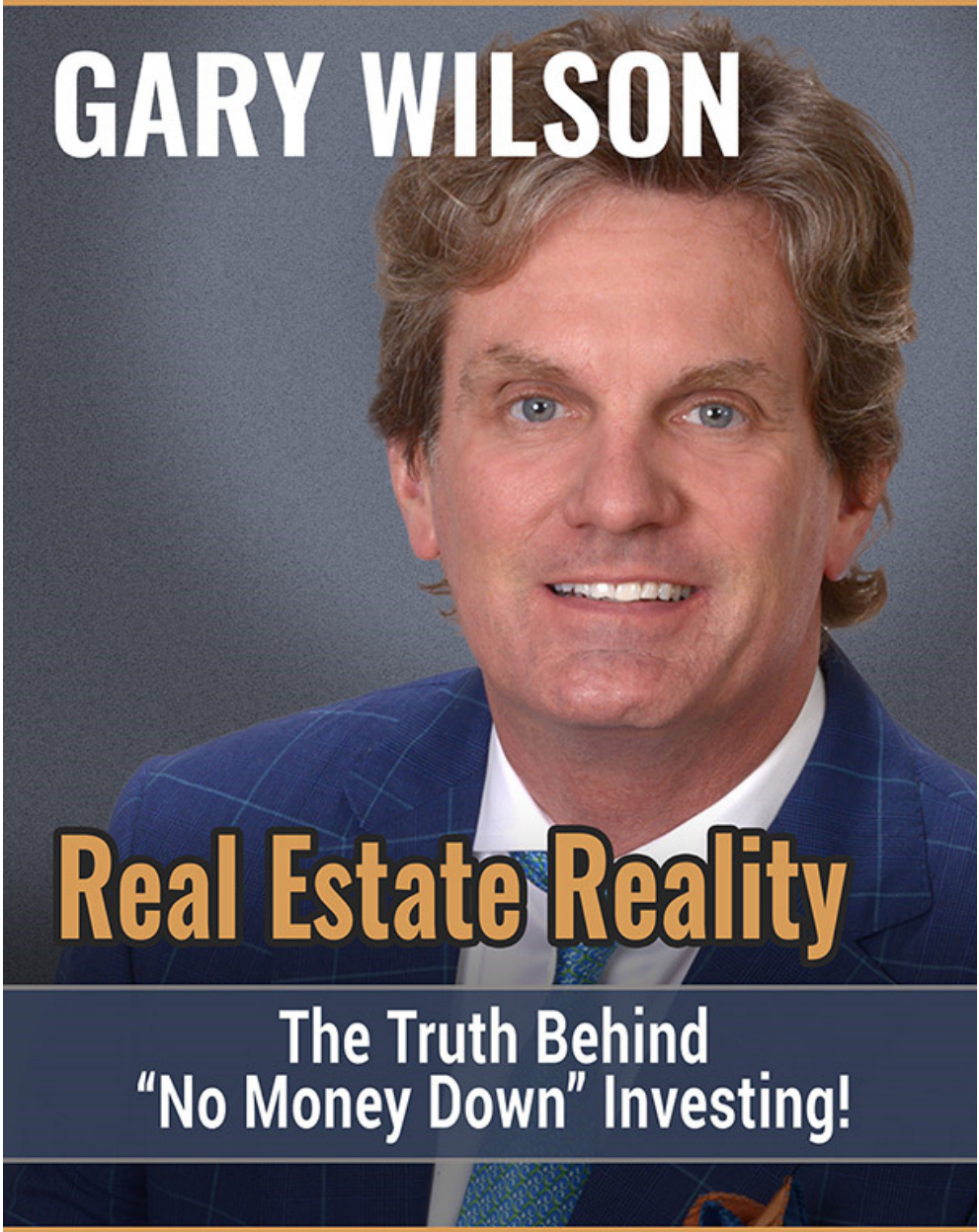
Secret advisor to Professionals & Business Owners



GARY WILSON

Real Estate Reality

The Truth Behind "No Money Down" Investing!

"Guiding You to Massive New Wealth in Real Estate in 1 Year or Less Guaranteed!"

"Finally, a book that exposes the truth about 'No Money Down Real Estate Investing.' Not a condemnation but an expose. Successful real estate investors do use creative financing techniques when appropriate and Gary explains how AND when to use them and when to use cash too!"

—ROCK THOMAS, Founder M1 Whole Life Millionaire program
Real Estate Investor and best-selling author of
The Power of Your Identity and *Your Epic Life Blueprint*

"I have built a world class real estate brokerage business, invested in numerous real estate deals, read numerous books and met numerous guru's on the subject, and I can tell you that up until now no one tells it like Gary when it comes to 'No Money Down' investing. Too many investors make the mistake of thinking 'No Money Down' is the only way to invest. Gary shatters this belief and tells the truth about how and when to use creative investing techniques."

—PAT HIBAN, author of the NY Times best-selling
Six Steps To Seven Figures and *Tribe of Millionaires*

"Gary Wilson's latest book may read like a contrarian view of No Money Down Real Estate Investing, but it actually sheds the Truth on a subject that is near and dear to every investor's heart and explains how to go from borrowing out of need to borrowing strategically to grow your Real Estate investment portfolio."

—MICHAEL McCARTHY, Co-Founder of GoBundance
The Tribe Of Healthy Wealthy Generous Men
and best-selling author of *The Miracle Morning for Parents and Families*

"I thought I knew a lot about creative finance and putting together real estate deals using other peoples' money but this book opened my eyes to even more possibilities. It's a solid look at a variety of creative finance strategies and definitely a book everyone should have in their collection."

—BRANDON TURNER, VP Growth
and co-host at BiggerPockets.com
best-selling author of *The Book on Rental Property Investing*, and *The Book on Investing in Real Estate with No (and Low) Money Down*

REAL ESTATE REALITY

THE TRUTH BEHIND
"NO MONEY DOWN" INVESTING

GARY WILSON

SECRET ADVISOR TO PROFESSIONALS & BUSINESS OWNERS

My Investment Services
1740 H. Dell Range Blvd
Suite 281
Cheyenne, WY 82009

Ordering Information:

Quantity sales. Special discounts are available on quantity purchases by corporations, associations, and others. For details, contact the publisher at the address above.

ISBN: 978-1-949150-90-2

Printed in the United States of America

TABLE OF CONTENTS

INTRODUCTION

There are people less experienced… and less intelligent than you who are getting better results. Does that ever make you wonder?

Less Experienced?

Less Intelligent?

Work Less?

Get mad… Who's mad about that? What is something they know that you don't?

Who's MAD about that?

What is the something?

Well… that's what we are going to talk about.

In a Nutshell

Teach you how to get from where you are now to where you want to go

IN THE BEGINNING…

When I was in college, I was blessed to have a roommate named Socrates. Both his parents were Greek. His mother was born here in the States, but his father was born in Greece. So Mrs. Demet went to Greece to attend a high school graduation, and came home with Mr. Demet. They lived south of Richmond, Virginia.

They were a great family. They took me in and treated me like one of their own. Mr. Demet was a wonderful teacher, and fortunately for me, he was a generous teacher. He taught me right alongside Socrates. I could not have gotten a better education. As a matter of fact, the lessons I learned from him have been worth more to me than the education I got from college.

After I graduated, I landed my first corporate nine-to-five job. Socrates and I again became roommates. Very good deal for me! We bought our first property together.

Now we had gone out to find a property, and being young college graduates living at the beach, we decided to buy a little townhome a few blocks from the ocean. It was great – of course it was going to be a chick magnet. We were going to live the life. But before the day was out, Socrates' dad set us straight. We got out of that deal,

thank goodness, because it would have been a real loser. He then took us by the hand and showed us what to do.

Instead we bought a nice little property in Virginia Beach – 478 Leslie Terrace – ten minutes from the beach, and two minutes from where I worked. Soc's dad cosigned the second mortgage and showed us how to do everything. He did not give us any money, though. Instead of giving us a meal of trout and salmon, he taught us how to fish.

At this point I started to dream! What if? What if I kept doing this and became a multi-millionaire, no… a billionaire!

I love the dreamers of the world, especially the ones who take action. They make things happen. We wouldn't be flying around in commercial jets today if it weren't for the Wright brothers. They believed they could create powered flight and they took action to make it happen. I love that story and I encourage you to get a book and read about it.

When I was a senior in college I interned at NASA in Langley, Virginia. I always wanted to be an astronaut. I was fortunate to see man take the first human step on the moon. I was six years, six months and 15 days old. The lunar module had landed on the moon the afternoon of July 20, 1969.

Later that evening I was outside in my pajamas with all the neighbor kids catching fireflies and playing hide and seek. Most of our dads were in Vietnam. Our moms were all inside Mrs. Hutchinson's house huddled around a black and white console television. They sat on the couch, arms interlocked and crying. I asked what the matter was (since in those days we were the first generation who watched war live on television and were used to "bad" news). My mom pointed to the television and I turned my head just in time to see Neil Armstrong drop down from the ladder and set foot on the moon. He

then said, "One small step for man, one giant leap for mankind." At that point I knew I wanted to be an astronaut.

I didn't become an astronaut but I've since been inside two space shuttles and visited the Johnson Space Center in Houston, Texas, and the Kennedy Space Center in Cape Canaveral, Florida.

When I was a kid I dreamed I could fly. Did you ever have that dream? Have your dreams come true? Well, they can. Real Estate helped me realize my dreams and they can help you realize yours, too. As an adult I dreamed of being free. I am now free in almost every way imaginable. When I graduated college though, I had to get a job. A J-O-B! Yikes!

MY FIRST EXPERIENCE WITH REAL ESTATE

My first day of work, I recall dreading "having to do this for the next forty years." I liked the people but hated the corporate nine-to-five gig – being stuck in an office with the beach so close and beautiful weather and gorgeous girls.

But I had to make money, right? I did and it allowed me to buy my first property with Socrates.

It was a four-bedroom, two-bathroom home. We bought it from a guy in the Navy. We assumed his first mortgage, refinanced his second, and gave him a note and a mortgage for the third – which was his equity portion of the property after the first and second mortgages.

Socrates and I lived there, and we rented the other rooms out. Essentially we were able to live for about $50 a month, because the other guys' rent covered our mortgage payment. I needed to invest only about $3,000 in the deal altogether.

We were on the water every day after work. Soc bought a used boat and a used van to tow it, and we went water skiing all the time. We

pioneered pulling stuff behind boats besides skis. We tried surfboards and other crazy stuff we thought would work including just us on our backs.

I saved a good bit of change because I wanted to buy more property. I remember Soc's dad telling us, while we stood at the dock of one of his beach homes, "If you boys do what I show you, you will not have to work for anybody else past the age of thirty-five." And thankfully for me, he was a real life example of success, someone who was actually investing in real estate and making money doing it.

I learned something very profound during this time. I learned I was not built to be sitting behind a desk in a corporate job, Monday through Friday, nine-to-five, for forty years; I knew I had to do something about it.

But then guess what happened? I found the girl of my dreams, got married, and had children. At that point, Mr. Demet did not think it would be a good idea for Soc and I to try to hang on to the home together. Virginia real estate rules were complicated, and with me being married and him not, we decided Socrates would buy me out. I got $8,000 out of the deal. Remember I put $3,000 in, and got $8,000 out in about a two-year time frame. Not bad – a 266% return! I knew I would never be able to do that in the corporate world.

