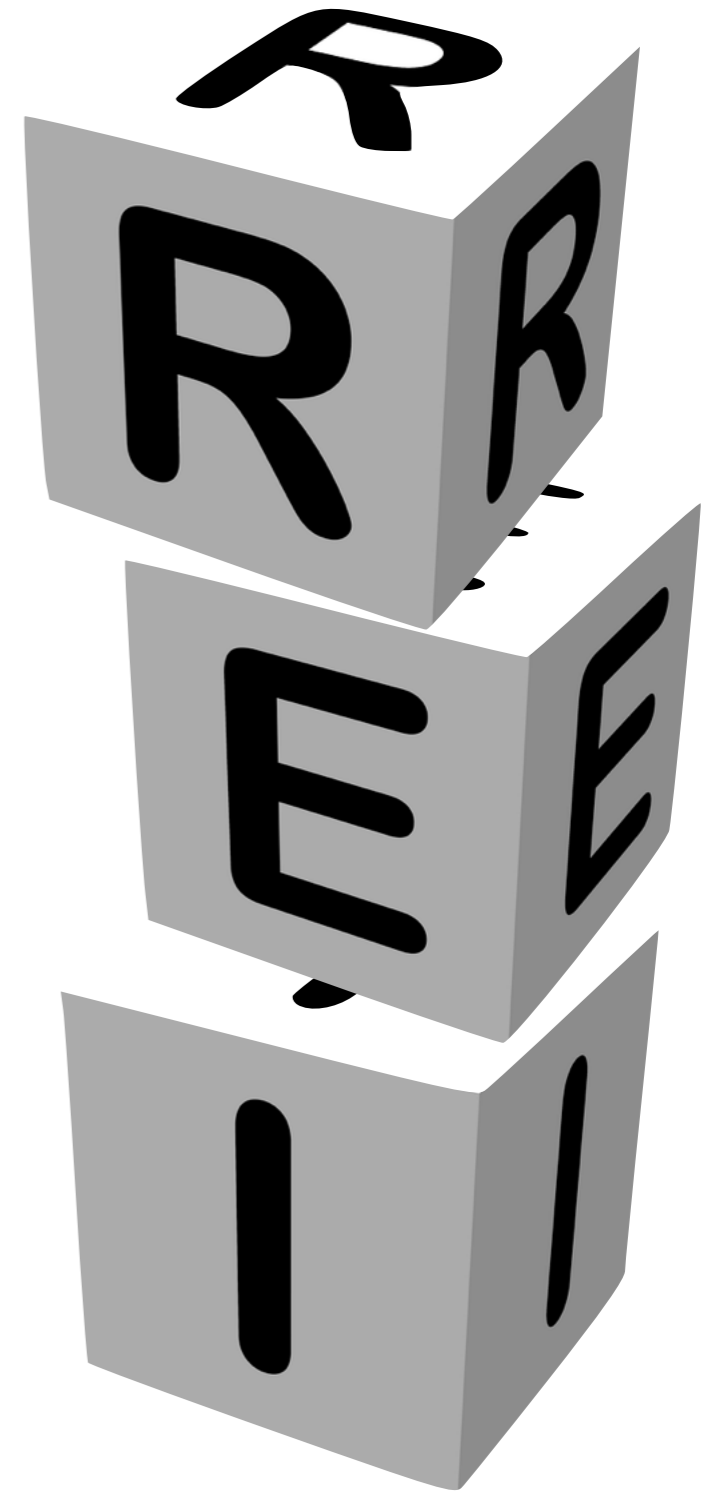


# Building Blocks of Real Estate Investment for Salespersons and Broker Candidates

Written and Instructed by:

**Melvin Hubbard**  
REALTOR® Private Investor





# Introduction

# Introduction Overview

## **1. Introduction to Real Estate**

- **What is Real Estate Investment?**
- **Who can invest in Real Estate?**
- **How to get started in Real Estate Investing?**
- **Where should someone invest in Real Estate?**
- **Why would someone want to invest in Real Estate?**

# Introduction Overview

## **2. Real Estate Investment Process**

- **Start-to-Finish Flowchart**

## **3. What is Covered in this Module?**

- **Basic principles of Real Estate Investing**
- **Investment Property types**
- **Real Estate Investment Financing**
- **Real Estate Investment Mathematics**

# Introduction to Real Estate



Unit 1

**WHAT...**

**is Real Estate  
Investing**



Unit 1

# Real Estate Investing



involves the purchase, ownership, management, rental and/or sale of Real Estate for profit.



Unit 1

# Real Estate Investing

Improvement of Realty Property  
(part of a Real Estate  
Investment Strategy)  
is generally considered  
to be a sub-specialty  
of Real Estate Investing called  
**Real Estate Development.**





# Real Estate Investing

- **Asset form with limited liquidity** (relative to other investments)
- **Capital intensive** (although capital may be gained through mortgage leverage)
- **Highly cash-flow dependent**





# CAUTION

If these factors are not well understood and managed by the investor, **Real Estate** becomes a risky investment.

**WHO...**  
**can invest**  
**in Real Estate**



Unit 1



**ANYONE!**

**ANYONE!**

**ANYONE!**



Unit 1

# Who Can Invest in Real Estate?



Real Estate Investment is not an **exclusive club** anymore.



Unit 1

# Who Can Invest in Real Estate?



ANYONE can be an investor. It just takes time to grasp the concepts.



Real Estate Investing

**HOW...**

**do I get started  
in Real Estate  
Investing?**



Unit 1

# How Do I get started in Real Estate Investing?

- **Learn** all you can about it
- **Network** with and learn from other investors
- **Set** long term goals
- **Develop** a realistic strategy
- **BUY YOUR FIRST PROPERTY!**



Real Estate Investing



**WHERE...**

**should  
someone invest  
in Real Estate**



Unit 1

# Where Should Someone Invest in Real Estate?

- In your **local** area
- In another **state**
- In another **country**
- In areas you are **comfortable**

with



**ALWAYS** use due diligence before  
investing in an unknown area.

**WHY...**

**would someone  
want to invest  
in Real Estate**



Unit 1

# Why Would Someone Invest in Real Estate?

- Equity
- Cash flow
- Appreciation
- More control of the investment
- Tax write-offs against other income
- Rental Real Estate = Solid Retirement Plan



# Real Estate Investment Process



Unit 2

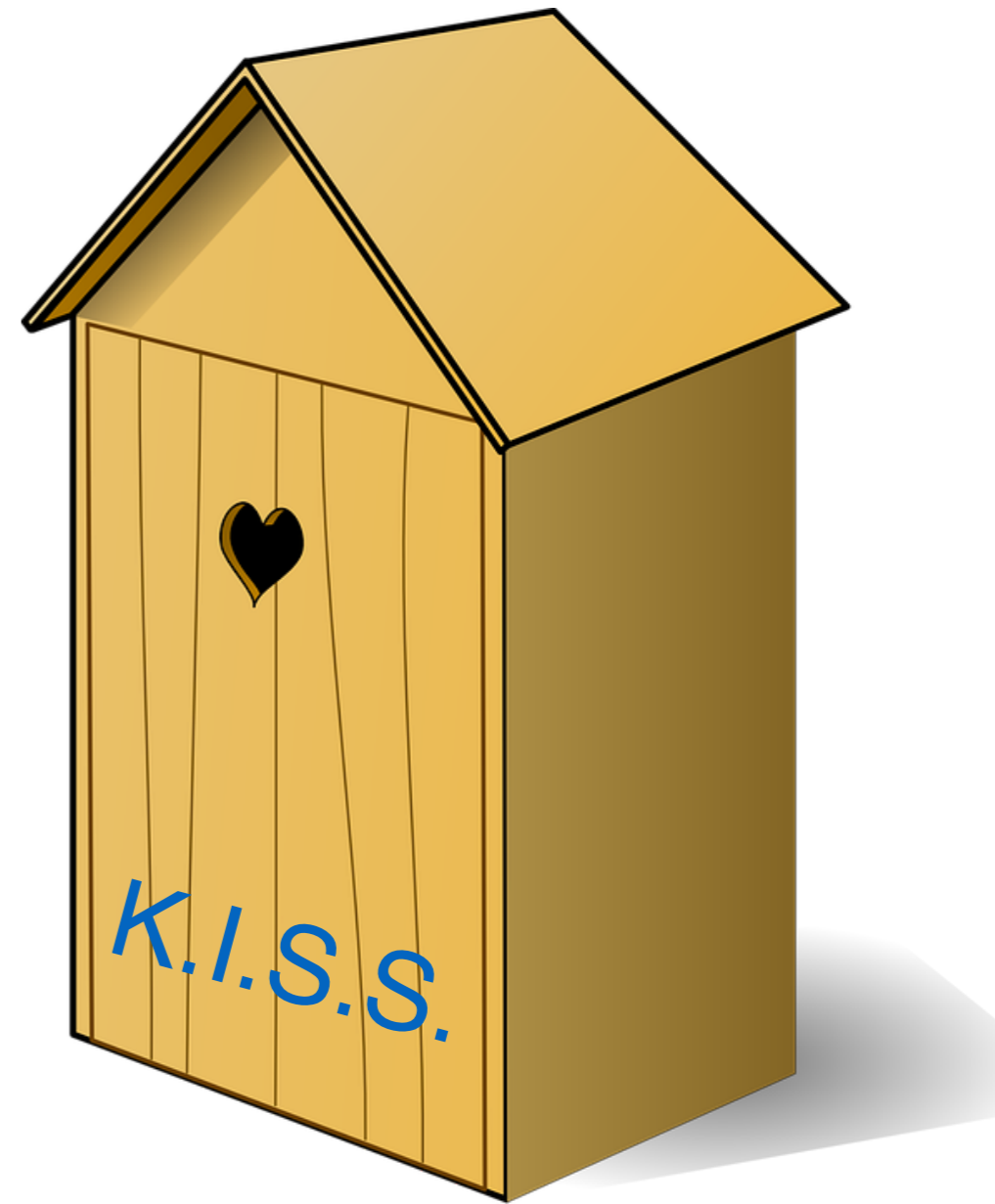
# K.I.S.S. or

**Keep**

**It**

**Simple**

**Stupid**



**This is the goal** in all Real Estate  
Investment Transactions.



Unit 2

# Start-to-Finish Flowchart

## Evaluate Goals

Evaluate your investing goals and develop an individualized property investment plan.

**STEP**  
**01**



## Choose Property

Choose from among a variety of properties. Find the one that fits your property investment goals. Then, sign a contract.

**STEP**  
**02**



**STEP**  
**03**

## Payment

The property is inspected and payment arrangements are made.



Framework

is very  
accurate  
and **easy to**  
**understand.**

# Start-to-Finish Flowchart

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# Start-to-Finish Flowchart

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**STEP**  
**02**



**STEP**  
**03**

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Framework

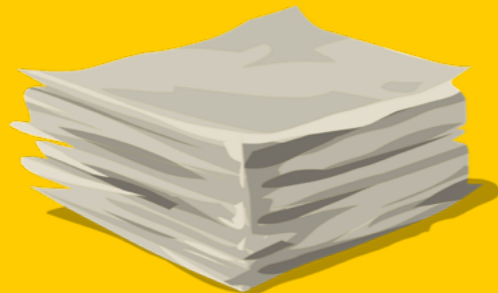
is very  
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# Start-to-Finish Flowchart

## Payment

The property is inspected and payment arrangements are made.

**STEP**  
**03**



**STEP**  
**04**

## Paperwork

All paperwork is filed and signed. The closing is completed. The entire process can be conveniently completed off-site.

## Collect

The property management agreement is signed and the investor can now begin collecting monthly rent payments.

**STEP**  
**05**



Framework

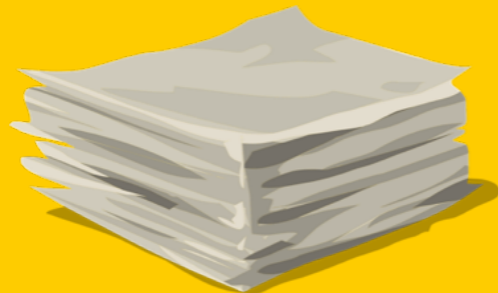
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# Start-to-Finish Flowchart

## Payment

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**STEP**  
**03**



**STEP**  
**04**

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All paperwork is filed and signed. The closing is completed. The entire process can be conveniently completed off-site.

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**STEP**  
**05**



Framework

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# What is Covered in this Module?



Unit 3

# Basic Principles of Real Estate Investing

- **Advantages-** Above Average Rates of Return, Use Leverage of Borrowed Money to Purchase Real Estate, Greater Control Over Investment
- **The Investment-** Unimproved Land, Income Property, Cash Flow, Operating Expenses, Method of Repayment, Amount of Rent Received, Investment Opportunities



# Basic Principles of Real Estate Investing

- Leveraging- Risk and Leverage, Equity Buildup, Pyramiding, Pyramiding Through Sale, Pyramiding Through Refinance
- Options- Real Estate Syndicate, Real Estate Investment Trusts (REIT), Real Estate Mortgage Investment Conduit (REMIC)
- Tax Benefits- Depreciation, Cost Recovery, Capital Gain, Exchanges, Deductions, Tax Credits, Installment Sales



# Real Estate Investment Property Types



- **Property Options!** Raw Land, Farm Land, Single Family Homes, Duplex, Triplexes, Small Apartments, Large Apartments, Commercial, Mobile Homes, RV Parks, Storage Facilities, Tax Liens, Notes, Large/ Small Commercial Space, Hotels, Motels



# Real Estate Investment Property Types

- Group Investing- Investing in REITs, Investing in Syndication, Investing in REMICs
- Tax Benefits- Depreciation, Cost Recovery, Capital Gain, Exchanges, Deductions, Tax Credits, Installment Sales





# Real Estate Investment Financing



- All Cash Approach to investing in Real Estate
- Traditional Financing Basics, Conventional Loans, FHA Loans, 203K Loans



Unit 3

# Real Estate Investment Financing

- Alternative Methods of Financing

Commercial Loans, Private, Hard Money, Home Equity Loans & Lines of Credit, Portfolio Loans, Owner Financing, Partnerships

- Understanding Types of Properties

Financing can be utilized for Commercial Loans, Private, Hard Money, Home Equity Loans & Lines of Credit, Portfolio Loans, Owner Financing, Partnerships Financing Basics, Conventional Loans, FHA Loans, 203K Loans



# Real Estate Investment Mathematics

- **Property Valuation** Cost approach, Sales Comparison Approach, Income Approach
- **Loan to Value (LTV)** Loan to Value explained, Loan to Value Formula, examples



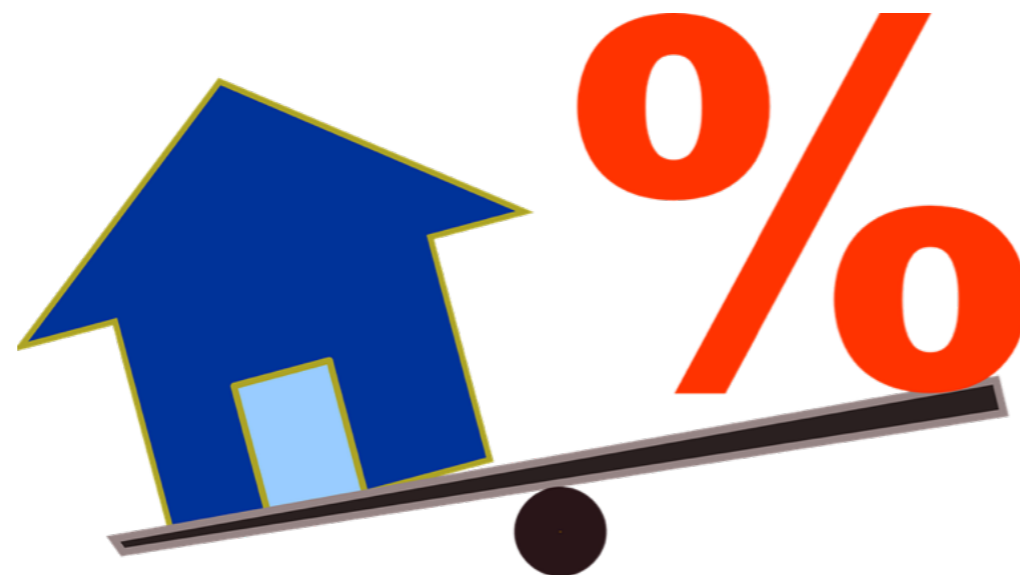
# Real Estate Investment Mathematics

- **Net Operating Income (NOI)** Net Operating Income explained, Net Operating Income Formula, examples
- **Capitalization Rate (Cap Rate)** Cap Rate explained, Cap Rate Formula, examples



# Real Estate Investment Mathematics

- **Debt Yield Ratio (DYR)** Debt Yield Ratio, Debt Yield Ratio Formula, examples
- **Return On Investment (ROI)** Return On Investment explained, Return On Investment Formula, examples





# Section 1

**Basic Principles of  
Real Estate Investing**

# Basic Principles of Real Estate Investing

## 1. Why Real Estate?

- **Advantages of Real Estate Investment**
- **Disadvantages of Real Estate Investment**

## 2. The Investment

- **Unimproved Land**
- **Income Property**
- **Cash Flow**

## 3. Leverage

- **Equity Buildup**
- **Pyramiding**

## 4. Tax Benefits

- **Unimproved Land**
- **Income Property**
- **Cash Flow**

# Basic Principles of Real Estate Investing

## 5. Real Estate Investment Options

- **Real Estate Syndicate**
- **Real Estate Investment Trust**
- **Real Estate Mortgage Investment Conduit**



# Why Real Estate?



Unit 1

**Real Estate** has always been an important part of an **investment portfolio**.



Like any other commodity, it has its

**GOOD** years and **BAD** years.

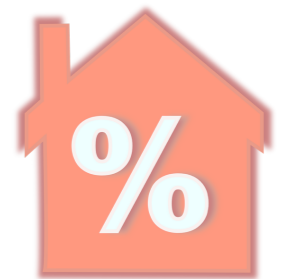


Unit 1

The property valuations were **at their highest** point during the beginning of this century. They were **later exacerbated** during the **recession** years of 2006-2008.



