

C H A P T E R**1****Five Magic Paths to
Making a Fortune
in Real Estate**

For many people, real estate has been the investment of choice to become wealthy. In no other way can you consistently and safely make substantial amounts of money. In this first chapter we'll take a look at each of the five "magic paths" to use real estate to gain financial freedom. We'll also look at how these techniques work with one another. We'll talk about how you can get started with little or no money and with modest work in your spare time on a road paved with great profits for years—a road where you are your own boss, you make your own time schedule, and, as you master these skills, you prosper.

THE FIVE MAGIC WAYS TO WEALTH

The general benefits of real estate that can make you wealthy were discussed in the Introduction, so now we'll turn our attention to a brief view of each of the five techniques explored in this book and how you can be flexible enough to profit with each one.

1. *Buy and fix up single-family houses for resale.* This is one of the greatest markets of all time. Nowhere else can the average investor

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start increasing wealth faster. Many of the skills needed are common-sense ones. First, you secure a property that is priced reasonably because it needs repair. Then, you manage or do these repairs yourself; and finally, you resell the property to a retail home buyer. Sound complex? Not at all. Because the single-family fixer-upper can be sold or rented to a huge market of buyers or renters, it's one of the most common real estate ventures. And you can find as much help as you need. If you work with a real estate agent, you'll discover his or her expertise in property values to be worthwhile. If you work with a carpenter or contractor, you will easily find out the expense of needed repairs. The fixer-upper is one investment opportunity that's win-win. It's ideal for getting started and generating cash, particularly for those investors who don't mind rolling up their sleeves and doing the necessary repairs themselves, at least to get started.

You start by looking for single-family properties that may be in distress but that do not require major repairs and that are low enough in price to permit a robust profit on resale. Two to four deals a year will earn you more than, for example, the average teacher's salary. One of the ways you will obtain property is through a lender, mortgage company, tax authority, or other lien holder that has foreclosed on a property. As foreclosures often need rehabilitating, they remain one of the best opportunities for acquiring fixer-upper properties. Since obtaining a foreclosed property is different than negotiating with a home seller, we address this separately. Here you will gain the special knowledge needed to make this area profitable.

2. Buy or control property to wholesale or "flip" to another investor. An alternative version to buying the fixer-upper, doing the work, and reselling it is to secure the property by contract and assign your position in the contract to another who will close and do the work. This is called wholesaling or flipping. Wholesaling or flipping a property means that you sell a property, normally as is, very soon after you secure it by agreement. Some investors concentrate on wholesaling as a primary activity. You might take title and resell in a simultaneous closing—buy and sell at the same sitting—or sell before taking title.

Wholesaling is perfect if you don't want to take title on a property and follow through with the necessary amount of fixing up and waiting for a retail buyer to come along. It's also great if your skills lie in negotiating deals with owners, or time constraints work against your doing the necessary repair project. It's a great way to make a profit without spending a lot of time, tying up much cash, or triggering a mortgage commitment. You may not make as much profit

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wholesaling as if you took title and completed the repair work, but then for little effort your modest gain will be a significant profit in a deal that may require little down payment.

3. Lease/option or "rent-to-own" property from a seller and contract future sale with a new tenant-purchaser. In lease/optioning property you control a property by leasing it from a willing owner who gives you an option to purchase the property sometime in the future. Favorable lease terms such as low monthly cost, long duration, ability to sublease, and a reasonable purchase price in the future are all terms you want to negotiate. In a typical lease/option deal you become sublandlord and rent out your leased property—for a higher price than you pay to the owner—to a tenant committed to buy at some future time. To insure this purchase you receive from your tenant-buyer a down payment, and in turn you give a credit of the monthly rent toward the agreed-upon purchase price. Only at the future closing will your renter take title.

It's an advantage for this renter because it gives him or her a chance to build up equity in rent credit as well as time to save more down payment before taking title. The renter also gains any appreciation in the property. For you as an investor it allows a profit as you net the difference between the lease amount you pay the owner and the rent the tenant pays you, while further receiving a cash gain at the closing of the future sale. Although you may not gain as much profit in comparison to that of outright ownership, the deal is similar to wholesaling in that you are able to avoid making a large down payment or securing a mortgage. And you could sell or assign your position at any time. A lease/option can be attractive to a current owner who wants to get rid of the day-to-day responsibility of running the property while procuring a specific future sale.

