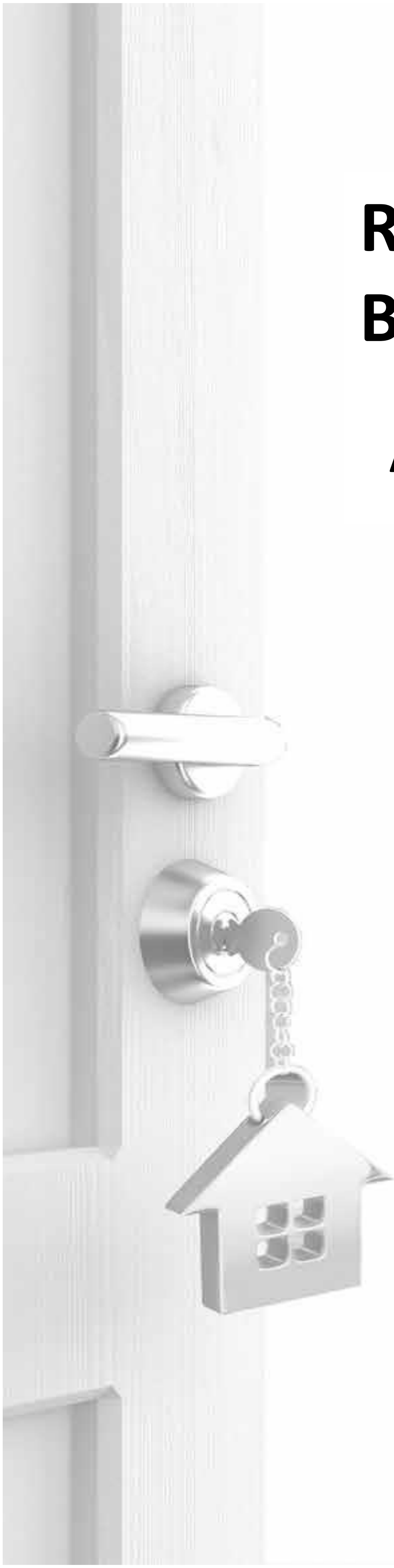

Retire on Real Estate Blueprint for Success

A Step-by-step Companion Guide

K. Kai Anderson

Advance Praise for:

Retire on Real Estate
And
The R.O.R.E. Blueprint for Success:
A Step-by-Step Companion Guide

"*Shark Tank* changes lives. *Retire on Real Estate* will change your life too! Dr. K. Kai Anderson is a leader in helping working adults rethink and reclaim their retirement possibilities. This book is brilliant! *Retire on Real Estate* is one of a kind because it connects the dots between retirement planning and real estate. Through clever chicken-and-egg metaphors, *Retire on Real Estate* does an impressive job of explaining the pitfalls of the current retirement system and the nuts and bolts of how to plan for the future using the powerful and surprisingly achievable tool of real estate. Anderson's inspirational, positive, and easy-to-read tone makes *Retire on Real Estate* a must read for everyone."
—Kevin Harrington, Original Shark on ABC's *Shark Tank*, Inventor of the Infomercial, and Founder of "As Seen on TV"

"*Retire on Real Estate* is a must-read for anyone considering buying residential real estate to rent, whether they are merely curious or totally serious. No get-rich-quick schemes here, Dr. Anderson also provides a step-by-step companion guide to her conservative, disciplined method of building a real estate portfolio and assuring income in retirement."
—Todd M. Sinai, PhD, Professor of Real Estate and Business Economics and Public Policy, University of Pennsylvania, Wharton School of Business

"In *Retire on Real Estate*, Dr. K. Kai Anderson answers one of life's toughest questions facing most new real estate investors: How do I get started? Kai writes not from theory but from her real-life experience as an investor. Learning from someone who has made mistakes, faced challenges, risen above setbacks, and today has a successful track record makes all the difference. Her step-by-step, first-hand knowledge of how to find, manage, and create cash-flowing property can put you in control of your financial future."
—Kim Kiyosaki, of RichDad.com, and Author of *Rich Woman* and *It's Rising Time*

"Dr. Anderson is an inspiration to budding real estate entrepreneurs everywhere. *Retire on Real Estate* presents a simple approach that anyone can use to get started using real estate as a tool for the generation of lasting wealth."
—Ian Parrish, President, Investors United®, America's oldest school for real estate investing

"*Retire on Real Estate* is one of the best books you can read if you feel like you're behind in saving for your retirement. You'll get a no-guilt proven plan that will let you stop worrying and start taking action."

—Steve Harrison, Original Publicist for Robert Kiyosaki's bestseller *Rich Dad Poor Dad*

"All readers, whatever their age, will find much to stimulate their thinking about what they can do to protect their retirement dreams with real estate in this book. Its breadth and scope, the variety of data explored, and the stark nature of the argument will provoke both thought and emotion about their nest egg being at risk. Dr. K. Kai Anderson's book *Retire on Real Estate* helps us plot a plan with the Why and the How to think more clearly about important issues in planning for the future."

—Connie Rankin, Author of *God Gave Us Wings: A Journey to Success: Theirs, Mine and Yours* and President and CEO, CRES & Associates, an award-winning commercial real estate firm, Houston, Texas

"Realtors will benefit greatly from this book. Providing *Retire on Real Estate* to clients will be extremely beneficial in helping clients see past their personal residence purchase and incorporate rental properties into their retirement investment portfolios. An exceptional read, *Retire on Real Estate* flows beautifully, laying out and thoroughly examining pros and cons of several retirement investment vehicles. *Retire on Real Estate* presents a comprehensive approach to analyzing successful real estate investment and convincingly argues real estate as the vehicle one can count on to provide ever-increasing cash flow and wealth."

—Michael Anderson, Real Estate Agent (no relation to the author)

"*Retire on Real Estate* has inspired me to buy more real estate than I already own! The guide-like design of *Retire on Real Estate* makes it easy for me to reference anything I've read if I have future questions. I now have the tools I need to increase my nest egg, and I have a place to turn to for answers. The visual aids and concise explanations made even the most complex subjects easy to understand. If you want to invest in your future, read this book."

—Kalen Bruce, MoneyMiniBlog

"Dr. K. Kai Anderson's seamless analogies and anecdotes speak to readers from all walks of life. Her candor shines through the pages as she shares her expertise and experiences. No matter your level of real estate expertise, Kai can teach you something practical that can get you started in the world of real estate today! As Kai artfully shares her knowledge in real estate, she introspectively examines her decisions, her fears, and her life. Kai not only shares her knowledge in real estate, but she also shares her insights into happiness, retirement, and success. She maintains a work-life-real estate balance, and you can too! *Retire on Real Estate* is a well-rounded financial resource that should be incorporated into every household."

—Justin DeCleene, MBA, Author of *Medical Adventures*

“A must-read for anyone interested in investing in real estate, no matter if you’re just getting your feet wet or are well versed and an experienced home owner. Retirement financial security is a scary concept, and so is buying property. With all her heart and soul, Kai takes us into her world and the experiences of two of life’s scariest decisions. This is a book that will be used as both a reference and a guide.”

—Rebecca Walden, Pharmacist, Mom, and Achiever of the Level I Goal

“Dr. Anderson cheers her readers on, while explaining how to reinforce one’s retirement with real estate. *Retire on Real Estate* is an eye-opening read, with helpful advice for EVERYONE! It is encouraging and informative without an ounce of condescension. I’m now ready to ‘get a chicken’!”

—Louise Suggs, Principal, Louise Suggs Design

"Dr. Anderson offers a practical guide on how to profit from residential real estate so you can retire with greater peace of mind."

—Julekha Dash, Baltimore Business Journalist, Former Senior Reporter at the Baltimore Business Journal and Former BmoreMedia Editor

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To bulk-order the parent book, *Retire on Real Estate*, visit:
www.amacombooks.org/go/specialsales or contact special sales:
Phone: 800-250-5308
E-mail: specialsls@amanet.org

To bulk-order the R.O.R.E. Blueprint for Success, contact the author directly via www.KKaiAnderson.com or via Lowe Press, P.O. Box #26213, Baltimore MD 21210.

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RETIRE ON REAL ESTATE (R.O.R.E). BLUEPRINT FOR SUCCESS: A Step-by-Step Companion Guide

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DEDICATION

As with the parent book *Retire on Real Estate*, this companion guide is dedicated to <u>YOU</u>, so that you have exactly the tools you need to make the final third of your life just as abundant as it is today . . . and perhaps even more so!

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HOW TO READ THIS R.O.R.E. COMPANION GUIDE

The book that you are holding right now is the companion guide to *Retire on Real Estate: Building Rental Income for a Safe and Secure Retirement*.

The parent book, *Retire on Real Estate* shows you *why* it is important to diversify your retirement plan with at least one rental property and build rental income for a safe and secure retirement. It also shows you generally *how* to go about doing this, whether you are just starting out or looking to purchase more property.

This companion guide elaborates on the "how" by providing a detailed step-by-step blueprint for success in purchasing, evaluating, and managing your ideal rental property. You may be inclined to skip the "why" and general "how" of the parent book *Retire on Real Estate*, however I urge you to read that book in full as well. There are all kinds of nuggets that will support you in your endeavors. For example, I divulge why the "nest egg" method of saving for retirement is "cracked," including truths that Wall Street doesn't want you to know, and how to prevent your 401(k), mutual fund, or financial adviser from robbing you of half your earnings. I offer a new perspective on authentic diversification and I map out a whole new mindset on taking charge of your personal financial future and retirement dreams, whatever they may be.

Both the parent book, *Retire on Real Estate*, as well as this companion guide, can be used on your own or with others. A study group can provide motivation and be a great forum for exploring ideas and opportunities. This companion guide can also be an excellent tool for real estate clubs to share with their members, both new and experienced alike.

Be it on your own or with others, as you work through this companion guide, and as you put the lessons and tools to work in the real world, you will gradually shift from being a contemplator, "window-shopper," or "tire-kicker," to being an actual property owner and landlord. As this happens, I encourage you to share your experiences and lessons learned on my website: www.GetaChicken.com! I want to hear from you about your journey!

RETIRE ON REAL ESTATE (R.O.R.E.) BLUEPRINT FOR SUCCESS

A Step-by-Step
Companion Guide

INTRODUCTION

The goal of this Companion Guide is to help you get the right property, at the right price, and secure quality tenants for your property so that it can be an essential, solid, income-producing component of your long-term financial plan. In the parent book to this Companion Guide (*Retire on Real Estate)*, I share with you the *Why* and the *How*. In other words *why* it is so important to have at least one rental property as a part of your long term retirement portfolio, (no matter how much is (or isn't) in that portfolio) and *how* to do it.

I describe rentals as being like chickens because they provide rental income month after month, just as chickens provide eggs day after day. In *Retire on Real Estate* I also describe the Ultimate Goal and I offer the Level I, II, and III Goals as well as many goal-achievement hacks that will help you attain whichever Level Goal you choose for yourself (or any goal, for that matter!). Finally, and most importantly, I share with you many specific techniques for acquiring a rental property. This *Companion Guide* gets into far more detail in terms of *how* to protect your retirement dreams with real estate, which is why I'm calling this the *Step-by-Step Companion Guide*.

For those of you who are mid-life and older, time is of the essence in getting started. For those of you who are younger, retirement may feel like a very long ways off. No matter what your age is, it is never too soon to start planning. In fact, time is your greatest ally! The sooner you start, the easier things will be for you later on and the more options you will create for yourself.

Even if you enjoy your line of work and/or specific job, you probably don't want to work literally until the day that you die. Meaning . . . you need a plan. You need an investment portfolio that is truly diversified beyond stocks and bonds and virtual assets. At minimum, you need the Level I Goal.

You can achieve the Level I Goal of owning one rental property with minimal impact on your current lifestyle. If you plan to use a property manager, all you need to do is use the techniques provided in this *Companion Guide* to purchase or otherwise acquire a good rental property and let the manager do the work. You can then simply continue your current lifestyle and continue working your job or career until you are ready to retire. As you are working, your tenants will pay off your property mortgages on your behalf, month after month. Their payment should cover the mortgage, the mortgage interest, property taxes, and all other expenses. When it comes time to retire, you will have added a degree of diversification to whatever savings, pension, and Social Security income are in your unique retirement picture.

If you've chosen to set and attain a Level II or III Goal, then, once your mortgages are fully paid off, you will be able to retire by *seamlessly* transitioning into the same lifestyle that you enjoy now. The parent book, *Retire on Real Estate*, goes into these goals in detail, however let me briefly explain them here. The Level II Goal is about owning enough rental property such that when added to whatever else you expect to have in retirement (Social Security, pension, retirement account distributions, etc.), after your mortgages are paid off, the rental income –after expenses – is enough to cover your monthly living expenses. The Level III Goal entails having enough rental income (after expenses), once the mortgages are paid off, to replace your income from your employment, with all other expected sources of income being "bonus."

Refer to the parent book, *Retire on Real Estate,* for the many specific ways you can acquire rental property. You can use a fixed-rate mortgage and gradually pay it off until it is paid in full, thereby keeping it for the long term as a secondary income stream. If you do this, your property will always be there for you and will help support you if you ever find yourself between jobs.

Both the parent book, *Retire on Real Estate,* as well as this *Companion Guide* are for everyone: young and old, frustrated and content, affluent and poor, and all those in between. This book is for you, no matter your situation. Whether one rental property is your landing place, or just a start in your real estate investing career, I can assure you that if you buy the right property at the right price and screen your tenants well, in the end, you will not regret it. And, again, showing you how to do this is the goal of this Companion Guide.

Chapter 1 of this guide goes into what to buy, what not to buy, and how to evaluate your potential property so that it will be a successful addition to your retirement portfolio (and not a liability or a headache!). Chapter 2 covers the six essential steps to evaluating and conducting due diligence on a potential property to purchase – or one that you are converting from using as a residence. Chapter 3 shows you everything you need to know about making strong but safe offers, negotiating a great deal on your own, and teaming up with a realtor to negotiate on your behalf. Finally, in chapter 4 of this guide, I share with you how to conduct the three essential components of property management, including how to find an awesome tenant or property manager. By the time you finish going through this guide, you should be sufficiently equipped with the information you need to go out and buy a cash-flowing rental property, from day one of ownership, or convert your existing home into a cash-flow-positive rental property.

> The key to everything is patience. You get the chicken by hatching the egg. Not by smashing it.
>
> *Arnold H. Glasow*

CHAPTER ONE:
FIND A CHICKEN!

What to Buy
(And What Not to Buy)

Finally! It is time to apply the material from the parent book and get your "chicken." As the name suggests this companion guide is an actual step-by-step guide for selecting a rental property (or deciding if a home you already own would make a suitable rental property), getting that rental property and managing it well.

WORKING WITH A REALTOR

Working with a real estate agent can be incredibly beneficial. The most obvious benefit is that agents can let you into virtually any property on the market. This is particularly helpful in the case of foreclosed "real estate owned" (REO) or bank-repossessed properties. Agents also often have inside-information about properties that are not yet on the market. In addition, real estate agents often tend to know certain geographical areas very well. If you find an agent who is intimately familiar with the area in which you would like to purchase, the agent will probably have knowledge about the style and quality of properties in that area, property values, and the rental market, as well as how these all vary within the different sections of your targeted area. Since agents often enter and tour countless properties almost every day, they understand, better than anyone else, the quality of home that you can obtain at different price-points in your area of focus.

> Only those who will risk going too far can possibly find out how far one can go.
>
> *T.S. Eliot*
> *American-born Playwright*
> *(1888-1965)*

An agent who has expertise working with real estate investors can also help you look at your numbers to ensure that there will be sufficient cash flow to meet your goals. They can help you think through the myriad of other details involved with the purchase of a multi-unit property. An agent can run "rental comps" for any of your prospective properties, before you buy, so that you can have a fairly solid idea of what you will be able to rent the property for. Finally, agents can be your "bad cop" by negotiating hard on your behalf for the best price and other terms.

If you decide to work with a real estate agent, be prepared to answer three questions during your initial phone call or meeting:

1. Where do you plan to buy, specifically (i.e., your location)?
2. What are your criteria (i.e., maximum purchase price, type of home, minimum number of bedrooms and bathrooms, etc.)?
3. How do you plan to cover the cost of the down payment?

Your real estate agent will search for homes that meet your criteria and budget, but you should also scour housing websites yourself to get a feel for the market. Try narrowing your search criteria to view only properties that meet your strict specifications. Then, just to see how those properties fit in with neighboring homes, broaden the price criteria. Are these homes priced lower or higher than their neighboring homes? You want to aim for homes that are lower priced than their neighboring homes as long as the quality is relatively on par. Check out the photos of potential properties and their neighboring properties. How much repair or renovation work will a given property need? Will it be an easy investment or an overwhelming one?

Even if you believe you have incredible vision, be careful not to be too much of a dreamer when it comes to fixer-uppers. You don't want to get in over your head in terms of cost or the amount of work required. As you start out, it is best to aim for properties that need the least amount of work prior to having a tenant move in. In the real estate world, this is called "turn-key" or "move-in ready" because it is ready for move-in simply with the turn of a key. The best value is usually a lower than usual price on a house that needs not much more than a "shave and a haircut" (real estate jargon for simple updates like new paint and carpet). As discussed later in my section on negotiating skills, don't be afraid to make low offers, even 20 percent lower than the list price.

FINDING PROPERTY YOURSELF

For some strategies, as discussed in the parent book, *Retire on Real Estate*, it make the most sense to find property without the assistance of a realtor. These include the lease/sublet and lease-option. You can also seek a property yourself for a standard purchase.

You see, there are two real estate worlds. The first is the one that we see all the time all around us. This is the *retail market* and it involves things that are more noticeable our general surroundings. For example, you can readily see "For Sale" signs that are planted in front of homes by various real estate brokerage companies. The retail market also involves things like the multiple listing service (MLS), real estate agent advertisements, and easy online search capabilities that are accessible to everyday folks such as www.MRIShomes.com, www.trulia.com, and www.redfin.com, as well as websites sponsored by specific realtor companies.

If you are hunting for properties in the "underground" real estate market, you should still comb through real-estate websites to get a sense of value for different types of homes in different areas of town. However, your activities will be a little different since you are looking for properties that are not listed with an agent. If you see a "For Sale By Owner" sign posted on a property, this is basically a more public view on the underground market.

Another underground method that is visible to the public is the use of "bandit signs." Bandit signs are signs that are often affixed to telephone poles that display something to the effect of "We Buy Houses" with a phone number. These signs are primarily used by individuals whose goal it is to find a property at one price and then find a buyer for a higher price. In real estate jargon these individuals are called "wholesalers," bird-dogs," or "contract flippers." Whatever your opinion of bandit signs, if you are looking for a property, you can simply call the phone numbers listed on these signs to find out if there are any homes in need of a buyer.

Other less visible underground real estate market transactions occur around us all the time when a property is bought or sold without officially being put on the market. Examples are when you purchase a home from a friend or relative, or buy your landlord's rental property. It also occurs when you call people who have properties that are posted "For Rent" or send letters or postcards to homeowners in neighborhoods that are of interest to you.

DETERMINE YOUR CRITERIA

> Dream like an eagle. Plan like a mouse.
>
> *Danielle LaPorte*

When seeking a personal home to live in there are certain things that are "must-haves" and others that are "nice-to-haves." The same is true for rental property. The difference is that must-haves for your ideal home are going to be a bit different from must-haves for your ideal rental property. The number one must-have for rental property is that it meets your minimum cash-flow threshold after expenses. If it doesn't fit the bill on paper, then you don't need to spend your precious time going to see the property.

It's best to invest in what you understand in an area that you know well enough. One caveat to this is that if all you know is expensive homes in expensive areas, you are going to need to expand your radius a bit. To be safe, you may want to aim for safe, decent middle-class areas with homes at reasonable price points. Above all, you are looking for positive cash flow and you are simply not likely to get this in McMansion developments or upper-middle class areas because rents do not usually escalate in proportion to home prices.

It is very important to have strict criteria in terms of what you are willing to consider and what you will ultimately purchase. Once you develop your own criteria, don't stray. Veering from the elements of your criteria may mean getting into the realm of risk. I encourage you to memorize your criteria and know them so well that you could easily share them with a real estate agent or another investor on a short elevator ride. Consider this example:

"I'm looking for a three- to four-bedroom townhouse in XYZ neighborhood. The house must have a purchase price under $100,000, it must be at least 20 percent under market value, it must have anticipated rents of at least $1,200 per month, and it must be essentially turn-key (i.e., repairs and upgrades under $2,000). It must have no less than $200 cash flow after paying my mortgage and all other expenses each month on a 15-year mortgage even when accounting for the expense of a property manager."

