DO YOU WANT

TRUTH OR COMFORT

IN REAL ESTATE INVESTING

JOHN TRAUTMAN

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By

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INTRODUCTION

Truth or comfort, what do you prefer? This was a question asked to a small group of us years ago by someone I looked up to. It was about a year before the recession. We all looked at him astonished that he was asking us this. Why would he suggest we had to choose? Things were going GREAT. He said that we were on a huge bubble and that we needed to prepare ourselves for what was to come. He broke it down into more detail, explaining how we were on an unsustainable model for real estate, and he wanted to give this same speech to the entire sales force of the bank. He did end up giving the speech about a month later, and shortly after that, he was no longer with the company.

For those of us who listened, it was information that helped us more easily navigate through some difficult times. Those who didn't listen got hit hard, including the bank. In fact, some lost everything, and the bank is no longer in business today. When people come to us and ask about wanting to get going in real estate investing (REI), I get excited for them, but it's work. That's why I named the book "Truth or Comfort." If you're looking for the truth, it's work but all worth it. It can provide for you and your family. For me, it hasn't been a get rich quick deal, but you can generate income over time, and it will allow you freedom, flexibility, and financial security if you allow it to.

Think about this for a minute and answer it honestly. How much time do you spend planning your vacation versus your financial future? Now, what if you owned one rental property free and clear? How would that impact you? What about 2 or 10 or 100? Nothing is going to be harder than getting your first property, but it will all be worth it. It gets easier the more you do. If you have picked up this book, then you have some interest in learning about real estate investing. You are not alone. REI is quite popular, as shows on HGTV attest.

However, TV shows and real life are always different. So, even if you have been watching shows regularly, you probably have questions and a few misconceptions. That is why I am writing this book. Let me make it clear that this book wasn't written to discourage you from investing in real estate. Instead, it was written to help you understand it and avoid any potential misconceptions. I absolutely love real estate. I love that it can provide financial security for you and your family, just as it has been the way that most average people in America have become millionaires. I did it. So can you.

I wanted to be sure that you had a good solid base of understanding before you began investing in real estate. To be successful, you need to make good decisions from the start. This will only be possible if someone gives you good, solid information. That is exactly what I've done Everything in this book is based on my personal experiences as a real estate investor. I've given you my helpful hints and tips to keep help you determine if REI is for you. If it is, this book will also help you get started with some best practices to keep your investments strong.

There are many facets and aspects to real estate investing. You'll learn as you read that there are many different ways to get started. There are many different ways to get financed. There are many different ways to invest that include rehabbing or renting and even some methods that do not require you to purchase a piece of property. I'll discuss all of this throughout the book.

Think of this book as a guide given to you by someone who has been there and done that. Or really, as is the case, someone who is there and is doing that. By the time you finish with this book, you will be prepared to get started investing immediately.

But you may be wondering, "Who is John Trautman, and why should I listen to his advice?" That is a great question and one that deserves an answer. I hope that you never take advice from someone without knowing their credentials! So, here is my story.

I grew up in Seattle and graduated from high school in Issaquah, Washington. After graduation, I moved to San Diego where I tried the college thing and eventually got a job selling cars, which led me to get into the finance end of the car business. This is where I had the opportunity to meet thousands of people. Real estate was the one common theme I saw between the people who were well-off, meaning they could do what they wanted and had money coming in on a monthly basis and those that were not well-off. It was real estate that gave them freedom and flexibility. It was real estate that allowed people to retire early and enjoy life with less stress. I wanted to do what they were doing.

I was 23 when I purchased my first house. This is where I lived and was my primary residence. At the age of 24, I paired up a real estate mentor and bought a $40,000 house in Tacoma, Washington. After $5,000 worth of renovations, we turned it into a rental property. Our plan was to buy properties, turn them into rentals, and get enough cash flow to look at longer-term investments. Our end goal was to pay off the house and live off the cash flow from the investments. We did this model over and over again, and my mentors advice was invaluable. He taught me to keep my emotions in check when investing. I still use that advice to this day. You cannot afford to get emotionally involved because you can make bad decisions when you do. Think about it like stocks. It's as simple as you want to buy low, and when and if you sell, you sell high.

After eight years, I quit the car business and went into the wholesale lending business. At this point, real estate had given me options. I was able to move from an account executive to regional VP over six states. Due to some interesting financial issues, I had to let my real estate holdings go. Nonetheless, the REI bug had bitten, and it wasn't long before I was looking for properties again.

My wife and I began my second round of investing in Detroit, Michigan in 2009. We were able to buy low and turn the properties into rentals. The fact is, we were picking up properties for as little as $3500. That's right! $3500. We were getting them as fast as we could. These rentals created a good cash flow. Once the rentals were making money, we would sell them to big investment companies, using the money we made to buy in other areas. That's when we set our sights on Phoenix and Scottsdale in Arizona. Our first purchase in this area was a condo in Scottsdale for $50,000. The property values began to grow so that we were able to purchase more and more properties to flip. Eventually, we began looking at commercial properties as well. Finally, we had enough money for a great house of our own in Paradise Valley, and our real estate investments allowed me to quit my day job. Real estate gave me the freedom I had been seeking for years.

Over the last 20 years, I've purchased hundreds of properties across the US, consisting of single family, mixed use, multi-family, office, retail, warehouse, and new construction. More importantly, I've done over 10,000 loans. I've learned to look at return on investment as a whole. I've learned to look at any property as long as it makes financial sense. I've learned that real estate investing takes a lot of hard work and requires a lot of due diligence.

I used the techniques and details I have discussed in this book to make all of that happen. I'm giving you these techniques so you can do the same thing without all of the trial and error. My suggestion to you is that you shouldn't quit your day job, not yet at least, but instead begin creating residual income. Put your head down, and one day, before you realize it, you have money coming in and can retire early. This is the way I've done it.

Think about it. If you can keep your current job, while acquiring real estate assets on the side that will allow you, at some point, to do whatever you want to do, that's not a bad plan. Imagine five, 10, or even 15 years from now. If you were able to quit your day job and still have a six or seven figure income, how would that sound? The issue I see is everyone is looking to get rich quick. If that's what you're looking for, this book might not be for you.

If this sounds good to you, then I encourage you to start with

Chapter 1 to learn about the 10 best reasons for getting into real estate investing. From there, I will walk you through the process from financing to finding properties to different types of investing. By the time you are through reading, you will be able to buy real estate for investment purposes. You will be on your way to financial freedom.

CHAPTER 1: 10 EXCELLENT REASONS YOU SHOULD CONSIDER REAL ESTATE INVESTING

The best place to begin is at the beginning. For investing of any kind, the big question is why this particular investment? Why do people choose to invest in real estate and is real estate something I should consider? Knowing the answers to these questions will help you determine if real estate investing is the right way to use your money and make a life change.

If you are like most people, you've been hearing naysayers suggest that now is not the right time for real estate. Words such as "recession," "subprime lending," and "housing bubble" are all over the news. Although these issues have affected real estate investing, they certainly have not ended it or even created much of a dent. For investors that understand cycles of the market and follow the rules, which you will be learning throughout this book, there are still plenty of investment opportunities in the market.

I have a lot of people or events that come to my mind when I think about real estate investing, but the most influential were those that helped me when I first got started. I was lucky to have great advisers. I think it's important to have people that you can bounce ideas off of. However, these people shouldn't be just anyone, but should be people who are successful in the field of real estate. "Find someone that has what you want, do what they've done, and get what they have."

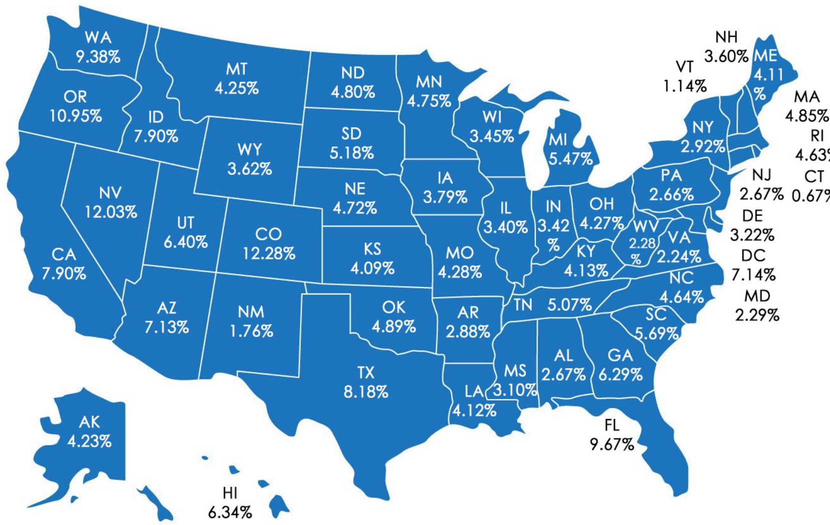
Here is a story I have told countless times that had a great impact on me when I was just getting started in investing.

I was 24 years old and doing finance at a car dealership. In the middle of the day in the middle of the week, a guy came in. He looked like he had been doing yard work. Looking at his application, he had written that he was self-employed and making $10,000 per month.

Out of curiosity, I asked what he did for a living. He responded that when he was in his early 20's, he started to invest in real estate and purchased 10 rental properties (this happens to be the amount of properties you can finance today) and worked his normal job for 13 years. He used all the money that came in from the rentals to pay off the home loans, living on his income from his job and using the income from the houses to eliminate the mortgages. This allowed him to retire from his day job before he was 40 years old. He then imparted this word of wisdom, "People plan their vacations more than they plan their future."

I think this had a huge impact on me because we were both the same age when we started investing. Maybe it was the thought of having people go to work every day to pay me for my asset. It could have also been that you can do real estate and your "day-to-day" job, too. Maybe it was that this guy had the freedom to do whatever he wanted in the middle of the week.

Actually, I'm sure it was all of these things along with the fact this was a very basic concept that was easy to duplicate. Here are 10 reasons why, despite bad press, investors like me are still choosing real estate, and why I feel that real estate investing is something you should consider as well.



PROPERTIES APPRECIATE IN VALUE

Over time, property values grow. This is especially true of properties in neighborhoods and communities that are experiencing growth. Unlike cars that lose money the day you take them off the lot, the longer you hold onto property, the more money you will make.

Keep in mind the real estate market has a cycle it goes through – the ups and downs. If you are flipping properties, you just need to make sure you don't get caught on a flip by buying high when the market turns. If you are buying and holding, even if you buy when it's high, if the property is producing a cash flow, time will eventually correct a bad purchase.

The Federal Housing Finance Agency (FHFA) House Price Index shows that houses have been appreciating steadily at 3 to 5% per year as a national average, with some areas being significantly higher. During the housing bubble, house appreciation did slip. However, for those that held on to their investments, prices have returned to normal in most of the country and appreciation is back on track. In fact, this past year, every state in the nation had a positive appreciation, and 15 states had higher than 5% appreciation.

Net worth and appreciating assets are closely connected. Some financial experts even believe that your net worth statement shouldn't include anything that depreciates. In fact, the only way to really increase your net worth is to reduce your debt and increase your appreciating assets. This means that real estate, with its track record of appreciation, is a perfect way to increase your net worth.

RENTAL HOUSES ARE A HOT COMMODITY

People tend to be waiting longer to get married, have families, and purchase their first house. However, they are getting pickier when it comes to renting. Many millennials prefer to rent a house instead of renting an apartment. They are looking for larger spaces, bigger yards, and more storage – all of which are sorely lacking in most apartment communities.

This is great news for those investing in real estate properties because this makes finding quality tenants for your property much easier. Whenever you have a commodity that is hot and scarce, you know that the investment is a good one.

Trautman's Tips: People will always need a place to live, so owning residential real estate is, in my opinion, a GREAT investment. Flipping houses is great, but what is your exit

strategy if all you do is flip? How do you retire? How do you create residual income? Flipping is a job. You are your own boss, but it is still a job. The only reason I flip a property is to create income to buy long-term rentals.

REAL ESTATE IS A LONG-TERM INVESTMENT

Owning real estate can be a long-term investment opportunity. In fact, those that chose to use real estate as a long-term investment were not hurt by the housing bubble burst or the recession because prices have bounced back. Over the years, there has always been a steady march upward in the value of real estate. Long-term investments with such a good track record are worth having in your portfolio.

CREATING POSITIVE CASH FLOW

In order to live a comfortable life, you need a positive cash flow. Nothing is worse than having more money going out than money coming in. Real estate can help you achieve this cash flow in two ways:

Through long-term investments: You can depend on the regular rental income of the properties you bought. As time goes on, your cash flow increases as you pay down your mortgage.

Through short-term investment: If you choose to flip houses, you create a positive cash flow each time you sell a property for more than you put into it.

Trautman's Tips: DO NOT buy a property that has a negative monthly cash flow in hopes that it will appreciate. This is a poor business model that is not sustainable. How many of these properties could you afford before you are broke every month versus having houses with a positive cash flow every month?

DIVERSIFICATION

Investors with a portfolio understand how important diversification is. For those new to the world of investment, diversification is simply the idea of not putting all of you eggs in one basket. For instance, having a portfolio of only stocks means that you would be at the whim of the stock market. If the stock market begins having issues, your entire portfolio could be wiped out in an instant. That's why, if you talk to any savvy investor, they will explain to you that any good portfolio will be diversified.

Trautman's Tips: I firmly believe that real estate should be one of the things you have in your portfolio. As a hard asset, real estate can generate cash flow and hedge against inflation.

HEDGING AGAINST INFLATION

As part of diversification, I suggested that the hard asset of real estate is a good hedge against inflation. This is such a big issue that I wanted to give this its own category. One of the biggest threats to any cash-based investment is inflation. That's because as inflation continues to rise, the value of the American dollar continues to drop. As a result, if you have cash investments such as a savings account, CDs, or IRA, the money in them won't be worth as much in the future as it is now.

Investing in real estate actually protects you from this problem because property values do not depend on the value of the dollar. In fact, the value found in houses, land, and multi-family dwellings actually goes up as inflation becomes a bigger problem.

Additionally, economies that deal with inflation are the ones that are growing. As the US economy grows, the demand for real estate grows as well. As a result, anyone who has invested in real estate will see an even bigger profit or return on their investments.

TAX BENEFITS

Real estate offers tax benefits that other traditional assets, like stocks and bonds, do not offer. Many traditional investment vehicles cost you money in taxes. Done correctly, real estate investing can actually give you some tax cuts and benefits. (See Chapter 16 for more details and always consult with a real estate tax professional before making decisions based on tax savings.)

Some tax benefits can include:

- Deductions for interest paid on mortgages
- Deductions for property taxes

- Deductions for repairs and maintenance on investment properties
- Deductions for insurance, travel, and agent fees for investment properties

MAKE MONEY USING OTHER PEOPLE'S MONEY

When you purchase real estate, you are unlikely to have all the money you need to make the buy on your own. Instead, you will get some sort of financing. We will talk about the types of financing in Chapters 3 through 5, but for now just keep in mind that you will be making money using other people's money (OPM).

This isn't something you can do for many other investments. For instance, if you want to build a stock portfolio, you would have to purchase stocks with your own money. The same is true for many traditional investments. However, with real estate, using other people's money is not only acceptable but typical.

Let's say you want to flip a house. You can borrow the money from a private investor, purchase the house, and then make repairs. Once you sell the property, you will have enough money to pay the investor back, and then you will have your own profit. It's a great way to make money for yourself without having to spend your own money up front.

Trautman's Tips: We are seeing opportunities to buy real estate with little down using the bank's money (OPM). When you get a renter, you are able to use Other People's Efforts

(OPE) to go to work to pay.

DEPENDABLE RETURNS

Real estate investing gives you stable, dependable returns. That is a rare statement in the investing world. Typically, investing is riddled with words like volatile, uncertain outlook, and risk. To realize that real estate is stable and has long-term gains with minimal risk is something to smile about. Building a stable future is extremely appealing, and this is one of the many reasons why people choose real estate. With returns you can depend on, you will be able to secure your financial future.

CONTROL YOUR INVESTMENTS

Most investment vehicles require that you relinquish a good bit of control to someone else, such as a financial planner. Then, you watch helplessly at the stock ticker, wondering if you are losing or gaining money.

With real estate investing, you will be able to make decisions for yourself. You will get to determine if you want to flip and sell or create long-term investments. You will get to determine what properties meet your criteria. You will get to determine what changes you make to the property before you flip or rent. Because of this, real estate investments actually put your finances in your hands.

Trautman's Tips: The way I see it, not everyone will invest in real estate, and that's fine by me. They can rent, and hopefully rent one of mine or your properties. Remember, there are always people who don't want to see you succeed. If you're

not successful, it justifies where they are in life. However, ask yourself this: Do the successful people I know own real estate? More importantly, do they have what I want?

CHAPTER 2: WHAT TO DO TO GET STARTED – 5 STEPS FOR SUCCESSFUL REAL ESTATE INVESTING

As you can see, there are many substantial benefits to choosing real estate investing. Now that you know why someone might choose to invest in real estate, let's begin to get an understanding of what real estate investing is and what it is not. The best way to learn about real estate investing is to get started by taking action. Here are some action steps that will get you moving and keep you on the right track. By following these steps, you will be able to know the right actions to take for a successful first real estate investment transaction.

STEP #1: KNOWING YOUR EXIT STRATEGY

It may seem unusual to be talking about exiting real estate investing before you have even purchased your first property. Mike Tyson said, "Everyone has a plan until they get punched in the face." To his point, always have a plan B, and if possible, a plan C.

There are two main ways for beginnings to invest in property. **These two strategies are:**

Buy a property for the long-term investment. After purchasing a property, you turn it into a rental for income.

Buy a property for quick profit. After purchasing a property, you quickly renovate and sell for more than you bought it for. This is called flipping.

Trautman's Tips: When I purchase, I look at both options. I want to be able to cash flow the property if I want a rental, but I also want the deal to be good enough that I can flip it and make some money. If you're doing your research and buying right, both of these options should be open to you. I like to keep my options open and suggest you do the same thing. When you're new at investing, look at houses at or under $100,000. In most cities, houses in this range will allow both holding and flipping scenarios to work.

Understanding whether you plan to keep the property or flip the property will help you determine what property to buy, and how you rehab them. Not knowing beforehand can get you into trouble. How? Well, let's think about financing.

Financing for long-term and short-term real estate is very different. Why would you go through the hassle of getting a 15-year mortgage for a house you plan to flip in 90 days? And did you know that some long-term financing will penalize you for paying off too quickly? On the other hand, short-term financing tends to have higher interest rates. That's not bad for a 3-month venture, but you certainly wouldn't want to pay higher interest over the course of 15 or 30 years!

The kind of property you purchase will also be affected by how you plan to exit. When flipping a property, you will need to think about the upgrades, as they differ from a rental, You will also need to think about things differently than when renting. For example, when flipping, you need to think about purchasing a house where people will wish to buy. The house also needs to be purchased at a low enough price that small renovations can create a profit. Finally, you need to feel confident that the house will sell quickly or you will see your profits dwindle.

On the other hand, if you want to rent the house to a tenant, you need to find an area where renters would like to live. These are not always the same as where buyers choose to go. You will also be looking for an area that will continue to grow so that your property appreciates over time.

Both scenarios are good ways to invest in real estate, but each has its own set of parameters for the financing and purchase. Always know beforehand how you plan to use the property. Without an exit plan, it is too easy to make mistakes that could end up costing your money.

STEP #2:
PICK A NICHE

Although you do not have to stick to the same kinds of property, it is often easier, especially in the beginning, to do so. When you do, it is easier to find financing, easier to network, and you are less likely to make errors because, over time, you learn what is needed by you and by your investors to make the purchase profitable.

There are basically five types of property to consider for investment: undeveloped land, single-family houses, multi-family houses, apartments, and commercial properties. Let's look briefly at these so that you can determine which works best for your financial needs.

Single-Family Houses: Just as the name implies, this is a house meant for one person or family. For many real estate investors, this is a great starter property because they are easiest to work with. With a single-family house, you can rent it, flip it, or just hold it.

Trautman's Tips: This is the easiest point of entry into investing in real estate and where I suggest you get started. The reasoning is that financing is easier, and the demand for single family houses is high. High demand means there will be larger pools of buyers when you eventually sell. In fact, the pool is much larger than any other type of property. Single-family houses offer lower risk and a faster return on your money. I suggest that once you find your niche, look at as many of those properties in your focus area as possible BEFORE putting in an offer. I suggest physically looking at least 30 to 40 properties.

Multi-Family Dwellings: These include duplexes (2 housing units), triplexes (3 housing units), and quads (4 housing units). As with single-family homes, these are great starter purchases for those beginning in real estate investment, especially if the exit strategy is finding rental properties. The cash flow opportunities in multi-family units is high. Plus, you have the option of living in one of the units while renting out the others. For many first-time investors, especially young investors, this is a great way to purchase property without having to figure out how to pay the mortgage.

Apartment Buildings: Apartment buildings are technically commercial property, but act more like a multi-family dwelling. Apartment buildings can be small (50 units or less) or large (more than 50 units). This type of investment requires far more hands-on interaction because of the large number of renters. For those with limited real estate experience, buying an apartment building could be overwhelming. However, if this is where you are headed, we discuss techniques for renting in Chapter 13 that will help you be successful.

Commercial Properties: Commercial properties, except for apartment complexes, are those intended for commercial activities. These properties include such things as office buildings, retail buildings, strip malls, and more. These properties are more difficult to manage than residential properties and do require that you have a solid financial footing.

Undeveloped Land: This is also known as raw land or acreage. Essentially, this is property that has absolutely no development. There are no dwellings and often no outbuildings. Why would you choose this type of property? You might decide to buy a large piece of property, divide it into smaller sections, and then sell. You could develop on the property and then sell. You could rent it out. You could simply purchase it on speculation that it will become more valuable due to its location. As highways and commercial developments get closer, the property will be worth more.

STEP #3:
KEEP TABS ON THE MARKET CYCLE

It would be irresponsible to make an investment without understanding the market of that particular investment. No one would suggest that you buy stocks without understanding the stock sector as well as the market for stocks at the time.

The same is true for the real estate market.

Although the real estate market changes rather slowly, unlike the stock market, knowing what is happening will help you purchase the right property for the right price. There are three main kinds of markets in real estate. These are known as a buyer's market, a seller's market, and a transitional market.

Let's learn just a bit about each.

Buyer's Market – In a buyer's market, there are more houses for sale than there are buyers to buy them. This is a great time to buy properties but not a great one if you have to sell. The reason that buying is great is that sellers are working harder to make their property stand out to potential buyers. They are often willing to fix more issues, offer more incentives, or give better deals to be sure their property sells. As the seller, however, you are the one pushing hard to find a buyer, which may lead to selling the property at a lower price just to get it sold. That said, a buyer's market is a great market for purchasing when you want to find a rental unit. Flipping during a buyer's market is a bit riskier since there are so many houses on the market. If you see changes that suggest the market is about to flip to a seller's market, however, you can make a great deal of money.

Seller's Market – In a seller's market, there are fewer houses than there are buyers. In this case, sellers have the control.

Buyers, on the other hand, have less time to consider a property and will have to be willing to "settle." This is not a good time to buy a property but a great time to sell.

Transitional Market – This market is also known as a neutral market, in which market conditions don't favor either the buyer or the seller over the other. It usually occurs as the market is moving from buyer's to seller's or from seller's to buyer's. This is because no market switches from one to the other overnight. During the transitional period, the housing market is stable.

The housing market runs in a cycle that starts with a shortage, moves to being stable, and then has a surplus, eventually going back to stable and then hitting a shortage again.

This happens due to many different factors including such things as:

- Interest rates
- Economic conditions
- Consumer confidence

When the interest rates are low, economic conditions are good, and consumer confidence is high, the number of potential home buyers increases. As demand for houses increases, eventually the supply lags behind the demand and a seller's market results. The opposite occurs when interest rates are high, economic conditions are poor, and consumer confidence is low. All of this slows demand, eventually producing a buyer's market.