As with any investment,  
**Real Estate** requires  
**CAREFUL** consideration of  
both its **advantages** and  
**its disadvantages**, which  
will be explained in this Unit.



Unit 1

# Advantages to Investing



- **Above Average Rates of Return**
- **Use Leverage of Borrowed Money to Purchase Real Estate**
- **Greater Control Over Investment**



# Above Average Rates of Return



Over longer periods  
(10 - 20 years or more)  
**Real Estate Investments**  
typically have shown **above** average  
(often times higher) rates of return.

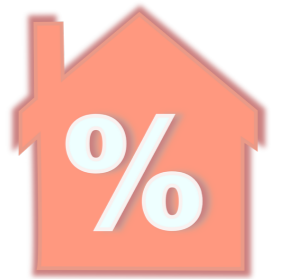
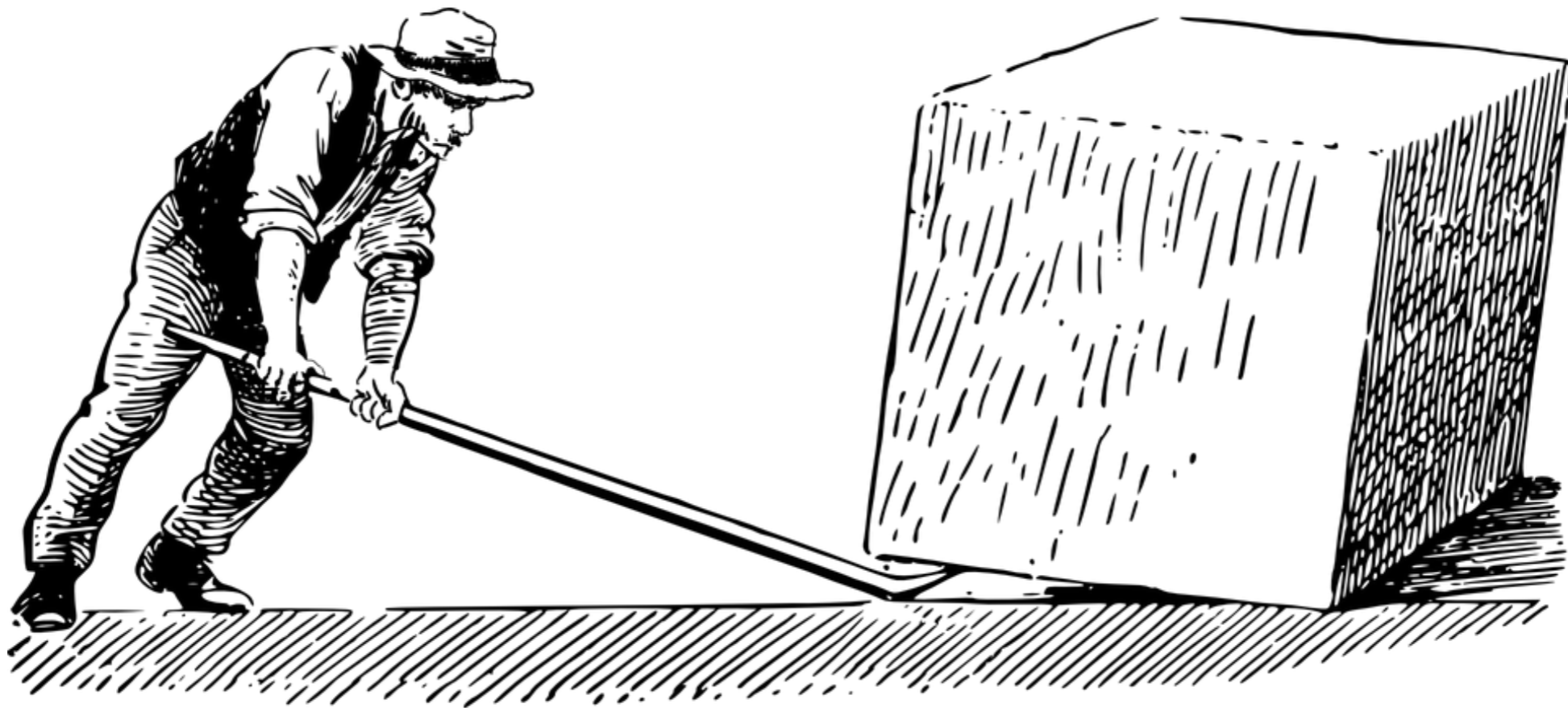
# Above Average Rates of Return



In some parts of the country, an **impressive return** can be received even after **relatively short period** of ownership.

# Use Leverage of Borrowed Money to Purchase Real Estate

Investors can use borrowed money for financing.



Unit 1



# Use Leverage of Borrowed Money to Purchase Real Estate



Assets, if held long enough, can return  
more money than the financing cost.

# Greater Control Over Investment

Real Estate offers  
more **immediate**  
advantages



# Greater Control Over Investment

Real Estate offers **greater control** compared to other options (such as stocks, bonds, or securities).



# Greater Control Over Investment

Real Estate marketplace consists of **buyers** and **sellers** that deal directly with each other.



Unit 1

# Disadvantages to Investing

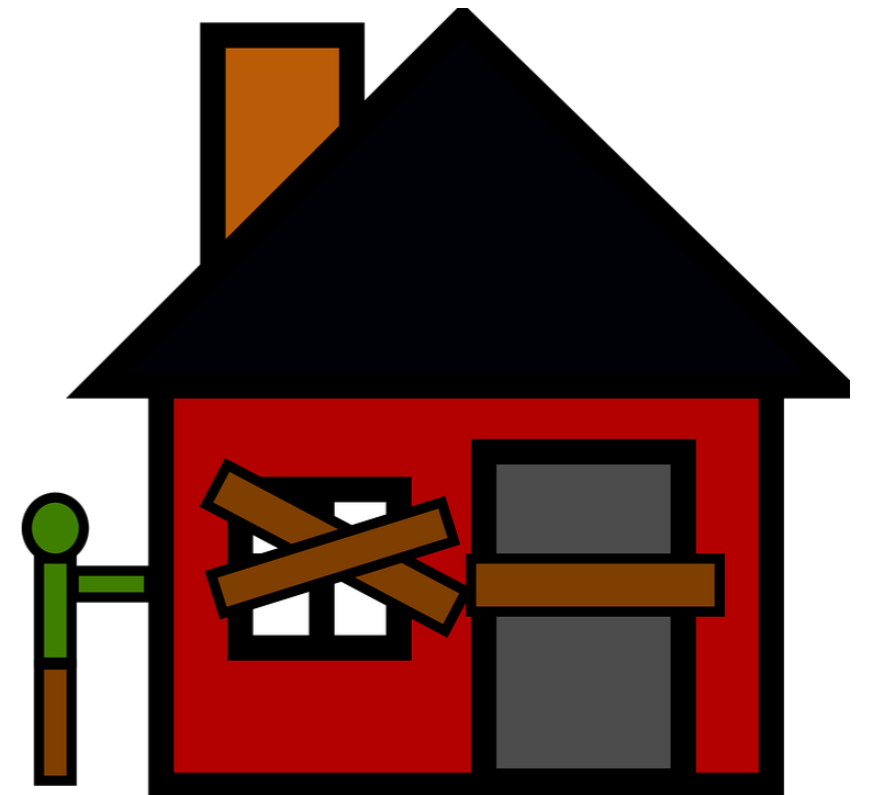


- **Above Average Rates of Return**
- **Use Leverage of Borrowed Money to Purchase Real Estate**
- **Greater Control Over Investment**



# Disadvantages to Investing

- Investing is Expensive
- NOT Highly Liquid
- Active Management is Required
- High Degree of Risk



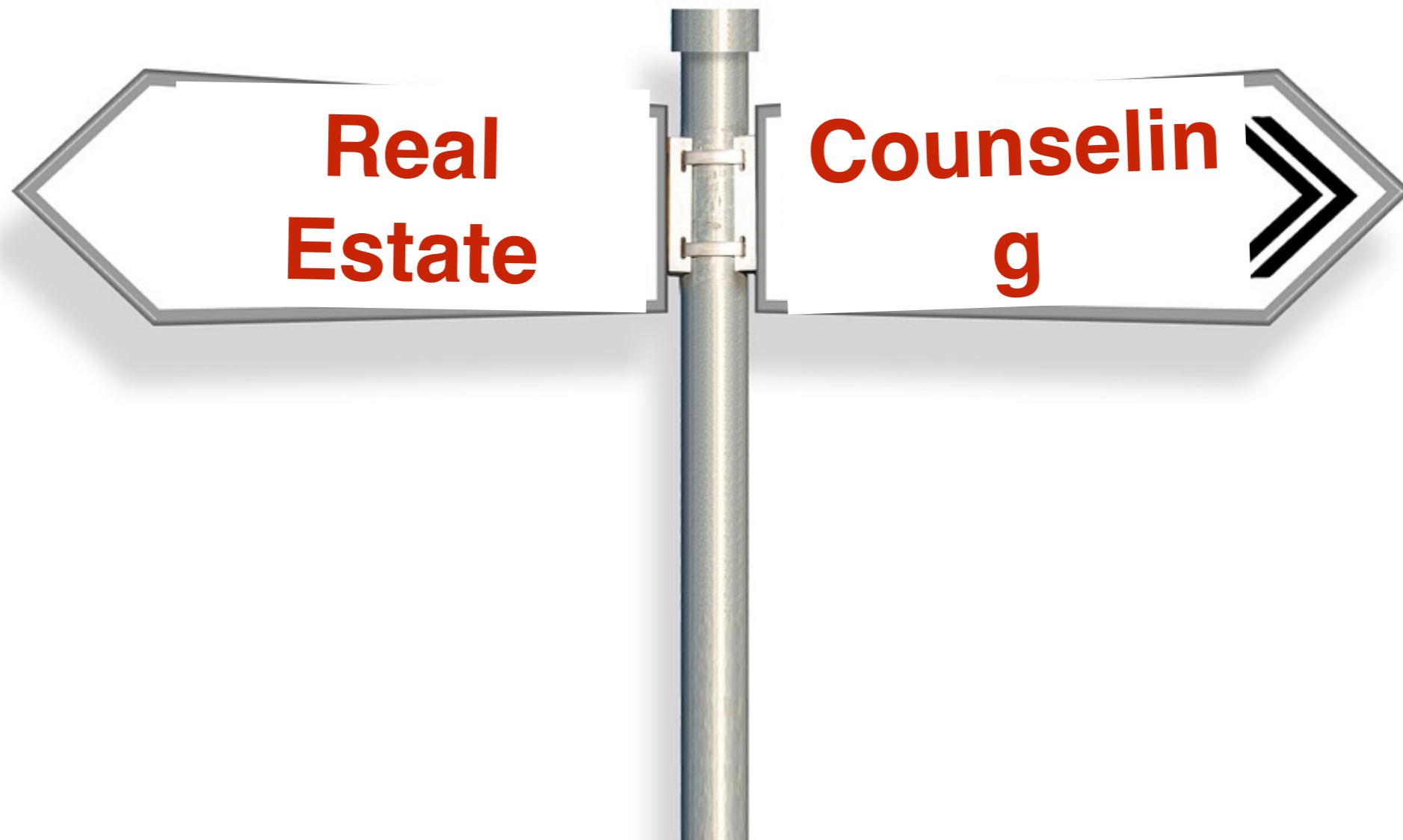
# Investing Is Expensive

Large amounts of capital is required, even when financing is available.



Unit 1

# Investing Is Expensive



Investing in **Real Estate** is difficult without expert advice.





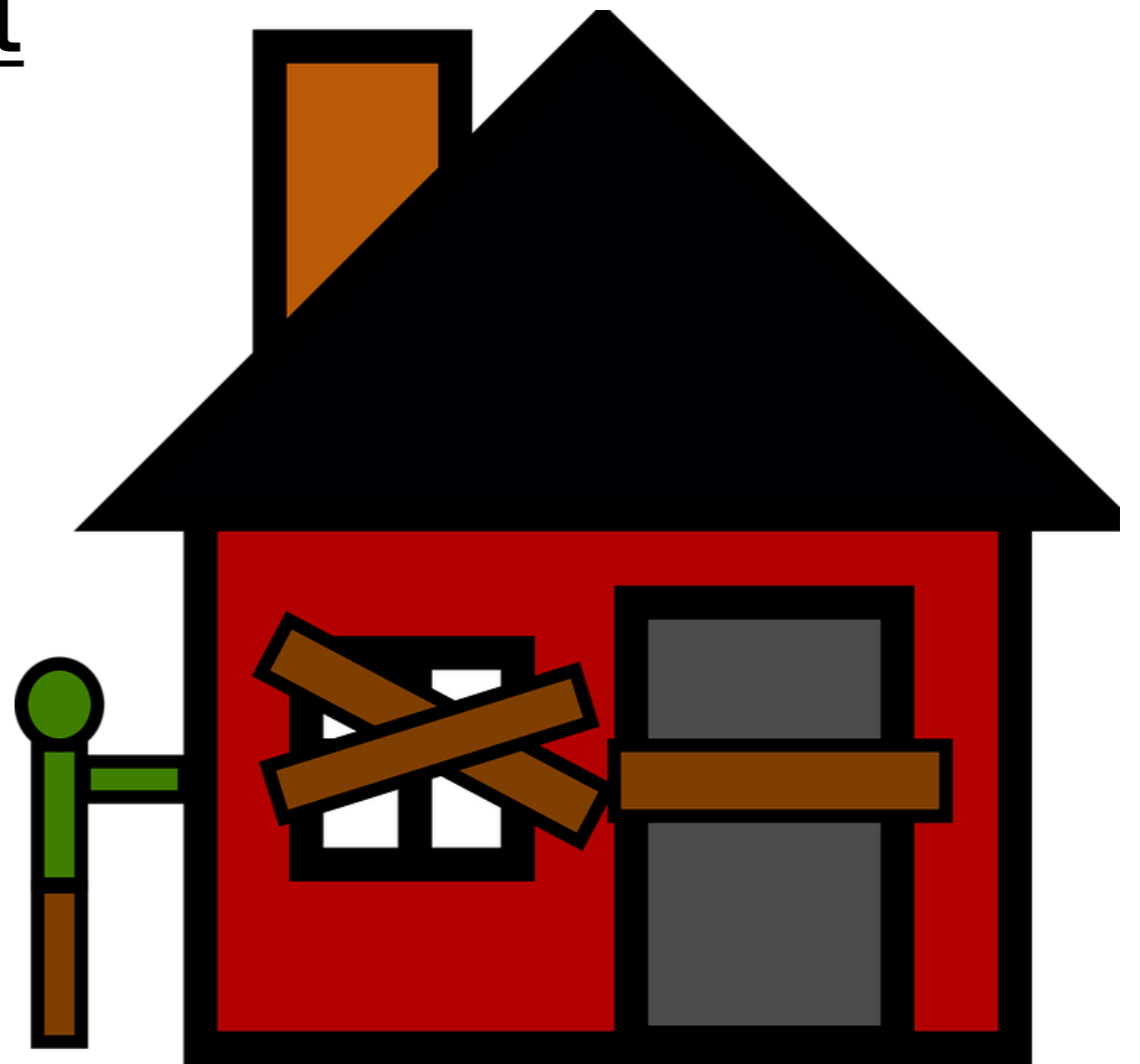
# Investing Is Expensive

Investing decisions **MUST** be based on careful study of **ALL of the facts**, and reinforced by a thorough knowledge of **Real Estate**.



# Not Highly Liquid

Unlike stocks and bonds, **Real Estate** is not highly liquid over the **short term**.



# Not Highly Liquid



In order to bring about a **quick sale**, a Real Estate Investor **might** have to accept a substantially lower price than desired.



# Not Highly Liquid

If the markets are down,  
the **investor** is at the mercy  
of the the lender (if they want  
to **refinance the property** and free  
up some cash).



# Active Management



**Investors** cannot sit and watch money grow.

# Active Management



**Investors must manage property  
or hire a manager**



Unit 1

# Management Decisions

## Management Decisions include:

How much to charge for rent?



How should repairs be handled?



What are the long-term goals?



Unit 1

Licensure of Real Estate brokers and Real Estate salespersons shall not apply to any person who as owner or lessor performs any of the acts enumerated in section 20-311, with reference to property owned, leased or sought to be acquired or leased by the person OR to the person's regular employees who are employed as on-site residential superintendents or custodians, with respect to the property so owned or leased or sought to be acquired or leased when such acts are performed in the regular course of, or incident to, the management of such property and the investment therein.