There are three essential components to your criteria, which will be covered next. These are:

1. Cash flow
2. Location
3. Property type.

Criterion #1: Cash Flow

Cash flow should be your number one priority in selecting a rental property. You do not want to get into a situation where you are paying more for your mortgage and other expenses than you are receiving in rent. You can determine your numbers, for your geographical area, by playing around on my free Cash Flow Analysis (CFA) spreadsheet, available on my website (www.GetAChicken.com).

Cash flow is the result of many factors working together: purchase price, interest rate, length of mortgage, expenses, rental amount, tenant's ability to pay, and vacancy rates. I'll go into these elements of cash flow in the chapter 2, "Check Out the Chicken". For now, however, when it comes to determining your criteria, know that you need to focus on all of these. For example, if we dissect my elevator pitch, we can find each of these elements. See the following example:

"I'm looking for a three-bedroom townhouse in XYZ neighborhood [a relatively desirable area with low vacancy rates]. The house must have a purchase price under $100,000, be at least 20 percent under market value, have anticipated rents of at least $1,200 per month, and must be essentially turn-key (i.e., repairs and upgrades under $2,000) [and thus low expenses]. It must have no less than $200 cash flow after expenses each month on a 15-year mortgage even when accounting for the expense of a property manager."

I've mentioned that when selecting a rental property, it is always best to seek something that you can get for at least 10-20 percent below current market value. This has more to do with protecting yourself than making a profit. You are generally looking to keep your property for a long stretch of time, or even indefinitely. However, in the event that you want to trade up into a better property, or if you need to sell quickly, having that extra cushion gives you a bit more flexibility, or margin, as well as providing a level of safety in the event of a downturn in the market. That said, if you are able to get a property for close to market price and are also very confident that you will be able to get a healthy rent to cover all expenses with a bit left over, then the property may still be a good decision.

Criterion #2: Location

We've all heard it: "location, location, location." It sounds trite, however location is one of the most important aspects of your criteria, after cash flow. You can update a house or even bulldoze it and build a new one from scratch. But there is no realistic way to change its precise location . . . and all that comes with it, such as the habits of the next-door property, the amount of litter that tends to collect on the street, the flow of traffic, etc.

> Success is the result of good judgment, good judgment is the result of experience, and experience is the result of bad judgment.
>
> *Gary Keller*

Your ideal rental property will be in a relatively safe area that is stable in terms of employers and/or university students. Universities satisfy both of these criteria because they employ a large number of people, have many undergraduate and graduate students and are likely to be around for a long time. Most of our properties are within a short walk of a university. Students love being able to walk to campus; for this reason the demand for our units has always been high, vacancies have been essentially non-existent, and rents have been competitive. Our other properties are within a short drive of a number of different universities and other employers in the area.

Another quality of a good location is that it is "hot," or on its way to becoming hot. An area that is becoming hot is one in which there is visible new development, access to restaurants, retail, and transportation, rising home prices, and high rental demand. In short, p*eople want to live there.*

While there is a lot of obvious appeal to buying in a booming area, many investors believe the best deals are those that are in the low end of the middle of any market.[1] These so-called "bread and butter" homes constitute the largest market where the most people in the population will be buying or renting a home.

The most important thing here is that you have an in-demand rental market. In other words, you want your property to be in an area where you can fairly easily find good tenants who always pay their rent on time and keep the place in reasonably good shape. In addition, if you plan to use a property manager, or if you want to have the flexibility of hiring a property manager in the future, keep in mind that good property managers tend to be selective; they don't accept *all* properties into their portfolios. In particular, they stay away from properties in areas that are considered unsafe. Note that if experienced property management companies are staying away from certain areas, it would be smart to do the same.

If you do not live near an area that seems both desirable enough and yet attainable financially to a sizable portion of the population, don't despair. It is simply a matter of expanding your radius. When you are starting out, it is really helpful if you can get to your property within a short drive (unless you plan to use a property management company), but not at the sacrifice of your criteria! As you widen your radius, consider the closest area to your home within driving distance that is strong and/or trendy in terms of employers and/or universities. Once you locate your ideal investing area, you must get to know it very well before you begin investing.

Criterion #3: Property Type

There is an infinite array of property types that you could purchase as a part of your long-term retirement plan. These include single-family homes and townhomes, duplexes and multi-unit properties. There are also a number of property types that may not be best suited for your long-term plan. See the next section on "What Not to Buy" due to their higher-risk nature.

It is often said that it is best to buy "the worst house in the best neighborhood, not the best house in the worst neighborhood." While I wouldn't necessarily advocate buying *the worst* house, there is truth to this saying. One reason is that when you attempt to refinance your property (whether it's to lower your monthly payment or pull money out to reinvest) the homes that surround your property will have a deciding effect on whether or not you can do this. Neighboring homes determine the result of your appraisal.

> Always do your best.
> What you plant now,
> you will harvest later.
>
> *Og Mandino*

We have a relatively nice property that sits directly on the line between higher- and lower-priced neighborhoods. However, in the aftermath of the housing debacle, we were unable to take advantage of the low rates by refinancing this property: It consistently under-appraised due to the lower-priced properties nearby.

One successful strategy used by many investors is to go for a middle-of-the-road, generic, decent home in a reasonably nice, safe, middle-class area. Other investors prefer to buy within or on the edge of neighborhoods that they believe are in the process of turning for the better. You don't want to get into something too expensive, nor do you want something run down. By aiming for the middle, you will be aiming high. No matter the quality of the surrounding homes, whatever you do, it is best to not invest in a high-end property. Just because these may be desirable for you and your family does not make them ideal rentals. Remember, it's all about the cash flow, and expensive homes generally do not collect commensurate higher priced rents.

The bottom line is that you need two things in your property, both of which are vitally important to your success:

1) You want a property that people will want to live in; and
2) You need positive cash flow.

Later in this chapter, I show you everything you need to know about evaluating prospective properties so that you can be sure your rentals have both of these two essential ingredients to success.

WHAT NOT TO BUY

There are a few types of investments I advise staying away from entirely. There is a whole section on what not to buy, and why, in the parent book to this companion guide, *Retire on Real Estate*. Briefly, I'll restate that you probably want to stay away from: homes that are either too cheap or too expensive; homes that are in dangerous or ugly areas; homes that are major fixer-uppers; and condos, timeshares, and raw land. Again, the parent book, *Retire on Real Estate*, goes into detail on why these various types of properties are more risky than your average, decent property in an average, decent area. Basically, you want to steer clear of properties that don't produce income (i.e., raw land), properties that have uncontrollable expenses (i.e., condos), and properties that are vulnerable in times of recession (i.e., vacation property), in particular if you will have a mortgage on the property.

CHAPTER TWO: CHECK OUT YOUR CHICKEN

How to Evaluate a Property (The Six Essential Steps!)

After you find a property that meets your criteria – one that you believe would be attractive to potential tenants in terms of its general area, precise location, neighbors, style and quality, number of bedrooms and bathrooms, yard, etc. – it is time to determine whether the property will make a good investment for you.

There are six critical steps to evaluating a property, and they should be conducted more-or-less in the following order:

1. Scrutinize the property financials;
2. Tour the property (with the AIM Tool);
3. Get (free) repair estimates from licensed contractors.
4. Hire a professional inspector to inspect the property; and
5. Conduct "due diligence"
6. Hire a title agent to conduct "title search"

These six steps are in the following order to save you both time and money. For example, if the property fails to meet your financial cash-flow criteria, there is no reason waste time on a personal walkthrough or the other steps. If you discover, on your personal walk-through, that the repair needs far exceed your time, energy and financial resources (in other words, that property is a dump), then there is no need to proceed with bringing other in to evaluate the property. Finally, if there is a glaring repair need, or even a list of smaller ones, it is best to have this priced out and possibly negotiated with the seller before spending money on a professional inspection.

> Blinding ignorance does mislead us. O! Wretched mortals, open your eyes!
>
> *Leonardo da Vinci*
> *Italian Artist, Inventor, and Renaissance man*
> *(1452-1519)*

After you complete Step #4, hiring a licensed inspector, you may want to revisit Step #3 and have a contractor – or contractors – price out the immediate and eventual repair needs of the property. This is essential for calculating your cash flow but is also helpful so that you can renegotiate the price with the owner of the property.

The six essential property evaluation steps are described in the remainder of this chapter. Once you complete all six steps, you will know whether you are ready to move forward with purchasing the property. You need to be willing to walk away from a property if it doesn't meet your criteria and generate cash flow. Be selective. If it doesn't work out for one, rest assured that there will be another one, right around the corner.

PROPERTY EVALUATION STEP #1: SCRUTINIZE THE FINANCIALS

There are a number of financial metrics that you can use to evaluate properties. The most important of these are cash flow, return on investment (ROI), and payback period. Cash flow has to do with the monthly income benefits starting with day one. ROI has to do with your rate of return each year. The payback period is the amount of time it takes to recoup your initial investment.

Cash Flow

Cash flow was briefly discussed in the section on determining your criteria earlier in this chapter. At this point, we'll go into this important concept in more depth. Cash flow is your take home pay at the end of each month, after paying all the property-related expenses. Whether you purchase a new property or convert an existing residence into a rental, cash flow is your number one priority. If you have positive cash flow, it will help you survive any real estate market. Many investors aim for a minimum of $200 per month in cash flow on a single-family house or townhouse.

However, the minimum amount of cash flow that *you* are willing to settle for is a personal decision based on several personal factors, including the stability of your current job, the amount of cushion you have in your paycheck and the amount you have in savings. You'll need a cushion either in salary, in savings or both for when things don't go as expected. Refer back to the parent book, *Retire on Real Estate*, for a detailed explanation of the different methods available to you in determining the amount of reserves you should have before moving ahead with a property.

In addition to these personal factors, you'll want to take a close look at several factors related to the property. Since cash flow is the difference between what comes in versus what goes out, let's look at those items separately.

Factors Affecting the Cash-in Side of Cash Flow

The "Cash-in" side of cash flow is the amount of monthly rent that you charge and the tenant pays. In evaluating a property, you can estimate the expected rent based on the rent amounts of similar properties in terms of type, size, state of repair, and interior and exterior beauty or quality of renovation, in the same geographical area. Expect to receive about the same rent as similar properties with the same number of bedrooms and bathrooms in the same area. This concept is what is referred to as "rental comps", which is short for "rental comparisons." To be safe, it is best to use the lower end of any range in your calculations. Use Craigslist and Zillow to determine these numbers or ask a real estate agent to run rental comps for you. As a side note, you can also explore various rental comps across different areas *before* narrowing down your specific location, so that you can determine the best area to focus on in your search.

Keep in mind that a place in an undesirable, unsafe, ugly, or inconvenient area may be hard to rent, which will therefore affect your cash flow. A property in an undesirable area will need to be priced lower to make it more appealing, but in doing so you may attract tenants who are less invested in taking care of the property.

A key factor in cash flow is the tenant's ability and willingness to pay the rent on time each month. Part of ensuring that you have a quality tenant able to do this is doing effective screenings, as described in detail in chapter 4 of this *Companion Guide:* "Tend to Your Chicken." However, the rent does not always need to come from the tenants themselves. There is a government program called “Section 8” which pays rent on behalf of the tenants, every month, without fail. Therefore, if you would like to provide housing in an area that is lower income and has fewer economic advantages, you may want to consider the Section 8 program, as Venesa does quite successfully. (Check out her story in Appendix B.)

Also related to the “cash-in” side of the cash flow equation is a term called “vacancy rate.” Vacancy rate refers to the percentage of time over a year that the home is not rented. As an example, if it typically takes you about one month to find a tenant, and if you must find a new tenant each year, your vacancy rate would be just over 8 percent (1 month divided by 12 months = 0.08). A home with a reasonably priced rent in a popular area could have a vacancy rate close to zero. It is relatively standard to assume a vacancy rate of 5 percent in your calculations, though rates can, and do, vary by area. If your real estate agent suggests that the vacancy rate is higher in your specific area, then by all means use the figure suggested by your agent. Also, for an extra margin of safety, you may want to double your expected vacancy rate in your calculations.

Factors Affecting the Cash-out Side of Cash Flow

The Ultimate Goal is to eventually own your property (or properties) free and clear. Until then, your largest monthly expense will almost certainly be your mortgage payment. Refer back to the parent book, *Retire on Real Estate*, for detailed information on the components of a mortgage payment, including the principal and interest.

Your mortgage payment is a direct function of the purchase price, down payment and “terms” (interest rate and payback period). Negotiating a lower purchase price with the seller will naturally affect your payment. In addition, financing the property over a longer period of time, such as 30 years, will also give you a lower payment.

However, if your cash flow can allow it, you may decide to sacrifice some of your monthly income for a shorter payback period. Sometimes paying a small bit more each month can cut in half (from 30 to 15) the number of years required to own the property outright. It is a good idea to shop around across a variety of different mortgage brokers, banks, and credit unions for the best rate and terms. They all vary somewhat, so shop until you find a bank or broker with a good rate. For more information on mortgages to stay away from and mortgages that will be meet your unique goals, refer to the parent book, *Retire on Real Estate.*

Expenses are also affected by the age and quality of the home, the number of repairs needed, and the amount of upgrades needed to rent the house at the point that is on par with comparable rental properties. Again, the parent book, *Retire on Real Estate*, has a lengthy section on so-called capital expenses – or CapEx – and how to plan for these heavy hitters. CapEx refers to larger repair and replacement expenses that properties need from time to time.

As described in Property Evaluation Step #5 (due diligence) other expenses to factor in include utilities, taxes and exterior maintenance. Call your gas, electric and water companies or look online to determine what the bills have been in the past. Be sure to look at records for the full year because the amounts will vary by season. You should also find out from the local tax assessment office the current taxes and how you can expect them to change. Note that this is a changing line item. As a property increases in value over time, property taxes also increase.

At www.GetaChicken.com, you can download my Cash Flow Analysis (CFA) Tool which provides a modifiable template as well as examples of a hypothetical property with a $100,000 purchase price across different scenarios of down payment, length of mortgage, and whether or not the property will be managed by a professional property manager. Use the modifiable component of the CFA Tool *each time* you evaluate a property to determine if the cash flow will meet your needs.

Net Operating Income (NOI)

Net Operating Income, or NOI, is the term given to the cash flow on a property *before* taking into account your monthly mortgage and/or loan payments (principal and interest, only). NOI includes all income and expenses of a property, including taxes and insurance, with the exception of the principal and interest components of your mortgage payment.

What this means is that when you achieve the Ultimate Goal of owning a property "free and clear," in other words with no mortgage, then the cash flow and NOI will equal because the principal and interest won't exist anymore. NOI can be helpful when determining the number of properties needed to achieve the Level II or Level III Goal, as described in the parent book, *Retire on Real Estate*. Again, the Level II and Level III Goals entail owning enough property such that once the mortgages are paid off, the income – *in other words the NOI* – will cover your living expenses either along with other sources of retirement income (Level II Goal) or on their own (Level III Goal).

In addition to planning your Level II or III Goal, NOI can also be helpful when comparing two or more different properties of similar price. However, when it comes to deciding *whether* to purchase any given property, it comes down to cash flow, since the actual (meaningful) cash flow will be lower, in reality, than the NOI would make the situation appear, due to the fact that cash flow accounts for all expenses, including your mortgage payment. You can determine the cash flow of any given prospective property by downloading my free Cash Flow Analysis (CFA) tool at www.GetaChicken.com. On this CFA Tool you can also play with different ways to adjust your potential cash flow using different mortgage terms, interest rates, down payment amounts, and other expenses.

Cash-on-cash Return

A second measure that you can use to evaluate a potential property is cash-on-cash return, which is one way of measuring return on investment (ROI), as discussed at length in the parent book, *Retire on Real Estate*. It can be particularly useful for comparing two or more potential properties against each other under different financing scenarios. You can also compare these potential rates of return to other methods of investing such as the stock market, mutual funds, a certificate of deposit, etc.

Annual Cash-on-Cash Return is the amount of money produced by the property (after all expenses), divided by the total amount that you paid to acquire it and get it "rent-ready." The "amount made" is your total *cash flow* in a year (total income minus total expenses), while the "amount paid" is the amount of money you spent to acquire the property, including the down payment, closing costs, and expenses for repairs and upgrades. Again, see the Cash Flow Analysis (CFA) Tool at www.GetaChicken.com to calculate the cash-on-cash return for your prospective properties.

Cap Rate

The capitalization rate, or "cap rate" for short, is similar to cash-on-cash return except that it does not factor financing into the equation. Therefore, cap rate is more of a pure measure of the "worth" of a property from an investment standpoint. It is a metric that you can use to determine whether the advertised purchase price makes sense. A good cap rate is generally thought of as 10%, but you can use a lower cap rate in some cases if rents are under market value and/or if there is room to improve the property. The cap rate equation is equal to the NOI in an average year divided by the proposed purchase price of the property.

For example, if a potential property is listed at $100,000, and has an estimated NOI of $10,000, then:

cap rate = $10,000 / $100,000 **= 10%**

The cap rate can also be used backwards in order to determine an ideal purchase price for your offers. For example, if you wanted a 10% cap rate, and your due diligence finds the NOI to be $10,000, then

purchase price = $10,000 / 10% = $10,000 / 0.1 **= $100,000**

Payback Period

Just as ROI is influenced by the amount of skin you have in the game, so is the payback period. The payback period is the length of time it takes to earn back your initial investment. Needless to say, the shorter, the better, because once you achieve your payback period, you can begin "making money."

As an example, suppose you buy a $100,000 property. You spend $20,000 on the down payment, $5000 on closing costs, and another $5000 on repairs and upgrades, equating to $30,000 in total out-of-pocket expenses. Hypothetically, if the cash flow is $5000 per year, then your payback period is six years ($30,000 divided by $5000/year = 6 years). Once you have completed your payback period, this is when you begin making money over and above your initial investment. You can use the projected payback period – along with cash flow and other financial criteria – to decide if you want to pursue a given property investment.

Taxable Income

One of the many benefits of rental property is that your taxable income is less than your actual income (before taxes). The reason for this is depreciation. Depreciation is a hypothetical deduction. It is considered bonus because it is not an actual expense that you are writing off. Depreciation starts when the property is "placed in service" as an investment property. In other words, if you convert your own home into a rental, then you can start taking the depreciation benefit the moment you move out and make the home available to rent.

The remainder of this section provides a brief overview of depreciation. However, if this stuff makes your eyes glaze over, just skip to the next section on Property Inspection, but do make a point of discussing depreciation with your accountant when you purchase a property. (On the other end of the spectrum, for those of you who crave a detailed understanding of depreciation, see Amanda Han and Matthew MacFarland's easily digestible book *The Book on Tax Strategies for the Savvy Real Estate Investor*.)

As a very brief overview, depreciation is estimated by looking at tax assessment records and dividing the value of the "depreciable basis" by the "useful life." So, what does this mean *in English*? The numerator, depreciable basis, is the portion of the tax assessment that is attributable only to the structure (not the land on which the structure sits). The denominator, the useful life, is always set at 27.5 years for residential property. As an example, if the value of a property is $120,000, and the value of the non-land component is valued at $100,000, the depreciable amount is calculated as $100,000 divided by 27.5, which equals $3,636. You can also deduct other components of the property, but for the sake of simplicity in this example, we've considered only the structure.

To continue with this example, the following steps show how depreciation relates to actual taxable income. First, use the Cash Flow Analysis (CFA) Tool provided in this book and for free on my website www.GetaChicken.com to determine the annual "net operating income" (NOI), just discussed. The CFA Tool for this example is illustrated in Table 1. As such, the monthly NOI is $683 using a property manager, and the annual NOI is $8,196. The next step is to subtract your other tax deductible real estate-related expenses over the year. In this example, say your deductions add up to $3,000. Then subtract the mortgage interest, which is $3,192, given the parameters in this example, as well as your depreciation, which is $3,636, as calculated above. In this example, your taxable income is -$1632 while your actual cash flow was $8,196. Notice that not only is your taxable income far less than your actual income, but it is a negative number, as is often the case with rental property, a loss that you deduct off the rest of your income tax return. This example this is shown on the following page.