After this I was playing the role of husband and father for the next ten years. When I turned 35, I woke up remembering what Soc's Dad had said, "Listen to me and do what I say and you won't have to work for anybody else when you're 35 years old!" Well, here I was, 35 years old, and a corporate zombie! Going to work every day at 6:00 in the morning to find parking, wasting away, gathering cobwebs, looking like a skeleton. At one point I actually had a cot in my office because I was working overnight so much. Ridiculous! I'd had enough and I decided to do something about it. And I did.

All on my own, without Mr. Demet or Socrates, I bought my next property.

741 Florence

In October 1998, I bought 741 Florence Avenue from a lawyer who was moving to New Orleans. She offered owner financing and I wasn't going to pass up the chance. I only had to come up with $5,000 of my own money.

I was able to get her to give me the same interest rate banks would give me. I purchased it for $42,000, and she held the note for the other money.

At the closing table I realized a glaring mistake on the settlement sheet. I was not given credit for my $5,000 down payment, and the prorated interest was backwards. Had I not caught the mistakes I would have lost over $5,000. Another big lesson – scrutinize every detail. Mistakes do happen in this business and it always costs money.

The property was a duplex with the first-floor apartment rented to a wacky elderly woman who is still there today. She was eccentric, made enemies of all the neighbors, kept the temperature inside her apartment in the 50s in the winter while wearing a coat, hat, and gloves indoors, and had every square inch of space packed with stuff. But she paid her rent on time every month in full without fail.

I did try to raise her rent by $10 after I took ownership of the place, but she was "having none of that, young man. Now be on your way!" So I got out of there as fast as I could with my tail between my legs wondering how I let some little old lady get the best of me.

The second floor was empty. I believe this was the last time Susan helped me prepare an apartment for renting. It took a lot of time and energy but we managed to get the job done and rented it to a nice

little alcoholic drug addict lady with two illegitimate boys (I didn't know that until later).

So far I was doing okay. I was making mistakes but still making money. One of the things I like about this business is that you can make mistakes yet still make money. I don't recommend it, but it's possible.

Several years later I sold it for $72,000; so I made $30,000 on the sale and the whole time I owned it, cash flowed. Cash flowed like crazy on that place.

Now I was getting to the point where I had exhausted my personal cash, so I looked around to determine where I could get more. I opened up a $25,000 personal line of credit – that is an unsecured line. It is based on your reputation as a good credible borrower. I actually went on and borrowed money against my own personal home using a home equity line for $40,000. That took me to 100% financing on my personal home. I know you may think it sounds risky, but it was a managed risk and one I was willing to take. And it was a risk that paid off.

802 and 804 Taylor Avenue

This was the last property I bought in my first year of operation and it was the crowning jewel of my Real Estate Empire. It was one big four-unit building with a pair of one-bedroom units on the first floor and a pair of two-story, three-bedroom units above.

The one-bedroom units weren't in bad shape and were currently rented. The three-bedroom unit on the right was vacant and needed some improvements before renting. The other three-bedroom unit was being rented as a one-bedroom because the second floor needed to be improved before it would be rentable. The electricity on the right needed to be separated between the two units. Finally, the gas needed to be separated between the units on both sides.

Sounds like a lot of work but I bought the place for $80,000 and the upside potential on rent and equity was tremendous. After buying nine other properties in less than a year I needed to take a different route in order to purchase this one. I took out a commercial line of credit secured by the equity in my nine other properties from a small private lender named Larry Newman whose company is called Briar Cliff Financial. I used that money as the down payment, and again got a first mortgage for the remaining 80%.

I immediately separated the gas and electric and passed the responsibilities of paying those bills into the tenants' hands. At the same time, I got the vacant three-bedroom unit ready to rent. I was having a hard time renting it when finally, at the end of the summer a Section-8 tenant came along. It was my first Section-8 tenant and I was a little nervous, but also a little desperate. They wound up being some of my best tenants ever. The next step was to get the other three-bedroom unit ready and rented.

As it turned out, the tenants in one of the one-bedroom units wanted to move into a larger unit, while the tenant in the newly finished unit didn't need all that space. So they swapped – lucky me! I now had a fully rented building bringing in almost $2,000 per month.

I quickly paid off the commercial line. As a matter of fact I also paid off my home equity line of credit and personal line of credit all within the next year. I sold that building a few years later for $132,000, so I made over $50,000 on the sale; cash flowed like a maniac while I owned it.

There are a lot of ways to buy real estate. Two are the most basic. The first is what I call 'Turn Key'. Buy the building the same way you would buy your own home – make a down payment and finance the rest with a mortgage and note. The second way is to buy wholesale, remodel, and sell for profit, or rent and refinance.

In a slow market, buying turn key is the preferable way, especially if you are buying a multi-unit rental property. The banks prefer it this way also. They like the fact that the property doesn't have to, or hasn't had to go through, extensive remodeling. They like the fact that it is already in use and is generating income. You can also get more favorable rates and terms this way.

I know it's not very glamorous and it runs counter to what you've seen on late night television. Yes, you can buy real estate without using any of your own money but it is more expensive that way, it's harder to get a good cashflow, the banks certainly don't like it, and when they're offering loans at ridiculously low rates, why not take advantage? Plus, it's easier to have a positive cashflow when you buy the traditional way and don't have to make crappy offers on crappy properties.

As you can see, these first few properties were purchased using creating purchasing techniques. While that is true, let's put things in perspective. First, let's look at the timeframes here. For example, the first property, 478 Leslie Terrace, was purchased when interest rates were still historically high. This was 1986. That was also the year Congress passed the Tax Reform Act of 1986, a broad sweeping change in the tax code that was not very favorable for self-employed individuals, like doctors, who also owned real estate.

The point I am making is that while I prefer not to use creative purchasing techniques, they do have their place in the world of real estate investing. No matter how you slice it, cash is king in business. Cash always gets the best price and even if financing is to be used, the more cash you have in the deal, the better the terms you can get on the funds you borrow.

Another important point is this. Too many people take creative purchasing techniques out of context. They think it is the ONLY way to invest in real estate. As a result they miss out on better deals

because of their limiting beliefs. Also, some techniques are better used for when you are just starting out and you don't have a choice. You have to borrow in order to acquire the asset. This means the person you are borrowing from is in control. The reality is that some techniques work better after you have acquired some real estate. In fact, even when I use cash to buy property, that doesn't mean I won't borrow later against the asset. In fact, I usually do. The difference is that now I am borrowing strategically once I own the income-producing asset and not out of need. This puts me in control. I like being in control.

MONEY: HOW TO DEPLOY IT

Every one of us, including you, wants to be financially independent. You think you know what you want, but I can tell you that what you need is to be financially free.

This book will give you a powerful tool in your arsenal to achieve financial freedom and independence in less time. Let's get started.

I am a big fan of using cash to buy real estate. It gives you more advantages than any other method of acquiring property. I know all of the theorists who insist that you should never touch principal. If you put things into context, what they are referring to is using principal for non-investment purposes.

Deploying investment capital to build wealth and income is a good thing not a bad thing. Deploying investment capital to purchase doo-dads for personal use is foolish. For the purpose of our discussion I want to review the different ways to keep and use money in various forms of investments.

Savings

This is probably the least effective way to preserve capital. It is however one of the safest. Funds in a savings account are relatively liquid, which means you can access them without penalty. Some banks will allow you to withdraw funds one to three times per month. Savings accounts can be a good way to keep an emergency fund on hand. If you have funds in excess of emergency requirements, then you can safely access this for the purpose of buying investment real estate.

CDs

CDs may pay a little more interest than savings accounts, but not much. They do however usually have early withdrawal penalties. Sometimes you simply forfeit interest earned. CDs may have a place in some people's lives, but not mine. Back in the day when I was a young banker, we had CDs that paid 15% and the terms were as long as ten years. You can bet your bottom dollar that I would gladly own some of those CDs now. Unfortunately, owning a CD now will likely cost you money instead of making it. If you have money held in CDs, you may want to consider using it to purchase income-producing real estate instead.

Mutual Funds

There are literally thousands of mutual funds, hundreds of mutual fund companies, and dozens of categories of fund types. I like no-load growth stock mutual funds to hold money long-term, over and above my real estate holdings. I like money market funds for short-term holdings and especially for storing money that I will use to buy more real estate. Bond funds are made up of short-term, medium-term, and long-term bond holdings. You have to know what you're doing relative to the interest rate environment to invest wisely in bond funds. Short-term bond funds are the least risky, but they still do have risks. I generally would not use even short-term bond funds to hold money that I will eventually use for purchasing real estate.

Stocks

Investing directly in stocks can truly be risky business. Even seasoned professionals get smoked when gambling in the stock market. This is not the place to keep money you intend to use later to buy real estate. If you are enamored by the idea of striking it rich in the stock market then God bless you and please get a lot of education and tread gingerly into those shark-infested waters. If you really want to be in stocks, why not consider a mutual fund that invests in stocks? Always look at the management of the fund and

the manager's track record, not just the track record of the fund itself. Also, look at their performance in up and down markets. Good luck!

Bonds

The basic rule with bonds is that you buy when rates are high and sell when rates are low. This is because people will pay a premium for high-yielding bonds when rates are low. Plus, while you own the bond you can make a decent return. If you buy high-grade bonds then your risk is reduced along with your rate of return. The bottom line here is – how do you know when you are in a high-rate environment versus a low-rate environment? Even the pros have a hard time with market timing. I do not suggest that you use bond funds to hold money that you intend to use for purchasing real estate.

Real Estate

Ah, real estate. Finally! This is what I am writing this book for. I love real estate, not because I love the business of being a real estate investor but rather because of what owning a lot of real estate has allowed me to do. I used to love real estate for the investing as well, but over time it started losing its luster. I still own investment real estate – don't get me wrong. But what I did during my evolution as a business person was to start other businesses from the profits of owning investment real estate. I opened a real estate brokerage business, a real estate settlement business, a rental property management business, and even an appraisal business. I had plans to start a mortgage brokerage business when the Big Recession hit and all the rules changed… that would have put me at a horrible disadvantage. So, literally within hours of signing documents to launch the business I pulled the plug based on my intuition. It turns out my intuition was correct. I watched as about one-third of mortgage brokers evaporated almost overnight.

The point I want to get across to you is that while you can make money in real estate, owning real estate can make the dream of

starting another business in an area of life that you enjoy much more realistic. I know people who started travel agencies, bought horse farms and stable horses, offer riding lessons, and basically pursue their passion for the equine life. I know people who moved closer to the water and started standup paddle board shops, surf shops, fishing shops, and charter businesses. The possibilities are endless. If you daydream of faraway places and fun activities, owning real estate can help make those dreams a reality. If you are in a W-2, nine-to-five job, it would be highly unlikely you could ever realize many of your dreams.

I love the dreamers of the world. If it weren't for dreamers like the Wright brothers we wouldn't travel by airplane, we wouldn't use a mouse to control a computer, we wouldn't talk on cell phones, we wouldn't drive cars, we wouldn't vacation in faraway places that would never have been discovered by courageous explorers, and we wouldn't have a country created so that all men could live freely as equals in their pursuit of wealth and happiness.

I say dream. Make it a daily practice to spend at least a half-hour dreaming – or what I call constructive daydreaming. The possibilities are endless.

