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"LINKING INVESTORS WITH CASH FLOW"

Discover the Top 10 Secrets of how to become wealthy through Real Estate

Top 10 Secrets of how to become Wealthy in Real Estate

In order to create your own personal wealth with real estate, it is important to know the 10 secrets that the wealthy know about real estate. Before we reveal these secrets, let's address three questions: What does it mean to be wealthy? Why would you want to be wealthy? Who are the wealthy?

First, what does it mean to be wealthy? The definition of "wealth" often includes the phrase "financially independent." What does that mean? When you choose to buy a new house, car, boat, rv or any number of things, what money are you using to purchase these items? Your earned income from your profession or the money you make from your assets? The key to wealth is having your assets pay for your expenses. Many people believe that is out of their reach and only for the ultra rich. That's simply not true.

For example let's say you saved $50,000 to invest. With $50,000 you could purchase 1 turn key rental property in cash or leverage your money if you can qualify for a loan and purchase 3 turn key rental properties. Let's say you purchased 1 turn key rental property in cash. Let's say the property nets $4,000 a year after all expenses paid and saving for vacancy and maintenance. Now if you wanted to buy a new luxury item that would cost $4,000 per year or less then you just created wealth for yourself. This example can be used over and over to calculate your house payment, insurances, etc. True wealth is when all your expenses are covered by your asset income.

For those that want to live in a mansion this takes more investment money than for those that are fine with buying a condo or a cookie cutter home for their personal residence.

Second why would you want to be wealthy? Wealth allows people to live a peaceful lifestyle and gives people the option to have freedom of time. Taking the steps to become wealthy can also allow people to set a new goal for a personal retirement date – which can actually be very exciting.

Third, who are the "wealthy"? Surprisingly, they are "normal" people like you. They are nurses, engineers, teachers, IT professionals, and middle management. They just chose to think differently about money. If you understand how they invest, you can create or increase your wealth too.

The last fact to cover before the Secrets is this…Wealthy people invest a lot in real estate. Estate tax returns are filed only by those with over $2 million in assets. The IRS completes a study of these returns every three years to determine what these individuals owned. Over 55% of the wealth of the individuals filing estate tax returns was in real estate…more than stocks, bonds, businesses, CDs, savings accounts, jewelry, collections, and everything else combined. Wealthy people use real estate to create, maintain, and protect their wealth.

Now on to the 10 Secrets. The first 5 secrets uncover WHY the wealthy own so much real estate. The last 5 secrets provide insight on HOW to buy real estate.

Why buy real estate

Secret #1: Diversify for Safety

After the real estate crash in 2006-2008 a 54 year old man came to me asking what he could do. His entire life savings of $750,000 was in over priced homes in the Phoenix area. Unfortunately, all his eggs were in the wrong basket and they all broke when that basket fell. He was 5 years away from his retirement date and lost nearly everything.

If you have a crystal ball and know what the future holds, then you could put all your money in the perfect place (and tell me what it is). Without that, however, diversification is the next best approach. Imagine how different this man’s story would have been if his assets had been diversified.

Wealthy people spread their risk out among a variety of wise options. Even if they own a lot of real estate—and the IRS studies prove they do—it can be well diversified with a variety of real estate.

In summary, Real Estate is a phenomenal diversification tool because it is not directly impacted by increases and decreases in the stock market or changes in interest rates.

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Secret #2: Maximize Reward & Minimize Risk

First, let's start with the "normal" assumptions about risk and reward. At one end of the risk scale, you have safe investments like CDs. Yes, the risk is very low, but the return is terrible. On the other end are stock options. You will either win big or lose all your money. Toward the riskier end is the stock market. It has potential for a good reward (perhaps 15-30% in a good year), but with the reality of significant risk (perhaps negative 15-30% in a bad year).

Wealthy people have already figured out how to get more reward with less risk. That is why they have more assets in real estate than they have in stocks, businesses, cars, jewelry, life insurance, and every other investment COMBINED. Why? Because they can earn rewards in the form of strong returns without taking on as much risk as some other investments with similar return potential.