Annual NOI	$8,196
Subtract other deductions	-$3,000
Subtract mortgage interest	-$3,192
Subtract depreciation	-$3,636
Total taxable income =	**-$1,632**

Table 1. Cash Flow Analysis Tool ($100,000, 20% down, 30 year)

#5			20% Down Not Managed 30 year Term		20% Down Managed 30 year Term
Purchase Terms	**PURCHASE PRICE**		**100,000**		**100,000**
	Down Payment	**20%**	20,000	**20%**	20,000
	Total Mortgage Amount		80,000		80,000
	Total Closing Costs	**4%**	4,000	**4%**	4,000
	Updates & Repairs		**2,000**		**2,000**
	Cash (Out of Pocket)		**26,000**		**26,000**
Monthly Operating Expenses	**Monthly Income**				
	Monthly Rent Expected		1,200		1,200
	Vacancy	**5%**	**60**	**5%**	**60**
	Effective Gross Rent (EGR)		**1,140**		**1,140**
	Monthly Operating Expenses				
	Management Fee	**0%**	0	**10%**	$ 120
	Insurance		50		50
	Maintenance/Repairs	**10%**	120	**10%**	120
	Other Expenses		-		-
	Property Taxes	**2%**	**167**	**2%**	**167**
	Total Operating Expenses (TOE)		**337**		**457**
NOI	**Monthly Net Operating Income (NOI = EGR minus TOE)**		**753**		**683**
Cash Flows & ROI	Monthly Payment (Principal + Interest) @	**4%**	**382**	**4%**	**382**
	Monthly Cash Flow		**371**		**301**
	Return on Investment (ROI)		**19%**		**14%**

PROPERTY EVALUATION STEP #2: VISIT THE PROPERTY

In the parent book, *Retire on Real Estate*, I told the story of my dad who taught me by example to never, *ever* buy a property without seeing it first. He bought some land in New Hampshire expecting it to be a beautiful, peaceful property nestled in the woods. I don't know if his intentions were to build a home on the property, or sell it later at a profit, or both, however neither outcome were in the cards. After signing papers and securing a monthly mortgage, my dad was in for quite a surprise! In fact, we all were. When we finally got to the property, we discovered that it was directly across the street from the county dump!

To help with your initial walkthrough, I've developed the quick and easy Anderson Inspection Method (AIM) Tool. (Taking photos and especially videos can also help with this!) The complete AIM Tool is included in the appendix of this guide and is also downloadable for free on my website www.GetaChicken.com.

The AIM Tool is designed to help you quickly size up the quality of a property. It will also help you remember aspects of the property and its condition later on and help you distinguish one property from another if you are evaluating more than one. It will also help you objectively compare the property to other properties you are considering. You can also use these items to decide whether you want the property in the first place. If it seems that it is just too much work to take on, it will be clear from looking at your answers and notes. You can also use these items to negotiate with the seller (without being insulting of course!).

Here's how the AIM Tool works. As you walk through the property, go down line by line and simply circle the words in the column that most correspond to the condition of each listed item. You can also make notes in last column. As you look back over your completed AIM Tool, you can quickly assess whether most of your circled items are in the good, fair, or bad columns and this will help you know how to proceed.

Windows are a major factor for me. Older homes with original windows are usually painted with lead paint, which can be expensive to remedy. On the other hand, keeping original lead-painted windows can be worse, especially in terms of the potential lead-paint exposure to families and the added difficulty in passing inspections. Another red flag has to do with the horizontal water pipes in the basement. If they are not visible, then this is a red flag in and of itself. If the property is older and if these pipes are made from iron, especially if there are little green dots or wetness visible on their downward side then this is also a flag that the pipes are gradually preparing to burst, unless they are replaced first of course. If you see the thinner copper pipes or white plastic pipes (CPVC), then you know that the pipes are newer and less likely to cause problems down the road.

Granted, these items do not necessarily need to be deal breakers. If you are still interested in the property, be sure to account for these repairs and upgrades in your projected initial expenses and cash flow lines and use this information to negotiate a lower purchase price – or better yet, funds received back at closing – with the seller.

Keep in mind that the AIM Tool is for *your* personal walkthrough and for gaining a ballpark assessment of the condition of the property and the work needed. It is not in any way a replacement for an inspection by a licensed inspector. If you end up having a contract accepted for the property, be sure to follow up with steps #3 and #4. Licensed home inspectors are trained to find issues and they often perform several inspections a day, so they *will* find things that you haven't found.

PROPERTY EVALUATION STEP #3: GET FREE REPAIR ESTIMATES

The third step in your evaluation of a potential rental property is to obtain free no-obligation estimates from at least one licensed contractor (three is ideal) to perform any necessary work on the property. It is best to do this before paying for and obtaining an inspection from a licensed home inspector because if there are large, glaring issues that are simply too overwhelming or expensive to fix, then there is no point in spending money on an inspection. If this is the case, you will want to simply move on. If you are already under contract, then you will quickly invoke one of your "escape clauses." See Chapter 3 about necessary clauses to include in your contract that will allow you to have your earnest deposit returned to you.

That said, in some cases, there may be no visible issues that are obvious to you, meaning that unless you simply want a contractor's opinion on the place in general, it would not make sense to bring in a contractor. If this is the case, or if your contractor's estimates are within an acceptable range after plugging them back into the Cash Flow Analysis tool (again, on www.GetaChicken.com), the next step is to proceed to the professional inspection.

It should be noted that this contractor step is rarely "one-and-done." You may need to use the information from your professional inspection (described next) to circle back around and have your contractors come back out and give additional estimates.

It is always a good idea to run the estimate(s) by the seller before deciding that a repair is too costly to continue. You never know – the seller may be willing to make the repair or provide funds back at closing for you to make the repair yourself. (Note that funds back at closing are infinitely more desirable than reducing the purchase price by the same amount because this provides real capital that you can use to improve the property on the first day of taking ownership.)

PROPERTY EVALUATION STEP #4: HIRE A PROFESSIONAL INSPECTOR

Once you have run the numbers on a potential property, visited the property, and determined the costs necessary for any glaring issues, and if everything still looks favorable, it is critical to hire a licensed home inspector to conduct a professional inspection. Ideally, you should use someone who has been recommended to you by another investor. If you use your real estate broker's inspector, then there is the potential for a conflict of interest since the broker's motivation is to help you buy a property and the inspector's job is to uncover issues with homes which could potentially lead to no sale.

You want an inspector who is competent, respectful, patient, and painstakingly thorough. In addition, you want someone who will conduct the inspection with you by their side, so they can explain everything that they see: the good, the bad, and the ugly. A good inspector will also respectfully take the time to explain how the house operates and what you need to do to properly care for it if and when the purchase goes through.

Your licensed inspector is well worth the money! For somewhere between $200 and $400, he or she is trained to see all kinds of things that most of us would never notice. As an example, we once had a pretty decent looking property under contract. It had new carpet, new paint, and seemingly new windows. However, the inspector discovered that the windows had been installed incorrectly, and that as a result, rain and snow had been given clear access into the core of the exterior walls for an unknown length of time. Where I saw lovely new windows, the inspector detected improper installation of those windows. As a result of this inspection, and after having licensed contractors back out to the house to determine the extent of the potential damage between the walls, we backed out of the purchase and avoided a potential nightmare.

Again, the best way to find a good inspector is through word-of-mouth from other investors. Other options include home buyers in general, realtors, or Angie's List. Just as a rental property can be thought of as a sort of insurance policy against an uncertain stock market, a good inspector is your insurance policy against an unknown property. Never cut corners here or you could end up kicking yourself later.

PROPERTY EVALUATION STEP #5: CONDUCT FINAL DUE DILIGENCE

By now you know exactly how to evaluate a property before buying it in order to maximize your chances of getting a good one! In the real estate world, this is called "due diligence." At this stage you want to conduct any and all "final due diligence." This means double checking all your numbers and doing any remaining homework that is necessary to ensure that you are making the right decision in proceeding with a plan to purchase a property. If your potential property has successfully passed Steps one through four, just discussed, then conducting any last due diligence is necessary before proceeding to the next step of working with a title agency or real estate attorney. Due diligence includes verifying actual numbers and ensuring that the Cash Flow Analysis (CFA) Tool has been accurately filled out. Verify from your mortgage lender the actual monthly amount that you will owe, including taxes and insurance. Obtain accurate projections of all utility bills by reviewing records for the full year to avoid seasonal variation. It is also important to verify with the gas/electric and water/sewage companies that there is no outstanding balance associated with the property address. The same goes for the property taxes. In addition, you can ask the property tax department whether and how you should expect your property taxes to increase with time.

At this point in time, you want to double check that the purchase price is in line with comparable homes, that your upcoming repair items and other expenses that you will have on the property are accounted for in your cash projections, and that your initial calculations were correct in terms of projected rent that you will receive.

PROPERTY EVALUATION STEP #6: HIRE A TITLE AGENT TO CONDUCT A TITLE SEARCH

Once a property had made it through final due diligence, the last step is to work with a title agent or real estate attorney on all aspects related to settlement. One component of this is to have the title company conduct a thorough title search. A title search is the process of determining that the property title is legitimate and free of any existing liens. In other words, you need to know that the person selling the property to you is indeed the rightful and sole owner so that once the sale takes place you can know with confidence that you are the new owner. The title company also searches for any outstanding mortgages, liens, judgments, and unpaid taxes associated with the property, as well as any restrictions, easements, leases, or encroachments or easements by neighbors. If all is well after your title company completes the title search and after you have completed steps one through five, just described, then the next step is to proceed to the settlement table (usually held at the title company) to purchase your golden chicken!

CHAPTER THREE:
GET THAT CHICKEN

How to Negotiate a Great Deal
(And Get Out of It, if Necessary!)

Whether you are flying solo or enlisting the help of a real estate agent, you must make offers. Often it takes several offers across different properties in order to acquire your ideal property at a reasonable price. This is where it gets really scary. You can analyze, inspect, and reanalyze a property to death, but until you make an offer you are no closer to your Level I, II, or III Goal of actually owning an investment property for your long-term retirement security.

This chapter goes into the essential step of making offers. It explains what is meant by an offer, how and when negation is a part of the offer-making process, and what elements to include in your offer to protect you in the event things don't go as expected.

WORKING WITH A REALTOR

> Man who waits for roast duck to fly into mouth must wait very, very long time.
>
> *Chinese Proverb*

Working with a realtor can be a great experience because a realtor will be your advocate throughout the entire buying process. This can be a huge stress reliever.

When you are working with an agent, however, it is best not to simply get in the back seat and wait for closing. Think of yourself as riding shotgun. You are in the passenger seat and your job is to navigate while your agent drives the car.

You will want to ask lots of questions. You will need to know the "comps" (prices of comparable homes, both recently sold and listed for sale) and the rental "comparisons" (rent-amounts for comparable properties). You will also need to make your needs known with your agent, so that they can advocate for them with the seller's agent. In your offer, you will want to include certain key clauses, as described later in this chapter. Some of the clauses I recommend may be unfamiliar to your agent, so it will benefit you immensely to familiarize yourself with them and push for them if necessary. Keep in mind that even though there are traditional ways of doing things in real estate, it is also a field with incredible flexibility. The sky is the limit in terms of what you can negotiate with a seller. Remember that, as Stevie Wonder put it, "If you don't ask, you don't get."

On a similar note, you can also make requests of your agent. For example, depending on your real estate agent and your relationship with that person, they may be willing to take their commission with interest over time, rather than all at once at settlement. In this way, you could either deduct the amount of the commission from your down payment or have receive a check a settlement to apply toward upgrades or repairs to the property. You would then pay the agent back according to an agreed upon interest rate and period of time. If you have no loyalties to a particular agent, you can even shop around for someone willing to help you out in this way. This arrangement would need to be communicated to the title company prior to settlement.

BASICS ABOUT THE OFFER

An offer is simply a legal contract that is complete with the exception of the seller's name and signature. This is submitted to their real estate agent by your real estate agent. If the seller accepts your offer, then they simply sign the document and return it to you. If they don't like any given aspect of the offer, there can be some back and forth between the two agents, on the behalf of yourself and the seller, until there is agreement.

If you are not working with an agent, all the work – from negotiations to submitting and resubmitting contracts to scheduling inspections – is in your hands. If you decide to represent yourself, during the negotiation stage, it is usually advantageous to have all your conversations and negotiations with the seller in person. (See the last section of this chapter.)

You then submit the written offer to solidify any verbal agreements that you and the seller have already come to. You can download a standard "Purchase and Sale" contract specific to your state (or country, if outside the US). Even at this point, there may still be some back and forth regarding some aspects of the offer. The seller may have questions or objections to certain clauses. You can use the offer to springboard into further negotiations. As explained in the last chapter, various aspects of the offer, such as purchase price or amount received back at closing, can further be negotiated throughout the entire property evaluation and due diligence phase between the time you have a signed contract (ratification) and the time you take ownership (settlement).

Whether with the help of an agent, or as a do-it-yourself (D.I.Y.) project, your offer is not legally valid until you submit an earnest money deposit. The legal term for this is "consideration." Never give cash as consideration and never write a check directly to the seller. If things go wrong, you may never see your money again. Instead, make your check out to the title company or real estate attorney that you plan to use for settlement. If you are using a realtor, you can also make your check out to the real estate brokerage company. The amount of the deposit is negotiable, however I've found that for most transactions a deposit in the amount of $1000 is often acceptable. Remember that the amount of the deposit shouldn't matter so much to you, as long as you have a strong enough "out-clause" in your contract and as long as you don't give the check directly to the seller. If you follow these precautions, then you *will* be able to get your money back if you decide to back out. The next section shows you some essential clauses for your offer that will allow you to back out of a contract if any element of your six-stage property evaluation turns out negatively or for any other reason.

KEY CLAUSES FOR YOUR OFFER

It is vitally important to protect yourself in case you decide to back out of your offer. To do this, you simply need to include at least one strong "out-clause" in your contract. An out-clause is language that allows you to cancel the offer and receive your earnest money deposit back for certain reasons. The ideal out-clause allows you to get out for any reason whatsoever, *even if you simply change your mind.* You really only need one solid out-clause.

While real estate agents have some standard out-clauses, their clauses are generally more limiting. For example, a standard realtor's purchase and sale contract has two general out-clauses: "contingent upon financing" and "contingent upon inspection by a licensed inspector within seven days." These give you some flexibility, but not a lot. Here are some examples of very strong out-clauses that you should consider using or requesting your agent to use:

1) This offer is contingent upon an inspection prior to closing by a licensed inspector, contractor, or another professional, that is satisfactory to the buyer.
2) This offer is contingent upon the approval of the buyer’s attorney.
3) This offer is contingent upon the approval of the buyer’s spouse or partner.
4) This offer is contingent upon a study period of XX days. [This clause is used more frequently for multi-unit buildings and commercial real estate.]
5) The buyer will be provided a key upon ratification of this contract and the buyer will have the right to market and show the property and to receive contractor estimates for work. This offer is contingent upon having a tenant secured to rent the property within 30 days after settlement.

A good out-clause can give you great peace of mind and help you sleep better at night as you proceed through the six property evaluation steps and decide whether to move forward with buying the property. You can pick your favorite out-clause from above, or construct your own. Whatever you do, it is a good idea to run your contract by an attorney or seasoned investor.

Again, you really only need one good out-clause. Using more than one could turn off the seller and make them wary that you might not go through with the purchase. This will weaken your offer and if there is competition for the property, you could lose the house to someone else.

When you purchase property as a rental, you’ll want to ensure that it is rented ASAP, ideally from day one. All you need is the right contract clause, a positive relationship with the seller, and the willingness to begin showing it to potential tenants even before you are the official owner. Of course, you’ll also need a key or the combination to a lockbox.

Being able to collect rent right away and not have to worry about filling the property will save you time, money, and jittery nerves. To do this, you need to use a clause to allow you to market and show the property during the time span between ratification and settlement. Secure your tenant with a security deposit and signed lease, with its own clause that the rental contract is contingent upon your going through with the purchase of the property and that the security deposit is refundable in the event you do not take ownership. If you make the request, the seller may even be willing to align settlement with the start-date for your new tenant. Remember, everything – literally everything – is negotiable. And, on that note…

NEGOTIATING WITH THE SELLER

Given that there are whole books on negotiation tactics, this section will be fairly brief. If you are not using a real estate agent, then you will need to do all the negotiating yourself. The most important thing to keep in mind when you are negotiating with a seller is to keep it friendly and positive and work toward a win-win for both parties.

Don’t be afraid to ask for what you need or would like, and remember that price is not the only thing on the table. When you give up something, always ask for something else. These various items include (but are not limited to):

1) Price
2) Closing costs
3) Seller financing (and seller financing terms)
4) Ability to assign the contract, if desired
5) Ability to market to prospective tenants before settlement

6) Settlement date (aim for the latest possible date to give yourself more time in marketing it; or request settlement to line up with a rental lease start date)
7) Appliances, lighting fixtures, furniture, art, or anything else you see on the property that can "sweeten the deal"
8) Ability to start repairs before closing

When it comes to price, it is often said that you make money when you buy, not when you sell. This basically means that you need to buy for the right price. Generally it is advisable to buy 20 percent below market value when you are able. This is also a safeguard because if you find yourself in a position of needing to refinance or sell the property, you are able to do so with more flexibility.

If you are negotiating directly with the seller, it is often best to have the seller propose the starting price, rather than proposing the first number yourself. This is because you never know; they might have a much lower number in mind than what you would have proposed. If their price seems too high to make the deal work out for you, say so and propose a new price based on the results of your Cash Flow Analysis (CFA) Tool (see www.GetaChicken.com). You can also ask them what the lowest price is that they would accept if you were able to buy using "all cash" right away. This will help you get to their true bottom line. Whatever the case, negotiation can and should have much back-and-forth, especially considering all the other items that could potentially come into play. After you ask a question or propose something, don't be afraid to sit in the silence, no matter how uncomfortable it might feel. If you are resolute on not breaking the silence, this will force the other party to respond to your question or offer in some way.

When you land on an agreement that meets the needs of both you and the seller, get it in writing ASAP. It needs to be added right into your contract, directly or as an addendum. Then make sure you and the seller sign the contract and initial next to any insertions or deletions that have been made into an existing contract. You are then one step closer to owning that chicken! Once you have a ratified contract, you will need to do the following steps before proceeding to the settlement table:

1. Conduct the six property evaluation steps, described the last chapter.
2. Discuss the potential investment with a CPA and/or accountant.
3. Work closely with your lender to fulfill their many requests and questions. (See the next section in this chapter.
4. Work on securing a quality tenant (see the next chapter).

Making your first few offers will be terrifying. And, trust me, having them accepted will be even more terrifying! Your first thoughts may be: "Am I paying too much for the property?" "What's wrong with the house that I'm not realizing?" "What if I can't find a tenant?" Rest assured that these are normal feelings that will bubble up. If you've done your homework, done your due diligence, and secured a quality tenant before going to settlement, the rational part of your brain can be invoked to quell your nerves and keep you and your retirement dreams on track.

WORKING WITH A LENDER

Note: This section was submitted by Justin M. Demola, Chief Operating Officer, MLB Residential Lending, LLC., in Springfield New Jersey (www.mlbmortgage.com).

The best time to start working with a mortgage originator is actually before you enter into a contract to purchase a property. Whether it's with a bank or mortgage broker, a "mortgage originator" is the individual who takes us from start to finish through the process of attaining a mortgage. Just like searching for the best rental property for your situation, you need to find the very best mortgage originator for you . . . that is, someone who is familiar with the local market, understands your long term goals and has access to mortgage products from a number of different sources. This last point is especially important in case anything changes during the process that could affect your eligibility for the product that you initially applied for.

Personal referrals are by far the best way of finding an originator. This individual has earned the referral based on his or her past performance with someone you know and hopefully trust. Most realtors have relationships with an originator, but it is also important to seek out a referral from someone who has actually used the originator to purchase property themself. Before committing to any one originator, it is best to speak with at least three originators that were personally referred to you.

Once you decide on an originator, it is most effective to get the process started so you can act swiftly when the right property comes along. You will typically need to supply 2 years' of income documentation, 2 most recent pay stubs, and 2 most recent asset statements for all accounts used for down payment and reserves. Supplying all of this information in advance of finding a mortgage will allow the originator and his or her staff to review your documents and counsel you on affordability and review available loan products.

As explained in the parent book to this companion guide, *Retire on Real Estate*, it is critical that you seek a fixed-rate mortgage, and ideally one with the shortest term you can safely afford. This is especially important for long term budgeting purposes. After all, when purchasing a property as a long-term rental, your Ultimate Goal is to pay off your mortgage as quickly as possible! However, you also want to be comfortable with your mortgage for the entire term of the loan. Many originators will tell you that you can always refinance in the future to save money, and, while that is often a possibility, there is no guarantee that interest rates will decrease or that you will qualify for a refinance when they do. Rather, it is best to find a mortgage product that you can comfortably afford and then put additional payments on a monthly or other periodic basis to cut down the length of the term.

Have you ever wondered how your mortgage broker or bank gets paid? Mortgage brokers are compensated by the wholesale lender with whom they originate the loan, while banks get paid when they sell the loan to an investor after closing. Both brokers and banks have access to comparable products and pricing and any difference should be very minimal to you. The mortgage process should not be intimidating if you choose the right professional. Your originator should be able to guide you through the process from start to finish without issue or concern.

> I learned that courage is not the absence of fear,
> but the triumph over it.
> The brave person is not the one who does not feel afraid,
> but the one who conquers that fear.

