet is a good source.
- Go to your public library and ask for a copy of *Thomson's Directory of Mortgage Brokers*, published by Thompson Financial Publishing. It lists mortgage brokers throughout the United States.

Reminder! Make copies first!

LENDER INFORMATION WORKSHEET

Here's an information worksheet to help you organize the information you receive from lenders and your mortgage broker. Make several copies of this form so that you can have one for each call or internet search you perform.

Date: ____________________

Property address: ____________________

____

____

Lending institution: ____________________

Address: ____________________

____

____

Telephone number: ____________________

Email address: ____________________

Web site address: ____________________

Contact person: ____________________

Amount of loan: ____________________

Down payment: ____________________

Interest rate: ____________________

Is interest rate locked in: ____________________

Loan term: ____________________

Fixed or ARM: ____________________

Monthly payment: ____________________

Prepayment penalties: ____________________

Closing costs: ____________________

Application fee: ____________________

Time frame to closing: ____________________

How Do I Qualify for a Loan? The Three Main Criteria

Underwriting is the process by which a lender determines if you're qualified for a loan. In other words: Are you a good risk? If you're working with a mortgage broker, he or she will help you get prepared. But you'll need to have your financial information in order no matter whether you're working with a broker or going directly to lenders. Three points a lender will consider are:

- Do you have sufficient income that is stable enough to allow you to make the loan payments on time and in the amount you need for your loan?
- Does your credit report indicate that you have a history of paying your bills on time?
- Does the property you wish to buy provide enough collateral to protect the lender's interest?

1. **Income.**

   How much income do you need to qualify for your investment loan? Here's where the work you did earlier pays off: By having an up-to-date personal financial statement (see Section 2), you're ready to present the lender the appropriate information. Lenders will want to know several specific things to qualify you for the loan, so you'll need to do a little additional figuring beyond your financial statement.

   Your mortgage broker or the lender may provide you with a pre-qualification form for these numbers. Gather the following information:

   The lender will want to see that you'll have enough money left over, after your monthly payment, for your living expenses plus reserves for emergencies that might occur. Use the information on your financial statement.

   Conventional investor loans usually require a loan-to-value ratio of 80% or lower, meaning the amount of the loan can't be more than 80% of the property's value. In other words, when purchasing the property, you'll likely need a down payment of at least 20%.

   Your qualification for the loan depends on the ratio of your income to your housing costs (your PITI, or principal, interest, taxes, and insurance) and to your overall debt. Most lenders use a ratio of 28% housing costs and 36% debt. Simply put, your housing costs should represent less than 28% of your income, and your payments for all debts (including things like car loans) should not be greater than 36% of your income. Use your financial statement and the figures you've gathered on the amount of the loan payment.

2. **Credit.**

   Do you have to have the perfect credit history to purchase investment properties? No, but good credit certainly expands your purchase possibilities. Without good credit, you may be limited to assumable loans or private financing for your investments. A lender—and a mortgage broker—will look at your credit history with the following in mind:

Can you repay the debt? Is your income enough to repay the debt in a timely fashion? Creditors will want to know your occupation, employment history, level of education, and amount you earn. In addition, they'll examine your expenses, including car payments, alimony and child support, number of dependents, credit card debts, etc.

Will you repay the debt? Does your credit history indicate good character and stability? Lenders will look at how much you owe, how often you borrow, if you pay your bills on time. They'll also examine your "flight" risk: How long have you lived at your current address, how long have you been employed, do you rent or own your home?

If you don't already have a copy of your credit report, get one. You can easily do so through the internet or by looking up credit reporting agencies in the yellow pages. You'll be charged a nominal fee. It's important to get your own credit report, because they can and do contain errors, and you'll want to get those straightened out before you talk to lenders. Also, your mortgage broker or lender by law can't discuss your credit report with you unless you've obtained a copy of the report yourself. If you do get a copy, a mortgage broker in particular may be able to help you resolve problems and get your credit in shape.

Note: It's against the law for a lender to discriminate against a borrower on the basis of age, gender, marital status, race, color, religion, national origin, or because you receive public income. You also cannot be denied a loan based on the fact that you have questioned a billing or disputed a claim against you. It's important to know your rights and be ready to raise a red flag if you feel you've been discriminated against.

