

Creating Your Own Rules To Investing In Real Estate

Let's start with some questions.

Is it better to invest in residential real estate or commercial real estate? Are three bedroom houses better than two bedroom houses? How much should you put down? Is positive cash more important than tax benefits or appreciation? Does the age of the property matter? Is it OK to pay full price? How long should I hold the property?

As you can see, there are many questions when it comes to investing in real estate. Ask any investor who been investing for a while and you will get a bunch of different answers to the same question.

Why?

It's because the investor has created a set of rules. These rules are the guidelines that that investor uses to make decisions to invest or not. It is the rules that determine the success or failure of the investment.

How are rules created?

Well, think about this for a moment. How are laws (which are rules) that govern this country created? Most were created for the purpose to either provide a benefit or solve a problem.

Rules are similar. They are guidelines to help us make sure we have the best chance of making a profit (the benefit) or avoiding a problem. They are guidelines that each one of us as individual investors create to fit our level of risk and the way we choose to operate our investment business.

As we develop experience, we will create our own rules based on our objectives. But in the beginning we have to create our rules based on facts and experiences of others.

That is what this report is about. I'm going to give you some facts about real estate and share with you some of my experiences so that you can start to create you own set of rules.

Let's get started by talking about what makes a good real estate investment.

The six main factors of what makes a good real estate investment.

1. **Location**, Location, Location. You heard it before and it is a fact. Location matters and it matters a lot! Whenever you are considering buying a property to rent you must ask yourself about the neighborhood. People rent neighborhoods! If the neighborhood is bad you will have a hard time finding good quality renters.

You should also be looking at what direction you think the neighborhood is moving toward. This is easy to do by driving through and look to see if there are improvements happening.

2. **Condition** of the property. Does the property need fix-up or could a tenant move right in? Is the fix-up that is needed minor or major? For example: Painting and cleaning is minor, but new windows and new furnace is major?
3. **Price** of the property. Is the price comparable to other similar properties? Is it above, below or about the same of the sold prices of other similar properties?
4. **Terms** of financing. Can you make the numbers work? Can you get enough rent to pay off all expenses and any loan payments?

Special Note: Price and terms always relate. A property that is worth \$200,000 may sell for more or less because of the terms. For example: A \$200,000 property may sell for \$250,000 because the seller offered a Contract for Deed with zero down and interest at only 3% for fifty years. I know this is unrealistic, but I'm trying to show you that the price doesn't matter if the terms are good enough and the numbers work.

5. **Seller's Motivation and Flexibility.** Does the seller REALLY want to sell? Some sellers think that they determine the value of their properties and will only sell if they get exactly what they want.

Well, they are WRONG! The value is determined by what a buyer is willing to pay.....Period. If a buyer won't pay what the seller is asking, it won't sell. The seller must understand this and be flexible to change the price or terms based on the market. If they are not willing to do this, they are not really motivated and don't really need to sell.

6. **Profit Potential** of the property. When you look at the five factors above and everything looks good, the last question you have to look at is, how will you make your profit? If you can't answer this, then you should not be buying that property.

What type of properties should I buy?

Ok, now that we know the six factors of a good investment we need to decide what type or types of properties we want to focus on. Below is a list of the type of properties and the advantages and disadvantages to each. You should use this information to decide what type or types of properties you want to buy. By the way, you can invest in any of them, they all work, it's just a matter of choice.

Small residential properties – (Single-family, condos, townhomes, duplexes, triplexes and four-plexes).

Advantages

- They are easy to buy.
- They are easy to finance.
- They require small down payments.
- They are easy to rent.
- They are easy to sell.
- They have less government regulations.
- They are all over the place and easy to find.
- They generally appreciate in value faster.

Disadvantages

- You have very little or no cash flow in the early years.
- You have more management headaches.
- Your investments are spread out.
- Vacancy can eat profits fast.

Larger Residential Properties –(Apartment buildings).

Advantages

- They generally have cash flow
- A small increase in individual rents can create large cash flow increases
- Everything is centralized
- You can have an on site manager to reduce management.