Market swings last for varying lengths of time, sometimes as short as months and sometimes as long as years. It depends on what drove the change. However, you can rest assured that eventually, the housing market will change. Understanding what the market is doing will help you make good decisions about investing in real estate.

So, what's the market? It depends where you are looking! Although you may find statistics about real estate on the national level, each state has its own market. In fact, each city can have its own market as well. Right now, in North Carolina, the capital city of Raleigh is in a seller's market where bidding wars are quite common. Not 30 miles away, in small towns like Sanford that do not have the infrastructure of the capital, the area is in a buyer's market.

Thankfully, you can determine the market of a particular area with the following online tools:

Online maps: Online maps can show you distances to key items such as highways, landmarks, and employment centers. You can also see public transportation, stores and restaurants nearby, and school locations. You can even use a "street view" feature to see what the area looks like.

Walk Score: This is an online resource that ranks cities by their walkability and public transportation. Additionally, you can learn about rental rates, housing prices, crime rates, and nearby sights.

Listing Sites: Sites like Trulia and Zillow can help you find comps in your area. If you are looking at commercial real estate, Loopnet is a good site for this information.

Market Reports: Most real estate brokerage firms offer reports for primary and secondary markets.

You can also talk to those that are currently investing. Ask about the market in your area, or see if other areas nearby might be better. You'll learn more about networking in Chapter 6.

Trautman's Tips: Think about it like a stock. You want to buy low and sell high. It's really just that simple. Also, you will hear this over and over, "You normally make your deal on the buy", meaning you need to buy as cheap or as right as possible to ensure your profits.

STEP #4: DETERMINING THE NEIGHBORHOOD AND THEN THE PROPERTY

When investing in residential properties, the first thing you need to do is determine which neighborhood is the right option. Here are some criteria to use when choosing a neighborhood:

Low crime rate. Properties in areas of high crime lose their value quickly.

Neighborhood is not declining. If a neighborhood is in decline, then your investment will not appreciate. Make sure the neighborhood is up-and-coming rather than "been-there-do-ne-that".

Has access to amenities. These include things such as swimming pools, parks, shopping, gas stations, restaurants, transportation, and schools. People are looking for convenience when buying or renting a house. Also look for close proximity to colleges and other higher educational opportunities, as well as federal and state government seats.

Is accessible to work. Finding neighborhoods that are close to employment centers or have access to easy commutes is important. Also, look for close proximity to creative industries like design, publishing, advertising, music, and television.

Area has low unemployment rates. This means that your tenants will have good jobs to pay your rent and your buyers will have the ability to get bank loans to purchase.

High average household incomes. This is especially true if you are flipping. You will want to be sure that those in the area can afford to pay top dollar for the house you are selling.

Studies show that if you start by finding a neighborhood with many of these qualities, the eventual property you buy will produce great returns.

Once you find the neighborhood, it is time to look at individual properties. This decision will be based on the purpose of the property. If you will be flipping the house, you will be looking for altogether different features than you would if you plan on renting out a property. For those that plan to flip, you will be looking for a property known as a fixer-upper. Your intent will be to buy low, make some small renovations, and then sell at a higher price. Your point is to find a good return on investment. On the other hand, if you are renting, you are not as likely to put renovating before renting, so you will want to find a house that is ready to rent quickly. That way, you can find tenants immediately.

STEP #5: KNOWING YOUR PAYMENT PARAMETERS

This step is key to making a good decision. It is knowing how much you are willing to pay for a particular piece of property based on your exit, the market, the neighborhood, and the comps for the area. Here are some things to consider when determining the price you pay for property.

CAP RATE FOR ROI

If you plan on renting the property out, then you need to determine the most you could pay for the property and still make a profit. Setting your upper limit is a good strategy. Here's how to create this limit:

Determine the rent for the property: To do this, look at other comparable properties in the area that are already for rent. How much do they charge? Is the property you are considering similar? If you try to rent too cheaply, you will often get poor tenants. On the other hand, if you ask too much, you won't get any tenants. Determining the right rent is a critical piece for determining the price of the property. You can find properties for rent in the area through Craigslist, Rent.com, and Realtor websites.

Determine your expenses for owning the property. Be sure to include such things as real estate taxes, mortgage payments, property and liability insurance, utilities, repair costs, and projected cost of vacancy. Projected vacancy cost is the loss you would incur if you have no tenants and is typically figured at 5% of the annual rent. So, if you rent the house for $1,000 a month, the annual rent is $12,000, and the project vacancy cost is 5% of $12,000 or $600.

Subtract the expenses from the estimated rent. This will give you a net income.

Divide the net income by the cost of the property. This will give you a cap or capitalization rate. This is the return on investment you can expect expressed as a percentage. The cap rate should be between 8 and 15%.

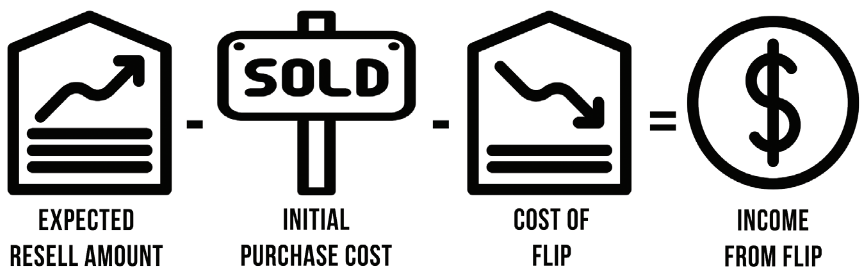
To help you determine a cap rate, divide your annual net income by the cap rate you prefer. This will give you the most you should spend on a property.

Here's an example. The capitalization rate, often just called the cap rate, is the ratio of Net Operating Income (NOI) to property asset value.

So, for example, if a property was listed for $1,000,000 and generated an NOI of $100,000, then the cap rate would be $100,000/$1,000,000, or 10%.

COST FOR FLIPPING

When flipping a house, the numbers are different. You don't care about yearly income and yearly expenses because you intend to sell the house long before a year has come to pass. Instead, you will be looking at how much the house costs now, how much you think you can sell it for in the future, and how much the repairs will be. The formula looks like this:



Expected Amount Of Resale – Initial Cost of House Purchase - Cost of Flip = Income from Flip

Since the goal is to make money on the flip, you want to be sure that you don't cut your numbers too close.

Once you understand these five steps, it is time to figure out your financing, make an offer, and purchase your first property. The following chapters will break down each of these final steps in detail so that you can fully understand what you need to do in order to make real estate investing a profitable endeavor.

CHAPTER 3: FINANCING OPTIONS MOST HOMEOWNERS HAVE CONSIDERED

Now that you have a good idea how to get started, it is time to look at the financial part of real estate investing. Where do you get the money? There are numerous ways to get the money needed for real estate investments. This chapter will discuss financing options that you have probably considered before because they are often used when purchasing a house as a residence. Chapters 4 and 5 will discuss financing options that are far more common to a real estate investor.

TRADITIONAL BANK LOANS

With this kind of loan, you find a house that you wish to purchase, you head to the bank with your financial information, and the bank determines if you are a good borrower, and if the house is a good investment for them. This option is very common among people that are purchasing a house for their own residence. For some investors, especially if they only plan on owning one or two properties, a bank loan can be the right move.

Let's look at the pros and cons of a bank loan:

Advantages

Once you are approved, you will know exactly how much money you can spend.

You will know exactly what the bank expects, which will make it easier for you to create your plan for renting or flipping the property.

Bank loans are stable because they are insured by the FDIC.

Interest rates are often lower than with non-traditional financing methods.

Disadvantages

Banks did crack down on lending after the housing bubble and subprime lending or 100% financing, although we are seeing it come back, is not there on non-owner occupied or investment properties yet.

If you already have a personal mortgage, it is very difficult to obtain a second mortgage. Unless your debt to income ratio is very low, your ratio will be unappealing.

Trautman's Tips: We have used traditional funding to refinance out of a hard money or private money loans, allowing us to get better rates and terms. We are able to pull the money we used to rehab the property too.

FRIENDS AND FAMILY

Friends and family can be a good source of money for real estate investments. However, financial matters have been known to break up friendships and marriages, so always think carefully before partnering with loved ones. Keep the following in mind:

Make sure anyone you ask has the means to make the investment. Also, keep in mind that all investments carry risk. Don't downplay the risk. Make sure that they understand the risk and can survive if all the money were to disappear.

Be forthcoming with your needs and why you want the money for investing. However, do not guilt anyone into investing with you. The outcome will always be bad even if the investment is sound.

Make the loan formal, including payment schedules. Your loan should have specific terms, and everyone should agree. State how much you are borrowing, the interest rate, payment dates, late fees, and any other terms. Put everything in writing. Keeping things professional will help alleviate tension and arguments.

Always give the money back with interest. Do not use loved ones as a source of free money. If they are willing to help you with your investment, be sure to pay them for their services. The interest rate needs to be fair, and both parties should agree.

Check all tax implications when receiving money from friends and family. If not done appropriately, the IRS could determine that you owe estate taxes. Always talk to a real estate tax professional when dealing with loans and gifts from others.

Don't make payments in cash. Use an online service or a check so that both parties have a record of what has been paid. Finally, pay them back in the same way you would pay any other loan.

Odds are, if you have done your homework, and you go to a friend or relative with a plan on investing in a property with things such as purchase price, rehab costs, closing costs along with contingencies, and profit projection, there is a good likelihood that they will invest. Think about it as a business plan. Everything you learn in this book will help you make your presentation. If you show them a plan that shows a better return than money sitting in a money market account, they may take you up on it.

When I got started, I used family funds to buy the property and fix it. Then I would refinance it and take the money out that I put in to do another property. I ended up creating a partnership, where I was 70% owner, and they were 30% owner of the property.

Trautman's Tips: If you have a deal that you know is great and cannot find an investor, email us. Heck, I may even do the deal with you.

Advantages

No red tape to get a loan.

Money can change hands quickly.

The process is less formal.

Disadvantages

Finances can lead to contention between loved ones.

Without proper tracking procedures, it can be difficult to prove how much you've paid back. Always create a working agreement with as many details as possible to eliminate any misconceptions.

SELLER FINANCING

Another option you have is to work directly with the seller. Sometimes, the current owner is willing to offer financing for the purchase of their house. Although this is more common when buying a private residence, it can happen with real estate investing purchases.

Let's look at both the good and bad for seller financing:

Advantages

Your credit score and debt-to-income ratios are not as important with seller financing. Sellers can be far more flexible than a bank.

Loan terms are also more flexible than you can find with a bank.

You may be able to get seller financing with little or no down payment.

The loan process is shorter, so you can get the property faster.

Disadvantages

Sellers that offer financing do not usually come down on their asking price. This means that you may pay more for the property than you would have offered if you had your own financing in place. Interest rates are usually higher than with a bank. Since the seller may lend to you without all the restrictions of a bank, they are taking more risks than a bank. The greater the risk, the higher the interest rate. Most seller financing is short-term. If you want to hold the property for a longer term, you will need to have refinancing in place when the time comes.

Trautman's Tips: You absolutely need to open escrow and use a 3rd party loan servicing company you send the payments to protect the both of you. I have heard many times in the past of people making payments to the seller, and the seller keeping the money without sending it on to the lender.

Seller financing is my favorite way of financing, and I have done a lot of deals this way. You have to look at the property and the motivation of the seller. For example, on commercial real estate, I find that office space has been hard to rent since the recession. If the owner is older and has done little work on the property, the property looks tired and few people will rent the space. This is a perfect opportunity for me to come in and offer little down and a lower interest rate of 4 to 5% for three to 10 years. They are feeling down about the property and are looking for cash flow. Seller financing is all negotiable, from rate to term. Whenever possible, I try to do this in person.

My solution is some cash in the pocket and a monthly payment. I will then upgrade the property and get renters. I've done this countless times.

A unique finance deal I did was to purchase a condo in old town Scottsdale for $125,000. It was fully remodeled and furnished with seller financing, and I only put $5,000 down. I purchased this in November and set it up as a vacation rental using Homeaway and VRBO. This made over $22,000 as a rental in a 5-month period. Then I sold it for $145,000 at the end of March. We made money on the rental and on the sale. When all was said and done, my profit was around $38,000.

Trautman's Tip: Look for property owners that may be discouraged about owning property and find the opportunity. I have found that good opportunities exist if the property is not owner occupied because something is driving them to sell. Many owners like the idea of earning interest to improve their return. The key is to make the property outperform the loan payment. Think outside the box.

But what if traditional loans won't work for you, your family has no spare money, and the owner of the property you wish to buy isn't offering owner financing? What do you do then? In the next two chapters, we will discuss financing options that frequently occur in real estate investing.

CHAPTER 4: THE FINANCING WORLD OF REAL ESTATE INVESTMENTS

Truthfully, with real estate investing, you will rarely use traditional loans, family money, or owner financing. Instead, you will rely on financing from sources more typical in the real estate investing world. Let's look these over and look at the pros and cons of each financing source.

INVESTORS

As you network with other real estate investors, you will meet some that are looking for investment properties and opportunities to invest in your endeavors. Typically, these investors understand how lucrative real estate can be, but they don't want to deal with the managing, purchasing, or rehabbing that goes along with real estate investments.

There are a few ways you can find real estate investors:

- Going to Real Estate Investing (REI) clubs and meeting new people (You will learn more in Chapter 6 on Networking)
- Interacting on real estate investor forums online
- Checking online sites such as Craigslist
- Posting an online ad aimed at investors
- Talking with real estate agents to find potential investors

- Going to the auctions in your town, and seeing who is actually lending

The more you chat with people that want to invest, the better chance you have of getting the money you need when you need it.

Advantages

The process is fast. In fact, in many cases, investors can get you the money the same day. Investors tend to be worried about the property and not your credit worthiness. This eliminates a lot of the red tape involved in a traditional loan process.

Although an investor will want a specific loan plan, the plan can have flexible terms that meet your needs. The investor will decide on the interest rate, how much profit they receive at the end of the deal, and if they get any income if the property is turned into a rental. Keep in mind that the more investors you know, the more likely you are to find someone that has a deal that fits your needs.

You can build a relationship with an investor. As you do so, you will likely be able to turn to them over and over again whenever you are getting ready to start another real estate endeavor.

Disadvantages

Investors get to set the terms. Since they have the money, they have control.

If you are buying property for the long-term, you could be tied to a specific investor for a long time.

It will take time to put together a strong presentation that will win over the investor. You'll need to show them the property, the advantages, and the exit strategy you have in place.

It takes time to develop relationships with investors. As you are getting started, this particular avenue may not be as readily available as it will be later in the process.

PARTNERSHIPS

In a similar way, if you know someone who is also interested in real estate investments, there is a potential for partnerships.

Partnerships can be done in a variety of ways, including:

A standard partnership: Both parties are invested equally, and both have a hand in purchasing and managing the property.

A silent partnership: One party provides funding while the other does the work of purchasing and managing.

LLC: This is a Limited Liability Company that protects your personal assets. This way, even if your investments go under, neither you nor your partner will lose personal property. LLCs also make taxes easier through a process called pass-through taxation. Before forming an LLC, speak to someone who is a real estate tax professional to help you.

Advantages

You will have access to more money than you have on your own.

Standard partnerships even out the responsibilities of owning and managing property.

Disadvantages

Everyone involved in the deal is emotionally tied to the deal. This could lead to poor decision-making.

A simple misunderstanding between partners could ruin the endeavor. That is why it is important that everything is done in a professional manner, and that all aspects of the deal are handled fairly. No one should ever feel taken advantage of.

The profit is shared with someone else.

HARD MONEY /PRIVATE FUNDS LENDERS

Although similar to an investor, a hard money lender doesn't care about your investment. They simply care about whether you will pay them back. Hard money lenders, also known as private fund lenders, are either individuals or small companies that specialize in providing financing to people who are investing in real estate. These lenders are usually very structured in what they will offer, how much they will offer, and the terms of the loan.

Trautman's Tips: The best way to find hard money lenders is through networking. The more connections you make, the more you will be able to find people and companies willing to lend you money if you have the collateral.

Advantages

Hard money lenders provide more financing options than traditional lenders. They typically do not require as much structure, making it easier to obtain the loan. Once you start doing loans successfully, you will have private lenders coming to you offering you better lending terms.

A hard money lender will work with collateral. The house you are buying can be the collateral for up to 75% of the value, in most cases. Additionally, you could use personal items, including vehicles, retirement savings, and other hard assets.

Many hard money lenders will set up an escrow account for you so that you can handle any repairs that come along with rehabbing a property. This is an especially helpful advantage because you will have the cash you need to get started on repairs, and the cash will be available when you need it.

You can often get private money for rehab work, too. As much as 10%.

Disadvantages

Hard money loans usually come with some very high costs. You may have to pay high down payments as an upfront way to prove you can pay the loan. You may also have to pay a high interest rate, especially compared to standard, structured loans.

Hard money loans are usually short term loans, which means they can have very high monthly payments. If you plan on keeping the property long-term, hard money lenders may not be the best option.

The vast majority of hard money lenders will only allow you to borrow up to 75% of the value of the house if you use it as collateral. This means you will still have to find a way to finance the other 25% of the house's value.

If you plan on flipping the property quickly, then a hard money loan could be ideal. You won't have to worry about the high payments and interest, and you can repay the lender as soon as you flip the house. However, if you plan to hold onto the house or fear that it will take a long time to sell, then a hard money loan may be too costly.

If you are keeping the property as a rental, you will want to set up traditional funding to refinance out of your hard money loan. Here is an example of what that might look like:

Property purchase price	\$60,000
Rehab cost with fees	\$20,000
Total =	\$80,000
ARV or appraisal amount	\$100,000
LTV (loan to value)	80%

You should be able to refinance your property at the 80% LTV for a payment of around \$400 per month excluding taxes and insurance.

CROWDFUNDING

Crowdfunding is the newest way to get money for real estate investments, and it has taken the world by storm. Although real estate investing doesn't seem like a "cause" that people would want to believe in or give their money to, it is happening. Many investors have been able to finance an endeavor with crowdfunding. With over $11 trillion in crowdfunding, it is definitely something to think about.

Below is a list of crowdfunding sites:

- Fundrise
- Realty Mogul
- Realty Shares
- CrowdStreet
- iFunding
- Prodigy Network
- Patch of Land
- Lendinghome

Advantages

You can get into the real estate market with very little money since you will be able to reach out to the crowd to obtain more funding.

Investors will feel much more connected because they are actually giving money to you, and they will know what the money is going for.

You can put all sorts of projects on crowdfunding websites to get more attention for what you are trying to do.

Disadvantages

The money is not free. You still have to pay back your investors, even if the deal doesn't work out.

It can be more difficult getting people to crowd fund a real estate deal than a project that deals with a social issue.

If you feel that crowdfunding may be right for you, here are some tips for making you more successful:

Always work with an established crowdfunding website. Never work with a fly-by-night operation that is here today and gone tomorrow. They could easily "go" with all of your money, still leaving you owing your investors.

Be very transparent and very honest.

Make the pitch very interesting. You do have to sell your endeavor, and you have to convince people that they should be interested in investing in you.

In addition to using other people's money, there are ways to fund your own real estate purchases. The next chapter discusses these financing options.

CHAPTER 5: SELF FUNDING

In addition to getting financing through a lender, hard lender, family and friends, seller, or investor, you also have the option of financing the deals with your own money. Let's discuss three ways this can be done.

SECOND MORTGAGES

A second mortgage on your house is typically easier to obtain than a new mortgage. If you currently own a home, the equity is sitting there without creating any income. A second mortgage allows you to put this equity to use.

There are two types of home equity loans: a fixed-rate loan and a Home-Equity Line of Credit (HELOC). Both are taken out for a period of 5 to 15 years, and both must be repaid in full if the house is sold. The similarities stop there.

With a fixed-rate loan, you are able to get a single, lump-sum of money. You repay that sum over a set period of time with a set interest rate. Just like with a first fixed-rate home mortgage loan, the payment and interest rate remain the same for the lifetime of the loan.

On the other hand, an HELOC is a variable-rate loan that resembles a credit card more than a mortgage loan. As a homeowner, you get approved for a certain spending limit. As you need money, you can withdraw that money using either a special credit card or check. Your monthly payments are then determined by the amount of money you withdrew and the current interest rate.

If you determine that a home equity loan is right for you, the first thing to do is contact the lender that has your original loan. Though you can get a home equity through another lending institution, the bank that has your first loan is typically the best place to start. They know you, know your history, and have a vested interest in getting you the money you need because you are already their customer.

However, check around for good interest rates and fees. If your current lender can't offer you a good deal, you can go elsewhere. There is nothing that states that first mortgages and home equity loans have to be connected in any way. If you already have an equity line of credit, the money is available immediately. You may even be able to write off some of the interest from the loan. (Be sure to check with your tax adviser about your situation.)

BUSINESS CREDIT

When you start thinking about investing in real estate, you will want to form a Limited Liability Corporation (LLC) as soon as possible for several reasons. The first reason is that a private lender will not want to lend to you as an individual. For financial protection, you don't want them to. You don't want people to have the opportunity to sue you or take away your personal assets, either.

Another reason for forming an LLC is that leveraging your personal credit means you can easily use up your personal credit lines. As you reach your limits, your credit card company can get worried and raise your rates. Additionally, your personal credit score will drop. This will hurt you whenever you try to refinance through a bank.

This is why it is important to look at building business credit. Business credit is great because if it is done right, you can build it so it's not in your name or on your credit.

To begin separating your personal credit profile from that of your company, follow these basic steps:

Step 1: Incorporate or Form an LLC

You need to have a separate entity to build a separate credit profile. Feel free to take a look at our incorporation and LLC formation services.

Step 2: Obtain your Federal Employer Identification Number (FEIN)

We can prepare this form for you and/or obtain the FEIN from the IRS on your behalf when you use our incorporation or LLC Formation services.

Step 3: Open a Separate Business Bank Account

Business funds and personal funds must always be separate.

Step 4: Obtain a D-U-N-S Number

This is a 9-digit number issued by Dun & Bradstreet that most companies utilize to verify the credit history of businesses. You can get your number by going to www.dnb.com

Step 5: Compliance

Make sure you've obtained all necessary business licenses, permits, etc. required in your jurisdiction.

Step 6: Business Phone Line and Yellow Pages Listing

Make sure your business is listed in the phone directory, and the phone line is in the business name, not in your personal name.

Step 7: Same Business Address

Make sure the same business address is used for your DUNS number, the yellow pages listing, and phone number, as well as on business licenses and company credit cards. Your home address is acceptable, however, private mailboxes and P.O. boxes may not be.

Step 8: Apply to "New Business-Friendly" Creditors

Apply to those companies that generally grant new businesses credit cards and lines of credit without requiring a personal guarantee. These companies will then update your credit profile with the various credit agencies. This is how you initially establish a business credit profile.

When applying for business credit, the lender will look at your personal payment history as well as your business's payment history. As a new real estate investor, you may end up with a higher interest rate and lower credit limit, but as you show your ability to pay, this can change to reflect better terms.

You will want to provide the lender the following information:

Social security number

Business tax ID

Business gross annual sales for the past fiscal year

Business net profit for the past fiscal year

When used wisely, credit cards can help real estate investors with cash needs for house flipping purposes. If you know that you need a specific amount of money to pay for rehab materials, your business credit card can come to the rescue. In fact, business credit cards are better than consumer credit cards because they often offer higher spending limits.

You may also be able to get a business credit card that has programs that address your monthly cash-flow needs. Banks realize that small businesses don't always have equal cash flow each month, so some business cards offer discounts for paying early or give you up to 60 days to pay without interest.

As with any credit, make sure you follow good credit rules when using your business credit card. For instance, do not go over your credit limit and pay off your balance as early as possible.

Trautman's Tips: Business credit is a great asset. You will want to set up an LLC or corporation to protect your personal assets as you buy property. With your company, you can build business credit to keep your debt to income ratio low. You do this by using your business to obtain lines of credit with companies like Home Depot, Lowes, building supply companies, and even lenders.

