Making Money by Investing in Real Estate

Buy Low, Sell High & Beyond

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Introduction

Real Estate investing is one of the most simplistic ways to earn money. With a relatively small monetary investment and some sweat equity, you can turn a substantial profit. The future outlook on real estate investing is positive and constantly evolving.

For new investors, one of the most difficult hurdles to overcome is learning the ropes of the real estate business. Real estate transactions are complicated, and if you are not educated on the ins and outs of the business, you potentially could lose large amounts of money, fast.

Before you get started in real estate investing, spend some time thinking about the best approach for your financial situation, personality, and risk tolerance.

One in four residential homes is bought as investment property. Many real estate investors are regular people just like you who make impressive side incomes. Some people even earn enough to make real estate investing their primary income.

In this book, you'll learn about strategies you can use when investing in real estate, the nuances of the complicated sales process, and other points to consider – like real estate law, tax implications, and non-traditional real estate investment options. While being a real estate investor is, at times, stressful, it also can be mentally and financially rewarding.

Chapter 1

Strategies in Real Estate Investing

Is Real Estate Investing for You?

Real estate is an intricate business that involves many different legal, financial, and interpersonal aspects. Are you ready to jump into this complicated business? Think about these essential questions before you make your first move.

1. How much money can you invest?

   Investing in the real estate market requires capital. The initial outlay of cash needed upfront to acquire a property may be large or small. However, once you assume ownership of the property, you are legally responsible for the full loan amount. Be sure you can afford to invest by looking closely at your personal financial situation. How much cash do you have? What amount of debt and how much interest can your finances handle? Think about how much you can lose.

2. Are you risk tolerant?

   Risk and capital go hand-in-hand. How much risk are you comfortable taking on? A large loss to a small investor has a much larger impact than the same amount to a wealthy investor with deep pockets. While risk-taking can be exhilarating, be honest about your finances and think about the level of risk that will be comfortable to you. Do you naturally enjoy taking chances, or do you tend to be more risk adverse? It's essential to success to know your comfort zone.

3. What are your future financial plans?

Are you interested in investing to maintain capital or to get the highest return in the shortest amount of time? Consider the amount of time, money, and risk associated with each scenario. Be logical. A straight 15% profit over a couple of weeks is not realistic. If you are interested in a high return, this usually means there's a longer time commitment, which means your money will be tied up. The value of property can change quickly, leaving you in a higher risk situation.

4. Do you have what it takes?

To be successful in real estate investing, you need to be detail oriented, a quick learner, and have excellent interpersonal skills. You need to have the self-management skills required to determine what you need to know, then go out and learn it and apply it.

5. How much time can you spend?

Think carefully about how much time you can commit to the day-to-day tasks required to be successful in this business. In the beginning, you'll need to spend a lot of time researching and learning about the business. With every endeavor you'll need to spend time working on legal issues, zoning and town issues, insurance, tax concerns, contracts, market research, financing.

If after considering these questions you are still interested in real estate investment – congratulations! This field is one of the most exhilarating ways to make a living.

Your First Real Estate Investment

Making your first real estate transaction, either as your primary residence or as a planned investment, can be profitable and exciting, but it can be overwhelming too. Follow these steps when starting out in real estate investing.

1. *Educate yourself.* This doesn't mean that you need to go back to school, but you do need to take responsibility for what you need to know, and learn it. Study the market you're interested in entering. Use the internet, local land records, and area real estate agents to find the sales prices of comparable properties. Learn about the transaction process, each person's role and responsibility, the legal requirements, and insurance. Each component carries fees that vary, and by researching prices you can avoid losing money.

2. *Get your financing in order*. A common mistake made by first time investors is to find the property first, then get financing. Before you go out to find that hidden gem, get pre-approved for financing. Decide on a lender by choosing a bank, mortgage company or online loan company. When talking with your lender, tell them how much you are looking to invest. They'll gather lots of financial information about you – income, credit history, liabilities – and give you an idea of how much they'll finance. With the many different financing choices available today, you'll need to decide which option works best for you. Financing plans have different variables including different rates, initial cash investment, and tax implications.

3. *Look for your property*. Finding real estate that you can make a profit with can be tricky. Use the internet and local newspaper's "Real Estate" section. Look for abandoned and "For Rent" homes. Drive around the area you're interested in and try to find "For Sale by Owner" properties.

4. *Negotiate a fair deal.* Once you've found the perfect house, you'll need to negotiate for the best price. Don't expect that you'll get a steal. Sellers are trying to the most money for their property, and buyers are trying to pay the least amount. Negotiating well involves working together with the seller to find a win-win situation. Be assertive, but plan to make concessions. Inflexibility often causes expensive delays and added stress.