Disadvantages

- They are harder to find.
- They are harder to finance with traditional lenders.
- They may require larger down payments.
- Repairs may be larger and more expensive.
- There is more government regulation.

Commercial Properties –(office buildings, warehouse, industrial, retail, etc.).

Advantages

They can have great cash flow.
They tenants may be long term.
They are easy to manage.

Disadvantages

They are higher priced.
They are harder to finance if using traditional financing.
Most lenders require large down payments.
It may take a long time to find tenants if vacant.
May have negative cash flow if vacant.

The type of properties that you decide to invest in depends on where you are at financially right now. If you just starting, I recommend that you start small because it is the easiest and doesn't take that much money to get started. Once you feel you understand it and can move to buying larger properties.

Ask questions to create your own rules.

The rules that you create are the answers to the questions that you ask yourself before you make a decision to buy and the why or reason behind the answers.

Maybe that didn't make any sense to you so let me explain. When I first got started to invest in real estate the first question that I asked myself was:

What type of real estate should I buy?

After looking at the advantages and disadvantages of each type of property, I decided to start with single-family homes. This is the answer to the question.

The why or reason behind my answer was because they were easy and didn't take a lot of money to buy.

So I created my first rule:

1.) The type of property that I'm looking for is a single-family home.

The second question that I asked myself was: How many bedrooms should it have?

After thinking about this, my answer was three or more. Why? Because most young families (which is the renter that I'm trying to attract) want three or more bedrooms. So this was my next rule.

Here's my second rule:

2.) Single-family home should have 3+ bedrooms.

I continued with this process. Ask a question? Look at the facts or past experience of others or myself to determine an answer and know the why or reason behind the answer.

I created a set of rules for the type of properties that I'm looking for and a set of rules based on the six main factors of what makes a good real estate investment that we talked about earlier in this report.

That's it. That is how you create your own rules.

I have created a worksheet for you to use at the end of this report to help you create your own set of rules. Use this worksheet "as is" or feel free to modify it in any way. I don't use the worksheet myself because I have my rules in my head.

I have also included at the end of this report a short sample of my rules that I use to purchase properties. You can use this as a model to create your own rules.

Note: Rules are guidelines. I break my own rules many times. When I buy houses, my rule is to buy three or more bedroom houses, however if the price is right and I think I can get the rent I will buy a two-bedroom house if the numbers make sense and it meets most of my other rules.

The most important rule to me is that the NUMBERS MAKE SENSE! I don't care about anything else until I meet that rule.

Also, You can create a different set of rules for different properties. For example: when I buy houses, my rule is: 3 or more bedrooms. When I buy apartment buildings, my rule changes to: each unit must have 2 or more bedrooms.

My last comment about your rules is this. If you go overboard and create a set of rules that are so restrictive you'll never buy any properties so don't create too many rules. Remember that the purpose of the rules is to help you make decisions so that you can profit and prevent problems.

Price (Circle one) Bad – 0, Ok – 2, Good - 3

Rule	Reason

Terms (Circle one) Bad –1, Ok – 2, Good - 3

Rule	Reason

Seller's Motivation And Flexibility (Circle one) Bad –1, Ok – 2, Good – 3

Rule	Reason

How am I going to profit?

Other Comments:

Short Sample of Rules

Here is a short sample of some of my rules for buying Single Family Houses:

Numbers

- Must have breakeven or positive cash flow with 15%-20% down
- Must be able to pay off loan and have breakeven cash flow in 15 years or less.
- In a worst-case scenario, any losses must be offset with tax saving and principal reduction.
- If the numbers don't make sense, I'll never buy.

Location

- I would feel good walking there at 10:00pm at night.
- It would live there if I had to.

Condition

- 3 or more bedrooms
- More than one bath
- Bedrooms have closets
- Repairs are OK if price is adjusted.
- Low maintenance yards
- No pools
- Newer furnace, roof unless price is adjusted.

Price and Terms

- No more than 10-15% out of pocket expense
- Must be able to pay off in 15 years or less

Seller's Flexibility

- Seller must be open to discussion

Profit

- The property must make money in either principal reduction, cash flow or tax savings.
- Never count equity as profit.
- The property must have potential of positive cash in the future.