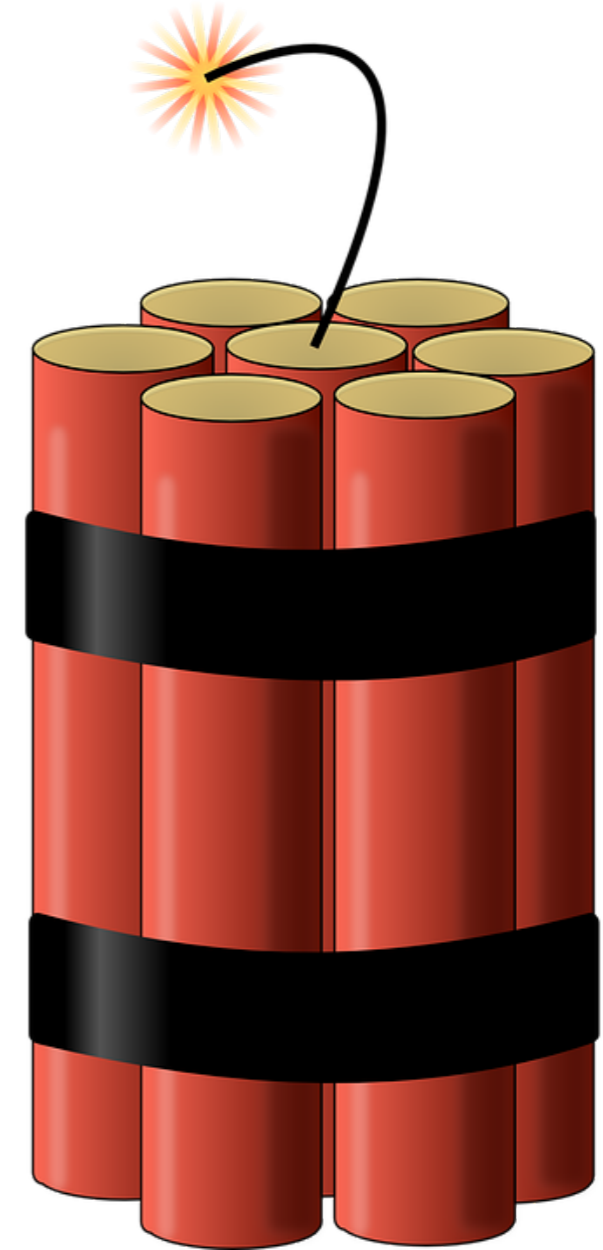
# High Degree of Risk



Real Estate  
Investment  
does not  
guarantee  
profit.

# High Degree of Risk

The reality that a property will **decrease** in value or not generate income to make it profitable is the volatile factor in this form of investing.



# The Investment

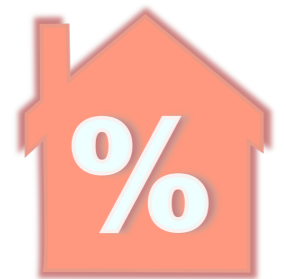


Unit 2

# The Investment



The Real Estate Investor  
anticipates various  
objectives.



# The Investment

- The most common form of **Real Estate Investment** is **Direct Ownership**
- Individuals and corporations may **own Real Estate directly** and manage it as investments or cash flow
- This type is know as **Income Property**



# Appreciation

**Real Estate** is an **avenue of investment** open to those interested in holding property, primarily, for increasing value (also know as **appreciation**).

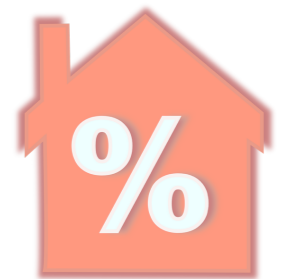


# Appreciation

## Two Main Factors:

**Inflation** The increase in the amount of money in circulation

**Intrinsic Value** The result of a person's individual choices and preference for a given geographic area (The greater the intrinsic value of a property, the more money it commands for the sale)



# Unimproved Land

Investors often speculate purchases of agricultural land or underdeveloped land in areas **where they expect major growth.**



Unit 2



# Unimproved Land

- **Property's intrinsic value** and potential for appreciation are not easy to determine (making it a riskier investment)
- **Lending institutions** are more reluctant to lend money for the purchase of raw land
- **Investment in land is best left to experts** (who can still make bad land investment decisions)



# Income Property

- A person who wishes to buy and personally manage the property may see that the rental income is the best investment
- The objective of directing funds into income property is to generate spendable income called **Cash Flow**



# Cash Flow

**Cash Flow** is the total amount of money left after all expenditures have been paid (including taxes, operating costs, and maintenance).



Unit 2

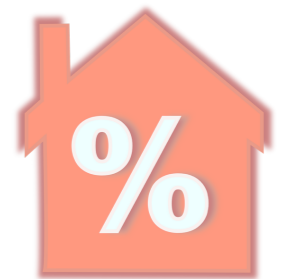
# Cash Flow

Three factors determine the **cash flow** produced by any parcel of Real Estate:

**Amount of  
Rent  
Received**



**Debt  
Repayment  
Method**



Unit 2

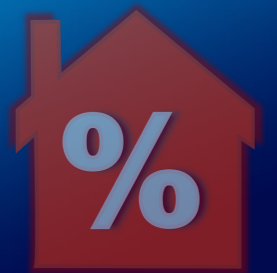
# Amount of Rent Received

The amount that a property may command is determined by a number of factors such as:

Property's Location

Physical Appearance

Amenities



Unit 2

# Amount of Rent Received



Keep in mind that if **cash flow** isn't high enough to cover all expenses, **negative cash flow** will be the result.



Unit 2

# Amount of Rent Received

At a time of  
high property  
appreciation,  
a minimal  
amount of  
negative  
cash flow  
may be  
acceptable...



# Amount of Rent Received

At other times, it could prove **disastrous**.





**Any broker** who, in the course of his Real Estate business and in connection with any transaction, accepts from any rental money, rental security deposit shall deposit such moneys in his escrow or trust account within three banking days of the date the agreement evidencing.



# Operating Expenses

To keep cash flow high, an investor has to keep operating expenses low. Some operating expenses include:



General Building Maintenance

Repairs

Utilities

Tenant Services

Keep in mind, it is not a good idea to keep operating expenses so low that the property condition suffers.



This will effect the desirability and treatment by tenants. Unit 2

# Method of Debt Repayment

An investor often stands to make more by investing borrowed money.

A hand in a dark pinstriped suit sleeve is holding the word "LOANS" in large, 3D, red, block letters. The hand is positioned palm-up, supporting the letters from below. The background is plain white.

LOANS

This is usually obtained through a mortgage loan or deed of trust.

# Method of Debt Repayment

Income-producing properties

include:

- Apartment
- Office buildings
- Shopping Centers
- Industrial properties
- Single Family Rentals
- Multi Family Rentals
- Condominiums



The prospective investor's due diligence should always include finding out whether or not there are any limitations on property rental.



Unit 2

# Leverage



Unit 3

# Leverage



Leverage is the use of **borrowed** money **to finance** an investment.



Unit 3

# Leverage

As a rule, an investor can receive a **maximum return** from the **initial investment** by:

- **making** a small down payment
- **paying** a low interest rate
- **spreading** the mortgage payments over as long a period as possible



# Risk and Leverage



Risk is DIRECTLY proportionate to leverage.

**Higher leverage is a greater risk** because of the **high ratio of borrowed money to the value of the property** (for both investors and lenders).



# Risk and Leverage

When property rates drop or vacancies rise, the highly leveraged investor **may be unable to pay** even the **financing costs** of the property.

**Lower leverage results in less risk.**



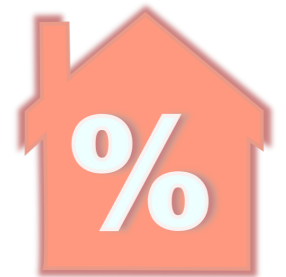
# Equity Buildup

**EQUITY BUILDUP:** The addition to the amount paid as down payment on the property of the principle payments, plus any increase in property value due to appreciation.

Example:

Market Value	→	\$450,000
<u>- Purchase Price</u>	→	<u>- \$200,000</u>
Equity Buildup	→	<b>\$250,000</b>

This house has **\$250,000** in Equity Buildup



# Pyramiding

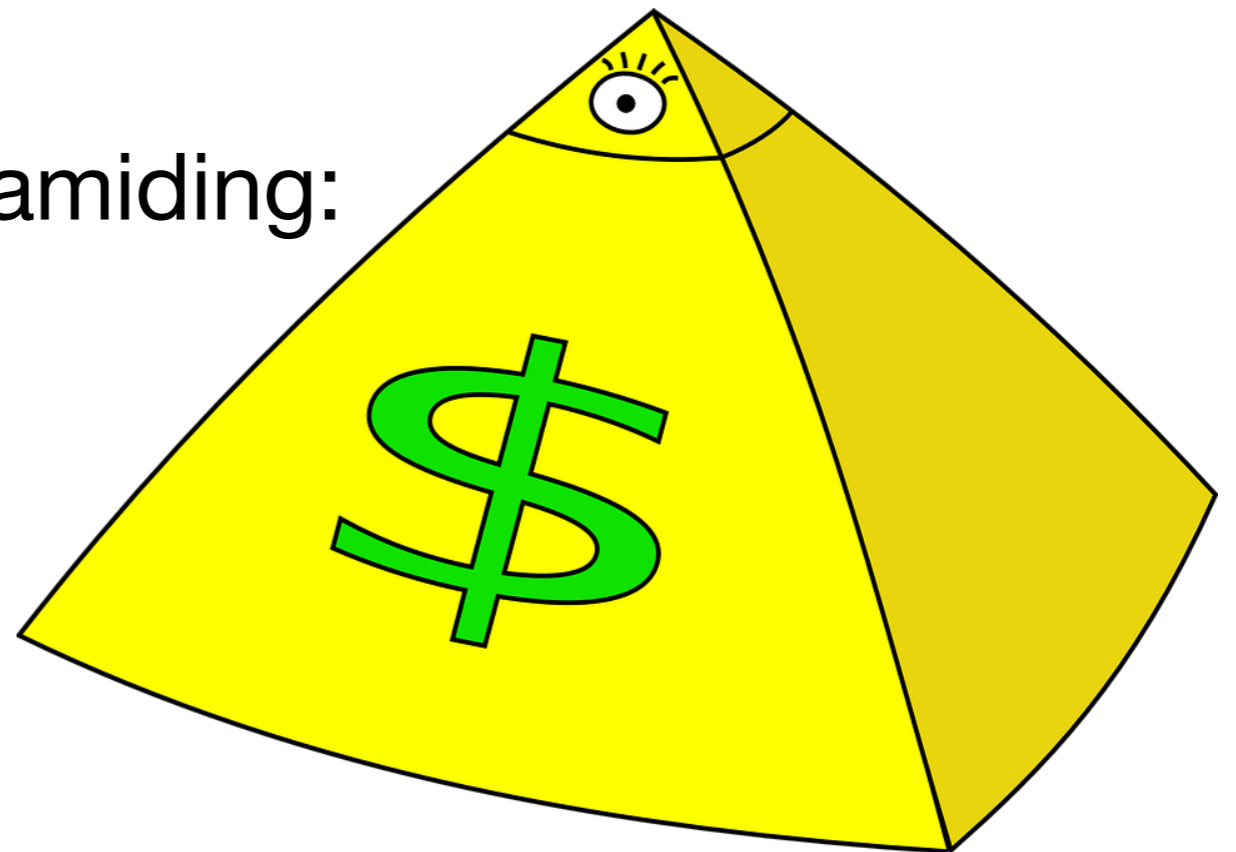
**PYRAMIDING:** The process of using one property to drive the acquisition of additional properties.

It can be an effective way for investors to increase their holdings without investing any additional capital.

There are two methods of pyramiding:

Pyramiding through sale

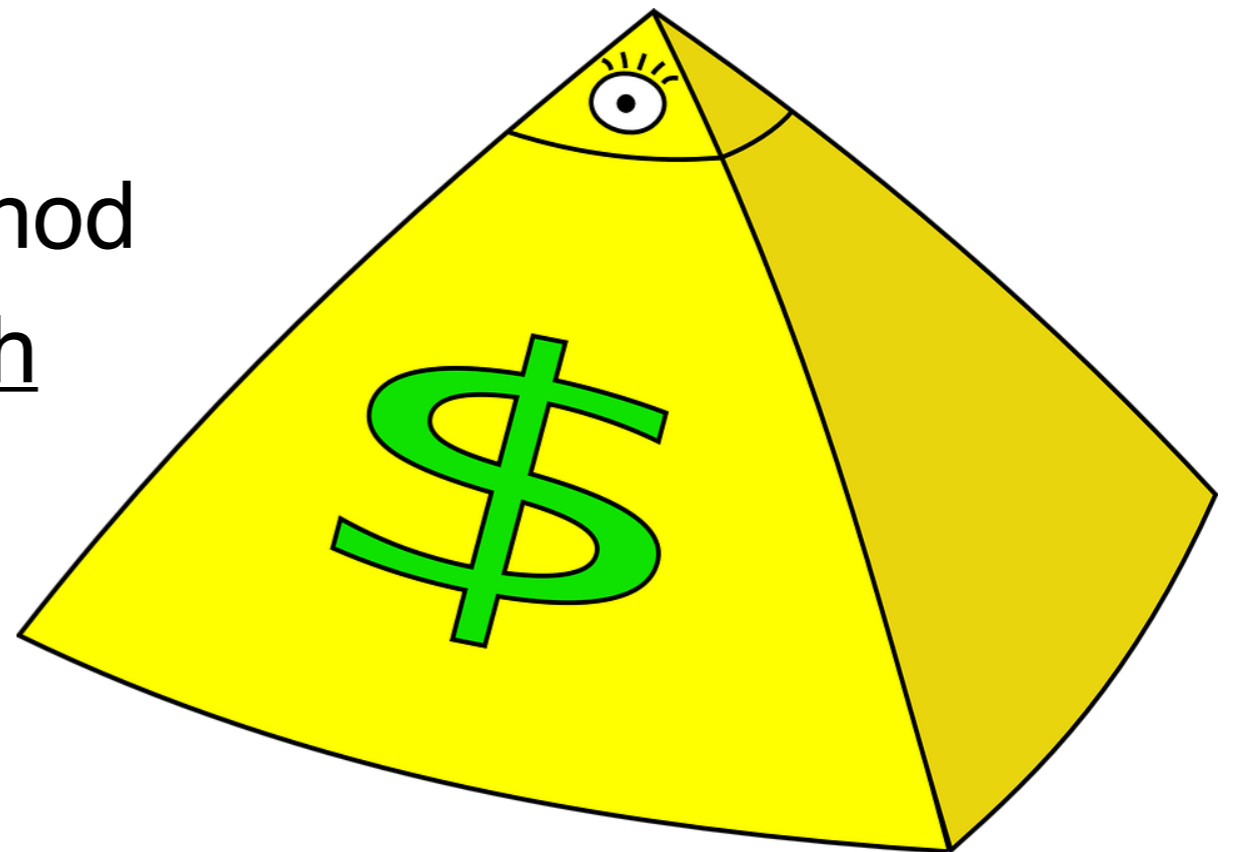
Pyramiding through refinance



# Pyramiding

- **Investor** acquires a property
- **Improves** it for resell (substantially higher price)
- **Profit** is used to to **purchase more properties**

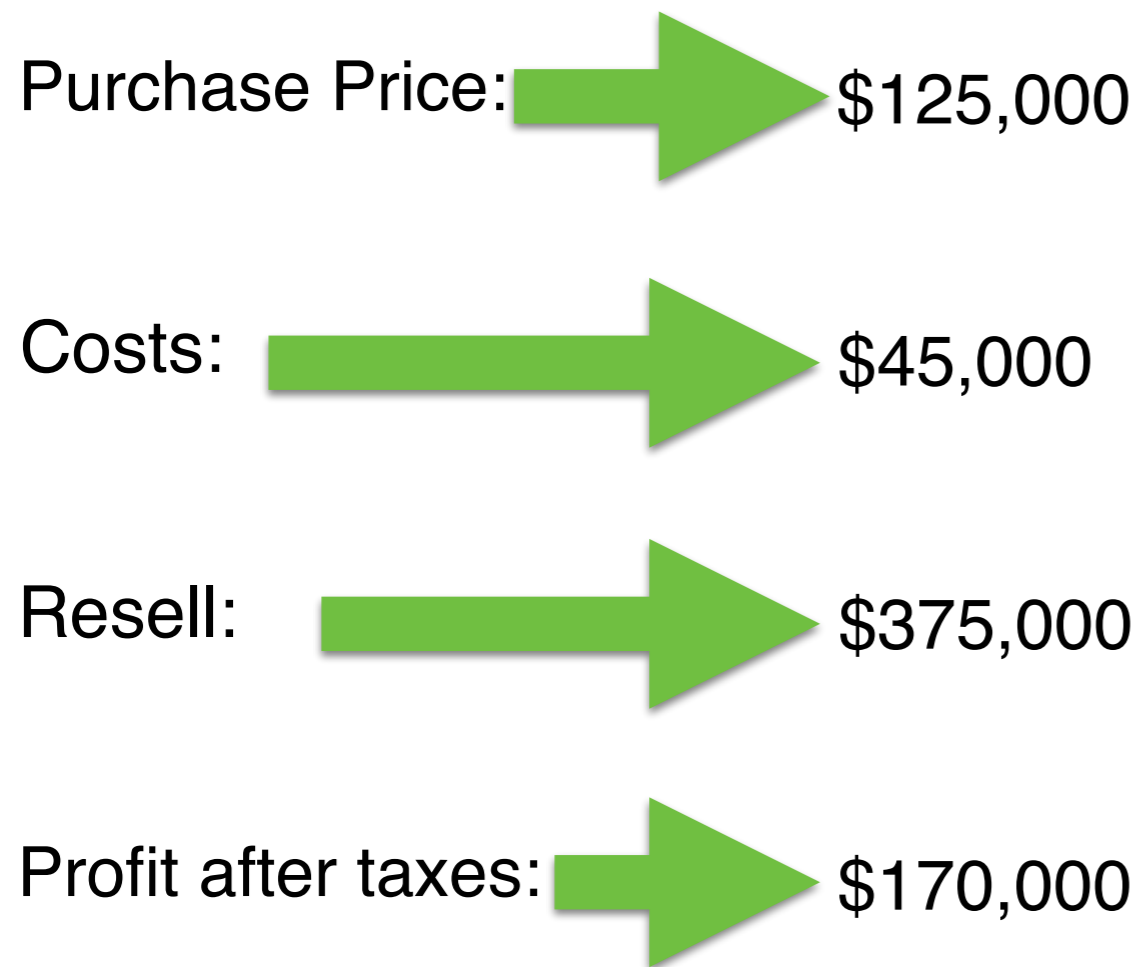
The **disadvantage** to this method is that the proceeds from each sale are subject to taxation.