Profiting in Real Estate

One report indicates that over 23% of total home sales in 2004 were bought as investment properties. This is not a surprise, since home prices have had a high percentage increase in recent years and the market has been experiencing high returns.

There are many ways to make money investing in real estate. “Flipping” a property means that you buy it, fix it up quickly, and resell it for a profit. Foreclosures are another way to get investment property, which is when a home owner defaults on a loan and the mortgage holder then puts it up for auction. With abandon property, it’s often unclear who holds the title to the property, so there’s extensive title research and legal work that occurs with these properties. Paper investments, or non-property real estate investments, are when you invest in a mutual funds or bond that is directly related to the real estate market, but not actual property. These investments should be made with advice of a professional broker.

Manage Your Exposure

Managing the risk associated with investing in real estate is key to protecting yourself from loss. The most important aspect of risk management in real estate is to know the law. It’s essential that you have a working knowledge of the real estate legal structure and requirements.

After you’ve researched property availability, cost, and buyer interest, you’ll need to hypothesize about what the future holds for your market. Will prices go up or down?

When considering your risk, keep the following points in mind:

1. *Think about the local economy*. Are there jobs available or are most companies in the area losing jobs? Are new homes being built more or less than over the past 5 years?

2. *Make wise financing choices*. When picking your funding source, think about how long you plan to keep the property. Adjustable Rate Mortgages (ARMs) are attractive because of their lower down payments and lower rates. You can pick the duration of the loan – typically either 1,5, or 7 year ARMs – and your rate will be adjusted to the prevailing rates after this period of time. If you plan to hold onto a property longer than the ARM, ARMs can cost you more because of the higher interest rates. It may be more prudent to opt for a fixed rate mortgage with the shortest length you can handle financially.

3. *Pay a large down payment to reduce your risk.* If you can put down 10%, you'll have instant equity in the property, and most likely get a better interest rate.

4. *Be creative with your mortgage payments.* Make larger monthly payments then require, or make one extra payment a year you'll reduce your principle.

Getting the Highest Return

To make the most money possible in real estate, the standard philosophy is to "buy low, sell high". Most people try to do this, and many do not succeed because it's hard to do. When trying to get the highest return possible, keep your costs down and do everything possible to draw in the highest bidders.

Once you own the property, do as much of the repair work yourself, as long as it is of a professional level. Shoddy work and inferior materials will cost more to correct later. With difficult projects, hire a trained professional from a small scale operation. Large contractors with several employees have to factor their large overhead into their prices.

When looking to maximize your profits, try to save money with your lender. Look around for cheaper loans with the less popular lenders. The large banks and financing companies usually have high fees and rates. Don’t accept overpriced fees. For example, your lender is charging $75 to deliver a few papers a short distance, ask for it to be reduced.

By educating yourself on the legal and accounting aspects of real estate transactions, you can save yourself thousands of dollars. If you learn the basics of these two areas you will know when to ask for a professional’s help.

When negotiating, be firm but flexible. Attempt to find a win-win situation where both you and the other party walk away from the table happy. Be clear on what you want, and what you can be flexible on. If the other party walks away angry and feeling cheated, they might try to sabotage your attempt to make a profit.

If you are selling your property, it’s important to also shop around and negotiate for the best prices on high priced items, real estate commissions, and closing costs.

“Staging” is setting the scene by making your property look its best. You will get the highest price for a property that has been properly prepared.

Actively market your property and you’ll get the largest pool of potential buyers possible. It is a benefit to the seller if there are several interested parties in your property.

Buy and Sell at the Right Time

Timing is important in all investments, but unlike other investments – bonds, stocks, and mutual funds to name a few - there are two characteristics specific to real estate investing.

1. Real estate transactions take a long time.

2. Each piece of real estate is unique.

In order to buy or sell property it takes a long time, and while the transaction is taking place, the market is constantly changing. This makes timing the purchase or sale of real estate tricky. When you are investing in real estate, you are trying to sell high and then jump back into the market by buying low. Timing the market in such a way is a challenge.

Look for property that is a "fixer upper" to get a good deal. If you have an aptitude for home repair or you know an inexpensive worker, you can increase the value of a home by over 10%. Search for foreclosure auctions and Notice of Default alerts in the area newspapers and online. Find a good deal on property by anticipating positive change in depressed areas. Up-and-coming neighborhoods, in areas where people have been leaving tend to have lower prices. Find areas where the government is involved in development efforts.

The key to employing any of these strategies is the access to capital. This doesn't mean having an account with a large sum of money in it. Instead, you need to have access to money. By maintaining a high credit score, nurturing an efficient relationship with your lender for quick approval for financing, and having access to liquid assets, you'll be prepared to jump when the right deal comes along.

Even in a slow market, the chance to make a profit investing in real estate is still likely. To do this, however, you'll need to do your homework, have a long-term outlook, and be able to walk away from any deal.