3. **Collateral.**
   Is the lender protected if you don't pay? Is your collateral enough to cover the loan? In mortgage loans, the primary collateral for the loan is the property. A lender must be assured that the value of the property will cover the amount of the loan if the buyer defaults. The value of the property as collateral is set by the appraisal, which reports the market value of the property at a specific point in time. The appraisal must be reported in writing by a qualified state licensed or certified appraiser, who may be either an employee of the lender or an independent contractor.

   What happens if the appraisal is low? If the market value appraisal is at or above the agreed contract price, the loan process can continue. But if it comes in below, the lender may not agree to your proposed loan amount. If this happens, immediately ask for a copy of the appraisal document. You can also ask for a new appraisal. Carefully examine the document to discover why the appraisal was low, then provide information and figures that might justify the higher price. Remember, a large part of any appraisal is affected by the individual appraiser's opinion. Learn to work with your lender, mortgage broker, and the appraiser to protect yourself and your investment against faulty appraisals.

Non-recourse: In certain cases your investment property may qualify for a non-recourse loan where the lender will look soley to the income and expenses of the property for repayment of the debt. You would not be personally liable for the debt.

When applying for a conventional loan, you'll need most, if not all, of the following information. You'll see that much of it comes from your personal financial statement.

Purchase Contract and Property Information

- Completed copy of sales contract
- Mailing address and property description
- Contact information for access to property
- Purpose of the loan and what the property will be used for (if you won't be living in the property and it's for generating income, the answer is "investment")
- Title information
- Source of down payment, settlement charges, and any additional financing

Personal Information

- Name of borrower(s)
- Current address (if less than two years, provide previous addresses)
- Social security or Federal ID number(s)
- Home or business telephone numbers, age, level of education, marital status, number and age of dependents
- Current housing expenses (rent, mortgage, insurance, taxes)
- Name and address of landlord/mortgage holder (past two years only)

Employment Information

- Two years of employment
- Recent pay stubs and two years of W-2 forms

- Complete tax returns and financial statement, especially if self-employed
- Written explanation of employment gaps
- Record of dividends and interest received
- Proof of other income (child support and alimony are included here)

Assets

- Complete information for all bank and money market accounts
- Two months of bank statements
- Current values of stocks, bonds, mutual funds, and other investments
- Vested interest in retirement funds
- Value of life insurance
- Information on cars: payments, if any
- Information on real estate you own: address and current market value, debt owed on properties, lender's name, address, account number, monthly payment, and current balance owed; copy of previous two years of federal income tax returns; a copy of all leases (if rental property)
- Value of significant personal property

Liabilities and Debts

- Itemized listing of all debts: loans, credit cards, other bills
- Written explanation of credit problems
- Details of bankruptcy within the past seven years, handwritten explanation of reason for bankruptcy, and evidence of good credit rating since the bankruptcy

What Other Loans Can I Get? Alternative Financing Sources

Sometimes you need to seek alternative loan sources because you don't meet the qualifications for conventional loans. But an alternative source might also be something you choose because it gets you a better deal.

There are three basic possibilities: government-sponsored loans, assumable loans, and owner or private party financing.

Government-sponsored Loans

Many government loan programs support home ownership for low- to moderate income families. The two main government agencies sponsoring these programs are the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA). It's important to note that these programs are available for owner-occupied residences only. Why, then, are they included here? One of the best ways to get into the real estate investment business is through the back door: by renting out your own home, then buying another one with a low cost, low down payment FHA or VA loan.

FHA (Federal Housing Authority) loans

The FHA insures against losses on real estate loans made by private lending institutions. Established in 1934, the FHA has insured millions of mortgages. Though deeply affected by the economic recession in the 1980s, it has made a strong recovery and is now in an even stronger position in the industry. The FHA administers many different programs that change over time; your lender or mortgage broker will be able to help you match up with those programs that specifically suit your needs.

PROS:

- Lower interest rate
- Lower down payment
- Easier qualifying requirement
- Assumable loans

CONS:

- Must be owner-occupied
- Maximum loan amount relatively low

How can I contact FHA directly? You can find them on the web at www.federalhousingauthority.com or at www.hud.gov and click on the FHA button.