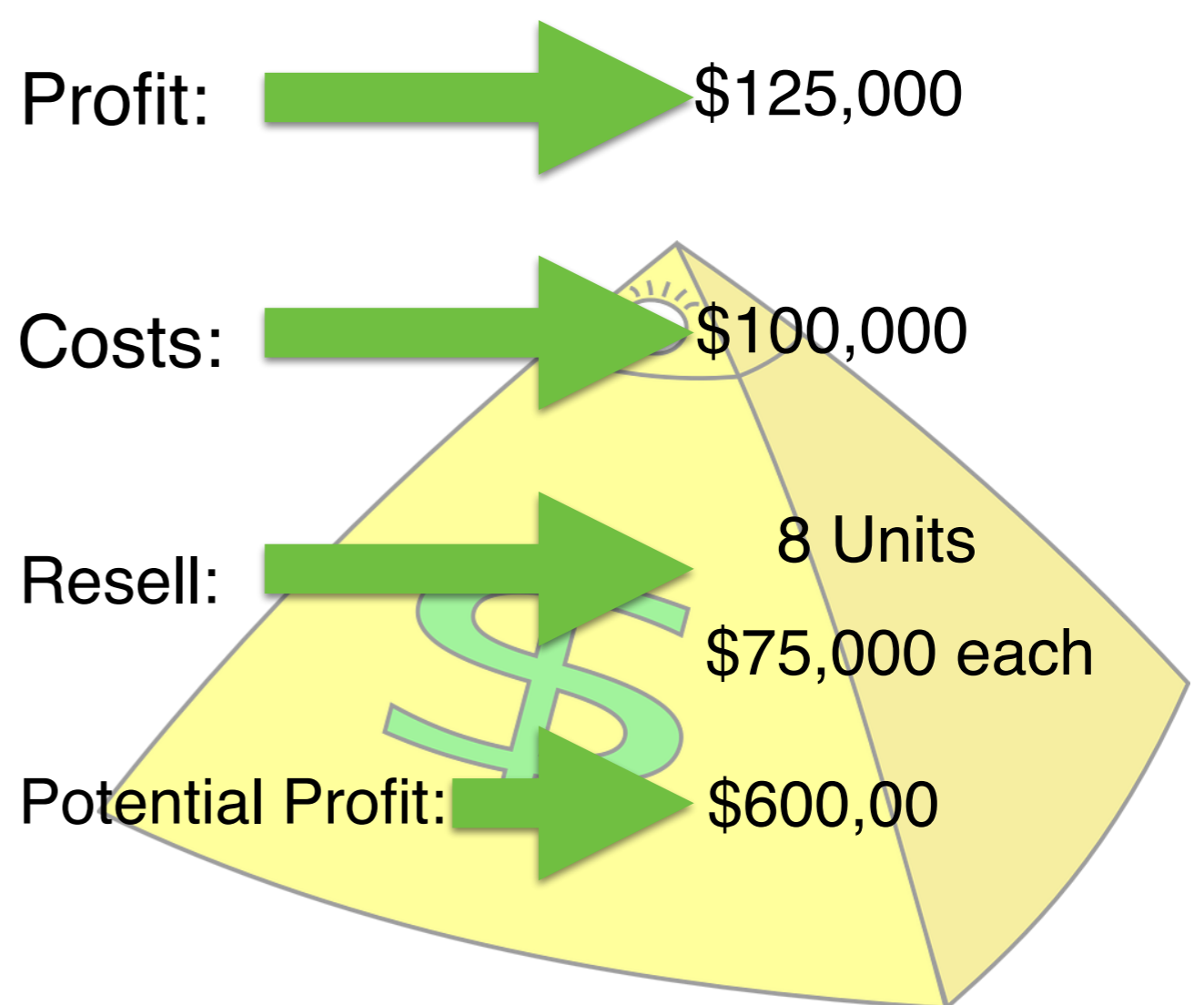
# Pyramiding Through Scale

## EXAMPLE:

### Original Property

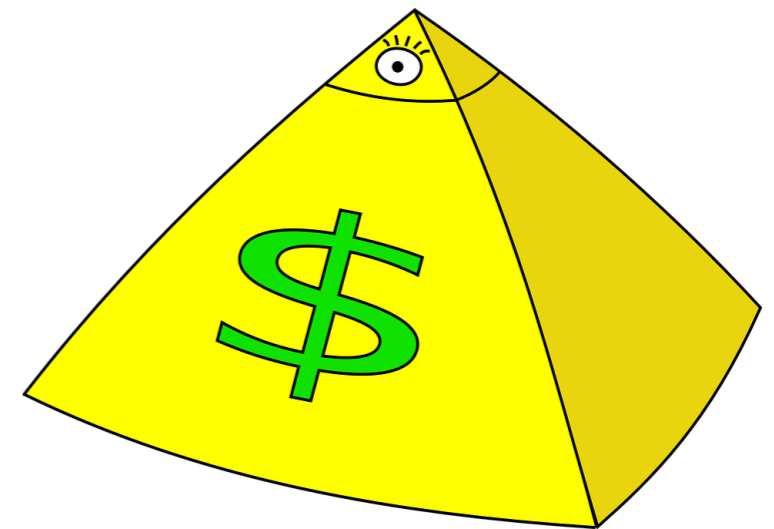


### Second Property



# Pyramiding Through Refinance

Value of the original property is used to acquire additional properties, while retaining all of the properties. Original property is refinanced and proceeds are used to purchase additional properties.



# Pyramiding Through Refinance

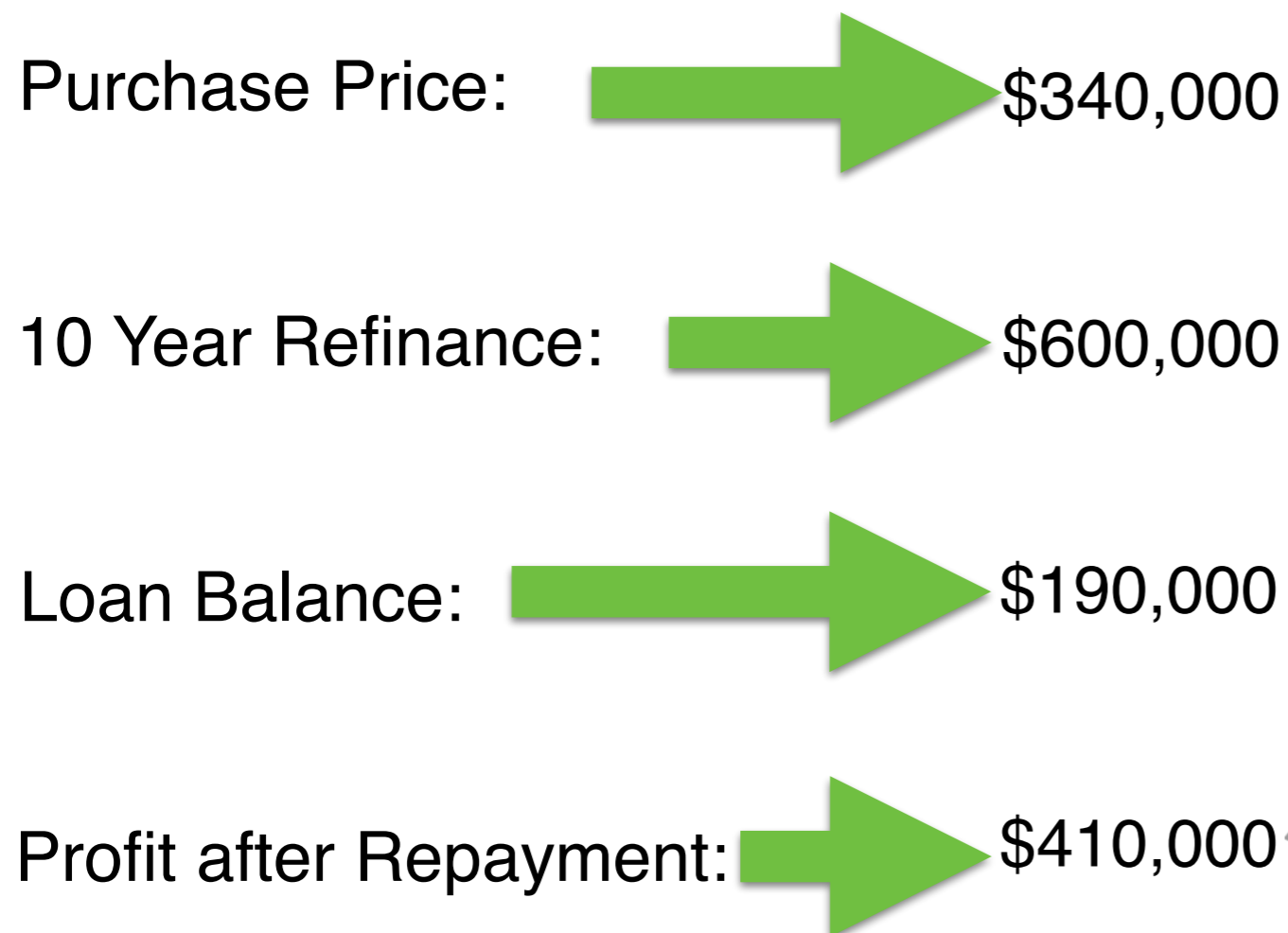
These properties are refinanced, enabling the investor to acquire further properties. By holding the properties, the investor delays the **Capital Gains Tax** on sales.



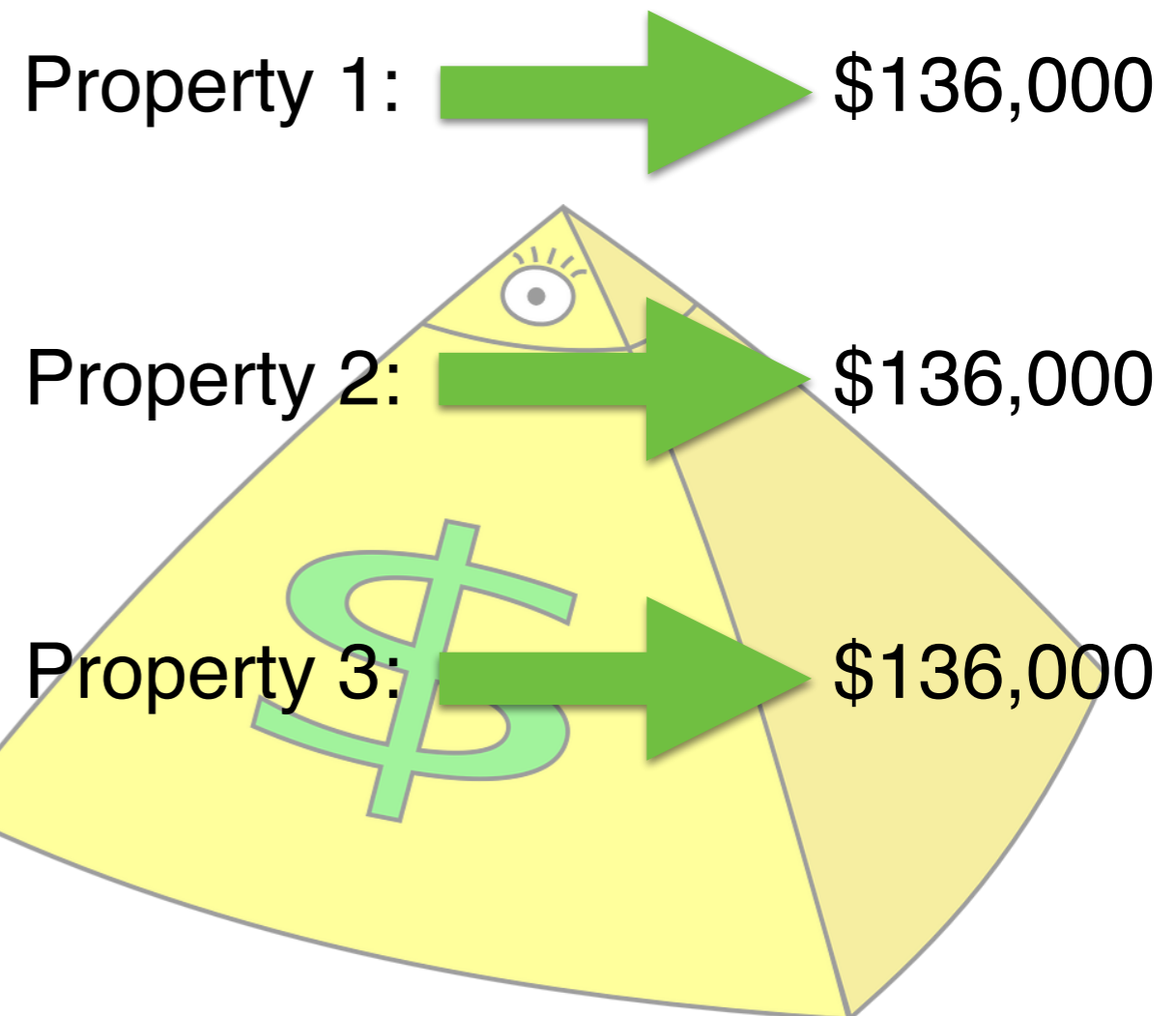
# Pyramiding Through Refinance

## EXAMPLE:

### Single Family Rental



### Refinance Pyramid Investment





# Tax Benefits

\*Please Consult a licensed Tax Professional or Investment SME regarding Real Estate Investment Options



Unit 4

# Tax Benefits

Some tax advantages of owning Investment Real Estate are **altered periodically by congress.**

\*Please Consult a  
licensed Tax  
Professional or  
Investment SME  
regarding Real Estate  
Investment Options



Unit 4



**Every real property securities dealer** shall file with the commission, annually, a report containing financial statements in accordance with generally accepted accounting principles, accompanied by an opinion thereon by a certified public accountant based upon an audit of the real property securities dealer's business subject to sections 20-329o to 20-329bb, inclusive, which is not materially restricted in scope.



# Depreciation (Cost Recovery)



- Allows **cost recovery** of an income-producing asset through **tax deductions** over the asset's USEFUL life (27.5 years)
- Investors rarely purchase investment property without expecting it to appreciate over time
- Tax laws recognize that all physical structures deteriorate over time

Cost recovery decisions can only be made on personal property and improvements to the land.