CHAPTER FOUR: TEND TO YOUR CHICKEN

How to Find a Great Tenant (Or Property Manager!)

Once you have a contract to purchase a property it's time to find a tenant. The very first step is to decide whether to hire a property manager or rent the property out yourself.

The answer will depend on a number of factors. How close do you live to the rental property? If you live within a short drive, you may be more inclined to rent it out yourself. However, if you live more than 30 minutes away or so, you might prefer to hire a good property manager who can check in on the house and tenants and be there at a moment's notice when necessary. That said, if you read Jen and Rachel's story in Appendix B, you will see that it is quite possible to have a long-distance property without a property manager. They use simple tricks like having their tenants meet the handyman (or handywoman) and providing monetary incentives for finding a replacement tenant upon move-out.

> What we anticipate seldom occurs. What we least expected generally happens.
>
> *Benjamin Disraeli*

Most importantly, it comes down to how much time and energy you have to handle property management. Even if you live in the same town only a short drive away, you might decide that you simply don't want to worry about any aspect of property management. This was the decision of Kevin and Andrea, also in Appendix B. They much prefer the hands off approach. On the other hand, I and many of the people I interviewed for *Retire on Real Estate* and this companion guide have found that it is quite doable as a do-it-yourself (D.I.Y.) side project.

Whether you do your own property management or hire someone to take care of that for you, it is important to understand the three main goals of property management. These are:

1) Take care of your tenants;
2) Take care of your property; and
3) Collect the rent on time.

D.I.Y. PROPERTY MANAGEMENT

Managing your own property is not rocket science. Nor does it warrant all the fear that comes to mind when some people think of being a landlord. In fact, it's often pretty tame (except, of course, when it isn't!).

Like many do-it-yourself landlords, I have my horror stories. That said, I have gotten through each one. Having an emergency fund is essential. Like climbing a tall mountain or accomplishing another challenging feat, you become bigger, smarter, and stronger after you get through a rough situation. And you are more equipped for the next one. There is a catchy song on a Daniel Tiger cartoon that my daughter was watching recently that sang: "Solve the problem yourself and you'll feel proud!" This is just as true for adults as it is for children!

In order to support the three aims listed above, there are eight general tasks to do-it-yourself property management:

1) Register your property with the city/state
2) Find potential tenants (i.e., marketing)
3) Screen potential tenants
4) Secure your tenant
5) Collect rent
6) Attend to repair and maintenance needs
7) Track all expenses and mileage
8) “Other duties, as assigned”

1) Register Your Property

It is very important to comply with all legal requirements of your jurisdiction. The first of these is related to maintaining lead-safe inspection certificates. Usually this entails passing a lead inspection and registering your property with your state’s Department of the Environment. Rules vary by jurisdiction, however before having the lead inspector to the property, it is best to ensure that you have no flaking or peeling paint visible on the interior or exterior of the home and you have no doors that rub their doorframes upon opening or closing.

You also will need to register your property with the appropriate city and state offices and, if required, obtain a permit to operate the property as a rental. Depending on your jurisdiction, these registrations may be one-time, annual, or when a property “turns over” or has a new tenant. Look online for the specific requirements of your particular city, state or jurisdiction.

2) Find Potential Tenants (i.e., Marketing)

Your first option in finding potential tenants is to hire a property manager or real estate agent to serve as a “tenant finder.” Such an individual can list your property as “for rent” on the Multiple List Serve (MLS), the national searchable database of all homes in the U.S. that are on the market for sale or for rent. Typically, your tenant finder will also meet potential tenants, conduct their credit screening, and work with the potential tenant’s agent if he or she has one. If you use a tenant finder, you can expect to pay the typical fee of the entire first month’s rent.

You can also find a quality tenant on your own fairly easily. There are many online resources such as Craigslist and Zillow. If you use Craigslist, you need to be savvy about the responses you receive. Scam artists are abound and constantly tweaking their method for conning property owners out of money. Legitimate responses won’t require you to do odd things, such as respond to an email address that was sent in a text message, or receive a large sum of money from an “employer” and refund back a small amount of it.

You may also consider going through local resources such as the housing offices at the colleges, universities, hospitals and large employers in the area. I’ve found it less useful to put a sign up in the front yard. This method, especially when the rent amount is not posted on the sign, seems to cast *too large* of a net, resulting in too many calls and a smaller proportion of those who would qualify based on requirements related to credit score, income, and pets.

3) Screen Potential Tenants

Good eggs and bad eggs look the same on the outside. And the same goes for tenants. It cannot be stressed enough how important it is to thoroughly screen your potential tenants. We learned how damaging it can be to slack on screening a couple times – which is a couple times too many! A comprehensive screening includes the following:

Phase 1: Initial Communication

My prospective tenants may not realize this, however, I begin screening them the moment they first make contact with me. Whether it is by email, text, or over the phone, I take note of whether they are courteous, friendly, and somewhat professional in their tone. Do they write in a way that is more or less grammatically correct (AND NOT IN ALL CAPS, which can sometimes be an indication of a Craigslist scam)?

Then, I gauge their response to my initial question, which varies slightly by whether I am seeking someone to join a house-share or someone who is interested in renting a whole house or unit.

If they are inquiring about a house-share, my first question is:

- Can you please tell me something about yourself and why you are moving?

However, if they are inquiring about an apartment or house (non-house-share), I simply ask:

- Can you please tell me why you are moving?

There are many reasons I ask these broad openers. For starters, it rules out many scam artists who send generic and often fishy-sounding and often lengthy responses (though the exact nature of the scam seems to continually evolve). The first question is also open-ended enough to give me more of a feel for the type of person they are, without freaking them out or coming across as a creep.

Keep in mind that prospective tenants are screening landlords too. For example, I never ask about someone's sex, age, or place of work in our early communications because these questions can be off-putting or just downright scary (especially for females!). And remember, never ask questions related to race, sexual orientation, gender identity, age, nationality (or place of birth), disability, religion, marital status, or whether they have kids. These questions violate the Fair Housing Act and are illegal.[2]

> For one who has conquered the mind, the mind is the best of friends. But for the one who has failed to do so, his very mind will be the greatest enemy.
>
> *Bhagavad-Gita*

Phase 2: Time-saving Screening Questions

Before going any further with a potential tenant, I've learned to ask a few key questions which allow me to quickly rule out someone who is not a good match. This saves everyone's time. It's no use spending time on additional conversations (or showings) if there are any immediate deal breakers. If they answer in a way that is opposite to my needs, then there's no point in going any further. The questions that I use are listed below (and you may also find that you come up with your own deal-breaker questions over time).

- I'm looking for someone to start June 1 [or whatever date the property will be newly vacant]. Will this work for you? If not, are you willing to pay beginning June 1?
- Are you able to comfortably afford the rent of $___ on an ongoing basis?
- If you decide that you want the place, are you able to provide a security deposit (in the same amount as rent) plus one month's rent, in full?
- Do you have any pets?
- Do you ever smoke indoors?

These last two points – the pets and the smoking – are about protecting your property. We discovered early on how pets can cause damage to a home. (See the "Tenant from Hell" section in the parent book *Retire on Real Estate*!) Remember that your property is an investment and you want to take good care of it, so that one day it will take good care of you. I hope you also keep in mind that it does not make you a hypocrite if you love pets and/or own pets yourself but don't allow pets in your rentals. That said, however, if you find yourself having a difficult time finding a tenant, you may decide to open it up to pet-owners, in which case, it is wise to require an additional "pet deposit" or charge an additional nominal "pet rent" as an added layer of protection against the wear and tear and damage potentially caused by pets.

Phase 3: The Meeting/Tour and the Application

If your prospective tenant lives locally, he or she will want to come see the place (and if it a house-share, meet the potential housemates). It is best to show up to that meeting with an application in hand. However, I've found that it is never effective to ask if they want to fill out an application. You never want to come across as too eager or pushy to have them take the space. Instead, it is best to wait until they ask you something like "So what's the process?" At that point you give them the application and if you both have the time, the applicant can fill it out on the spot and provide a modest application fee. We charge $30 which goes directly toward the cost of the credit screen. Remember that nothing is final until you properly screen your applicant (see the following section, "Screen Your Tenant") and receive a security deposit (see the section "Secure Your Tenant").

If your prospective tenant is long-distance, it is important to be the human face on the rental as much as possible. The reason for this is that there are so many scams out there and home-seekers have become very wary. Have a phone conversation and offer to give a house tour via Skype or FaceTime at a mutually convenient time or ask if they know anyone local who could come see the place on their behalf. If you are seeking one person to join an existing houseshare it is also a great idea to arrange a Skype or FaceTime meeting between all parties.

We have a one-page application that we use with all our prospective tenants. I've included this on my website www.GetaChicken.com which you can access for free. This application includes a line for them to enter their Social Security number so that you may run a credit screen, and line for references. (Be careful to protect all completed applications while they are in you possession and shred them once you are finished.) The applicant must sign that they are willing to have their credit run and that they understand that we will be contacting their references. Finally, it is always a good idea to request a copy of their driver's license or another form of identification to verify their identity, as well as a copy of their most recent pay stub.

Phase 4: Screen Your Tenant

Screening is an essential step toward ensuring that you are getting a high quality tenant, in other words one who will take reasonably good care of your property and who will pay their rent on time. It takes only a few minutes to make a few phone calls and shoot the application off to a credit screening company, but these few minutes could save you hours of frustration or potentially months of unpaid rent. I certainly know this from experience . . . from instances in which I was too lazy to make the calls or too lenient with the findings.

Phase 4.a: Credit Screening

Doing a credit screening will help you understand how likely it is that the individual will fulfill their obligations in paying his or her rent on time. While paying bills responsibly is a core value for some people, it unfortunately isn't for others. If someone fails to make payments on their other obligations and loans, then this will show up on their credit report, which is an indicator that they may not prioritize making payments to you either.

We've learned the hard way never to judge a book by its cover, especially when it comes to potential tenants. The times we did this, we were really burned. We made an assumption that because the tenant seemed "nice," they would pay their rent on time. Unfortunately, until you crack it open, a bad egg looks just as nice on the outside as a good one. In this instance, I'm not saying that bad eggs are necessarily always "bad people." This could also refer to people who get in over their heads or are overly optimistic about their finances and then are not able to pay their rent.

> Good eggs and bad eggs look the same on the outside.
>
> *K. Kai Anderson*

When you read a credit report, look first at their overall credit scores. The precise number does not matter that much. If it is in the mid- to high-600s, or higher, it is generally fine. You also want to check the extent to which they have "delinquent payments." There are many companies to choose from these days. The company we use is called AAA Credit Screening Services. This company has reasonable rates and they can have a report to my inbox within 30 minutes. I've provided the contact information for AAA Credit Screening Services in the Online Appendix C *Recommended Reading and Other Resources*.

Phase 4.b: Background Screening

It seems like conducting a background search would be an obvious step to screening your prospective tenants. However, in this case you need to proceed with caution. Even though those with criminal backgrounds are not an officially protected class under the Fair Housing Act, the US Department of Housing and Urban Development stated in April 2016 that denying housing based on criminal background is, by definition, discriminatory and may indeed be a violation of the Act.[3] However, this is currently a grey area. According to Laura Kusisto's article on the subject in the Wall Street Journal:

> Fair-housing lawyers say that they aren't opposed to background checks, but that searches shouldn't be used to reject tenants automatically. They say landlords should be required to perform an individual assessment of the severity of the offense, the length of time that has passed and whether it is relevant to whether an applicant will be a good tenant.[4]

In other words, use your best judgment, but don't deny someone housing to someone based on a knee-jerk reaction. Also, remember that an arrest is different from a conviction. Plenty of people are arrested who are never found guilty. Since African American and Hispanic/Latino individuals are arrested disproportionately, it could be discriminatory to deny housing to those with an arrest history.

If you chose to conduct a background search, focus on violent and/or sex offense crimes, and/or recent crimes. You can find background screening resources online, many for free by entering the Google search terms "judiciary case search," "sex offender registry," "criminal background search" along with your state's name.

One last point related to background search: Judiciary case searches often show instances in which your prospective tenant was the plaintiff suing someone else for something. I find this part equally informative because it will highlight if someone has a tendency to sue others. It's best to stay away from litigious people like this whenever possible.

Phase 4.c: Employment or Academic References

We always call the prospective tenant's employer to confirm that they work there, how long they've worked there, and the number of hours worked per week. I look for steady employment and monthly income that is at least three times the rent amount. If speaking with a direct supervisor, look for qualities such as dependability, likability, and respect. If your prospective tenant is in college or graduate school, call to confirm enrollment. I've never had the experience of someone giving a fake employment or school reference, however do be wary of that possibility. This could happen if an applicant gives you contact information for a friend who then plays the role of an employer. If something smells like a rotten egg, ask some tough questions of the "reference', do some additional research, and trust your instincts.

Phase 4.d: Landlord References

It is very important to call all landlord references, both current and prior. The reason to get past landlord references is that there is a possibility that a current landlord with a bad tenant may give glowing remarks simply to facilitate the tenant in moving out. There are a number of questions you can ask. Here are some of them:

1. How long has this person rented from you?
2. Do they always pay their rent on time?
3. Would you rent to them again?
4. Did they take relatively good care of your property?
5. Did they disappoint you in any way or break their agreement in any way?
6. Is there anything further that you'd like to add?

Phase 4.e: Roommate References

If you are able to get contact information for existing or previous roommates, these are often more authentic references than other personal references. People usually give their friends and family members as personal references and both tend to be similar to the applicant and to look out for one another. It is almost not even worth your time to get personal references unless they are current or former roommates.

Check out Their Car and/or Visit Them in Their Current Home: In certain situations you may want to find a reason to drop by their current pad to see how they live. Just give them notice that you plan to stop by so that you don't violate their privacy. I have a disclosure on my tenant application (which they sign) that gives me the right to stop by a prospective tenant's current home as a part of the tenant screening process. This screening strategy is most relevant, and justifiable, if you are seeking a roommate for your own home. It is equally justifiable if you are setting up a house-share for people live together as roommates.

If stopping by their home feels too intrusive or difficult for whatever reason, you can also – more casually – check out their car. If the interior is clean and free from trash and papers, then there is a greater likelihood that they also keep their home clean and clutter-free.

Phase 4.f: The Security Deposit

Once you find your ideal tenant, you need to secure them as quickly as possible. That's not to say you should put pressure on them, because there is no greater turnoff than pressure or the appearance of desperation. Play it cool but let them feel wanted. Let them know that you would be honored for them to rent your place.

If they are interested in your place, they absolutely MUST give you a security deposit. This is the only way to truly secure a tenant. In other words, it is best to avoid "holding" a place for someone unless they provide a *full* security deposit. Over time, we've learned that if someone refuses to give or delays in giving a security deposit, it usually means one of three possibilities:

1. They can't afford your place. Sadly, if they stretch themselves financially and do take it, they will very likely have problems paying the rent thereafter. Also, never accept a partial security deposit. This is a huge red flag of a problem that they will have down the road in paying the rent on time.
2. They are just pretending to be definite as they continue to shop around. In this case, it is possible that they will vanish while you are holding the place for them, and losing time all the while.
3. They are not 100 percent committed to staying in the area (or moving to the area, if they are from out-of-town). In fact, we had the experience of a European graduate student whom we held a room for, only to find out that he was stalling due to issues with his student visa.

Again, no matter what, and no matter how much you like them, no matter how committed they say they are, *if they refuse to provide a security deposit, do not hold the place for them*. Money talks. Everything else walks. I mean literally, I've found that even if someone says they love the place and that they definitely want it, if they stall in providing their security deposit, then usually it's due to one of the reasons above, and they may disappear. Sometimes they explain why they are backing out, and sometimes they literally vanish by not returning emails or phone calls.

To protect yourself against a bad tenant situation, you will need to complete all the tenant screening items described in the last section. If you would like to take one additional measure of protection, do what Jake and Mary do. (See their fascinating story in Appendix B.) They rent on a month-to-month basis to avoid having to go through a costly and time-consuming eviction if the tenant refuses to pay rent.

Another level of protection is to require your tenant obtain renter's insurance and list you as additional insured. Requiring renter's insurance will protect you from liability and it will protect you from having to draw from your own insurance policy in the event of leaks, floods, and other headaches. Listing you as the insured on their policy will serve as additional protection for you over and above your own property insurance and general liability umbrella policy. If you want to learn more about the benefits of renter's insurance to property owners, please read the document prepared by four lawyers across four different states entitled *Liability and Property Insurance: The Basics and Hot Issues, Including the Insurance Certificate Problem.*[5]

4) Collect Rent

Collecting rent sounds onerous to many people. However, if you've done everything right in terms of screening and securing quality tenants, this is easy and even exciting. We often, literally, get paid while we sleep or while we are on vacation. Imagine going to bed and waking up the next day to find more money in your bank account than you had when you went to bed. The icing on the cake – automatic bank transfers – is made possible by the digital age in which we all live these days. All of our 20 current tenants either use automatic bank transfers, PopMoney.com, or PayPal, or they physically walk the check into my bank and deposit it into my account. This means we don't have to worry about collecting checks or losing them before getting them into the bank or having them lost in the mail.

It is critical that you stay on top of collecting rent. We know from experience that if a tenant gets behind it can be impossible for them to get caught up. It is standard for a lease to have a grace period until the fifth of the month. However, as we indicate in our lease, the grace period does not constitute a right to pay the rent late. On the second day of the month, if you haven't seen the rent yet, it is time to start reminding them. On the fourth or fifth day of the month, they should get a reminder about the late fee. Then it is up to you to enforce that. We have it stipulated in our lease, that the late fee is due *with rent* if rent is received after the fifth of the month. That way, it is not something we need to collect separately.

We usually waive the late fee the first time a tenant is late with the rent. We know stuff happens, finances can get tight, and paying the rent can simply be forgotten. Besides our tenants are our customers and we want to keep them happy! But, as we remind them on the first occurrence, we do ask for the late fees when it happens again.

5) Attend to Maintenance and Repair Needs

When it comes to property maintenance and repairs, you have a few options. If you are handy and have the time, you can attend to some or all items yourself. Otherwise, you will need to arrange the service call, and often be there to let in the workers. If it is not convenient or desirable for you to spend your afternoon waiting for the plumber to show up, you do have a couple other options.

If you have a handyman or handylady whom you trust, you can simply give them a key and have them let themselves in (after giving proper notice to the tenants of course).

In fact, your next option is to do what we do as much as possible with our local properties, and what Jen and Rachel do with all of their long-distance properties. We simply ask the tenants to help. Whenever possible, I coordinate the service visit with your tenants' schedule and ask the tenant to be available to meet the handyman or service contractor, and I schedule accordingly. This is far less intrusive on my own family time and usually just as effective. Jen and Rachel, with long-distance properties, literally build the expectation into their leases that the tenants are responsible for meeting maintenance and repair workers as needed.

Your final option, of course, is to hire a property manager to take care of the details. If the monthly cash flow affords it, this can be an excellent way to own property for the long-term and not have to have to deal with the work of owning it. Many people choose this hands off method, including couples Amanda and Matt, and Kevin and Andrea, whose stories I've included in Appendix B. See the next section in this chapter to learn how to select a good property manager.

6) Track All Expenses and Mileage

Once you step into the world of making money through real estate, you should begin saving receipts and tracking expenses and mileage. This will help you at tax time so that you are more organized and prepared to take all the deductions that are rightfully yours. This will also help you stay on top of unusually high expenses and attend to issues as they arise. For example, an unusually high water bill could be a sign of a dripping tap or a running toilet. Staying on top of such issues will help you reduce the expenses side of your cash flow equation. You should always look for opportunities to lower your expenses, even if they are just nickels and dimes here and there. Like everything in life, the little stuff can add up and become something larger if you aren't careful.

7) "Other Duties, as Assigned"

As a landlord doing your own property management, there is an almost infinite array of other duties that come up. Many of these are not glamorous, but they must be done. In some cases you can hire someone to take care of a necessary task if you don't mind the expense. In other cases, you might prefer to do it yourself. In either case, remind yourself that *it will all be worth it in the end*.

> It will all be worth it in the end. I hated every minute of training, but I said "Don't quit. Suffer now and live the rest of your life as a champion!"
>
> *Muhammad Ali*
> *World Heavyweight Boxing Champion*

HIRING A PROPERTY MANAGER

As we talked about in the beginning of this chapter, there are three important goals of property management. These are the following:

1) Take care of your tenants;
2) Take care of your property; and
3) Collect the rent on time.

When you select a property management company, you want to be confident that they will take each of these three goals very seriously.

Qualities of a Good Property Manager

A good property manager (even if it yourself, managing your own property) is someone who is professional, responsive, organized, proactive, experienced, relentless, trustworthy, and "yes to all of the above"! The first letter of each of these key traits spells PROPERTY, and I'll go into each one here:

Professional: Good property managers carry themselves in a way that is professional and respectable. They show up on time. They do what they say they are going to do, within the timeframe they say they are going to do it. They don't make excuses.