I believe God wants us to be happy not sad, wealthy not poor, healthy not sick. I believe it is our duty to fulfill the purpose that He has intended for our lives, which is to bring others closer to Him. What better way to do this than to be our highest and best selves, living examples of how joyful life can be when we make the absolute most of the precious gift of life He has given us?

When you own investment real estate you are providing a good service to your fellow man. You are helping yourself by helping others first. And herein lies one of the greatest truths of success… and that is, if you help enough other people get what they want then you will get plenty of what you want. You can thank Zig Ziglar for that pearl of wisdom which is actually scriptural in its origin.

Now for one of the other pearls of wisdom, I am going to encourage you to not really *own* real estate. That's right. You will *control* it without actually owning it. It is far better to own companies than to own real estate. Read on.

FINANCING: USE CASH – JUST SAY "NO" TO DEBT

If you have ever read any of Carleton Sheets' material then you know that there are at least 30+ ways to buy real estate. Some are very good and some are not so good, depending upon your circumstances.

The bottom line is that the more money you borrow to buy real estate, the more you will be at risk. The absolute best way to buy real estate is to use cash, pure cash, baby. The truth is that people die, people have babies, people get married, people get divorced. People get new jobs. People lose jobs. It happens. It's not a matter of "if" but "when." So ask yourself, what will happen to your highly leveraged empire if the economy turns sour?

What if there is a real estate bust like what happened in 2008-2010? What happens if the pool of decent renters is raided by lenders who need to loan money and so they relax their standards like they did beginning in the 1990s with the Clinton administration and continued until 2007? I'll tell you what happens. All of your good renters become homeowners and you get left with the dregs of society. That's what happens and that, more than anything else, will cripple your real estate empire. And if it doesn't, then it will certainly put you in a horrible position when the economy spins into a recession and your properties lose a lot of value. Then you're stuck with all these bad tenants wrecking your properties and not paying their rent. Then you can't get another loan to keep things afloat because the banks won't lend you money anymore. Get the picture?

Besides, I can show you mathematically how you can build a much stronger, less risky, and more profitable real estate empire by using all cash and only cash. If you graph it out, it will look like it takes a while to get going, and it will. However, when your mega cash cow starts to feed itself, look out. You will be a juggernaut that can't be stopped. You will absolutely make a lot of money. No one can stop you. You will owe no one. And better yet, the next time there is a recession you will be the one everyone is running to, to buy their properties. You will be King of the world!! GWARRRRRRRR!!! Who's Your Daddy Now??? Go ahead. Take your best shot, you no-money-down gurus.

Now having said that, I know that because you can borrow money now at around 4%, a lot of you will do it. Go ahead. I did, too. I can promise you though that in the end you will learn to regret it and you will see that it is taking you longer to build your massive money-producing monster. If you do borrow, promise me that you will put down at least 20%. I recommend 25% or more. This way you will get the best rates and terms. Remember, all you borrowers out there, to keep your ratios in check. Never owe cumulatively more than 2/3 of what you own and never have debt payments more than 1/3 of your gross rents. If you manage these ratios, the banks will always love you, and unless you are a complete moron you should always be making money.

Before borrowing from commercial banks to buy real estate, if you have a 401K you should check with your employer because you may be able to borrow against your 401k an amount up to 50% of its balance. It gets even better. You aren't borrowing from anyone else. You are borrowing from YOU, Inc.! And guess what? The interest you pay on what you borrow is paid to YOU, too! And guess what else? It isn't taxed either. You know, maybe our government isn't so bad after all. In fact I bet there is one good guy in our government who was an entrepreneur at one time and saw this amazing opportunity to do something really good for a lot of people. The cost

of borrowing from a 401K is usually a small administration fee. No application fees. No appraisal fees. No junk fees of any kind.

If you are just starting out and don't have a lot of cash lying around, like us seasoned veterans, do take heart. You would be amazed at how easy it is to form a partnership with an individual who does have money lying around. Sometimes a veteran real estate investor will partner with one or more newbies to teach them the ropes – and more importantly to have one or more bird dogs out there doing the hunting.

When they find a suitable prey, the investor puts up the money and he and his protégé split the profits. I have seen this work with doctors also. In fact it could work with anyone who has more money than time.

Another way to begin acquiring real estate when you are starting out and don't have a lot of cash is to borrow from a private investor. They usually charge more in interest and fees than a bank but they are also more open-minded and creative. They usually understand the real estate investing game pretty well and aren't interested in forming partnerships or teaching newbies. They will often finance up to 100%. They may also loan you money that you secure with other property you have.

They're really not that hard to find either. Some mortgage bankers and brokers keep private investors in their back pockets to keep a deal moving forward rather than watch it die an agonizing death where nobody gets paid. Private investors can be tough. I have used them. I do not recommend it although I know some of you will have to try because you just have to have that sweet deal. I get it. I really do. I ended up being okay, but it did cost me a lot of interest payments.

Still another way to acquire properties when you don't have cash is to use hard money lenders. They call them hard money lenders for a

reason. It is a hard way to do business. They charge exorbitant interest rates and exorbitant fees to get the money. They usually have a very quick term, sometimes referred to as a balloon payment. In other words, you have three to six months' use of their money paying interest only, then at the end of the three- or six-month term you have to pay back all of the principal amount that you borrowed. If you can't pay it back they will take your property. And they will. Trust me. Sometimes people use this method to buy a rental property that needs work. They will borrow enough money from the hard money lender to buy the property and rehab it so that they can then rent it out. Then they go to a commercial bank to get a traditional mortgage on the property to pay back the hard money lender and even have excess cash from the traditional loan to line their pockets.

For years when money was easy, I would pay cash for a property and for the remodeling, then borrow from a bank in the form of a traditional first mortgage with easy terms and a low interest rate. This way I would continue to build my rental property empire while at the same time increase the amount of capital I had to work with. Keep in mind that it all has to be paid back and if you are a borrower, you have to keep your ratios in check or you will stop growing and wind up borrowing from private investors or worse yet, hard money lenders.

In the end, Cash is King. If you use any other method to acquire real estate then you are putting yourself at risk – and sometimes grave risk. Life happens and when it does, remember the golden rule: "The man with the Gold makes the rules." If you don't owe the banks and other people, you get to make the rules. If you owe the banks and other people, *they* make the rules. And they aren't as nice as you. Don't be a sucker and fall for all that debt crap. Be a man and pay cash.

Now, I want to talk about using creative strategies when investing in Real Estate. Up until now you may be wondering if I ever used creative strategies when investing, and the answer is "Yes." I probably just sent a shockwave up your spine, especially if you remember some of my earlier comments. I did learn a lot from a gentleman named Carleton Sheets. He now makes his information available for free. He is one of the vanguards in the modern era of Real Estate investing and he will tell you that he learned a lot of creative investing techniques from people and resources dating back to the 1950s. Some of those actually go back hundreds, even thousands of years.

I want you to be aware that there are creative techniques to investing. I also want you to be aware that you will have to work a lot harder to invest if you are trying to do so while not using traditional techniques or without using your own money. No matter, these are valuable in that they will stretch your knowledge and imagination and perhaps give you a few ideas to use in unique situations. I commend Mr. Sheets for making so much information available for free. I'm going to go over a few techniques that are old school and some I used when interest rates were much higher. Also, take note that you should check with your tax accountant, Investor/Agent, or even Real Estate attorney before using some of these, just to make sure they are able to be used in your state or province. Some of the government programs may or may not be available in your state or province.

I think you're going to really like this section. You will certainly learn a lot so get out your pen or pencil and turn everything else off. You will need your whole brain for this. Let's do this. Turn the page.

CREATIVE INVESTING TECHNIQUES

For many years now I have been on a cash basis. However, when I first got started investing I used creative financing. Most investors learn these techniques early on in their investing career, like I did, as a way to avoid the cost of borrowing money from institutional lenders (banks, savings and loans, etc.) and to overcome unaffordable monthly mortgage loan payments and poor or nonexistent credit. Even people with money realize, if they can purchase property with very little or no money down and keep their monthly payments low, then they will have made a good real estate investment even better. Please note though that when you borrow or leverage too much, your equity position will be smaller and your cashflow will be lower, too!

Leverage means making the most of what you've got. This could mean borrowing from yourself or others based on a little capital and good credit, or it could mean leveraging the circumstances of a seller or yourself. When it comes to real estate investing, leverage is the use of other people's money. When the leverage is 100% (no money down), it means getting other people's money to do everything. If you invest $100,000 to purchase a $1,000,000 property, and the property generates a spendable cashflow of $200,000 per year through leverage, then you have earned two times – or 200% per year – on your investment ($200,000 divided by $100,000). If you purchased the same property "no money down," your return of $200,000 would have been infinite.

Are there people in the world who are willing to sell their properties creatively? Yes, there are. There may be more or less at different times depending on where we are in the business cycle. If interest

rates are very high then you will see more sellers willing to be creative. If inventory is high then you will see the same thing.

SOURCES FOR CREATIVE FINANCING

As you progress through the individual "no money down" and creative financing techniques, you will be able to identify at least ten sources for creative financing. They are as follows:

1. The seller
2. The property itself
3. Investors
4. Partners
5. Tenants
6. Real estate agents and brokers
7. Your services and skills
8. Existing loans on the property
9. Unsecured paper and secured paper on equities (equity is the value of an asset minus any debt or money you owe on it)
10. Institutional lenders (banks, savings and loans)

A common limiting belief is that if you purchase property "no money down," the seller gets no cash. This may be true with some of the techniques, but there are others that will allow the seller to leave the closing table with cash. However, the cash does not have to be yours.

Not all sellers who are willing to be creative are in distress. In fact, when sellers are able to walk away from a closing table with cash in their pockets, you can purchase a seller's property more creatively, even though the seller may have initially been inflexible and interested in a more conventional sale.

The other important thing to remember is that, while a seller is inflexible today (or so the seller may say), that situation may well change within a few days or weeks. Sellers' circumstances, emotions,

and needs change rapidly. A seller may be inflexible today but very eager to sell the property creatively tomorrow.

All of the "no money down" techniques are described in detail, so you can apply them immediately. Eventually, you may combine different aspects from several techniques.

Since interest rates rise and fall continuously, the percentages used in these examples were selected for illustrative purposes only. The actual rate you offer will vary, depending on the current interest rates and the flexibility of the seller. The values of property are for illustrative purposes as well. A good "bread and butter" property may have a fair market value of $150,000 to $200,000 in one area of the country, and a value twice that or more in another.

Just remember, the basic premise of real estate investing is that interest rates must be – and usually are – commensurate with value.

NOTE: There can be some limiting beliefs out there that you may encounter and have to overcome. One of them is that mortgages are no longer assumable. This is not true! VA mortgages are still assumable and so are many adjustable rate mortgages!

Here are some of the more basic creative purchasing techniques you can use to get started investing in Real Estate.

Strategy 1: Using the Broker's Commission

I generally don't like this because I am also a broker, too! However, I have been on both ends of this technique and it does work if presented properly. From time to time, you will come across a property listed by a broker that is being offered for a 10% down payment. Typically, the seller is asking for the 10% to cover the broker's commission, as well as closing costs.

Brokers' commissions are generally 5% to 7% of the purchase price. If a broker both lists and sells the property, the broker receives the entire commission. If another broker is involved, then usually the commission is split 50/50.