Let me clarify. Does investing in real estate have risk? Yes. It would be foolish and unethical (and probably illegal) to say otherwise. But not all risk is created equally.

The single biggest risk with investments is the risk of losing your principal. In other words, if things go really badly, how much of your investment can you get back? With real estate, this risk is much different than it is with the stock market for three reasons.

First of all, the value of your real estate cannot drop to $0. Whether you purchase a rental property or a property to rehab and flip, it is worth *something.* If you pick a stock, there is a risk that the company could go bankrupt leaving your investment worth pennies or nothing at all.

The second reason real estate principal is less risky is that there are fewer corrections. Real estate values go up and down, but not as much as you might think. In the past 90 years, there have only been two times when national real estate values dropped by more than 10%. One was the Great Depression and the other was 2006-2008. Specific properties or neighborhoods can lose value, but national real estate values have been steadily increasing for decades. The third reason explains why.

Interesting Fact: There is no decade in U.S. History in which national property values decreased. Every correction (including the Great Depression and the Recession of 2006-2008) had a recovery that resulted in higher home prices by the end of the decade.

The third reason real estate principal is less risky is supply and demand. Decade after decade, the population of the United States increases due to longer life expectancies, growth from new births, and immigration. The demand for land and property continually increases, but the supply of land is fixed. When demand increases and the supply remains the same, the price goes up.

Wealthy people seek out investments in which they have great upside potential and limited downside potential. Real estate purchased wisely meets those criteria.

Secret #3: Use "Other People's Money" to Create Wealth

This is probably the most powerful secret to creating wealth.

Assume Investor A bought $100,000 of investment property and paid cash. Assume Investor B used $100,000 to make a 20% down payment and borrowed another $400,000 in order to buy $500,000 of investment property. Assume all borrowing was at 7% with 15 year loans, the houses appreciated at just 2% per year, rent never increases, and the property yielded a 12% annual net income (rent minus insurance, taxes, management, and maintenance). Each of the first 15 years, Investors A and B would enjoy net annual incomes of $12,000 and $16,856, respectively. Once loans are paid off, the net annual income for Investor B would jump to $60,000.

Much more impressive are the net property values once the loans are paid off in 15 years. For Investors A and B, those assets would be worth $134,587 and $672,935, respectively. For 15 years, investor B used "Other People's Money" in the form of rent, to leverage his money and create more wealth than Investor A.

This simple concept is the most powerful secret that enables wealthy people to use real estate to create and increase their wealth.

Secret #4: Protect Assets from Inflation

Let's start with a simple example of what inflation does to your buying power. Assume you have $1,000 and you invest it at 1% interest so you can use the interest to buy 10 loaves of bread each year. Assume the current cost of bread today is $1 and inflation is 3% (we have been averaging a little more than this for the past decade).

In one year, you earn $10 in interest, but a loaf of bread now costs $1.03. You can no longer buy 10 loaves. You can only buy nine. By year 10, your investment is still generating $10, but a loaf of bread is now $1.34 and you can only buy **seven** loaves of bread. That's bad news for your family.

Although we have not had double digit inflation in many years, what would happen if we did? If inflation spiked to 10%, in year 10, the bread in the above example would cost $2.59 and you would only be able to buy **three** loaves. That's really bad news for your family.

How does owning real estate protect you from inflation?

First, owning real estate protects your buying power. Inflation is a term that describes the increases in the cost of living. Rent is one cost of living that increases with inflation, whether you live in an apartment or home. In other words, your tenants EXPECT rent to increase along with inflation. Assume you owned a $100,000 property and rent was $1,000 per month. If inflation is 3%, after one year you could increase the rent to $1,030 per month. That may not seem like much, but it is keeping up with inflation. Inflation no longer decreases the number of loaves of bread you can buy. That's good news for your family.

Second, owning real estate protects your asset value. In the initial example, your $1,000 CD is still worth $1,000 after 10 years. That may seem like good news, but if you cashed it in, it would not buy as much as $1,000 did when you started.