Saving Cash on Little Things Adds Up

Buying property is one of the largest purchases you'll ever make. Even if you aren't putting up a large down payment, by having a mortgage you are making yourself responsible for a sizable amount of money. There's also the possibility of tax consequences.

By saving as much cash as you can, you'll have money for the things that inevitably pop up. As it is, you know you'll need to pay for the closing costs and the initial down payment. Closing costs include the mortgage, fire and hazard insurance, title fees, and many other costly items.

Follow these tips to save money:

1. Get the best financing deal you can find. First and foremost, be sure to have your financing in place BEFORE you make an offer. To get the best deal, research the rates available for your credit score and try to get financing companies to compete for your business. Ask what options are available given your credit rating. Negotiate with your lender to lower or eliminate costly fees and charges. Avoid paying an application fee if you can.

2. Find your own providers. You don't have to use the companies that your agent or lender recommend. This is important when selecting your title and insurance company. Your agent and lender have lists of recommended companies because they have pre-established relationships. Keep in mind that you are the one paying them. Carefully review their fees and rates before making a decision. You can use any company you wish.

3. Be willing to negotiate. Even a seller in a seller's market needs to be flexible. People sell for many reasons – death in the family, divorce, job transfers, etc. Sellers in these situations are highly motivated to complete the real estate transaction quickly at almost any cost. If you're willing to work with them and be flexible, you may get a good deal.

TIP:

Consider negotiating a deal where the seller pays a larger portion, or all, of the closing costs.

Chapter 2

The Real Estate Sales Process

All About Flipping

Buying real estate and selling it again fast, and ideally for a profit, is called "flipping". This type of real estate investing is completely legal and ethical. Negative press over flipping real estate probably comes from media coverage of real estate fraud situations, where people have intentionally overpriced the market value of a home, fraudulently completed documents, or worked with others to take advantage of a buyer. None of this happens in an honest flip.

Finding a property that is a good flip requires a few ambitious steps on your part. You'll be looking, most likely, for an under priced home in need of repair. Or you will be looking for a seller that wants to sell fast, thus getting you a lower price.

One way to find property leads is to talk to friends, family, business associates, real estate agents, or bankers. Go out to the neighborhood you're considering and look for "For Sale by Owner" signs, or ring doorbells to see if anyone in the area is considering selling.

Check the public land records and look for "fire sales". This usually means that the owner of the property is having difficulty making mortgage payments. If you contact them and they agree to sell, you're helping them out of their difficult financial situation. And you're getting a property that may make a profit. If done respectfully, there's nothing unethical about this transaction.

TIP:

Make money without even having to find financing. If you enter into a contract to purchase real estate, and then sell the contract to another buyer before the close of escrow, you can turn up to $5000 in profit!

To be a successful real estate flipper, you will need to hone or develop many skills. You will need to have an eye for the diamond in the rough. You should be able to accurately size up buyers. It is best if you are handy and can take care of basic home repairs. It is very important that you are detail oriented and a multi-tasking project manager. Flipping involves many details, and it's important to be on schedule with the project to avoid costly delays. Lastly, you will need to have superior interpersonal skills.

Plan to retain the services of a professional accountant, unless you are sufficient at these skills. Also find a good lawyer who can provide you with legal counsel.

Finding Financing – Creative Ideas

For many years, the way to finance real estate was to make a 20% down payment, and get a loan for the remaining 80%. Of course you could make a higher down payment, but 20% was typically the minimum. Luckily, this standard has changed.

There are now several finance options available to the real estate investor. One popular way to finance your purchase is to have a second mortgage. The buyer makes a 5% down payment, and borrows the remaining 15%, usually at a higher interest rate, on a different loan.

Even though it's nice to invest less on a property, the higher interest rate isn't the only drawback. Usually, if the buyer does not meet the 20% minimum, they are required to get costly private mortgage insurance (PMI).

You are able to remove PMI when the loan-to-value (LTV) ratio reaches 80%. This is achieved by paying down the second mortgage and appreciation of the property value. This does not happen often because the property is usually sold or the buyer refinances before PMI can be removed.

For creative investors, other financing sources exist. Manufacturers of homes in planned developments are often willing to provide financing to early buyers.

Another risky and rather complicated way of financing a property is called ‘sub2’ which stands for ‘subject-to’. This type of deal is when the seller gives you the deed to the property, the loan stays in place, but the buyer never legally takes over the loan, just the payments. There are many different versions of this kind of transaction. Because of the complexity and risk, this method of funding an investment is not recommended for beginners.

You can also consider forming a limited partnership to finance your real estate investment. There are many different arrangements on this method. Some types involve each person in the partnership contributing in a portion of the cost, usually 50% each. However, sometimes the profit is distributed relative to the original amount invested. Another arrangement is that one half of the partnership contributes the capital, and the other half provides the needed services, such as repairs on a home that needs to be fixed. There are many different variations of this method.