VA (Department of Veterans Affairs) loans

In 1944 Congress approved what is commonly known as the GI Bill of Rights. Among the benefits of this legislation was a program whereby veterans could obtain no down payment loans that were guaranteed by the government; by the year 2000, the government was guaranteeing loans up to $203,000. Of course, the borrower has to be a veteran or a veteran's dependent (or, with some provisions, the unmarried widow or widower of a veteran).

PROS:

- Lower interest rate
- No down payment
- Easier qualifying requirement
- Assumable loans

CONS:

- Must be a veteran or the dependent of one
- Relatively low maximum guarantee amount
- Must be owner-occupied
- Not assumable by a non-veteran

How can I contact the VA directly? The Department of Veterans Affairs administers state and local offices. Check out the web site at: www.homeloans.va.gov.

Assumable loans

Assumable loans are loans that are already in existence and that can be taken over, or assumed, by the person purchasing the property. In other words, the purchaser can pick up the loan rather than have to find new financing. There can be fees attached to assumable loans, but they are usually smaller than those incurred with a new loan. In some cases, the buyer doesn't even have to qualify for the loan—but be sure to read the fine print before assuming that this is the case. As for the difference between the amount of the loan and the purchase price, the seller and buyer will have to make arrangements for the purchaser to either pay in cash or finance this difference. In many cases the seller may be willing to finance the amount; if not, it's up to the purchaser to find the money.

PROS:

- Lower interest rate (usually)
- Lower closing costs
- No loan qualification process (sometimes)

CONS:

- Assumption fee

Owner and private party financing

These are loans not made by conventional lending institutions, but by private individuals. They may be made by people you know, your parents or a relative, private investors, or more commonly, by the sellers themselves. This can be an excellent way to finance a purchase, but be careful. You must protect yourself with a written document outlining the amount and terms of the loan. This is one of the situations where you should consult a lawyer before signing anything! Take no risks, and be sure all the papers are in order.

PROS:

- No lending fees
- Low to zero down payment
- Favorable terms
- No qualifying necessary

CONS:

- You must be sure that the contract is legal, and that all your interests are addressed and covered in the loan documents.

Rich Dad's Definitions: You'll Need to Know

Closing: The process by which ownership of a property passes from the seller to the buyer. Also known as "settlement," closing includes the delivery of a deed, financial adjustments, the signing of notes, the disbursement of funds necessary to complete the sale, and appropriate recording of documents.

Closing Agent: A third-party agent of your choosing (an attorney, escrow agent, representative of the title company, or a professional closing agent), who handles all aspects of the actual transaction.

Estoppel Certificate: A written statement by each tenant outlining the amount of rent being paid and whether any concessions have been promised to the tenant during the rest of the term of the lease.

RESPA: Consumer protection legislation designed to guard homebuyers from unnecessarily high closing costs. The act, requiring a uniform settlement form (which can be modified under specific circumstances) to be used nationwide, has helped standardize closing costs across the United States.

Chapter Five

CLOSING THE DEAL

What Do I Need to Know?

You've got a contract and you've arranged for financing. The next step is settlement. Chances are you've been through a settlement before, probably when you bought your own home. Especially the first time, it can be a bewildering experience. Buyers and sellers are expected to sign piles of documents, many of which contain lots of legal terminology. You may also be writing a few checks to pay closing costs and other fees. It helps tremendously if you're prepared and know what's coming.

Settlement for the real estate investor is almost exactly the same as it is for the homebuyer. The only significant difference is if the property you're buying is already occupied by a tenant or tenants.

In this section, you'll learn what to expect during settlement, what you should bring, and what specific tenant-related details make settlement for real estate investors different. If you have any questions after reading this section, you can learn more from the U.S. Department of Housing and Urban Development, which has established guidelines for the closing process. Contact HUD at 451 7th Street, SW, Washington, DC 20410 or call (202) 708-1112. You can also check out the excellent HUD web site at www.hud.gov. It's filled with excellent information, including the HUD pamphlet Settlement Costs, and a copy of the Settlement Statement Costs. Some states have special regulations relating to settlement. Be sure to ask your agent or the closing agent if there are any special rules of regulations in your state.