In contrast, the value of your property would generally increase along with the inflation. At just 3% inflation, your $100,000 property is worth $134,392 in year 10. If double digit inflation kicks in (assuming 10%), your real estate would be worth $259,374 in 10 years.

In summary, real estate provides great inflation protection in two ways:
Income. If the cost of goods and services increases, the amount you collect in rent generally increases as well.
Value. When it is time to sell your investment property, the value of that property generally increases along with inflation.

No other investment protects both your income and your asset from inflation like real estate can.

BONUS: The Power of Economics
When we combine these last two secrets, something amazing happens.
You use leverage and Other People's Money to create your wealth.
You lock in today's interest rates and benefit from inflation.

Assume you put down 20% and borrowed the remainder to finance a $100,000 property. Your monthly payment would be approximately $429.46 (at 5% for 30 years). You currently collect $1,000 per month in rent. But over time, that rent increases along with inflation while your monthly loan payment remains fixed. Below is a chart of what you could collect in rent (increasing at 4% inflation), the profit before loan (if expenses are 50% of rent), the amount of your loan payment, and an estimate of net profit. These are hypothetical numbers to illustrate how you can benefit from inflation and other people's money. In 30 years, rent is three times higher and profit is over 16 times higher than when you started.

Year	Rent Collected	Profit before Loan	Loan Payment	Net Profit
0	$1000.00	$500.00	$429.46	$70.64
5	$1216.65	$608.32	$429.46	$178.86
10	$1480.24	$740.12	$429.46	$310.66
15	$1800.94	$900.47	$429.46	$471.01
20	$2191.12	$1095.56	$429.46	$666.10

25	$2665.84	$1332.92	$429.46	$903.46
30	$3243.40	$1621.70	$429.46	$1192.24
31	$3373.14	$1686.57	$0	$1686.57

Secret #5: Enjoy Tax Benefits

It may not be the most exciting reason or the biggest reason to invest in property, but there is no denying the tax benefits of investing in real estate.

The tax benefits fall into three categories. First, you have deductible out-of-pocket expenses. The way the IRS views it, owning real estate is similar to running a business and nearly every expense related to that business is deductible. There are obvious deductible expenses such as repairs and insurance. There are less obvious expenses, such as the travel costs for you to visit the property. I know many people in the Midwest who have investment property in Florida. Every time they visit the property, the travel expenses are deductible.

The second category of tax benefits is depreciation. This is a deduction, but it is not tied to an out-of-pocket expense. Assume you buy a $100,000 property that generates $12,000 in revenue and $4,000 of out-of-pocket expenses. Your net cash flow is $8,000. However, you should be able to deduct about $3,000 in depreciation so that you only need to pay taxes on $5,000 of income instead of $8,000. As a matter of fact, there is a tax strategy called “Accelerated Depreciation” that may enable you to deduct up to $10,000 of depreciation. You could actually have a positive cash flow of $8,000 and still show it as a loss of $2,000.

The third category of tax benefits is deferral. Simply put, why pay taxes today if you could pay them in five years? If you do not plan, you will have to pay taxes when you sell a property for more than your basis in it. With a little planning, however, you may be able to defer taxes on the sale by taking advantage of a 1031 exchange. Believe-it-or-not, you may be able to defer these taxes for your entire lifetime and then have them “waived” at your death so your heirs do not have to pay these taxes (the technical term is called “stepped-up basis”). That is effective tax planning.

We are not going to get into the numerous tax credit opportunities that could save you thousands more in taxes. These credits are available for things such as low income housing, property in an enterprise zone, or investing in renewable energy when repairing the property.

The bottom line is this…there are many great ways you can get tax benefits from owning real estate. Talk to your CPA to see which make the most sense for you.