SELF-DIRECTED IRA

Most people with an Individual Retirement Account rely on someone else to invest that money wisely. Perhaps it is a bank holding the IRA, or a broker, or through a plan at work. The money placed into the IRA is used for stocks, bonds, and mutual funds. And the owner of the IRA — you — hopes that the investment was wise and will reap rewards.

However, you do not have to give up this kind of control of your IRA. Instead, you can open a self-directed IRA and use the funds for investments such as real estate. With a self-directed IRA, you decide where you want your retirement funds to be invested. Although this can still include stocks, bonds, and mutual funds, it also includes alternative investment vehicles such as real estate. Real estate is the most popular alternative investment vehicle for a self-directed IRA because of the potential higher rate of return. The only stipulation the IRS makes to individuals with IRAs is that they do not invest in life insurance contracts or in items that are collectible such as art, jewelry, or cars.

You cannot lend against real estate with your basic IRA. You will need to open a self-directed IRA, and this is an easy process. In order to do this, you need to find an independent administrator to serve as a trustee or custodian. An administrator will walk you through the steps needed to set up a self-directed IRA.

You can set up a self-directed account with new money, but then you'd only be able to fund it with the maximum IRA contribution each year. If you don't currently have an IRA or 401(k), this is, of course, your only option. If you do have an existing IRA or 401(k), however, you can transfer some or all of the assets from these accounts.

A personal IRA can be rolled over via direct trustee-to-trustee transfer. For instance, you can tell the bank or investment firm that has the account to transfer to the credit union. You can make as many direct trustee-to-trustee transfers as you like within a year.

If you're currently working for the company that holds your retirement account, you cannot transfer these funds to a new IRA (please verify with your current employer, though). If you leave the company, however, you can roll over the funds from your retirement account and transfer them into a new self-directed IRA fund.

Most brokerage houses handle traditional IRA accounts, but very few will handle a self-directed IRA. Make sure you take the time to interview the custodian you will be working with. Ask as many questions as you can regarding how you will work together. Knowing upfront what your custodian's responsibility is and how you can manage your account effectively will make the relationship run smoothly.

Here are some things to look for in a good custodian:

Does the custodian have good customer service?

Is the custodian available via many communication sources, i.e. email, telephone, fax?

Are the fees reasonable?

Does the custodian understand the IRS' rules and regulations regarding investments?

Are they knowledgeable in IRA real estate investments?

Do you feel comfortable talking with them about all aspects of your portfolio?

The IRS has many rules and regulations regarding IRA accounts. Be sure to speak with an accountant about all rules regarding Self Directed IRA investing.

MIXING AND MATCHING

The wonderful thing about real estate investing is that you are not limited to just one kind of financing. You are free to use one kind on one investment and another on the next. In fact, you can even use more than one kind of financing on a particular investment.

Advantages

Using a variety of methods allow you to get started without having to put up any of your own money.

There will be no need to come up with a down payment.

Disadvantages

You will have to remember what terms you have set up with each different funding source.

You will keep to keep up with different payment schedules.

You may incur more charges, interest, and expenses than if you used just one source.

TIPS TO GETTING FUNDING

When you are looking for ways to finance your endeavor, one of your best choices is creativity. There are plenty of different options if you just know how to look for them. However, getting funding requires you to convince them that you have the right project and can repay the loan.

Here are three tips to help you appeal to lenders:

Have cash available. In some instances, you will need to provide some kind of down payment or upfront payment in cash. Having the cash readily available makes you more viable for a loan.

Do your homework. Have a plan mapped out showing the detail of what you plan to purchase the property for, rehab cost, along with holding cost, and commissions. The more detail you have, the better. Sharing this with any potential investor lets them know you are serious and knowledgeable.

Show you are a strong borrower. Any type of lender, whether a private investor or a bank, will want to make sure you are dependable. That means you need to show yourself as strong. To do that, you need a high credit score. Work on getting your score above a 740. If you don't have a high credit score, having several months worth of payments in the bank will also show you are a strong borrower. Lenders will want to know you can handle paying them no matter what may come your way.

Finding money is one of the biggest steps you need to take so that you can ensure you are able to get started investing. Since most of the financing options require good networking, the next chapter will go into detail about networking, what it is, and how to make it work for you.

In real estate, it isn't so much what you know, but who you know. Real estate investing is not something you do entirely alone.

You will need the support of others such as:

- Realtors
- Lenders
- Other investors
- Contractors

- Inspectors
- Lawyers
- Accountants
- Property managers (if you choose to outsource this)

And more.

Finding the right people for your team will be extremely important. The best way to find the support you need is through networking.

The more you can connect with people who are already involved in real estate, the more you will be able to learn and create the bonds you need. Then, when it is time to make a real estate purchase, you will have a working relationship with people who will be able to help you.

Trautman's Tips: In this business, as in life, if you say you're going to do something, you better do it. Your reputation is important, so do your best do protect it. If you're unable to do the deal, let them know that too. People will appreciate you being upfront. They may not like it, but they will respect it.

CHAPTER 6: WHY NETWORKING IS THE KEY TO REAL ESTATE INVESTING

HOW TO NETWORK

The first thing you need to recognize is that networking takes time. The reason the word "work" is in networking is that it takes effort to create the relationships that will lead to great connections for your business. Let's look at the three stages of networking to see what you will need to do.

Stage One: Get in front of the right people. Have your business cards ready. Be able to tell others what you do in 30-seconds (this is sometimes called an elevator pitch). And more important than learning what to say is learning how to listen. Always ask what others do and what they need, then listen to the answers. The focus at this stage of networking is to meet people and begin building relationships.

Stage Two: Look over all of the business cards and contact information you have. Which contacts had an immediate connection? Whose objectives were similar to yours? Who had a business that would work well in conjunction with your own? These are the people you should work to build a relationship with. This is rarely done at a networking event. Instead, call them and get to know them over coffee or a meal. Don't focus on a business transaction. Simply focus on getting to know them better. A key in business is that people tend to do business with those they like. Finally, do what you can to help the people on this list. Match them with others. Share information. Be the person for them that you hope they will become for you.

Stage Three: Now that you are known to share information and help others, people will come to you. This is the final stage of networking. At this point, you are well-connected. Although it doesn't happen overnight, it will happen if you network correctly.

Networking is always good, and having a good reputation for being able to close deals is even better and will bring you more deals. For example, I moved to Arizona three years ago, and an acquaintance that I barely knew brought me a good deal. It was not a great deal, but it was a good deal. We did it. Because of that, a wholesaler had a property he had to move that day, or he would lose it. The guy I did the deal with had the wholesaler call me. We are finishing the deal now, and the profit will be about $300,000. I wouldn't have seen this deal if I didn't get out there, meet people, and be able to deliver when needed.

Trautman's Tips: Those people that find that networking doesn't work usually stop at Stage One. They go to meetings and collect cards. They talk about themselves and listen. Then they repeat it again at the next meeting. Real networking may begin at a meeting or event, but it never ends there.

REAL ESTATE INVESTING CLUBS

One of the best ways you can network is through real estate investing clubs because they are designed for the purpose of networking. Real estate investing clubs can be local or online. They bring together people who can help you get started in your real estate investment journey.

There are many advantages to joining a real estate investment club. Here are a few:

Get education about real estate investing from those that have done it. Although you may think this is only true for beginners, good investors are continually learning new ways to invest and new ideas for flipping or renting houses.

Stay motivated by talking to other real estate investors.

Connection to those who can help you with your investments, especially those who are offering financing.

Investment opportunities offered by others in your club.

Information about potential properties.

Information about local regulations that could affect your investments.

Recommendations for vendors to use when investing

Learn about the local market.

Learn about rents and property values in the area.

And more.

As you can see, there are numerous advantages to real estate investment clubs.

FINDING THE RIGHT LOCAL INVESTMENT CLUBS

There are many real estate investing clubs you could choose from, but you won't have the time or the need to join them all. Instead, you'll want to find a club that meets your needs. A good way to do this is to contact the founder or president and ask some questions.

Here are a few to consider:

How much time do members have for networking?

How much of the meeting is educational?

Are products sold during the meeting?

What type of real estate and real estate investing does this club focus on?

How many members are investors?

What is the ratio of new investors to experienced investors?

What are the yearly dues for your real estate investment club? (Generally, real estate investment clubs should charge anywhere between $25 and $200 a year.)

Although it is possible to join a club that meets online, it is much harder to network this way. The best option is to find groups that meet at least quarterly in person so that you can make the right connections. Check Appendix 1 for links to help you find real estate investing clubs local to your area.

Trautman's Tips: One national club I like is www.reiclub.com. Their website has a great deal of information on it for all investor types. Also, the odds are they have a local monthly meeting going on in your area. Make it a point to attend these meetings when you can, but don't be the person that's a professional at going to meetings without investing.

FORMING PARTNERSHIPS THROUGH NETWORKING

One of the advantages you can get from real estate investment groups is the option to form partnerships. This may be especially appealing to new investors who would like to have more guidance on their first deals. You may feel more comfortable working with someone else who has more knowledge and experience.

Partnerships are business transactions. Before becoming partners with someone, make sure you have developed a good working relationship and feel comfortable with the way they work. You'll also want to take a look at their references, credit, and background in real estate.

Finally, you will want to create a formal partnership agreement. A good partnership agreement will have the following:

Specific roles of each partner.

Specific responsibilities of each partner.

How and when each person will be paid. For instance, is it a profit share? Is compensation tied to a resale?

Signatures of all involved.

Have it reviewed by an attorney.

NETWORKING BEYOND REAL ESTATE CLUBS

Although being part of an REI club is important, it is not the only place to network. There are many other groups in your local area where you can meet the right kinds of people and learn of great deals. Just because a group isn't about real estate, doesn't mean that they won't be great for leads. In fact, if you happen to be the only real estate investor in the group, that gives you an edge.

Here are some groups to consider when networking:

- BNI -Business Networking International
- Chamber of Commerce
- Convention and Visitor's Bureau
- Jaycees
- Kiwanis
- LeTip
- Lions Club
- Local Merchant Associations

- MasterMind Groups
- Optimists
- Rotary Club
- Women in Business Networking

CHAPTER 7: PURCHASING A HOUSE IN FORECLOSURE

A very common way to find property for investment purposes is by purchasing a house in foreclosure.

There are three main ways this can happen:

Pre-Foreclosure – Buy a property directly from the homeowner so that they can avoid foreclosure.

Auction – This is a completely different world from purchasing a house in a traditional manner. Buying at Auction will be discussed in detail in Chapter 8.

REO – Purchase directly from a real estate company that has taken possession of a property in foreclosure.

DETERMINING IF FORECLOSURES ARE THE RIGHT PATH

Before you jump into purchasing foreclosures, you have to decide if this is the right investment path for you. Many novices assume that foreclosures are a get rich quick scheme. You buy a house for less than it is worth and then resell it for a large profit. The truth is that foreclosures can be a great investment opportunity, but you have to be sure you find the right houses and follow the right process.

Here are some things to consider when deciding if buying foreclosed properties is right for you:

Are you willing to take risks? Oftentimes, when buying a foreclosure, you have to act fast and without a lot of information. This means that you could make mistakes that are costly.

Are you willing to put the time into learning laws? When you purchase during any of the stages of foreclosure, you have to follow certain laws and ordinances. Knowing these laws are important before you begin investing.

Do you like multi-tasking? With foreclosure properties, you'll be tracking several at a time. Once you get a property, you'll have many tasks to complete throughout the foreclosure process.

Do you know your exit strategy? Some foreclosure houses are good for flips, and others are good for rental properties. Knowing your exit before you buy will help you purchase the right properties.

Do you like the challenge of the hunt? It is possible to have several foreclosures in your sights but not get any of them, especially if they go to auction. Having the right mindset will keep you interested and excited to keep trying.

If you answered yes to all of these questions, then foreclosures may be the right path for you. The rest of this chapter will help you learn what you need to know in order to purchase a foreclosure for investment.

THE FOUR STAGES OF FORECLOSURE

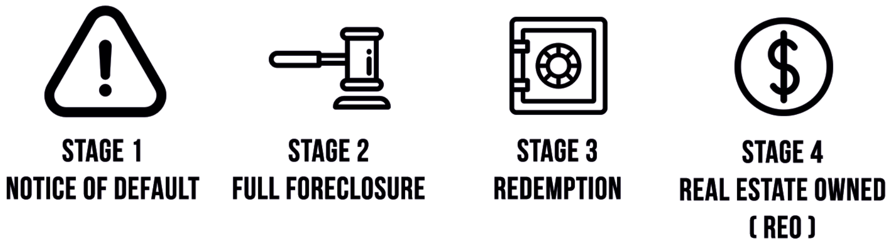
In order to really understand buying a house in foreclosure, you will need to understand the four different stages. Depending on which stage of foreclosure the house is in will determine how you would go about buying it.

Stage 1 – Notice of Default: This stage begins when the homeowner misses their first payment and will last until the bank files a notice of default. The length of this stage varies from state to state and lender to lender. If you purchase a house in pre-foreclosure, you will still be buying the property from the homeowner, not the lender. An advantage to buying in this stage is that you will get all the disclosures so you will know the condition of the property before you actually buy. The disadvantage is that you have to work fast because there is a clock ticking. Once the house actually goes into full foreclosure (Stage 2), you will no longer be able to buy from the homeowner.

Stage 2 – Full Foreclosure: The house goes into full foreclosure and is put up for auction. At this time, you can only buy through auction, not the traditional methods for purchasing a property. As you will learn in the next chapter, auctions are generally cash only, so you will need to be able to pay with either cash or a cashier's check.

Stage 3 - Redemption: Redemption is a stage of foreclosure that only happens in some states. During this stage, the borrower can work with the lender to get their house out of foreclosure. You still have the opportunity to buy the house, but you would need to buy it from the owner, not the lender.

Stage 4 – Real Estate Owned (REO): At this final stage, the bank owns the house. This means you will buy the house directly from the bank during this stage.



Keep in mind that each state has its own rules about foreclosure. It is a good idea before buying foreclosed property to understand the rules for your area. You can find your state's foreclosure rules here:

http://www.realtytrac.com/real-estate-guides/foreclosure-laws/.

DIFFERENCE BETWEEN STANDARD, SHORT SALE, AND REO SALES

Let's look at three different ways you could purchase a property so that you can see the difference between them. We will analyze a standard sale first. This will go over everything needed to buy a house the "standard" way. Then, we will look at a short sale, which is an agreement between a homeowner and the lender to sell the property quickly in order to avoid the foreclosure process. Finally, we will look at REO sales.

STANDARD SALE

We'll start with a standard sale because most people are familiar with this type of real estate purchase. This is most likely how you bought your own house, and may even be how you purchased your first investment property.

A standard sale looks something like this:

You look at a property that is for sale.

You see seller disclosures that indicate any issues with the house.

You make an offer based on what the seller is asking and what you feel the house is worth.

You negotiate with the seller to come to an agreement on sales price.

You go into an escrow period, during which the loan or other financing is finalized.

At closing, you sign all closing documents, provide down payments or closing costs or both.

Ownership changes hands.

With a standard sale, the house is usually considered move-in ready. It probably won't need that many repairs, and you will be able to immediately use the house for a rental property unless you plan on making upgrades with the intention to sell.

SHORT SALE

A short sale is different. This is a transaction in which the lender will agree to work with the homeowner in order to sell the property for the balance due on the loan. Sometimes, the amount can be a little less than the balance due in an attempt to avoid foreclosure.

Here are some facts you need to understand about a short sale:

You will still work with the homeowner during this time, but the agreement has to be approved by the lender.

There are no negotiations in a short sale. The lender will want the loan balance or an amount they've predetermined.

The approval process for a short sale can last longer than the escrow period of a standard sale. In some situations, the approval process can last up to 180 days.

When the sale is approved, you will finish the process with the lender and then take possession of the property.

Short sales can be time-consuming, so if you want to get a property right away, this may not be the type of foreclosure to consider. However, this is an advantageous way to purchase a property because:

You can find a good price for the property

The bank and homeowner are trying to avoid foreclosure, making them easy to work with

The property isn't in full foreclosure, so many short sales have little property damage.

One short sale I did was in old town Scottsdale. I was excited about this particular property because I could see myself living there. It was a great little mid-century modern development that had a ton of charm. I picked up this property for $250,000 on a short sale. Then, I did $20,000 in rehab work that included flooring, paint, patio pavers, a roof, and appliances. I had the property back on the market in 11 days. My wife kept teasing me saying that I wasn't on a TV show and could take more time! I love seeing how fast we can get things done as a team. I sold it for $360,000.

REO SALE

Finally, there is the REO sale. In this situation, the property has gone through the whole foreclosure process. An auction was attempted, but the property didn't sell, or there wasn't a high enough bid. Now, the lender owns the property, and they will sell it themselves.

This is a very different process from standard or short sales.

There will be no price negotiations. The lender has been paying insurance and taxes on the property. They have a certain amount of money invested in the house. Their goal is to sell the house for the highest offer.

When you purchase an REO property, you are buying as-is. Unlike standard and short sales, you will not get any disclosures about the condition of the house.

You will have to hire your own inspector. This is money out of your pocket even if you choose not to go forward with the purchase.

Your financing needs to be in order before you make an offer. For traditional mortgages, the property will have to be appraised high enough for the loan. Typically, FHA and VA loans are not available on REO properties.

The process can take time. The bank will be looking for good offers. As they come in, they will reevaluate your offer.

You will want your own lawyer to be sure that the purchase contract is in your favor.

Some states charge a per diem at closing if the closing goes long.

The REO deals are some of the best deals we have seen. Why? Because the bank got them back at the auction, and in most situations, they know they are going to lose money when they sell. It is just business, and they will look at most reasonable offers. They are not emotionally connected to the property, so they, more often than not, just want it gone.

FINDING FORECLOSED HOUSES

Here are some simple and straightforward ways you can search for foreclosed houses.

Newspaper Notices: You will find listings for auctions. In addition to finding out about a particular house, you can also get information on the local auctioneers. Then, you can go to their website or contact them to find out more foreclosure listings.

Lender Websites: Local bank and mortgage lender websites may have listings under an REO headline.

Real Estate Sites: You can search websites like www.zillow.com. Sites such as these allow you to filter your search for foreclosed properties. Keep in mind that the listings may be old, so do your research. Another website you can consider is RealtyTrac.com. To look at foreclosures on this website, you will need to pay for a subscription, but if you use it regularly, the cost may be worth it to you.

Bank-Owned Auction Companies: If a property goes into REO, the bank or mortgage company may attempt to have another auction. Lenders typically use an REO auction house. The three best known include Hudson and Marshall, Williams and Williams, and REDC (Real Estate Disposition Corporation). You can search their websites as well.

Hire a Buyer's Agent: A buyer's agent who specializes in REOs and foreclosed houses will be able to locate listings and then give you the information.

MLS: This will be the most complete and up-to-date list available. You can search specifically for REOs. However, you won't find auction properties since they haven't reached the REO level yet. The MLS will also allow you to use specific search criteria so that you can look for the types of houses you want to buy.

Networking: The more you make connections through networking, the more you will learn about foreclosure properties that are available.

Trautman's Tips: Find out where the auction is held in your area and what days the auction is held. Then, go watch and ask questions. This is a GREAT place to meet investors, private lenders, and others interested in real estate. I have found that this where you find the hustlers. They are always more than willing to let you know what's going on.

PROPERTY INSPECTIONS

When it comes to property inspections, there are two thoughts on the matter. Some professionals suggest you always have an inspection. Others suggest that there is no need to go through the cost and time of the process. In fact, they say since banks will not negotiate and the property is being sold as-is, there is no need to inspect, but you need to know of any potential issues with the property.

When you first start investing, you should always have an inspection. Just because you cannot use an inspection as leverage against the bank to negotiate a better price doesn't mean you don't need an inspection at all. In fact, in foreclosure situations, the inspection becomes all the more important.

When you purchase an REO or otherwise foreclosed house, you will know nothing of its history, what it has been through, and what may be wrong with it. All you will know is that you are buying the property. Obviously, this is one of the risks of buying foreclosures.

However, you can minimize the risk by getting an inspection. The inspection will help you determine what is wrong with the property and allow you to determine how much it will cost to fix the issues. You may get great news suggesting that little is wrong. You could also get bad news that makes rehabbing the property too expensive to make a profit.

When you hire an inspector, make sure they know that the property is a foreclosure. This will help them to focus on areas of concern for houses that have been vacant.

These include:

- Problems with the HVAC system, including the heating and air conditioning units, ventilation, and duct work

- Mold

- Water problems with pipes, appliances, and fixtures

- Vandalism

Choosing an Inspector

Once you've established yourself as a real estate investor, you will have specific go-to people to call for inspections. However, in the beginning, you will have to decide whom to hire. Ask around to get a few referrals for inspectors that have worked on foreclosed properties. Then spend some time interviewing them.

Here are some questions to consider:

- Are you a member of a professional home inspector organization?

- What is your background?
- What type of professional experience do you have? What is your experience with REO and foreclosed properties?
- How quickly could you get to a house inspection for a property I am interested in?
- How long will the actual inspection take?
- Can you provide me a list of the things you will inspect in the house?
- Will you take extra measures to look for foreclosure specific problems?
- Can I be present for the home inspection?
- Once the inspection is completed, how quickly will I receive the report?
- What type of information will be included in the report?

Trautman's Tips: You will not be able to hire a company to do an inspection on every property. It's just unrealistic. You will need to learn how to do your own inspections and bring your contractor with you if needed. The more eyes on the property, the more likely you'll identify any potential issues. I cannot remember the last inspection I did, but I have been doing this for 20 years. You will get there too, but in the beginning, you cannot afford to make costly mistakes. Get an inspection when you can, or at least get someone who

knows what to look for and has the experience.

Foreclosed properties can be very lucrative for real estate investors, and they may be the right choice for you. Now, let's look at buying a house from auction.

CHAPTER 8: BUYING PROPERTIES AT AUCTION

One of the ways to invest in foreclosure properties is buying at auction. This is a completely different world than purchasing a house in a short sale or as an REO. For that reason, it is important that we explore auctions in detail as you determine if this is the right way for you to purchase investment properties.

WHY DO PROPERTIES GO TO AUCTION?

Properties only go to auction under specific circumstances, and how they get there depends on the type of auction. There are two types when it comes to real estate: foreclosure, also known as mortgage auction, and tax lien auction.

MORTGAGE AUCTION

Here are the steps a property has to go through in order for it to go to auction:

The homeowner doesn't pay their mortgage for several months in a row, and they do not contact the mortgage company in an attempt to work out some type of deal or payment plan.

The mortgage owner (bank or other financial institution) will then file a notice of default. This is a document that is filed with the county recorder.

The homeowner has a certain period of time in which they can pay the amount owed or renegotiate with the lender in an attempt to keep the property. If they do not, then the house is foreclosed on.

Some lenders immediately put the house up for auction at this point. Others attempt to sell the property before taking it to auction.

This whole process can vary in time frame from several months to more than a year depending on the mortgage owner and their own policies.

TAX LIEN AUCTION

In this situation, the property is seized by the tax authority, not the owner of the mortgage. There are two different situations in which this can happen:

The property owner does not pay property taxes for an extended period of time.

The property owner becomes severely delinquent on their income taxes.

In either case, the tax authority has the right to seize the property, put it up for auction, and use any equity from it to cover some of the taxes owed.

A FEW DETAILS ABOUT AUCTIONS

Before we delve into the process of buying properties on auction, let's go over a few details that you need to keep in mind:

The auction can take place in one of several different locations. The most common include the local courthouse, a hotel conference room, online, or at the actual property.

The starting amount for the auction can vary. At times, it starts at the remaining balance of the loan, but sometimes it starts lower depending on the current housing situation.

In a foreclosure auction, the lender is not allowed to make a profit on the auction. If an auction price comes in higher than the remaining amount owed, then all liens will be paid, and the remaining money will go to the original homeowner.

There are two types of property auctions: absolute, in which the highest bidder gets the property and lender confirmation, in which the lender decides who wins the auction.