Responsive: Good property managers are responsive. They promptly respond to your emails, texts, and phone calls. Equally important, they promptly respond to tenants' inquiries and demands. If someone is locked out, they find an immediate solution. If there is a flood in the basement, they show up or have a maintenance person show up right away to deal with the situation. You care about your tenants (they are your customers and you want them to stay!) and you care about your property (it is your product and you want it to stay nice and last for a long time!). Being responsive is key.

Organized: Good property managers stay on top of registration due dates and take care of registering your property with the appropriate city and state authorities. They have organization systems that they religiously follow for keeping track of income, expenses, communications with tenants, late rent, receipts, etc. They provide you a monthly report that is organized, comprehensive, and easy to understand.

Proactive: Good property managers anticipate vacancies and work quickly *before* a tenant moves out to ensure that – ideally – no more than half a day (for cleaning) goes by before the next tenant moves in. That is unless additional repairs, maintenance, or painting is required, in which case good property managers have all these activities pre-arranged so that they can occur the moment the first tenant moves out (and even before, if possible!) with the new tenant lined up to move in thereafter. Remember, vacancies are not your friend.

Experienced: Good property managers know what they are doing when it comes to finding quality tenants. Quality tenants are those who pay their rent on time (or in advance!) and do minimal damage to the home. Good property managers know how to cast a wide net to find prospective tenants, they properly screen potential tenants, and they are able to quickly seal the deal to secure a good tenant. Good property managers find tenants that you are proud to have in your home.

Ruthless: Yes, ruthless. You are paying them to be the "bad cop." They need to be able to be tough with tenants when it comes to collecting rent or enforcing other rules. Worrying about stray cats moving in, loud parties, or soaring water bills should not be your problem. You're paying a property manager to make these things *their problems*. Most importantly, when you do have a problem tenant like someone who can never seem to pay their rent on time, your property manager must be able to be ruthless and relentless with them so that the unpaid rent doesn't slide past the fifth day of the month. I can tell you from experience that "I'll pay you the second half on the 10^{th}," quickly becomes replaced with the "15^{th}," then the "20^{th}," and then "next month." Then, all hopes of receiving your rent are down the drain. Most tenants are good and honest, but some get in over their heads (potentially avoidable if you check their credit and income) and some are simply not trustworthy (also potentially avoidable if you check references).

Trustworthy: You need to know that your property manager has your back no matter what. You need to know that your property manager cares about your property just as much as you do, and that they will not allow it to sit vacant or go without needed repairs. You need to know also that they are honest, that you will not be taken for a ride. In other words, that money spent for maintenance and repair is being spent in just that way.

Yes to all of the Above! All of the qualities just mentioned are important in a property manager because each ultimately supports your three overarching and very important aims, which again are taking care of your tenants, taking care of your property, and collecting the rent on time.

How to Select a Good Property Manager

The best place to start in selecting a property manager is a referral and the best referrals are from other landlords or tenants whose property is being managed. Referrals from other professionals in the real estate industry (realtors, title companies, inspectors, etc.) may simply be an attempt to do someone a favor rather than offer a true referral that springs from having had a terrific experience. If you don't have any good local referral sources for a property manager, you can do a property manager search on the website of the National Association of Residential Property Managers at www.NARPM.org/find/property-managers.

Once you have a small handful of recommended property managers, it is best to screen them and talk to their references. This is especially important because your aim is probably for this to be a very long-term relationship. The first step in screening your potential property managers is to contact them, observe them, and interview them. This will allow you to see them in comparison to each other, rather than just on their own. You want to get a handle on how well they meet each of the PROPERTY criteria. You should specifically look for the following:

Professional: When you first contact them, do they promptly respond to your emails, texts, and phone calls? Are they responsive to your questions and not defensive? Do they talk too much (as in trying too hard to sell you)? How are they dressed? Did they show up on time to your first meeting? Did they communicate well before the meeting? Did they bring a sample monthly report and rent roll to the meeting? If not, be sure to ask for it and evaluate whether they send it within 24 hours of your meeting.

Responsive: Ask for property owner and tenant referrals so you can speak to both about how responsive the property manager is.

Organized: Ask your prospective property manager about city/county and state property registration rules. You want to know if they know their stuff. Confirm that they take care of annual registration requirements. Ask them what systems they use for keeping track of income, expenses, communications with tenants, late rent, receipts, etc. The property manager should volunteer to provide you a sample monthly report and a rent roll. Take a look at it. Does it make sense? Is it legible, organized, and comprehensive? Are all the repairs and service calls itemized?

Proactive: Ask to see evidence from other properties' profit and loss statements and rent rolls regarding late payments and vacancy rates. You want to see vacancies under 5 percent, with lower being better of course. Ask what their strategies are for ensuring low, or no, vacancies. What does the manager do to anticipate vacancies and have a new tenant lined up the day of or the day after one tenant moves out?

Experienced: Ask your prospective property manager how they go about locating tenants. Do they simply post on the MLS and wait? Do they only use Craigslist? Or do they go beyond these two commonly used sources and advertise with universities, local employers, or on other websites or in local papers? Ask how they screen potential tenants. Do they perform background checks and credit screenings? Do they call references or leave this to you? What credit score cutoff do they use when selecting tenants? How often do they have to evict a tenant? While experience with evictions is desired, you want someone who has a very low track record of having to evict in the first place. Otherwise, it means that they are not very good at screening tenants!

Ruthless: What is the property manager's track record with collecting rent and enforcing other rules? Ask for examples. How often do they have tenants who are late in their payments or fail to pay? Note that this could be the sign of a bad property manager just as much as a bad tenant. What attempts do they make to collect overdue rent and how successful are they?

Trustworthy: Do you get the sense that your property manager will care about your property just as much as you do? Do they care about vacancies? What does your gut say – do you trust this person? Can you trust them with your money and your personal account numbers?

Yes to all of the Above! Ask for references from other landlords and be sure to call them and ask them about all of the points just mentioned, from P to T. While it might feel scary, unfamiliar, or even mistrusting to do so, checking references is a part of life. It is also a part of your own due diligence in making one of the most important decisions related to this precious and long-term investment that is YOURS. The bottom line is this, again: Do you get the sense that your property manager will take care of your tenants, take care of your property, and collect the rent on time? These three elements are the cake. The rest is just icing.

Property Management Agreements

All property management arrangements are unique. Fees usually range between 5 and 10 percent of the monthly rent amount. These fees vary by region and by the scope of work of the property manager. For example, all-inclusive versus not all inclusive and charging additional fees for "extra management duties" such as attending to maintenance issues, filling vacancies, and handling evictions. If your arrangement does include additional fees, these fees could be either flat fees or a percentage. Bear in mind that most companies take the first month's rent for themselves for the work of finding a tenant for the property. However, keep in mind that every aspect of the agreement has the potential to be negotiated.

Property management agreements also vary significantly with respect to the duties that they will perform for the agreed-upon price. Always read the agreement closely to be sure that it includes all the essentials: finding tenants, collecting rent, registering the property with the city and state authorities, arranging for repair and maintenance workers, and handling emergencies. Usually you will set up a reserve fund for repairs and maintenance.

FINAL WORDS

Now that you've finished reading this "owner's manual," you are ready to get started! At this point, you may wish to double back and read the first chapter and, if you haven't done so already, start thinking about your criteria. Again, to do this you can play with the Cash Flow Analysis (CFA) Tool on my website at www.GetaChicken.com using numbers that make sense in your market. Then just move yourself through this companion guide in a step-by-step fashion until, lo-and-behold, you are the proud owner of at least one cash-flowing rental property, complete with quality tenants!

If you haven't read the parent book yet *Retire on Real Estate: Building Rental Income for a Safe and Secure Retirement*, then now really is the time. The two books are really meant to go together. *Retire on Real Estate* will show you why it is so important to diversify with rental property, how to craft a plan that is unique to you, and how to get started with your first (or next) rental. After helping readers think their personal goals related to rental property (or any goal), *Retire on Real Estate* shows how to overcome mental and financial roadblocks not only in getting started but also in actually attaining your goal.

APPENDICES

APPENDIX A

Our Story

The course of my life changed permanently the day I read *Rich Dad Poor Dad* by Robert Kiyosaki. From this master, I learned the revolutionary concept of “Your house is not an asset” among countless other lessons.

My launch into real estate investing entailed the simplest kind of all rental property acquisitions: moving and converting my home into a rental. My girlfriend (now wife) and I were at the point in our relationship where we were ready to take that next step. However, my one-bedroom condo felt too small for the two of us and her home – a house-share with a roommate – was also not ideal for obvious reasons. As luck would have it, we noticed one day that the tenant of the two-bedroom unit across the hall from my condo was moving out. We jumped on the opportunity to have a look around and quickly called the owner. Within a matter of only a couple weeks, I had gone from being the owner of a small condo to the landlord of that condo and the tenant of another.

This is how we first learned about the power of cash flow. As landlord, I received $1100 each month for the smaller, but nicer unit that I owned. As tenants, we paid only $1000 per month for a larger unit that was but more dated. The net result of this move was an extra $100 each month (plus a lot of extra space!).

Having considered real estate investing for much of my life, this first taste of being a landlord was thrilling! And I realized that it really wasn’t actually all that hard. A few months later I enrolled in a year-long real estate investing course at the Investors United™ School of Real Estate Investing. Over the course of that year, I purchased my first two investment properties, which I found by sending letters to landlords of properties along the busier streets in popular areas of town.

I ended up selling my condo just as the housing meltdown was beginning, a move that I was particularly relieved about since the condo fees seemed to be increasing all the time. The two rentals were break-even with respect to expenses and income, with much of the maintenance and repair costs coming out of my regular salaried income. We eventually made a change that had a powerful impact on our cash-flow. We switched both properties into “house-shares.” In this way, instead of renting each house as a whole, we rented room-by-room to individuals. Given that the homes were both within walking distance to a major university, it has always been easy to rent by the room. In fact, many people are eager to pay less than they otherwise would to rent an apartment, while having access to a larger home and new friends at the same time.

In the aftermath of the housing crash we bought our next three homes to aid our retirement goals. For two of the three, we temporarily leveraged my retirement funds by using a 401(k) loan for the down payment, payable in five years, on top of 15-year term standard fixed-rate mortgages. For the third property, we converted my Roth IRA to a self-directed Roth IRA and used those funds to purchase a fixer-upper which we renovated and then rented out as in a rent-to-own arrangement.

At this point, we have achieved the Level III Goal. Once the mortgages are completely paid off, the income from our handful of properties will be equal to our current income from our work. Our current plan is to pay down the mortgages on our existing properties as quickly as possible. Before retiring, however, we plan to use the monthly income from the rentals to pay for our daughter’s future college tuition. Then, finally, we’ll use the income to fund our safe, comfortable, and financially self-sufficient retirement dreams.

Since we will own our properties free and clear within 7 to 14 years, we feel a certain sense of calm knowing that we will never have to worry about whether we will be able to retire or whether we will run out of money in retirement. Sure, we have other retirement funds doing their thing in our other traditional mutual-fund based retirement accounts. We will probably also have Social Security in some form or another. But because we are creating an infinite flow of eggs, rather than building up one risk-laden nest egg to nibble away at in our golden years, we know that we'll never have to worry. And that feeling is priceless.

APPENDIX B

True Stories of "Not-Chickens"

This appendix portrays the real-life stories of people I call "Not Chickens." (There are many more stories on my website at www.GetaChicken.com!) They are not chickens because they are the proud owners of one or more rental property. They either had an opportunity, found an opportunity, or created an opportunity to build lasting wealth through the use of one or more rental properties *and they went for it*. Opportunity stares us in the face every day. It comes in all different shapes and sizes. It might be the opportunity to keep our house as a rental when we move. It might be the opportunity to purchase a rental from a neighbor. It might be actively getting out there and scouting out potential properties. Even a mere idea for how to do something differently is an opportunity. Opportunities are all around us all the time. The not-chicken thing to do is to start with one opportunity, and then go for it 100 percent.

Not-chickens are not as rare as you think. If you open up the conversation and talk about real estate with people, you will discover not-chickens all around you. You will discover that it's not so uncommon to hold rental property. From your next-door neighbor to your plumber to your accountant, you may be surprised to realize how many people have, hold and benefit from rental property.

In this Appendix, I share some real life stories of ordinary people like my wife and I who happen to own rental property as a part of their long-term financial plan. You will see that each story is unique. You will also see some common threads. For example many of our not-chickens got their start, as we did, by simply by moving and turning their existing home into a rental. Intentionally buying a two-family house to achieve both a home and a rental in a single step was another common strategy that people used to get started. A third common theme was leveraging an existing property, by refinancing either a home or rental, to pull money out for a down payment on a next property. As you read these stories, notice that these individuals are just regular people like you and me. Read with an open mind. *Because if I can do this, and if they can do this, so can you.*

LEVEL I GOAL INVESTORS

Level I Goal investors have so much to be proud of. Rather than simply hoping or praying they have enough money saved for retirement, and rather than using the money-sucking lottery as a retirement plan, as many people seem to do, these individuals and couples have consciously decided to keep one property as a part of their long-term retirement portfolio as they go about the rest of their life.

Kevin (Age 33) and Andrea (Age 33)

Starting off as high school sweethearts in northern Virginia, Kevin and Andrea went to college, got married, bought a fixer-upper townhouse (with a low-down payment program), and had a couple darling children, all in the right order! Then they made a slightly less conventional decision, one that is sure to have a positive lasting impact on the remainder of their lives. One that will serve as an "insurance policy" for life's uncertainties, especially when it comes to eventually retiring in a pension-less world.

You see, Kevin and Andrea's real estate investing career actually began long before they became landlords. It first started in their minds. They had been thinking about acquiring a rental property for quite a bit of time, as they had a coworker and an uncle who had been investing in real estate rather successfully. In fact, they knew deep down, that they just *had* to own a rental property, and yet they also had enough self-awareness to know that they had just enough fear to prevent them from actually going out and buying their first rental.

So they took the path of least resistance to move forward with their Level I Goal. They decided to move their family into a more comfortable home and keep their existing townhome as a rental. After all, they knew their house well, they knew the neighborhood well, and most importantly, *they already owned it*.

To move forward with this goal, Kevin and Andrea decided to create a budget and sock away money for a down payment on their new house. Finally, a few years later, their hard work paid off and they were able to buy a new home and keep their starter home as a rental.

Even though they live only a couple miles from their property, Kevin and Andrea decided to use a property manager. This property manager – whom they absolutely love – is the same agent who sold them both of their homes. They approached him and asked if he would be willing to manage their first home as a rental after they moved. They wanted to use a property manager because they had gotten off to a rocky start with their first tenant who had an unreasonable amount of demands. So, Kevin and Andrea modified their strategy and handed the keys – and the responsibility – over to their new property manager. This way, they can simply enjoy their time with their children, friends, family, and church community. They have the luxury of almost never having to think about their property as they go about their daily lives.

Kevin and Andrea like the idea of having a rental property because they know it will be extra income for the family once the mortgage is paid off. They believe that if there is ever another housing crash, then they will only benefit from more renters. More so, their location is in a high-demand rental market since their townhouse is convenient to the highway and only 20 miles south of Washington D.C. Even more appealing to them is the fact that their home is in an area with a strong military presence. As is true for any area where there are military bases and training academies, many people who are associated with the military prefer to rent, rather than buy since they are typically reassigned every two to four years, often without much notice.

For Kevin and Andrea, these location-related qualities give them the peace of mind to know that their investment is stable for the long term and will provide extra income when it comes time to pay college tuitions, as well as a margin of safety for their future retirement, plus a tangible, appreciating asset that they can eventually pass down to their kids.

Beth (Age 37) and David (Age 41)

Beth and David met in college through their mutual love of soccer. When they realized they loved each other more than the game itself, they knew they had something. Neither one of them had thought that could be possible! They later got married and bought a townhouse in a neighborhood that turned out to be not exactly their favorite. Suffice it to say that there was a crack house across the street!

They eventually decided they wanted to move to a safer neighborhood with a better school system for their future children. Plus they wanted a big yard where they could kick a soccer ball around.

Beth and David didn't let the fact that they'd bought their house in 2007 at the peak of the housing market stop them from moving. In fact, they'd always wanted a rental property. So they simply saved up funds for their next home, moved, and turned their first home into a rental.

Beth and David say the transition to being landlords has been a smooth one. They did some painting, staged their home, took a bunch of quality photos, and listed it for rent on Craigslist. They hosted an open house, where they had a pretty good turnout. They collected three applications (with application fee). After using TransUnion SmartMove (www.mysmartmove.com) for their background checks and credit screenings, they selected a couple with the highest credit score with whom they'd also had a good conversation. They asked for a month and a half times the rent as a security deposit and charged an additional pet rent of $10 per month for the dog.

After the property was rented, they took advantage of low interest rates and refinanced their mortgage to a lower payment that was more in line with the rent. They are now working to pay off their mortgage as quickly as possible by making biweekly payments. They figure paying their mortgage off quickly will open up options in terms of extra income, college tuition, a house for their kids once they are grown, or maybe even eventually trading the property for a beach house.

They say they are thrilled to have this investment. The crack house is gone (by chance). The neighborhood is improving. And mostly, they love the fact that they are building equity while someone else is paying their monthly costs of ownership. The tenants have been awesome to work with and have even renewed their lease. Beth and David couldn't be happier.

LEVEL II GOAL INVESTORS

Level II Goal investors are those who have consciously decided to collect and hold more than one rental for the long term. Level II Goal investors are those whose rental income will supplement their other sources of monthly income once the mortgages are paid off and in retirement in general.

Venesa (Age 36)

Venesa had been interested in the idea of real estate investing for much of her adult life. Like many of us, she had purchased and read multiple books on the subject. Then, after meeting and falling in love with her now second husband, they took the plunge together . . . twice! A modern-day Brady Bunch family, she (a government employee) and he (a self-employed car-transporter) became a family of six overnight. When he and his children moved into Venesa's home, instead of selling his place in Virginia, they decided to hold onto it and rent it out, even with it being in a different state. They instantly learned the value of real estate from that smart move, as it had positive cash flow from the very start. Venesa attributes part of their success to the government program called "Section 8." By enlisting the house in Section 8, they were able to help out a family with few financial resources while receiving guaranteed rent from the government. It was a win-win arrangement. Plus, their tenant has been terrific both in taking care of the property and also in promptly communicating any repair needs to Venesa and her husband. The family has been a long-term tenant now of six years, and counting.

Fast-forward a couple years. Venesa and her husband decided to find a place with more space for their family of six. Instead of selling, again they decided to keep Venesa's house and rent it out. With this second rental, however, they learned a valuable lesson the hard way (as we all do in life!). The lesson that Venesa would like to pass on to readers is this: Never rent to a family member or friend! Unfortunately, they did this and the family member stopped paying rent. Venesa and her husband were able to stay afloat thanks to having steady income from their full time jobs and cash flow from the first rental. Nonetheless, their outlook is bright. Not only do they view this property as a long-term investment (and learning opportunity), they plan to purchase a couple additional homes in the not-too-distant future. Their plan is to pass all four properties down to their four children in order to help them get started in their adult lives. In fact, since their oldest son has his eyes set on Ohio State University, their plan is to buy a home in that area for him and some fellow students to live in as a house-share. This savvy, forward-thinking plan will not only help them *save* vast sums of money on college housing, it will actually allow them to *make* money at the same time, all while securing a long-term asset that will eventually be owned free and clear.

Venesa and her husband view the rentals as a family business. With their eyes set on eventually passing the properties and the responsibility to their children, they've consciously engaged their kids in various aspects of property management and upkeep from the very start. Note that this gift goes beyond the tangible asset of the house itself. Venesa and her husband are fostering creativity, problem solving, and "can-do" business mindsets in their children, so that they will have the internal resources to succeed financially in life.

When asked what investment property ownership means to her, Venesa said that the properties signify "tangible wealth" that will last for generations to come.

Heather (Age 45)

Heather's story is quite unique. Heather has a background that includes everything from working in construction to majoring in finance in college. She was born into a commercial real estate family business that her grandfather had started and her father and her father's brother now own. She and her cousin are currently the property managers in the family business in exchange for 12.5 percent ownership of the family business each.

Ironically, in spite of being highly experienced in property management, Heather's first personal investment opportunity was one that required virtually no property management at all. It was also the type of opportunity that the vast majority of us would have driven past without ever having noticed. However, since Heather had been living and breathing real estate from the time she was born, she was prepared to act when opportunity presented itself. On one of her many travels from their office in Massachusetts to one of their properties in Maine, she noticed a piece of land go up for sale on a very well-traveled road.

