



CHAPTER 1

Seize the Opportunity!

If you've been looking to make money in real estate, whether part-time or full-time, you've probably seen the 2 A.M. infomercials that promise: "Earn unlimited income in your spare time!" "Create a personal fortune in real estate with *no money down*!" "Only \$75 will bring you hundreds of thousands of dollars in real estate earnings!!!" These infomercials make buying and managing rental properties seem so easy. They depict people just like you and me enjoying luxury cars, boats, and huge homes—and all the leisure time in the world.

Does this sound too good to be true? Well, yes and no. Can you make a lot of money in rental properties and retire rich? Absolutely! Many people have done so. But, is it instant and easy money? Not necessarily. Just as in any business, to make money in real estate you must work hard and be disciplined, persistent, and educated. *Then* you'll experience the fruit of your labor. The reality

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is that the process of buying a rental house—especially your first one— isn’t as easy as it may seem on TV. But one thing is for sure: Buying rental property can be a lot of fun, very profitable, and personally fulfilling when you have the right expectations and are willing to work hard to succeed at it! And to increase your chance of success you need to be educated.

And that’s what this book is about. It’s designed to show you how to make buying your first rental house a success, from my personal experience. I’ll share how I bought my first rental house—the challenges and fears I faced, the people I needed to meet, the books I read, what I did right (and what I did wrong), and what I will do differently on the next one. Remember when you were a kid how your parents would tell you about what happened when they were young? Well, they didn’t want you to make the same mistakes they did. They wanted you to learn from their experiences. I want you to learn from my experiences. To give you a frame of reference, for my first rental house, after working 8 to 12 hours for seven straight Saturdays, I earned back my down payment and rehab costs and then cashed out \$9,000 tax-free on top of all that. Pretty cool, huh? Well, if a 2.7 GPA from Ball State University can do this, so can you. And this book will show you how!

MY STORY

Here’s my situation. I am 40 years old, a college graduate, and the youngest of four children. I’ve been in various facets of the financial services industry for more than 12 years, starting in mortgage banking, retail banking, financial planning, and now settling in as a commercial banker. Granted, I may have more financial training than most readers, but I also have more than most real estate investors who are worth 10 times as much as I am. So being a financial expert is obviously not the magic ingredient to getting started. It is not necessary to have an extensive financial background. This book will discuss many of the financial ins and outs and details of

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what you can expect. I'm married with two daughters, eight and six years old, and see buying rental properties as a means to diversify my income, pay for my daughters' college educations (and weddings, of course!), and for my wife and me to retire comfortably. Buying my first rental house is the first step to achieving these goals.

I first got interested in real estate when my older brother Phil read *Nothing Down* by Robert G. Allen (Simon & Schuster) back in the early to mid 1980s. I was probably a freshman in college and he was a fifth-year architecture major. A few years later he confided to me that he spent an hour a day thinking about how to make money without having to work every day. Eventually he was in a commercial real estate deal with seven partners that turned out great, but he has not gone further than that one deal. Even though he never pursued additional deals, I was fascinated by the details of that one major project.

Phil is so conservative by nature that the concept of working for profits rather than wages has always scared him. I, on the other hand, have always been fascinated by working for profits rather than wages. I saw my father get laid off after 37 years with the same company because a new accountant thought he was overpaid. As you might imagine, my father is not a big fan of accountants. Working for wages doesn't provide *real* security. It provides the *illusion* of security. Real security lies between your ears. Real security comes from having several streams of income through several types of skills. You could have been the best railroad engineer in the world, but when the airplane came along you would be out of a job. Or you could be the best airline pilot in the world, with 25 years' experience, and then videoconferencing and terrorism come along and you get laid off. The world is constantly evolving. Either change and adapt or get left behind. The choice is yours.

I had seen some of my friends make money in real estate, and in the spring of 2002 I decided it was time for me to do it. I thought, "Why not? I have above-average skills in carpentry and home repair.