Foreclosure auctions are handled by trustees who have been hired to represent the mortgage owner. In tax lien auctions, the local sheriff will be responsible for holding the auction.

If there are tax liens, contractor liens, or second mortgages on the house, then the person who wins the property will also have to pay off those liens. For that reason, it is best to know the liens on a property before bidding on it at auction.

Now, with all of that in mind, let's talk about what you will need to do to buy your first auction property.

Step 1: Finding and Flipping Properties

Begin by finding properties online. Most banks, mortgage owners, and auctioneers will keep updated information about the property which you can find on the web.

Once you have a list of properties, it is time to do your research.

Glean as much information about the property as you can online.

Print out the information to keep in your filing system.

Go to the physical property. This will help you see things you can't see in an online report such as the condition and the neighborhood.

If possible, chat with the homeowner or a neighbor to find out more about the property.

If you plan on purchasing homes at auction regularly, then you will need to create a system so that you can track the properties and keep information updated regularly. This is important because the details can change very quickly.

For most real estate investors interested in auctions, the process is ongoing. You are not likely to just track and bid on one property at a time because you could lose out on an auction. You simply can't afford to deal with just one property.

Step 2: Confirming Property and Auction Status

The next thing you will need to do is confirm the status of the auction. Remember, the owner has a chance to pay the amount owed on the property between the time when the auction is scheduled and when it takes place. Verifying the status keeps your files in order, allowing you to eliminate properties that are no longer going to auction.

This can be done by contacting the trustee of the auction in advance to see if it has been canceled or postponed. Although you can wait for the day of the auction, knowing early can keep you from getting ready for an auction that isn't going to happen.

When determining the auction status, you will also need to confirm the location of the auction. Although this information will be in your file, it is possible for auction locations to change.

Step 3: Determine Bid Amounts

Before you go to the auction, you need to determine how much you are willing to spend. It is best to determine an estimated market value of the property. You will also want to know how much is owed on a mortgage and the balance of any liens on the property. This information is a matter of public record and is available with a call to the county recorder.

Step 4: Have Your Money Lined Up

You will need to have the money lined up for the auction before the auction begins. You won't be able to bid and then find the money. Different states have different rules, but typically you need your money with you that day.

Some states require that you pay the full amount of the winning bid at the time of the auction. They may accept cash or cashier's check.

Some states require only that you pay a certain percentage of the winning bid at the time of the auction. In most cases, that amount is 10%. You will them need to pay the remainder of the amount within a specified number of days.

Occasionally, you will find an auction that allows you to bid with financing. In those cases, you don't have to have the money from the mortgage in hand, but you do need to be pre-approved for financing. These types of mortgage auctions are rare, though, and generally, you will need cash in hand.

The different ways to get cash for auctions were discussed in the three chapters on financing: Chapters 3 through 5.

Once you have the money lined up, you need to get the money in the right form. As I stated, some auctions require cash while others accept cashier's checks.

Step 5: Bidding at the Auction

Auction bidding can feel a bit intimidating because so much is going on. But don't let the hub-bub stop you. In fact, once you get used to it, the commotion can be exhilarating.

The first thing you should do is locate the auctioneer so that you know who will be running things. Then you need to be observant and take your cues from the other people at the auction. You can use other bidders as a guide. Keep in mind, however, that they should never dictate how much you bid or when you place a bid.

Although some of the long-timers know exactly what to do and when, don't let this intimidate you. Watch them and learn what they do.

Step 6: Buying the House

If you find that you are the winning bidder, your work is not done yet. You need to take some further action.

Get the proper documentation from the auctioneer. This should be documentation that shows you are the winning bidder and now own the property.

Speak with the auctioneer and any real estate attorney involved about additional steps needed. In some states, the ownership will transfer immediately to you, while in some states, you may need to wait a specified period of time for a court date to confirm the sale.

If you are in a state with a redemption period, the homeowner will have the opportunity to buy back the property for the amount you paid at auction plus fees. This doesn't happen often, but it can. So, if you live in a state that includes a redemption period, do not make any repairs to the property until that period is over.

You may need to evict the current owner. Although this may be done by the auction trustees, that is not always the case. Be sure to follow the proper eviction procedures for your state.

You will need to go through these steps each time you bid on a property at auction. Not every auction is going to go your way, but each is a good learning tool. The more auctions you attend, the more likely you are to end up with a great investment property.

Trautman's Tips: If you want more preparation, I recommend that you go to an auction just to see it in action. Don't plan on bidding. Instead, go for the experience and education. I would recommend going to the auction at least 3-4 times before buying so you can get used to the process. This is a great way to get an idea of how things go and what will happen.

5 TIPS TO REMEMBER

Since auctions are different from other types of property purchase, let's look over five tips to help you be successful when you go to an auction.

Get an Inspection If Possible: Sometimes, it is possible to get a professional inspection of a house for going up for auction. If you can do this, you should. If you can't get it professionally inspected, do look at the property on your own. Inspections can let you know of issues with the house and help you determine your maximum bidding price.

Stay Within Your Bidding Guidelines: It is easy to get excited at an auction and get caught up in a bidding war. However, as you begin the process of real estate investing, you should not go over the maximum bid you set. Doing so makes sure you have the cash on hand that you need and helps you make a profit when you sell.

Get a Title Search Whenever Possible: A title search will let you know about any liens against the title. If you know about the liens up front, you can calculate the cost of paying the liens as you determine your maximum bid. A surprise lien could mean the difference between profit and loss.

Insure the Property Immediately: The house has been in foreclosure and may be vacant. Vacant houses are targets for vandalism, so it is important to insure the property the same day you buy it.

Don't Begin Work During the Redemption Period: If your state has a redemption period, never begin work until the period is over. Some states have a redemption period of 12 months, so it may be tempting to get started on repairs. However, if the homeowner redeems the property, they will not be required to repay you for work you have done.

If you follow these tips, you will find that bidding at auction is a great way to find real estate investment properties.

LET'S FACE IT – AUCTIONS CAN BE A BIT RISKY

Auctions can be very sweet deals. You can often get a house for a fraction of its value, selling it later for a good profit. However, like anything, there are risks involved as well. Let's look over the main risks of buying at auction and determine what you can do to minimize those risks.

PROPERTY IN POOR CONDITION

When you purchase a house at auction, you will not know as much about the condition of the property as you would if buying from a Realtor. This is especially true if you were not able to get an inspection. Buying at auction means you are buying the property as-is. Unless you know what the "as-is" actually is, the condition of the property may be a surprise you weren't expecting.

You can minimize the risk with an inspection. If this is not possible, try to get a walk-through and take someone with you that understands house repair. In the early stages of your real estate investment career, you should always look at a property yourself. Do not rely completely on a listing or someone else's description.

NO SELLER'S DISCLOSURE

When you purchase a house from a seller, they are required by law to provide a seller's disclosure. Though these documents vary from state to state, the purpose is to ensure the buyer knows of any pre-existing issues with the property. The seller is required to list any known problems at the time of sale. This could include something as minor as a hole in the wall to something as serious as electrical wiring issues. If the seller doesn't document something they knew to be problematic, the buyer can get out of the purchase.

Auction sales, however, do not require a seller's disclosure. This means that even if the owner knows of an issue, they are not obligated to tell you about the issue before you bid.

Once again, the best way to minimize this issue is to have an inspection or perform a walk-through of the property. The more properties you see, the better able you'll be to determine issues and the cost of repair.

Trautman's Tips: ALWAYS go to the property ahead of time and try to get as much info about the property as possible.

LIENS

It is quite possible that there will be a lien against the property of a house up for foreclosure auction. If the liens are low, then you could still easily make a profit. If they are too high, the property may not be the right one for you. If you purchase a property at a tax lien auction, the bid price is designed to pay off that lien.

The way to minimize this risk is to get a title search of the property. If you can't get a title search, then research the title yourself through your county office before making a bid. Auctions can be a fantastic way to bring in more money through real estate investing as long as you understand what to look for and how to minimize your risks.

Trautman's Tips: Auctions can be a great place to pick up properties. I know people that buy every week at auctions and have created a great business model around it. If you are in larger metropolitan areas, look for companies that offer a "one-stop shop" approach. They will research the properties, provide financing for buyers, figure out rehab costs, lend you money, and even offer a portfolio of tradespeople to help you. If you can identify those types of companies, take time to research and learn what they have to offer.

CHAPTER 9: HOW TO BUY A PROPERTY TO FLIP

Do you love watching real estate shows on TV? Most people do, and that has really opened up people's eyes to the world of flipping properties. However, most of the shows glamorize the process and don't always give you the whole story. In this chapter and the next, I will help you see the profit potential in house flipping as well as the less glamorous side.

Let's start by putting a bit of realism into the idea of flipping.

Here are some things to consider:

Properties do not always sell as quickly as you hope. The longer a house sits on the market, the lower your profits are going to be because of holding costs, etc.

Sometimes, the rehab on the property is more than you had anticipated.

Some flips don't make much money. Some even lose money.

With that said, I have found flipping to be a great way to make money with real estate investing. Yes, I have had properties sit on the market too long. I have had rehabs run over cost. I have even lost money. But overall, flipping has been a very beneficial investment strategy.

FOUR THINGS TO CONSIDER TO MAKE FLIPPING WORK FOR YOU

Before you start looking at possible flipping properties, take a look at these tips for making flipping work for you.

Find the right house at the right price. Not every house is the right house for flipping and not every house can be purchased for the right price. You will need to know your rehab costs, understand how much you can sell the property for later, and then find a house that allows you to fix and sell while making a profit. Remember, buy low in a good neighborhood and profits are more likely.

Use dependable contractors. You will not be doing all the rehab work yourself, so you need to find dependable contractors. The best way to do this is through your networking. Finding someone that has done rehab work before and understands the nature and speed of the work is essential. Finding a reasonably priced contractor will also help you make a good profit.

Having the financing in place. Chapters 3 through 5 talk extensively about having the money in place that you need. Flipped houses are often foreclosed houses, so having the money sources lined up is essential. Once again, this is why you need to be involved in networking.

Sell for a profit. Though this may seem obvious, the truth is that if you can't sell the house for a profit, then the deal isn't the right deal. The sale price of the house must cover your initial cost to purchase the house, the repairs, and the interest from your loan deals. Anything beyond that is your profit.

Trautman's Tips: Depending on where you live your profit margins may vary. We try to make at least 20% net profit.

COSTS ASSOCIATED WITH FLIPPING

In order to decide if a deal is a good one, you need to understand the costs associated with flipping a property.

Trautman's Tips: When it comes to house flipping, a budget is more than necessary. It is an absolute must. A budget will help you make a profit.

THE SALE

Obviously, you will have to buy the property. If you have ever purchased a house before, you know that there are more expenses than just the agreed on purchase price. You will also have fees, taxes, and escrow costs. The sales costs can include, but are not limited to:

- Contract Price
- Broker Fee
- Lender's Lawyer Fees
- Holding Costs
- Points Costs
- Insurance Fees

- Prorated Taxes (City, State, County)
- Title Work
- Other Assorted Closing Costs

These are the costs you will have to pay up front, so you have to consider them a part of the sales price of the house.

THE REHAB

Although we will discuss rehabbing more in the next chapter, here are a few things to keep in mind.

Expenses associated with the rehab depend on how much work the property needs. Some of these costs can include:

- A General Contractor
- Materials
- Appliances
- Paint
- Landscaping

It is also a very good idea to have an extra buffer in case something goes wrong with the house. As I've said before, I always count on a 10% overage because even inspected houses can have issues that weren't found. You just never know what might come along.

The point of a rehab is to get the property into sellable condition. In Appendix 4, I provide a cheat sheet of items to consider when rehabbing a house. As you look at the list, you can determine how much you will need to spend.

Also, keep in mind that structural repairs will be more costly than cosmetic repairs. Structural repairs include things such as:

- Roof
- Foundation
- Wiring
- Plumbing
- House additions

Although houses with these issues don't have to be avoided, it will be important to know of the issues beforehand and set your price accordingly.

Trautman's Tips: Structural repairs may need a building permit. This can slow down your flipping process. Be sure you know the rules of the city before buying a house with structural issues or starting structural repairs.

CHOOSING A NEIGHBORHOOD

Now that you understand the costs associated with flipping, it is time to find the right property. But before you drill down to a property, you need to begin with choosing a neighborhood or area of the city. If you talk to any Realtor, they will say the same thing. The mantra for choosing and buying a house is simple: **location, location, location.**

People who want to buy a house will often sacrifice things they want in the property to ensure they get the right neighborhood. On the flip side, people may fall in love with an absolutely beautiful, absolutely perfect house only to pass on it because it is not in a good neighborhood.

Location matters, so it is important to choose the right neighborhood when you buy a property with the intention of flipping it. In addition to things such as growth, good schools, and access to conveniences, there are a few more points to consider when flipping.

Look at the real estate history of the neighborhood. You want to find a neighborhood that is steadily rising. Areas that are falling or have sporadic house value prices are less likely to bring you the profit you want.

Know the market. Always know the market of the neighborhood, which can be different than the market of the city as a whole. Be sure that houses are selling and that the number of offers on houses is high. The more offers there are, the higher the sales price will be.

How many rentals are in the neighborhood? If the number of rentals is high, then this might be a bad area for flipping. Essentially, it is showing that owners are having trouble selling and have turned to renting their properties instead.

Look for aging neighborhoods. Older areas often have smaller houses that appeal to the baby boomers who are now retiring and want to downsize. This is a large contingency of home buyers. Additionally, smaller houses are better for flipping because there is a shortage of entry-level houses, making a smaller house much easier to sell. Finally, rehabbing on an older house can make a big difference, boosting up the final sales price.

Look for improvements in the neighborhood. If a neighborhood is getting improvements from the city, it will be appealing to new buyers. These improvements include things like street paving, sidewalks, new street signs, or streetscapes.

Pay attention to negative attributes of the neighborhood. Certain neighborhoods are just not right for flipping. They include areas with high crime rates, gang activity, drug activity, and adult industry stores such as liquor stores and adult bookstores.

PICKING THE HOUSE

Once you have settled on a neighborhood or two, your next step will be finding houses that are truly flip-worthy. There's a fine line between a house you can rehab and a property that is too far gone for a profit.

Although there are no hard and fast rules about what makes a property flippable, there are some key characteristics that will always be important.

Three bedroom houses. These houses are the most appealing to the most potential buyers.

Two bathrooms. Most people would like to see at least two baths unless the house is exceptionally small.

1,500 to 2,000 square feet. This keeps your rehab costs down and increases the number of buyers.

High ceilings. Older houses had much lower ceilings that give a house a cave-like feeling. Buyers prefer the higher, more open feeling.

Modern door openings. Many older houses have tiny, short doorways. This can be an issue, especially for moving in modern furniture.

Usable kitchen. People prefer room to cook and entertain.

Do an inspection whenever possible. When you are rehabbing houses, inspections will help you determine your rehab costs and help you uncover more costly structural issues.

Once you find a house that fits the parameters for a flip, then you can make an offer to the homeowner, go to the auction, or deal with the bank on the REO. As with any real estate investment, know your spending limit and stick with it.

I found two duplexes on one large lot on the MLS. It was priced right at $250,000, but it looked to be in bad shape. The shape was so bad, in fact, that I was the only offer. But, with a little TLC, the place looked amazing. I found that the foundation, structure, electrical, roof, and plumbing were all in good shape. It just hadn't been updated in a while.

I put in less than $100,000 fixing both up duplexes. After rehabbing the units, I rented out all four very quickly. In fact, we had people asking about moving in before the rehabs were done.

Once they were rented, we put them out as a wholesale deal for $455,000, and it sold the first week. (I will explain wholesaling in Chapter 12.)

In the next chapter, I will explain the rehab and selling portion of the flipping process.

CHAPTER 10:
REHABBING AND SELLING A PROPERTY

Once you have purchased a house to flip, it is time to begin the rehab. The following tips for rehabbing and selling a house will work for properties you are flipping, for those you bought to rent, or for those that you have been renting but now wish to sell. However, we will be discussing flipping in particular.

It is important to rehab in a way that increases the interest in the property and attracts the largest pool of buyers.

Here are a few tips to help you do just that:

Be Cost-Conscious Without Being Cheap or Extravagant: Home buyers will be looking for good value. So, buying the cheapest appliances will turn off buyers. On the other hand, buying the highest priced brands available will price your flip out of reach of a large number of buyers. Always rehab with resale in mind, thinking about other houses in the neighborhood, and final costs. When rehabbing, you need to know your area. For lower end projects, don't put high-end finishes. The same holds true for high-end houses. These will not need cheap finishes.

Keep Things Neutral: In order to sell a house, people need to be able to see themselves living there. Give buyers a neutral slate in terms of colors on the walls and floors. Although you may love bright colors, these could turn off potential buyers. Stick with modern neutrals and earth tones.

Rehab With The Buyer In Mind: You need to learn what the buyer wants. This will be based on current real estate trends as well as the neighborhood. Remember, you are flipping for the new owner. Don't walk into a house improvement store, forgetting that you won't be the one living on that property. Instead, keep the buyer in mind so you appeal to the largest pool.

Trautman's Tips: Go to open houses and look at design trends. Get ideas from current listings.

Keep Styles In Mind: When people look at a house with a certain look to them, they expect that look to carry through the property. This means you have to consider the style of house and then work within those confines. For example, if you are flipping a historic style house, you should redo the fireplace with a historic feel rather than a modern one.

Trautman's Tips: The goal is to sell your property fast. The way you do that is to get as many people in that house as possible. The more people that look at it, the higher the odds are you will find your buyer. I ALWAYS take professional photos, and this helps. For around $100, you should be able to get great photos. Do not take photos on your phone. If you are working with a real estate agent, invest in professional photos.

COSMETIC REHABS MOST HOUSES NEED

When I first started doing rehab work, I did a lot of things I shouldn't have. For instance, I would add high-end finish items or less durable items on properties that were rentals. What actually needs to be changed in the house will vary depending on the state of the property when you buy it. However, here are some basic cosmetic rehabs that most properties can use:

Locks: It is a good idea to put new locks on the house. This keeps the house safe during your rehab. Plus, the buyers will be happy knowing no one else has keys to their new house.

Flooring: Floors quickly show wear and tear, so most rehab will address the flooring. Look at the current real estate market to determine what people want. Flooring fads change quickly, so be sure that what you put in is what is trending now.

Paint: The walls should get a fresh coat of paint because this is the easiest way to make a space look new. Stick with neutral shades that will appeal to the most buyers.

Light Fixtures: This is another easy and affordable way to upgrade a property. Additionally, replace switch plates and outlet covers with new ones for a fresh look.

Kitchen and Bath: The two most important rooms in the house in terms of value are the kitchen and bathrooms. This is where you should spend the bulk of your rehab budget. Look at the flooring, fixtures, cabinets, countertops, and appliances. Keep in mind the finishes, meaning brushed nickel, chrome, oiled bronze, etc. You will want to stick with one finish throughout the entire house.

Curb Appeal: This could include painting or pressure washing the exterior of the house and light landscaping. Remember, the first thing people see is the exterior of the house. First impressions are very important.

Trautman's Tips: Curb appeal is best done with landscaping, paint, and awnings.

Finally, you may want to look at the windows, especially if they are in poor condition. Window replacement is a high-value ROI, so if the windows are older, the newer double-paned models will increase your house's value.

These are just the basics, but you will need to do at least this much work in almost every house flip to ensure the profit you desire. You cannot afford to let your flipped house sit on the market for very long. Every day it does not sell is a day you are losing money. The key to a successful flip is including improvements that make the property more appealing to potential buyers so a quick sale can occur.

Trautman's Tips: I've learned to use the same types of products in my rehabs on as many projects as I can. For example, on my commercial office spaces, I always use the same white paint. That way, when there are touch ups to do, I always know the color. For flooring, I use a wood-looking laminate that is very durable. If it tears, I can just cut it out and replace that piece.

It is difficult to give you an average cost of rehabbing since it is so unique to each area of the country, as well as the individual property. However, a good rule of thumb for a traditional fix and flip is around $35 per square foot. If you have a 1500 sq ft house, you could expect to spend around $52,500 as long as it doesn't need a new roof or have foundation issues.

Trautman's Tips: One of the advantages of selling a flipped house is that you will be able to list the updates. Be sure to list everything that has been added or upgraded to the house.

When it comes to rehabbing a house, whether for flipping or for rental purposes, finding the right contractors and subcontractors can keep you sane. These are the professionals that will take your house from uninhabitable to profitable.

Trautman's Tips: I've learned that hiring a general handyman is a bad idea. Hire people that specialize in a certain skill or trade. I refer to this as "staying in their bucket".

INS AND OUTS OF FINDING CONTRACTORS AND SUBCONTRACTORS

If you listen long enough, you are going to hear horror stories about contractors that were late, that didn't do the job the right way, or that rode off into the night without finishing the job. Since finding the right contractor is so essential, let's talk about how to find the best contractors and what to do once you have them hired.

WHERE TO FIND CONTRACTORS

REIC: As I've stated before (See Chapter 6), networking is going to be a key to finding good contractors. I recommend that you start by asking around your local Real Estate Investment Club (REIC). Investors that are currently involved in the rehabbing process will have good leads for the contractors and subcontractors you need.

Drive By: Take a look around your area to see who is doing work. Stop and chat. Ask questions. See how they are running their project.

Construction-Related Stores: Head over to your local hardware or big-box home improvement store to find contractors. The best time of day is first thing in the morning as they begin their day.

Online: Sometimes, searching online is the best way to go. However, if you go this route, be sure to ask for references to contact as well as jobs they have completed. Then, call the references and take a look at the jobs. One place to find good contractors or subs online is through Angie's list.

GET MORE THAN ONE BID

Even when you find the right contractor, you should typically get more than one bid. Until you've been working with a contractor for a long time and know that his/her prices are competitive, this advice is spot on. Many real estate investors use the "Rule of 3". Get 3 bids and then compare prices, timelines, and materials

This rule suggests that you get three different bids. Not only will you find the bid that makes the most sense for you, but you will learn a lot about the process of rehabbing and a lot about the different contractors.

Trautman's Tips: A good way to determine how fair a contractor is on pricing is to ask about a simple rehab project, such as painting a house. The average cost of paint-

ing a house is about $1 per square foot including paint. If the contractor overbids, then you have learned something about their pricing structure without having to go further with the interview.

SHOULD YOU HIRE SUBS?

You have the option of handling your rehabs one of two ways. You can either hire a contractor who does all the work and/or hires and manages his own subs to take care of all the work, or you can hire your own subcontractors and manage them yourself. This will depend a lot on how hands-on you choose to be with your flipping projects.

The plus side of having a contractor is that they do all the managing. They also deal with all the different people and their schedules and their issues. Finally, a general contractor can usually handle more than one project at a time, which can be beneficial to you if you have more than one property to flip.

The downside is that it will cost you more to pay a general contractor to handle the project than it will to pay each subcontractor individually.

Trautman's Tips: I put an ad on Craigslist and post a job with detailed information. I include such things as: must be experienced, must have their own truck and tools, must have references, etc. Anyone that responds without answering my questions doesn't get an interview, and I just move on. I then hire 2 or 3 of them for the day and determine who is the best . This is much more effective than calling the people that are posting their jobs on Craigslist. Also, once I

find a good sub I ask for recommendations of other subs for work that needs to be done. This works well because good subs often work with other good subs.

PUT SYSTEMS IN PLACE

Once you've rehabbed a few different properties, you will begin to get a list of systems and materials in place. For instance, you will know:

- Brand and color of paints
- Fixtures
- Flooring
- Countertops
- Appliances

All of this will help you determine a price sheet that you can give to your contractor. For each job, you can just check the things you need and cross out those that you do not.

Another system you will want in place is buying and paying for the materials your contractor will need. There are three easy ways to do this:

Buy the Materials Yourself: You can buy what is needed and bring it to your rehab. This can be intensive if there are many different rehab projects going on.

Set Up Accounts: Have an account set up with your local big box hardware store, small hardware store, and lumber yard. When the contractor goes in, they can put the materials onto your account. This is a good method once you know and trust your contractor. Be sure to match the items on your account with the work done by the contractor to avoid paying for materials that were not used for your rehab project.

