LEARNING MADE EASY

4th Edition

Real Estate Investing

for dummies®
A Wiley Brand

Take advantage of new federal tax laws

Find and evaluate properties with maximum potential

Generate wealth in any market

Eric Tyson, MBA
Best-selling Author of *Investing For Dummies*

Robert S. Griswold, CRE
Best-Selling Author of *Property Management Kit For Dummies*

Eric and Robert's Principles for Success

by Eric Tyson and Robert S. Griswald

- **Real estate is a proven wealth-building vehicle.** Investing in rental properties can generate current income and significant tax benefits as well as build equity from appreciation over the years and decades.
- **Although many people can succeed investing in real estate, rental property investing isn't for everyone.** Consider your investment preferences and personal temperament before buying property. Do you have the time to devote to real estate investing? Are you comfortable troubleshooting problems or hiring a property manager?
- **Make sure you're financially fit before investing in rental properties.** Pay particular attention to your monthly budget and make sure that you have adequate insurance coverage. Most successful real estate investors build their real estate investment portfolio through saving money and then gradually buying properties over the years.
- **Don't underestimate the importance of establishing good credit.** The best returns on real estate rely upon the use of credit to obtain the leverage of using OPM (other people's money).
- **Your first (and often one of the best) real estate investment is buying a home to live in.** Real estate is the only investment that we know of that you can live in or rent to produce income. You can also derive large tax-free profits when you sell your principal residence at a higher price than you paid for it.
- **Focus on residential properties in the beginning.** Residential property is an attractive investment and is easier to understand, purchase, and manage than most other types of property. If you're a homeowner, you already have experience locating, purchasing, and maintaining residential property.
- **Among residential property options, our top recommendations are small apartment buildings and single-family homes.** Attached housing makes more sense for investors who don't want to deal with building maintenance and security issues. Attached-housing prices tend to perform best in developed urban environments.
- **Have your real estate team in place before you begin your serious property searching.** Line up a real estate agent, loan officer, tax advisor, lawyer, and so on early because the real estate investor with the best resources can identify the properties to ignore and those worthy of careful consideration. Move quickly — the speed at which you can close a transaction is an advantage in any type of market.

- **Look for properties in the path of progress.** Areas where new development or redevelopment is heading are where you want to be. The best real estate investment properties are ones that are well located and physically sound but cosmetically challenged and poorly managed.
- **You don't get rich trying to find no-money-down real estate investment deals.** Don't believe informercial hucksters. Don't expect to buy top-notch rental properties that way.
- **Making at least a 20 to 25 percent down payment provides access to the best financing terms.** You can make smaller down payments — even as low as 10 percent or less — but you often pay a much higher interest rate, loan fees, and private mortgage insurance. Leverage, or the use of the lenders' money to cover the majority of your acquisition costs, can boost your rates of return. But too much leverage can be dangerous if the rental market turns and your debt expenses are high.
- **As the size and complexity of the deal increases, financing options become less attractive.** The financing options for larger apartment buildings (five or more units), commercial, retail, industrial, and raw land generally require more money down and/or higher interest rates and loan fees. But more advanced real estate investors can enjoy higher overall returns plus the benefits of easier management and stability from long-term tenants.
- **For low entry costs, consider real estate investment trusts (REITs) and lease options.** You can buy these exchange–traded securities (which can also be bought through REIT focused mutual funds) for a thousand dollars or less. With lease options, you begin by renting a property you may be interested in purchasing later, and a portion of your monthly rent goes towards the future purchase. If you can find a seller willing to provide financing, you can keep your down payment to a minimum.
- **We prefer the adage of "Location, location, value.**" It clearly emphasizes location but also the importance of finding good value for your investment dollar. Owning real estate in up and coming areas with new development or renovated properties enhances finding and keeping good tenants and leads to greater returns. Properties in great locations with extensive deferred maintenance, especially aesthetic issues that can be inexpensively addressed are another great opportunity.
- **Make real estate investments close by.** Buy property within two hours away by your favorite mode of transportation. Venture further only when you really know another real estate market and regularly find yourself there for other reasons or you've found an excellent property manager.

- **Any decision about where to invest starts with an evaluation of the overall region's economic trends.** If the area isn't economically sound, then the likelihood for successful real estate investments are diminished.
- **You're purchasing a future income stream or cash flow when you buy an investment property.** What you pay for a property and the cash flow it generates makes a significant difference in the success of your investment. The key is identifying which properties sellers have underpriced.
- **Don't rely on the seller's numbers when evaluating a property's potential.** Speak directly with the seller to determine the history of the property and their motivation for selling. But, don't rely on historic operating results offered by the seller or broker. Develop your own numbers through evaluating the property with a team of qualified professionals who are specialists in the physical and fiscal management of real estate.
- **The buy-and-flip real estate investment strategy can work, but it also has a downside.** Buying and flipping can be a way to make quick money in real estate if you time your investments correctly in a rapidly rising real estate market. However, flipping can cause your profits to be taxed as ordinary income and you could lose during a market downturn.
- ***Bottom line:* Real estate professionals, and you, should value a property based on the projected Net Operating Income (NOI).** Project the NOI preferably for the next few years. Projecting the NOI is time consuming and requires a lot of experience, especially if you plan property changes to increase income and/or reduce expenses.