<u>How to buy real estate</u>

Secret #6: Buy the Right Way

There is never a right or wrong way to buy real estate. There is the right or wrong way for YOU to buy real estate. I cannot stress this enough…you should ignore nearly every recommendation for how you should invest in real estate and every horror story of how you should NOT invest in real estate. Why? Because the stories did not come from someone with your exact circumstances. Every situation is different and what works for one investor may not work for another. Okay…do not ignore the stories. Listen for ideas to use and pitfalls to avoid, but do not let someone else's experience determine what you should do. Following are three recent examples that should help clarify.

I worked with a doctor who was investing $100,000 and borrowing $400,000 in order to purchase eight separate properties. I asked him "If for some reason, five of these need new roofs at the same time, could you put another $10,000 to $15,000 in?" He replied "I may not be happy about it, but sure. I make $400,000 per year and I could put in whatever is needed if something like that happened." Three days later, a friend of his wanted to invest $40,000 and borrow $160,000 to get some properties. I asked him "If for some reason there was an emergency, could you put another $5,000 to $10,000 in?" He looked at me with concern in his eyes and said "Well, no. I have $40,000 to invest and this investment needs to stand on its own without any additions."
Leveraging 80% Loan-to-Value worked for the doctor, but not for his friend.

A lady in an affluent part of town was interested in investing $300,000 with no leverage. She wanted to buy one nice house and rent it out. I informed her that she would be able to rent it for $1800 to $2000 per month. However, there were some incredible opportunities in another part of town where she could pick up multiple properties at an average price of $50,000 and an average rent of $750 per month. That same $300,000 would be able to generate about $4,500 per month in rent. After all expenses, the one property would net her about 5% while the multiple properties would net her about 12%. She did not care. She was less concerned about earning a little more than she was about feeling comfortable with her property. Everyone has different preferences.

An investor had been having great success purchasing larger, older homes around town and converting them to senior shared housing (ie: renting a 4 bedroom property by the room to four different seniors). That worked for him because he had been working with seniors in the community for years. He knew what their needs were, how to provide for it, and exactly how to market it to keep his properties filled. Although this was quite profitable for him, it would not make sense for most other investors because they lack the skills and experience he had that enabled it to work.

The bottom line…I have identified over many ways of investing in real estate. Each one appeals to different investors depending on their time frame, risk tolerance, cash flow, tax situation, and other factors. There is not a right way or wrong way to invest in real estate. Each one is either right or wrong for YOU.

Secret #7: Liquidity and Cash Flow
Some people avoid investing in real estate because it is "not liquid." Although technically true, they miss out on incredible opportunities because they do not understand two facts about real estate liquidity.

First, real estate can be sold more quickly than you think. However, there may be a price to this “fire sale.” To avoid it, use proper planning to ensure you have sufficient liquidity in your assets so that you never need to “hurry up and cash out” of your real estate.

Second, although real estate itself lacks liquidity, it frequently generates more liquid cash than other investments. Honestly, how many other investments send you 12% to 18% of their value every year in the form of monthly checks? If you read books from successful real estate investors, you find that many of them use the phrase “cash machine” to refer to their properties.

People who avoid real estate because it is not liquid may not have thought of the first fact about liquidity and most certainly are unaware of the second. Be sure to buy real estate using the strategy that matches your goals so you can turn on your “cash machine” when you need it.

Secret #8: Benefit from Info/Data

As with any investment, there is risk when you invest in real estate. However, unlike most investments you have the ability to greatly minimize that risk by educating yourself with accurate information and data.

There are several categories of knowledge and data that you should acquire and analyze in order to increase your odds of success (this is a significant part of the services we provide).

The first category is your personal financial information. Given your assets, diversification, tax status, time frame, and other factors, what is the best way for you to invest in real estate? We provide this service and call it your Cash Flow Links Wealth Plan.

The second category is market information. This could include predictions about whether or not the value of the property is going to increase. More important than predictions are the data behind them. An area that is experiencing population growth and job growth is more likely to experience property value increases. There is increasing demand for properties. If the area is mostly developed and lacks open land, then the likelihood of a price increase is even higher because the supply cannot increase to meet the demand. This is just one brief example of how a wealthy person would conduct research to improve their odds of profiting.