Provide Contractor with Money for Materials: Once you know your contractor well, you may want to provide cash installments for the purchase of materials. The contractor will use the cash you advance and provide you with receipts before asking for the next installment.

CHOOSING AN AGENT VS. LISTING YOURSELF

After you are finished with your rehab, you will need to determine whether you want to sell the property on your own or hire a real estate agent. You need to weigh the pros and cons of each before making a decision.

THE REAL ESTATE AGENT

An agent can be a big help when selling a property because this is a job they know well. However, they also charge a percentage of the selling price, which cuts into your profit.

Trautman's Tips: Consider getting your real estate license. This could help in a few areas. Finding deals may be easier because you can use the MLS to set alerts on new listings that fit your criteria. You will also be able to make money on the buy and sell of properties. A typical commission is 6%,

and this is normally split 3% to the selling agent and 3% to the listing agent. Also, what if you were to sell a house to a friend once or twice a year? This can create an additional source of income for you while giving you exposure.

So, what do you get for the money given to an agent?

An agent will:

- Help you determine a realistic asking price by finding the after repair value (ARV).
- Know good marketing tools for selling the property.
- Offer professional photography (make sure they do this) of your property for marketing purposes.
- Be available to attend open houses and meet with buyers at all hours of the day.
- Manage requests for information and questions about the property.
- Contact a variety of prospective buyers from their current database.
- Handle sales negotiations for you, which is a time-intensive process.
- Prepare contracts of sale and handle all offer paperwork.
- Take on some of the legal liability.

- Be the buffer between you and the buyer.
- Finalize the sale.

Working through a real estate agent will save you time, hassle and legal fees. They also have a substantial number of contacts and resources to find those who want to buy your house. But this convenience does come at a cost.

Trautman's Tips: When I work with an agent, and we've agreed upon a price, I the negotiate the commission. For instance, if I have a house that should sell for $300,000, then the listing agreement states that they will receive a full commission for anything over $285,000. From $270,000-$284,999, they lose a percentage point. Less than $270,000, their commission is reduced another percentage point. Remember, it's all a negation. You should reward your agent for performing, but they should also participate in price concessions. Also, you can do shorter contracts with agents such as 60 or 90 days. I prefer not to sign a contract for more than 120 days.

SELLING ON YOUR OWN

As with anything, there are also advantages to selling the property on your own. The biggest advantage is that you are not paying a commission to the agent. Although commissions vary from state to state and Realtor to Realtor, the average commission is 6% of the selling price. So, if you are selling a house for $120,000, the agent's commission would be $7,200. That $7,200 comes out of your profit.

Selling on your own will take some knowledge and skills. You'll need to learn about marketing, the legal aspects of a sale, negotiations, and closing. However, it can be done. It just depends on how involved you wish to be in the sale of the property.

This is becoming a more popular way to sell a property. There are many FSBO listing sites where you can get your house exposure just like a traditional listing.

Trautman's Tips: If I do a FSBO, I normally pay a 4% commission to the selling agent. When agents are picking houses for people to tour, they can see this extra percentage point, and it appeals to them since they will get paid more money for the same effort.

PREPARING FOR THE SALE

Before putting the house up for sale, you need to be prepared for the sale. Here are some tips selling flipped properties (or any property you have on the market).

Have the Disclosures: You are now the homeowner, so you will be required to disclose any issues you are aware of. You should also know the stats on the house like when it was built, the building materials, climate control systems, total square footage, lot size, etc.

Stage the House: You want people to walk into the house and feel as if they could move in. Although you can sell it empty, many people stage the house with furnishings and artwork because a staged house feels more "homey." Remember, the goal is to have them be able to imagine living there.

Determine the Selling Price: If you are working with an agent, they will perform a market analysis to help you come up with a price. If you are selling on your own, then do your research about comparable houses in the area. You should come up with two prices: the listing price and the lowest amount you will be willing to take when you sell.

Coming Soon Sign: You know when you're working on a house, all the neighbors are watching and anticipating what you did to it and what you are going to list it for? They may know someone interested. Or, someone just driving by may see your "coming soon" sign, and you could sell it before it's even listed. I've done this a few times and am always happy I did.

Set Open House Days: This is an excellent way to get attention for the property very quickly. Make sure your open houses are listed on the MLS. This way, agents can see what houses will be doing an open house in advance.

SELLING A FLIPPED HOUSE

Selling a house that you rehabbed is identical to selling any other property. Here are the major steps for selling a house through traditional channels:

Step One: When a buyer becomes interested in your property, they will present an offer. The offer will tell you what they are willing to pay, contingencies (conditions that must be met to make the contract binding, such as passing inspection), and potential closing dates.

Step Two: If the offer is not acceptable, you will need to make a counter- offer with terms you feel are more appropriate. This negotiation can go back and forth until everyone is satisfied with the deal.

Trautman's Tips: I always counter. It doesn't need to be on the price but may be on the closing date or something minor. Buyers may feel that if they got everything they wanted that they could have got a better deal and get cold feet. Make them work for it.

Step Three: Once you accept an offer, you will enter into a legal contract called a Purchase and Sale Agreement that outlines the specific terms and conditions agreed upon by both you and the buyer. At this point, you are legally bound to sell your property unless one of the contingencies occurs.

Step Four: At this point, it is time to open escrow. The escrow company will make sure the contract is correct and handle all the money during the contract period. During this time, your buyer will have the house appraised for their lender, as well as have it inspected.

The inspector is looking for problems with items such as the roof, heating and air system, water heater, plumbing, electrical, and structure of the house. There should be no surprises here since you have just rehabbed the house and know all the issues. Be sure you are as cooperative as possible, making sure the appraiser and inspectors have access to all areas of the house. If the buyer comes back to you with repairs based on the inspection, you can choose to make the repairs or cancel the contract. If it is a minor repair, making it can move the sale forward.

Step Five: Immediately before the closing, the buyer will have a final walk-through. They will make sure that the condition of the house is the same, that all items that were to be left behind have been left behind and that the house is clean.

Step Six: During the closing, both you and the buyer will sign the necessary paperwork to complete the transaction. After the title is transferred, your buyer will receive the keys and you will receive the payment for the house. Your closing agent will then pay off your existing mortgage and any other closing fees. Once everything has been paid, you will receive the balance.

Step Seven: And, last but not least, the papers will be filed with the correct local agencies for recording.

5 REHABBING TIPS FOR FLIPPING SUCCESS

Although rehabbing can be a bit tricky, following these tips will lead you to successful house flipping.

Have Enough Money: It is easy to underestimate the costs of a rehab, especially if you are new to real estate investing. That is why I always add a 10% overage fee to all of my calculations. Make sure you have enough money to fix what needs to be fixed.

Know the Timetable: TV shows may lead you to believe that houses can be rehabbed in a week or two. Although it is possible, and I have done it, most houses take longer. This is especially true if you are dealing with an HOA or building codes. You do want to flip and sell as quickly as possible but always plan for enough time when determining your profit margins.

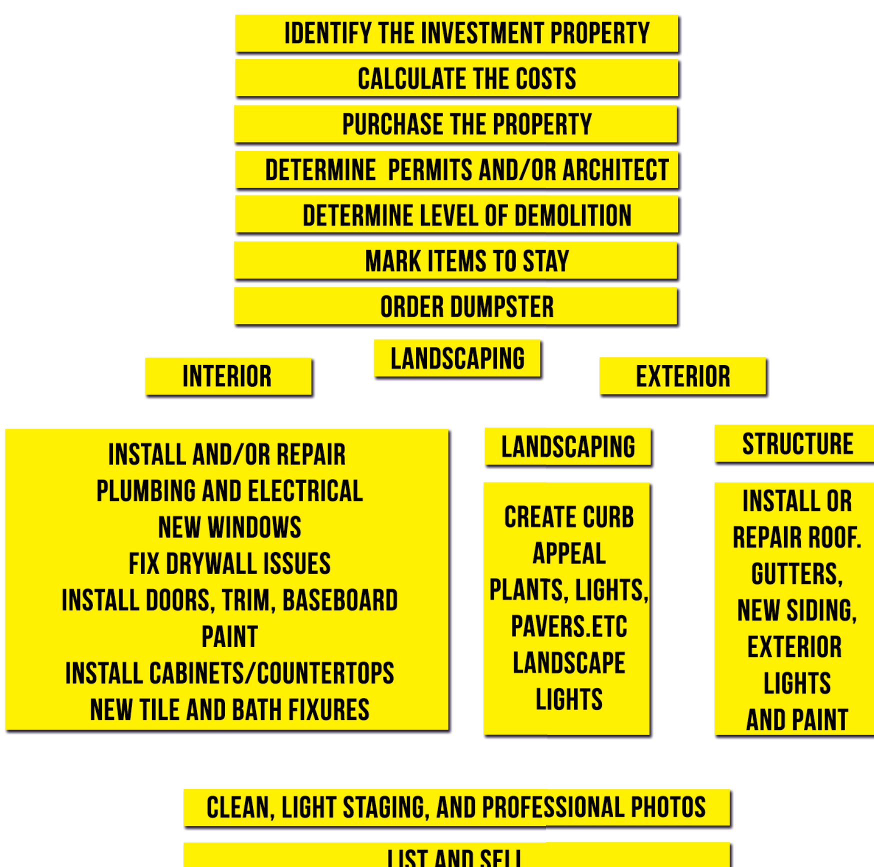
Use Contractors and Professionals: Even if you are very handy, you are not going to be able to rehab an entire house quickly by yourself. Hire skilled people to handle the rehab, such as a general contractor, electrician, plumber, carpenter, flooring expert, and painter.

Stay Neutral: This one bears repeating because trying to flip a house that reflects your personality instead of the buyer's personality will cost you money. Always rehab with the buyer in mind. If hardwood is selling, then you should add hardwood, even if you prefer carpet. Remember, you want the property to appeal to as many people as possible, so neutral colors are always the best choice.

Do Your Homework: Know what is trending in your area. Be careful not to rely too heavily on the Internet. You can easily find outdated information or information that pertains to one area of the country and not another. Talk to other real estate experts in your area to determine what buyers want. In the next chapter, we will discuss the entire flow of flipping a property.

CHAPTER 11: THE FLOW OF THE FLIP

Much of the information found in this chapter is found in more detail throughout the book. However, I wanted to provide a chapter that started at the beginning of a flip and worked through to the end. This will give you a mini-handbook in one simple chapter to help you know the flow of the project and keep the basic points in mind.



STEP 1:
IDENTIFY THE INVESTMENT PROPERTY

First, you will need to decide where you'd like to invest. The best way to do this is to determine a state with a good market. You can learn more about the market in Chapter 2. Once you know the state, it is time to determine the city and then narrow down your choices to the right neighborhood.

You will want to look for the following:

- Easy access to freeways
- Up and coming neighborhood
- Access to amenities
- Accessible to work
- Low unemployment rates
- High average household incomes
- High rated school districts

Once you have identified the neighborhood, it is time to identify the specific properties. Always try to buy low so that you can make small renovations that will lead to a high selling price.

Here are some key characteristics a house should have for flipping purposes:

- 3 bedrooms
- 2 bathrooms
- 1,500 to 2,000 square feet
- High ceilings
- Modern door openings
- Usable kitchen
- Lack of structural issues

How you find the right properties will depend on how you purchase them. If you are looking at foreclosures, you can look in the newspaper, lender websites, real estate sites, bank-owned auction companies, the MLS, or through networking (See Chapter 6). Networking will be the most valuable way to find real estate deals in your area.

STEP 2:

CALCULATE THE COSTS

Understanding your budget when flipping a house is crucial to you making a profit.

Keep the following costs in mind:

- Contract Price
- Broker Fees (both buying and selling)
- Lawyer Fees (both buying and selling)
- Holding Costs
- Points Costs
- Insurance Fees
- Prorated Taxes (City, State, County)
- Title Work
- Other Assorted Closing Costs
- Contractors and Subcontractors
- Paint and Materials
- Appliances and Fixtures
- Cabinets
- Flooring
- Landscaping
- Cleaning

- Staging
- Professional Photos

STEP 3:

PURCHASE PROPERTY

As you know, it will be important to already have financing options in place prior to finding an investment property. The different financing options are discussed in detail in Chapters 3 through 5.

If you are purchasing your house through a real estate agent, they will walk you through the specific steps needed. In this case, you are more likely to be using a bank loan, your own cash, or owner financing. If you are purchasing a foreclosure through an auction or REO, then you will want to examine Chapter 8.

STEP 4:

DETERMINE PERMITS AND/OR ARCHITECT

Timing is very important when flipping a house. The longer you wait to get your renovations started, the more money you lose. As soon as you have purchased the property, it is time to get an architect, if needed, and get the proper permits for any jobs that need to be done.

Every city and county is different in terms of what projects need a permit and what projects do not. Typically, projects that touch on public and personal safety, plumbing, electrical, and natural gas will need permits.

Most cities and counties will require a permit for the following activities:

- Demolishing a load-bearing wall
- Changing a roof line
- Expansion of house
- Electrical
- Fences over a certain height (usually 6 feet)
- Decks over a certain height (usually more than 30 inches above grade)
- Sewer
- Adding a carport or garage
- Anything that requires a new opening, such as new doors, windows, or skylight
- Fireplaces
- Garage conversions
- New furnaces and water heaters

- Roofing that involves structural elements

Other projects that could require a permit include:

- Adding new plumbing lines
- Demolishing any wall, even if not load bearing
- Replacing doors and windows
- Cutting down trees
- Retaining walls over 4 feet

Typically, you will not need a permit for the following (but always check with your city's and county's planning departments for specifics):

- Roofing, if it is similar to the old roof
- Flooring
- Replacing existing plumbing fixtures
- Replacing countertops
- Adding siding
- Minor electrical work such as replacing an outlet or circuit breaker
- Decks below 30 inches

- Addition of outbuildings that do not need electrical or plumbing
- Adding low fences
- New appliances, if not changing plumbing lines or electrical circuits

Beyond looking at the county and city, be sure to go over any HOA rules and regulations before beginning a rehab project.

STEP 5:

DETERMINE LEVEL OF DEMOLITION

Talk to your architect and contractors about what needs to be done to sell the property quickly and easily based on current houses for sale and what buyers are seeking in that area. Your demolition can include typical items such as flooring and kitchen cabinets, or it can be more severe such as wall removal to create a larger kitchen or more open floor plan.

STEP 6:

MARK ITEMS TO STAY

Go through the house and mark anything you wish to keep. This will help your contractor and/or subcontractors know what they should be doing. If you usually change out all countertops, but a property has countertops in good condition, you don't want your contractor pulling them out for replacement accidentally. This will eat into your profit.

STEP 7:

ORDER DUMPSTER

Although some cities have curb pickup for things like old appliances and furniture, rarely do they provide this service for rehab jobs. Since you will have a lot of waste, you will need to order a dumpster. Dumpsters are typically ordered for a period of time, and the cost also depends on the weight once it is full. Most dumpsters cost around $500.

STEP 8:

REHABBING THE INTERIOR

When flipping a house, you should keep the following tips in mind:

Think about the cost of appliances and finishes. They should reflect the neighborhood and value of the house.

Keep your colors neutral.

Follow current real estate trends.

Keep the style of the house in mind when you rehab.

The most typical interior rehabs include:

- Install and/or repair plumbing and electrical
- New windows

- Fix drywall issues
- Install doors, trim, baseboard
- Paint
- Install cabinets/countertops in kitchen and bath
- New tile and fixtures in bath

STEP 9:
REHABBING THE EXTERIOR

When it comes to rehabbing the exterior, you need to think in terms of curb appeal. What will make your flip stand out from the crowd of houses in the neighborhood? A good first impression is a great way to make your property stand out and increase the selling price.

For the landscape, consider doing the following:

- Create curb appeal through things such as plants, lights, pavers, new mailbox, etc
- Install irrigation system
- Add landscape lights

In terms of the exterior of the house, consider the following:

- Install or repair roof, gutters, new siding

- Paint
- Exterior Lights

STEP 10:
CLEAN, LIGHT STAGING, AND PROFESSIONAL PHOTOS

The point of cleaning and staging a property is to make it sell faster and for more money by making it the most appealing house to the greatest number of potential buyers. No one should see your house before it is cleaned and staged. And never have the photographer take professional photos before this crucial step.

Staging an empty house is different from staging a house that is currently being lived in. Instead of taking out extra items, you will want to add in a few key items to give your property a feeling of warmth. The point is to help potential buyers feel like they could live in the space. Buyers have trouble doing this in a totally empty house, so you will want to add some small touches and a few pieces of furniture.

Here are some things to consider:

- Doormat
- Stage the dining room, living room, and at least one bedroom
- Display a few small touches in the kitchen like kitchen towels, decorative jars, or a basket of fruit

- Towels in the bathroom along with a dish of decorative soaps
- Consider hanging a few framed pictures for impact

Once the house is staged, it is time to take photos. Since over 90% of house searches are done online, it is necessary for you to put photos of your property on the Internet. You will want these photos to make the property look fantastic so that as many people as possible want to come to see the real thing.

STEP 11:
LIST AND SELL

The final step is listing your property and getting it sold. You will have to decide whether you want to sell on your own (FSBO) or hire a real estate agent to help you. You can read more about the pros and cons of this decision in Chapter 10.

The steps for selling a house are listed in Chapter 10. Here is a recap of those steps:

- Buyer presents an offer
- You will present a counteroffer
- Offer is accepted
- Enter into a Purchase and Sale Agreement
- Open escrow

- Buyer will have house appraised and inspected
- Buyer may have requests based on inspection. You may fix the requests and/or renegotiate the price at this time.
- Buyer has final walk-through
- You and buyer will attend the closing
- File the papers with the correct local agencies

In the next chapter, we will discuss wholesaling as another method of selling a property.

CHAPTER 12: WHOLESALING PROPERTIES

Wholesaling, though a form of real estate investing, is significantly different from the methods we've discussed so far. Why? Because with wholesaling, you will never take ownership of the property. Instead, you'll get a property under contract and then assign the contract to an investor.

The property you find will typically be a distressed property. The investor will use cash, credit lines, or hard money loans to provide funds, which allows the closing to be quick. Most investors will look at the property to rehab and flip.

As a wholesaler, you are simply the middle man. You get paid by putting together a good deal. Let's see how that works.

HOW WHOLESALING WORKS

Let's call you Investor A.

As an investor, you find a great deal and sign a Purchase Agreement with the seller of the property. You will create the Purchase Agreement with the option to assign or sell this contract to another investor, who we are going to call Investor B.

Next, you, Investor A, assigns the Purchase Agreement to Investor B with a simple contract called an Assignment Agreement. This transfers all of your rights to Investor B and releases you from any liability or obligations. Essentially, it substitutes Investor B for you.

Now, Investor B will buy from the seller at the same price, terms, and deadlines that you set up. What is on the original Purchase Agreement applies to Investor B instead of you.

So, how does Investor A make money? Through something called an Assignment Fee. In addition to purchasing the property from the buyer, Investor B will also pay you a fee for finding the property and setting up the deal.

Let's look at this process a little more closely.

STEP 1: LEARN THE MARKET

In order to find the right properties, you need to know where to look. Of course, the place to look is where investors are buying. You will want to buy properties that appeal to investors.

To do this, you are going to have to network. Get to know investors that are buying properties to rehab. As you meet them, ask them questions about their recent deals.

Questions can include such things as:

- What was your last deal?
- What neighborhoods do you prefer?
- How many beds and baths do you prefer?
- Would you mind telling me the price you paid for you last

project?

- How much did it cost to rehab?

- What type of returns are you looking for?

Then, sum up everything you've heard. Ask them if you could find a property for the amount they stated in the neighborhood of their choice with the bed and bath requirements that could be repaired for their recent rehab amount, would they be interested in buying?

Not only have you found a potential investor, but you have a ton of information about what investors are looking for. Do this over and over until you have a good feel for what investors are buying and where.

Another way to figure out the right neighborhood is to ask a real estate agent to pull data on cash sales. A concentration of cash sales will show you areas where investors are buying.

Now, you have an idea where to start looking for properties.

Trautman's Tip: Find a small area to get started. Look at just two to three neighborhoods until you know the market and how to wholesale. As you get a larger list of potential buyers, you will be able to branch out further.

STEP 2: CREATE A LIST OF INVESTORS

The way to make wholesaling work is to have investors willing to take the property off your hands quickly. So, it is a good idea to have a list of investors that would be interested in properties you have available. There are many different ways to create this list. In addition to the networking you should be consistently pursuing, here are a few other ways to find potential investors:

Run an Ad: Put an ad in the newspaper that says you have properties for sale that are great for rehabbers or investors. When they call, get their name, number, fax, email, and information about the types of houses they want to find. Let them know that you have several properties in the works and will send them info as soon as something is solid. Most investors will want to be on your list.

Trautman's Tips: Find out things like their preferred neighborhoods, price range, type of construction, minimum and maximum square footage, and type of construction. The more information you have, the more likely you will be able to find something that is appealing to them, making the job of wholesaling the property much easier.

Contact Landlords: Drive through neighborhoods and write down the phone numbers listed on "For Rent" signs. Call the numbers and ask the landlords if they would like more rentals in the area. Once again, ask them what they are looking for.

Research Online: Search your county's website online to determine property owners. When you find someone or an LLC that owns more than one property in a neighborhood, they may be interested in buying another. Another good place to do research is on craigslist.org, or other online classified websites.

Local Bandit Signs: Many investors put out bandit signs stating something like, "We Buy Homes for Cash." When you see a sign, call them to find out what they want.

Cash Buyer's List: Remember the list that you had the real estate agent pull in Step One? Not only will this list help you find the right neighborhoods, but it will also help you find the investors that own the properties. If you can't find an agent to pull the data, you can also get it from Prop Stream or county records.

STEP 3: FINDING THE RIGHT PROPERTY

Once you know where you want to buy and have a list of potential investors, it is time to find the right property. To do this, you need to find motivated sellers.

Here are a few ways this can be done:

Drive the Neighborhood: Drive through the neighborhood and look for potential houses. These will have yards that look overgrown, exteriors in need of some TLC, or a vacant look. Write down the addresses and find out the owner's name through the county tax records. Houses in these conditions tend to have people motivated to sell.

Buy a Homeowner Absentee List: This is a list of property owners that do not reside at the property. You can get these lists through Listsource.com, many other list sellers, and title companies. Although some on the list will be landlords, many will be owners due to inheritance or have relocated without being able to sell their house. Sometimes, the property is vacant because it needs repairs to qualify for a loan, but the owner doesn't have the money to make the repairs, and they were not able to sell as-is.

Banks – REO List: Banks that own houses due to foreclosure can create a good wholesaling opportunity. To read more about REOs, read Chapter 7.

Estate Sales/Probate Properties: Many people inherit property but would prefer to have cash. Going to an estate sale or looking at probate properties can help you find someone that is motivated to sell.

Classified Ads: Check out the FSBO ads in the local papers and online sources such as Craigslist. Not everyone that sells FSBO is in distress, but some are. Plus, once a house has been sitting on the market a long time, which is often the case with FSBO houses, sellers become more motivated to make a deal.

FSBO Yard Signs and Websites: In addition to looking in the classifieds for FSBO properties, you can also drive around and find FSBO signs. Also, check out your local FSBO websites.

Pre-Foreclosure Notices: Houses going into foreclosure have very motivated sellers. If the property is right, and the equity is high, this could be a good wholesaling opportunity.

Bird Dogs: It is possible to pay someone to sniff out the homes for you. Of course, you have to pay for their services, but it is something to consider.

Networking: Although I listed this last, this is, by far, one of the best ways to hear about good deals. Remember, networking is the key to being a successful real estate investor.

Once you have a property in mind, contact the owner with a call to action stating that you are interested in buying their house. This can be a phone call, a personal visit, or a letter. If you decide to write a letter, make sure it is personalized.