A variation of the lease/option technique is only to negotiate an option—the right to buy at some future time—without passing this right on to a tenant. In this way, with limited risk to yourself, you control the appreciation of the property and have time to arrange for financing for a future close and/or find a buyer.

4. Buy and hold single-family houses for long-term investment. The first three "magic paths" deal with several short-term techniques of ownership and control. The fourth involves buying and holding the single-family home for a longer period. The buy-and-hold technique relies on the long-term appreciation of a property over a 3- to 20-year period. Here we examine the continuing renting and management of a single tenant in one property and how it differs from

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shorter-term techniques. Buying and holding a house that does not necessarily need rehabilitation but perhaps is worthwhile because of location or price can end up being a bargain as time increases its value. Many investors have used their investment skills to profit from long-term single-family rentals.

5. Buy and hold multifamily apartment and small commercial properties. You might stumble onto a six-unit apartment building or a small commercial building that may need fixing up (and what one does not?) and you decide to make the repairs and resell it right away. That's fine. Or, as you just read in the previous section, you might also decide to buy and hold a single-family property. That's okay, too. However, consider that the basic construction and design of an apartment (or commercial) building permits the continued use, and abuse, of nonowning tenants more than a single-family house normally built and designed for the presumably more considerate owner-occupant. True, over the years numerous investors have collected houses like postage stamps and rented them out for the long term. But, due to design and durability, the long-term investment has less risk if it's a building built specifically for tenants.

Therefore, an excellent way to start in long-term investing is to buy a duplex or another building of up to six or eight units. The chapters (14–17) on multiple units discuss income, expenses, and mortgage costs that must be considered to assure a positive cash flow. Benefits besides cash flow include equity buildup through appreciation, and amortization of debt. The risk includes making sure apartments stay rented and maintenance is not delayed. Here you will find what you need to know about the benefits of long-term property ownership and how to find, buy, and manage these properties profitably.

The techniques discussed in this book may be altered to fit the property activity in your area. You might fix up a single-family home to hold long-term. You might fix up an apartment building to sell. You might even combine techniques. You might buy a single-family home and exchange its equity into a small apartment building. You might add an option to a property you wish to lease and rereant.

You will achieve your maximum effectiveness by being flexible enough to use several of these techniques. But that doesn't mean you should start by mixing techniques together. Begin by focusing on one area. Perhaps you might wish to start in the area that interests you most. The next chapter will discuss buying, rehabbing, and reselling the fixer-upper; much of the information will support the

techniques that follow. As a guide for success, you must study and learn what will work in your own market. You must locate and inspect property, negotiate with current owners, and arrange financing, lease, or option for what you wish to acquire or purchase.

NOW IT'S TIME TO MAKE REAL MONEY

Success can come from using any one of the five “magic” techniques, or a combination of several. The idea is not to jump from one technique to another indiscriminately, but to begin by focusing on one, to specialize in that area, and then add to your growing expertise by undertaking one of the other methods. However, too many good opportunities can come up at a moment's notice not to be able to take advantage of them. Therefore, you may need to be versatile enough to shift gears at any time into another mode. It certainly would not be unusual to have a lease/purchase in process when the chance comes up to buy a distressed single-family.

Now that we've said it's best to begin with one technique, we will also say that while it's true that specializing in one niche improves your expertise in that area, the opportunities available in any given property market may not be in your area. Besides, if openings in any one niche area were in abundance the competition would be fierce, driving up prices beyond reason. It's best to stay flexible and be prepared to learn another method—again, one method at a time—so that you can take advantage of varying opportunities.

If you work only in a narrow area, like buying and holding single-family houses, you will miss much of the picture because you are concentrating on a small part of real estate investing. Perhaps you should consider buying and selling without holding over a period of time, or becoming a landlord of a building designed for long-term use, such as an apartment building. Specifically, buy low and resell a few properties to build up some cash before holding a few, or sell with owner financing for a cash flow. Unless you have lots of money in the bank, don't think just of holding, but of buying and selling.

The bottom line is that while you will be learning and gaining experience, you will also be making money and building a financial base that will make you wealthy. And, yes, it may seem easier to hone your skills in a single area and develop such expertise there, but you want to be able to take advantage of whatever the case is in your

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market. It's a lot of work, particularly when you must anticipate several avenues of investment techniques, but it is rewarding.

