How To Invest In Single-Family Houses

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The numbers used in the examples for this report may be different based on the area you live in. Please focus on the concepts presented and then input the numbers that you will be experiencing when you do your evaluations.

IS THIS A GOOD DEAL?

You and your wife have saved up some money and want to purchase your first investment property, a single family house. Ralph Cranston is one of the top real estate agents in the area and you contact him. Ralph tells you about a house located at 7605 Larkview Court that has just hit the market and is **priced $10,000 below market price.** The price is $175,000. It has 4 bedrooms, 2 ½ baths, 2 car garage, 1540 square feet, and was built in 2004. There is already a great tenant in the property paying $1200 per month. You go by the property and can see that it has a tile roof, is in immaculate condition and in a good area. Ralph tells you that properties in this area have been appreciating 5% per year for the last 3 years and you need to act quickly as this property won't last long. **So what do you do? Is this a good deal? Should you make an offer?**

Your answer should be "you don't know!"

My next suggestion is that you should tell Ralph a phrase made famous by Donald Trump:

YOU'RE FIRED!

Ralph may be a great agent when it comes to selling owner occupied homes but based on his actions so far, it really looks like he doesn't have a clue when it comes to working with investors in real estate.

INTRODUCTION

When you decide to invest in any improved real estate, whether it is single family homes, multi-family units, commercial or industrial property, you are becoming involved in two different businesses. The first is a real estate acquisition business. The second is a real estate management business. If you make mistakes in either business, the results can be devastating.

I have two major goals that I try to accomplish with all the materials that I share with people who want to be successful real estate investors.

My first goal is to teach you information that will allow you to know more about investing in real estate than 98% of the real estate agents in your area.

My second goal is to put you in a position that allows you to make intelligent decisions for yourself without having to **trust** broke people who really don't know what they are doing and sales people whose major goal is to earn a commission.

I believe the basic philosophy of purchasing single family homes is the same as for any other income producing real estate. I strongly recommend that you first attend my live seminar or watch my video seminar:" **How to Build a Real Estate Money Machine**" and read my book "**What Your Real Estate Agent, Loan Officer, and Investment Guru Don't Want You to Know About Investing In Residential Income Property**" before purchasing any investment property. I also cover your management business in my book, **How to Management Residential Income Property for Maximum Profit.**

To find this information along with much, much more, go to:

www.BakersfieldIncomeProperties.com

I also strongly recommend that you join the Win the Game of Money Institute. You can register at: **www.WinTheGameOfMoneyInstitute.com**

WHAT IS THE BEST PROPERTY TO BUY – A SINGLE FAMILY HOUSE OR MULTI-FAMILY PROPERTY?

This is a question that I am asked frequently. Should I buy single family homes, duplexes, triplexes, fourplexes or 5 or more units? And my answer is, **"IT DEPENDS."**

There are lots of investors who like to purchase single family homes and do very well. Other investors like multi-family properties. Let me discuss some benefits and negatives that I have observed from each type of property.

BENEFITS TO PURCHASING SINGLE FAMILY HOMES

1. The financing is usually better for investors.
2. Single family dwellings are easier to lease for a long period of time.
3. The tenants are usually more stable.
4. The tenant usually pays for all the utilities such as water, trash, gardening, etc.
5. When it is time to sell, you will have more types of buyers. You can sell the property to either a person who wants to live in the property or an investor.
6. When you sell the house, you have a better chance of cashing out.

NEGATIVES OF PURCHASING SINGLE FAMILY HOMES

1. You will be competing with buyers who want to purchase single family homes as their personal residences.
2. The ratio of rent you can charge compared to cost of sale is usually lower than the ratio for multi-family, especially as the price of the house goes up. This makes it harder to get a positive cash flow.
   Example: The gross rent from a $400,000 fourplex will be a lot higher than a $400,000 home.
3. Professional management usually charges more for a house than the per unit cost for a multi-family property.
4. When you have a vacant house, you have a 100% vacancy rate.

BENEFITS OF PURCHASING MULTI-FAMILY PROPERTIES

1. The ratio of the rent collected to the price of the property is usually better than single family homes.

2. Sometimes you can be more creative when financing multi-family units than single family homes.
   Example. Owner carries back some of the financing.
3. When you have a vacant unit in a fourplex, you have a 25% vacancy rate.
4. You usually get more “bang for the buck.” The cost per square foot will usually be less for multi-family units than single family houses.
   Example: Let’s say that you can purchase a 4000 square foot fourplex with 1 car garages for each unit. The price is $400,000. With the property you get four kitchens with four stoves, ovens, dishwashers and garbage disposals. You get four heating and air conditioning units. You get a four car garage. A house around the corner with 4000 sq. feet will have fewer amenities but will usually cost a lot more.