Borrowing a portion of the commission, or giving the broker a portion of the ownership in lieu of all or part of the commission, is sometimes possible, especially when dealing with a listing broker. If the listing broker is also the selling broker, the commission will not be split, and the broker will be in a better position to loan all or part of it to you.

If you find some initial reluctance from the broker, you might try to offer the broker a note for an amount larger than the commission. For example: if the broker's commission is $15,000, you might consider offering an $18,000 promissory note. The note might bear interest at 12% with payments of 1% per month. In other words, every month you would pay $150 to the broker. At the end of the year you would have reduced (amortized) the note by 12%, or $1,800. The note could become due and payable in five to seven years. Generating all or part of the down payment this way, is inexpensive.

Before approaching an agent or broker about borrowing a commission, it is important to understand how commission splits are handled in a real estate office. When a seller lists a piece of property with a broker, the broker's compensation is stated in the contract. It is usually computed as a percentage of the total selling price. Within a broker's office, salespeople have a splitting arrangement with the broker. Generally, the splitting agreement (50/50; 60/40, etc.) is predicated on the salesperson's annual productivity. While a seller will generally not know about internal splitting arrangements, an informed seller does know that the commission is always negotiable at the time the listing agreement is signed.

Brokers, beware! The one possible negative is when you are asked to partner with the consumer on a deal and make your commission your contribution. It all looks good on the front end but the risk may show up later if something goes wrong. If in this circumstance the consumer files a complaint and they are not a licensed real estate agent and you are, a hearing officer will often hold you to a higher standard. As a result they may hold you more accountable than the consumer.

Here is what this may look like. First, you have an agent who is creative and flexible AND knows how to work with investors – an Investor/Agent!

Broker's commission is usually 5% to 7% of the purchase price.

Initially, ask the broker to loan all of his or her commission to you, secured by a note and mortgage, at a reasonable rate of interest, say 5%.

If necessary, offer the broker a note for a slightly higher amount and at a higher interest rate.

You have reduced the amount of cash needed to purchase a property.

In several instances, I know of students who have not only succeeded in persuading the broker to take a note for his or her commission, they have actually borrowed money from the broker. In one case, the broker went into his pocket for $10,000 to make the deal work. The broker believed in the property and was to receive a $14,000 commission if the sale was successful. He wrote a check to the buyer for $10,000, and in return, he received a $24,000 note secured by a mortgage on the property.

By the way, one of the advantages of you becoming a licensed broker yourself is that you can, in most cases, share in a portion (often up to 50%) of the commission. That certainly beats borrowing! Another angle related to becoming a broker is you may

intentionally choose not to share in a brokerage commission (and let the broker know this); this gives the broker further incentive to work harder toward having the seller accept your offer. If you choose this strategy, you can still try to borrow the commission. At that time, you subtly imply to the broker: If he or she doesn't want to lend you all or part of the commission, you would instead like to share in the commission.

Strategy 2: Defer a Portion of the Purchase Price

In some areas of the country, local real estate prices are very high, making it nearly impossible to achieve a break-even or positive cashflow. This problem can be overcome in two ways: 1) Negotiate no-interest or low-interest financing by the seller, or 2) Defer a portion of the purchase price. The latter alterative is usually easier. This works great in places like San Francisco or Vancouver, B.C.

Assume a seller has a three-bedroom, two-bath home on the market for $1,000,000. There is an existing $500,000 assumable first mortgage on the property. In return for obtaining his or her purchase price, the seller is willing to carry back a mortgage for the balance at the going market rate of interest.

The fair market rent rate on the property is $8,000. You could offer to assume the first mortgage, and give the seller a second mortgage with two notes; one note for $250,000 at a market rate of interest and the second for $250,000, also fixed at a market rate of interest but with the interest deferred for five years. At that time, the notes – plus the unpaid interest on the second note – would become due. Or preferably, the first note would stay on the property, making only the free second note with deferred interest due.

Interest on $250,000, 6% simple interest per annum, for 5 years equals $18,000 per year.

Be sure that the deferred interest on the second note ($250,000) is only accumulated, not compounded. Otherwise, you will be paying interest on interest. That could cause the unpaid balance of the $250,000 note plus interest to escalate dramatically.

At the end of six years, you could refinance, paying off the first mortgage plus both notes or – most preferably – the second note only for $250,000 plus interest. Ideally, the seller's first note for $25,000 and the second mortgage taken back would stay on the property. If the second mortgage is to stay on the property after refinancing, the mortgage would have to include a subordination clause that would be inserted at the time you buy the property and sign the mortgage.

If the rent rate will not support the first and second mortgage – for $250,000 – the interest on that note could be adjusted down, to a point where the property could support the payments. The second note would then be correspondingly increased.

Strategy 3: Deposits, Rent Credits, and Real Estate Tax Credits

I have done this a number of different ways to close on a property. At closing, you will receive a credit for unpaid real estate taxes. Real estate taxes are generally paid in arrears, meaning the seller is always behind in paying taxes. For example, real estate taxes for this year are due and paid sometime near the beginning of the following year. The buyer receives a credit for the real estate taxes, which have not yet been paid.

In the case of income property, security deposits are credited as well. Some landlords collect the final month's rent at the time of signing the lease. By doing this, this rent is turned over to the buyer at closing. Finally, the buyer receives credit for part of the rent, which has been collected in the current month. For example, if you close on income property on the 10th of the month, you will receive credit

for approximately two-thirds of the month's rent. If you close on the first of the month, you will either receive the rents collected already by the seller, or you will immediately collect the rents yourself. Credits can be used to reduce the amount of cash required for the down payment.

Sometimes, these credits can be substantial. On a ten-unit building, there might be $10,000 in security deposits, an additional credit for unpaid real estate taxes of $5,000, and the last month's rents of ten times the monthly rent rate. You can see that it would not be unusual for credits on a building this size to be as much as $25,000.

You should also remember that when buying property, you will have no expenses during the first 30 days. Since mortgage payments and other expenses – such as utilities – are paid in arrears (after you use the service) and rents are paid in advance, you will have one month's rent that is not committed.

Let's say you purchase a ten-unit building on the first of the month. You receive rents in the amount of $10,000. You receive a credit for security deposits of $10,000, and you receive a credit for the last month's rents of $10,000. Assuming that real estate taxes are $5,000 per year, you receive a real estate tax credit of up to $5,000, depending on when the closing takes place.

If you are getting a new mortgage, the first payment will not be due until the 1st of the following month. You can use the second month's rent to pay the first mortgage payment. If you were assuming an existing mortgage, where the payment is due around the 15th of the month, you could talk to the lender about moving the mortgage payment ahead to the 1st of the following month. You will probably have to pay one-half month's interest, but you would benefit by receiving as much as one-half month's rent payments. This extra cash could be used for a down payment, for fixing up the property, or your own personal use. Your total credit just for these items will be $35,000!

Because of this, you have substantially reduced the amount of cash needed to close on this building. These credits may very well be enough to make this a "cash back at closing" deal.

Strategy 4: Land Contracts (Agreements for Deed or Contract for Deed)

This form of seller financing is quite popular in some parts of the country. It is most often used with the sale of vacant land or lots. In concept, it calls for the purchaser to pay for all or most of the property before he or she receives legal title. In its simplest form, a land contract works like a mortgage, except that the legal title does not pass until a predetermined and stipulated number of payments have been made.

Theoretically, it provides additional protection for the seller in the event of default. If the purchaser does not make the payments as agreed, then the land contract usually stipulates that the money paid – up to the date of default – is deemed to be rent for the period from the term of possession to the date of default. To clear the title if default occurs, a "Quit Claim Deed" should be given by the purchaser to the seller. This should be done at the time of purchase, to release the purchaser's equitable interest in the property.

When a land contract is used, the contract will call for specific dollar payments. These are usually monthly with the money applied in the following order: 1) to interest on the purchase price; 2) to any applicable charges, such as real estate taxes, insurance, and special assessments; 3) to the unpaid principal balance of the purchase price. If the contract states that the legal title will pass before the principal balance is paid in full, then a "balloon" payment will usually become due. However, the seller could take back a note and mortgage in lieu of the "balloon" payment.

Some people believe a land contract provides a legal way around due-on-sale clauses found in many mortgages. Not so. The due-on-

sale clause is triggered by any transfer of legal or equitable title to real estate. While legal title is not transferred with a land contract – until the stipulated number of payments have been made – equitable title has passed. From a practical standpoint, the due-on-sale clause is not triggered, because no deed has been conveyed and recorded, and insurance continues in force in the name of the seller. It is unlikely, but not impossible, that the lender would learn of the transaction.

Let's look at an example. Assume that you find a two-family property that is on the market for $240,000. There is an existing first mortgage of $120,000 with monthly payments of $1,000. The mortgage is not assumable. The owner is asking for $40,000 cash down, and is willing to take back a "wrap-around" mortgage for $200,000 at 8%. Let's say you are able to persuade the seller to accept $220,000 for the property. Rather than take legal title to the property and give the seller a "wrap-around" mortgage, the seller sells you the property on a land contract. Since land contracts protect a seller more, you have convinced the seller to accept a $20,000 down payment, consisting of 10 semi-annual payments of $1,000 each with no interest. You then agree you will pay the seller $200,000 at 8% interest only for five years. At that time, you will agree to take legal title to the property. With the added monthly payment for taxes and insurance, which we will assume to be $500, your total cash out of pocket will be $1,500 per month. You know that the two-family property will bring in a total income of $2,000 a month. If you add a 10% management fee and a $100 per month cost for maintenance, then you will have approximately $200 per month positive cashflow.

This is win/win for both parties. You are buying the property with little money down. The seller has the security of knowing he or she has not conveyed legal title of the property to you, and there is a positive cashflow.

If you use this technique to buy a property, there are words of warning. If the contract for deed is for an extended period of time, then a number of events could take place that might put you in a precarious position. If the property is mortgaged with a mortgage containing a due-on-sale clause, then it is possible – although unlikely – the lender will learn of the land contract sale and call the loan due, possibly demanding the loan be properly assumed with related fees and an adjustment of a higher interest rate. Your contract should contain language stating, if this happens, how you and the seller will handle this problem. A reasonable way is to have you and the seller agree to split any additional or increased costs that arise from this event.

Also, to protect yourself from the sellers' divorcing, declaring bankruptcy, becoming mentally incompetent, or dying, you should have the seller execute a deed. The deed should be held by a reputable title company. Your monthly payments should be mailed to the title company, and when the agreed upon number of payments have been made, the title company will record the deed.

At the time you enter into the land contract, a title search should be done to make certain the sellers have clear title. Then – as mentioned earlier – after the contract has been signed, the contract itself or a memorandum of the land contract should be recorded in the public records of the county, where the property is located.

In order for this to work, you need a seller who does not need cash at closing but would like monthly income and little risk.

The buyer has a property for almost "no money down." In fact, with a security deposit and last month's rent from a tenant located before the closing, the buyer may even put cash in his or her own pocket.

The buyer has "purchased" a property even with bad credit.

The buyer has a positive monthly income of over $200.

The seller has a small down payment, a monthly income, and has been relieved of ownership responsibilities while getting almost all of what they asked for!