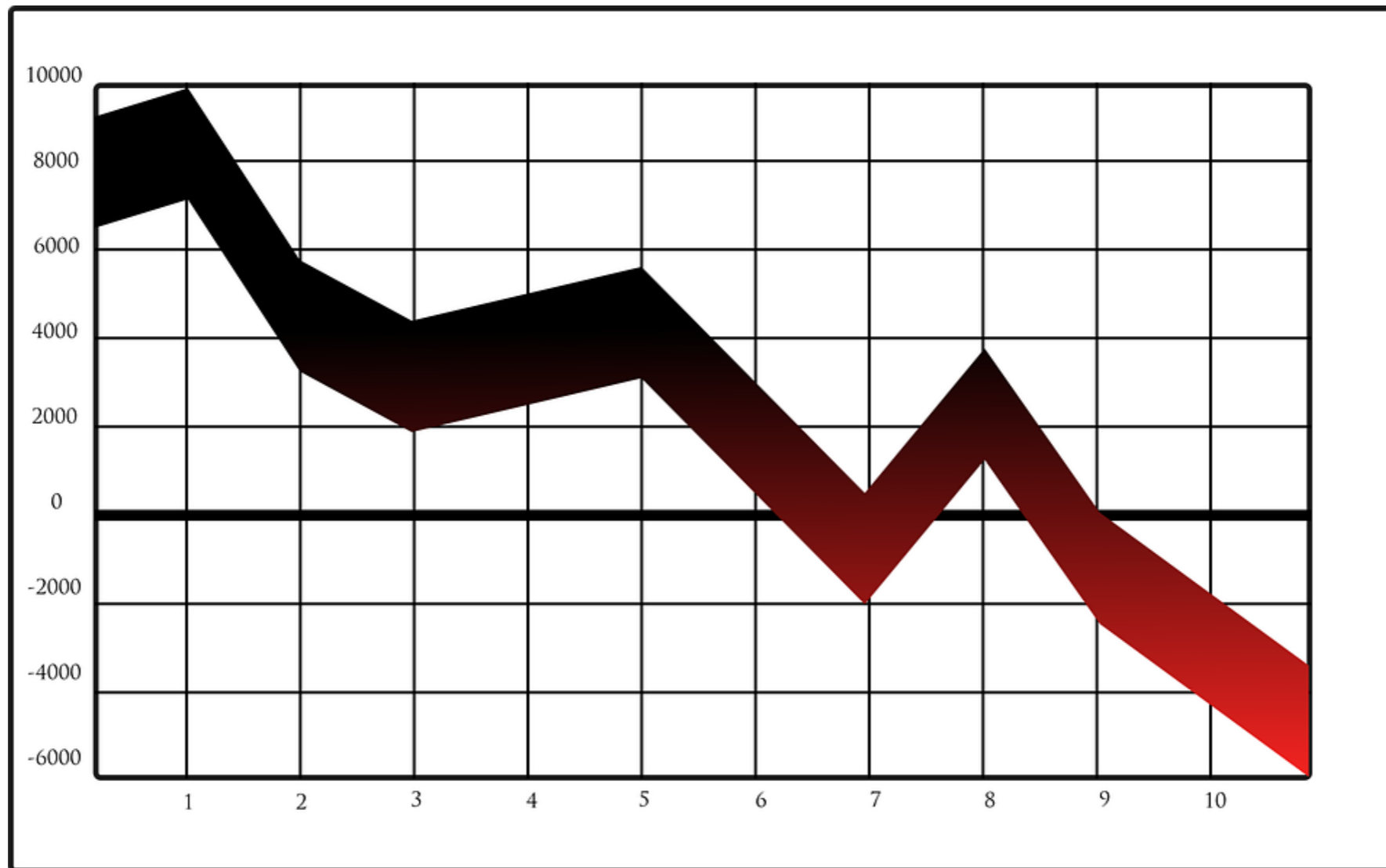
Unit 4

# Depreciation (Cost Recovery)

**Straight Line Depreciation** is when depreciation is taken periodically over the asset's lifetime.



# Depreciation (Cost Recovery)

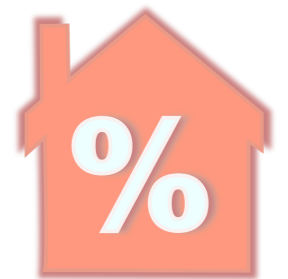
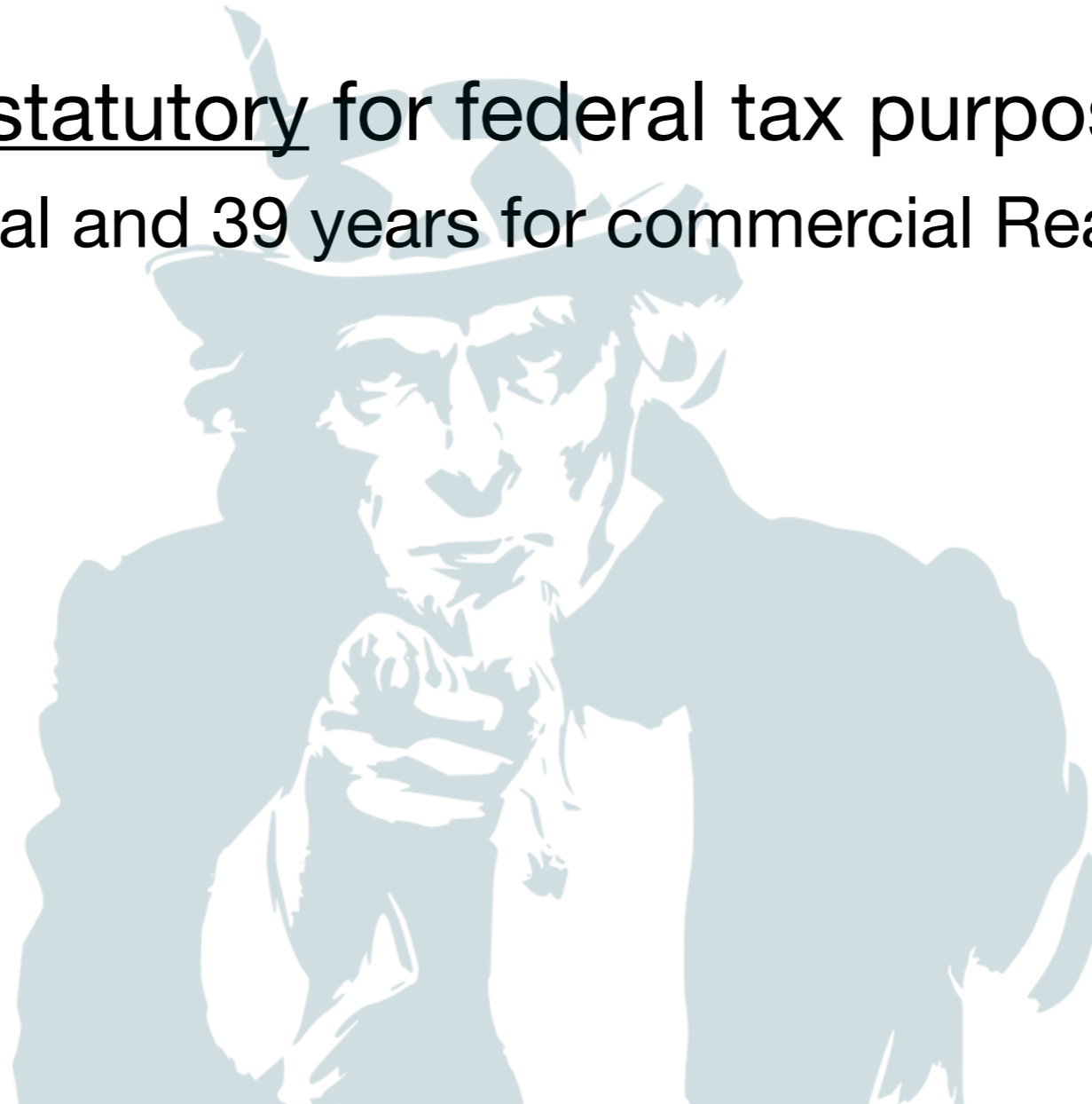


## **Accelerated Cost Recovery System (ACRS)**

was used to claim greater depreciation for **certain property prior to 1987** (gradually reducing the deduction each year).

# The Taxpayer Relief Act of 1997

- Established specific rules governing holding periods and taxability of depreciation for real property
- Currently statutory for federal tax purposes (27.5 years for residential and 39 years for commercial Real Estate)

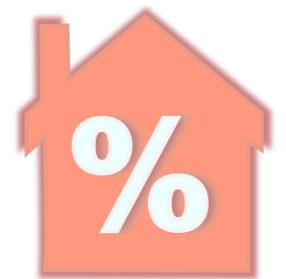
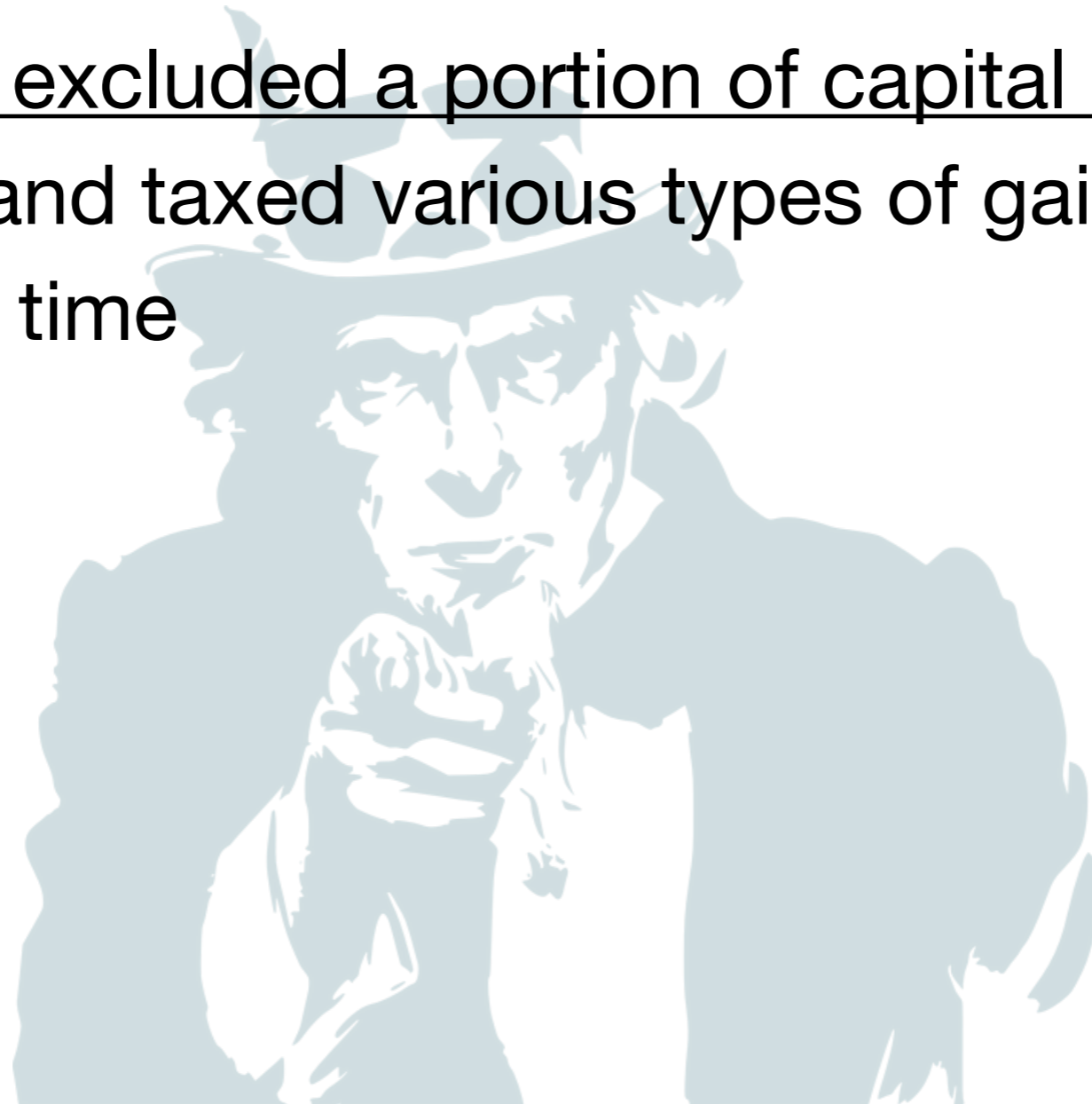


Unit 4

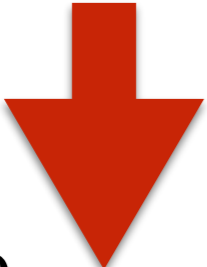

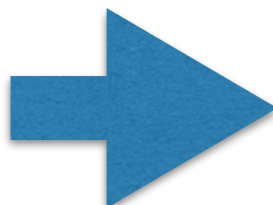
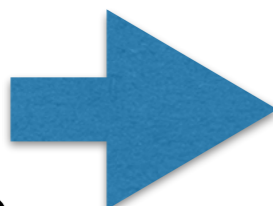
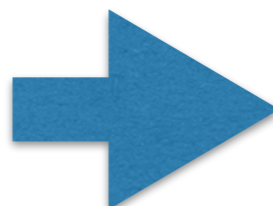
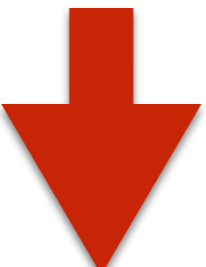
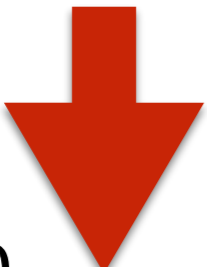
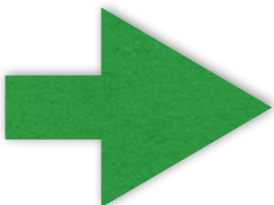



# Capital Gain

- The difference between the **adjusted basis of property** and its **net selling price**
- The law has excluded a portion of capital gains from income tax and taxed various types of gains differently from time to time



# Capital Gain Example

Selling Price: \$300,000 	5% Commission: \$15,000 	Closing Costs: \$1,800 	Net Sales Price: \$283,200
Original Cost: \$95,000 	Improvements: \$25,000 	Total Costs: \$120,000 	Depreciation: \$15,000
Adjusted Basis: \$105,000 	Net Sales Price: \$283,200 	 Total Capital Gain: \$178,200	

# Exchanges

- Real estate investors can defer taxation of capital gains by making property exchanges
- The properties involved must be of like kind to qualify for a tax-deferred exchange (as defined in Section 1031)
- One parcel of Real Estate is of like kind to another parcel of Real Estate even when they have different uses as long as both are held for investment (not owner-occupied) and are not located in a foreign country



# Exchanges

Real estate and personal property can not be exchanged in a **tax-deferred transaction** because **they are not of like kind**.



# Exchanges

A property owner will only incur tax liability IF additional capital or property is received.

*The additional property or capital is taxed*

*The value of the boot is added to the basis of the property*

*The tax is deferred not eliminated*

When the investor sells the acquired property, the capital gain will be taxed.



# Exchanges

**State income taxes** can be deferred by using the Exchange Form of Property Transfer. Use of a qualified intermediary is considered a **safe harbor** by the IRS and is essential for a delayed exchange.



Except as otherwise provided, each person who offers residential property in the state for exchange shall provide a written residential condition report to the prospective purchaser at any time prior to the prospective purchaser's execution of any binder, contract to purchase, option or lease containing a purchase option.



# Deductions



In addition to tax deductions for depreciation, investors may be able to deduct losses from their Real Estate Investments.



# Deductions



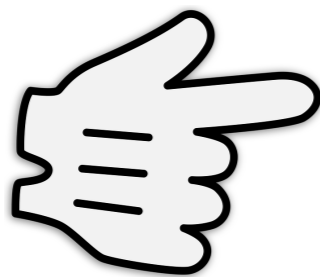
Tax laws can be complex and  
**MUST be strictly followed.**

# Deductions

- **Amount of loss that may be deducted depends on** whether investor actively participates in day-to-day management of the rental property or makes management decisions
- **Other factors are the amount of loss** and the sources of the income from which the loss is to be deducted
- **Investors who do not actively participate** in the management or operation of the Real Estate are considered passive investors
- **Passive investors may not use losses** to offset income from wages, income from stocks, bonds or the like



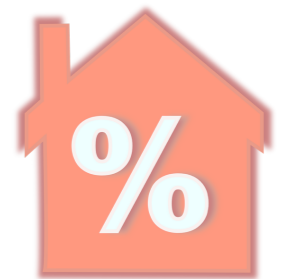
# Deductions



The tax code cites **specific rules** for active and passive income and losses and may be subject to change.

# Deductions

- **A direct reduction in the tax due** rather than a deduction from income before tax is computed
- **Certain tax credits allowed for the renovation** of older buildings, low-income housing projects and historic property
- **Tax credits encourage revitalization** of older properties and the creation of low-income housing



# Installment Sales

- A taxpayer who sells real property and receives payment on installment basis pays tax only on the profit portion of each payment received
- Interest received is taxable as ordinary income



# Real Estate Investment Options



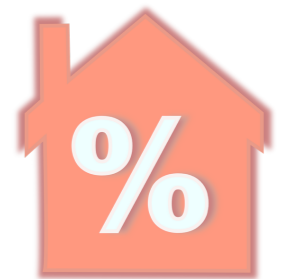
Unit 5

# Real Estate Investment Options

Various structures exist for Real Estate Investment, including the following:

- Real Estate Syndicates
- Real Estate Investment Trust (REIT)
- Real Estate Mortgage Investment Conduits (REMIC)

\*Please Consult a licensed Tax Professional or Investment SME regarding Real Estate Investment Options



Unit 5

Any general or limited partnership, joint venture, unincorporated association, or similar organization, but not a corporation, owned beneficially for not less than eighteen persons and formed for the sole purpose of, and engaged solely in, investment in or gain from an interest in real property, including, but not limited to, a sale, exchange, trade or development. **An interest held by a husband and wife shall be considered held by one person.**



# Real Estate Investment Syndicate

- Permits people with **modest** capital to invest in **large-scale operations**
- Individuals pool their resources to own or develop a particular piece of property
- Typical syndicate projects will include high rise apartment buildings and shopping centers bullet



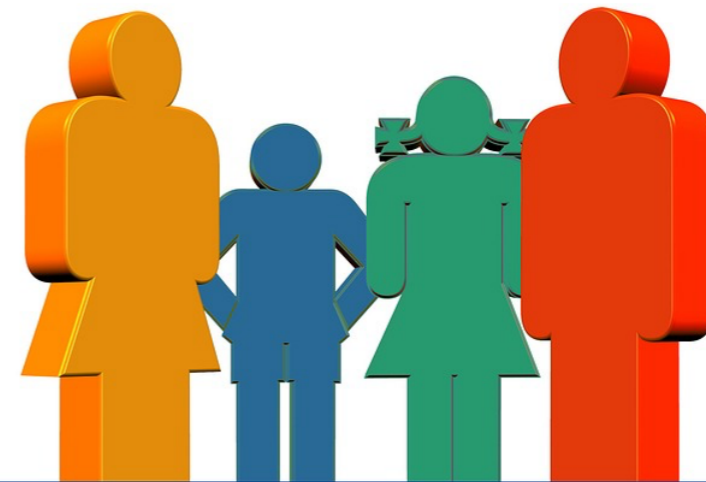
\*Please Consult a licensed Tax Professional or Investment SME regarding Real Estate Investment Options



Unit 5

# Real Estate Investment Syndicate

- Syndicate members may hold property as tenants in common or joint tenants
- Various kinds of partnership, corporate and trust ownership options are available
- Real Estate Brokers License is not required to sell Real Estate syndicate securities



Syndicate Members

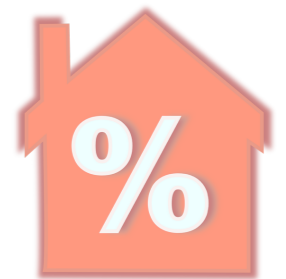
\*Please Consult a licensed Tax Professional or Investment SME regarding Real Estate Investment Options