After watching her family in the long-term real estate business for her whole life, she felt finally ready to jump into the game herself. She was eager to create her own passive income stream and her own long-term wealth-development strategy.

So Heather submitted an offer. Once she had a ratified contract to purchase the land, she set to work on finding an excellent, well-connected commercial real estate agent. She found someone with an "in" among restaurants and who proceeded to land her a deal with a popular fast food restaurant. Jackpot! Then, with signed lease in hand, Heather went to the bank to obtain a mortgage. The bank struggled with the fact that she was technically self-employed but because she had excellent credit, she was able to successfully obtain a mortgage. Jackpot again! The down payment for the purchase came from a home equity line of credit (HELOC) on her primary residence. As a result, without any money out of her own pocket, Heather used two streams of "good" debt to create one incredible stream of unending income, as you will see in a minute.

Once she had a ratified contract with a fast food restaurant, Heather had to plan what to do with the existing structure on the lot. To save costs on demolition, she approached the nearest fire department to see if they would like to use it for training ground. To her delight, they did. And in exchange, the firefighters hauled off all the resulting debris from the lot. Heather came up with a second move to save on some costs. She struck a deal with one of the firefighters who had expressed interest in keeping the oil that was still in the oil tank. In exchange for the oil, this firefighter removed the tank from the property for her, which was no small undertaking.

You may be curious about the numbers on this kind of investment. The restaurant pays Heather $4300 each month to rent the land. Heather's original monthly mortgage payment on the land was $2400, which she recently refinanced to a 10-year mortgage with a $1500 monthly payment. This means until her asset is paid off, her cash flow is $2800 each month. Thereafter, her cash flow will be the full $4300 until she increases the rent at the end of their ten-year contract. It's no wonder that Heather has a glimmer in her eye as she half-jokes that this investment is her 401(k). She will own it free and clear by the time she is 55. Heather is confident in the long-term sustainability of this investment. The restaurant has a vested interest in staying because it built the structure that sits on Heather's land. Even if the restaurant does eventually pull out, Heather is not worried; they would be leaving their building behind them thus only improving the value of Heather's property.

In addition to this first amazing real estate investment, Heather used the strategy of buying a house for herself and then keeping it as a rental upon moving. However, before renting it out she refinanced it in order to lower her monthly payment and improve the cash flow potential. This was just after the big real estate bubble of 2007 and though she still couldn't sell the house, she was able to rent it to a family who had lost their own house to foreclosure. This family has been there now for the last five years. The house has been good for the family since Heather charges a reasonable rent; plus it's been good for Heather because it became the second asset in her personal real estate portfolio.

John (Age 48)

Currently a political staffer for a State representative, John got his start in real estate when he was a waiter and a student. He had gone back to school later in life to finish his degree and at that time was waiting tables to make ends meet. It was 2002 and he moved in with a friend to save a little money; meanwhile his friend used the extra income to offset his mortgage on the house. Over the next couple years as it became clear to John that his friend was making money off him, he realized that he wanted to get into the game.

John started exploring homes in the more affordable parts of town and found a two-unit building listed for only $90,000. While he missed this opportunity, it had made him aware of this particular part of town for the next time. Indeed, a couple months later he noticed a duplex on the same street with a "For Sale By Owner" (FSBO) sign in front. Partnering with his father (to save on the down payment), John bought the house. He moved into one unit and a cousin rented out the second unit. As he had anticipated by doing a careful analysis of the numbers before buying, his financial situation improved overnight. John went from paying $800 to roughly $200 in housing expenses. The $770 he received in rent almost completely covered his $970 mortgage.

After a couple years, another FSBO two-unit apartment house opened up on his same street. At this point John knew the neighborhood and the rental market in that neighborhood fairly well, so he was able to quickly jump on the opportunity. John's two properties were both cash-flow positive from the very start. The rental income was immensely helpful to John's day-to-day financial situation because his job was not particularly lucrative. Within another few years, after housing values had come down from the boom in 2007, he decided to purchase a third property – this time, for himself, and he rented out the unit in which he had been living. This new home was a foreclosed property that needed a fair bit of work. An FHA loan allowed him to get in with a down payment of only 3.5% of the total (purchase price plus $50,000 in rehab costs).

In our conversation, John marveled at the fact banks will easily give $100,000 (and more!) for the purchase of a real estate investment, and yet it can be virtually impossible to get this kind of money anywhere else. John is very glad to have his two investment properties and plans to purchase more over time. He benefits from the monthly cash flow and also sees them as critical components of his overall retirement plan.

Svetlana (32)

Svetlana moved to the US from Russia and is happy to call sunny Los Angeles home. Being a realtor, she has understood the power of real estate for a long time. However she didn't limit herself to the traditional financing world of banks and mortgage brokers. Rather, she harnessed the powerful strategy of seller-financing with her very first investment property.

Svetlana's first investment was a four-unit building located in the neighboring state of Utah. She chose Utah because she found purchase prices in LA to be too high to offer positive cash flow potential. Unfortunately, however, this long-distance purchase became untenable because she had not anticipated a quirky local zoning law that prohibited her from renting out one of her four units. In addition, she felt out of her comfort zone with respect to Utah's cold and snowy winters!

Because of these issues, Svetlana sold her apartment building a year later and purchased a new multi-unit building in the High Desert outside of LA. She is now stringently following some advice she received at her local real estate investment club to buy one rental each year for 15 years. She finds this recommendation manageable and realistic enough to actually do. Indeed, after four years (at the time of this interview) Svetlana is the proud owner of three multi-unit homes (each with two or three apartments) with a fourth one on the way.

Her advice to newbies is to stay in-state or at least within a certain radius of your hometown. Also, do your due diligence in terms of local ordinances and laws that might affect your ability to manifest your calculations. In addition, she reiterates the importance of building a cushion before you purchase, knowing your numbers and not going forward with a purchase if your numbers are too tight. She has two last words of advice: Get started! In her words, "Anyone can do this, no matter your age."

At this point, Svetlana has found a location and type of property that work for her. As a result, she has become an expert within her specific range of focus. She uses a property manager for all her properties in order to free up her time for purchasing the next property. She is glad that the first investment property didn't discourage her from continuing to accumulate properties. Indeed, Svetlana has achieved the Level II Goal of financial comfort once the properties are paid off. She is well on her way to achieving her personal Level III Goal of complete financial self-sufficiency.

Jake (69) and Mary (69)

Life wasn't always as comfortable for Jake and Mary as it is now. When they started their life together as a married couple, they both worked in the same factory. In 1971 they bought their first home, which was a two-family home, for $14,000. Unfortunately, the company they worked for closed down and they lost their jobs the very day before they closed on the purchase of their first house. Fortunately, they were not stuck with paying the whole mortgage as they would have been had they bought a single-family house. The rent from the upstairs unit helped ends meet during these tough times. This was important because they went through many more years of job upheaval across several different companies. It was the early 70's and there was a recession at play, gas shortages, and tough economic times for many companies and families. Had their first purchase, during those hard times, been a single-family home rather than a two-family home, they likely would have lost it to foreclosure.

Jake was eventually offered a job as a school teacher. He jumped on the opportunity since it promised to be more stable than his previous jobs in the various factories. Therefore, with the income from both of their jobs, Jake's involvement in the Army reserves, and the rental unit upstairs, Jake and Mary worked hard to pay down the principal on their mortgage.

All their hard work paid off the day Jake and Mary seized the opportunity to buy the two-family house next door. They took out a mortgage on 80 percent of the purchase price and the 20 percent down payment came from a second mortgage on the equity in their first home. A few years later when the opportunity came along to purchase a third duplex in the neighborhood, Jake and Mary knew again that they couldn't pass it up. They had become pros at buying property using no money from their savings. They had also become pros at maintenance, repair and property management.

A few years later, Jake and Mary decided to move out of their duplex. They took out yet another second mortgage to cover the cost of the down payment on a larger single family home for their family. Again, they worked to pay off this second mortgage and then, again, they leveraged their equity for the purchase of another home, this time a beach house at a popular vacation destination.

When Jake retired from his job as a school teacher at age 66, many of his colleagues exclaimed, "Aren't you going to get another job?" His answer was that the apartments kept him busy enough and provided the cash flow he needed to complete his retirement picture. Now that Jake is three years into retirement, he has some perspective. In his words, "When you retire, you feel such relief. You look so refreshed. It's like a big load has been taken off."

Jake and Mary credit their success to a number of factors. The first was having purchased multi-family homes, rather than single-family homes. This created greater income potential and spread the vacancy risk. Another factor was the use of 15-year mortgages rather than 30-year mortgages. They felt this was a critical component to gaining equity quickly, equity that they leveraged to purchase additional property. They also credit their success to location, in that the properties are within a fifteen minute drive to just about anything, for example highways, shopping, hospitals, universities and other large employers. Finally, they enjoy being so geographically close to their rentals that they are literally choosing their neighbors when they select their tenants.

When I asked Jake what advice he would give to new landlords, he shared the following: 1) Rent on a month-to-month basis, so that if you need to get rid of a tenant you can do so quickly without having to evict; 2) Always be tough and enforce late fees; 3) Raise the rent if the water bill seems excessive; 4) Be tough if a tenant moves pets in against the rental policy. Simply tell them: "Either the pet's gotta go, or you gotta go." 5) Never rent to relatives because it is difficult to enforce delinquent rent and can create disharmony in the family.

At the time of this writing, Jake and Mary's home and three duplexes are completely paid off. Only the beach house has a mortgage, and this is easily accommodated by the income from the other properties. A bonus to owning the properties is that when Jake's parents needed affordable end-of-life care and housing, they were able to help out by having them stay in one of their ground level units. They plan to pass their properties down to their two sons upon their death.

Jake and Mary's current income is a blend of rental income, social security benefits, and pensions making them solid Level II Goal investors. They are fortunate that all sources are steady income streams rather than the kind of nest egg that gets smaller as one goes through retirement. Jake and Mary's retirement years are comfortable. They even have a vacation property where they can spend time with their sons and grandchildren and kick up their feet and be, well, even more comfortable.

Marisha (Age 73)

Marisha is lucky to have made it to her fourth birthday. By the time she was born, in 1942, the Germans and Russians had invaded and occupied her native country of Poland. The first three years of her life were spent living in an environment in which Hitler was literally in the process of having all non-German Poles murdered, deported, or forced into slave labor. Between 1939 and 1945, nearly 22 percent of Poland's population died as a result of the Soviet and Nazi occupation.

When Marisha was 19 years old, her parents moved her and her four siblings from Poland to the U.S. They didn’t have much in terms of money, however they had something worth much more . . . strong family ties. It was Marisha’s aunts and uncles who made it possible for her and her family to come to the U.S. They were willing to go to any and all lengths to bring the family together, so they all pitched in to purchase seven transatlantic airplane tickets.

Then, with virtually no sense of the English language, 19-year-old Marisha embarked on her new life in a working class town outside of New York City. She and her older sister found work as seamstresses at a sewing company in New York City’s Long Island. Three years later, she got married, had her first child, and started her family. Then, three more children later, and after eight years of renting, they bought their first home.

Unlike most first homes, Marisha and her husband’s “starter home” was a six-family building. They lived in one unit and rented the others. It was a difficult life, however, and not the happiest of marriages. Marisha eventually decided that her only choice was to file for divorce. The courts gave her custody of the kids and their home (the apartment building) too. Marisha’s husband became a tenant in one of the units. To make things less complicated, Marisha decided to sell the building and used the proceeds to buy a single family house for her and her children.

After some time, Marisha realized that she wanted to get back into the landlording business. She still had some money left over from the sale of her 6-unit building and felt that this would be a good way to invest her money . . . better than leaving it in the bank where she might be tempted to spend it! So she set to work and hired a real estate agent to help her find a good rental property. She decided on a nice two-family home with a nice yard around the corner from her current home.

After her kids were grown, Marisha eventually sold her single family home and used the proceeds to pay off the mortgage on the two-family house as well as purchase a second six-unit apartment building in the same neighborhood. She moved into one of the two-family units and now calls that home.

At 73 years old, Marisha is enjoying the Level III Goal of a financially self-sufficient retirement. She says that she is very happy with her decision to have purchased the rental properties. They have brought her a level of financial safety, comfort and independence that otherwise would be nonexistent. The buildings have literally created streams of income for Marisha. In addition, Marisha has really enjoyed getting to know her tenants. They have been a community for her in a sense, since she has lived in one building or the other for many years. The tenants have also been helpful to her in terms of building maintenance and lawn care. As an older lady, she says she really values both the community aspect and the helpfulness of her tenants.

Her advice to beginning landlords is to always rent to good, responsible people who will take care of the property, keep it clean and pay the rent on time. She believes that the simple act of checking references has been a key component to her success. She also keeps money in an emergency fund for issues that arise with the homes.

LEVEL III GOAL INVESTORS

Level III Goal investors are those who have accumulated either a handful of properties or one larger apartment building. They have either paid off their mortgages or are working to pay off their mortgages, knowing that once they do, the income from these properties will be enough to fully fund their monthly expenses, lifestyle, and retirement dreams. If Level III Goal investors have other sources of retirement income, including Social Security benefits, they will not be dependent on these sources of income. They will be icing on the cake. The cake, itself, is what they have proudly built for themselves with real estate.

Amanda Han (Age 38)

After reading Robert Kiyosaki's game changing book, *Rich Dad Poor Dad*, Amanda and Matt knew they just *had* to own rental property. The idea wasn't totally new to either of them. After all, Amanda's parents and grandparents were real estate investors and the main focus of Amanda and Matt's joint tax and accounting practice was helping real estate investors strategize and save money on their taxes. However, in spite of their comfort level with the financial aspects of real estate investments, Amanda claims that she was so nervous on the day they bought their first rental that she felt like "jumping out of the window!"

Now, over ten years later, Amanda and Matt own a total of eight rental properties, mostly in Las Vegas, Nevada. Even though they live in California, Amanda knows Las Vegas very well since she was born and raised there and she still has many family members and friends in the area.

Most of Amanda and Matt's rentals are single-family homes in relatively safe, working class neighborhoods. Amanda explained that there is strong demand for rentals in this unique city because it is a very "cash intensive" economy. In other words, while people make good money, much of that income is from tips. As a result, these types of workers don't always qualify for mortgages, especially those with a tendency to not report their tip income at tax time thereby giving the appearance of very low income. Amanda believes the strong demand for rental property is also affected by the vast number of Las Vegans who were burned by foreclosure and bankruptcy when the housing market crashed in 2007. Since then, many of these individuals have either been unable to qualify for a new mortgage or so jaded by the experience that they have no desire to own their own home.

Amanda and Matt use a property manager for all their properties. Not only are they out-of-state, but they simply don't enjoy property management or dealing with tenants. They prefer to let the property manager handle all the work involved in renting and maintaining their homes. Instead, Amanda and Matt focus their energy and time on helping their clients through their accounting business and on acquiring new properties for their long-term retirement portfolio.

Amanda believes that your property manager can make or break your investment. In fact, she has a friend who was taken advantage of by an unethical property manager of her long-distance apartment complex. To protect themselves, Amanda and Matt have an in-town family member check on their properties intermittently; they also check them when they are in Vegas.

When I asked Amanda what tips she would like to pass on to readers, she said this: When you purchase an investment property, don't envision yourself moving in. You must understand that it is an investment. Also, if the numbers don't work out, just don't buy it. We are always learning lessons as we go along. Some mistakes you can easily recover from, such as changing your property manager or doing some rehab after a bad tenant. However, it can be much more difficult to get out of a property that is not in line with your immediate cash-flow needs and long-term financial goals.

Amanda and Matt are firm believers in the long-term wealth building potential of rental property. Their properties are on 30-year mortgages in order to maximize their cash flow in the present. They believe in saving up their money and then making that money work for them by redeploying it into the purchase of additional property. Their current plan is to hold properties for the long term. They plan to refinance them when possible, pull money out, and again put that money to work in a next property.

Deb (Age 57)

Deb is a therapist who is semi-retired and loving life, all because of some smart real-estate related decisions that she made earlier in her life. It all started in her thirties after she and her husband got divorced. It was at that point in time that she decided she didn't want to go back to paying rent. Rather, she wanted to earn rent from someone else!

So, instead of just dreaming about this, Deb took action by purchasing a two-family home using money from her portion of the sale of her and her ex-husband's home. She and her young children moved into one half of this New Jersey duplex and she rented out the other half. The income from the rental unit was able to pay most of the mortgage for the whole property. This freed up her work-related income to use for their day-to-day living expenses and to pay down the mortgage. Her goal was to pay down the mortgage as quickly as possible. Indeed, ten years later, Deb owned the whole duplex free and clear.

At that point, Deb decided to buy a modest house for her and her now teenage children. To do this, she obtained a home equity line of credit (HELOC) on her recently paid-off two-family house for the down payment. She then used the income from both sides of the duplex to pay off the HELOC as quickly as possible. Deb and her kids then moved into yet another home using the same strategy and keeping both of her existing properties as rentals.

Last year, Deb sold two of her homes at substantial profit in order to fulfill her dream of becoming an inn keeper. With the proceeds from the sale of her homes, she and her partner purchased a gorgeous, historic bed-and-breakfast in Asheville, North Carolina with no mortgage.

They currently enjoy having no housing expenses of their own, plus cash flow from that very first duplex which she still owns, and cash flow from guests who visit their inn. Just as in the game of Monopoly, Deb literally traded her red houses for one green hotel and has been thriving in life ever since. She and her partner enjoy a high quality of life in a lovely setting and they collect rent for the pleasure of sharing the space in their lovely inn with others.

Enid (76)

Enid grew up in a poor family in Tennessee. She was the first in her family to graduate from college, which for a poor, African American female in the South in the 1960's was a feat unto itself! After she graduated, she moved to Buffalo New York to work as a guidance counselor in the school system and start a new life for herself.

The school system came with a pension, so Enid knew she wouldn't have to worry too much about her retirement. Nonetheless, during those working years, she started a side business in which she imported African art which, with her kids' help, she hauled around to various festivals to sell. She eventually retired at 56 from the school system and also gave up her side business. To supplement her pension, Enid did some investing over time by buying and selling stocks on her own . . . until the stock market dropped in 2008. She kept thinking it would bounce back but it showed no signs of recovery. Worried, Enid pulled all her money out minus the $80,000 that had vanished before her eyes. And that was the moment she decided to try real estate.

Enid bought her first property at a foreclosure auction for $6500. She was not able to see the interior before the auction, so it was a bit of a gamble. However, it was on an okay street in an area fairly close to her home in the city of Buffalo, and she figured for the price tag, it would be worth the gamble. Turns out, it was. The house needed only minor repairs and it came with rent-paying tenants. To this day, she still owns the property.

Soon, her grandson came to live with her and he took to the whole investing idea. With his help scouting properties, she bought another property at auction. This one was only $3500, but this time it ended up being a bit of a nightmare. After purchasing it, again interior sight unseen, she found significant water damage to the entire house due to pipes that had burst over the winter. But little by little, and with the help of her grandson's handy skills and other hired workers, they were able to fix it up for under $20,000 and eventually rent it out. Enid continues to be the proud owner of this property as well.

Enid now owns four properties, plus her home that she shares with her companion, plus three more that he owns. Their properties are all two-family homes, half of which are rented as "Section 8." She likes all her tenants and says that Section 8 has been a positive experience for her. They do have annual inspection requirements, but Enid doesn't mind. She says it forces her to keep her properties in good and safe condition, which she would want to do anyway.

Altogether, she and her companion's fourteen mortgage-free rental units come to over $100,000 in income each year, which she says is a darn bit better than her mutual fund. Granted, the mutual fund is invested conservatively due to her age and yields only about 1.5 percent per year. But, due to her age, she really shouldn't be invested in risky stocks anyway. She considers her mutual fund investment to be basically as good as a savings account.

In the end, Enid is grateful for her rental properties. The properties, plus Social Security and her pension, allow her a comfortable life. She lives in top floor unit of the duplex that she's occupied for forty years. It's not a mansion, but it works for her. She enjoys an awesome quality of life making jewelry and sculpture in her attic studio/exercise room. She believes everybody should have a hobby before they retire, in order to help them make the transition into retirement. Enid says that she'll never be bored. Considering that she's in her upper 70's and still enjoys laying tile and painting her own rentals, I'm inclined to believe her!

Enid is not only an amazing and vibrant woman, but she's also an awesome role model for her kids and grandkids. Her son is still grateful to her for having convinced him, when he was 22, to buy a house instead of a car. Back in 1985, she'd explained to him that the $2500 he'd spend on a house would go up in value over time, but $2500 for a used car would only go down in value and his car would eventually wear out. He listened to her sage advice, and now this same home – which is now a rental property – is worth more than $100,000.