> "Do your homework BEFORE you go to closing so that you can achieve the best possible outcome from the transaction."

Before Closing What to Do to Get Ready

Settlement itself will be orchestrated by the attorney or closing agent or by the title company. Your main responsibilities occur in the weeks before settlement. You'll work closely with your broker or agent—and with the closing agent you hire—to accomplish several important steps. Follow the checklist below.

Pre-closing checklist:

Select a closing agent and set the closing date.
Check with your broker or agent about finding a good closing agent, or follow the process you used to hire other members of your team. Your contract probably stipulates a closing date, but it's not unusual for it to be changed. A lot of work must be done prior to closing, so talk with the closing agent to be sure you've got enough time.

Make sure your financing is in order.
You'll need to be sure that everything is in good order before you go to closing. Keep on top of the loan process—call the lender or your mortgage broker to check on the status of your loan.

Check out your closing costs.
The law requires your lender to give you a good faith estimate of your closing costs (see opposite). Shortly before the settlement date, you'll be told exactly how much money you'll owe so that you can get a bank check or certified check. Personal checks are usually not acceptable.

Check with your closing agent to find out exactly what you'll need to bring to settlement.
This is the time to gather all relevant paperwork and necessary identifications that may be required at closing.

Get a survey and inspection.
A survey identifies the property and verifies zoning and the location of boundaries. The inspection—usually part of the due diligence process—is necessary to verify that any conditions represented in the contract have been corrected.

Review the contract and check dates.
Make sure you go over all the contingencies from the contract and see that they have been met by the date specified.

Perform a title search and acquire title insurance.
You'll need a report by a title insurance company, which reviews the history of the property and ensures that no one other than the seller has claims on it. In addition, you'll be required to obtain title insurance to protect you and your lender against undiscovered encumbrances.

Get homeowner's insurance.
Required by most lenders, this policy protects the property and contents from fire, theft, and other disasters.

Take a final walkthrough.
Fully inspect the premises and make sure that the seller has completed all necessary repairs that were outlined in the contract.

What are Closing Costs?

Closing costs are the expenses incurred in the completion of a real estate transaction. The amount varies from state to state; check with your broker about what you should expect. Your certified check should be made payable to the settlement agent handling the closing. Here are the elements that make up the closing costs and who pays what:

Buyer Pays

- Balance of the down payment
- Title search
- Title insurance
- Survey fee
- Buyer's attorney fees
- Lender's attorney fees
- Loan origination fee or loan discount (also known as points)
- Charges for recording the deed
- Charges for recording the mortgage
- First month's interest on the mortgage
- Escrow deposit to cover accrued real estate taxes
- Credit report
- State and local transfer taxes

Seller Pays

- Seller's attorney fees
- State stamp tax
- Tax for deed
- Broker/agent commission
- Termite repairs
- Tenant deposits

What's Proration?

Since most closings don't conveniently occur on the last day of the month, some expenses and closing costs—and, if tenants are already in place, rental income—must be divided between the seller and the buyer for the partial month during which settlement occurs. These items usually include:

- Real estate taxes
- Mortgage interest
- Insurance premiums
- Rental income
- Pre-paid contracts (such as termite and pest, yard maintenance, etc.)
- Homeowners Association Fees

The Day of Settlement

Settlement itself should be fairly brief. You'll have to sign a seemingly endless pile of documents, but since you've done your homework (along with the help of your team), things should go smoothly.

Here are some things you should bring:

- Your real estate broker or agent! No joke, this is important. You'll want your agent with you to help guide you through the process and be there to answer any questions you may have.
- A copy of the contract.
- Your loan application or loan assumption application.
- Certified check for down payment and closing costs.

The seller brings:

- The leases and estoppel certificates if the property is occupied.
- The keys.
- Warranties and guarantees.
- Complete financial records.
- Copies of any contracts currently in force.

- Maintenance agreements.
- Formal assignment of leases.
- The formal deed.
- Any insurance policies in effect.
- Latest utility meter readings for water, gas, and electricity.

Should You Bring Your Attorney?