Real Estate Investing

for dummies
A Wiley Brand

Real Estate Investing

4th Edition

by Eric Tyson, MBA, and
Robert S. Griswold, MBA, MSBA, CRE

for dummies®
A Wiley Brand

Real Estate Investing For Dummies®, 4th Edition

Published by: **John Wiley & Sons, Inc.,** 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

Published simultaneously in Canada

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002. For technical support, please visit www.wiley.com/techsupport.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at http://booksupport.wiley.com. For more information about Wiley products, visit www.wiley.com.

Library of Congress Control Number: 2019948942

ISBN 978-1-119-60176-0 (pbk); ISBN 978-1-119-60177-7 (ebk); ISBN 978-1-119-60178-4 (ebk)

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1

Contents at a Glance

Table of Contents

Introduction

Welcome to *Real Estate Investing For Dummies*, 4th Edition! We're delighted to be your tour guides. Throughout this book, we emphasize three fundamental cornerstones that we believe to be true:

- Real estate is one of the three time-tested ways for people of varied economic means to build wealth (the others are stocks and small business). Over the long term (decades), you should be able to make an annualized return of at least 8 to 10 percent per year investing in real estate.
- Investing in real estate isn't rocket science but does require doing your homework. If you're sloppy doing your legwork, you're more likely to end up with inferior properties or to overpay. Our book clearly explains how to buy the best properties at a fair (or even below market value!) price. (Although we cover all types of properties, this book concentrates more on residential investment opportunities, which are more accessible and appropriate for nonexperts.)
- Although you should make money over the long term investing in good real estate properties, you *can* lose money, especially in the short term. Don't unrealistically expect real estate values to increase every year. Downturns in the local real estate prices may create temporary buying opportunities, but we aren't real estate day traders. When you invest in real estate for the long term, which is what we advocate and practice, the occasional price declines should be merely bumps on an otherwise fruitful journey.

About This Book

Real Estate Investing For Dummies, 4th Edition, covers tried and proven real estate investing strategies that real people, just like you, use to build wealth. Specifically, this book explains how to invest in single-family homes; detached and attached condominiums; small apartments including duplexes, triplexes, and multiple-family residential properties up to 20 to 30 units; commercial properties, including office, industrial, and retail; and raw (undeveloped) land. We also cover *indirect* real estate investments such as real estate investment trusts (REITs) that you can purchase through the major stock exchanges or a real estate mutual fund.

We've always relied on tried-and-true methods of real estate investing, and our core advice is as true today as it was before the real estate downturn in the late 2000s.

If you expect us (in infomercial-like fashion) to tell you how to become an overnight multimillionaire, this is definitely *not* the book for you. And please allow us to save you money, disappointment, and heartache by telling you that such hucksters are only enriching themselves through their grossly overpriced tapes and seminars.

Unlike so many real estate book authors, we don't have an alternative agenda in writing this book. Many real estate investing books are nothing more than infomercials for high-priced DVDs or seminars the author is selling. The objective of our book is to give you the best crash course in real estate investing so that if you choose to make investments in income-producing properties, you may do so wisely and confidently.

Here are some good reasons why we — Eric Tyson and Robert Griswold — are a dynamic duo on your side:

Robert Griswold has extensive hands-on experience as a real estate investor who has worked with properties of all types and sizes. He is also the author of *Property Management Kit For Dummies* (Wiley) and was the author of two popular syndicated real estate newspaper columns for more than 20 years. He has appeared for more than 15 years as the NBC-TV on-air real estate expert for Southern California. And for nearly 15 years, he was the host of the most popular and longest running real estate radio show in the country — *Real Estate Today! with Robert Griswold* on Clear Channel Communications.

Robert also holds the Counselor of Real Estate (CRE), Certified Commercial Investment Member (CCIM), Professional Community Association Manager (PCAM), and Certified Property Manager (CPM) designations. He earned a bachelor's degree and two master's degrees in real estate and related fields from the University of Southern California's Marshall School of Business.

Eric Tyson is a former financial counselor, lecturer, and coauthor of the national bestseller *Home Buying For Dummies* (Wiley), as well as the author or coauthor of numerous other bestselling books in the *For Dummies* series, such as *Personal Finance, Investing, Mutual Funds,* and *Small Business*.