STEP 4: THE CONTRACT

When you contact potential sellers, you need to be sure to explain to the sellers what you plan to do. Otherwise, the seller will get confused and upset over the transaction. If they know what you are doing, the whole process will be smoother.

Here are some things the seller should understand:

- You do not intend to buy the property
- You plan to put the property under contract and sell it to someone else who will buy the property
- You will keep the seller in the loop at all times

- If you can't find a buyer, then the contract will expire with no sale

If they agree with these terms, then you can set the price and create a Purchase Agreement. The purchase agreement will have to contain an "assignment clause" that allows you to assign the agreement to a third-party. Without this clause, you will not be able to sell the Purchase Agreement.

Here is a sample assignment clause:

"Contract may be assigned by Buyer. If assigned, all rights, privileges and responsibilities under this contract will be assigned and Buyer will be relieved of same."

You will also want to put in a contingency stating that if a buyer isn't found within a specified period of time, the purchase agreement will expire.

Here is a sample of that contingency:

"This agreement is subject to finding a qualified buyer within 30 days."

Finally, you will want a standard inspection contingency that allows you to back out of the deal if the inspection is not good.

A sample inspection contingency looks like this:

"The Buyer's offer is subject to a satisfactory inspection within ten (10) days."

Trautman's Tips: Always run your contract wording by an attorney in your area to be sure that the clauses are valid and legal in your state.

Be sure that you do not sign a purchase agreement that asks for a non-refundable earnest money deposit. If you are working with a real estate agent, they may suggest offering an earnest money deposit to the seller. However, if the contract becomes void because of the inspection or an inability to find a buyer, you want to be sure that you get your earnest money back in full without penalty or withholding.

STEP 5: DUE DILIGENCE AND CREATING AN INVESTOR PACKET

Once the Purchase Agreement is signed, it is important to know the relevant details about the property. You will be marketing the property, so you will want to be sure to have an inspection done and be aware of anything negative.

The inspection needs to be timely and within the allowed time frame in the Purchase Agreement. If you find significant issues or can't get the data you need, pull out of the deal before the deadline date.

You will also want to bring in your contractors to give you an estimate of repair costs, as well as a title report.

Once all the inspections are completed, it is time to put together an investor packet. This report will tell them about the property and help them easily evaluate the deal. You will have the most success when you provide your investors with proof of the details. Therefore, the report will include information such as:

- Summary
- Property Report
- Property Specs including square footage, number of beds and baths, and year built
- Purchase Price
- Rehab bid
- After Repair Value (ARV)
- Address
- Selling points about the area
- Property Listing
- Purchase Contract
- Comps
- Photos
- Preliminary Title Report
- Issues discovered through the inspection

At this point, it is time to contact your list of buyers. Fax, email, or mail your list with the packet information. Many times, the property will be snapped up quickly.

In addition to marketing to your list, you will also want to market the specific property online, through classified ads, and with property signs.

STEP 6: ASSIGNING THE CONTRACT

Once you have an interested investor, it is time to begin negotiations and then move forward with the purchase. Since you want to move quickly, you will not have time to deal with those that are not ready to move forward quickly.

One way to handle this is to provide documentation to interested investors that looks something like this:

“Thank you for your interest in the property located at ________________(Property Address). To move forward with this purchase, I will need the following:

Your signature on the Assignment Agreement. Fax or email to me by 5:00 pm tomorrow.

An assignment fee of $__________ via wire by 5:00 pm tomorrow.

When both items are received, the property will be reserved in your name. I will contact ____________________ (Closing Agent and Location) to begin closing. They will contact you with closing documents for your review and approval.

My goal is to close this transaction on ____________ (30 days from date of this letter). Your funds and paperwork will need to be submitted to _______________(Closing Agent) by that time."

Keep in mind that the fee is fully refundable if the sale doesn't close as intended. Therefore, keep the funds in an account until the closing.

Trautman's Tips: When it comes to the assignment fee, I typically ask for $5,000 to $10,000.

STEP 7:
CLOSING

Once you have a signed Assignment Agreement and the assignment funds, you'll need to deliver the appropriate documents to the closing agent. Depending on your state, this will either be a title company or a closing attorney.

Not all closing agents understand how wholesaling works and have no clue when it comes to an assigned purchase agreement. Therefore, you will want to find someone that has done wholesale work before. Ask other investors for their recommendations.

They will need the following:

- Copy of signed Purchase Agreement

- Copy of signed Assignment Agreement
- Proof of the funds that you've received

The closing should be simple because it is an all-cash deal.

A SAMPLE WHOLESALING DEAL

Let's take a look at how a deal might look.

You find a house that is worth $100,000 in good condition. The sellers are going into foreclosure and need to sell quickly.

After an interview with them, you find that they need to pay $50,000 to the bank and need an additional $5,000 for moving expenses. After a quick look around the house, you determine that the rehab will cost about $15,000.

You offer them the $55,000 they need. They accept the offer.

You now contact an investor that is willing to pay 65% of the house's value. He buys the house for $65,000, giving you the $10,000 in an assignment fee and $55,000 to the sellers.

The investor will be able to make a profit of $15,000 to $20,000 on this piece of property:

House Sale – House Purchase – Assignment Fee – Rehab Costs = Profit

$100.000 - $55,000 - $10,000 - $15,000 = $20,000

There are a lot of advantages to wholesaling a property. The main one is that you don't need much in the way of cash to get started. You can also obtain your profit more quickly than with a rehab or flip with a lot less responsibility and risk.

CHAPTER 13: INS AND OUTS OF PURCHASING RENTAL INCOME PROPERTIES

Although many real estate investors buy property with the intent of selling quickly, there is another option. Buying with the intent to rent is known as buying residual income properties. It's a great option if you are trying to create a steady stream of income. In fact, for some people, buying and maintaining rentals produces enough income that they are able to quit their "day job."

IS YOUR PERSONALITY RIGHT FOR BUYING RENTALS?

As with everything in life, not everyone is cut out to own rental properties. Here are some questions to ask yourself to determine if this is a good avenue of real estate investing for you:

- Do I have the time and patience to grow my business? Building residual income property takes time, and you won't start making a livable income immediately.

- Do I have the time I need to invest in the process?

- Do I have the money I need to invest in the process?

- Do I like the idea of owning my own business? Buying rentals is different from buying and rehabbing a house. As an owner of rental properties, you will be taking on the role of a business owner.

- Do I enjoy the different aspects of owning rental properties, such as management?

If you said yes, or at least "I think so," to most of these questions, then buying rentals might be for you.

HOW RENTAL PROPERTIES DIFFER FROM FLIPPING PROPERTIES

Residual income properties are extremely lucrative when done right. However, buying and renting is different in many ways from flipping a property. Let's look at some of these main differences.

PROPERTY MAINTENANCE

With a flipped house, you buy, go in and rehab, and then sell. Once you've sold the property, you never need to think about it again (except maybe to remember lessons learned from the process). When you purchase a property to rent, however, you continue owning the property. Yes, someone else will be living in the house, but the maintenance will be your responsibility.

What does this mean in terms of profitability? It means that when you are considering buying a rental, you need to be sure to calculate expenses associated with the maintenance of the property.

FINDING TENANTS

With a flipped house, you are looking for someone to buy the property from you. With rental properties, you are looking for tenants. With good tenants, your property will bring in the required income each month. Finding good tenants is a key to being successful in residual income properties and will be discussed at length in the next chapter.

No one likes to talk about problem tenants, but it is possible to find yourself with a poor tenant that is not taking care of the property or is not paying on time. Of course, there are good ways to keep this problem to a minimum that we will discuss in the next chapter as well.

VACANCIES

Even the very best properties are vacant at times. During this time, the property will not be producing income, but will still be producing expenses. It is important to consider vacancy rates when calculating your potential profits on a piece of property.

UNDERSTANDING EXPENSES

Remember that math class back in high school? Well, with rental properties, you are going to want to pull out the calculator and think clearly about ongoing expenses. Flipping requires you to think about the here and now – what do I need to do to make this property sell now for this amount? With rentals, you have to think about the here and now – what do I need to make this property rentable? But, you also have to think about the future – what will the expenses be on a monthly, yearly, and sporadic basis during my ownership of the property?

Future expenses include such things as:

- Property taxes
- Utilities not covered by tenants
- Vacancy
- Repair expenses between tenants
- Repair expenses when the property has a tenant
- HOA if applicable
- Rental tax
- Insurance

Knowing these expenses will help you determine what you will need to ask for in rent.

As you look at potential properties, you will look at the money you put into the property along with the money you would get back. If the numbers aren't right, then the property is not a good one for residual income.

CASH FLOW EXAMPLE

Let's look at an example of a rental property to see how the cash flow works.

Here are the details for a single-family home:

The purchase price is $110,000. You pay 20% down from your own cash reserves, which means you need to finance $88,000. You can get a conventional, 15-year loan at 4% interest with a payment of $651. With insurance and taxes totaling $1,400 a year, you have a monthly mortgage payment of $767.

Based on these numbers:

Total mortgage expenses per year are $9,204.

You determine you can rent out the house for $1,200 a month for an annual income of $14,400.

Annual risk for vacancy and nonpayment is 6% of total annual income. 6% of $14,400 is $864.

Expected repairs are typically calculated at 1% of the property value. 1% of $110,000 is $1,100.

Finally, there is advertising and other miscellaneous costs. For this example, we will use $300.

Rental Income – Loss of Income – Repairs – Mortgage Payments – Misc Expenses = Cash Flow

$14,400 - $864 - $1.100 - $9,204 - $300 = $2,932

To find the monthly cash flow, you divide this number by 12 to get $244.

After paying your expenses, this property would provide you with $244 a month in income. At the end of 15 years, the property will provide a significantly higher income because you will no longer be making the mortgage payment.

Always run these numbers when considering a rental property. It's the only way to determine if you are making a good investment choice.

Trautman's Tips: Determining what makes a good investment choice is really on a case by case basis. However, I don't typically do anything under 20% or $20,000. The only exception would be for wholesaling.

I found a building that was listed on the residential MLS. Because it was listed incorrectly, it was hard to sell because the right buyers didn't know the property existed.

The building was 2500 sq ft, and I picked it up for $220,000 or $92 per sq ft. Historically, it was a one tenant use building. I negotiated selling financing with $20,000 down at a 5% interest rate with a balloon payment due in full in five years. I was able to break this space down into 9 separate spaces, pulling in just over $4700 per month.

But that is not the best part. After stabilizing the building, I made an offer to pay the note off early to the seller at 80% of the note value, reducing our initial investment by $40,000, giving me a true purchase price of $75 per sq ft.

This is a scenario that I have seen and done more than once. Often people hire a "friend" who is an agent to list a property. However, commercial and residential real estate couldn't be more different. So, this was one of the opportunities we spotted. The other was just the way to view the end use of the property with several tenants. The final was that when you have seller financing, it is possible to negotiate an early payoff. You can even negotiate this in the contract up front, stating early payoff incentives with a timeline and percentage amount.

WHAT TO LOOK FOR IN A PROPERTY

When you choose a property for residual income, you are looking for something different than you would if you were planning on flipping a house. Let's talk about several different factors and then consider what you need to look for in rental properties specifically.

The Neighborhood: The neighborhood you choose will affect your type of tenants, and the tenants you attract will affect the neighborhood you need to choose. For example, if you buy a house near a college, then your main tenant pool will be college students. If you buy a house in an aging neighborhood, then you will need to attract tenants that are elderly or getting ready for retirement. You should always consider the tenant base for the neighborhoods you choose.

Property Taxes: The amount of property taxes will affect how much you charge for rent. This means you need to be sure that the taxes are in sync with the rental prices in the area. For instance, if an area has a high tax rate but the rental prices are low, then you may not be able to make enough with your rental income to create a positive cash flow. You can find out about the taxes on a particular piece of property by contacting the tax assessor's office.

School District: If the house you choose is in a family friendly neighborhood, then you are likely to attract tenants with families. Parents try to find houses to rent in areas with a good school reputation. The better the school district, the more you will be able to charge in rent. If you buy a rental in a family friendly neighborhood, make sure it is a 2 or 3 bedroom.

Crime Rates: As with any kind of real estate purchase, you will want to buy a house in a neighborhood with a low crime rate. Renters care about this just as much as home buyers.

Job Market: An area with a good job market will help you attract long-term renters. Having a house that is accessible to local jobs will also allow you to charge more in rent.

Amenities: As when flipping a house, you need to choose houses that are close to amenities, such as proximity to public transportation, city parks, movie theaters, gyms, and shopping centers.

Future Developments: It's a good idea to check in with the municipal planning department and find out if any new developments will be going up in the area. As these developments grow, then the value of properties around them will grow as well. Also look for negative developments such as low-income housing or large developments that will create traffic issues or the loss of green space.

Number of Listings: A large number of houses for sale is not a good thing for a flipper because it means that people aren't buying in the area. However, they may be renting. Sometimes, these neighborhoods are perfect for the rental market.

Rent Prices: Of course, you will want to check what other people are charging for rent. This will help you determine how much you can reasonably charge.

Vacancies: In addition to rental prices, check on vacancy levels. If an area has too many vacancies, then the rent might be too high. Or there is another problem with the area?

Natural Disaster: You need to know if the neighborhood is in a natural disaster zone such as earthquakes, hurricanes, or flooding. This will affect how much you pay in insurance.

Additionally, you will have to choose a specific type of property that you would like to turn into residual income.

You have different choices including:

- Single family homes
- Duplexes
- Tri and quad-plexes
- Multi-unit buildings

If you are a beginner to real estate investments, then the best place to start is single-family dwellings. Residual income properties are an excellent way to bring in consistent money. Some people choose to combine rental incomes with flipping. They get a few residual income properties going and then use the cash flow to pay for a flip project. They can work hand in hand.

CHAPTER 14: FINDING THE RIGHT TENANTS

UNDERSTANDING THE LEASE

Before you find tenants for your property, you will need to have a lease agreement, sometimes known as a tenancy agreement. This is a legally binding contract between you and your tenant. It will cover what is expected of you as the landlord, as well as what is expected of the tenant. There are many different things you could include in a lease agreement, but some of the staples include:

Occupancy Limitations: You want to limit who can live on the property so that you have control over the tenants. You can state an occupancy limit of no more than a certain number of people. You can also limit them to those who lived with them at the signing of the lease. If the tenant later has someone else that would like to move in, then a new lease can be drawn up if you desire.

Terms of Tenancy: This will put specific terms on the lease itself, including how long it lasts. Most leases are for a year, but it can be month-to-month, bi-yearly, or even two-year leases depending on what suits you the best. Just make sure this is outlined fully in the contract.

- Rental Amount - Included in the rental amount are things such as:
- Amount of Security Deposit – be sure to follow state laws
- Amount of monthly rent

- Acceptable payment forms
- Late fees, as well as the grace period before late fees accrue
- NSF fees for bounced checks
- How the security deposit will be used when the tenant moves out
- How the deposit will be returned minus deductions
- Pet fees
- How the security deposit will be held and what will happen to any interest on it

Repairs and Maintenance: This should include tenant and landlord responsibility. The tenants will be responsible for keeping the property clean and sanitary. This may or may not include mowing the lawn. The landlord will be responsible for handling any defective situations on the property.

Changes: You will need to outline what changes can be made with or without your permission. For instance, can the tenant paint? If so, do they need to contact you first?

Access to Property: You need to include a clause within a contract stating that you are allowed to enter the property. This clause will state when you can enter and how much advance notice you will provide.

Restrict Illegal Activity: You are not responsible for illegal activities such as drug dealing and excessive noise. Illegal activities on your property will lead to eviction.

Pet Policies: Be very clear on a pet policy. If you do not allow pets, then say so within the contract. If you do allow pets, then include any restrictions, such as size of pets, number allowed, and the tenants' requirements to keep the property clear of pet waste.

HOA Restrictions: If your property is in an HOA community, the HOA rules and regulations should be included.

Initials: The back pages of a lease should be summary statements that require all party's initials.

Trautman's Tips: There may be other restrictions you need to include based on specific laws within your state. The main thing you need to do in a lease agreement is outline everything specifically and clearly.

SCREENING FOR TENANTS

When you purchase a property, you will need to find tenants. However, you don't want to just find any tenant. Instead, you want to find good tenants. Good tenants create no problems, pay on time, and keep your profit high. Finding good tenants takes some energy, but it is worth the effort. If you follow these steps, the likelihood that you get a great tenant is significantly higher.

Step #1: The Application

Start with an application. This will allow you to get all of the information you need to properly screen the tenant.

You can find sample rental applications online, and then you can customize them to your needs, but here is information that you absolutely should include on the forms:

- Full legal name and date of birth
- Social Security number
- Driver's License number
- Current address and name of landlord
- Previous address and name of landlord
- Current employment with contact information
- Number of years at current employment. This shows stability, so the longer, the better.
- Yearly income level. The monthly income should be close to 3 times the rent.
- Personal references
- Names and ages of other residents who will live on the property
- An "In Case of Emergency" contact and number
- You will also want to include specialty questions about the tenant's history, such as:
- Have you ever been evicted? **This is a deal killer for me.**
- Have you declared bankruptcy in the past seven years?
- Have you ever been sued for rental damage?
- Have you ever been sued for nonpayment?

- Have you ever broken a lease?
- Have you been convicted of a felony?

The application is the first line of defense when renting your property. Once they have filled out the application, it is time to look for potential issues. For instance, looking at their employment record or yearly income can help you determine if they will be able to pay their rent. Rental history gaps could indicate an issue, as could any past problems with evictions or bankruptcies.

Step #2: Credit Check

There are two different checks you will need to run on any potential tenant. The credit check is the first of these. The purpose of checking credit is to determine whether the applicant has been paying bills on time and has a low enough debt to income ratio to handle the rent payments. If someone has a history of late payments, has filed for bankruptcy, or has a high debt ratio, they are likely to make a poor tenant choice.

You will have to get the consent of any applicant before running a credit check. This is required by law according to the Fair Credit Reporting Act. The easiest way to handle this is to have a credit report authorization form as part of the rental application.

In some states, a credit check will also tell you if someone has been convicted of a crime or if they have been evicted before. The laws on this vary from state to state.

To run a credit check, you will need the name, social security number, date of birth, and current address of the tenant. The easiest way to run credit checks on tenants is through a credit check service. The two most well-known are AAA Credit Reporting and Experian Tenant Verification. It's a good idea to get the credit score from all three reporting agencies: Experian, TransUnion, and Equifax.

If you choose not to accept a tenant due to something listed on their credit score, then you must, by law, send them a letter stating this. Some of the things you should include in the letter are:

- Which reporting agency listed something bad.
- The general categories of negative marks on the report, such as not enough credit, too high of a debt to income ratio, and too many delinquent payments.
- A statement indicating that the federal government allows every person to obtain one free credit report a year or within 60 days of being denied credit.
- If you fail to send this letter to any tenant you turn down for credit report reasons, then you could be in trouble with the government if the tenant pushes the issue.

Trautman's Tips: I do not qualify a tenant based on credit score. I use ability to pay, proof of employment, and rental history. Everyone has their own level of comfort. Find the set of criteria that works for you. I am looking to see if they are stable. In other words, do they move around a lot from job to job or place to place? If so, you may want to pass on them. Also, do they have gaps in employment? I want to make sure they have the stability and ability to pay.

Step #3: Background Check

In addition to the credit check, you will want to run a background check on potential tenants. A background check can look for things on both a state and national level, including:

- Listings in the sex offender database
- Criminal records
- Rental history
- Work history

There are several different agencies that will run background checks for a fee, which can range from $30 to $50 per tenant. If you decide to pay for a background check, let the potential tenant know that the charge is part of the application fee.

Step #4: Previous Landlords and References

Always check with previous landlords and references. By making this call, you can learn things about the applicants that will help you make a good decision.

When you contact the landlords, ask questions that tell you about the applicant's tenant history. Such questions include:

- Did the applicant have any non-payment issues?
- Did the applicant have any delinquency issues?
- Was the property in good condition when the applicant moved out?

- Were there any damage issues while the applicant lived there?
- Did they cause any problems as a tenant?
- The goal is to get a realistic view of the potential tenant.

Trautman's Tips: Ask the same basic questions of every landlord or reference. This will help you get the information you need and keep you from being accused of discrimination.

Step #5: The Interview

Finally, you will need to interview the potential tenant. Don't have the interview until after you've completed the first four steps. This will keep you from spending time interviewing applicants that don't meet your standards.

During the interview, you have to be careful not to ask questions that discriminatory in nature.

To help you, here are things you cannot discuss:

- Race
- Religion
- Gender
- Nationality
- Disability
- Marital status
- Sexual Orientation

- Arrest Record (You can ask about convictions, but not arrests.)

Trautman's Tips: Always meet your tenants. In addition to vetting them through the methods above, listen to your gut. Meet your tenants. Plus, the personal connection will increase the likelihood that they will take care of your property.

Also, when people inquire about the property, get back to them ASAP. I cannot tell you how many people I know who wait hours our even days to get back to people. I think that is foolish. You do all this work to find someone, and you don't pick up the phone or get back to them? Why? The bottom line is to do what you say you're going to do. People will respect you for it and think about it. If rent was due, and they didn't pay, would it be okay for them not to get back to you for days?

While investing in Detroit, I remodeled single family houses. I was able to get tenant referrals from the Section 8 inspectors. Tenants from Section 8 had gone through the screening process, so it cut down on expenses and provided a tenant that had a state-funded voucher for rent. The lesson here is constantly working to produce a quality product. Your product becomes your reputation.

FEDERAL LAWS TO UNDERSTAND

Fair Housing

The Federal Fair Housing Act was created in 1968 as a way to avoid discrimination against people seeking to rent or buy properties. The Act covers discrimination against people in seven different categories:

- Race
- Color of Skin
- Religion
- Sex
- Nationality
- Disability
- Familial Status

As a landlord, you will not b able to refuse rent due to these issues. You will also need to be sure not to make discriminatory statements or threaten to interfere with a person's fair housing rights.

Disability Law

One of the things covered under the Fair Housing Act is disability. A disability is defined as something that mentally or physically restricts a person's major life activities including seeing, hearing, talking, walking, communication, breathing, learning, performing tasks, caring for themselves, and controlling bodily functions.

Let's take a closer look at disabilities to be sure that you handle tenants with disabilities correctly.

- You cannot deny someone housing because of a disability.
- You cannot force them to live in different housing because

of a disability.

- You cannot charge extra fees or rent or require extra qualifications because of a disability.
- You can deny housing to a person with a disability only if they did not meet qualification standards, such as ability to pay rent or the background check.

Some disabilities require different accommodations. The HUD states that reasonable accommodations are required at the expense of the tenant, but only if correlates directly to their disability and doesn't fundamentally change your operations.

CONSIDERING A PROPERTY MANAGER

Some real estate investors choose to farm out the landlord duties to a property manager. Although this frees you up from finding tenants and keeping up with payments, it also costs money. I do not use a property manager unless the property is out of state. However, if you are certain that you want to pay someone else, here are a few things you should know.

WHAT IS A PROPERTY MANAGER?

This is a person or company who specializes in managing rental properties for other individuals. They will be the ones that find tenants, collect rent, handle maintenance and repair issues, respond to complaints, and deal with evictions. Essentially, they take over the day-to-day processes.

WHEN SHOULD YOU HIRE ONE?

There are definitely advantages to hiring a property manager, but the cost can add up and will eat into your cash flow. So, you don't necessarily want to hire such a company except under specific circumstances. Some of the times you should consider hiring one would include:

- You have more properties than you can manage on your own.
- If you live too far away from the rental property to make visits feasible.
- If your day job keeps you too busy to manage the property. For most people, this is not an issue. You may need to hire a handyman, but you can still manage your own property.

FINDING A GOOD PROPERTY MANAGER

If you decide you would like to hire a property manager, then the next thing you need to do is find one that will do a good job.

There are a couple of ways to find the right manager. The first is to get recommendations. If you have been networking, then you may have contacts who can make recommendations to you. If you don't have a network in place yet, then check with the local apartment association.