Unit 5

# Real Estate Investment Syndicate

**Private Syndication** generally involves a small group of closely associated or experienced investors.



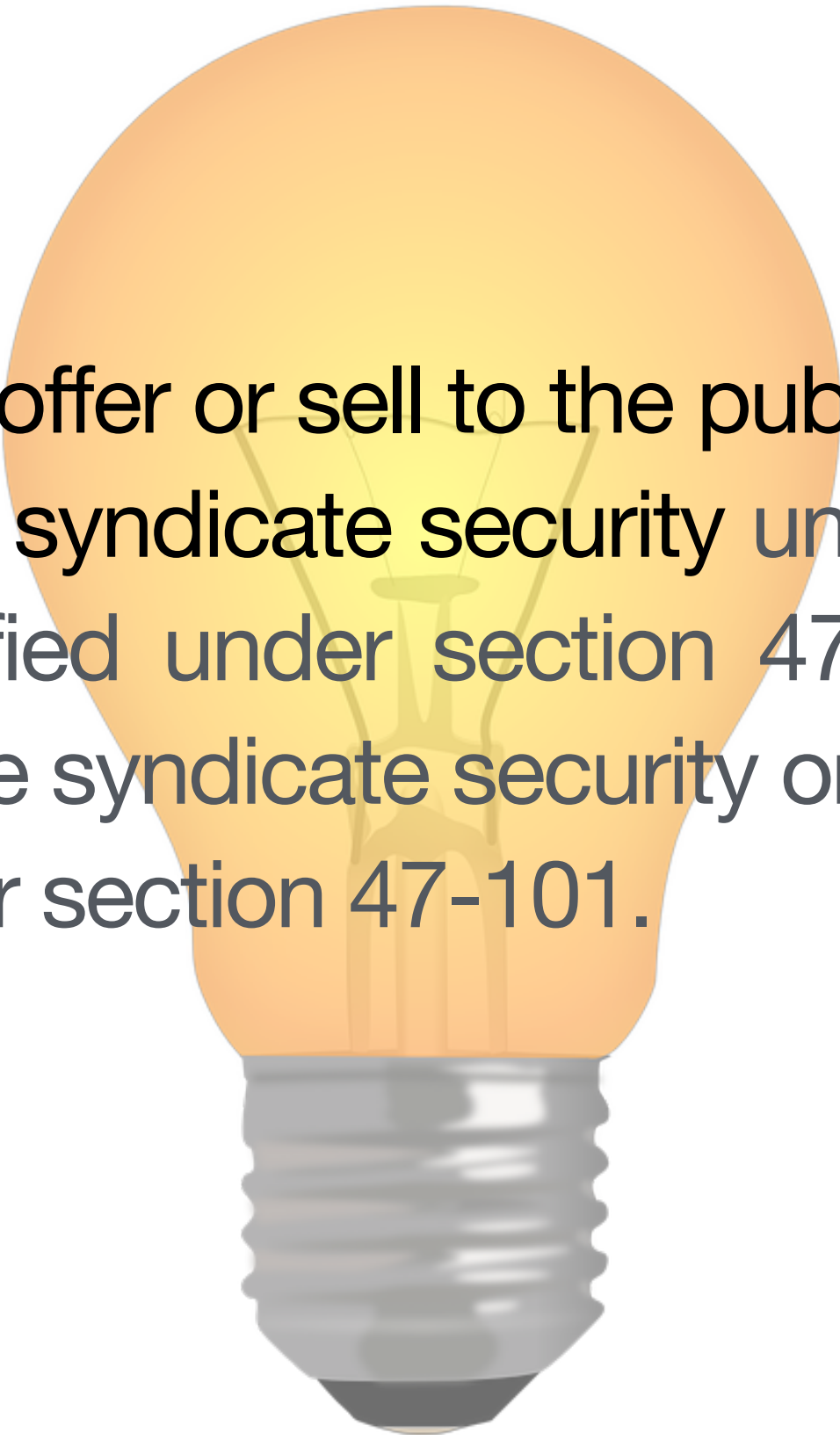
Unit 5

# Real Estate Investment Syndicate

**Public Syndication** involves a much larger group of investors (who may or may not be as knowledgeable about Real Estate as an investment).



Both federal and state laws must be followed.



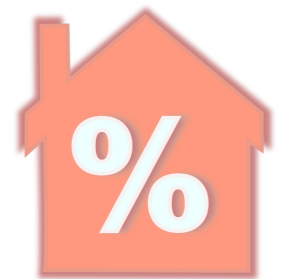
**No issuer** shall offer or sell to the public in this state any Real Estate syndicate security unless such sale has been qualified under section 47-92 or unless such Real Estate syndicate security or transaction is exempted under section 47-101.

# Real Estate Investment Trust (REIT)

## **A corporation, trust or association**

- (1) which is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (3) which (but for the provisions of this part) would be taxable as a domestic corporation;
- (4) which is neither
  - (A) a financial institution referred to in section 582 (c)(2), nor
  - (B) an insurance company to which subchapter L applies;
- (5) the beneficial ownership of which is held by 100 or more persons;
- (6) subject to the provisions of subsection (k), which is not closely held (as determined under subsection (h)); and
- (7) which meets the requirements of subsection (c).

**As Defined in 26 U.S. Code § 856**



Unit 5

# Real Estate Investment Trust (REIT)

- By investing in a REIT, an investor can take advantage of the **same tax benefits** as mutual fund investors do
- A REIT doesn't have to pay corporate tax (as long as 90% of its income is distributed to its shareholders)
- To qualify for a REIT, 75% of the trust's income must come from Real Estate

**As Defined in 26 U.S. Code § 856**



Unit 5

# Real Estate Investment Trust (REIT)

Investors purchase certificates in the trust which, in turn, invests in Real Estate or Mortgages.



**As Defined in 26 U.S. Code § 856**



Unit 5



# Real Estate Investment Trust (REIT)

Profits are distributed to all of the investors.



**As Defined in 26 U.S. Code § 856**



Unit 5

# Real Estate Mortgage Investment Conduit (REMIC)

## **Any entity—**

- (1) to which an election to be treated as a REMIC applies for the taxable year and all prior taxable years,
- (2) all of the interests in which are regular interests or residual interests,
- (3) which has 1 (and only 1) class of residual interests (and all distributions, if any, with respect to such interests are pro rata),
- (4) as of the close of the 3rd month beginning after the startup day and at all times thereafter, substantially all of the assets of which consist of qualified mortgages and permitted investments,
- (5) which has a taxable year which is a calendar year, and
- (6) with respect to which there are reasonable arrangements designed to ensure that—
  - (A) residual interests in such entity are not held by disqualified organizations (as defined in section 860E (e)(5)),

**As Defined in 26 U.S. Code § 860D**

# Real Estate Mortgage Investment Conduit (REMIC)

- Complex qualification, transfer and liquidation rules
- REMICs must pass Asset Test (after a start up period, almost all assets be qualified mortgages and permitted investments)
- Investor's interests may consist of only one or more classes of regular interests and a single class of residual interests

# Real Estate Mortgage Investment Conduit (REMIC)

- Holders of **regular interests** receive interests or similar payments based on either **fixed rate or variable rate**
- Holders of **residual interests** receive distributions on a **pro rate basis**



**Any Broker who holds a REMIC regular interest** can request tax information from the representative of the REMIC

Publication 938 - Who May Request Information

**The tax on capital** under Conn. Gen. Stat. §12-219 does not apply to REITs under Conn. Gen. Stat. §12-219(c).

IP 2010(21) - Tax on Net Capital

**REIT dividends are taxable in Connecticut** to the extent that they are included in federal gross income.

IP 2010(21) - Owners of REITs

# Section 1 Quiz

Name: \_\_\_\_\_

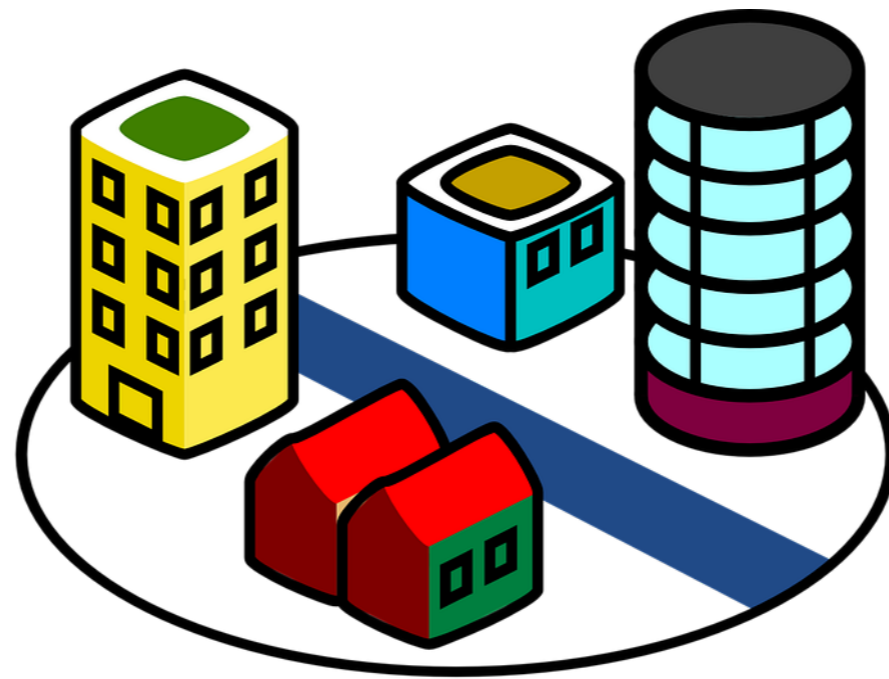
Answer the True / False questions below based on the information we covered in this Section.

1. Investing in Real Estate is good idea if you are looking for something that is highly liquid. \_\_\_\_\_
2. Property Location, Physical Appearance and Amenities factor into the amount of rent a property will bring in. \_\_\_\_\_
3. Lending institutions are very willing to lend money for unimproved land. \_\_\_\_\_
4. Lower Leverage results in higher risk. \_\_\_\_\_
5. Pyramiding is an effective way for investors to increase their holdings without investing any additional capital \_\_\_\_\_
6. Congress never change any of the tax advantages associated with owning investment Real Estate. \_\_\_\_\_
7. Interest received from installment sales is not considered taxable income. \_\_\_\_\_
8. Tax laws are complex and must me be followed. \_\_\_\_\_
9. A Real Estate brokers license is required to sell Real Estate syndicate securities. \_\_\_\_\_
10. Real Estate Syndicates can have less than 18 individuals. \_\_\_\_\_

# Section 1 Answer Key

1. False / page 11
2. True / Page 23
3. False / Page 20
4. False / Page 32
5. True / Page 34
6. False / Page 41
7. False / Page 55
8. True / Page 51
9. False / Page 61
10. False / Page 64

Created by Melvin Hubbard



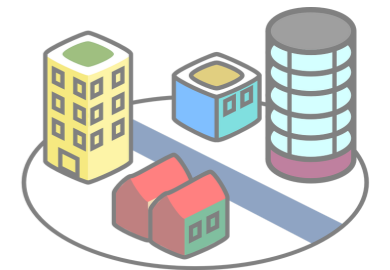
# Section 2

**Real Estate Investment Types**



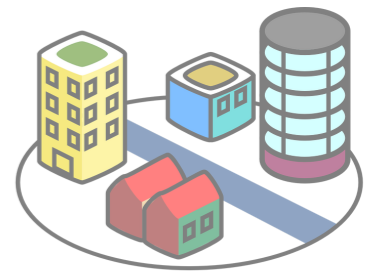
# Real Estate Investment Types

- **Raw Land**
- **Farm Investing**
- **Single Family Homes**
- **Duplex / Triplex / Quad**
- **Small Apartments**
- **Large Apartments**
- **Parking Lots**
- **Hotels/Motels**
- **Large/Small Commercial Office Space**
- **Notes**
- **Tax Liens**
- **Storage Units**
- **RV Parks**
- **Mobile Homes**
- **Commercial**
- **REITs**



Unit 1


# Investment Property Types



Unit 1

# Raw Land


**Raw land** is nothing more than **basic earth**.



Land on its own can be improved to add value.  
It can be **leased** or **rented** to **create cash flow**.  
Land can also be subdivided and sold for profit.

# Raw Land

**Raw land** is nothing more than **basic earth**.



Some investors **choose to buy** raw land with hopes (or plans) that someday the land will become much more valuable...

# Raw Land

**Raw land** is nothing more than **basic earth**.

...due to external developments like the construction of a freeway or from a development being built nearby.

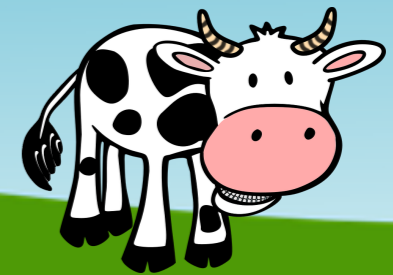


# Farm Investing



Investing in farming can seem like a strategic move.

# Farm Investing



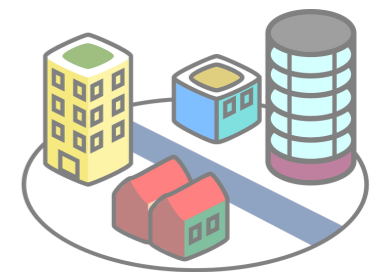
● Recession or not, people still have to eat!

# Farm Investing

For that reason, many investors regard agriculture and farming investments as being **recession-proof**.



The closest that an investor can get to owning a farm (without actually doing so) is by investing in farming-focused REITs.

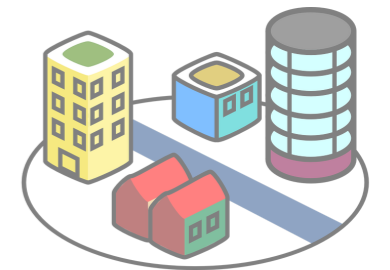




# Single Family Homes

Perhaps the most common investment for most first time investors is the **single family home**.

Single family homes are relatively **easy to rent, easy to sell, and easy to finance**. That said, in many areas, the rents derived from SFRs (single family rentals) **won't be enough to provide positive cash flow**.



Unit 1

# Multifamily Homes

**Small multifamily properties** (2-4 units) combine the financing and easy purchasing benefits of a single family home.



# Multifamily Homes

Purchased properly these can **cashflow** quite well.

There is often **less competition** than what you'd run across bidding on single family homes.

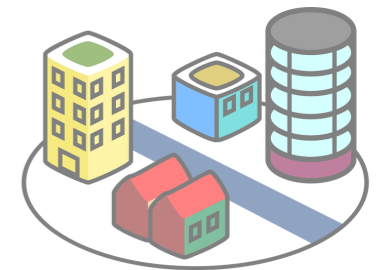
These properties can serve as both a solid investment as well as a personal residence for the smart investor.



# Multifamily Homes

Another perk of the small multifamily property is the ability to take advantage of "economies of scale," as only **one loan is needed** to secure the 2, 3, or 4 units in the property.

One of the things that makes these investments so appealing is that most banks look at small multifamily properties with four units or less with the same guidelines as a single family house, which can make qualifying for a loan much easier.



Unit 1

# Small Apartments



**Small apartment buildings** are made up of **between 5 and 50 units**. Though the line between small and large apartments is not set in stone, most investors typically draw the line between small and large apartment buildings at around 50 units.



Unit 1

# Small Apartments



These properties can be **more difficult to finance** than single family homes or 2-4 unit properties, as they rely on commercial lending standards instead of residential ones.

That said, these properties **often provide significant cash flow** for the investor who can deal with the more management-intensive nature of the properties.

# Small Apartments

Competition is generally seen on a lower scale for this property type, as they are too small for large, professional REITs to invest in but too large for most novice Real Estate Investors.

Instead of being priced based on comps, the **value** of these properties are based on the income they bring in.

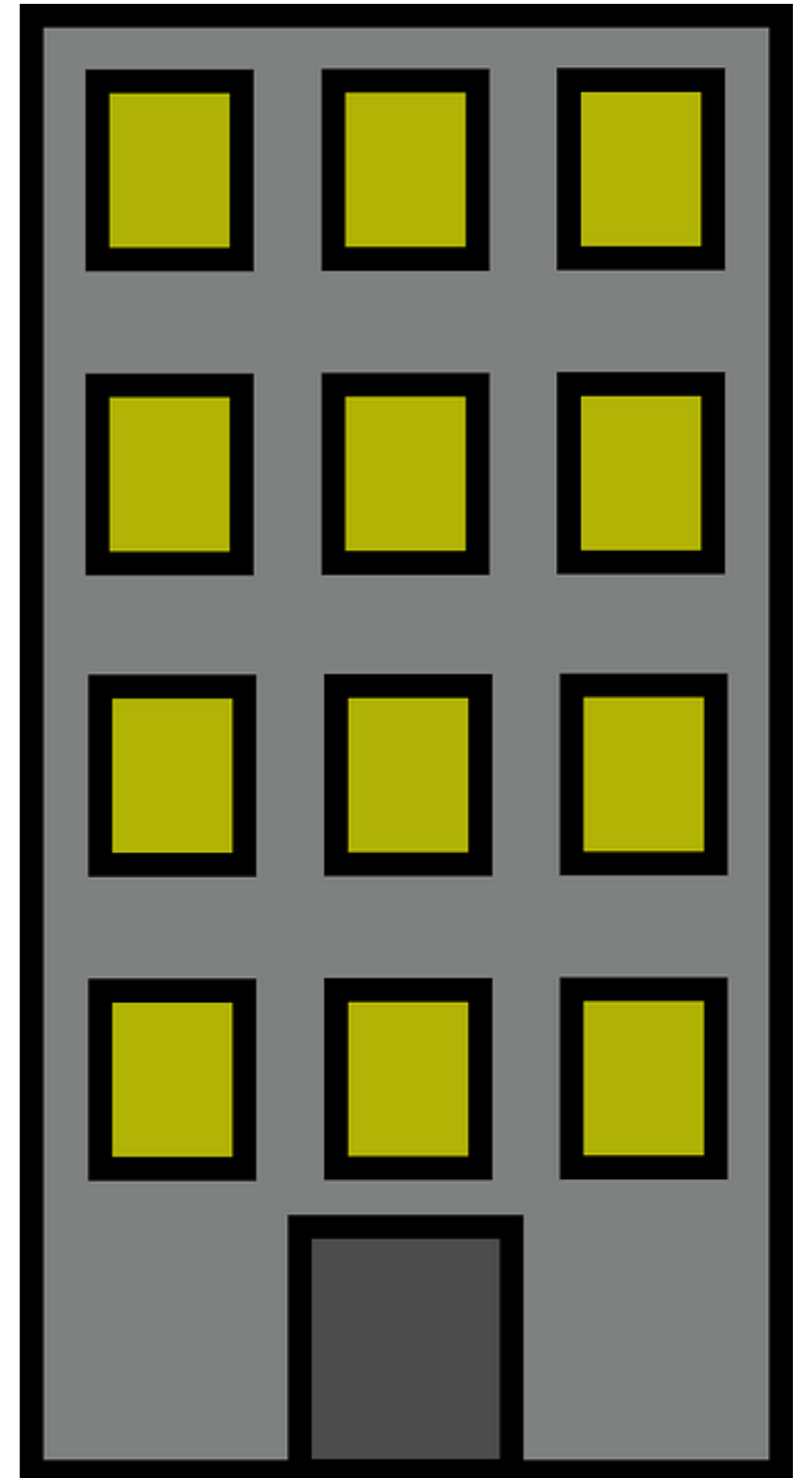
This **creates a huge opportunity** for adding value by increasing rent, decreasing expenses, and managing effectively.