Eric has counseled thousands of clients on a variety of personal finance, investment, and real estate quandaries and questions. A former management consultant to Fortune 500 financial service firms, Eric is dedicated to teaching people to better manage their personal finances. For more than 25 years, he has successfully invested in real estate and securities and started and managed several businesses. He earned an MBA at the Stanford Graduate School of Business and a bachelor's degree in economics at Yale.

Foolish Assumptions

Whenever an author sits down to write a book, he has a particular audience in mind. Because of this, he must make some assumptions about who his reader is and what that reader is looking for. Here are a few assumptions we've made about you:

- You're looking for a way to invest in real estate but don't know what types of properties and strategies are best.
- You're considering buying an investment property, be it a single-family home, a small apartment complex, or an office building, but your real estate experience is largely limited to renting an apartment or owning your own home.
- You may have a small amount of money already invested in real estate, but you're ready to go after bigger, better properties.
- You're looking for a way to diversify your investment portfolio.

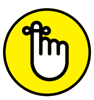
If any of these descriptions hit home for you, you've come to the right place.

Icons Used in This Book

Throughout this book, you can find friendly and useful icons to enhance your reading pleasure and to note specific types of information. Here's what each icon means:

INVESTIGATE

We use this icon to highlight when you should look into something on your own or with the assistance of a local professional.



REMEMBER

This icon flags concepts and facts that we want to ensure you remember as you make your real estate investments.

TECHNICAL STUFF

Here we point out potentially interesting but nonessential (skippable) stuff.

TIP

This icon points out something that can save you time, headaches, money, or all the above!

TRUE STORY

Look for this icon to find real-life examples of real estate situations to help exemplify a point.

WARNING

Here we're trying to direct you away from blunders and boo-boos that others have made when investing in real estate.

Beyond This Book

In addition to the content of this book, you can access some related material online. Head to `www.dummies.com` and type in "Real Estate Investing For Dummies Cheat Sheet" in the search box to find additional tips for investing.

Where to Go from Here

If you have the time and desire, we encourage you to read this book in its entirety. It provides you with a detailed picture of how to maximize your returns while minimizing your risks in the real estate market. But you may also choose to read selected portions. That's one of the great things (among many) about *For Dummies* books. You can readily pick and choose the information you read based on your individual needs. Just scan the table of contents or index for the topics that interest you the most.

1

Getting Started with Real Estate Investing

IN THIS PART . . .

Understand that real estate is just one of many available investment options for you and grasp why you may want to consider it in your investment portfolio.

Identify the pros and cons of managing rental properties and how you can fit real estate into your overall personal financial plans.

Examine the gamut of real estate options so that you know which ones may be better choices for you, depending on your circumstances.

Separate fact from fiction when it comes to passive real estate investments (for example, real estate investment trusts) and riskier approaches like no money down and property flipping.

Begin to assemble a team of competent professionals who can assist you with investing in real estate.

IN THIS CHAPTER

» Focusing on the potential of real estate investing

» Contrasting real estate with other investing options

» Deciding whether real estate is really for you

» Arranging your overall investment and financial plans to include real estate

Chapter 1

Evaluating Real Estate as an Investment

When coauthor Robert first entered the real estate field while attending college decades ago, his father, a retired real estate attorney, advised that he use his monthly income primarily to pay day-to-day living expenses and allocate money each month into long-term financial investments like real estate. This solid advice has served Robert well over the years.

It's never too early or too late to formulate your own plan for a comprehensive wealth-building strategy. For many, such a strategy can help with the goals of funding future education for children and ensuring a comfortable retirement.

The challenge involved with real estate is that it takes some real planning to get started. Contacting an investment company and purchasing some shares of your favorite mutual fund or stock is a lot easier than acquiring your first rental property. Buying property need not be too difficult, though. With a financial and real estate investment plan, a lot of patience, and the willingness to do some hard work, you can be on your way to building your own real estate empire!

In this chapter, we give you information that can help you decide whether you have what it takes to make money *and* be comfortable with investing in real estate.

We compare real estate investments to other investments. We provide some questions you should ask yourself before making any decisions. And finally, we offer guidance on how real estate investments can fit into your overall personal financial plans. Along the way, we share our experience, insights, and thoughts on a long-term strategy for building wealth through real estate that virtually everyone can understand and actually achieve.

Understanding Real Estate's Income- and Wealth-Producing Potential

Compared with most other investments, good real estate can excel at producing periodic or monthly cash flow for property owners. So in addition to the longer-term appreciation potential, you can also earn investment income year in and year out. Real estate is a true growth *and* income investment.