GUIDELINES FOR GETTING STARTED

Here are some guidelines for choosing which method you might begin with:

1. Study your local market. The technique you use will be determined by the opportunities available. You have to work with what people want in your area. In Chapters 2–6 on fixer-uppers you will see more on measuring your local market.
2. Note what's going on in your regional economy. Will fixer-upper opportunities be better in a few years when the local manufacturing plant relocates? Or will apartment buildings rise in value, as more people are coming into your area than are leaving?
3. Try to find the technique that appeals to you, something that not only fits your market but fits you.
4. Note that some techniques require more money, at least to put down initially, than others. Specifically, the lease/option allows you to put little down to get the deal started, but the apartment building purchase may require 10% to 20% down unless you can finance it creatively.
5. Gauge the amount of time you have available to get started. And be aware of when that time is free. Generally, real estate allows you control over your time. You can probably manage and maintain a small apartment building in the evenings or on the weekends, but working on a fixer-upper may require some weekday time when tradespeople are available.

COMBINE TECHNIQUES TO ENSURE SUCCESS

First consider a basic axiom of real estate investing: When possible, have a secondary possibility for the property. For example, if you're buying a fixer-upper for resale as your primary investment, bear in mind its potential as a rental in case it does not sell right away for the amount you want. In other words, think "insurance": What al-

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ternative will you have as a fallback position to safeguard this investment? This has nothing to do with lacking confidence in your original intent; it's simply some preinvestment precautionary thinking that will make it easy for you to shift gears if you have misjudged the market.

So you must be prepared. That's why you need to be able to think on different levels and be willing to manage the investment in a different way if it turns out you need to do so to best maximize your profits. In the example of shifting a fixer-upper to a rental (at least temporarily), part of your consideration might be the property's suitability as a rental in terms of durability and location.

Another example of shifting techniques midstream would be a situation where you have a small apartment building that you were going to buy and hold, but because of the expense of needed improvements you would prefer to resell it soon for a modest profit and recoup capital funds. To have this as a viable alternative, you need to know beforehand the exact cost of repairs and know how much they will increase the value of the building in order to judge whether it is a good investment overall.

BEFORE YOU ROLL UP YOUR SLEEVES

A lot of us have managed to struggle through the ups and downs of real estate values of the past decade. Some say genius is a rising market. But many investors with knowledge and creativity can survive in any market by learning to distinguish lucky chances from solid investment techniques.

Note that profitable investing can be done anywhere in the nation. Even within well-to-do regions there are houses that are modestly priced. There is opportunity everywhere. You need never get discouraged! There are always fellow investors working through the same deals elsewhere. Be persistent and good deals will come your way. Remember, if you spend an hour a day looking for the right property, in a few weeks you might land a deal, and from there you can see how productive you will become if you do it consistently.

If you know what is going on in your local economy, you can take better advantage of the opportunities. Is the answer to specialize? Perhaps, but only if your market does not offer a wide-ranging opportunity to carry out more than one technique successfully. To be the most productive, you will use two if not three techniques in

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which you can succeed. Additionally, you must read and research all you can on creative real estate investing. Capability comes from knowledge and imagination!

TAKE SOME MEASUREMENTS OF YOUR MARKET

Before we leave our overview and go into details of our first strategy, take a moment and evaluate your own marketplace. Here are some characteristics you could investigate about your marketplace and the neighborhoods in which you will look for property:

- Establish the territorial area in which you will prospect for property.
- Determine territorial divisions of neighborhoods in which you will do business.
- In each neighborhood determine if the number of home sales as well as the value of their prices are rising or falling, and look at trends for the past several years.
- Look at the number of single-family houses in contrast to the number of multifamily dwelling units, and find whether the trend for the past several years is increasing or decreasing.
- For single-family houses, determine the ratio of tenants to owner-occupants, and the trend there for several years.
- Determine the profile of the typical buyer in each of the respective neighborhoods.

Don't let this list intimidate you. Investigating these characteristics isn't meant to be a demanding task. You probably already know much of the information. Whatever you don't know can be learned from local real estate agents, property appraisers, assessors, or other investors. A check at the county registry of deeds office may also be helpful. The purpose is for you to start gaining a sense of what's happening in real estate in your marketplace. This will start you thinking about whether the value of single-family properties is going up and whether the tenant mixture is moving toward owner-occupants—two important points in using the real estate techniques in this book.