NEGATIVES TO PURCHASING MULTI-FAMILY PROPERTIES

1. The quality of the tenants may be less than for a single family home.
2. The owner will pay more of the utility and services costs such as water, trash, and gardening.
3. Purchasing 5 or more unit complexes will usually require more down payment.

As I said at the beginning of this section, in determining the number of units a person should consider buying, a single family home up to a multi-plex, the answer is **“it depends!”**

SPECULATOR VERSUS INVESTOR

I spend a lot of time in my material discussing the importance of becoming a professional investor, not an amateur speculator. I define a speculator as an individual that purchases an asset with the hope of it going up in value, appreciating. They have heard the mantra that real estate <u>always</u> increases in value. Their goal is to buy low, sell high. That is where they obtain their yield. There are many assets that appreciation is the only way to make a yield such as gold, paintings, some stocks, vacant land, etc.

Income producing real estate can offer four ways to make a yield:

1. Appreciation
2. Debt Reduction
3. Tax Benefits
4. Cash Flow

In my opinion, appreciation is the **least** important of the four. Professional investors focus on cash flow as more important than tax benefits and debt reduction adding to the benefits. If it doesn't make sense as a cash flow asset, it should be passed by.

7605 Larkview Court

Let's go back to the Larkview property and spend some time doing what all qualified agents and professional investors do, analyze the potential yield.

Example 1: Remember the rent was $1200 per month. Property taxes for Larkview are $2588 for the year and the yearly property insurance premium is $850 for a total of $3438 or $286 per month. When we subtract these two expenses from the rent we get $914 per month ($10,968 for the year) for cash flow without allowing for any vacancy and maintenance costs. If you pay all cash, your cash on cash return would be:

$$\$10,968 \div \$175,000 = 6.27\%$$

Is this a good yield for single family homes?

The answer is "You Don't Know!"

Now what happens if the house does not appreciate during the year? Your yield for the year is 6.27%.

What happens if the home appreciates 5% for the year, $8,750? Your yield then becomes

$$\$10,968 + \$8,750 \div \$175,000 = 11.27\%$$

Is this a good yield for single family homes?

The answer is "You Don't Know!"

In reality, for you to obtain these yields, you would have to sell the property with no costs of sale. These costs can run as high as 8% of the sales price plus tax consequences.

Example 2: You buy the house with 20% down ($35,000) and obtain a new first trust deed for 80% ($140,000), interest of 6.5% amortized over 30 years. Payments would be $884.90 per month. If we add the taxes and insurance, the total expense is $1171 per month and the net cash flow is $29 per month ($348 for the year). (Remember we didn't allow for any vacancy or maintenance costs)

Is a projected cash flow of $348 exciting to you? That disappears if the property is vacant for 12 days, you need a faucet replaced or a window gets broken. Heaven forbid if you have to replace the air conditioner. That could cost you 10 years worth of cash flow.

Your cash-on-cash return would be:

$348 ÷ $35,000 = **1.0%**

Is this a good yield for single family homes?

The answer is "You Don't Know, But Probably Not!"

Now, what if I tell you that I have good news? You will get some additional yield from other benefits of owning the property!

First of all, you will have debt reduction of $1565 for the year. This is like the tenant placing this amount in a savings account for you.

You will also get to depreciate the property which results in the IRS giving you an additional amount, we will use $1660 in this example, on your tax refund.

Now what does your yield look like?

$348 + $1565 + 1660 = $3573 ÷ $35,000 = **10.2%**

Is this a good yield for single family homes?

The answer is "You Don't Know?"

Let's hypothesize that your property appreciated 5% for the year.

What would your yield be now?

Cash flow + Debt Reduction + Tax Benefits + Appreciation ÷ Down Payment = Yield

$348 + $1565 + 1660 + $8750 = $12,323 ÷ $35,000 = **35.2%**

The answer to this whole dilemma is you need to look at a lot of properties and analyze the yields they will produce. Only by developing this knowledge will you know if a property is a good deal or needs to be rejected.