Strategy 5: Rental Participation

More seasoned investors who are ready to retire are more likely to work with you using this strategy. You might persuade a seller to give you a "no money down" or low purchase, low-interest seller financing. You may even utilize a moratorium of interest, which is an agreement that no interest will be due on the seller's note and mortgage for a specified period of time. You would agree to give the seller a portion of any rental increases.

Assume you are negotiating to purchase a property that rents for $1,000 per month or $12,000 per year. Offer the seller 10%, 15%, or even 25% of any annual rental income that exceeds $12,000 per year, excluding any forfeited security deposits. This money might go toward any unpaid interest, or it might be considered a "reward" for the seller agreeing to a low-interest loan. You might do this for a period of three to seven years. In essence, the seller participates in the risk as well as the rewards of the property.

Strategy 6: The Wrap-Around Mortgage

Assume the following situation. A seller has a property with a fair market value (F.M.V.) of $250,000, and an existing assumable mortgage of $150,000 at 8% interest with payments of $1,270 per month. The seller's equity is $100,000 ($250,000 less $150,000).

A classic, yet conventional, "no money down" way to buy the property would call for the buyer to assume the first mortgage of $150,000. Next, the buyer would give the seller a second mortgage for the $100,000 balance, at a mutually agreeable interest rate – suppose 10% – with payments of $1000 per month. The purchaser's total payment would be $2,270 per month.

To avoid the cost and liability of assuming the existing mortgage, offer the seller a $250,000 "wrap-around" mortgage, payable at the rate of 10% interest, with payments of $2,225 per month. On the surface, it appears to be the same proposition, but look at the actual effect.

A "wrap-around" mortgage is a new mortgage which literally "wraps" around the old mortgage. By using a "wrap-around" mortgage, the buyer makes payments on the new mortgage directly to the seller, and the seller continues to make payments on the old mortgage. Since the payments on the new mortgage are larger than on the old mortgage, the seller keeps the difference.

In the "wrap-around" mortgage example, you will pay the seller annual payments of $26,700 ($2,225 times 12). The seller will pay annual payments of $14,700 ($1,225 times 12) on the first mortgage. The seller will keep the difference, or $12,000 per year ($26,700 less $14,700). The seller's equity is $100,000, so the seller is actually netting 12% ($12,000 divided by $100,000) on the transaction. The first mortgage – because it is older and more of the monthly payment is being credited toward the principal balance – is being paid off at a faster rate than the "wrap-around" mortgage. Therefore, when the first mortgage is paid off in 20 years or so, the "wrap-around" mortgage will still have an unpaid balance of about $165,000. The seller's equity has effectively grown from $100,000 to $165,000 and, in the meantime, has earned 12% annually; a win/win situation.

The seller keeps $12,000 in interest per year for a 12% return on his/her $100,000 equity. The seller's mortgage is paid off in 20 years. The seller's equity in the mortgage has grown from $100,000 to $165,000.

Buyer accomplishes a "no money down" deal. The buyer avoids the cost and liability of assuming the first mortgage from a bank.

In the next section, I introduce one more great way to acquire property creatively that doesn't require you to have a lot of cash or great credit. It is called a lease option.

LEASE OPTIONS

Most people are familiar with automobile leases, as more than 50% of new car transactions are now leases rather than sales.

At the end of the automobile lease period, typically two or three years, the lessee has an option to buy the car. During the lease, the "tenant" gets to test the car and see if it meets the driver's needs. At the end of the lease, the lessee can either return the car to the "landlord" dealer or exercise the option to buy the car.

Real estate lease options are very similar, except the dollar amounts are larger.

Such realty transactions are a combination rental, sales, and finance for a fixed term, such as one year, three years, five years, or longer.

The longest lease option I have negotiated, as the buyer, was for 15 years. But I have heard of commercial lease options as long as 45 years. However, as a lease option realty seller, I prefer one-year lease options so I can "adjust" the monthly rent and the option purchase price annually.

Several years ago, a local residential real estate broker phoned to ask if I was interested in a lease option on a nice three-bedroom, two-bath house if I could act fast because his client was anxious to return to their home country. We agreed to meet the next morning at a nearby coffee shop.

The broker suggested I prepare a lease option offer, along the guidelines he outlined, so we could discuss it with the owner. As I filled in the blanks on the printed lease option form, the only non-issue was the $125,000 fair market value option price the owner insisted on receiving.

My next issue was the lease option term. Having been cut down on my previous 10-year lease option offers for other houses to five years or less, I was thinking big when I filled in 15 years.

Next, I decided to offer the owner $500 per month net rent. I agreed to pay his monthly mortgage payment, property taxes, insurance, and all necessary repairs. I also agreed to prepay one year's net rent of $6,000. Also, I needed the right to sub-lease to a tenant.

When I got to the line on the lease option form for the rent percent to be credited to my purchase price when I exercise the option, I filled in 50%.

As for the realty broker's commission, I agreed to pay half up-front and the other half if and when I exercised my purchase option.

The meeting went smoothly. The only debate was about the rent credit. Neither the broker nor I recall how we agreed on the odd number of 17%. The owner and I signed the lease option, the broker agreed to arrange title insurance (at my expense), and a few days later my lease option was recorded.

Thirteen years later, I elected to exercise my $125,000 purchase option. By then the owner had died of a heart attack and I acquired the title from his heir in Hong Kong. But that's another story. Yes, the broker then received the remainder of his commission.

When to Use a Lease Option

There are always more lease option buyers than sellers. Buyers understand the benefits. But most sellers don't understand their equal or greater benefits.

Lease option property owners often don't comprehend what their benefits include: continued income tax deductions such as mortgage interest, property taxes, and rental depreciation. If the option purchase price terms annually "adjust" to reflect rising property

values, the seller can benefit from increased market-value appreciation, too.

Additional lease option benefits for sellers include an over-supply of eager lease option buyers; lease option tenants will pay higher-than-market rent in return for the rent credit toward the purchase price; tax-free, up-front option money until the option is exercised; lease option tenants will pay top dollar; and the lease option future owner tenant usually treats the house or condo extremely well.

How Buyers View Lease Options

At the closing table a few years ago, a couple who bought their rental house from me on a lease option revealed how they viewed their five-year residency before I practically forced them to exercise their option.

The wife said their $1,500 per month rent seemed high, but she and her husband considered it as $1,000 very reasonable monthly rent, plus a $500 "forced savings account" for their rent credit toward the purchase price.

Lease option buyer advantages include: 1) up-front "option money" is smaller than a typical down payment; 2) lack of mortgage interest and property tax deductions are outweighed by the "forced savings" rent credit (typically 10% to 100% of rent paid); 3) the buyer can try out the home before buying; 4) the option purchase price is locked-in for the specified term; 5) the buyer can move in within a few days after signing the lease option.

How to Sell Homes on Lease Options

Although most local home sales markets are currently quite strong, there are pockets of slow home sales. Whether you are a home seller, builder, or real estate agent, a delayed lease option sale is better than no sale. Lease options work in all price ranges, especially when there is little cash buyer demand.

My most effective lease option newspaper classified ad is headlined "$10,000 MOVES YOU IN." Of course, change that amount up or down for your situation. Then describe the house or condo benefits, the monthly rent, and keywords "Rent to Own" or "Lease option."

Saturday and Sunday advertised open houses usually provide quick results. Be prepared with at least 100 information sheet flyers describing the home with an attached rental application form.

It's best to insist on a $500 or $1,000 deposit check from serious prospects. Owners should then run credit checks on all lease option applicants before selecting the best qualified.

How Buyers Can Create Lease Options

Most cities have few or zero lease options advertised. However, prospective lease option buyers can create their own by reading the "homes for rent" classified ads and offering a lease option when you find a house or condo you want to eventually buy, or running your classified ad under "homes wanted," such as "Executive needs 4 BR, 2.5 BA home on five-year lease with option to buy. Excellent references. Call Gary at 123-456-7890."

SUMMARY: Lease options offer major benefits for home sellers, buyers, and realty agents.

Summary of Benefits to Seller

- Price of property is at the top of market value range or based on a formula to include inflation.
- Option money received is tax deferred.
- If rent is not paid on time, the option is forfeited. (Thus, the rent is usually paid on time!)
- The tenant has "pride of ownership" and an incentive to take better care of the property.
- The rent, including option payments, is usually set at or above the fair market rent.

Summary of Benefits to Buyer

- Risk is reduced while financial leverage is increased.
- Option consideration is small compared to the value of the property.
- If the property is not worth more than the option price, the buyer can walk away from the contract.
- Buyer usually receives control and possession of the property.
- Purchaser could even generate profit from the property by leasing it to someone else.
- Consideration paid and any rent credits received.

Sublease Income Property for a Profit

What if you find a single-family home that is offered for sale, far less than its fair market value? The property is being offered at $50,000 and its value is about $100,000. If rented, its fair market rent would be approximately $500 per month.

You could offer the seller a three-year lease option with payments of $550 to $600 per month. Credit toward the purchase price would be a minimum of $200 to $300 per month. You could sublease the property to a tenant for $600 per month; depending on the terms of your lease option, you could have a break-even cashflow. Even if you have to supplement the rental income with cash out of your pocket, it will probably only be temporary. Over the next three years, you could reasonably expect rents to go up at least 5% per year; by the end of the second year, you will almost certainly have a positive cashflow.

The benefits to the seller in this situation are as follows. Not only would the seller receive the asking price for the property, but all of the tax benefits of owning real estate would be retained, since the property is being leased and is now considered investment property. The portion of the monthly income that would be credited toward

the purchase ($200 to $300) would be exempt from income tax, until the option is exercised or until the option expires.

The benefits for the buyer are obvious. While you may have only a break-even or a very small positive cashflow, you are receiving a $200 to $300 per month credit toward the purchase price; you are, in effect, banking money each month and the tenant is paying for it.

The buyer receives a $200 to $300 per month credit toward the purchase price. The tenant is, in effect, paying for this credit.

The buyer may even have a small monthly cashflow. It is possible that the property value will exceed the option price at the end of the option period. The seller receives the asking price for the property. Tax benefits would be retained on investment property. Non-taxable monthly income would be received until the exercise or expiration of the option.

Protecting Yourself with Lease Options

If you enter into a lease option agreement – without taking care or protecting yourself – then you might find the specific terms of the lease option binding, and it will be almost impossible to exercise. The following precautions are important.

Record the Option:

Anytime you enter into an option agreement with a seller, you should record the option or an affidavit and memorandum of agreement in the public records of the county. This protects you, the purchaser, more than it does a seller. It provides notice to the world that you have an option to buy the property. If the seller should sell the property to anyone during the option period, then the new purchaser will buy the property, knowing you have an option to buy the same property.

To record the option, it should be notarized. If the option agreement is signed before this notarization takes place, then the seller may be

reluctant to later sign a second time, in front of a notary public. Make sure it is all done at the same time.

Right to Sublease:

Whether you plan to live in the property or not, you should always make certain that your lease option gives you the right to sublease the property to another tenant. That right is not inherent in a lease, unless specifically spelled out.

Right to Assign:

In some states, the right to assign a contract is protected by law. In other states, it is not. Assignment is the right to transfer the contract and all your rights to someone else. To avoid any misunderstanding or litigation, you should make sure that the right to assign the contract is spelled out in your lease option contract. If you do not exercise the option yourself, then you should have the right to sell it. Your "equity" in that property is valuable. After all, you have been paying rent each month and a portion has been allocated to the option price.