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I finished my basement in 1996. I was a mechanic through high school and college at a marina where I obviously worked with my hands every day. I have a brother who is an architect. I used to have a neighbor who was a building superintendent. Heck! I can ask a lot of questions at Home Depot and Lowe's and get all the free advice I need! While finishing my basement, I visited the home supply stores often. If I was venturing into an area I had never worked in before, I would ask two or three different store employees the same question. Then I might also ask a friend or neighbor. When I received a consistent answer, I would go with that solution. I have also been collecting business cards of people who could help me with electrical and plumbing work, as I need it. So what's holding me back?" The only answer was looking at me in the mirror, and he was not getting any younger.

Are you reading this and thinking, "Doug, I don't even own a hammer, and I don't have a clue how to open a paint can"? Fret not! I did not do all the work myself. Although I can do some electrical work and plumbing, I preferred to leave all that to the experts. My wife was not too keen on having me on the roof, either. So we had help there also. I will discuss in detail later in the book how to develop your professional team.

Where most people think of excuses as to why they can *not* do something, I began listing all the reasons why I *can*. I knew the mortgage business. I knew how to fix toilets, patch drywall, and light the pilot light on a hot water heater (why don't they call it a cold water heater?). I had all the hand tools of an average homeowner (well, maybe a few more tools than the *average* homeowner).

You see, often the biggest obstacles that keep people from succeeding in the real estate business are the obstacles they erect in their own minds—the fears, apprehensions, and worries that come with making a significant change (for the better) in your life. It was time I worked on the obstacles holding me back. Therefore, your first homework assignment is to make an "I can" list. Hint: Your first reason should be "If Doug can do it, I can, too!"

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\$9,000 CASH BACK AT CLOSING

What I did with this first house is a textbook case on the “cash back at closing” type of deal. I’ll go in more detail on this in Chapter 8, but here’s the overview. The house was foreclosed, vacant, and now owned by a bank. It was dirty inside and outside. The split-level house was appraised for \$122,000, and I bought it for \$101,000. I got the bank to finance 80 percent of the appraised value, which is \$97,600, for the first mortgage. I kicked in \$3,400 as a down payment to cover the difference. I then spent \$3,000 on expenses such as utilities, a mortgage payment, application fee, appraisal, insurance, and so forth. I spent \$7,000 at Home Depot and Lowe’s and with contractors to do all the repairs and then advertised it for rent.

Once I fixed up the house, it was appraised for \$139,000. I got a new mortgage for 90 percent of the appraised value, or \$125,000. So here’s how the numbers break down:

- \$125,000—new mortgage.
- \$97,600—pay off initial mortgage.
- \$7,000—to cover expenses (Home Depot, Lowe’s, contractors, newspaper ads).
- \$5,000—for refinancing expenses, including two points for investor rates.
- \$3,000—for expenses (utilities, insurance, mortgage payment, etc.).
- \$3,400—for down payment.

The net result? \$9,000 to me tax-free. This is because loans are *not* taxable! The money can be spent just like income but it doesn’t get taxed like income. All this for seven Saturdays’ worth of work! That is an average of \$1,285 per day of labor. Of course, that was only the middle of the process. It took time to learn about real estate investing. It took time locating a house. It took time renting out the house. I will take time to maintain the house.

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SLEEPLESS NIGHTS

Making money is the fun part. But just as with any worthwhile, moneymaking endeavor, you must be willing to pay the price. For me, the price was enduring several sleepless nights, seven sore Sundays, and time away from home.

Waking up at 2:37 A.M. is not fun, and I did it a lot. I would lie awake worrying whether I was doing the right thing, how much work needed to be done before I could advertise it for rent, and how much more money I would have to spend. What if somebody breaks in and steals all my tools? Did I get the right insurance coverage on the house? How can I get the master bathroom sink to stop dripping? My wife, on the other hand, never lost a minute of sleep! I would tiptoe out of the bedroom wide awake, and very jealous.