Government loans are available to low income investors, or buyers who have served in the military. These programs are usually only available for primary residences.

Did you ever think about buying a home on a credit card? This is another method of financing your real estate purchase, although it’s usually not recommended. Obviously, the interest rates on most credit cards are substantially higher than loan rates. Another drawback is that lenders determine your creditworthiness based on your outstanding debt, and if you use credit card cash advances to cover the 5-20% down payment that you need, you’ll probably get turned down for a loan. This is also true for money borrowed from friends or family, unless you can show that the money is truly a gift.

The Lender’s Perspective on Loaning Money

Lenders are in the business of lending people money because they make carefully calculated decisions based on your risk. They have two expectations;

that you will repay them and that they will make a profit. To judge if you are capable of meeting those two criteria, lenders look closely at your current financial position and your historical financial situation.

When judging your financial past, lenders will look at:

1. *Credit history*. They'll review the size and number of previous loans and the repayment history on those loans. They'll also look at your FICO scores and various other raw data.

2. *Income history.* What is your profit history on your other investments? Over what length of time? They'll look at the last three years of income statements and tax returns, your debt, and any legal judgments that may impact your financial standing.

3. *Your experience with loans.* Basically, the lender wants to know that you are trustworthy and will hold up your end of the loan agreement. This means you need to be reliable and make good business decisions.

4. *Current holdings and financial situation*. Lenders are most interested in liquidity – your cash flow and income.

When lenders are looking at your ability to make a profit, they'll want to know about your total expenses related to the property. How much will it cost you to take care of the property? What will your insurance rates, taxes, and cost of repairs be? The lender wants to see that you can cover your costs associated with home ownership, as well as their interest charges.

Lenders often want short repayment periods, while it usually more beneficial for the buyer to have longer periods. Longer repayment periods mean that you can avoid origination fees, additional appraisal fees, and other costs. When it comes to loans for investment property, a 20 year fixed rate loan is considered a long loan. Normally this includes a balloon payment five to ten years into the loan.

If your lender tries to push you into a shorter repayment period, you can set up an arrangement that you re-price after five years, instead of having to pay a large amount of cash in one lump sum. A common alternative is the prevailing prime interest rate plus 1%.

Keep in mind that most things in real estate investing are negotiable, and that your lender can be your partner in real estate investing. Developing a positive long-term working relationship with your lender can only help you.

Hunting for Your Hidden Gem

Even in a strong market with the new technology available to give up-to-the-minute assessments of properties, an investor can lose large amounts of money in a short period of time. For the best chance to successful obtain your perfect investment property, consider these suggestions:

- Take advantage of the internet. You can find a “hidden gem” by searching through the millions of properties listed online, and viewing the property’s description, pictures, asking price, and legal information. Usually, the only way to avoid a real estate agent fee is to look for property listed For Sale by Owner, or posted on other free sites.
- Look into getting your own access to the Multiple Listing Service (MLS). A license is required in some areas, but some places you can buy into the service for a fee.
- Get out and investigate the area that you’re considering buying in person. Will the price be held down because of the condition of the neighborhood?
- If possible, talk to the neighbors. They might give up information about the property that the seller hasn’t mention, like the front yard that floods after two days of rain.

- Get a professional inspection. When you make your offer, add a satisfactory home inspection contingency. Use a trusted professional inspector and carefully review the detailed inspection report. Few properties, even new construction, are perfect. Use the report to negotiate the repair of problems or an adjustment to the selling price.

The Importance of the Home Inspection

The condition of real estate is different in every situation. To protect yourself when making such a substantial investment, it is important to have a thorough inspection by a trained professional. Make your offer to purchase property contingent on a satisfactory home inspection, and you will avoid investing in a money pit.

What exactly is considered “satisfactory”? Any home containing wood should have a pest inspection, where the inspector looks for evidence of damage caused by termites, mice, carpenter ants or other pests. This inspection is separate from that done by the home inspector.

Your home inspector should focus on every mechanical and structural aspect of the property. They will look for substantial cracks in the foundation, levelness of the structure, and moisture in the basement. Water penetration is evident when there is mold, mildew or efflorescence - a white powder that shows where water has penetrated. High tech inspectors use lasers to see if the things are level and specialized radon gas meters to determine if there is a radon gas issue.

The structure of the home is closely inspected. Homes rest on top of a foundation. Floors have been installed on top of this foundation, and it needs to be inspected to ensure that proper materials have been used. Next, the walls might have improper framing or possible damage from water. Electrical and plumbing systems lie within the walls, and where possible, these interior systems are inspected for wear, out-of-code construction, and damage. Pipes are