By providing you with the right to assign the contract, the seller also benefits. The seller does not have to find another buyer for the property. As you would expect, the lease option contract provided with your course gives you the right to assign.

Right to Extend:

Some lease option contracts will have a section which spells out the terms under which the option may be extended. Other contracts specifically say that the extension of the lease option is prohibited. Some contracts may be silent on this point. Regardless of what your lease option says or does not say, make certain that you have the right to extend the option period for at least one year. This extension clause could be added to the "lease option" contract or, if there is inadequate room, an "addendum" could be used.

And here is yet one more technique, although more advanced than the prior one. It involves the use or partners.

PARTNERSHIPS

Getting started flipping or buying rental properties can be very difficult for aspiring investors. The biggest problem for most investors is finding the money to flip or the down payment for rentals. In some cases an investor has a lot of money, but no time to find deals, renovate houses or perform the other tasks needed to invest in real estate. In other cases an investor may have the knowledge and time to invest, but no money. A partnership can be a mutually beneficial way to invest in real estate if done right.

I used to partner with my colleague Vince. It would have been really tough for me to flip houses or sell real estate without a partner to help with the financing and mentoring. But in some ways I think having a partner also held me back and provided a comfort zone that allowed to me to relax more than I should have. Having a partner in real estate deals can be a great way to get started, but if you don't set things up right it can be a disaster and destroy relationships.

How does a partnership on fix and flips work?

Many people want to flip houses. It appears to them to be a quick way to make a lot of money. I am approached by investors all the time who want to start flipping houses. Flipping is a very difficult business to get into, especially if you have no money. It takes patience to find deals, it takes time to make repairs, it takes expertise and knowledge to learn your market. If it were easy to buy a house with none of your own money, fix it up real quick and sell it a couple of months later for a $30,000 profit, everyone would do it!

Most people who want to flip houses do not take the time needed to learn their market, save money, or research the costs involved when flipping. If you want to flip houses, but need a partner to help fund

you, you must bring something to the table. I don't partner with people looking to flip houses, because I stay busy enough with my own deals and flips. If I were looking for a partner though, here is what I would want from them if I was the money source.

- **Local market knowledge:** I would want any investor to know what neighborhoods have potential. What previous deals would have been good flips. What the target purchase price and sales price would be.
- **Know the costs**: Many investors underestimate the costs on a flip. Buying costs, carrying costs, repair costs, selling costs all need to be accounted for. I want details, not that a home "meets the 70% rule."
- **How will you get the deal**: The hardest part of flipping is finding a deal with enough room to make a profit. Are you using the MLS with a Realtor or direct marketing or something else?
- **What is my involvement**: Do I have to do any work in the transaction? Do I have to determine value, find contractors, or find the deal?
- **Who will do the work?** Will you make repairs yourself? Will you hire a contractor or do you already have a contractor? If you do the work yourself, do you have the experience to do it right and quickly?
- **What is the time frame**: Have you planned out how long the process will take and whether it is realistic? It will probably take longer than three months to flip a house.

In a fix and flip partnership, a typical split is the person who provides the money gets 50% of the profits and the person who does all the work gets 50%. Don't expect your money partner on a flip deal to find the deal, find the contractor, or handle the sale. What would they need you for?

If you are splitting up the money and the work portion of the flip, it can get much more difficult. If you decide each partner will pay 50% of the costs and do 50% of the work, it can be tough keeping track of hours and finances. Most people who enter partnerships like this have jobs and try to do the work on the side. One partner ends up doing more work than the other and gets frustrated. Or one partner puts more money in than the other and gets frustrated. The key is to make sure everything is in writing.

How does a partnership work with rental properties?

Rental property partnerships can be even trickier than fix-and-flip partnerships. I have had hundreds of rentals and I don't have partners on those properties either anymore. The tough part is knowing how the partnership will progress through time. One partner may want to cash out in five years while another wants to hold the properties for 30 years.

It is also a little tougher figuring the returns on rental properties. When flipping, you know what the profit is after a flip. With rentals, you have equity pay-down, tax advantages, appreciation, and cashflow. Some of these returns are seen in the form of cash in your pocket like cashflow. Other returns like appreciation and equity pay-down are not seen unless the home is sold or refinanced. Not only do you have to come up with a percentage of the actual profits (cashflow) that will be split, but you have to come up with a percentage of the equity that will be split if the properties are sold or if one partner wants to sell out and the other wants to keep the properties.

Things to consider with a partner on rental properties:

- **Who does the work**: Will both partners work to find properties or will one do all the work? How will repairs and maintenance be handled? Who will screen tenants or will a property manager be used?

- **How much money will each partner put in**: Will one partner put in all the money and the other do all the work? Will it be a mix of money and work?
- **What percentage of the profits will each partner take**: It can be very tough figuring profits with rentals. You will have up and down cashflow months and houses can be depreciated. With depreciation, tax returns will show less profit than you actually make. You also need to have reserves in place for maintenance and vacancies. You have to decide what each partner's role is worth and how profits will be split.
- **What percentage of equity does each partner get**: When you get a mortgage on a property the equity will slowly increase as payments are made and the house might appreciate as well. If you bought the property below market value you also increase equity. That equity does not do good unless you sell or refinance, but you need to figure out what percentage each partner gets if you sell or refinance.
- **What happens if one partner wants out**: The biggest problem with rental properties and partnerships is ending the relationship. How long do you plan to own the property together? What if one partner needs money and wants out? What if the house doesn't make as much money as you thought and a partner wants out? You have to figure out how to end the relationship before the partnership starts, deciding what will happen if one partner wants out.

As you can see it can be very tricky handling a partnership with rental properties. Determining the amount of work each person is responsible for is tough, determining an exit strategy is tough, and determining what percentages each investor gets… and when… is also tough.

If you decide to enter a partnership, everything has to be in writing. I don't care if your partnership is with your brother or your best

friend, it should be in writing. There are multiple reasons why everything should be in writing.

- **People forget things**: It would seem you would never forget the details of a partnership that involves thousands of dollars, but it happens. Put everything in writing so there are no mistakes or fall-outs from simply forgetting the terms.
- **Partners need to know roles**: If you are doing a flip with a partner and decide to share the work, how much time will each person put in? One partner may have a family emergency or may have to work overtime. How many hours will each person put in and what are the consequences if they don't pull their weight? One of the biggest problems is one partner thinks he does all the work while the other collects the profit without doing anything.
- **Exit strategies**: With rental properties you have to know what happens if one partner wants to be bought out or has to sell. How is market value determined, how will costs be split, etc.? With a flip, what happens if you decide not to flip the house because the market changed?
- **Use of professional services**: If one partner is a contractor or real estate agent, how will they be paid for their services? Will they get a higher percentage of the profits for their expertise or for saving money on commissions? Will the contractor or agent be paid like they would at any other job?
- **Rates, terms, payoffs**: If you are borrowing money from a partner, all the terms of the loan or agreement need to be in writing. Some agreements are a pure profit split, but others might involve private money lending with interest rates, length of the note, etc.
- **Decision making:** Who has the final say on how much money to spend, how to repair a house, what properties to buy, etc.? What happens if the partners don't agree? This is another big issue that can cause problems if not in writing.

A huge issue with partnerships is when one side either forgets or does not live up to agreed upon obligations. If you have it in writing what the obligations are and what happens if those obligations are not met it will make a partnership much more successful. The partners will have more motivation to work hard and it will be easier to handle problems when they come up.

Many people ask me how to structure a partnership when they collaborate on rental properties. One question was:

"We have the money and knowledge to buy rentals, but we have the opportunity to partner up with another investor, so how do we structure it?"

My answer: Why do you need a partner? Why bring someone in to share the profits on a deal when you have the money and know-how? You will make much more money on real estate deals when you do not have a partner. The purpose of a partner is to provide something that you cannot or do not want to provide. You give up some of the profits to spend less of your own money, use someone's time or their expertise. If you don't need any of those things, don't give up your profits!

I also see many people who are looking for a partner or a mentor to help them start investing. The problem is they want someone to show them how to buy houses, fix them up, find great deals and make a ton of money. But the person looking to be taught how to invest is offering nothing back to the investor, except for a willingness to work hard.

I have this partnership proposed to me over and over and almost every time there are huge problems on my side of the deal.

1. When I ask the person who wants help what they can offer me in return, they say determination, hard work, etc., but they list no specific skills. What can you do better than other people who will help me become more successful or help the deal be more

successful? Are you good with computers? Do you have carpentry skills? Are you an expert marketer? Willingness to learn and work hard is not a skill and something everyone says they have. If you want to impress someone, be as specific as possible about how you will help them make more money.

2. Most successful investors do not have time to train someone about the entire process of investing. They also may not want to train someone to compete with themselves! Don't be put off if an investor does not want to mentor you, because it is a very involved process that takes time. Paying for knowledge and experience is also an option and shows you are serious. Most people who want free help and have nothing to offer in return won't even use that help if they get it and it becomes a giant waste of time for everyone.

3. Many aspiring investors looking for a mentor will want someone to tell them how to do everything. I have had people come to me saying, "How do I make money flipping houses?" Well, I could write a book on that and still not answer all of your questions (actually I did write a book on flipping titled "Flipping For Profit Without The Risk"). I point out articles for people to read or point them toward my book but they don't want to take the time to read the articles or pay $20 for a book. They want everything done for them without doing any work. If you want to impress a potential partner or mentor, do your research and learn as much as you possibly can. The more knowledge you have, the better chance you have of impressing someone enough to help you.

If you want to be a partner in a real estate deal you must have something to offer. You need to bring money, expertise, skills, or pay for the opportunity. There are no shortcuts in becoming a successful real estate investor.

CONCLUSION

Partnerships can be a great way to get started if you need help. Partnerships can also be a nightmare if you do not have roles clearly defined or everything in writing. Partnerships also evolve and you may have to be flexible as people's priorities in life change. My partnership with my colleague Vince changed over the years until I ended up buying him out. We had everything in writing when we made changes and that helped things go smoothly.

If you enter a partnership, make sure you take the time to set it up right. If you don't need a partner, it sure is nice having complete control… and all the profits.

Now that you have a few ways to begin investing in Real Estate without having a lot of cash or not having great credit, let's focus on what you ultimately want to do which is be on a cash basis!

This is the point where you are in control. You can start to grow your portfolio vertically instead of horizontally.

VERTICAL VS HORIZONTAL GROWTH (FLATLINING)

I discovered early on that "no money down investing" isn't the only way to invest in Real Estate. I call this flat-lining or horizontal growth. There's another kind of investing where you're actually building up over time and growing vertically.

I can pick them out of a crowd. After they take a training program from one of the "no money down" guys, they swear they're going to buy a lot of properties and you're going to be their agent who gets all those commissions.

So they're down there, and they're buying the same kind of properties over and over again, just adding the same type, growing horizontally. They'll tell me, "I want you to help me buy 100 single-family homes so I can retire," and I'm like, "You're going to die before you buy 100 single-family homes."

That's not why we call them "flat-liners," but they're flat-liners because they're buying the same kind of properties, growing horizontally. Now, typically, these are like C-minus properties – typically.

Now, would you say the rents on these properties go up much over time, or do they stay relatively flat? They stay flat. And it's the same with the values of these properties, too.