Sometimes I sat at my computer and tried to list all the things I had to do to this house to get it ready to rent. I thought if I got it all out of my head that way it would help me to sleep better. It didn't, so save yourself some time and don't try that method. A couple of times I watched Carlton Sheets infomercials and tried to picture myself on his show. I'd find myself getting mad at those people who made it sound easy. Again, don't try that method! I would be so worn out the next day that I'd come home from work, eat dinner, and then fall asleep on the couch with my kids as we watched *Animal Planet*. I've taken Melatonin for years to help me sleep at night, but during this process it didn't seem to help much.

My wife Nan and the kids coped well with Daddy being gone for seven straight Saturdays, 8 to 12 hours at a time. They would always bring lunch, and Nan would try to help for an hour or two before the kids wore out our patience and theirs. If you have ever tried to paint with children around, you know they always want to help. They get a paintbrush, make about five strokes with a brush, and they are done! Now you have an extra paintbrush to clean. Then Nan had to leave with the kids to maintain sanity in the marriage. I

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will talk later about your support group, but it is worth hearing it here, too. Your family needs to know what is involved.

Now that I am on the other side of things, I sleep a lot better and do not worry as much. Why? I have gone through the process, survived, and now know what to expect as I build my real estate portfolio. You see, the hardest part about getting into real estate investing is buying the *first* property. Once you've gotten over the "first-house jitters," you'll gain more confidence to take your real estate assets—and cash flow—to the next level.

CREATING YOUR OWN SUCCESS STORY

With that said, let's talk about you. What is your story? What has gotten you interested in buying rental properties? What are your goals? What kind of money do you want to make from your own real estate business? What do you want the money to do for you? Are you looking to generate retirement income or save for your child's education or make enough money to vacation anywhere you want in the world? Does that sound like another homework assignment? Well, I will not be checking your homework, but I do think you need clearly defined goals. Have a plan for your profits from your first house. Do you want to pay off a loan? Do you want a down payment for a second rental house? By setting a goal, you will become more focused on what needs to be done to get there.

Whatever your financial goals, investing in rental properties can be a great vehicle for creating your own success story. Why? Consider these trends:

- **Stock market decline.** As of this writing, the Standard & Poor's 500-stock index is down 25 percent over the past 12 months. The Nasdaq 100 is 65 percent below its March 2000 peak. Investors are looking to protect themselves from further losses and have been moving money into hard assets that they can see, smell, and touch—like real estate. Am I advising you

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to sell your stocks and buy real estate? No! However, these statistics should cause you to think more about diversification.

- **Unsettled job market.** Job security is a myth—and the baby boomers are especially coming to terms with this. The number of unemployed workers age 55 and older has jumped about 23 percent, from 431,000 in June 2000 to 521,000 in June 2001, according to the U.S. Department of Labor. Job hunts for unemployed boomers are taking longer and yielding smaller salaries. According to a recent study cited by *USA Today*, workers over 50 take almost twice as long to identify and get a new professional role than workers who are 30 or younger. The study also found that as workers get older, their salary prospects plateau and eventually decrease. Even workers with relatively safe careers are thinking more about how they would fend for themselves in a major down market.

Guess what? There is no age discrimination in buying real estate. An 86-year-old person can qualify for a 30-year mortgage. A lender cannot turn someone down simply because of the person's age. Theoretically, we know chances are not good for someone to live to 116 to pay back that loan. However, if the applicant qualifies, the loan will be approved. If the borrower dies, the heirs can sell the house and pay off the loan.

- **Favorable interest rates.** Bankers typically require a little higher interest rate when lending for an investment property. But with 30-year mortgage rates running just above their three-decade low, you can still find financing for about 7 to 8 percent. The neat thing about real estate that you don't get with stocks, bonds, and mutual funds is that the bank will lend you 90 percent of the money to buy a house. This is great leverage! You certainly won't find banks willing to lend you 90 percent of the money to buy mutual fund shares—not even if the fund has a 50-year track record! So what does this say about real estate? The bank is very comfortable with using real estate as collateral because historically it not only has held its value, it appreciates in value.

