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Real Estate Investing For Canadians

FOR
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Douglas Gray
Author of *Making Money
in Real Estate*

Peter Mitham

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***Real Estate
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by Douglas Gray and Peter Mitham

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About the Authors

Douglas Gray, LLB, is one of the foremost experts on real estate in Canada. He's written over 22 books on real estate and personal finance, all of them bestsellers. They include seven books on real estate, such as *Making Money in Real Estate*, *101 Streetsmart Condo Buying Tips for Canadians*, and *Mortgages Made Easy*. He brings to this book 35 years of experience investing in residential properties, as well as many years as a lawyer representing buyers, sellers, lenders, borrowers, and developers. President of the National Real Estate Institute Inc., headquartered in Vancouver, British Columbia, Doug is a consultant and columnist, and regularly gives seminars on real estate across Canada for both professional Realtors and the public. His Web site is www.homebuyer.ca.

Peter Mitham is a prolific freelance contributor to newspapers and magazines who has written on Canadian real estate for publications in both Canada and abroad. He writes a weekly column of real estate news for *Business in Vancouver* (www.biv.com) and contributes regularly to *Western Investor* (www.westerninvestor.com), a sister publication focused on real estate investment opportunities in Western Canada. Peter's articles on real estate, renovations, and construction appear regularly in agricultural, trade, and consumer publications in Canada and the United States. Growing up in Quebec, he was fascinated with the catalogues of property listings and mortgage applications in the home office of his father, an appraiser (now retired). This is his second book.

Dedication

We dedicate this book to the current and potential property owners and landlords of Canada, for whom it was written, and from whose experiences and insights it evolved.

Authors' Acknowledgments

This book has been much more than a collaboration between two authors. The insights and advice of several readers, editors, and professionals has helped make this book what it is.

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Acquisitions, Editorial, and Media Development

Editor: Robert Hickey

Developmental Editor: Kelli Howey

Copy Editor: Allyson Latta

Cartoons: Rich Tennant
(www.the5thwave.com)

Composition

Publishing Services Director: Karen Bryan

Publishing Services Manager: Ian Koo

Project Manager: Elizabeth McCurdy

Project Coordinator: Lindsay Humphreys

Layout and Graphics: Carl Byers, Andrea Dahl,
Denny Hager, Barbara Moore,
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Proofreaders: Susan Moritz, Techbooks

Indexer: Andrea Battiston,
Colborne Communications Inc.

John Wiley & Sons Canada, Ltd

Bill Zerter, Chief Operating Officer

Jennifer Smith, Publisher, Professional and Trade Division

Publishing and Editorial for Consumer Dummies

Diane Graves Steele, Vice President and Publisher, Consumer Dummies

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Andy Cummings, Vice President and Publisher, Dummies Technology/General User

Composition Services

Gerry Fahey, Vice President of Production Services

Debbie Stailey, Director of Composition Service

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Introduction

If you've ever bought a home, you've invested in real estate, even if you didn't plan to use the property to finance your retirement. Chances are, like many people, you may not even have considered real estate from an investment perspective — it's simply been your own patch of ground, somewhere you can relax and call home.

But real estate is an important part of the personal investment strategies pursued by many people — and not just the Donald Trumps of the world. If you've picked up this book, you probably think real estate might be for you. Congratulations! No matter where you are in your journey, this book can get you started and see you through to the close of your first deal — and the beginning of your second!

Foolish Assumptions

This book is reader-focused, so by definition we've had to make a few assumptions about you. Although we've never had the pleasure of meeting, we expect that you're most likely a novice when it comes to investing in real estate. Perhaps you've never bought a property; perhaps you've bought only your own home. This book will be a primer for you.

We also want to make sure that you enjoy a fresh take on the art of investing in real estate, particularly if you do have some experience in the market. Although we can't offer an in-depth analysis of each topic, we do provide an excellent overview and some pointers for honing your strategy (watch for sidebars, vignettes drawn from real-life examples, and so forth).

Because you may be interested in more than just buying a property, we haven't neglected to track down other ways in which you can understand, participate in, and benefit from the real estate market even if you don't want to own your own acreage — yet.

Should any of these assumptions about yourself ring true, read on! We look forward to working with you.

How This Book Is Organized

We've organized this book into five parts and an appendix. We hope you'll find it easy to use, and a clear guide to investing in real estate. But for starters, here's a quick look at what you can expect to find in each part. The book is modular in format, allowing you to read chapters as you require the information. But that doesn't mean you can't read it through, beginning to end.

