LEARNING MADE EASY

Real Estate Investing

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Real Estate Investing

ALL-IN-ONE

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Real Estate Investing All-in-One For Dummies®

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Table of Contents

List of Tables

List of Illustrations

Book 5 Chapter 21

Book 6 Chapter 22

Book 6 Chapter 23

Book 6 Chapter 25

Book 8 Chapter 28

Book 8 Chapter 29

Book 8 Chapter 30

Introduction

Successful real estate investing requires smart decisions. *Real Estate Investing All-in-One For Dummies* presents basic real estate investing topics — such as buying and selling houses, investing in foreclosures, and flipping properties — but also introduces advanced subjects, like international and commercial real estate investing, that can help you build even more wealth. You even get the ins and outs of short-term rentals like Airbnb, so all your passive income options are covered.

This book can help you start investing in real estate quickly and easily, thanks to expert tips and information that will help you avoid costly mistakes. It's your one-stop resource for all things real estate. Explore the pages of this book and find the topics that most interest you within the world of real estate investing.

About This Book

You don't need a fancy degree to invest in real estate. What you *do* need is a desire to read, absorb, and practice the simple yet effective strategies in this book. *Real Estate Investing All-in-One For Dummies* is designed to give you a realistic approach to investing in real estate. It provides sound, practical lessons and insights. You're not expected to read it from cover to cover. Instead, this book is designed as a reference tool. Feel free to read the chapters in whatever order you choose. You can flip to the sections and chapters that interest you or those that include topics that you need to know more about.

A quick note: Sidebars (shaded boxes of text) dig into the details of a given topic, but they aren't crucial to understanding it. Feel free to read them or skip them. You can pass over the text accompanied by the Technical Stuff icon, too. The text marked with this icon gives some interesting but nonessential information about the subject of real estate investing.

One last thing: Within this book, you may note that some web addresses break across two lines of text. If you're reading this book in print and want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

Foolish Assumptions

No matter your skill or experience level with real estate investing, you can get something out of this book. Here are some assumptions we made about you as we wrote this book:

- You're new to investing in real estate and don't know what properties and strategies will work for you.
- Your real estate experience is limited to renting an apartment or owning your own home, and you're interested in finding out more about foreclosures, flipping, and other investment options.
- You may already be a seasoned real estate investor, but you're ready to go to the next level with commercial and international properties.
- You want to diversify your investment portfolio.

Icons Used in This Book

Throughout this book, icons help guide you through suggestions, solutions, and cautions. Here’s what they mean.

REMEMBER The name says it all! This icon indicates something *really* important to take away from this book.

TECHNICAL STUFF Information marked with this icon is interesting but not crucial to understanding real estate investing. Skip it or read it; the choice is yours.

TIP This icon highlights helpful strategies that can enable you to build your real estate portfolio (and your wealth) faster.

WARNING This icon indicates treacherous territory in real estate investing. Skip this information at your own peril.

Beyond the Book

In addition to the material in the print or e-book you’re reading right now, this product comes with a free access-anywhere Cheat Sheet that can put you on the road to successful real estate investing. To get this Cheat Sheet, simply go to www.dummies.com and search for “Real Estate Investing All-in-One For Dummies Cheat Sheet” in the Search box.

Where to Go from Here

If you’re a new real estate investor, you may want to consider starting from the beginning; head to Book 1 on getting started. That way, you’ll be ready for some of the more advanced topics introduced later. But you don’t have to read this book from cover to cover. *Real Estate Investing All-in-One For Dummies* makes it easy to find answers to specific questions. Just turn to the table of contents or index to locate the information you need. You can get in and get out, just like that. Good luck!

Book 1

Getting Started with Real Estate Investing

Contents at a Glance

Chapter 1

Evaluating Real Estate as an Investment

IN THIS CHAPTER

» **Focusing on the potential (and downsides) 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**

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!

This chapter gives you information that can help you decide whether you have what it takes to make money *and* be comfortable with investing in real estate. You compare real estate investments to other investments. You find some questions you should ask yourself before making any decisions. And finally, you get guidance on how real estate investments can fit into your overall personal financial plans. Along the way, you find 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 this book helps 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 later section "Being aware of the tax advantages.")