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- **Tax incentives.** There are three types of income you can earn—and here is the breakdown:
 1. *Earned income and dividend income.* This is your salary or commission job with W-2 or 1099 federal taxes up to 39.6 percent plus state taxes (in Georgia it is 6 percent, so there we go up to 45.6 percent total). Don't forget your 14 percent social *insecurity* tax (FICA).
 2. *Long-term capital gains.* This refers to money that is created from selling an asset like a stock that you owned for more than one year—it's generally taxed at 20 percent federal plus state tax. For example: You buy XYZ stock at \$10 a share and sell it for \$20 two years later. You will be taxed \$10 per share profit at 20 percent. That is an after federal tax profit of \$8 per share minus your state tax.
 3. *Passive income.* This can be money generated from rental houses. With depreciation, tax deductions, and write-offs we can usually get that down to close to 0 percent taxes or at least in the low single digits.

Now . . . where would *you* like to spend your time? Working for an income that is taxed at 45 percent or 0 percent?

- **Consistent track record.** Over the long term, housing has proved to be a consistent, if unspectacular, performer. According to the government's House Price Index, the average home value in the United States has increased 32 percent in the five years ended March 31, 2002. The government says the average house gained 8.8 percent in value in the 12 months also ending March 31. Rising prices have led to a buildup in home equity that gives many aspiring landlords a source of wealth to tap for a down payment on a rental property. Most of the equity you acquire in your home over a long period of time will come from its appreciation, not from your monthly payments reducing the outstanding principal on the mortgage.

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DO YOU HAVE THE RIGHT STUFF?

Do you have what it takes to succeed in rental property investing? By this, I don't mean financial assets like cash and credit. While these are important, what's absolutely essential is having the right psychological makeup, the *intangible* assets to make it. Just as with any great business opportunity, real estate investing is not for everyone. That's because, contrary to popular get-rich-quick gospels, real estate investing requires a lot of hard work and personal sacrifice. You are obviously willing to make a time investment. After all, you bought this book when you could have bought an entertaining Tom Clancy book! Not that this isn't a hotbed of excitement. However, don't wait for the movie.

What are the intangible assets you need to succeed in real estate? Ask yourself these 10 questions.

1. **Can I stomach the risks?** You must overcome your fears of failure as nagging negative thoughts run through your head, like:
 - What if I buy this house, fix it up, and nobody rents it? Okay, is that a realistic worry? You may need to adjust the rent or be creative. But the chances of never renting are slim.
 - What if the house generates *negative* cash flow? How will I keep from losing my shirt? No one recommends negative cash flow, so don't go into a deal that appears to be negative from the beginning. However, if you have a setback, like more repairs than you anticipated, look at the numbers. This is not where you want to be, but don't let the fear of this keep you from pursuing the possibility.
 - What happens if my tenants make two payments and walk out after trashing my property? Yes, this is possible, and if you stay a landlord long enough it may hap-

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pen. Do some research of the probability of that happening. Who do you know who is a landlord now? I was amazed to find out how many people in my church and how many of my friends' parents had rental property. Ask them how many times they have had a renter trash the house in two months. If you have enough properties this may eventually happen, but chances are slim it will happen on your first house. That is why we get credit applications on prospective tenants.

- What if my house catches on fire? That is why we have insurance. I would encourage you to meet your property insurance agent for breakfast or lunch and discuss details about what is covered and what is not covered. He/she will have some wonderful insights and might be able to hook you up with a client who could act as a mentor to you.
- What if an eyesore like a gas station is built next door and devalues my property? You can do your part to reduce this risk by doing your homework. Check to make sure there are no rezoning plans for the immediate location around your prospective property. If you buy a house in a subdivision you have drastically reduced that chance.

If you can stomach the risks, you'll do fine. Just make sure you go into a venture with your eyes wide open and make low offers.