Another option for finding the right company is to use the Internet and search. You can look for directories online, but make sure they are professional. Additionally, you can check with:

The Institute of Real Estate Management (IREM), where you can click "Find a Professional" and start the search in your area.

www.irem.org.

The National Association of Residential Property Managers (NARPM) where you can search directly for property managers.

www.narpm.org.

If you find a couple of property management companies that interest you, then your next step would be to interview them, find out what they will and won't do, and then look into their prices. Don't hire someone until you have met with them to ensure they are what you are looking for. Choosing the right property manager is a must if you decide to go this route.

We do all our own property management when possible. The only time we don't is if we are out of state. This being said, it is another part of the being an investor. This should be the easiest part of the process once you get the right tenant. Think about this. You will give up around 8-10% of the gross income for someone else to receive the check and process the payment.

Then there is the issue of a premium. Did you know most property managers have a set price that usually has a premium on it, so the work gets done quicker. For example, a typical hot water tank should cost you around $550 to replace with parts and labor. In many instances, a property manager will pay someone $800. Why would they do this? It's not their money. This is another great reason you should do it yourself. You may want to see a list of standard repairs they have set so you if you do go down the path of property manager, you will know ahead of time what they are or their general labor rate.

CHAPTER 15 :
REAL ESTATE INVESTING WITH LIENS AND DEEDS

THE BASICS

As you know, property owners must pay property taxes. So, anyone owning real estate must pay their taxes each year. Those that don't pay their taxes are tax delinquent, and tax delinquency can eventually lead to foreclosure.

Every state has their own rules about tax delinquency and how long a property can be delinquent before it is seized. For most states, the time varies between two and five years delinquent, at which point, the municipality will seize the house. This is true even if the house is owned free of mortgages.

As with other types of foreclosures, each state has different rule and regulations. In addition to different rules about the length of delinquency, they will also have different rules about foreclosure and how they plan to regain their lost tax revenue. No two states do this the same way, so it will be important for you to understand the process your state follows.

In general, however, the point is for the municipality to make up for their lost tax revenue. They also want to get the property off their books. That means that the market value of the house has little to do with the sale. If the county needs to regain $15,000, that is the only number they are concerned with. The value of the house is not considered. This means that you can have a good opportunity to purchase a house at far below value.

Some states sell tax liens, some sell tax deeds, and others sell both.

Let's see how they work.

TAX LIENS

In states that use Tax Liens, the county will sell a tax lien certificate to an investor when the property becomes delinquent. The investor does not buy the property, but instead is buying a lien on the property. The delinquent owner still owns the property, but the tax lien certificate holder gets the amount of the lien plus interest. If the property owner does not pay off the lien during the redemption period, the owner of the lien can foreclose on the property and take ownership.

You will need to understand your state's rules regarding:

- The time period for redemption
- The amount of interest that can be charged
- Foreclosure proceedings

Tax Liens can give you a high return on your investment, and can easily provide a strong return that is higher than conventional investments. Appendix 5 has a list of interest earned and redemption periods as of 2016.

TAX DEEDS

If you live in a tax deed state, you are actually buying the property. Additionally, most tax deed states have no redemption period. To get a tax deed, you will be purchasing the property through a foreclosure auction.

Once again, you will need to understand the rules of the state. However, the foreclosure will be handled by the county, so you'll just have to understand how long a property has to be delinquent before the tax deed sale begins.

REDEEMABLE DEEDS

If you buy a redeemable deed, you are purchasing the deed to a property. However, unlike the tax deed, a redeemable deed has a redemption period. This means that after the redeemable deed is sold to the investor, the prior owner can redeem the deed and buy the property back from the investor. The prior owner will need to pay the full amount that the property sold at the tax sale plus fees and penalties. If they do not do so within the redemption period, then the property will be officially owned by the investor.

If you live in a state with redeemable deeds, you will want to be sure to do no work on the house until the redemption period is complete. If the prior owner redeems the property, they do not have to reimburse you for any upgrades.

Trautman's Tips: Some states sell both liens and deeds, depending upon the county. Make sure that if you live in a state that sells both that you do your homework before going to a tax sale. You will want to be sure that you know what

you are bidding on.

HOW MONEY IS MADE

For tax liens, the investor can make money one of two ways. The most common way is through interest. If the homeowner repays their back taxes within the redemption period, the investor will make money from accrued interest.

If the homeowner does not pay the taxes before the redemption period, the investor can make money by foreclosing on the property. Of course, it is important that the investor understands the value of the property and realizes the risks of what can happen to the property during the redemption period.

When it comes to tax deeds, the investor makes money by becoming the owner of the property through a foreclosure auction. Once the investor owns the property, they can rehab and flip or keep the property for rental purposes.

STEP 1:
FIGURE OUT WHERE YOU WANT TO INVEST

Every county in every state is different. So, you should begin by determining whether you are interested in tax liens or deeds. Then begin investigating counties. You can go to www.naco.org to find out about counties across the US. Many counties provide online tax lien information for free.

Trautman's Tips: Tax liens are a great place to start if you have limited capital. However, if you want to buy invest-

ment properties, the best place to start would be with tax deeds.

STEP 2:
CONTACT THE TAX COLLECTOR OR TREASURER

Next, you will want to contact the tax collector or treasurer for the county or counties of interest.

Here is the information you will need:

- Date, time, and place of next tax sale.

- List of tax liens or properties to be auctioned. Some counties have this list online and some in their office. You may be able to have the list mailed to you for a fee. You can also look at local newspapers for the sale notice.

- Get the rules of the sale. These are the terms and conditions, including whether you need to pre-register and how you will need to pay.

- The interest rate. For states with varied interest rates, it is good to know how the properties are defined and what interest rate will be available for each.

- List of unsold tax lien certificates or properties from the last sale. Most counties have unsold liens or properties

STEP 3:
NARROW PROPERTY LIST

The list you get will be long, and you obviously can't and don't want to purchase every property listed. So, you are going to have to narrow your list. You'll do this by looking at the Tax ID #, Folio #, Parcel #, or Real Estate #.

This number will give you:

The legal description of the property

The property address

The owner's name

The assessed value

Size of parcel

What structures are on the parcel

You will be looking for properties that meet your location criteria. Once you find parcels that meet your location, you can search the county records.

STEP 4:
FIND PROPERTIES THAT ARE WORTH MORE THAN BACK TAXES OWED

You can now search for these particular properties in the county land records. Many counties now have this online. The point here is to find properties that are worth significantly more than the taxes that are owed.

Trautman's Tips: Be sure to look for other liens against the property. You don't want to get a property only to find that you will owe money to other lien holders.

THE BIDDING PROCESS FOR LIENS

The bidding process for deeds will be similar to the auction bidding process discussed in Chapter 8. However, when it comes to liens, every state has its own process. Let's look at a few to get an idea of how they work.

Lower Interest Rate: The bidding starts at the interest rate set by the state. Bidders bid for a lower interest rate. For instance, if a state has an interest rate of 16%, then the initial bid would be 16%. Investors would then bid lower rates until the bid is at the lowest rate that someone is willing to accept. The winning bid will have a tax lien certificate charging that interest rate. The delinquent homeowner will have to pay the 16% in order to redeem the property. The county keeps the difference between what you collect and the 16%.

Percentage of Property: In this kind of auction, the investor is bidding on a percentage of interest in the property. The opening bid is the amount of back taxes owed. Bidders then bid for a smaller interest in the property. The winner is the person willing to take the smallest interest and becomes the certificate holder.

Premium Bid: In this type of auction, the certificate can be bid up. The bidding starts at the amount of the taxes owed. There is a rate of interest paid on the face amount of the certificate, but the investor may decide to pay more than the face amount for the certificate. The excess bid will reduce the investor's yield.

Keep in mind that bidders will need to pay the full amount quickly. Some states require cash at the auction, others require a deposit and the full amount due within 24 to 72 hours.

The best thing to do is attend an auction to see how it works firsthand. If possible, go with another investor you've met while networking so that you can ask questions.

CHAPTER 16: A GUIDE TO REAL ESTATE INVESTMENT AND TAXES

Few people like to discuss taxes. In fact, it is right up there with root canals. However, as a real estate investor, you will find that keeping good records for tax purposes is very important. In addition to getting some great tax deductions, you will also be required to pay taxes on income gained. This chapter will go over a bit of both.

However, never rely on any book written about taxes unless it is current and written by the IRS. Tax laws can change yearly, which means most tax books or chapters are out of date within months of publication. That is why it is important to have a tax advisor or accountant that can help you. I recommend that you hire a tax accountant that is well-versed in real estate transactions. You can often find great accountants by networking with other investors.

DEDUCTIONS FOR REAL ESTATE INVESTMENTS

As an investor, you will be able to make deductions on your tax returns that can save you money. There are many different deductions that are currently available. Let's look at them and what you will need to do to take the deduction. Remember, always talk to your tax accountant to find the deductions suitable to your particular situation.

DEPRECIATION

Depreciation is a deduction you can take on any type of property because it loses value over time. The land doesn't depreciate, but the house will. The deduction itself will be spread over a span of 25 years, so you will have to understand how to count this when you file your taxes.

Properties that can be depreciated must meet certain parameters:

- You must show proof that you own the property.
- The property must be used for income production. In other words, investment property can be depreciated while your residence cannot.
- The property must have a determinable life span of usefulness.
- The property must have a life expectancy of more than one year.

The actual depreciation process is very detailed, which is why you will want to hire a tax expert. To learn more, you can look at IRS Publication 946 (https://www.irs.gov/publications/p946/ch04.html).

PROPERTY MANAGEMENT

If you hire a property management company to manage your rental properties, then you can deduct their fees and expenses.

These property management companies fall under a deduction category for lease related professional services. To take this deduction, you will need receipts showing how much you paid the company for their services.

PASSIVE ACTIVITY

A passive investor is someone who is not involved in the day-to-day activities of managing a real estate property. These rules can be confusing, but you can find out everything you need to know about them through IRS Publication 925 (https://www.irs.gov/publications/p925/ar02.html).

LIST OF DEDUCTIONS

There are many things you can deduct on properties that you own. Here is a list of deductions that may be available to you. Once again, be sure to talk with your tax advisor.

- Wages and Salaries
- Materials and Supplies
- Business Educational Expenses
- Business Legal Fees
- Accounting Fees
- Business Interest
- Property Taxes

- Business Utilities
- Advertising Expenses
- Business Rent
- Business Entertainment Expenses
- Bank Service Charges
- Travel Expenses
- Business Charitable Contributions
- Business Gifts
- Real Estate Commissions
- Consultant Fees
- Closing Costs
- Trade Shows
- Business Internet Access
- Seminars
- Mileage
- Home Office

- Mortgage Interest
- Tax Advice and Preparation Fees
- Business Legal Fees
- Mileage
- Home Office
- Advertising Fees
- Employees
- Repairs on Rentals
- Casualty or Theft Loss
- Insurance (Rentals)
- Property Loss (Rentals) up to $25,000
- Paying Taxes

Whether you have rental income or you are flipping houses, you are going to have to pay taxes on the money you make. There are two main types of taxes you will have to pay: income tax and capital gains tax.

RENTAL INCOME TAXES

The income you receive from the rental will count just like any other income. However, unlike some income, you will not need to pay FICA on this income. You will also get to deduct expenses from the income before reporting it.

Although you can pay yearly, you may want to consider paying your taxes quarterly. This will avoid a big expense all at one time.

CAPITAL GAINS TAXES

If you buy properties, flip them, and then sell them, you will have to deal with capital gains taxes. These taxes are calculated differently depending on how long you hold onto the property.

If you buy, flip, and sell the house in less than a year, then you will have to pay capital gains taxes based on the same brackets as income taxes.

If you have the property in your name for a year or more, then you will pay long-term capital gains taxes, which are lower numbers that can range from zero to 15 percent, depending on your tax bracket.

If you are trying to calculate your capital gains taxes so that you can be prepared for these expenses, then you will need to know two numbers: the selling price of the property and your tax basis. The tax basis is calculated by adding the amount of money you have invested in the property including renovations, purchase price, labor costs, and improvements.

To determine if you have a capital gain, subtract your tax basis from the selling price of the property. If you have a positive number, then you have a capital gain. If you come out with a negative number, then you have a capital loss.

Trautman's Tips: If you have capital losses on some properties and capital gains on other properties, you can subtract the losses from the gains so that you have to pay fewer taxes. You can even choose to carry forward losses so that you can use them to offset capital gains in the future.

THE SECTION 1031 EXCHANGE

There is a specialty transaction that can help you defer capital gains taxes. It's called the Section 1031 Exchange. According to this rule, you can sell an investment property for a profit and then roll that money over into another investment property. If you do this within 60 days of the sale, then you will not have to pay the capital gains taxes. There are a few of stipulations:

You have to get the new purchase completed within 60 days of the sale.

The properties have to be "of like kind".

PROPERTY TAXES

Obviously, you will have to pay property taxes on any properties you own, and these taxes are paid on a county and city level. Property taxes are assessed by your local government, and the assessor will come up with a number based on "highest and best" use.

If the property taxes are not considered a special assessment, then you can deduct them from your rental income.

SPECIAL TAX CONSIDERATIONS FOR REAL ESTATE INVESTORS

If you become a real estate investor, you will have to pay state and federal income taxes as discussed as well as capital gains, but that isn't all. Here are some things to keep in mind for tax purposes on houses you have flipped.

SELF-EMPLOYMENT TAXES

You may have to pay self-employment taxes, depending on how you set up your company structure. Self-employment taxes cover several things, including Medicare and Social Security. Depending on where you live, you could also owe state income and self-employment taxes.

EXPENSES

When you purchase real estate, it is important to keep track of all that you do. Every repair and renovation can be a tax deduction as long as you have proof. Here is a list of the most common items you will need at tax time:

- Bank Statements
- Purchase Receipts
- Contractor Bills and Receipts

- Transaction Settlement Documents
- Miscellaneous Expenses
- All Receipts for Deductions

Keep in mind that this list is not inclusive. Talk to your tax advisor to determine everything you can write off.

As a real estate investor, it is a good idea to understand the basic tax laws. It is a better idea to hire someone who does this full time and knows all the ins and outs. Their expert advice will help you keep your tax liability low.

CHAPTER 17: FOURTEEN TIPS FOR SUCCESS IN REAL ESTATE INVESTING

If I were to ask you if you wanted to be successful in real estate investing, what would you say? That may sound like a crazy question! Everyone wants to be successful, right?

Although people start out excited about investing, after reading through books and articles, listening to lectures, taking in blog posts, and listening to advice from those that have done it, some people begin to get scared. They wonder if it is too hard or if they will ever remember all they need to remember.

That is why I wrote this chapter. It is true that when you are new to real estate investing, there are many things to consider. It is easy to become overwhelmed. However, stop the negative self-talk right now! Instead, focus on these fourteen simple tips that have been gleaned from years of experience.

If you follow these tips, you can feel confident that you can successfully buy your first house and begin your real estate investing adventure.

TIP 1: KEEP THINGS SIMPLE

The first tip gets to the heart of the matter. Yes, there are a lot of things to learn about real estate investing. Yes, you will continue to learn for years. I'm still learning after investments! Yes, there are times when things may seem difficult to understand. (That's when you call a coach like me!) However, real estate investing, in general, is not complicated.

The basics are here in this book! If you follow these steps, you can successfully purchase a piece of property. Don't feel like you have to add more steps or bring in advanced ideas. Just take a deep breath and get started.

Here are a few "simple" facts to keep in mind as you take the plunge:

There are many different ways to get the cash needed to invest in real estate. Do not sweat over cash in hand.

Networking will help you get the connections you need.

With time and effort, you can make real estate investing a full-time job if you choose.

So, keep things basic. Don't over-complicate your first purchase.

TIP 2:
LEARN TO MAKE GOOD OFFERS

Knowing how to make an offer that is good for you AND good for the seller will help you be successful in real estate investing. Always remember that sellers are people just like you. They have property and hope to make money on their sale. If you keep this in mind, then you can find a win-win solution where everyone walks away with a smile.

Of course, the point of this book is to make sure you get the best deal you can. As you create more deals, you will learn how to find out their motivation for selling and make offers that respond accordingly. For instance, if you find they hate being a landlord, they may sell for less, even if the Realtor has a higher price in mind.

In the beginning, you will always want an inspection. However, as time goes on, you may see a deal and realize you can get the price down by forgoing the inspection and offering cash at closing. Or you can give yourself a 48-hour inspection window instead of the typical several weeks. Getting the deal done quickly can motivate people to sell for less. I wouldn't recommend doing this to a new student, but once you have done enough deals, you will become more comfortable. My point is that a good deal is good for everyone. However, what makes it good for the seller could be about more than final asking price.

Be careful about low-balling an offer. Although you will find stories that talk about the low-ball offers and the great deals that have come because of them, the truth is that offering a price that is far too low will typically backfire. The seller usually knows the right price for their house. They are aware of the market. They know what to expect from buyers. When you offer something that is too low, they will feel insulted. Worse yet, they may choose to avoid working with you in the future.

Typically, if I'm interested in a property, and it's a new listing, I try to figure out how much I can get them to go down. More often than not, if it's a new listing that I'm interested in, it is priced well below where it should be. At that point, I'm just trying to make sure I get the deal.

To offer a realistic price, be sure to do your homework. Look at comps, but make sure you are comparing apples to apples. Learn what increases the value and decreases the value of a house. Recognize that the comp for a house with all new appliances and hardwood floors will be different from a house with no updates. If you learn to understand the comps, you will be able to make good offers. A good offer is a good first step to a good real estate investment. As a reminder, when submitting an offer, realize that they will almost always counter. You need to leave room in your offer for counters as well as unforeseen contingencies.

Finally, there will be times when you realize that you didn't go low enough or that there was a better deal to be had. When this happens, you can get more aggressive on the inspection. Use what is found as a way to pick up more money or bring the price down to something that truly reflects the best deal for you.

TIP 3:
ACCURATELY ESTIMATE REHAB EXPENSES

If you buy a property that needs some rehab work, learning to accurately estimate your expenses will help you be a successful real estate investor. To do this, you'll want to know what needs fixing, determine the price of fixing it, and have a budget that you keep. However, if you underestimate the price of rehab or forget to put something on the list, your profits will be eaten up! My rule of thumb is to always plan for overages and unforeseen issues. I use a 10% variance factor.

Sometimes, when a real estate investor realizes they've made an error, they decide to try doing the work themselves to save money. The problem is that, unless you have extensive rehab experience, you can easily get in over your head. I suggest that you always use a contractor for projects that are beyond your skill level and experience. You should spend your time finding new deals because this is where you strengths lie. Over time, you will learn some trade skills. If you want to do some of the work, that would be fine, but if not, let the people you hire do their jobs while you manage the entire job. As you learn about rehabbing, bring along an expert to see the prospective houses. Ask for their advice. If you are lucky, you've got a friend that can do this for you. If not, then it would be worth hiring someone for their assessment. You can find contractors as you network. Eventually, you will be able to look at a house and know the costs involved for a number of projects, but if you are uncomfortable with something, get professional advice!

Also, when getting bids for jobs, get several detailed bids for the work. The bids should explain exactly what is going to be done and for how much. This allows you to compare apples to apples when looking over the bids. Sometimes, a lower bid isn't the lowest if they are leaving something out, such as materials.

TIP 4:
HAVE YOUR FINANCING IN PLACE

Once you've found a house, financial matters come into play. It is at this point that many deals falter because the buyer was not prepared. Don't let this happen to you. Instead, have your financing prepared in advance. Check out Chapters 3 through 5 for ideas about financing, then determine the right path for your first purchase. Keep in mind that every purchase is different, so different forms of financing can be used.

When considering your financing, always have a bit of a buffer. Even if you've followed Tip #3, you may run into something that costs more than you expected or find a problem you didn't know existed. If your financing is too tight, then you won't have the funds to make those repairs.

One of your biggest assets when investing in real estate is networking. The more connections you make, the more access you will have to what you need. This includes financing, as well as finding the right contractors at the right price. Networks will be your greatest asset.

As you become better connected, having your financing in place will come to mean something entirely different. It may just mean having a list of investor's names that want to work with you when you have a good deal. At this point in my investing, I can bid on a good deal without having specifics in place because I have strong relationships with investors that can get me fast funding. But remember, these relationships take time to build, so in the beginning, have the actual financing in place.

TIP 5:
ALWAYS LISTEN TO YOUR HEAD

Have you ever seen a house and fallen in love with it instantly? It is just the right amount of something to make your heart pound, and you feel like this is "the only house" for you. That, my friends, is your heart talking. It is okay to let your heart have a bit of say in the matter of real estate investing, but never let your heart have the last say. Instead, listen to your head.

My first mentor taught me a lot. One of the first things he told me was keep the emotion out of real estate investing. Instead, think about it like a stock. You want to buy low and sell high. Never get emotional. I use those words to this day, and it helps keep everything in perspective.

Remember, you are buying property with the intent of making money. So, although the house may appeal to your heart, the numbers may not appeal to your head. Always look at the number and do the calculations. If they don't add up, then your heart will need to fall in love with another house. This will be fine because there are other houses out there. Rarely is "the only house" really the only house! In fact, every time I think that I've lost the "only" house, an even better deal comes up.

TIP 6:
REMEMBER THAT REAL ESTATE INVESTING IS A BUSINESS

This tip is similar in nature to Tip #5. Once again, you need to put your heart away and listen to your head. You are likely to hear stories that sadden you. Maybe you find a house for sale that needs to sell quickly because the owner is going to have to foreclose. Maybe you have a renter that can't pay because their car broke down. These are sad stories, but it doesn't change the reality that real estate investing is a business.

Even if someone needs to sell quickly, don't let your heart pay too much for a house that doesn't make sense. Even if someone has a sad story about why they can't pay the rent, don't let your heart take over and take a loss. Getting emotionally involved means that you will make bad financial decisions.

Here's what you have to remember at all times: real estate investing is a business and needs to be run like a business. If you do this, you will be able to make smart decisions.

TIP 7:
KNOW HOW TO LEVERAGE YOUR PROPERTY APPROPRIATELY

It is important to use leveraging in your real estate investing, but you will need to know the difference between positive leveraging and overleveraging. The way to do this is by calculating the debt service coverage ratio (DSCR) for an investment to determine if it will earn money for you.

The debt service coverage ratio will allow you to understand your cash flow so you can be sure you are going to gain money in the deal. Calculating the DSCR is easy if you follow these steps:

Calculate the cash flow. The formula is:

Total Rental Income – 6% for vacancy and rent loss – mortgage payment = cash flow

Calculate the net operating income (NOI). The formula for

NOI is:

Cash Flow – other expenses from owning a property such as taxes and insurance = NOI

Calculate your annual mortgage payments using a mortgage calculator.

Divide the NOI by the annual mortgage payments to get your DSCR. If your DSCR = 1, then you break even. If your DSCR is greater than 1, then you make money. A DSCR less than 1 loses money. Most real estate investors hope for a DSCR of 1.5 or greater.

The DSCR is also useful when speaking to lenders. If you have several properties with positive DSCRs, then your lender will feel better about loaning your money.

TIP #8:
BE READY TO STAY IN FOR THE LONG HAUL

Real estate investors can make great money. But, this is not a get rich quick kind of scheme. Real estate appreciates over time. If you are ready to become an investor and stick with it, then you will see rewards. In fact, real estate investing beats the S&P 500 and did so even during the recent housing crisis. But, to make the money, you have to put in the time and do the work. Real estate is a great investment. Becoming a real estate investor is a great job or second job. But, it is a job. So, do the work necessary over time, and you will see the results you want.

TIP #9:
KEEP ACCURATE TAX RECORDS AND HIRE A TAX PROFESSIONAL

Taxes. That word makes most people shudder. I've gone over some basics about taxes, but don't rely on Chapter 15 to tell you everything you need to know. The truth is that tax laws change…often. If you don't know the laws, then you could lose money. That is why I suggest that you keep accurate records of everything you spend, the gas you use, the mileage in your car, and the cost of having a home office.