Jen (30) and Rachel (35)

Jen and Rachel knew they were a match the day they met. On top of an instant click, they noticed that, as far as real estate goes, they had been living parallel lives up till that point and had similar dreams and goals for the future. Both had lived in other cities prior to meeting in Baltimore and both had purchased properties in those other cities in the aftermath of the housing meltdown. In addition, both had decided to hold on to those properties for the foreseeable future.

Jen had purchased a home near the University of New Mexico in Albuquerque where she had been attending graduate school. At the time, she lived in her house and rented out the other rooms to other graduate students in order to cover the cost of the mortgage (plus a little extra). When she later moved to the East Coast she decided to switch her house over to a single tenant, who has been there ever since.

Split screen over to Rachel. In spite of being a financial planner, or perhaps because of it, Rachel believes in the long-term stability and income potential provided by real estate. When she lived in Texas she purchased a home for herself and then turned it into a rental when she moved. When she lived in Providence, Rhode Island she did the same thing. Then she landed in Baltimore. After about six months of being a tenant and getting to know Baltimore, she took the plunge and purchased a “historic” (old) “rowhome” (townhouse) for herself in the Patterson Park neighborhood.

Then, when they were ready to take their first big step together as a couple, Jen joined Rachel in this home that Rachel had gradually been fixing up. Over the next couple years, Jen and Rachel then purchased two more rentals in the same up-and-coming neighborhood. Finally, they bought a new home for themselves and once again turned their existing one into a rental.

The couple now owns six rentals across four states. Like most successful investors, they found a model that seemed to work for them and they stuck to it. All of their properties were bank-owned (“REO”) foreclosures or short-sales which they purchased in the aftermath of the housing crisis. All of their properties needed some minor upgrades but no major rehab at the time of purchase. They made a habit of installing granite countertops and stainless steel kitchen appliances and painting all the walls tan to make their properties stand out. They strongly believe in making their properties desirable in order to attract quality tenants who will be easy to manage from a distance. They also understand that part of the desirability factor is location, which is why all of their properties are in hip, hot or otherwise desirable rental areas.

Jen and Rachel’s purchase strategy has been to get a good price on a REO property and use a loan off either one of their 401(k) retirement plans for the down payment. They do some upgrades, wait a year and then refinance to recoup their down payment and pay back their 401(k). As a couple, they always put both names on each title but only one name on the mortgage. In this way they are able to attain more mortgages across the two of them together than if they were both on all the mortgages (since there is often a five mortgage per person limit in the standard mortgage industry). Their arrangement with each other is that the one whose name is not on the mortgage always contributes money toward the down payment so that they both have a financial stake in the property.

Because cash flow is positive on some of their properties while flat on others, Jen and Rachel have chosen to save money by not using property managers. Instead, they do thorough screenings so that they are able to find tenants who have steady income and good credit and who can afford their homes. They’ve also developed some creative ways to manage from a distance. For instance, they coordinate repairs through their tenants (and the tenants know the deal upon signing on). Also, when an existing tenant gives notice of plans to move out, Jen and Rachel offer the tenant $20 to show the house to each new prospective tenant who comes to check out the property. Everything else is handled electronically and over the phone.

Overall, Jen and Rachel are pumped about their investments. They feel like this is a great time to be landlords because many young people prefer to rent and many others who were burned in the housing crash have no choice but to rent. They also enjoy their jobs and rely on the income for their living expenses and the investment opportunities provided by them. They view their real estate holdings, not as a replacement to their retirement accounts, but as a way to diversify beyond these accounts. Their mortgages are all 30-year terms in order to maximize cash flow. However, Jen and Rachel are patient. They are young, they have time, and they will be in terrific shape for retirement when that day comes.

Alfredo (41) and Rose (47)

It was 2006 and Alfredo and Rose were planning a dream wedding. Meanwhile, they were trying to figure out where they would live once they got married. Alfredo was working in sales at a steel company and attending school in financial economics at night, while Rose was working as a real estate agent. They were renting an apartment in a neighborhood called Fells Point in Baltimore, Maryland. However, they knew their next home would be different. They knew they had to be on the other side of the whole rental equation.

Alfredo was determined to find a multi-unit building where the tenants' rent covered the cost of their mortgage plus the cost of the asset until it was owned free and clear. So, while Rose planned a wedding, Alfredo set to work finding an apartment building for their post-nuptial life together. They knew they wanted to stay in the neighborhood. After all, Fells Point was a cool place to live. Originally a ship-building and commerce seaport (back in the 1700's), Fells Point grew to become the hip, somewhat touristy waterfront neighborhood that it is today. It has quite a number of restaurants, pubs, and shops and is enjoyed equally by the residents of the neighborhood as well as the many local visitors and out-of-town tourists.

After making offers on a couple small buildings, both of which were rejected, the stars came into alignment for Alfredo and Rose. One day, when Alfredo was out walking their dog in their neighborhood park, he fell into conversation with another guy, also out with his dog. In their conversation, this fellow expressed concern about his future living situation because, as he said, the owner of his 23-unit apartment building had recently announced his intentions to sell the property. Alfredo had a deep feeling that this was the opportunity he'd been looking for. In fact, from that moment on, he would look at the building through his rented window and say to Rose with conviction, "We're going to own that building!"

Alfredo wasted no time in contacting the owner. The owner was an older Italian guy who was retiring and looking to cash out. Also being Italian, Alfredo found it helpful to their negotiations to bond over their shared heritage. As with any negotiation, it helps if you can find a similarity or point of common interest (a trick that salespeople have understood for decades!). The owner said that he didn't actually need all of his money at once and, in fact, he would be willing to lower the price if Alfredo and Rose would borrow money from him and pay him back with interest over time. The owner wanted to provide this "seller financing" – as explained in Chapter 8 – so that he could spread out his gain, reduce his immediate taxes and earn guaranteed interest on the amount borrowed by Alfredo and Rose. Alfredo and Rose were glad to take him up on the offer!

The stars continued to align for these soon-to-be newlyweds. A neighbor of theirs recommended the name of another neighbor who was a real estate attorney. She drew up a contract that Alfredo and Rose submitted to the owner as their written offer. In the course of their discussions, and based on her knowledge of current state laws, this attorney recommended a legal strategy to help them save money on their transfer taxes, which on an apartment building of this size, would have been substantial. In those days, limited liability companies (LLC) in the state did not have to pay state transfer taxes on the purchase or sale of property. Therefore, Alfredo and Rose convinced the owner to convert his "general partnership" into an LLC and then to sell them the LLC.

At the time they purchased the property, the units were all pretty run down and the rent amounts were incredibly low for the area. After purchasing the property, they borrowed money, once again from the owner. Then, one-by-one, they renovated the units each time an existing tenant moved out. And each time they did, they raised the rent to make it commensurate with comparable apartments in the neighborhood. They found that the money they put into the renovations quickly paid off in terms of the higher rents that they were able to collect. After about five years, Alfredo and Rose refinanced their property and paid back the owner the balance of the amount owed.

Recently, there has been a lot of development in the area, which has driven up prices, but has also driven up demand for their units, which are priced a fair bit lower than the recently constructed ones. They have also tested the idea of one unit as an AirBnB rental. They keep it nicely furnished, provide nice linens, and are able to make roughly twice the income as their other units in a given month.

Their building provides healthy positive cash flow every month. They are now at the point where they are deciding their next move. The good news for them is that, thanks to having boldly bought this building eleven years ago, they have options. A new home for the family, a beach house and a second apartment building are all on the table. Whichever direction they decide to take, their next down payment can come from their savings (from their existing cash flow) and/or the equity in their property (which can be tapped in the form of a refinance or second mortgage).

For now, however, they and their children are happy living in their building and continue to love the neighborhood. Alfredo and Rose know they will never have to worry about retirement. In fact, they believe it could come soon to them since they have only nominal personal housing expenses and their monthly cash flow from the building now surpasses their monthly living expenses. Once the mortgage is completely paid off, working will be completely optional. With this one purchase, Alfredo and Rose's apartment building has catapulted them into the realm of the Level III Goal of complete financial self-sufficiency for the rest of their lives.

Catherine (54)

"I'll hit one million, then I'll cash out." This is what Catherine, a former fire-fighter and a stock-market day trader, told herself. Then she did it. She actually passed the one million mark. However, she waited a moment too long. Within three hours, the value of her stock had plummeted by three quarters. Ouch. It was in this very moment that Catherine knew for certain that she was in over her head. She realized there were forces at play and players in the market that were infinitely more powerful than herself. This crash marked a pivot point in her life. It marked the point at which she realized she needed a different way to protect herself and her two kids financially. And that was when she knew she had to try real estate.

So in 1998, Catherine put together a group of five other moms who were also concerned about money. They decided to have a go at rehabbing a property together to sell for a profit. Each chipped in $20,000, either pulling from savings or borrowing from a retirement account, home equity line of credit (HELOC) or another kind of loan. Then, armed with $100,000, the ladies bought a property for $50,000 in a transitional neighborhood. They budgeted $50,000 in renovation costs and ended up selling the property for around $150,000.

These adventurous ladies rotated care of the kids while they took turns learning different skills that could be applied to the renovations. Catherine says that the experienced contractors in the area were demeaning at first, though over time they grew to respect them and eventually offer useful, even nonpatronizing advice and helpful contacts. While this experience didn't make them millionaires, it did launch most of them into other ways of making money in real estate.

For Catherine, she found her career in fixing up properties and holding for the long term. Catherine now has six rental properties, down from her high of ten. When she was at ten, she decided to sell off the ones that were the most problematic for her in terms of the types of tenants that she was able to attract and retain for long tenancies. Selling off the four helped her pay off the mortgages of the others. In addition, since she has become proficient at rehabbing houses, she continued doing some other fix-n-flip work in order to accelerate her goals in paying down the mortgages.

At this point, Catherine has only one mortgage at $974 per month and she receives $8000 per month in rent from her six rentals. Catherine is happy with her income and considers herself retired. She says she has more than enough, especially given that she enjoys living frugally anyway, driving a used car and shopping at thrift stores. She says that about a year ago she noticed that, for the first time, she was completely free from money worries. She realized that she had been experiencing a state of "enough" for so long that she was actually starting to believe it! Her old fears of not having enough had simply vanished.

Catherine now helps others who are looking to diversify their retirement plans, often at the last minute. Most of her clients are in their 50's and are worried about not having enough money to survive retirement. Catherine's five-year plan is to eventually trade her homes for a multi-unit apartment building (of approximately 20 units), which she expects will net her roughly $30,000 a month. By doing a 1031 exchange on these properties, as explained in Chapter 8, she will legally avoid taxes on the sale by directing her profit into the purchase of another investment property. She plans to partner with her now grown children on this venture, hoping to pass down both the adventure and the sense of financial security that come with real estate investing.

Catherine says that, frankly, she is surprised that so many people think owning rental property is risky. To the contrary, she believes that it is far riskier to work for 30 years, sock away money little by little, and expect some kind of magical retirement in the end. This single mom and former firefighter is living life to its fullest, has time to spend with her children and do whatever she pleases most of the time. Most importantly, she will never have to worry about where money will come from as she gets older because she has created streams of income that - while they might change form – will never run out.

APPENDIX C

Recommended Reading

The Art of Happiness: A Handbook for Living by His Holiness the Dalai Lama and Howard Cutler

The Battle for the Soul of Capitalism by John Bogle

The Book on Investing in Real Estate with No (and Low) Money Down by Brandon Turner

The Book on Managing Rental Properties by Brandon Turner and Heather Turner

The Book on Rental Property Investing by Brandon Turner

The Book on Tax Strategies for the Savvy Real Estate Investor: Powerful Techniques Anyone Can Use to Deduct More, Invest Smarter, and Pay Far Less to the IRS! by Amanda Han and Matthew McFarland

The Desire Map: A Guide to Creating Goals with Soul by Danielle LaPorte

The Firestarter Sessions: A Soulful + Practical Guide to Creating Success on Your Own Terms by Danielle LaPorte

How to Retire with Enough Money and How to Know What Enough Is by Teresa Ghilarducci

Investing in Real Estate with Lease Options and "Subject-To" Deals: Powerful Strategies for Getting More When You Sell, and Paying Less When You Buy by Wendy Patton

It's Rising Time! What it Really Takes to Reach Your Financial Dreams by Kim Kiyosaki

The Millionaire Next Door: The Surprising Secrets of America's Wealthy by Thomas J. Stanley and William D. Danko

The Millionaire Real Estate Investor by Gary Keller

Pound Foolish: Exposing the Dark Side of the Personal Finance Industry by Helaine Olen

Retire Happy: What You Can Do Now to Guarantee a

Great Retirement by Richard Stim

Rich Dad's Cashflow Quadrant by Robert Kiyosaki and Sharon L. Lechter

Rich Dad Poor Dad by Robert Kiyosaki

Rich Woman by Kim Kiyosaki

The Science Behind the Law of Attraction by Srinivasan Pillay, MD

Think and Grow Rich by Napoleon Hill

Tinker, Dabble, Doodle, try: Unlock the Power of the Unfocused Mind by Srinivasan Pillay, MD

Unfair Advantage by Robert Kiyosaki

What Every Real Estate Investor Needs to Know about Cash Flow… And 36 Other Key Financial Measures by Frank Gallinelli

APPENDIX D

Glossary

This glossary contains many of the terms – both technical and slang – that have been used throughout *Retire on Real Estate* and this Companion Guide. Italics are used to indicate words that are also defined in this glossary.

401(k) Plan - A *retirement* savings plan that is offered by some employers in which employees contribute a certain percentage of their paycheck to be invested in *mutual funds* and in which the employer often contributes *matching* funds. See *dollar cost averaging* and *retirement plan*.
403(b) Plan – The 401(k)-equivalent retirement savings plan that is available to employees of some public education systems and nonprofit organizations. See *401(k) Plan*.
457 or 457(b) Plan – The 401(k)-equivalent retirement savings plan offered by state and local public employers and some nonprofit employers. See *401(k) Plan*.
1031 Exchange – Also called a "Like-kind Exchange," the legal way to not pay taxes on the sale of an investment property as long as the profit from the sale is used to purchase another investment property of equal or greater value.
Active investing for passive income – Doing the work yourself to set up a stream of *passive income*, such as creating monthly income from owning and/or managing a rental property. The opposite is *passively investing*.
All cash – Real estate jargon meaning that a property is to be purchased with no *mortgage* or any other loan. Since an all-cash *offer* is usually stronger in a *seller's* eyes than one that requires financing, it can often be lower while still being competitive.
Adjustable Rate Mortgage (ARM) – A high-risk *mortgage* with payments that are usually lower than a *fixed-rate mortgage* initially, and after a pre-determined period of time is subject to higher *interest* rates.
Amortization – Repayment of a *mortgage* through regular monthly installments of *principal* and *interest* for a pre-determined number of years, after which you own the *property* outright.
Appreciation – The tendency for the *value* of a property to increase over time. One should view appreciation as a fringe benefit to investing in real estate, but never a guarantee.
Asset (1) – Per the financial planning industry, anything of financial value that can be converted into cash (i.e., stocks and bonds, automobiles, real estate, retirement funds, and savings).
Asset (2) – Per *Rich Dad Poor Dad* author Robert Kiyosaki, something that provides income on a consistent basis. For example rental property that has *positive cash flow* is an asset. An asset may be owned with a *mortgage* or other loan, or it may be owned *free and clear*. The opposite of an asset is a *liability*.
Baby Boomer – This term typically refers to those born between the years 1946 and 1964. See also *Millennial* and *Generation X*.
Balloon Mortgage – A high-risk *mortgage* that offers a low interest rate for a fixed period of time, after which the entire balance of the loan is due in full (usually accomplished by refinancing the *mortgage* or selling the *property*).
Buyer – The person who submits a contract to a *seller* for the purchase of a property.

Cash flow – The amount of monthly income provided by a given investment property after accounting for all monthly expenses, including mortgage or other debt used to acquire or leverage the property.

Chicken – A metaphor used throughout this book to refer to income producing rental property. Just as a hen produces *eggs* on an ongoing basis, rental property produces income on an ongoing basis.

Closing – Often used interchangeably with *settlement*, this is the term given to the final purchase of a property. It is customary for the *buyer* to sign documents at the office of a *title company* or real estate attorney. Documents may also be signed online. The *seller*'s attendance at closing is optional.

Closing costs – Any and all fees that are paid at the time of settlement. Fees can be paid by the buyer and/or the seller, depending on what is agreed upon between both parties and specified in the *contract*. These can include fees to the attorney, *title company*, real estate agent, and mortgage broker. They can also include government fees such as recording costs, transfer taxes, property taxes and financing fees such as mortgage application fees, *points*, and appraisal fees.

Collateral – Property or other assets that a lender of a loan or mortgage has legal permission to seize, through *foreclosure*, if the borrower fails to make loan payments according to an agreed upon schedule.

Consideration – Anything of value that is given in exchange for a promise. In real estate, this is usually in the form of money held as an *earnest money deposit* in *escrow* until *settlement*. It is provided in tandem with a *ratified contract* in order for that contract to be legally binding.

Contract – The document that a buyer and seller both must sign for a real estate transaction to be legally binding. A contract must state the nature and *terms* of the agreement and must include *consideration* to be legally binding.

Corridor Theory – My theory for how to achieve a large goal in spite of not having all the answers – or even all the questions – in advance. It entails visualizing yourself walking down a long corridor that is sectioned off by multiple doors. You must open each door, as it presents itself, and achieve the challenge behind that door. You are then better prepared to open the next door and traverse the length of the corridor until you reach your goal at the end.

Deposit – The *earnest money deposit* that a buyer submits with a *contract*, as *consideration*, to demonstrate intent to follow through with the purchase a property. This money is usually submitted to and held in *escrow* by a realtor, *title company* or real estate attorney until the date of *settlement*.

Depreciation (1) – The tax-benefit to owning rental property in which you are permitted to deduct from your income tax return the hypothetical wear and tear of the building and its contents at fixed rates.

Depreciation (2) – The term to describe the situation when a property's value goes down over time, as occurred in the housing market crash of 2007. To safeguard against the risk of depreciating values, when purchasing property it is never wise to *speculate* and it is always wise to buy for *cash flow*. Opposite of *Appreciation*.

Defined benefit plan – See *Pension*.

Defined contribution plan – A type of employer-sponsored retirement plan in which the employee and/or the employer make contributions to a retirement account on a regular basis, which are to be drawn from in retirement. See *Nest Egg* and *Retirement Plan.*

Diversification – Planning for your *retirement* and/or old age by using a mix of strategies, in order to increase your chances of success and lessen your overall *risk*.

Dollar cost averaging – The act of putting money into a *mutual fund* account on a set schedule so that contributions are averaged across both up and down markets. This is in contrast to trying to time the market and also has been popularized as a way to help individual investors save money on a consistent basis.

Down payment – A portion of the total *purchase price* of a property that a lender may require a borrower to provide from funds other than the mortgage. Down payment funds traditionally come from savings, however they can also come from a 401(k) loan, a *HELOC*, a retirement account, equity from a refinanced property, a partner, or the seller.

Earnest money deposit – See *deposit.*

Effective Gross Rent (EGR) – On a prospective rental property, the anticipated rent minus the anticipated loss in income due to vacancy.

Equity – The *value* of a property minus the total amount owed on the property.

Escrow – The holding of funds by a third party until some specified condition has been fulfilled. The term most commonly refers to the holding of an *earnest money deposit* by a realtor, *title company* or real estate attorney until the date of *settlement.*

Fees (Expense Ratio) – Also called the Annual Operating Expenses or Annual Fund Operating Expenses, the expense ratio is the annual fee that mutual funds charge their shareholders. It expresses the percentage of assets deducted each fiscal year in *fees*, including 12b-1 fees, management fees, administrative fees, operating costs, and all other asset-based costs incurred by the fund. Portfolio transaction fees, or brokerage costs, as well as initial or deferred sales charges are not included in the expense ratio. The expense ratio accrued on a daily basis reduces the overall rate of return by that amount. See *Fees (mutual fund or advisor)*.

Fees (mutual fund or advisor) – A number of different types of fees that, when taken together, can have a large negative impact on the value of your retirement account over time. For example, fees totaling 2 percent reduce the performance of your account by the same amount, such that an account with a 7 percent return would really only receive a 5 percent return when fees are factored in. See *Fees (Expense Ratio)*.

Financial advisor – See *financial planner.*

Financial planner – A term used interchangeably for two related, but vastly different, professions: 1) a true investment advisor who is obligated to provide unbiased financial planning advice that is in the client's best financial interest; and 2) a broker-dealer or salesperson who is required to provide advice that is merely suitable, but not necessarily *most suitable* for a given client, and who is allowed to provide biased advice without informing clients of their conflicts of interest.