2. **Do I have the time to devote to this?** If you travel several days per week and have two small children at home, you may not have time to do this. Count the cost (in time) before you dive in. This way, you're committed to spending whatever time it takes to succeed. If you feel guilty about the time, you will not enjoy the work nearly as much.
3. **Do I have the hunger to keep learning and growing?** Knowledge is literally power. The more you learn about

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the business, the more money you'll make—and the less money you'll lose. Do you understand mortgages? Do you like to deal with people? Do you like to work with your hands? Do you know how to paint? Do you know how to fix a toilet? Do you know how to fix a leaky faucet? Do you know how to research problems and find a solution? Identify what you need to learn and then focus your time and resources on acquiring the knowledge and skills you need to overcome the deficiencies. This book, along with others I recommend you read, and your local home improvement store will get you well on your way to knowing what you need to know.

4. **Do I possess an opportunity mentality?** What one person sees as a dump a savvy real estate investor sees as a potential cash cow. You need to see opportunities where others do not. The smell of opportunity is cat urine. When you walk into a house that literally stinks and you can immediately knock \$10,000 to \$15,000 off the asking price. New carpets and paint might cost \$3,500. Cosmetic problems will turn off 99 percent of the people looking at a house. You have to look at this house through rose-colored glasses. See the house as it will be when renovated.
5. **Am I self-motivated?** As motivational guru Zig Ziglar puts it: "If you do the things you *ought* to do *when* you ought to do them, a day will come when you do the things you *want* to do *when* you want to do them." You are the boss on this project. No one is going to watch over your shoulder and encourage you. You must be your own motivation. Get back to that "I can" list and build off of your accomplishments.
6. **Do I have access to financial reserves?** Do you have a savings account, an equity line of credit on your current home, or credit cards for repairs, advertising expenses, and so forth? Don't forget to look beyond your finances to other people's money. What if you do the work but Bob supplies

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the money? Having the money is different from having access to the money. You just need the access!

7. **Do I have access to partners?** Who can I call on to help me? Two people going in together on their first deal might have a calming effect on both. They might team up for financial reasons or for simple collaboration. I consider my wife a partner, and she was my sounding board on many occasions.
8. **Am I coachable?** Am I willing to learn, change my habits, and forgive myself for mistakes? I hope you have already begun to learn from this book. As for mistakes, they are only truly mistakes when you don't learn from them. You will read about several changes I would have made to my first success story. I'm not mad at myself for making mistakes—I didn't know any better—and next time there will be fewer regrets. I'm still proud of myself for doing the first deal. To get the first deal behind you is a wonderful feeling. The second rental property will be so much easier—and I bet I make some mistakes there, too!
9. **Am I able to withstand criticism?** What if my family and friends think I've lost my mind—will I be able to stand up to their ridicule? Let me make a suggestion here. If you know family members or friends will not be supportive, then don't tell them. Currently my father-in-law does not know about our rental house. As a child of the Depression, he would have lost sleep for weeks worrying about our debt. That was my job! I didn't need company. What good would come from telling him? Chances are you will find your friends and family to be more supportive than you expected. I had much more support than I expected.
10. **Am I sophisticated and wary?** Will I see at least 10 houses before I put an offer on a house? We all want to put a bid on the first house we look at. Will I resist the temptation to buy something I really don't feel comfortable with? Know the difference between nerves and that old gut feeling.

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If you answered “yes” to each of these questions about yourself, you stand a great chance for success. Whether you’re looking to become a big-time real estate mogul or simply to earn part-time, supplemental income, this book will show you how to take the first critical steps to make it happen.

ACTION STEP

Log on to my web site at www.firstrentalhouse.com and sign up for my free newsletter. You’ll also be able to see my schedule of book signings and seminars.

MOTIVATIONAL QUOTES

Small opportunities are often the beginning of great enterprises.

Demosthenes

A simple man believes anything, but a prudent man gives thought to his steps.

Proverbs 14:15