MAGIC PATHS FAQs

Before you read about how to put the five “magic paths” to work, take a moment to look at these frequently asked questions.

Is this book designed for the experienced real estate investor?

Absolutely not. Although anyone with real estate experience could benefit by reviewing the material here, what is presented is primarily for the beginning investor.

Will these strategies work in my area?

Certainly. Although markets vary, opportunities abound in each area. The book contains a discussion on how to evaluate your local market for using the best strategy.

Do I create a lot of debt in real estate investing?

Not necessarily. Creating debt is not your goal. Just remember what debt you do take on is backed up by a tangible property that is worth more. And when these debts are paid off their value will have gone into your pocket.

Will all the techniques discussed in the book work?

Yes, they comprise the major techniques used to practice investing in real estate in the United States today. Although some have more popularity than others, none are minor or insignificant.

Do they involve “no-money-down” schemes?

Not at all. Some require more money than others. But often several techniques are used to build up cash reserves for their use elsewhere.

What is this so-called creative financing all about?

Creative financing is a catchall term that usually involves financing other than or beyond a traditional mortgage loan. When used in this book it refers to the seller’s participation in secondary financing and the conservative use of a home equity loan.

Will using the techniques described here take much time?

Some take longer than others. You certainly don’t need to give up your present work to get started with using several of the techniques. Securing and arranging the work on a fixer-upper can often be done easily on a part-time basis. Correspondingly, however, something like

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the operation of several apartment buildings may take a larger commitment in time, unless professional management is used.

If I'm buying a single-family house or small apartment building do I have to swindle the seller?

Of course not. Great profits come from dealing fairly in the marketplace. Note that all prices come from comparable sales in the marketplace; even a damaged fixer-upper has a reason for its low price.

Is this book comprehensive and all I need to know?

No, your study of real estate should be lifelong. Although the techniques presented here are thorough and intended to get you started, each is its own field with a distinct fraternity of followers, books, courses, and gurus.

Are negotiations with sellers difficult?

Not at all. Even when you need to offer a seller less than what he or she is asking, a seller is generally persuaded by the factual material and comparable selling prices that you will gather regarding a property's value. You can make negotiating pleasant if the seller knows that you want to take some of the responsibility of the real estate problem off his or her shoulders. Note that you can often come near the seller's asking price if you name the terms; that makes it win-win for you both.

I'm not sure about my credit. How do I go about qualifying for a mortgage?

Two observations: First, consider that many investment properties, both single- and multifamily, are financed in whole or in part by the seller; second, many lenders base their mortgage decisions more on the value of the property and less on the borrower. Once you have real estate, regardless of how it's financed, you will have gone a long way to repairing any credit problem.

Do I need a real estate license?

Not to practice as an investor, you don't. In fact, having a license may compromise your investor status with the Internal Revenue Service (IRS), as well as be a hindrance in working with sales agents. Further, many sellers simply don't want to talk to brokers, so don't license yourself to become one. Note that wholesaling a property may feel like it requires a license, but even here you're selling a contract to buy a property over which you have a measure of control—and not for a fee, but for a markup, or difference in price.

Do I need to incorporate?

Generally, no. In fact, you will lose important tax advantages if you do. Incorporating is supposed to limit liability, but if individuals within a corporation act irresponsibly, the corporation will not shelter their liability. As far as liability for someone having an accident on your property goes, you should always cover yourself with the proper insurance, and liability insurance is relatively inexpensive. As for liability for the mortgage, even if you have a corporation you are likely to be required to sign personally on the mortgage. (In this regard, you should always make sure the mortgage is less than the value of the property.)

What are the main ways in which I will spend my time?

Oh, yes, I didn't tell you yet? It's not so much about bricks and mortar (although there may certainly be some of this). You will spend most of your time contacting people, and the second biggest investment of your time will go toward establishing value by investigating comparable sales.

Will it take persistence?

Yes, definitely. It will also take indefatigability, stamina, determination, purpose, grit, and, of course, pluck. Yes, lots of pluck.

In the next chapter, we'll begin setting out the way you make money with fixer-uppers.