Whether or not you need your attorney at settlement depends on how complicated the transaction is. If you're just starting out and you've followed rich dad's advice to start small and keep things simple, you may not need an attorney there on the day of settlement. (Some states require you to have an attorney; your broker should let you know.) Otherwise, have an attorney present if:

- The property is a large apartment building with many leases.
- There are unusual zoning issues to be resolved.
- You have questions about payment of closing costs or prorations. Try to resolve these beforehand, but if there were any sticking points, it doesn't hurt to have your attorney present on settlement day.
- Complicated contingencies were written into the contract.

I Can't Read All These Documents!

There are many documents to sign at closing. Ask about getting copies ahead of time so you can read them without wasting time at settlement. You should look for certain things.

Here's a closing checklist:

- Examine the deed to be sure it conforms to the contract.
- Check to see that all liens have been removed.
- Obtain rent rolls and lease agreements, estoppel certificates, a record of unpaid rents, and any other details pertaining to the tenants.
- Check the proration figures.
- Check to be sure all contingencies have been removed.
- Take possession of all warranties, service contracts, and guarantees.

What is a Settlement Statement?

The Department of Housing and Urban Development (HUD) has guidelines overseeing the closing process, and those guidelines include a settlement statement to be used in all real estate transactions.

The HUD web site (www.hud.gov) also has a detailed explanation of each item on the settlement statement and how it is to be filled in. If you don't have access to the Internet, you can call HUD at (202) 708-1112. In addition, your broker or agent will be very familiar with everything on a settlement statement. Don't be afraid to ask questions.

A. **Settlement Statement**

U.S. Department of Housing and Urban Development

OMB Approval No. 2502-0265

B. Type of Loan

1. ☐ FHA 2. ☐ FmHA 3. ☐ Conv. Unins. 4. ☐ VA 5. ☐ Conv. Ins.	6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

D. Name & Address of Borrower:	E. Name & Address of Seller:	F. Name & Address of Lender:

G. Property Location:	H. Settlement Agent:	
	Place of Settlement:	I. Settlement Date:

J. Summary of Borrower's Transaction		K. Summary of Seller's Transaction	
100. Gross Amount Due From Borrower		**400. Gross Amount Due To Seller**	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)		403.	
104.		404.	
105.		405.	
Adjustments for items paid by seller in advance		**Adjustments for items paid by seller in advance**	
106. City/town taxes to		406. City/town taxes to	
107. County taxes to		407. County taxes to	
108. Assessments to		408. Assessments to	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
120. Gross Amount Due From Borrower		**420. Gross Amount Due To Seller**	
200. Amounts Paid By Or In Behalf Of Borrower		**500. Reductions In Amount Due To Seller**	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)		502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
Adjustments for items unpaid by seller		**Adjustments for items unpaid by seller**	
210. City/town taxes to		510. City/town taxes to	
211. County taxes to		511. County taxes to	
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. Total Paid By/For Borrower		**520. Total Reduction Amount Due Seller**	
300. Cash At Settlement From/To Borrower		**600. Cash At Settlement To/From Seller**	
301. Gross Amount due from borrower (line 120)		601. Gross amount due to seller (line 420)	
302. Less amounts paid by/for borrower (line 220)	( )	602. Less reductions in amt. due seller (line 520)	( )
303. Cash ☐ From ☐ To Borrower		**603. Cash ☐ To ☐ From Seller**	

Section 5 of the Real Estate Settlement Procedures Act (RESPA) requires the following: • HUD must develop a Special Information Booklet to help persons borrowing money to finance the purchase of residential real estate to better understand the nature and costs of real estate settlement services; • Each lender must provide the booklet to all applicants from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate; • Lenders must prepare and distribute with the Booklet a Good Faith Estimate of the settlement costs that the borrower is likely to incur in connection with the settlement. These disclosures are manadatory.

Section 4(a) of RESPA mandates that HUD develop and prescribe this standard form to be used at the time of loan settlement to provide full disclosure of all charges imposed upon the borrower and seller. These are third party disclosures that are designed to provide the borrower with pertinent information during the settlement process in order to be a better shopper.

The Public Reporting Burden for this collection of information is estimated to average one hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

The information requested does not lend itself to confidentiality.