Part I: Understanding Real Estate

No investment opportunity comes without risk, so we take some time in this part to discuss the options open to you as a real estate investor and the requirements for entering the market, as well as briefly cover the risks you'll face once you're involved. We take a look at how real estate can play a role in your long-term financial plan, and how the various kinds of real estate can work for you. We also introduce you to the concept of market cycles and some of the challenges joint ownership and government regulations can pose. Finally, we discuss investing strategies and how to formulate one that works for you.

Part II: Preparing to Buy: Financing Real Estate Investments

A bit of cash and a fistful of dreams can work wonders, but you should also know how much property you're capable of buying. In this part, we cover financing of your investment and help you identify resources, and cultivate the relationships that can assist you in finding even more resources. We also talk about mortgages, and how to make the financing you've got go further (not to mention the limits of financing). Because the ownership structure you choose may help you achieve your investment goals, we discuss ways you can own real estate, such as personally, through a partnership or a company.

Part III: Selecting Properties: Where to Look, What to Watch For

A prime location isn't the only thing that makes for a good real estate investment. Researching and identifying a property for purchase involves so much more, and we discuss the factors you need to consider as well as brief you on

the basics of sizing up neighbourhoods. We also give you a heads-up on working with market cycles to improve your chances of being a successful investor. We try to make sense of complex topics like appraisals, cap rates, and operating expenses, and give tips on making the best of bad situations. We walk you through the due diligence process — one of the most important parts of selecting a property — and tip you off to the kinds of frauds that could rob you of your investment. Finally, we discuss closing the deal, and strategies that will help you get a deal that's to your liking — and the vendor's.

Part IV: Building Value: Managing Your Investment and Seeing a Return

Becoming an investor means knowing how to manage a property, not just buy it, and this part helps you make the most of your hard-won asset. We discuss property managers, tenant selection, and landlord-tenant relations. We offer tips on reducing your risks through sound management practices, and reducing your costs through regular maintenance. We also offer insights into strategies for managing expenses and deductions that can save you money, and what to do when it's your turn to become a seller.

Part V: The Part of Tens

There's always something more to say, and always something more to explore. This section points to places you can turn to, whether you're researching a purchase, preparing to renovate, or looking to sell. We also offer tips on building the value of your property, from doing upgrades to managing cash flow.

Icons Used in This Book



Several icons throughout this book flag information for you that you may want to record, remember, or read later. These include the following:

Why reinvent the wheel? Tips pass along useful information based on the experience of those who've gone before.



Knowing what *not* to do is key to managing your risks. Warnings convey information that can save you time, money, and frustration.



Some concepts deserve extra emphasis. Remembering these items may make your life as an investor easier and, we hope, more successful!



We aim to provide useful information, but sometimes it helps to have some background. Technical stuff is important, but feel free to read it later.



When the basic information we provide can benefit from more specifics, we encourage you to do your own research.

Where to Go from Here

Canada is a big country, and that means a lot of real estate. But because the real estate that makes up each province is governed by the laws in that province, much of what we talk about in this book may play out differently in different jurisdictions. But this book can get you started, and we hope you take time to read the whole thing (even if you don't read it in order). You should find it a good companion as you navigate through the idiosyncrasies of various provincial regimes and at the same time stay focused on the big picture. Consider us part of your research team, and let us back you up as you pursue deals and discuss the finer points of your own situation with your advisers.

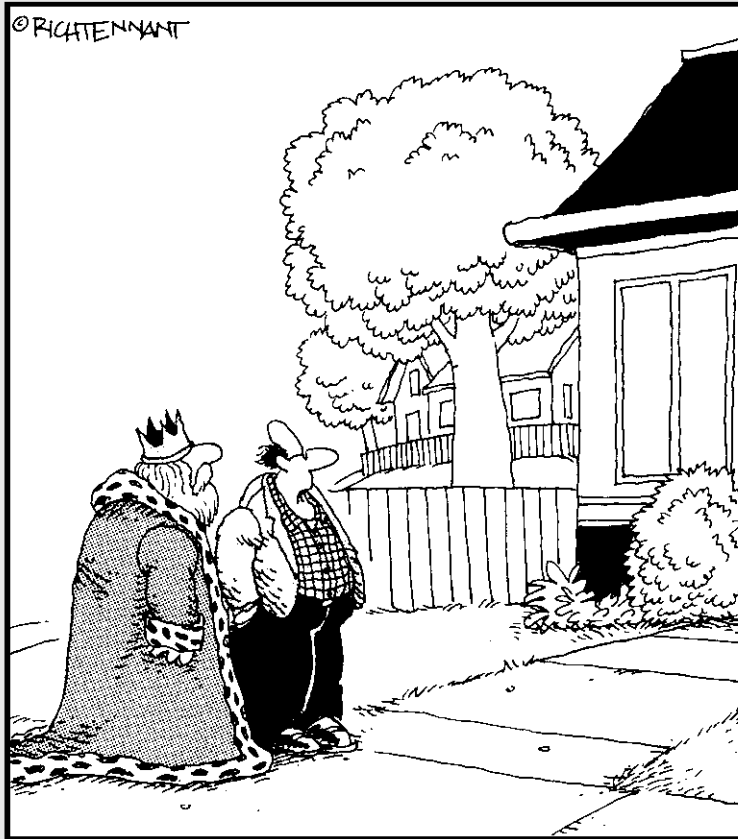
Above all, enjoy the time you spend investing in real estate!