These properties are a great place to utilize on-site managers who manage and perform maintenance **in exchange for free or decreased rent.**

# Large Apartments

This class of property refers to the large complexes you might see all across the country that often include pools, workout rooms, full time staff and high advertising budgets.

These properties can cost millions of dollars to purchase, but can produce stable returns with minimal personal involvement.

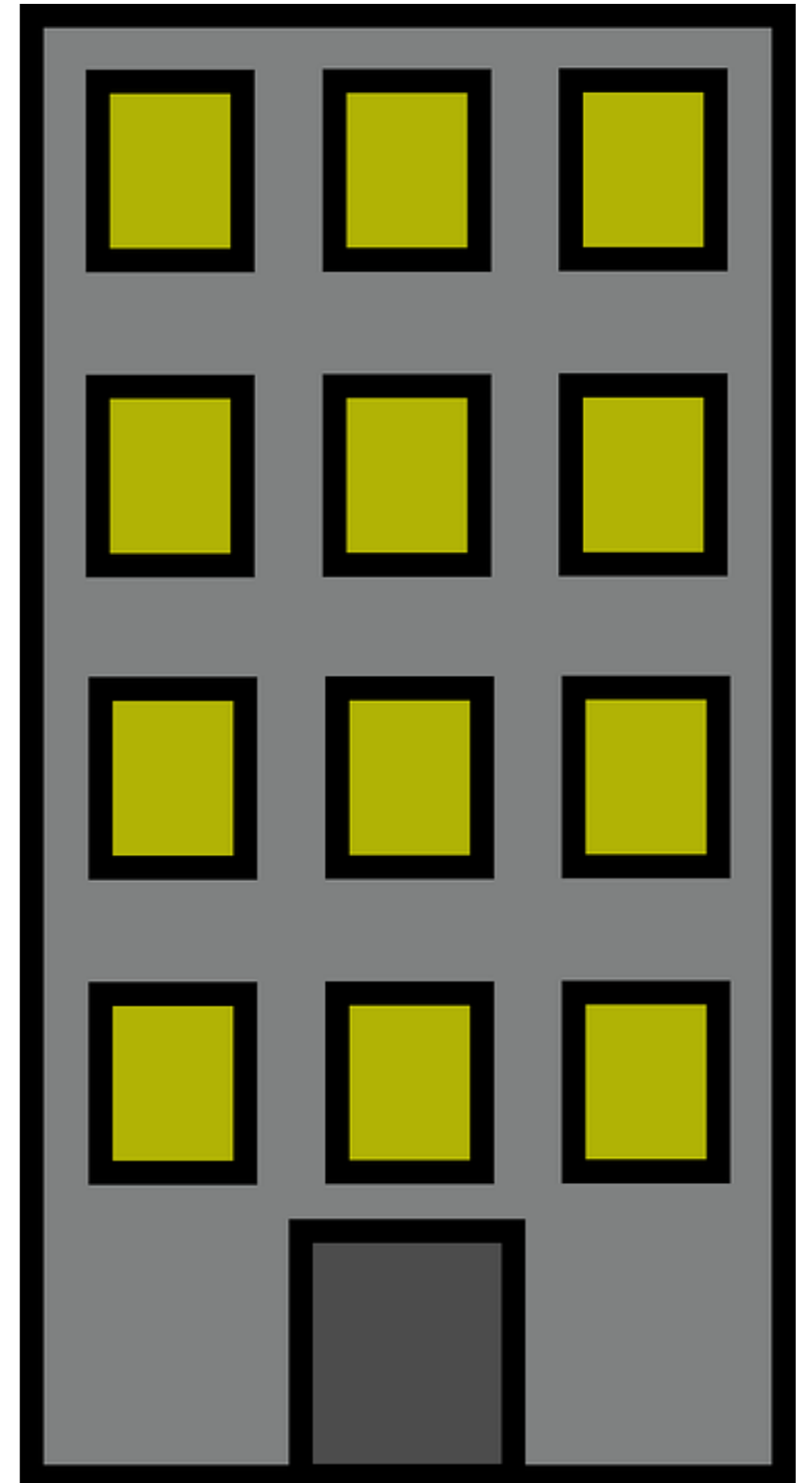




# Large Apartments

Many large apartments are owned by "syndications," which are small groups of investors who pool their resources.

Large apartments are not ideal investments for first time investors, unless you have an excess of capital available and good guidelines.

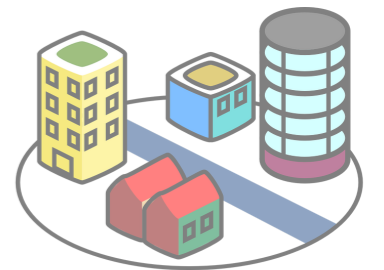


# REITs

REIT stands for a Real Estate Investment Trust.



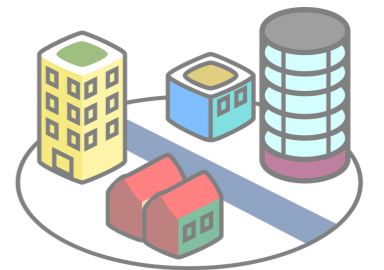
In the most simplistic definition, a REIT is to a Real Estate property as a mutual fund is to a stock.



# REITs



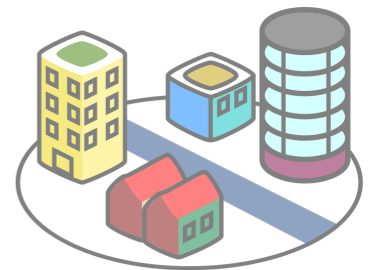
A large number of individuals pool their funds together, forming a REIT, and allow the REIT to purchase large Real Estate Investments (such as shopping malls, large apartment complexes, skyscrapers, or bulk amounts of single family homes). **The REIT then distributes profits to individual investors.**



# REITs

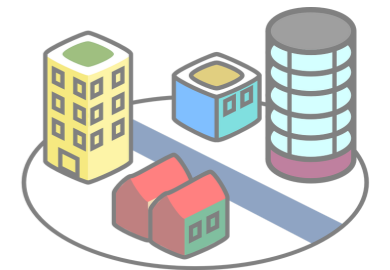


This is one of the **most hands-off approach** to investing in Real Estate. **Do not expect the returns found in hands-on investing.** You can buy shares in a REIT via your stock account. They often have a relatively high dividend payment.



# Commercial Real Estate

Commercial investments can **vary dramatically in size,** style, and purpose, but ultimately involve a property that is leased to a business.



Unit 1

# Commercial Real Estate

Some commercial investors rent buildings to **small** local businesses, while others rent **large** spaces to supermarkets or big box megastores.



Unit 1

# Commercial Real Estate

- Often provides **good cash flow** and consistent payments
- They may carry **much longer holding periods** during times of vacancies
- Commercial property **can often sit empty** for many months or years
- Investing in commercial Real Estate is not recommended for beginners (unless you are starting from a very solid financial position)

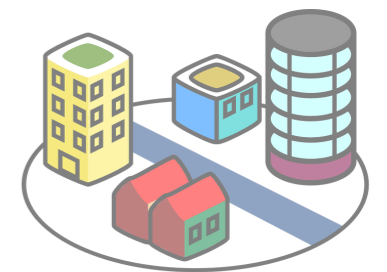


# Mobile Homes

You can start investing in mobile homes with **little money out of pocket.**



Whether it's a home in a mobile home park or on its own land, **many of the strategies used in other types of Real Estate Investing can be applied to mobile homes.**



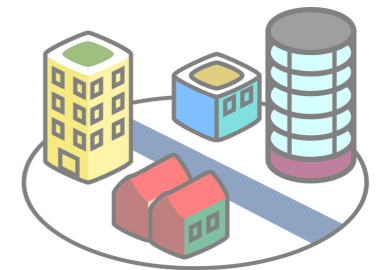
Unit 1



# RV Parks



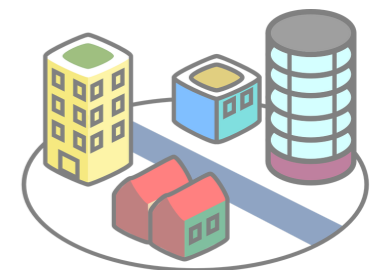
RV parks can have **good cash flow**, without most of the traditional headaches of being a landlord as an owner/operator of an RV park. **You don't own any housing or vehicles that need to be repaired.**



Unit 1

# RV Parks

- Every tenant is responsible for their own RV.
- Maintain the common areas (no specific way)
- Fees can be collected in advance
- Tenants can be removed on a day's notice if they cause trouble or don't pay
- Tenants vacationing or escaping winter are generally in a good mood (more often than apartment or house renters would be).



Unit 1

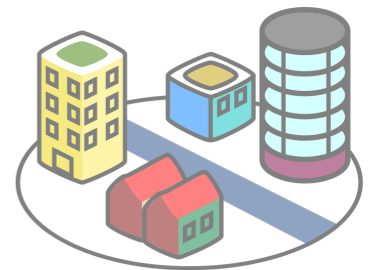
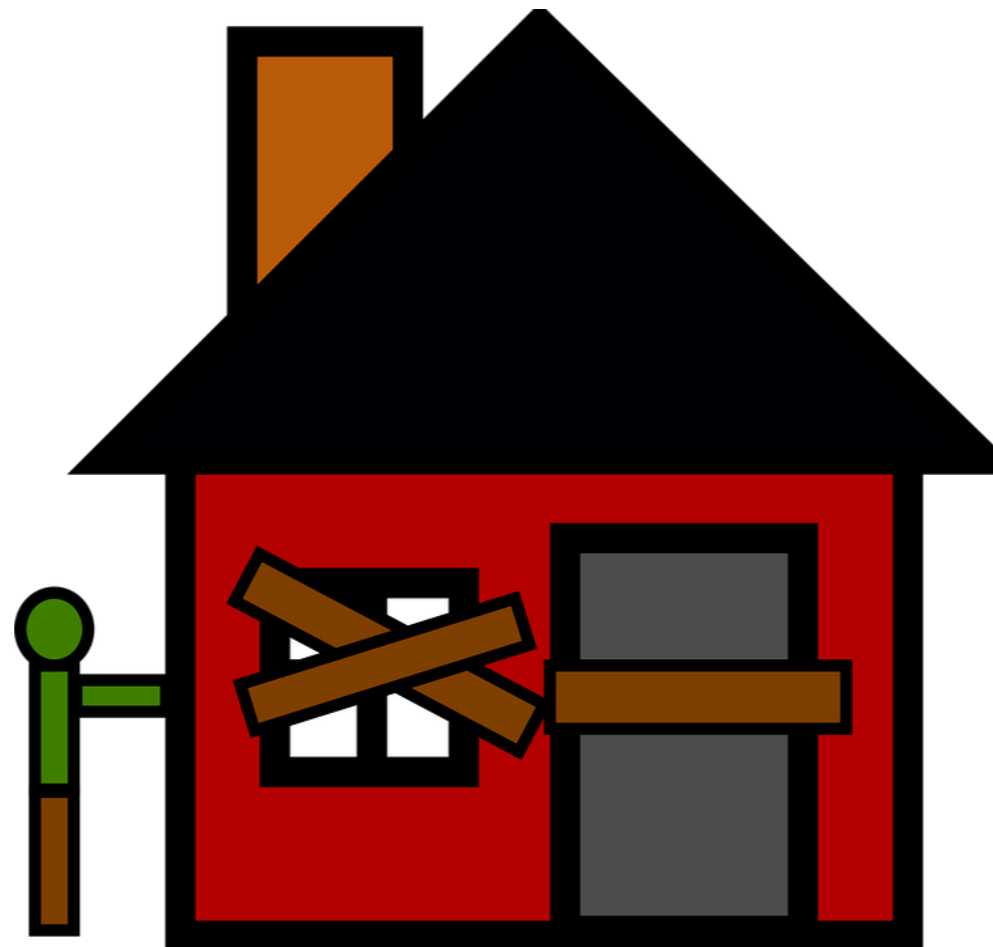
# Storage Units



- Typically offer **higher rates of return** on the investment
- Purchase with a **better cap rates** than apartment buildings
- You also do not have the traditional **tenant problems** that goes along with an apartment complex
- They have lower maintenance & operating expense ratios
- **Location is key** and competition is fierce in some areas

# Tax Liens

When homeowners don't pay their taxes, the government (local, state, or federal) can foreclose and resell the property to investors for the amount of taxes owed.

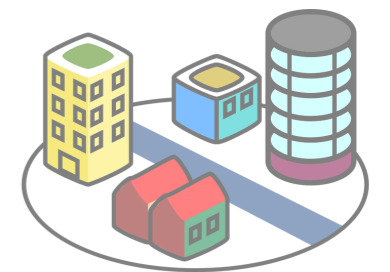
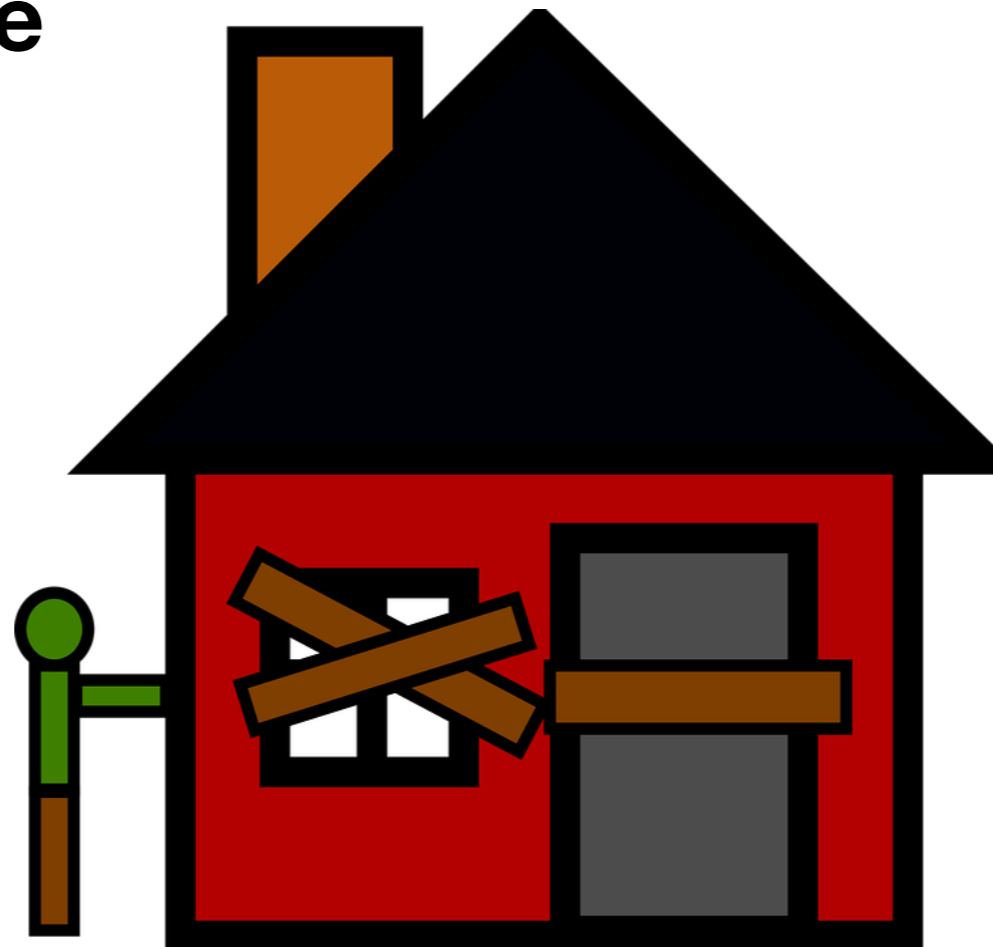


Unit 1

# Tax Liens

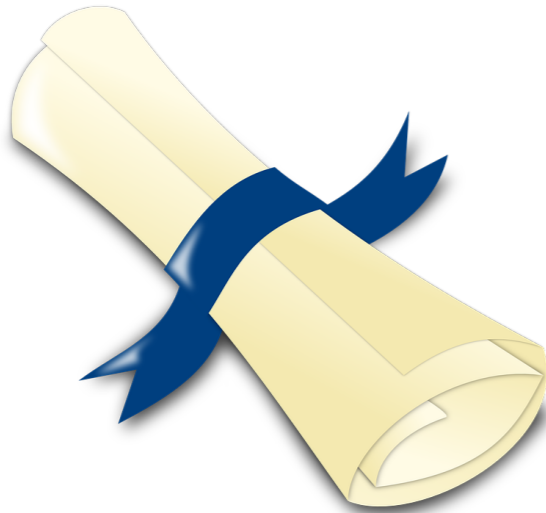
This can often mean **incredibly inexpensive properties**, but use due diligence and don't jump into this kind of investing **unprepared**.