If I can teach you how to become a professional investor, making decisions based on facts that you have access to, I know you will have a much better chance of success than someone with their fingers crossed.

THE ART AND BILL MODEL

In all my material I try to teach two things:

- How to obtain a good cash flow on your property
- How to obtain a high yield on your initial down payment.

The way to reach both of those goals is to apply what I call the Art and Bill Model which makes maximum use of leverage.

Art is a multi-billionaire and he will loan you as much money as you want to borrow at 8% interest. The loan will be unsecured and the first payment of interest only will be in 30 days. How much money do you want to borrow from Art?

Tough question, huh? What would you do with the money?

Bill is the world's safest borrower. He is looking to borrow as much money as he can at 12% interest. He will pay interest only payments with the first payment due in 30 days. Now, how much money would you like to borrow from Art at 8% and loan to Bill at 12%?

Your answer should be a really large number!

What is happening here? You are making a 4% return on borrowed money. Every $1000 you borrow you make $40 for the year. You are making a profit on borrowed money.

What would your yield be on this type of transaction? Most people state "4%."

That is incorrect. How much of your own money did you invest in the deal?

$0.00

You are making an INFINITE YIELD when you use Art and Bill properly!

I teach this process using real estate. When you borrow money from a bank you will be paying a certain interest rate just like you borrowed from Art.

When you purchase a property, it will have what is called a CAP RATE which is the rate of return you would earn if you owed the property free and clear. If the CAP Rate is higher than the interest rate, **you will be making a yield on borrowed money**.

Example: If the cap rate on 378 Beech Street is 8.7% and the interest rate that you pay the bank for the loan is 6.25%, you will make 2.45% on the amount of the loan that you received.

This is an extremely powerful concept that is used by a majority of the world's richest people. It is using the concept of OPM – Other People's Money, an extraordinary form of LEVERAGE.

Let's go back to our Larkview property. Our cash flow if the property was free and clear and we didn't allow for any maintenance and vacancy was $10,968. The sales price was $175,000. The cap rate for this property would be:

$$\$10{,}968 \div \$175{,}000 = 6.27\ \%$$

Do you remember what the interest rate was for the loan? It was 6.5%. We have a negative relationship between the cap rate and the interest rate. Art and Bill are negative. We cannot take advantage of positive leverage on this property.

Is this a good deal?

In my opinion, it is not. I would suggest moving on to a property that had a higher rent to purchase price ratio.

Read my book, "**What Your Real Estate Agent, Loan Officer, and Investment Guru Don't Want You to Know About Investing in Residential Income Property**" for a lot more detailed explanation of this subject.

LOCATION VERSUS TIMING

For years and years, we have been told that the 3 most important words in purchasing a home are location, location, and location. I have to strongly disagree with that answer. The three most important words in purchasing a home or any other piece of real estate is the same as any other investment – timing, timing, timing.

However, the timing for purchasing an owner occupied home versus income property is a little different. The two major numbers that affect a home buyer are:

1. the current interest rate and
2. the sales price of properties.

You will find that there is a pretty direct relationship between these two numbers.

AS THE INTEREST RATE GOES DOWN, PRICES GO UP
AS THE INTEREST RATE GOES UP, PRICES GO DOWN

PERSONAL RESIDENCES

A lot of home buyers save up a little money, go to the local real estate agent who then directs them to their favorite lender to get prequalified. After the loan officer gets all their information: income, expenses, assets, liabilities, etc., they come up with a number that is the maximum payment the buyer can afford. Depending on the interest rate, they determine the amount of loan that the payment can support and then add the buyer's down payment and that is the maximum price of the home the buyer can qualify for.

Example: Brad has $7000 for a down payment and the lender calculates that he can afford a payment of $850 per month. Let's assume the interest rate is currently 6%. The loan amount would be approximately $141,700. Adding on the $7000 down payment, Brad would need to stay under $149,000.

Now, let's suppose that Brad waits and the interest becomes 7.5%. Based on the $850 per month payment, Brad can now only qualify for a $121,500 loan and with his down payment he would need to look at houses under $129,000. Brad has lost $20,000 of purchasing power.

If the interest rate goes from 6% to 7.5%, not only Brad is affected. All buyers are. In most cases, sellers will have to lower their prices to attract buyers who can qualify. This change in interest rate causes a trend on all homes for sale.