But the better properties typically may be C-plus – maybe B-minus, we'll say. Over time, would you say the rents go up more on those

properties over time compared to the C-minus ones? And what about the values of those buildings?

They do.

What happens is, over time it creates vertical growth, more income, more equity, so it's not a straight line. It's more of a curve.

Now, for my first property, I bought half of a house with my college roommate, Socrates. His dad was going to help us do it. He didn't give us money. He didn't give us a fish; he taught us how to fish. Make sense?

Two years later I got married and Soc bought me out. In 2 years I turned $3,000 into $8,000 and because we rented out the other two spare bedrooms, our out of pocket costs were a mere $50 a month!

Three years after that I moved to Pittsburgh. Ten more years had gone by before I bought my next investment property. I would watch Carleton Sheets every morning at 5:00 A.M. as I was working out. It was the only thing on at that time of day. Well, I started investing this way, the no money down way.

I was doing this for 17 years and I had a whopping 42 units in 17 years. Then I started paying more attention to these other investors.

I eventually got my Realtor's license and at first I was attracting more "no money down" investors because I was attracting what I was doing. But every now and then I'd work with an investor who was actually using money AND buying better properties!

After about three years, I realized, "You know what? They know something I don't know." But now I know it, which is these properties go up in value more over time, and so do the rents. Over time, they have more wealth and income goes up.

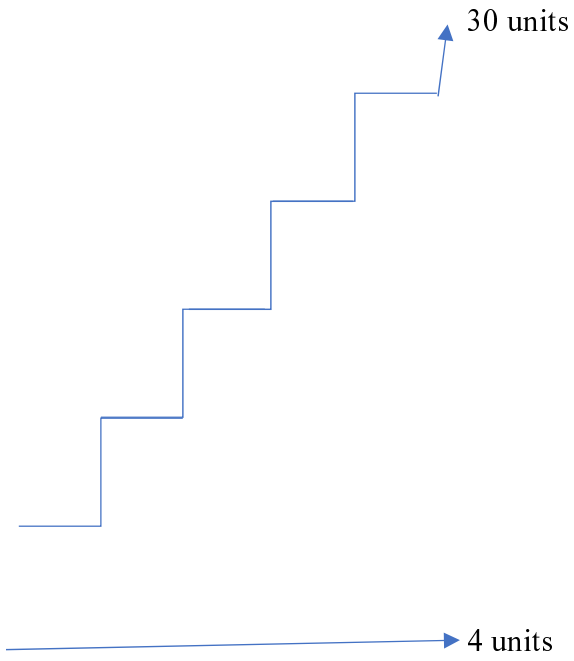
Who do you think the lenders are going to want to work with? The investors who are using real money buying better properties, or the

"no money down" investors? Lenders like the guys with money! The "no money down" guys have to call the lenders and walk in with their hat in their hand, asking for money. The lenders take the guys with money golfing!

So when I switched to what the better investors were doing, I went from 42 units to 250 units in less than five years. I literally had 208 more units by doing this. At first it was a struggle because my mindset was, "Don't use your own money," because we always were taught that.

By the way, the reason they teach those techniques is this. When they survey people and they ask them about money, like, "What can you afford?"… what do people tell them? "I don't have any money." That's why they teach them no money down techniques.

Now when you grow vertically, it takes discipline, patience, and different strategies. When I first switched to this strategy, I saved every commission I earned from working with other investors and I saved all of my net operating income from my rentals to use as the down payment for my next purchase. Because I bought this way I got better deals. I had more equity and I had more income. As a result, getting the next property became easier and easier. I eventually had a pretty significant equity position in my portfolio and was able to leverage that by getting a blanket line of credit across my portfolio and buy bigger properties! And these better properties increased in value more over time because I was able to get better rent increases on these better properties. Now the machine was feeding itself and me. I was essentially FREE!



Horizontal Vs. Vertical Growth: which is better?

And now that you are on a cash basis, or perhaps have equity in other properties, there are several other creative purchasing techniques that you can use to further leverage your cash position.

Strategy 1: Bank Loans and Other Creative Sources of Down Payments

Banks and other types of lenders will make loans based on your signature, or perhaps, the equity you have in a car, boat, or other property. Demonstrate your ability to repay these loans by working with a few local banks. Start by borrowing small amounts and repaying the loans earlier than agreed. With this technique, building up a line of credit with two or three banks is not difficult.

You will also find the seller can be a good source to lend you the down payment. When the required down payment is only a few

thousand dollars, or when you are a few thousand dollars short, a flexible seller may agree to a delayed down payment 6 to 12 months after closing. Offering the seller a high interest rate can help you do this. Many sellers would find a 12% to 15% interest rate attractive and might even spread the down payment over a longer period of time (for example, 24 to 48 months). On a relatively small amount of money, the higher interest rate does not actually cost you much more and it is tax-deductible. One of my students just did this in Wisconsin!

Strategy 2: Blanket Mortgage

Another favorite of mine is the blanket mortgage. I did my first one of these with a small community bank. It was in the form of a commercial line of credit. A seller might be willing to sell "no money down," taking back a mortgage for the entire equity of a property. However, many sellers are afraid the buyer will walk away from the property before building up a substantial equity, forcing the resale of the property all over again. If this happens, sellers are concerned they will receive the property back in a condition worse than when it was originally sold.

To overcome a seller's fear, you could persuade them by offering additional collateral with a "blanket mortgage." A blanket mortgage includes more than one property. You might use equity in your home, another property, or even an automobile under the terms of a blanket mortgage.

Caution: With the blanket mortgage, the seller may be taking back for a term as long as five or ten years. Since you do not want to tie up your extra property that long, make certain that the mortgage contains terms that will allow you to release your home or other property from the mortgage, after you have made payments on time for a period of 6, 12, or 18 months.

When I did my first one, the lender documented everything including a lien on all the properties under the blanket but did not record the liens and wasn't going to unless I started to get behind or go into default.

Strategy 3: Buy Low, Refinance High

I used this technique dozens and dozens of times once I was on a cash basis. If you have access to sizable amounts of cash, this technique is excellent. You can sometimes buy properties for 75% to 80% of fair market value or less, from people who need to sell for all cash right away. I have bought properties for 50% of value using cash!

On one of the Superior Avenue properties, I was contacted by the brother of a city councilman who, like his brother, was also an investor. They asked if I could buy one of three properties they had under contract because they could only buy two. I looked at the property and quickly decided to go for it. They were closing in less than a week. I made my 50% offer and they took it. I paid very little in closing costs because the title company had already done all the work on all three properties, including the one I bought! Even after remodeling I more than doubled my investment in value, and cash flowed more than $1000 per month to boot! I also refinanced the property, getting all of my money back plus another $28,000 in cash. In other words I also utilized the prior technique!

Many professionals have cash available to invest under these circumstances. They have neither the time nor expertise to go into the marketplace to find properties like this. If you can, then enter into a working relationship with these types of people; it will generate a good yearly cashflow for yourself and your investor. A win/win situation is created for both of you.

Strategy 4: Home Equity Loan

This is one of the very first strategies I used when I started investing in real estate. It leverages the capital in your own home. Many lending institutions make loans secured with the equity in your home or other properties by up to 80% of their value or more. There was a time when you could get a loan of up to 125% of the value of your home. That also partially led to one of the biggest economic downturns in history! The interest rate is usually tied to the prime rate. Shop around… some lenders may offer a rate anywhere from 0.5% below prime to 4% over prime rate. Generally, you will get a better rate if you are borrowing a larger amount of money ($100,000 or more) than if you borrow a small amount.

The payoff period is often 5 to 20 years, depending upon the lending institution. Most institutions do not charge any points (the percentage of the loan the borrower must pay to the bank for making the loan – one point equals 1% of the loan amount). In addition, the originating costs of the loan are very small, and the interest paid may be tax-deductible. If you get this in the form of a line of credit then you can use and reuse this source of capital over and over again!

Strategy 5: Obtain a New Mortgage to Pay Off Existing Loans and Provide Down Payment Money

You can use this strategy when the seller owes nothing on the property, or when the amount the seller owes is not greater than 40% of the property's value. However, you must have a flexible seller willing to help finance the property. I love working with sellers who owe nothing on their property. They are more willing to listen to creative strategies.

For instance, assume the seller of a $500,000 house has an existing loan of $100,000, but they are looking for a $150,000 down payment and willing to carry the financing for the balance of $250,000 ($500,000 less $100,000 less $150,000). Simply obtain a new first

mortgage for $250,000, which can pay off the existing $100,000 mortgage and give the seller $150,000. Next, give the seller a second mortgage in the amount of $250,000. The $250,000 first mortgage – plus a $250,000 second mortgage – gives the seller his or her total asking price of $500,000.

A seller who may be reluctant to accept this offer, may ultimately agree to accept an offer with more cash up front. For example, obtain a new loan in the amount of $350,000, giving the seller a $100,000 larger down payment than expected, or a total of $250,000 ($350,000 new mortgage proceeds minus $100,000 old mortgage payoff).

The seller receives total asking price and the entire down payment needed. The buyer has a "no money down" deal.

Many banks, but not all, will want you as the purchaser to put some of your own cash in the transaction. If you have none, but do have equity in another property you own, then securing the second mortgage from the seller may satisfy the bank. Basically, you would say to the banker, "I am, in effect, using my equity in another property I own to borrow money from the seller of this property, and I'm using that money for my down payment." Another alternative is you could bring in a partner who has equity in another property, which could be used to secure the seller's mortgage.

An additional solution would be for the seller to transfer the property to you "as-is," with the existing loan remaining on the property. Once the property has been deeded to you, you would then obtain a new first mortgage for $250,000 and complete the transaction as described. If you find bankers inflexible in making a new first mortgage loan under these circumstances, contact mortgage brokers. They frequently are more flexible than banks, but charge higher interest rates or more points.

Here is one last technique you can use that is more sophisticated than the previous ones but is a great strategy if you already own properties. It is the 1031 Exchange.

1031 EXCHANGES

Whenever you sell business or investment property and you have a gain, you generally have to pay tax on the gain at the time of sale. IRC Section 1031 provides an exception and allows you to postpone paying tax on the gain if you reinvest the proceeds in similar property as part of a qualifying like-kind exchange. Gain deferred in a like-kind exchange under IRC Section 1031 is tax-deferred, but it is not tax-free.

The exchange can include like-kind property exclusively or it can include like-kind property along with cash, liabilities, and property that are not like-kind. If you receive cash, relief from debt, or property that is not like-kind however, you may trigger some taxable gain in the year of the exchange. There can be both deferred and recognized gain in the same transaction when a taxpayer exchanges for like-kind property of lesser value.

Who qualifies for the Section 1031 exchange?

Owners of investment and business property may qualify for a Section 1031 deferral. Individuals, C corporations, S corporations, partnerships (general or limited), limited liability companies, trusts and any other taxpaying entity may set up an exchange of business or investment properties for business or investment properties under Section 1031.

What are the different structures of a Section 1031 Exchange?

To accomplish a Section 1031 exchange, there must be an exchange of properties. The simplest type of Section 1031 exchange is a simultaneous swap of one property for another.

Deferred exchanges are more complex but allow flexibility. They allow you to dispose of property and subsequently acquire one or more other like-kind replacement properties.