Then hire a great tax professional to help you get all the right deductions, like depreciation and passive activity loss. They will also help you pay the right taxes for things such as capital gains taxes and 1031 exchanges. A good way to find a tax professional is to ask your network.

TIP #10:
BECOME AN EXPERT AT SCREENING TENANTS

Finding the right tenants for your real estate properties is key to your success. Chapter 13 deals extensively with this topic and explains that screening tenants gives you total control over what type of tenant you will get. Screening helps you avoid problems with late payments and non-payments, how your property is used, and damage to your property.

Although some people feel that tenant screening is a lot of work, it is definitely the kind of work you want to do. Creating good tenant screening procedures will help you keep your real estate investments on track.

Some screening tips include:

Look at stability. How often does the applicant change jobs? How often do they move?

Look at income.

Look at debt to income ratio. Anything over 50% is a red flag.

Be wary of first-time renters and those with past evictions. Dig deep into these tenants to determine if they are going to have issues. Consider asking for a co-signer.

TIP #11: KNOW THE RULES AND REGULATIONS

There are all sorts of rules and regulations that surround real estate investing whether you plan on flipping the property or turning it into a source of residual income. For example, if you buy a house in an area that has an HOA, or if it is a house in a historic neighborhood, there may be regulations on changes you can make to the exterior, including paint color, landscaping and more. There are also permits needed to make certain changes to your property. Failing to follow the rules and get the right permits can create problems.

How can you learn about the rules and regulations?

Talk with your network.

Get a copy of any HOA rules and/or speak to the HOA President.

Get a copy of the historic neighborhood rules and/or speak to the society's president.

Contact your city planning department for rules on remodeling, additions, and changes to property. Ask for clarification on anything that doesn't make sense to you.

Talk with a local contractor that works within these regulations.

Understanding the rules before you purchase is a good idea. This will keep you from underestimating the costs of repair since following specific guidelines could make the project more expensive.

TIP #12:
ALWAYS DO YOUR RESEARCH

Before making a decision on buying a piece of property, always do the research. Remember, real estate investing is about facts not about feelings!

Make sure you know about the city your property is in. You can do this by driving around to see about access routes to the highway, traffic patterns, a good town center, accessible public transportation, and shopping. Then go by foot and stop in to local stores. Ask managers about their business. Finally, make a few calls to people in the area.

Look at the specific area your property is in. Do other properties nearby look to be well maintained? Does the neighborhood feel appealing?

Check out the town hall to see about any developments going on in the community.

Check comps for properties in the area. This will help you know its value.

Determine the market rents in the area if you plan to rent out the property.

Find out about property taxes, utilities, and insurance on the property.

Look at other local statistics such as the schools, median income, unemployment rate, population count, real estate taxes, crime statistics, and more. Most local government websites have this information readily available.

Know the zoning regulations for your property, especially if you hope to expand it or convert it.

Doing the right research will help you make smart decisions that lead to great real estate investments.

TIP #13:
LOOK FOR GREAT LOANS AND LENDING TERMS

Lenders have changed in the past decade, especially after the real estate bubble burst and subprime loans came to light. Nonetheless, not all loans and terms are the right ones for you. Make sure that you look for a loan that meets your needs.

When looking for a loan, you should try to steer clear of the following in most cases:

Loans that cannot be paid off early. You don't know when you might want or need to sell. So, staying clear of loans with big fees for early payoff should be avoided.

Loans with variable interest rates. If you plan to keep the property for longer than the initial variable rate period, then you should consider a fixed interest rate. You cannot predict what the future holds for interest rates, and you don't want to end up with a loan with high interest rates you can't cover with rental costs.

However, with so many different loan arrangements, the best thing is to think through all the terms and play devil's advocate. What is the worst thing that can happen? Can you afford it if it happens?

Finding a good loan can often be achieved through networking. You'll make the connections you need to find proper financing and good deals on property.

TIP #14:

KNOW HOW MUCH TIME YOU WANT TO SPEND

Once you've been investing in real estate for a long time, you will have a lot of processes in place that make buying and selling rather easy. However, even these pros spend quite a bit of time at their real estate investing job. It will never be a "hands off" occupation.

Being a real estate investor takes a lot of work and commitment. If you underestimate the time commitments, then you could become overwhelmed or disillusioned. So, be realistic. How much time do you have to spend? Then think about the various ways to invest in real estate and match those to your time commitment. If you do, you'll be satisfied with your investment choices.

BONUS TIPS TO REMEMBER

If you follow these 14 tips, you will be well on your way to being a successful real estate investor. But I always love to give just a bit more than promised. So, here are a handful more tips to consider as you begin your investing journey.

Don't over focus on one negative experience. The truth is, you will make mistakes. I've made mistakes. I'll continue to make mistakes. It happens. So, when you make one of the inevitable mistakes, take note, LEARN from it, and move on.

I manage my own properties, and I suggest you manage yours, too. Why give away 8% of your gross income to someone else? Not only are you giving away your money, but they are not likely to negotiate the best deal for you. I think it is important that you meet your tenant. This makes everything more personable, making the tenant respect the property more and pay on time as compared to working with a management company. I have used management companies before, but only when I invest in areas out of state. You've done all the hard work. Why pay someone else to receive a check monthly?

Take advice from professionals. Find a mentor/mentors or find someone who has what you want and then do what they have done to get what they have.

Everyone loves to give advice. Your friends will have it. Your family will have it. However, the advice that should count the most is that from professionals who understand real estate. You're going to get tired of hearing it, but using your networks will help you find the professionals you can trust.

Know your parameters before going into a sale. You should always know what you can afford before looking at a piece of property or heading to an auction. Have a firm number and stick with it. This will keep you from grabbing at a property that is out of reach. If you know your parameters and stick to them, you will avoid many real estate investing mistakes.

Even though you are new to the real estate investment world, following these tips will give you a leg up on other beginners because you'll know what to focus on.

CONCLUSION

That's the basics. In this book, you've been given all the tools and information you need to get started investing in real estate today. My question is this: Are you going to do it?

Are you scared? Don't be. Start at your own pace. After all, that's what we talked about in the beginning of this book, isn't it? What's the worst thing that can happen? It's not a get rich quick scheme, but to build wealth and a residual income, right? So, start small and lets focus on getting one property.

I've talked with many life coaches that have all told me the same thing. People get cold feet when starting something new. They read all the right material. They ask all the right questions. In the case of real estate investing, they do all the due diligence on a house. But…they can't cross the starting line.

How long have you been considering investing in real estate? How many books have you read? How many TV shows have you watched? If now isn't the time to get started, then when will be the right time? Think about this: What if you had gotten started investing when you first thought about it? Where would you be today? What would your life look like?

At Real Estate Knowledge Institute (**http://www.realestateki.com/**), we can walk you through the process. We don't want you stumbling around the Internet, reading more books and blog posts, and watching more TV shows. We want you to get started.

That is why we will provide an experienced Real Estate Investor to help you know the next step. We can provide you with a personal, customized, results-focused training program that can teach you everything from start to finish. Why waste months or even years when you don't have to? Every day, those of us at Real Estate Knowledge Institute work one-on-one with investors just like you who have a very specific goal and just need the guidance to get there.

Take what you've learned in this book to get started. Then contact us for the next steps. Let us help you go out there and pursue your real estate investing dreams. We are waiting for you. Let's make dreams happen.

APPENDIX #1: FINDING A LOCAL REAL ESTATE CLUB

REIClub.com

http://www.reiclub.com/real-estate-clubs.php

National Real Estate Investors Association

http://www.nationalreia.com

Bigger Pockets

https://www.biggerpockets.com/rei/real-estate-clubs/

CRE Online

http://www.creonline.com/Real-Estate-Investment-Clubs/index.html

MeetUp.com can help you find unaffiliated groups in your area

https://www.meetup.com/

APPENDIX #2: LANDLORD TENANT STATUTES BY STATE

To make it easier for you to find the proper laws you need to follow, here is a list provided by Nolo.com of the specific statutes by state.

Alabama

Ala. Code §§ 35-9-1 to 35-9-100; 35-9A-101 to 35-9A-603

Alaska

Alaska Stat. §§ 34.03.010 to 34.03.380

Arizona

Ariz. Rev. Stat. Ann. §§ 12-1171 to 12-1183; §§ 33-1301 to 33-1381; 33-301 to 33-381

Arkansas

Ark. Code Ann. §§ 18-16-101 to 18-16-306; 18-16-501 to 18-16-508; 18-17-101 to 18-17-913

California

Cal. Civ. Code §§ 1925 to 1954.1, 1961 to 1995.340

Colorado

Colo. Rev. Stat. §§ 38-12-101 to 38-12-104, 38-12-301 to 38-

12-302, 38-12-501 to 38-12-511, 13-40-101 to 13-40-123

Connecticut

Conn. Gen. Stat. Ann. §§ 47a-1 to 47a-74

Delaware

Del. Code Ann. tit. 25, §§ 5101 to 5907

District of Columbia

D.C. Code Ann. §§ 42-3201 to 42-3610; D.C. Mun. Regs., tit. 14, §§ 300 to 311

Florida

Fla. Stat. Ann. §§ 83.40 to 83.682

Georgia

Ga. Code Ann. §§ 44-7-1 to 44-7-81

Hawaii

Haw. Rev. Stat. §§ 521-1 to 521-78

Idaho

Idaho Code §§ 6-301 to 6-324, §§ 55-208 to 55-308

Illinois

735 Ill. Com. Stat. §§ 5/9-201 to 321 & 765 Ill. Comp. Stat. §§ 705/0.01 to 742/30

Indiana

Ind. Code Ann. §§ 32-31-1-1 to 32-31-9-15

Iowa

Iowa Code Ann. §§ 562A.1 to 562A.37

Kansas

Kan. Stat. Ann. §§ 58-2501 to 58-2573

Kentucky

Ky. Rev. Stat. Ann. §§ 383.010 to 383.715

Louisiana

La. Rev. Stat. Ann. §§ 9:3251 to 9:3261; La. Civ. Code Ann. art. 2668 to 2729

Maine

Me. Rev. Stat. Ann. tit. 14, §§ 6001 to 6046

Maryland

Md. Code Ann. [Real Prop.] §§ 8-101 to 8-604

Massachusetts

Mass. Gen. Laws Ann. ch. 186, §§ 1 to 29; ch. 186a, §§ 1 to 6

Michigan

Mich. Comp. Laws §§ 554.131 to .201 & 554.601 to 554.641

Minnesota

Minn. Stat. Ann. §§ 504B.001 to 504B.471

Mississippi

Miss. Code Ann. §§ 89-7-1 to 89-8-29

Missouri

Mo. Rev. Stat. §§ 441.005 to 441.880, §§ 535.010 to 535.300

Montana

Mont. Code Ann. §§ 70-24-101 to 70-27-117

Nebraska

Neb. Rev. Stat. §§ 76-1401 to 76-1449

Nevada

Nev. Rev. Stat. Ann. §§ 118A.010 to 118A.530; 40.215 to 40.225

New Hampshire

N.H. Rev. Stat. Ann. §§ 540:1 to 540:29, 540-A:1 to 540-A:8; 540-B:1 to 540-B:10

New Jersey

N.J. Stat. Ann. §§ 46:8-1 to 46:8-50; 2A:42-1 to 42-96

New Mexico

N.M. Stat. Ann. §§ 47-8-1 to 47-8-51

New York

N.Y. Real Prop. Law §§ 220 to 238; Real Prop. Acts §§ 701 to 853; Mult. Dwell. Law (all); Mult. Res. Law (all); Gen. Oblig. Law §§ 7-103 to 7-109

North Carolina

N.C. Gen. Stat. §§ 42-1 to 42-14.2, 42-25.6 to 42-76

North Dakota

N.D. Cent. Code §§ 47-16-01 to 47-16-41

Ohio

Ohio Rev. Code Ann. §§ 5321.01 to 5321.19

Oklahoma

Okla. Stat. Ann. tit. 41, §§ 101 to 136Oregon

Or. Rev. Stat. §§ 90.100 to 91.225

Pennsylvania

68 Pa. Cons. Stat. Ann. §§ 250.101 to 399.18

Rhode Island

R.I. Gen. Laws §§ 34-18-1 to 34-18-57

South Carolina

S.C. Code Ann. §§ 27-40-10 to 27-40-940

South Dakota

S.D. Codified Laws Ann. §§ 43-32-1 to 43-32-30

Tennessee

Tenn. Code Ann. §§ 66-28-101 to 66-28-521

Texas

Tex. Prop. Code Ann. §§ 91.001 to 92.355

Utah

Utah Code Ann. §§ 57-17-1 to 57-17-5, 57-22-1 to 57-22-7

Vermont

Vt. Stat. Ann. tit. 9, §§ 4451 to 4469a

Virginia

Va. Code Ann. §§ 55-217 to 55-248.40

Washington

Wash. Rev. Code Ann. §§ 59.04.010 to 59.18.912

West Virginia

W.Va. Code §§ 37-6-1 to 37-6A-6

Wisconsin

Wis. Stat. Ann. §§ 704.01 to 704.95; Wis. Admin. Code 134.01 to 134.10

Wyoming

Wyo. Stat. §§ 1-21-1201 to 1-21-1211, §§ 34-2-128 to 34-2-129

APPENDIX #3: REAL ESTATE TERMINOLOGY

A

Acceleration Clause – A clause that will appear in your mortgage that allows the lender to demand payment of an outstanding loan. This is often due to a borrower defaulting on the loan or transferring the title to someone else without notifying or consulting the lender.

Adjustable Rate Mortgage – Also referred to as an ARM, this is a type of mortgage has an interest rate that fluctuates based on the current index.

Amortization – Your mortgage payment can include payment toward the balance, taxes, interest, and insurance. Over time, the amount spent toward interest decreases and the amount going toward principle increases. A table showing the whole layout of the payments is called an amortization table.

Annual Percentage Rate or APR – This number comes from a formula set by the government to reflect the actual annual cost of borrowing money. The APR will be higher than the note rate on the mortgage loan.

Appraisal – A written, detailed process that justifies the price of the property, based on property details as well as comparable sales nearby.

Assessed Value – The value of the property based on the public tax assessor. It is used solely for taxation purposes.

Assignment – Changing the ownership of the mortgage on a property.

B

Balloon Mortgage – A mortgage in which smaller monthly payments are made over the course of the mortgage and then, at the end of a set period, a large payment is made to cover the rest of the balance.

Bill of Sale – This written document is required by law to indicate that the title has been transferred from one person to another.

Broker – There are different levels within the real estate agency. Some agents are brokers, but for the most part, real estate agents work for a broker. Additionally, brokers can be connected with the mortgage industry, as a person or company that works as a go-between for the lender and borrower.

C

Certificate of Eligibility – If a veteran is attempting to get a VA loan, they will need this document, which is issued by the Veteran's Administration.

CRV or Certificate of Reasonable Value – Document issued by the Veteran's Administration after the appraisal to indicate the value of the house, which can be covered by a VA loan.

Chain of Title – Over the years, as a property is transferred from one owner to another, all of this history is kept in the chain of title, and it can be traced back to the original owner of the house.

Clear Title – Title on a house that doesn't have any liens on it or legal concerns about ownership.

Closing – A meeting between the buyer and seller as well as any brokers and lawyers to sign all documents to exchange a house. In some states, the closing is when the documents are recording at the recording office.

Closing Costs – Costs associated with the actual purchase of the property, often called "non-recurring costs." They can include prepaid property taxes, HOA fees, broker fees, Realtor fees, and more.

Cloud on Title – Term used when a problem occurs with the title. It is cleared up when the deed is released or through a court order.

Common Areas – In the case when a property purchased is a townhome, condo, or similar, there will be common areas that are used by any residents. This can include swimming pools, parking areas, ingress, egress, picnic areas, tennis courts, etc.

Comparable Sales – Recent sales of nearby properties that have comparable sizes, amenities, and prices.

Condominium – Property in which common areas exist and buildings are connected together. The purchase of a condominium is just for the interior of the unit.

Contingency – A condition that must be met before a contract is considered binding.

Conventional Mortgage – Any type of home loan with the exception of those connected to the government, which would include FHA and VA loans.

D

Deed – Legal document that gives the title of the property over to someone.

Deed-in-Lieu – Another term for deed in lieu of foreclosure. It is the act of conveying the title from the borrower over to the lender to avoid the foreclosure process.

Depreciation – When a property loses value, it has depreciated.

Due on Sale Provision – A provision that is may be included in a mortgage that states a lender can demand repayment if the borrower were to sell the property.

E

Earnest Money – When a potential home buyer makes an offer on a house, they will need to provide earnest money, showing that they are serious about buying the property. The money is then refunded back to them, used for closing costs, or applied to the mortgage at closing.

Easement – In some cases, one property owner will have a right of way through another property so that they have access to their property. This is called an easement.

Eminent Domain – The government has the ability to pay fair market value for a private property and then take over that property for public use.

Encroachment – If one property owner adds to their house in some way that illegally intrudes over the property line. The property owner can be forced to remove their improvement.

Encumbrance – Anything on the title that keeps it from being clean, such as a mortgage, a lease, a restriction, etc.

Equal Credit Opportunity Act – Law stating that a creditor must make funds equally available to people no matter their race, color, national origin, age, sex, marital status, or religion.

Equity – Financial interest a homeowner has in their property. The difference in the value of the property and the amount owed on the property.

Estate – All real property owned by an individual at the time of their death.

Exclusive Listing – A contact that allows a real estate agent to have full rights to sell a property and disallows any other agent from selling it themselves.

F

Fair Market Value – The actual value of the property based on the current market and other factors.

Fee Simple – Term that refers to the most interest a person or private party can have in a piece of real estate.

Firm Commitment – An agreement on the lenders part to make a loan to a borrower. Once a firm commitment is in place, the borrower knows they will be able to get the loan.

Fixed-Rate Mortgage – Type of mortgage in which the interest rate never changes for the life of the loan.

Fixture – Personal property in a real estate sale that are integral to the house, such as lights and certain appliances.

G

Grantee – The person who receives the real property.

Grantor – The person who is conveying the real property to someone else.

H

Home Equity Line of Credit (HELOC) – A credit loan extended based on the equity available in a house.

Home Inspection – The process of having a professional evaluate the property for any issues that could be considered dangerous.

Homeowners' Association (HOA) – A nonprofit group put in charge of managing common areas of a planned neighborhood or development, such as a townhome or condominium.

J

Judgment – A decision made in court that can cover such things as repayment of debt, liens against the title, etc.

Jumbo Loan – A type of loan that exceeds the loan limits set forth by Fannie Mae and Freddie Mac.

L

Lease – This is an agreement between the property owner and someone who will be living on the property. It explains the payments for the property as well as any conditions the two parties must meet for the term of the document.

Legal Description – A description of a property that is recognized by the law.

Lien – Any legal claim that can be made against a property. All liens must be paid before a property can be sold.

Liquid Asset – Any asset that can be quickly converted into cash.

Lock-In – When a lender agrees to give a buyer a loan, they generally quote an interest rate and a lock-in guaranteeing this rate. A lock-in term is the period of time that this guarantee is good for.

M

Multi-dwelling Units – Properties that have separate housing for more than one family. These include duplexes, triplexes, quads, townhomes, condos, and apartments.

N

Note – A legal document that requires a borrower to repay the loan in addition to interest within a specific time period.

Notice of Default – When a borrower has not paid a loan based on requirements, this formal document will indicate that the borrower knows they have defaulted on the loan.

P

Public Auction – A meeting in which an auction is held to purchase property. It is used by lenders to attempt to reclaim some of the money they lost when a mortgage has gone into default.

Purchase Agreement – A contract that is signed by both the buyer and seller of properties indicating the conditions set forth for the sale of that property.

R

Real Estate Agent – A person who has been licensed to transact sales of real estate properties.

Real Estate Settlement Procedures Act (RESPA) – Law that requires borrowers have a notice of closing costs in advance of the actual property sale.

Real Property – All parts of the property, including land, structures, trees, or anything other permanent structure.

Rent Loss Insurance – Insurance designed to protect the property owner when they are renting out the property. It can cover loss to fire or other types of casualties.

Right of First Refusal – Provision set in place that requires the property owner to give someone else the first opportunity to purchase a property before it is listed for sale.

S

Seller Carry-Back – When the owner of the property is the one providing financing. It is most often used in terms of an assumable mortgage.

Subdivision – A neighborhood or housing development with a certain type of property and common features.

Survey – A map that shows the legal boundaries of the property as well as any rights of way and other features.

Sweat Equity – Improvements to the property made through labor instead of cash purchase.

T

Title – The legal document that indicates a person or party owns a property.

Title Company – These companies are solely responsible for examining titles and ensuring they are clean before a real estate transaction.

Title Search – A check on the title to ensure it is clean. It is usually completed by the title company.

Transfer of Ownership – The transfer of property from one person or party to another.

Transfer Tax – A state or local tax that must be paid when a title goes from one person to another.

Truth in Lending – Federal law that requires a full disclosure of mortgage details including terms and conditions, annual percentage rate, and other details.

APPENDIX #4: REHAB CHEAT SHEET

- **Exterior:**
- Trees, Limbs, Shrubs Trimming
- Lawn Work
- Replacing Dead Shrubs and Flowers
- Mulch
- Clutter Removal
- Driveway and Walkway Repair
- Power Wash Exterior
- Paint Exterior
- Replace, Add, Repair Shutters
- Replace, Repair Gutters
- Paint Garage
- Replace, Repair Exterior Lights
- Replace, Paint Mail Box
- Power Wash Exterior

- Paint Exterior
- Replace, Add, Repair Shutters
- Replace, Repair Gutters
- Paint Garage
- Replace, Repair Exterior Lights
- Replace, Paint Mail Box
- **Interior, General:**
- Cleaning
- Window Cleaning, Repair
- Window Coverings
- Patch, Paint Walls
- Repair, Replace Doors and Doorknobs
- Replace Light Switches and Wall Outlets
- Replace Smoke Detectors
- Replace Thermostat
- Replace Exhaust Fans, Covers

- Repair, Replace Flooring
- **Kitchen:**
- Replace Sink
- Replace Faucet
- Replace, Repair Countertop
- Refinish, Replace Cabinets
- Replace Cabinet Hardware
- Line Shelves, Drawers
- Replace Appliances
- **Bathrooms:**
- Replace Vanity
- Replace Sink
- Repair, Replace Light Fixtures
- Replace, Repair Toilets
- Replace Towel Hangers
- Re-Caulk Tub, Shower, Sink, Toilet

- Repair, Clean Tile Grout
- **Bedrooms:**
- Upgrade Closets
- Repair, Replace Light Fixtures, Switch Plates, Register Covers
- **Basement:**
- Clean Rafters
- Clean Pipes and Wiring
- Seal Cracks
- Clean Concrete and Walls
- Paint
- Repair, Replace Windows
- Re-Apply Insulation
- **Mechanical Issues:**
- Replace Furnace Filters, Returns
- Repair Slow Drains
- Replace Appliances

- Repair, Replace Hot Water Heater

APPENDIX #5:
TAX LIEN STATES

State	Interest rate	Redemption Period
Alabama	12%	3 Years
Arizona	16%	3 Years
Colorado	9% plus federal discount rate	3 Years
Florida	18%	2 Years
Illinois	18% every 6 months, or 36% per year	2 to 2 ½ years, depending upon the property classification.
Indiana	10% on the minimum bid if redeemed in less than six months. 15% on the minimum bid if redeemed in more than six months but less than 1 year. Interest on the overbid amount is 10% per year.	1 year for "A" and "B" properties; 120 days for "C" properties.
Iowa	24%	21 Months

Kentucy	12%	1 year
Louisiana	17%	3 Years
Maryland	10 to 24%, depending upon the county or city	6 Months
Mississippi	18%	2 Years
Missouri	10%	Up to 1 year, depending upon the property classification.
Montana	10%	2 to 3 years, depending upon the property classification.
Nebraska	14%	3 Years
Nevada	12%	120 days for vacant land, 2 years for improved land.
New Jersey	18%	2 Years

New York	10 to 14%, depending upon the county or municipality	Minimum of 2 years.