REMEMBER

The vast majority of people who don't make money in real estate make easily avoidable mistakes, which we help you avoid.

The following list highlights the major benefits of investing in real estate:

- **Tax-deferred compounding of value:** In real estate investing, the appreciation of your properties compounds *tax-deferred* during your years of ownership. You don't pay tax on this profit until you sell your property — and even then, you can roll over your gain into another investment property and avoid paying taxes. (See the "Being aware of the tax advantages" section later in this chapter.)
- **Regular cash flow:** If you have property that you rent out, you have money coming in every month in the form of rents. Some properties, particularly larger multi-unit complexes, may have some additional sources, such as from parking, storage, or washers and dryers.

  REMEMBER

  When you own investment real estate, you should also expect to incur expenses that include your mortgage payment, property taxes, insurance, and maintenance. The interaction of the revenues coming in and the expenses going out is what tells you whether you realize a positive operating profit each month.
- **Reduced income tax bills:** For income tax purposes, you also get to claim an expense that isn't really an out-of-pocket cost — depreciation. Depreciation enables you to reduce your current income tax bill and hence increase your cash flow from a property. (We explain this tax advantage and others later in the "Being aware of the tax advantages" section.)

» **Rate of increase of rental income versus overall expenses:** Over time, your operating profit, which is subject to ordinary income tax, should rise as you increase your rental prices faster than the rate of increase for your property's overall expenses. What follows is a simple example to show why even modest rental increases are magnified into larger operating profits and healthy returns on investment over time.

Suppose that you're in the market to purchase a single-family home that you want to rent out and that such properties are selling for about $200,000 in the area you've deemed to be a good investment. (***Note:*** Housing prices vary widely across different areas, but the following example should give you a relative sense of how a rental property's expenses and revenue change over time.) You expect to make a 20 percent down payment and take out a 30-year fixed rate mortgage at 6 percent for the remainder of the purchase price — $160,000. Here are the details:

Monthly mortgage payment	$960
Monthly property tax	$200
Other monthly expenses (maintenance, insurance)	$200
Monthly rent	$1,400

In Table 1-1, we show you what happens with your investment over time. We assume that your rent and expenses (except for your mortgage payment, which is fixed) increase 3 percent annually and that your property appreciates a conservative 4 percent per year. (For simplification purposes, we ignore depreciation in this example. If we had included the benefit of depreciation, it would further enhance the calculated investment returns.)

TABLE 1-1 **How a Rental Property's Income and Wealth Build Over Time**

Year	Monthly Rent	Monthly Expenses	Property Value	Mortgage Balance
0	$1,400	$1,360	$200,000	$160,000
5	$1,623	$1,424	$243,330	$148,960
10	$1,881	$1,498	$296,050	$133,920
20	$2,529	$1,682	$438,225	$86,400
30	$3,398	$1,931	$648,680	$0
31	$3,500	$1,000	$674,625	$0

Now, notice what happens over time. When you first buy the property, the monthly rent and the monthly expenses are about equal. By year five, the monthly income exceeds the expenses by about $200 per month. Consider why this happens — your largest monthly expense, the mortgage payment, doesn't increase. So, even though we assume that the rent increases just 3 percent per year, which is the same rate of increase assumed for your nonmortgage expenses, the compounding of rental inflation begins to produce larger and larger cash flows to you, the property owner. Cash flow of $200 per month may not sound like much, but consider that this $2,400 annual income is from an original $40,000 investment. Thus, by year five, your rental property is producing a 6 percent return on your down payment investment. (And remember, if you factor in the tax deduction for depreciation, your cash flow and return are even higher.)

In addition to the monthly cash flow from the amount that the rent exceeds the property's expenses, also look at the last two columns in Table 1-1 to see what has happened by year five to your *equity* (the difference between market value and mortgage balance owed) in the property. With just a 4 percent annual increase in market value, your $40,000 in equity (the down payment) has more than doubled to $94,370 ($243,330 – 148,960).

By years 10 and 20, you can see the further increases in your monthly cash flow and significant expansion in your property's equity. By year 30, the property is producing more than $1,400 per month cash flow and you're now the proud owner of a mortgage-free property worth more than triple what you paid for it!

After you get the mortgage paid off in year 30, take a look at what happens in year 31 and beyond to your monthly expenses (big drop as your monthly mortgage payment disappears!) and therefore your cash flow (big increase).

Recognizing the Caveats of Real Estate Investing

Despite all its potential, real estate investing isn't lucrative at all times and for all people — here's a quick outline of the biggest caveats that accompany investing in real estate:

- **Few home runs:** Your likely returns from real estate won't approach the biggest home runs that the most accomplished entrepreneurs achieve in the business world. That said, by doing your homework, improving properties,