Part I

Understanding Real Estate

The 5th Wave

By Rich Tennant



"I could rent you this one. It's got a pool in the backyard. Then I got a six bedroom with a fountain out front, but nothing right now with a moat."

In this part . . .

Wondering how real estate is going to fit into your life? Here's the best place to start! We demystify the basic concepts associated with real estate investing and give you the tools you need to start developing your investment strategy. We discuss the various challenges and opportunities and explore how you can prepare yourself to become a successful real estate investor.

Chapter 1

Identifying Opportunities

In This Chapter

- ▶ Taking a look at real estate investments
 - ▶ Determining goals and limits
 - ▶ Making real estate a part of your investment strategy
-

Some days, it seems like everyone wants to be a real estate tycoon. And why not? Land is a relatively stable investment and, hey, it's nice to see your investment once in a while, which you can do with land, unlike with other, intangible investments that are just figures on paper. Whether you have a handful of homes you rent to university students, renovate a run-down character house you can sell for a handsome profit, or buy the neighbourhood strip mall and make it a gathering point for the area, you've got opportunities for making money as well as making a contribution to your community.

Real estate is everywhere: the apartment or house you call home, the mall where you go shopping for groceries and clothes, and the office where you work. Even the park where you take your kids and walk your dog are properties with potential investment value. But like any other investment, real estate has its risks, too. Remember the old saying "land rich, cash poor"? The expression summarizes the very real wealth that exists in land but also the financial dangers land ownership poses if you don't have a strategy. What kind of real estate interests you most? Have you considered the skills — and weaknesses — you bring to your role as an investor? Successful investment in real estate means becoming land rich in order to become cash rich, too. You want to do it right!

In this chapter, we discuss the various opportunities awaiting you as an investor, and some of the risks real estate carries. We look at some of the considerations you should bear in mind as you're sizing up the different investment tools available. Finally, we investigate how real estate can fit into a long-term financial plan, and the implications that it can have for your retirement and your estate.

Investigating Real Estate Investing

So what's the big deal about real estate, anyhow? Why is everyone from the government honchos who manage the Canada Pension Plan right on down to your uncle Ed buying property? In this section, we check out the advantages of real estate and compare property relative to other kinds of investments you may consider as part of your portfolio.

Discovering the opportunities

Statistics from the Canadian Real Estate Association indicate that residential real estate has increased in value by an average of 5 percent annually over the past 30 years. Not every property will make the same gains in every year or from city to city, but the trend is unmistakable: The long-term potential for the appreciation of your real estate investment is tremendous. And several reasons bolster our argument that an investment in real estate makes sense. We outline them below.

Leverage opportunities

Leverage is all about using a small amount of your own money and letting someone else's cash do the rest of the work. Because real estate provides the loan's *security*, a guarantee of repayment if you're unable to pay off the loan, the risk is low. Should your *creditors*, the people who've loaned you cash, demand immediate repayment and call your loan, you could find your property the subject of proceedings that lead to its court-ordered sale.

We discuss some of the basics of setting your limits as an investor elsewhere in this chapter, and discuss financing at greater length in Chapter 5.

Equity opportunities

By paying down a mortgage, you're paying down the purchase value of the property and making its value your own. Real estate is unlike many other investments because it gives you a chance to build *equity* — your share of the property's net worth at the time of sale — over the course of the investment rather than put it in up front and hope for the best. Given the chance of appreciation in the value of real estate while you're making those payments, that's a significant advantage at the time of sale.

Return opportunities

That's return on money, not the chances you'll return alive from a property! But you'll probably do that, too, and get to enjoy the benefits of a net return of as much as 150 percent annually on your investment. How do we figure that?