- **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 cash flow 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 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. (Find out about this tax advantage and others in the later section "Being aware of the tax advantages.")

- **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. The following simple example shows 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 revenues 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

Table 1-1 shows you what happens with your investment over time. 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, depreciation is ignored in this example. If the benefit of depreciation had been included, 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

Year	Monthly Rent	Monthly Expenses	Property Value	Mortgage Balance
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 you can 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, and practicing good management (and sometimes enjoying a bit of luck), you can do extremely well!
- **Upfront operating profit challenges:** Unless you make a large down payment, your monthly operating

profit may be small, nonexistent, or negative in the early years of rental property ownership. During soft periods in the local economy, rents may rise more slowly than your expenses or they may even fall. That's why you must ensure that you can weather financially tough times. In the worst cases, rental property owners lose both their investment property and their homes. See the later section "Fitting Real Estate into Your Plans."

- **Ups and downs:** You're not going to earn an 8 to 10 percent return every year. Although you have the potential for significant profits, owning real estate isn't like owning a printing press at the U.S. Treasury. Like stocks and other types of ownership investments, real estate goes through down periods as well as up periods. Most people who make money investing in real estate do so because they invest and hold property over many years.
- **Relatively high transaction costs:** If you buy a property and then want out a year or two later, you may find that even though it has appreciated in value, much (if not all) of your profit has been wiped away by the high transaction costs. Typically, the costs of buying and selling — which include real estate agent commissions, loan fees, title insurance, and other closing costs — amount to about 8 to 12 percent of the purchase price of a property. So, although you may be elated if, in the short term, your property appreciates 10 percent in value, you must consider the overall financial picture. You may not be so thrilled when you realize that selling the property may not have any greater return than stashing your money in a lowly bank account.
- **Tax implications:** Last, but not least, when you make a positive net return or profit on your real estate

investment, the federal and state governments are waiting with open hands for their shares. Throughout this book, you discover ways to improve your after-tax returns. Keep in mind that the profit you have left after government entities take their bites (not your pretax income) is what really matters.

These drawbacks shouldn't keep you from exploring real estate investing as an option; rather, they simply reinforce the need to really know what you're getting into with this type of investing and whether it's a good match for you. The rest of this chapter takes you deeper into an assessment of real estate as an investment as well as introspection about your goals, interests, and abilities.

Comparing Real Estate to Other Investments

Surely, you've considered or heard about many different investments over the years. To help you grasp and understand the unique characteristics of real estate, the following sections compare and contrast real estate's attributes with those of other wealth-building investments like stocks and small business.

Returns

Clearly, a major reason that many people invest in real estate is for the healthy total *returns* (which include ongoing cash flow and the appreciation of the property). Real estate often generates robust long-term returns because, like stocks and small business, it's an *ownership investment.* This means that real estate is an asset that has the ability to produce periodic income *and* gains or profits upon refinancing or sale.

Research and experience suggest that total real estate investment returns are comparable to those from stocks — about 8 to 9 percent on average, annually. Over recent decades, the average annual return on real estate investment trusts (REITs), publicly traded companies that invest in income-producing real estate such as apartment buildings, office complexes, and shopping centers, has appreciated at about this pace as well.

And you can earn long-term returns that average much better than 10 percent per year if you select excellent properties in the best areas, hold them for several years, and manage them well.

Risk

Real estate doesn't always rise in value — witness the decline occurring in most parts of the U.S. during the late 2000s and early 2010s. That said, market values for real estate generally don't suffer from as much volatility as stock prices do. You may recall how the excitement surrounding the rapid sustained increase of technology and internet stock prices in the late 1990s turned into the dismay and agony of those same sectors' stock prices crashing in the early 2000s. Many stocks in this industry, including those of leaders in their niches, saw their stock prices plummet by 80 percent, 90 percent, or more. Generally, you don't see those kinds of dramatic roller-coaster shifts in values over the short run with the residential income property real estate market.

However, keep in mind (especially if you tend to be concerned about shorter-term risks) that real estate can suffer from declines of 10 percent, 20 percent, or more. If you make a down payment of, say, 20 percent and want to sell your property after a 10 to 15 percent price decline, you may find that all (as in 100 percent) of your