THIS IS ALSO TRUE OF INVESTORS

However, there is more than just the interest rate versus the price. There is the market rent, the vacancy factor, and the costs of expenses that need to be taken into effect.

Our goal is to time the market so that the difference between the cap rate and the interest rate is a nice positive number.

We want to apply the Art and Bill Model successfully.

If we have a nice positive ratio, it is time to be in the market. If the ratio is negative or slightly positive, it is time to stay on the sidelines.

WHAT DO BANKS LOOK AT WHEN QUALIFYING A BUYER FOR A RENTAL PROPERTY?

Besides looking at a buyer's personal income and expenses to pay for an investment property, the lender looks at the income and expenses that are generated by the investment property. Lenders are looking at the Net Operating Income (Gross Income minus all expenses except mortgage payments) to service the loan on the property. Based on the net operating income, they determine what payment the property will support and then determine the loan amount that the payment will service.

Example: Pete is considering purchasing a 3-bedroom, 2 bath house in a stable area on Vermont Ave. that he can rent for $850 per month. Pete will pay the mortgage payment, taxes and insurance. He will also be responsible for any major repairs. The tenant will pay for the water, gardening, and minor maintenance costs. The taxes will be $1100 and the insurance will be $620. Pete allows $75 per month for reserves for maintenance.

Gross Yearly Income	$10,200
Taxes	1,100
Insurance	620
Reserves	900
Net Operating Income	$7,580 – Amount left to service the debt.

The Net Operating Income divided by 12 gives us the monthly cash flow if we owned the property free and clear.

$$\$7,580 \div 12 = \$631.67$$

To break even, this is the monthly payment we could afford to make on the property.

Pete can obtain a loan at 6.5% interest rate.

To break even, the maximum loan Pete can get is $99,350. If Pete puts down a 20% down payment, he can afford to pay $124,000 for the house.

At this price, Pete has debt reduction, tax benefits, possible appreciation, <u>but no cash flow</u>.

If Pete can purchase the house for $124,000 is this a good deal?

Let's look at the property using the Art and Bill model.

The cap rate would be $7580 ÷ $124,000 = 6.1%. The interest rate is 6.5%.

The interest rate is higher than the cap rate which gives us a negative Art and Bill relationship. We are not making money on borrowed money. We are not taking advantage of good leverage.

Example: Let's say Pete starts with the goal of having the CAP Rate 2% greater than the interest rate. If the interest rate is 6.5%, then Pete wants a CAP Rate of 8.5%.

We know that the CAP Rate = Net Operating Income ÷ Sales Price

Then the sales price would equal the NOI divided by the Cap Rate.

$7580 ÷ .085 = $89,176

If Pete pays $89,000 for the Vermont Street property and puts down $17,800 the loan amount would be $71,200 and payments would be $450.03. If we multiply the payment by 12 we get yearly mortgage payments of $5400 and a yearly cash flow would be $7580 – $5400 = $2180.

We are making 2% on borrowed money. We have positive cash flow of $181.67 per month.

Our cash on cash return would be cash flow divided by down payment.

$2180 ÷ $17,800 = 12.25%

This is the process a professional investor will use when looking at investment property.

I hope you will do two things:

1. **Take the time to learn how to become a professional real estate investor.**
2. **Find the right people to add to your mastermind group. The most important member will be a knowledgeable real estate agent that will look out for your interests, not their own.**

Please take advantage of all the material available at our website,

www.BakersfieldIncomeProperties.com

Here is a list of just some of the information available at our website:

Free Seminars Live or Online

"How to Win the Game of Money" - 2 hour seminar with 66-page workbook

"How to Build a Real Estate Money Machine" - 2 hour seminar with 50-page workbook

Free eBooks

"What Your Real Estate Agent, Loan Officer, and Investment Guru Don't Want You to Know About Investing in Residential Income Property" – 276-page ebook

"How to Manage Residential Income Property for Maximum Profit" – 127-page ebook

Free Reports

How to Live For Free
The Ordinary Man's Way to Wealth
Getting Your Financial Bathtub in Order
How to Sell Residential Income Property for Maximum Profit
How to Save Thousands of Dollars When you Purchase Residential Income Property
Information on Tax Deferred Exchanges and Installment Sales
and much, much more!

I hope you have found this booklet beneficial. If I can be of any service, please feel free to contact me at any time.

THIS REPORT IS BROUGHT TO YOU BY:
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