To qualify as a Section 1031 exchange, a deferred exchange must be distinguished from the case of a taxpayer simply selling one property and using the proceeds to purchase another property (which is a taxable transaction). Rather, in a deferred exchange, the disposition of the relinquished property and acquisition of the replacement property must be mutually dependent parts of an integrated transaction constituting an exchange of property. Taxpayers engaging in deferred exchanges generally use exchange facilitators under exchange agreements pursuant to rules provided in the Income Tax Regulations.

A reverse exchange is somewhat more complex than a deferred exchange. It involves the acquisition of replacement property through an exchange accommodation titleholder, with whom it is parked for no more than 180 days. During this parking period the taxpayer disposes of its relinquished property to close the exchange.

What property qualifies for a Like-Kind Exchange?

Both the relinquished property you sell and the replacement property you buy must meet certain requirements.

Both properties must be held for use in a trade or business or for investment. Property used primarily for personal use, like a primary residence or a second home or vacation home, does not qualify for like-kind exchange treatment.

Both properties must be similar enough to qualify as "like-kind." Like-kind property is property of the same nature, character, or class. Quality or grade does not matter. Most real estate will be like-kind to other real estate. For example, real property that is improved with a residential rental house is like-kind to vacant land. One exception for real estate is that property within the United States is

not like-kind to property outside of the United States. Also, improvements that are conveyed without land are not of like-kind to land.

Real property and personal property can both qualify as exchange properties under Section 1031; but real property can never be like-kind to personal property. In personal property exchanges, the rules pertaining to what qualifies as like-kind are more restrictive than the rules pertaining to real property. As an example, cars are not like-kind to trucks.

Finally, certain types of property are specifically excluded from Section 1031 treatment. Section 1031 does not apply to exchanges of:

- Inventory or stock in trade
- Stocks, bonds, or notes
- Other securities or debt
- Partnership interests
- Certificates of trust

What are the time limits to complete a Section 1031 Deferred Like-Kind Exchange?

While a like-kind exchange does not have to be a simultaneous swap of properties, you must meet two time limits or the entire gain will be taxable. These limits cannot be extended for any circumstance or hardship except in the case of presidentially declared disasters.

The first limit is that you have 45 days from the date you sell the relinquished property to identify potential replacement properties. The identification must be in writing, signed by you, and delivered to a person involved in the exchange like the seller of the replacement property or the qualified intermediary. However, notice to your attorney, real estate agent, accountant, or similar persons acting as your agent is not sufficient.

Replacement properties must be clearly described in the written identification. In the case of real estate, this means a legal description, street address, or distinguishable name. Follow the IRS guidelines for the maximum number and value of properties that can be identified.

The second limit is that the replacement property must be received and the exchange completed no later than 180 days after the sale of the exchanged property or the due date (with extensions) of the income tax return for the tax year in which the relinquished property was sold, whichever is earlier. The replacement property received must be substantially the same as property identified within the 45-day limit described above.

Are there restrictions for deferred and reverse exchanges?

It is important to know that taking control of cash or other proceeds before the exchange is complete may disqualify the entire transaction from like-kind exchange treatment and make ALL gain immediately taxable.

If cash or other proceeds that are not like-kind property are received at the conclusion of the exchange, the transaction will still qualify as a like-kind exchange. Gain may be taxable, but only to the extent of the proceeds that are not like-kind property.

One way to avoid premature receipt of cash or other proceeds is to use a qualified intermediary or other exchange facilitator to hold those proceeds until the exchange is complete.

You cannot act as your own facilitator. In addition, your agent (including your real estate agent or broker, investment banker or broker, accountant, attorney, employee or anyone who has worked for you in those capacities within the previous two years) cannot act as your facilitator.

Be careful in your selection of a qualified intermediary as there have been recent incidents of intermediaries declaring bankruptcy or otherwise being unable to meet their contractual obligations to the taxpayer. These situations have resulted in taxpayers not meeting the strict timelines set for a deferred or reverse exchange, thereby disqualifying the transaction from Section 1031 deferral of gain. The gain may be taxable in the current year while any losses the taxpayer suffered would be considered under separate code sections.

How do you compute the basis in the new property?

It is critical that you and your tax representative adjust and track basis correctly to comply with Section 1031 regulations.

Gain is deferred, but not forgiven, in a like-kind exchange. You must calculate and keep track of your basis in the new property you acquired in the exchange.

The basis of property acquired in a Section 1031 exchange is the basis of the property given up with some adjustments. This transfer of basis from the relinquished to the replacement property preserves the deferred gain for later recognition. A collateral effect is that the resulting depreciable basis is generally lower than what would otherwise be available if the replacement property were acquired in a taxable transaction.

When the replacement property is ultimately sold (not as part of another exchange), the original deferred gain, plus any additional gain realized since the purchase of the replacement property, is subject to tax.

How do you report Section 1031 Like-Kind Exchanges to the IRS?

You must report an exchange to the IRS on Form 8824, Like-Kind Exchanges and file it with your tax return for the year in which the exchange occurred.

Form 8824 asks for:

- Descriptions of the properties exchanged
- Dates that properties were identified and transferred
- Any relationship between the parties to the exchange
- Value of the like-kind and other property received
- Gain or loss on sale of other (non-like-kind) property given up
- Cash received or paid; liabilities relieved or assumed
- Adjusted basis of like-kind property given up; realized gain

If you do not specifically follow the rules for like-kind exchanges, you may be held liable for taxes, penalties, and interest on your transactions.

Beware of schemes

Taxpayers should be wary of individuals promoting improper use of like-kind exchanges. Typically they are not tax professionals. Sales pitches may encourage taxpayers to exchange non-qualifying vacation or second homes. Many promoters of like-kind exchanges refer to them as "tax-free" exchanges, not "tax-deferred" exchanges. Taxpayers may also be advised to claim an exchange despite the fact that they have taken possession of cash proceeds from the sale.

Consult a tax professional or refer to IRS publications listed below for additional assistance with IRC Section 1031 Like-Kind Exchanges.

References/Related Topics

- Publication 544, Sales and Other Dispositions of Assets
- Form 8824, Like-Kind Exchanges
- Form 4797, Sales of Business Property

BUYING REAL ESTATE FROM WITHIN A SELF-DIRECTED IRA

That's right! You can buy rentals AND flip properties from within a self-directed IRA! And all of the growth and profits occur essentially tax-free!

The big difference between using the "no money down" techniques in the beginning of your Real Estate investing career and using these latter strategies once you've created more equity and cashflow is *control*. Borrowing out of need to acquire the asset puts the lender in control. Borrowing strategically against the income-producing asset, after you've acquired the asset using cash and/or equity in your other properties, puts *you* in control. Big difference.

In fact this is the difference between you trading time for money and being financially *free*! The final point is this… No money down techniques have their place in Real Estate investing. If you don't have to use them, then don't! You can get better deals without them. But if you absolutely have to use them, then use them wisely just to get started and use the right ones! Remember they have their place but that doesn't mean every place! I hope this helps you get clarity on this subject and more importantly helps you see your vision of being financially *free* more clearly!

Now that the machine is feeding itself there is no limit to how far you can go. I suggest you expand the territory that you invest in. You may also want to consider partnering with other investors and engaging in a few joint ventures.

I also encourage you to leverage your real estate holdings as a platform upon which you can launch other businesses!

WHAT'S NEXT?

Buy and sell large apartment complexes.

Start your own Real Estate brokerage business.

Start your own Property Management business.

Start another business related to Real Estate and investing… like a painting, plumbing, or electrical contracting business.

The bottom line is this. In order to not just survive but thrive, you will have to feel, think, speak, and act like a business because you are a business. As a business, use the following statement as an affirmation to say to yourself every day: "I am a business and I leverage my Real Estate license or current investing activities as an income-producing asset to generate multiple streams of income." You will leverage what you are already doing.

Please review the following diagram. Now you can see how to maximize your time and effort to generate the most income in the least amount of time and with less expense.


My Investment Services
The Path to Prosperity
MASSIVE PASSIVE CASH FLOW BLUEPRINT
01
You invsest
02
Wholesalers
03
Rental Investor
04
Build Team
05
Referrals
06
Owner Occupied
07
Property Manager
08
Flippers
INVESTOR AGENT

WHAT ELSE IS NEXT?

In addition to building other businesses, you could start investing in larger properties. That's what I did. My next move was to buy a 78-unit apartment building. I learned more about real estate that way, particularly in the world of commercial real estate. I have been involved in the purchase and sale of other commercial properties as a result.

But before we both continue with our life's journey, take a closer look at the Wheel of Fortune.

Let's make sure you have a plan in place now that you are finished reading this book and preparing to turn the last page. When you look at this wheel, you can see that you can enter and begin profiting from a number of starting positions. Let's say you are, or want to start, flipping homes. That section of the wheel is your starting point. But your Path to Profit doesn't end there. It begins there.

At this point you may want to get your Real Estate license and begin listing and selling your own flips. This way you can start to generate more income in the form of commissions through the use of your license, thereby leveraging what you're already doing to generate multiple streams of income.

Let's say you're buying rentals and managing them yourself. Again, you could begin managing your own properties through an LLC and while you're at it, get your Real Estate license and manage other people's properties too, generating all that extra income. Starting to get the picture?

Let's say you don't have a dime to your name. You could start wholesaling and generate income that you could then use to do your own investing in rentals or flips.

Let's say you are a Real Estate agent and you want to start your own investing. Decide what type of investing you want to do first. If you want to flip homes, then work with investors who are flipping homes. You will earn extra commissions and apply those proceeds to doing your own flipping, plus you'll learn more just by being in the flipping game with other investors.

Maybe you want to own rentals. Well then, start working with investors who invest in rentals. You will earn those commissions, learn a ton *and* not only start buying your own rentals but start managing them too… for even more income.

Is this making sense? Here again is the wheel. Have a look and start to imagine where you are now and where you want to go on your Path to Profit. Then call me. Email me. Come to one of the Massive Passive Cashflow Method 3-day events. Come see me teach in person at one of the daily classes.

Visit MyInvestmentServices.com/events to see where I'll be teaching.

Visit MyInvestmentServices.com/products and take one of the training programs associated with any of the five major disciplines in Investment Real Estate.

Visit MyInvestmentServices.com/blog and read from the hundreds of subjects related to Real Estate!

Visit MyInvestmentServices.com/podcasts and listen to one or all of the interviews with other experts who share information to help you!

Don't just sit there. DO IT!

About the Author

Gary Wilson has been a Scout Master in Troop 194 of the Greater Pittsburgh Region and involved in scouting for more than a dozen years as an adult and was a scout as a boy.

He started investing in Real Estate at the age of 23, less than one month after graduating from Old Dominion University, and accumulated a 250-unit portfolio while teaching others to do the same.

Gary ranked in the top 5% of all Realtors in the Western Pennsylvania Market (according to annual Five-Star surveys).

He is a licensed broker in Pennsylvania and Virginia. He achieved the Platinum level of service while launching and growing Win Realty Advisors, LLC; Win Rental Management, LLC; and Win Settlement Services, LLC.

Gary has taught in classrooms across the U.S. and Canada to tens of thousands of students and has personally trained thousands of investors and agents who want to realize the pleasure of rental profits without the pain, flipping without the risk, and wholesale for profit so everybody wins.

For more information call or email:
1-800-931-2605
Gary@MyInvestmentServices.com
Or visit: MyInvestmentServices.com