Simply put, the return is calculated on your investment. If you buy a \$200,000 property with a \$20,000 down payment and the property doubles in value over five years, the increase in equity is \$200,000. That amounts to approximately \$150,000 after the government taxes the appreciation in the property's value, or *capital gain* (we discuss capital gains at greater length in Chapter 15). This would represent a return of 750 percent over five years, or at least 150 percent annually on your original investment of \$20,000. Given that the debt you incurred to buy the property would have decreased over the course of the five years, and provided leasing allowed you to see income from the property, you would enjoy an even greater return on your investment.

Tax opportunities

Real estate offers several tax advantages for investors, especially if you have a strategy in place. Though taxes erode the return you'll see on investments that provide a fixed return, such as bank accounts, bonds and guaranteed investment certificates (GICs), and though stocks and other equities put your principal at risk, real estate investments often allow you a reduced tax rate. The tax advantages range from tax-free capital gains on your principal residence to savings as great as 50 percent on taxes levied on capital gains from investment properties. You'll also be able to deduct investment expenses and write off any depreciation in property values. We discuss taxes in greater detail in Chapter 15.

Hedge opportunities

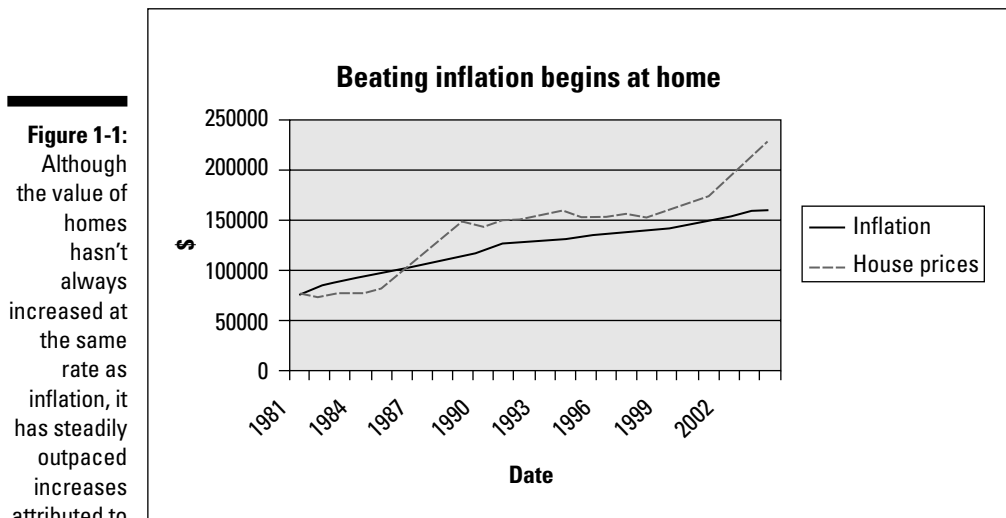
No, we're not suggesting you hide from your creditors in a bush! The kind of hedging we're talking about means taking shelter from the effects of inflation, which works to erode your buying power. The rate of inflation varies from month to month, year to year and even country to country. But real estate typically appreciates at a rate three to five percentage points above the inflation rate. So if inflation is running at 3 percent, look for your investment in real estate to appreciate at 6 to 8 percent. If you choose wisely, your investment stands a good chance of increasing at a rate greater than that of inflation as Figure 1-1 shows.



You're paying off your mortgage in dollars that reflect inflation, also known as *real dollars*. So, although the value of your mortgage is going to diminish over time, you will be receiving more money thanks to salary increases or rental revenue increases that will make your mortgage more affordable.

Flexibility opportunities

Real estate offers a variety of investment options that give you flexibility in terms of how much attention they demand and the amount of risk you'll bear. By investing in just one property rather than several, or in partnership with family or friends, you can limit (or increase) your involvement to the level that suits you.



The average list price of a house in 1980 was \$67,024, according to the Canadian Real Estate Association. While homes haven't always increased at the same rate as inflation, values have steadily outpaced any increases attributed to mere inflation.

Source: Canadian Real Estate Association

Learning opportunities

Most investments entail some sort of learning process. Real estate is no different. Prior involvement in buying property, such as a home, may make it easier, but don't underestimate the need to learn about the particular dynamics of investing in real property. Real estate investment also offers opportunities to learn about the community issues and economic trends at work in neighbourhoods. And, if you're game for the role of landlord, you'll also have a chance to improve your people-management skills.

Considering alternatives

But wait! Do you really want to buy a patch of dirt, or a stack of bricks? Why not let someone else worry about the paperwork associated with ownership and the hassles of managing an investment property? You have better things to do, and better places to put your money, right?

True enough — and if these are your nagging doubts, you will do well to consider other forms of investment. Fear not, though: Some investments even let you enjoy indirect benefits from the fortunes of the real estate business without direct exposure to the risks! The three main alternatives to investing in real estate include