Fixed-rate Mortgage – A mortgage whose interest rate is unchangeable for the entire length of the mortgage (usually 10, 15, 20 and 30 year terms).

Foreclosure – A situation in which a lender seizes a property which has been held as *collateral* on a *mortgage* due to the borrower's inability to make the scheduled principal and interest payments on the mortgage. This involves eviction, repossession and subsequent resale of the property.

Free and clear – The ownership of a property without a *mortgage* or other loan attached to it.

Generation X – Also called "Gen X," this term typically refers to those born between approximately 1965 and 1980. See also *Millennial*, *Generation Y*, and *Baby Boomer*.

Generation Y – Synonymous with M*illennial*. See also *Generation X* and *Baby Boomer*.

Heirs – Those who will benefit from your real estate investments and other *assets* after you die. These usually mean your spouse or partner, your children and/or other loved ones. Heirs could also be taken to mean a charitable organization or religious entity included in your will.

Home Equity Line of Credit (HELOC) – A variable-rate loan that is provided by a lender to a borrower based on a percentage of the borrower's *equity* in an existing property. The existing property serves as *collateral* and may be seized through *foreclosure* if payments are not made according to an agreed upon schedule.

Individual Retirement Account (IRA) – A *retirement* savings vehicle that typically includes a mix of stocks, bonds, *mutual funds* and sometimes REITs and other assets that you must buy at one price and sell at a higher price in order to capture value. Unlike an *employer-sponsored retirement plan*, the IRA is an investment vehicle that is opened by individuals on their own, rather than by through an employer.

Inflation – The rate at which prices for goods and services are rising, and by extension the rate at which the purchasing power of that country's currency is falling in a given country's economy. Since 1913, when the U.S. Federal Reserve was created and began tracking inflation, the inflation rate in the US has been 3.22 percent on average, translating to prices doubling roughly every thirty years.[6] This means that one dollar in 1913 would have the same purchasing power as $23.93 in 2016 (US Bureau of Labor Statistics online inflation calculator).[7]

Interest (as related to a mortgage) – The amount charged by a lender to a borrower for a mortgage, expressed as a percentage of the principal.

Interest-only mortgage – A *mortgage* on a property in which you are only obligated to pay the amount of interest that has accrued each month. Since you are not paying down the *principal* (unless you make extra payments), this type of *mortgage* does not improve the amount of *equity* you have in the *property*, does not get you closer to owning the property *free and clear*, does not protect you against the forces of *inflation* over time, and relies on the less predictable force of *appreciation* for safety and net gain. Opposite of *Fixed-rate Mortgage*.

Lease – A legally binding rental agreement which specifies something (ex: a rental property) that is being exchanged for something else (ex: rental payment in the form of money) for a specified period of time.

Lease Option – Also called "Lease with the Option to Purchase" and "*Rent-to-Own*," this is a type of rental agreement that gives a *tenant/buyer* the option to purchase a rented property within a specified period of time. This type of agreement is used in both residential and commercial real estate purchases.

Lease/sublet – The strategic move in which one rents a property from a property owner and then, with the owner's permission, rents the property out to a new tenant or group of tenants, collecting the difference between the rent paid and the rent received as a monthly fee.

Leverage – The ability to acquire and eventually own outright an otherwise unaffordable *asset* through the tool of a *mortgage*.

Liability – Something that costs you money on a consistent basis without providing any monetary gain in return. For example, consumer *debt* and rental property with *negative cash flow* are liabilities. The opposite of a liability is an *asset*.

Matching – The funds that an employer contributes to an employee's *401(k) retirement* account or other employer sponsored retirement account.

Millennial – Also called *Generation Y*, this term typically refers to those born between approximately 1980 and the early 2000's. See also *Generation X* and *Baby Boomer*.

Mortgage – A method of purchasing real estate by borrowing money from a bank or other lender with the property being purchased as *collateral*. The borrower is obligated to pay back the mortgage according to certain *terms* until it is eventually owned *free and clear*. If the borrower fails in this obligation, the lender can *foreclose* and take ownership of the property as *REO*.

Mutual fund – An investment vehicle in which your money is pooled with that of many other investors and invested by a money manager across a number of different stocks and/or bonds in hopes that the funds will go up in value over time. This can be a *retirement account* but is not necessarily limited to retirement accounts.

Negative Cash Flow – The undesirable *cash flow* situation that occurs when the sum of the monthly *expenses* (including mortgage or other debt) on a property is greater than the monthly *income* for that property.

Nest egg – A lump sum of money that an individual builds up over his or her lifetime and sets aside, usually in some type of *retirement account* to be drawn down from later, in *retirement*. See *Retirement Plan* and *Defined Contribution Plan*.

Net Operating Income (NOI) – The term given to the *cash flow* on a *property* before accounting for the *principal* and *interest* portion of a monthly *mortgage* payment.

Net Worth – The sum of all your *assets* minus the sum of all your *liabilities*.

Offer – A proposition to purchase a *property* that a hopeful buyer submits to the property's owner in the form of a contract.

Owner financing – See *seller financing*.

Passive income – Income received on a consistent, regular basis with little effort to maintain it, for example rental income earned on a monthly basis.

Passive investing – The act of turning your money over to a financial advisor, mutual fund, or other retirement account either on a one-time or consistent basis, and rarely thinking about it again.

Pay yourself first – Lingo in the personal finance world that implies having money automatically deducted from your paychecks in a "dollar-cost averaging" way and deposited into your retirement accounts before you have a chance to spend it on anything else.

Payback Period – The payback period is the length of time required to recover the cost of an investment.

Pension – More formally known as a "*defined benefit plan*," this is the gradually disappearing system in which employers pay their retired workers monthly income for life, the amount of which is usually based on length of service and final salary.

PITI – The acronym for "*Principal*, *Interest*, Taxes and Insurance" refers to the four components of a monthly mortgage payment.

Points – The percentage of a total loan or *mortgage* amount that you pay at the time of *closing* in exchange for a lower *interest* rate on that mortgage, with one point being equal to one percent, two points being two percent, etc.

Ponzi Scheme – The phony investment of other people's money, with false claims of strong returns and the constant recruitment of new clients' money to pay fictitious returns to existing investors for the false appearance of authenticity.

Positive Cash Flow – The desirable *cash flow* situation that occurs when the monthly *income* is greater than sum of the monthly *expenses* (including mortgage and/or other debt).

Primary Residence Exclusion – Provision in the tax code allowing homeowners to avoid paying taxes on the capital gains from the sale of their home as long as they lived in their home for at least two of the five years immediately preceding the sale.

Principal (1) – The portion of your monthly *mortgage PITI* payment that goes toward paying down the overall *principal (2).*

Principal (2) – The total amount owed on your *mortgage*. As you make payments, this number will gradually decline until it is ultimately paid off and you own the property *free and clear*.

Property – A house, building, condominium, or piece of land owned by someone, usually with rental potential and tax obligations.

Property management (by you) – Management of someone else's *property* by you (not recommended unless you are a licensed professional property manager).

Property management (for you) – Management of property by a licensed professional property manager, to include all aspects of securing and retaining tenants, collecting rent, and overseeing maintenance and repair issues of the property.

Purchase Price – The bottom line amount that the seller will receive for the sale of a property from the buyer and the buyer's lender(s).

Ratified – The status of a contract in which it is legally binding because it has been signed by all parties.

Recession – A significant decline in the economy lasting longer than a few months.

REIT (Real Estate Investment Trust) – A company that invests in *real estate* through *property* and/or *mortgages* and often trades shares, similar to a stock or *mutual fund*, on major stock exchanges. They offer investors an extremely liquid way of investing in real estate but must be sold higher than the original purchase price in order to capture value.

Rent-to-Own – See *Lease Option.*

REO (Real Estate Owned) – After foreclosure and the unsuccessful attempt by the bank to sell a property at auction (due to the amount owed being greater than value), the ownership of a property by a bank.

Required Minimum Distribution (RMD) – The legal requirement in the United States that individuals withdraw a certain minimum sum of money each year from their *retirement accounts* beginning at age 70½. RMD applies to all employer sponsored retirement plans and IRA-like plans except for the Roth IRA.

Retirement – The period of one's life in which one no longer exchanges time for money in the form of work.

Retirement Plan – The term usually used to refer to an employer sponsored *401(k), 403(b)*, *457*, or governmental TSP retirement plan or a self-sponsored *Individual Retirement Account (IRA)* or self-employed 401(k) plan that is typically invested in stocks and/or bonds in the form of a *mutual fund*. See *Retirement Plan (Roth), Retirement Plan (Non-Roth or Traditional)*, *Defined Contribution Plan*, and *Nest Egg*.

Retirement Plan (Roth) – A *retirement plan* that is not tax deductible during the year invested, but comes with the advantage of having earnings that are free from being taxed at time of withdrawal as long as the beneficiary is at least age 59½.

Retirement Plan (Non-Roth or Traditional) –A retirement plan that is tax deductible for certain individuals (depending on income and whether the individual or his or her spouse has the option of a investing in a Roth retirement account through work) during the year invested, however – unlike the Roth products – the earnings are subject to income tax at time of withdrawal at age 59½ or greater.

Risk – The chance things will not go as expected or the likelihood of losing money.

Return on Investment (ROI) – A measure used to evaluate the real or projected performance of an investment or to compare two or more different investments. It is equal to your total annual *cash flow* (income minus expenses) divided by the amount you personally invested to purchase the asset. The less you invest out of your own pocket, the higher your ROI.

Roth – See *Retirement Account (Roth).*

Second mortgage – An additional mortgage on a property, also referred to as a home equity loan or home equity line of credit. Failure to pay can trigger foreclosure proceedings. A second mortgage is subordinate to the primary mortgage, meaning that in the case of default, the first mortgage gets paid off first before the second.

Self-directed IRA (Roth and non-Roth) – The investment vehicle in which you are the manager and you have the ability to invest your money in both the *stock market*, index and *mutual funds*, and real estate, precious metals (silver, gold, platinum), oil, restaurants, a startup companies, and interest-bearing loans. See also *Individual Retirement Account (IRA)* and *self-directed Solo 401(k)*.

Self-directed Solo 401(k) – An investment vehicle that is similar to the *self-directed IRA (Roth and non-Roth)*, but with slightly different rules.

Seller – The person or party who is selling a property.

Seller financing – The situation in which – like a bank – the seller of a property lends money to the buyer, and the buyer pays this money back at an agreed upon interest rate over an agreed upon period of time. This money can either be used for a portion or entirety of the purchase price of the property. Also called *owner financing*.

Settlement – Often used interchangeably with *closing*, this is the term given to the final purchase of a property. At this time, it is customary for the buyer to sign documents at the office of a *title company* or real estate attorney. Documents may also be signed online. The seller's attendance at closing is optional; many sellers opt to sign papers prior to the actual closing date.

Special Assessment Fees (related to a condominium) – Fees that a condominium homeowner's association charges unit-owners to cover the cost of building repair or upgrades that exceed that amount in the current budget.

Speculation – The practice of purchasing property (or land, stocks, gold, silver, etc.) with the sole expectation that property values will *appreciate*. It is always safest to buy properties that provide *positive cash flow* in the near- and long-terms.

Stock market – The place where stocks and bonds are bought and sold, or "traded" in the form of *stock market investing*.

Stock market investing – The *risk*-laden practice of purchasing stocks and bonds at one price, with the goal of later selling at a higher price.

Tenant – Someone who pays rent to a landlord or *property manager* in exchange for space in which to live or conduct business.

Tenant/Buyer – The individual in a Rent-to-Own agreement who is under contract to rent a property with the option of purchasing it within an agreed upon period of time.

Term – The length of time until a *mortgage* or loan is fully repaid.

Thermostat Change and Results Theory – My theory that we have daily habits that keep us at a given state of being, or "temperature," in various areas of life (finances, weight, clutter, etc.), until we positively or negatively change our "thermostat setting" by changing some element of our behavior on a consistent or even daily basis, which then results in our landing at our new setting or state of being.

Title company – A business that ensures that a property's title has no liens (outstanding financial obligations) and is otherwise legitimate, issues title insurance to protect the lender, maintains *escrow* accounts, conducts *settlement* of the sale of a property, and files all paperwork with the appropriate governmental entities.

Turn key – The term used to classify a home that is for sale that is nice enough to occupy without any additional work. Synonymous with the term "move-in ready."

Vacancy – The period of time in which a property is not rented and there is a loss of revenue. In estimating expenses, you must include an estimated vacancy rate. Investors often use 5 percent, however this may vary depending on your specific property and location.

Value – The amount of money someone would actually pay for a property, given the value of comparable homes (i.e., "comps") or given the *net operating income* on the property.

Wall Street – The informal way of referring to the *stock market.*

APPENDIX E

Anderson Inspection Method (AIM) Tool

The following pages contain a tool that I designed to assist myself (and now you) on personal walk-throughs of properties. I call this the Anderson Inspection Method (AIM) Tool. The AIM Tool is not intended – in any way, shape, or form – to replace a professional inspection. It *is* intended to help you *quickly* assess the *general* quality of a property, so that your are able to remember that property and its issues at a later point in time, and compare properties against one another (using AIM Tools for these all properties visited). I've also found that it also provides some objectivity. It prevents the temptation to minimize the amount of work needed by scanning down the checklist and noticing that many of the circled items fall in the "poor" category.

The AIM Tool is simple to use. As you walk through a property, simply check out the home in the following order: exterior, basement, kitchen, and then the rest of the house. As you go through each area, go down the list and simply circle the category that best describes what you see. Each category generally falls into one of the three overarching labels: good, fair, and poor.

Anderson Inspection Method (AIM) Tool (Page 1 of 5)

	Circle the most fitting answer for each line:			Notes
I. Exterior & First Impression	**Good**	**Fair**	**Poor**	
Quality of neighborhood and street	Litter-free and nice homes	Some litter & deterioration	Litter and vacant or deteriorating homes	
Neighboring Homes to each side of property	Litter-free and nice homes	Some litter & deterioration	Litter and vacant or deteriorating homes	
Grounds, Lawn and Landscaping	Excellent landscaping	Plain landscaping or overgrown grass	Wildly overgrown, poor grounds, or retaining walls falling apart	
Trees and Other	Nice trees, no problems	No significant tree issues	Trees growing into foundation or electrical wires	
Grading of the ground	Ground slopes away from house	Average grading	Ground slopes toward house; signs of damage	
General look of house	Very nice	Fair	Terrible	
Roof	In excellent shape	In adequate shape	In rough shape; signs of leaking	
Siding type and quality	Good quality and appearance	Good quality but needs cleaning	Needs new siding or brick needs repointing	
Any Paint, Front	Very nice	Worn, but not flaking	Flaking paint	
Steps (Exterior)	In excellent shape	In adequate shape	In rough shape, uneven, too steep or missing handrail	
Porch	Very nice	Old or dated	Falling apart in places	
Quality of door & lock	Very nice	Functional but fair looking	Non-functional, non-locking	
Garage	In excellent shape	In adequate shape	In rough shape	
<u>Exterior and General Impression: Other Notes and General Comments:</u>				
<u>Address:</u>				

Anderson Inspection Method (AIM) Tool (Page 2 of 5)

	Circle the appropriate answer for each line:			Notes
II. Basement	**Good**	**Fair**	**Poor**	
Steps (From interior of home into basement)	In excellent shape, with handrail	In adequate shape	In rough shape, uneven, too steep or missing handrail	
Is there a smell?	None	Mildly damp	Moldy	
Moisture on floor	None	Damp	Puddles or dark patches of mold	
Asbestos tiles (Usually 9”x9” tiles)	None	9”x9” tiles present and still intact	9”x9” tiles present but not intact	
Moisture in rafters	None	Past signs of a leak	Signs of a current leak	
Moisture in rafters along edge of house	Dry	Dry	Damp; check for termite tunnels	
Airtight rafters along edge of foundation	Dark when interior light is off	Dark when interior light is off	Sunlight is visible through cracks	
Pipes	Copper or CPVC; no leaks	Galvanized steel	Galvanized steel with corrosion and evidence of pinhole leaks in parts	
Wires	New wiring and box	New wiring and small box	Knob and tube	
Furnace, Heat Pump or Boiler	New	Old, connected and working	Old, signs of age (puddles, corrosion); presence of oil tank or boiler	
Hot Water Heater	New	5-10 years old, connected and working	10+ years old; signs of age (puddles, etc)	

II. Basement: Other Notes and General Comments

Date of Furnace/Boiler:

Date of Hot Water Heater:

Address:

Anderson Inspection Method (AIM) Tool (Page 3 of 5)

	Circle the appropriate answer for each line:			**Notes**
IV. Kitchen	**Good**	**Fair**	**Poor**	
General look	Modern and clean	Basic but decent	Dirty, falling apart, or ancient	
Lighting	Modern, bright, clean	Functional but dated	Dated, dull, or falling apart	
Essential Appliances (Refrigerator, Oven, Stove)	Modern and working	Functional but dated	Non-functional or missing	
Extras: Dishwasher, Garbage Disposal, Ice Maker, Built-in Microwave	All present, modern and clean	Some present, functional but dated	None present or not working	
Sink & Faucet	Modern, nice and clean	Basic, fair	Old, worn, dripping	
Countertops	Modern, nice and clean	Basic, fair	Falling apart or disgusting	
Under the sink	Clean, no stains	Water stains from prior sink leaks but dry	Pooling water from leak; evidence of mice (droppings)	
Cabinets – Exterior	Nice, modern, clean	Plain but in good shape	Doors missing, falling apart, ugly or dirty	
Cabinets – interior	Nice, level, clean	Plain or stained	Very warped, dirty, or deteriorating, or evidence of mice	

III. Kitchen: Other Notes and General Comments:

Address:

Anderson Inspection Method (AIM) Tool (Page 4 of 5)

	Circle the appropriate answer for each line:			Notes
III. Whole House	**Good**	**Fair**	**Poor**	
General look	Modern and clean	Basic but decent	Dirty, falling apart or ancient	
Lighting & Ceiling Fans	Modern, bright, clean, and working	Functional but dated or dirty	Dated, dull, dirty, falling apart, broken	
Windows	Modern and clean	Functional but unattractive; no lead paint	Old, lead paint, unopenable, or they fall down	
Exterior-facing Walls	Flat, smooth	Flat	Warped, caving, leaning, wet, or sunlight visible	
Wall Paint	Modern, nice	Plain or dirty but not flaking	Flaking*, wet, or moldy	
Steps (Interior Main)	In excellent shape	In adequate shape	In rough shape, uneven, too steep or missing handrail	
Floors	Beautiful	Clean and in decent shape	Dirty carpet, rough hardwood, or breaking tile	
Floors – Look under items or rugs	No difference	Object/rug is hiding some minor flaw	Object/rug is hiding a major defect	
Ceiling	Flat, smooth	Former signs of leak, but dry	Caving, bubbling, wet, moldy	
Ceiling Paint	Lovely	Plain or dirty	Wet or flaking*	
Doors	Lovely appearance; latch and don't rub when shut	Fair appearance; Latch and don't rub	Ugly, missing, non-latching, rubbing against frame when shut	

IV. Whole House: Other Notes and General Comments:

Number of bedrooms?

Other rooms?

*** Note: Visual evidence of flaking or peeling paint can be the source of a failed lead inspection.**

Address:

Anderson Inspection Method (AIM) Tool (Page 5 of 5)

	Circle the appropriate answer for each line:			Notes
V. Bathrooms	**Good**	**Fair**	**Poor**	
Bathroom #1: General look	Modern and clean	Basic but decent	Dirty, falling apart, or ancient	
Bathroom #1: Lighting	Modern, bright, clean	Functional but dated	Dated, dull, or falling apart	
Bathroom #1: Shower Fixtures	Modern and working	Functional but dated	Non-functional, leaking, broken, or missing	
Bathroom #1: Tub	Clean and new-looking	Plain, dated or tired-looking, areas of missing caulk	Dirty, broken, flaking refinish, moldy caulk	
Bathroom #1: Toilet	Modern and working	Functional but dated	Toilet not working, leaking, "running," or missing	
Bathroom #2: General look	Modern and clean	Basic but decent	Dirty, falling apart, or ancient	
Bathroom #2: Lighting	Modern, bright, clean	Functional but dated	Dated, dull, or falling apart	
Bathroom #2: Shower Fixtures	Modern and working	Functional but dated	Non-functional, leaking, broken, or missing	
Bathroom #2: Tub	Clean and new-looking	Plain, dated or tired-looking, areas of missing caulk	Dirty, broken, flaking refinish, moldy caulk	
Bathroom #2: Toilet	Modern and working	Functional but dated	Toilet not working, leaking, "running," or missing	

V. Bathrooms: Other Notes and General Comments:

Number of Bathrooms: ____ Full ____ Half ____ ¾ (toilet, sink & standing shower)

Address:

APPENDIX F

References

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