The third category is information and analysis of a specific piece of property. Every single piece of property should have its own analysis completed. There is numerical data such as revenue (rent), property value, taxes, repair costs, management fees, and more. In addition, other important information includes, but is not limited to zoning, future plans for the area (city development), school system, public transportation, understanding the potential renters or buyers of the property, and more.

Gathering and understanding data from these three categories is how wealthy people make decisions that increase the likelihood of profits and decrease the risk of loss. I have seen research protect an investor from paying too much for a property and I have also seen research lead an investor to purchase property other investors were avoiding (they missed out because they did not know).

Secret #9: Be Unemotional

The secret of gathering data leads right into this secret. Your investment in real estate is a business. Wise business decisions are made based on data (and an occasional gut feeling) without the involvement of emotions. Many of the worst real estate investing decisions I have seen were made because the investor allowed their emotion to override the data and their logic.

One example is that of an investor who wanted to sell a property but would not be reasonable about the selling price. He was so proud of the work he had put into rehabbing it, that he considered it to be the best house in the neighborhood and insisted that it be sold for more than any other house in the neighborhood. After a year on the market (without a tenant), he finally conceded and lowered the price. He lost thousands of dollars as a result. I'm not talking about the difference between what he wanted and the lower price. I am talking about the year that he waited…without collecting rent…while paying insurance, taxes, and upkeep. He could have sold for the lower (correct) amount a year earlier and saved himself thousands.

Many examples involve investors who manage the property themselves. They do not have the heart to make tough decisions when they are looking the tenant face to face. That is why I believe that delegating property management to an expert is one of the wisest decisions you can make.

Hiring a property manager provides a layer of insulation between you and the tenant which makes those tough decisions much easier. It also provides a layer of insulation between you and the property. When it is time for a repair, many investors tend to pay too much for higher quality materials…because that is what they would want in their homes. However, a property manager may help you save money by showing you the appropriate quality of materials for your rental property.

Wealthy people understand that their real estate properties are a business and they run these investments like a business. You should do the same. Delegate what you can and utilize the advice of experts to make wise decisions…not emotional ones.

Secret #10: Use Supply and Demand

Do you recall the "Interesting Fact" earlier in the report? There is no decade in U.S. History in which national property values decreased. Is it a coincidence that there is no decade in U.S. History in which the national population decreased? We have a fixed supply of land in the U.S. and in the world. As demand for land increases (because of population increases) there is only one inevitable outcome. Economics 101 states that when demand increases and the supply remains the same, the price will increase.

Understanding supply and demand makes it easier to understand why property values—over any long term period—have always increased. Understanding supply and demand can also identify specific opportunities in a local market. Below are two examples.

In the past few years, investors in many cities across the country have earned amazing profits with the "fix and flip" strategy. Why? There was an abundance of *distressed properties* on the market because of foreclosures, bankruptcies, and other circumstances. When supply exceeds demand, prices drop. Investors were able to get some great bargains on these properties. At the same time, demand for *move-in ready properties* started increasing. However, there was a shortage of these properties. With the supply low and the demand increasing, prices started going up.

Investors who understood this were able to buy distressed properties at a bargain, rehab them, and sell them for a profit. Following are some examples. A distressed property is bought for $70,000. It is rehabbed for $30,000. It is sold for $125,000. A profit is made because the demand is for *move- in ready* properties. Buyers were either unwilling or unable to buy the property for $70,000 and rehab it themselves. They could have saved $25,000 on their new home.

Investors in our areas averaged 25%* profits and the average turnaround time was about four months. In 2012, of the U.S. cities with at least 500 or more fix and flips, eight of them had ***average*** returns of 35%* or greater. Not only did these investors understand supply and demand, but they took action to benefit from the opportunity.
* These are Gross returns and do not factor in selling costs.

Summary

I honestly hope you enjoyed these ten secrets and that you can use them to start creating your own wealth. My personal goal is to help as many people as possible to achieve financial independence. If there is anything I can do to help you create or increase your wealth, please let me know.

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