Previous editions are obsolete

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form **HUD-1** (3/86)
ref Handbook 4305.2

L. Settlement Charges	Paid From Borrowers Funds at Settlement	Paid From Seller's Funds at Settlement
700. Total Sales/Broker's Commission based on price $ @ % =		
Division of Commission (line 700) as follows:		
701. $ to		
702. $ to		
703. Commission paid at Settlement		
704.		
800. Items Payable In Connection With Loan		
801. Loan Origination Fee %		
802. Loan Discount %		
803. Appraisal Fee to		
804. Credit Report to		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee to		
807. Assumption Fee		
808.		
809.		
810.		
811.		
900. Items Required By Lender To Be Paid In Advance		
901. Interest from to @$ /day		
902. Mortgage Insurance Premium for months to		
903. Hazard Insurance Premium for years to		
904. years to		
905.		
1000. Reserves Deposited With Lender		
1001. Hazard insurance months@$ per month		
1002. Mortgage insurance months@$ per month		
1003. City property taxes months@$ per month		
1004. County property taxes months@$ per month		
1005. Annual assessments months@$ per month		
1006. months@$ per month		
1007. months@$ per month		
1008. months@$ per month		
1100. Title Charges		
1101. Settlement or closing fee to		
1102. Abstract or title search to		
1103. Title examination to		
1104. Title insurance binder to		
1105. Document preparation to		
1106. Notary fees to		
1107. Attorney's fees to		
(includes above items numbers:)		
1108. Title insurance to		
(includes above items numbers:)		
1109. Lender's coverage $		
1110. Owner's coverage $		
1111.		
1112.		
1113.		
1200. Government Recording and Transfer Charges		
1201. Recording fees: Deed $; Mortgage $; Releases $		
1202. City/county tax/stamps: Deed $; Mortgage $		
1203. State tax/stamps: Deed $; Mortgage $		
1204.		
1205.		
1300. Additional Settlement Charges		
1301. Survey to		
1302. Pest inspection to		
1303.		
1304.		
1305.		
1400. Total Settlement Charges (enter on lines 103, Section J and 502, Section K)		

Previous editions are obsolete Page 2 of 2 form **HUD-1** (3/86) ref Handbook 4305.2

Final Thought

OVERCOMING THE FEAR OF FAILING

For years I have traveled the world, speaking on entrepreneurship and investing. My intent is to highlight the importance of financial education and how financial education is essential to financial freedom and financial security. When asked what I personally invest in, I say, "I became financially independent investing in real estate."

Regardless of where I am—the United States, Australia, South Africa, Europe, or Asia—or to whom I am speaking—rich or poor—what I hear back are similar responses to the idea of investing in real estate. Here are a few choice comments:

- "I don't want to fix toilets."
- "I don't have any money."
- "I don't have the time."
- "Real estate is risky."
- "What if I lose money?"
- "You can't do what you do here."

It is my opinion these responses are simply excuses. Excuses that mask a deeper, darker, hidden, unexpressed reality. In my opinion, most people who use these excuses are:

1. Not educated in real estate.
2. Lazy.
3. Afraid of failing. All of the above.

I say this because most people want to be financially free. Most people would love to have financial security. Most people would love to have money coming in regardless of whether they worked or not. Many people would love to stop working and do something they really wanted to do.

To me, real estate represents freedom. Real estate means control over my life and my future. I am not depending upon a retirement plan filled with stocks, bonds, and mutual funds—investments that someone else manages. I want control of my financial destiny.

This is why when I hear such excuses as "I don't have any money" or "I don't want to fix toilets." I know these excuses are just that. I know people are looking at the journey, not the destination. A friend of mine has two sayings about this human failing. His first saying is, "Everyone wants to go to heaven, but no one wants to die." His second, "Many people will not start the journey until all the lights are green."

Unfortunately, too many people allow their excuses to get between them and the life they would love to live. Rather than look beyond real estate, looking at what becoming a real estate investor can do for their lives, most people are blinded by their own excuses. They see what they are afraid of rather than what they want in life. Fear and laziness blur their vision, limiting the boundary of their lives.

Success comes when you focus on your dream, not your fears.

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