**Tax lien sales are complicated transactions that require research, knowledge, and experience.**



Unit 1

# Notes



Investing in notes involves the buying and selling of paper mortgages. When a home is purchased with a loan, a “note” is created explaining the terms of the contract.

**Promissory Note Template**

## Promissory Note

**Amount:** \_\_\_\_\_ **Date:** \_\_\_\_\_  
**Place:** \_\_\_\_\_

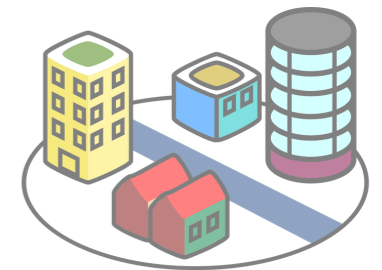
I Mr. ABC, make commitment to pay XYZ Company, the Sum of \$ \_\_\_\_\_.  
Repayment is to be made in the form of 200 equal payments at the interest rate of 7.2% of \$ \_\_\_\_\_ payable on the 10th of each month, beginning 10/01/2011 until the total amount of debt is paid.

**IN WITNESS WHEREOF**, I set my hand under seal this \_\_\_\_ [the day] of \_\_\_\_\_ [month], 20\_\_ and I acknowledge receipt of a completed copy of this instrument.

\_\_\_\_\_  
*Sign: [Signature of borrower]*

\_\_\_\_\_  
*Name & Address: [Party name]*

**Notary Public - SEAL**  
**My Commission Expire** \_\_\_\_/\_\_\_\_/\_\_\_\_



Unit 1

# Notes

For example:

An apartment owner decides to sell his property for one million dollars. He offers to carry the full note (thus allowing the new buyer to avoid using a bank loan).

The new buyer will make payments of 8% per year for thirty years until the full one million dollars is paid off. If that owner decided they no longer wanted to be involved, he might choose to sell that mortgage to a "note buyer."



# Notes

Just like any other Real Estate Investment, many times a note will be sold for a discount when the seller is motivated to sell.

A note buyer will then begin **collecting the monthly mortgage payments** and will have the right to keep the note or sell it again in the future.

**Promissory Note Template**

## Promissory Note

**Amount:** \_\_\_\_\_ **Date:** \_\_\_\_\_  
**Place:** \_\_\_\_\_

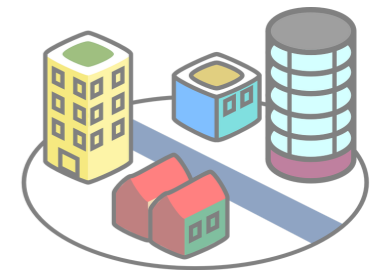
I Mr. ABC, make commitment to pay XYZ Company, the Sum of \$ \_\_\_\_\_.  
Repayment is to be made in the form of 200 equal payments at the interest rate of 7.2% of \$ \_\_\_\_\_ payable on the 10th of each month, beginning 10/01/2011 until the total amount of debt is paid.

**IN WITNESS WHEREOF**, I set my hand under seal this \_\_\_\_ [the day] of \_\_\_\_\_ [month], 20\_\_\_\_ and I acknowledge receipt of a completed copy of this instrument.

\_\_\_\_\_  
**Sign:** [Signature of borrower]

\_\_\_\_\_  
**Name & Address:** [Party name]

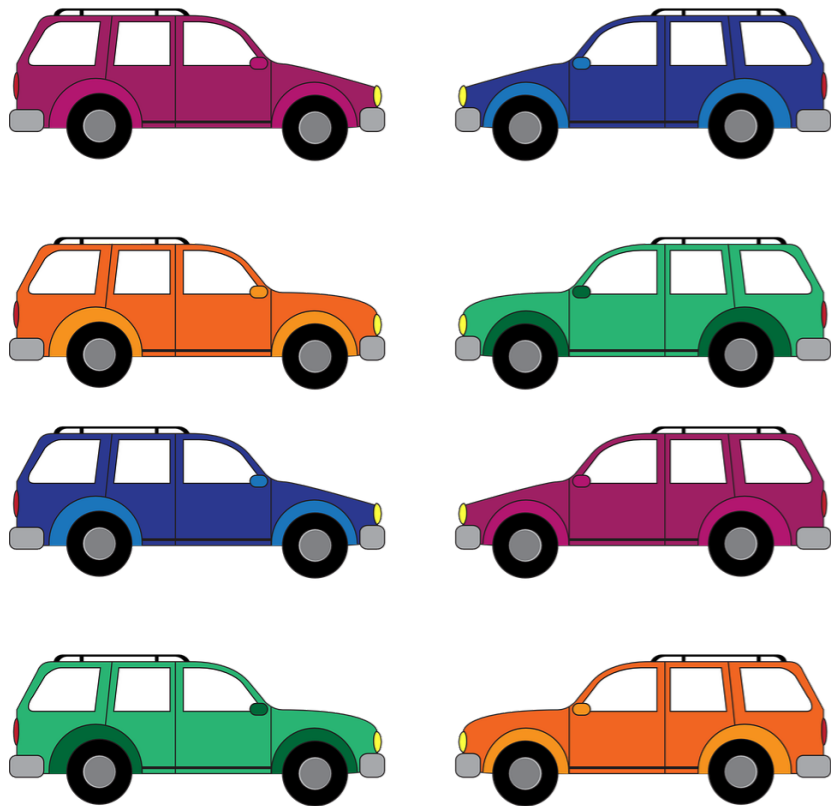
**Notary Public - SEAL**  
**My Commission Expire** \_\_\_\_/\_\_\_\_/\_\_\_\_



Unit 1

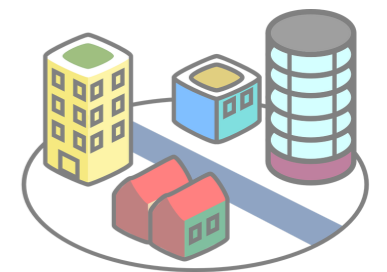


# Parking Lots



Investing in Parking lots can be lucrative depending on the following factors:

- Location (crucial to profitability of the lot)
- Number of parking levels
- Type of patron using the lot
- Amount of Activity  
(Daily, Monthly, Yearly)



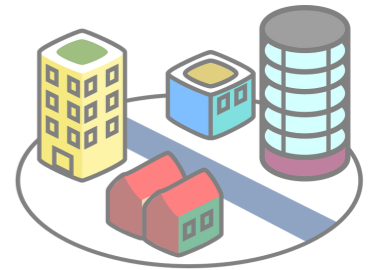
# Parking Lots



Approved Ticketing Systems -  
(more functions = more expensive)

Area Attractions that directly impact  
patronage of the lot:

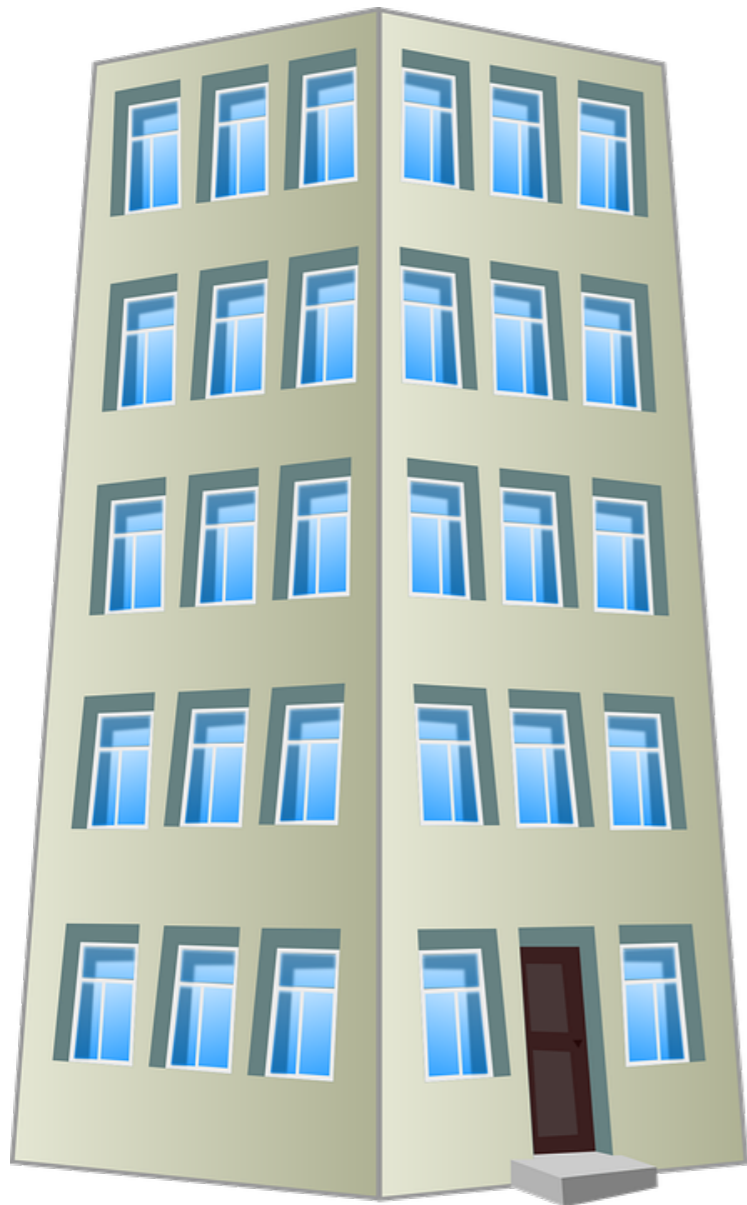
- Office Buildings
- Movie Theaters
- Sports Stadiums
- Metro Areas
- Nightlife
- Amusement Parks



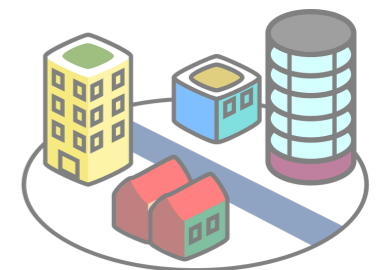
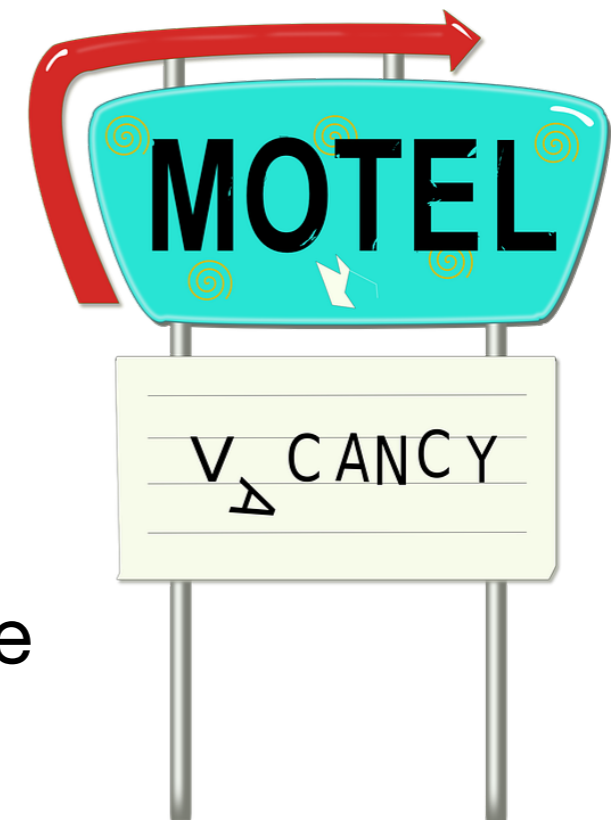
Unit 1

# Hotels and Motels

Investing in hotel rooms is an excellent and profitable alternative to the traditional buy and hold investment...



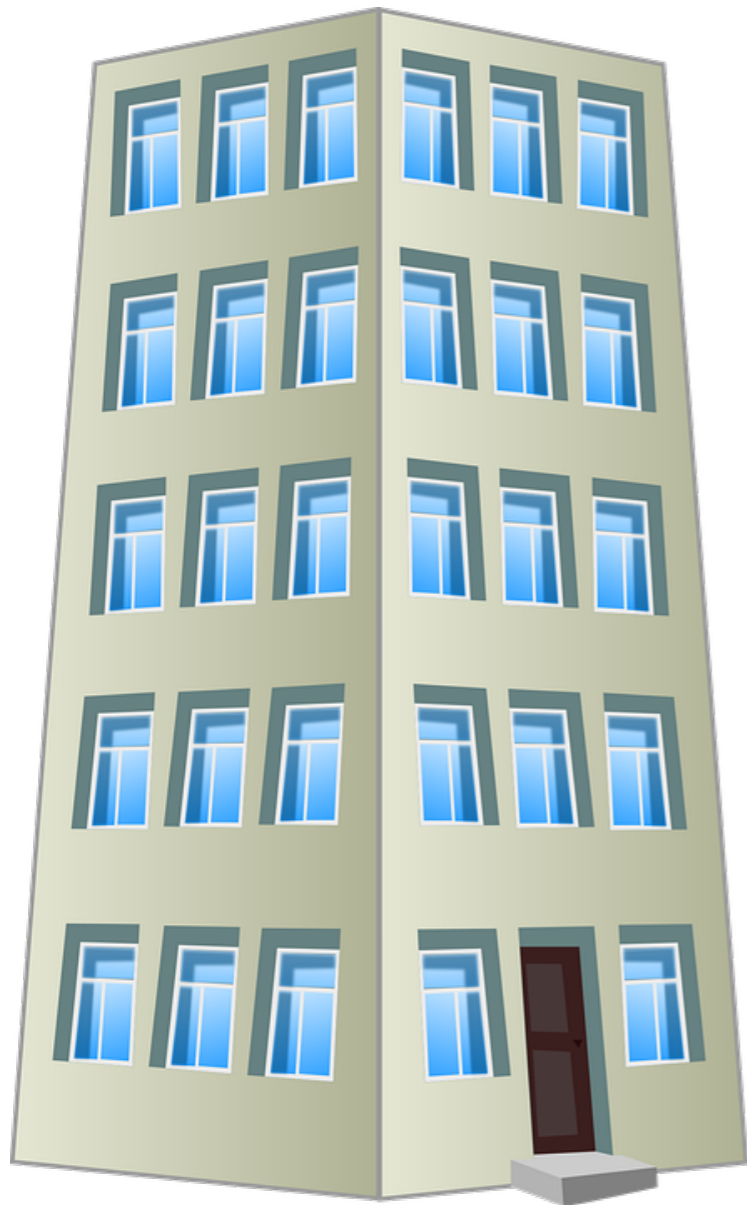
allowing property investors to invest in the commercial sector at an affordable and accessible level and providing diversification for their property portfolio.



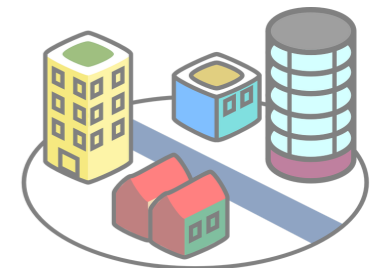
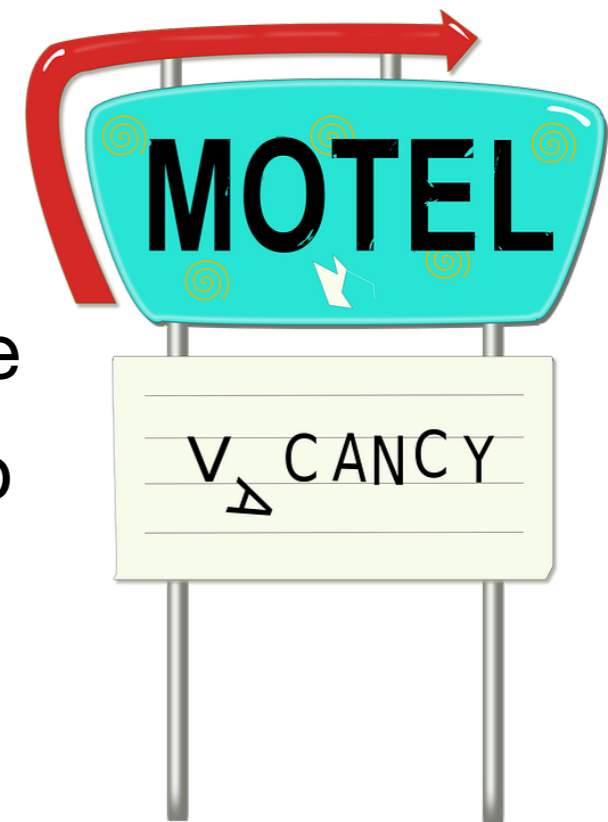
Unit 1

# Hotels and Motels

Hotel rooms typically are of a leasehold tenure, similar to a residential apartment.



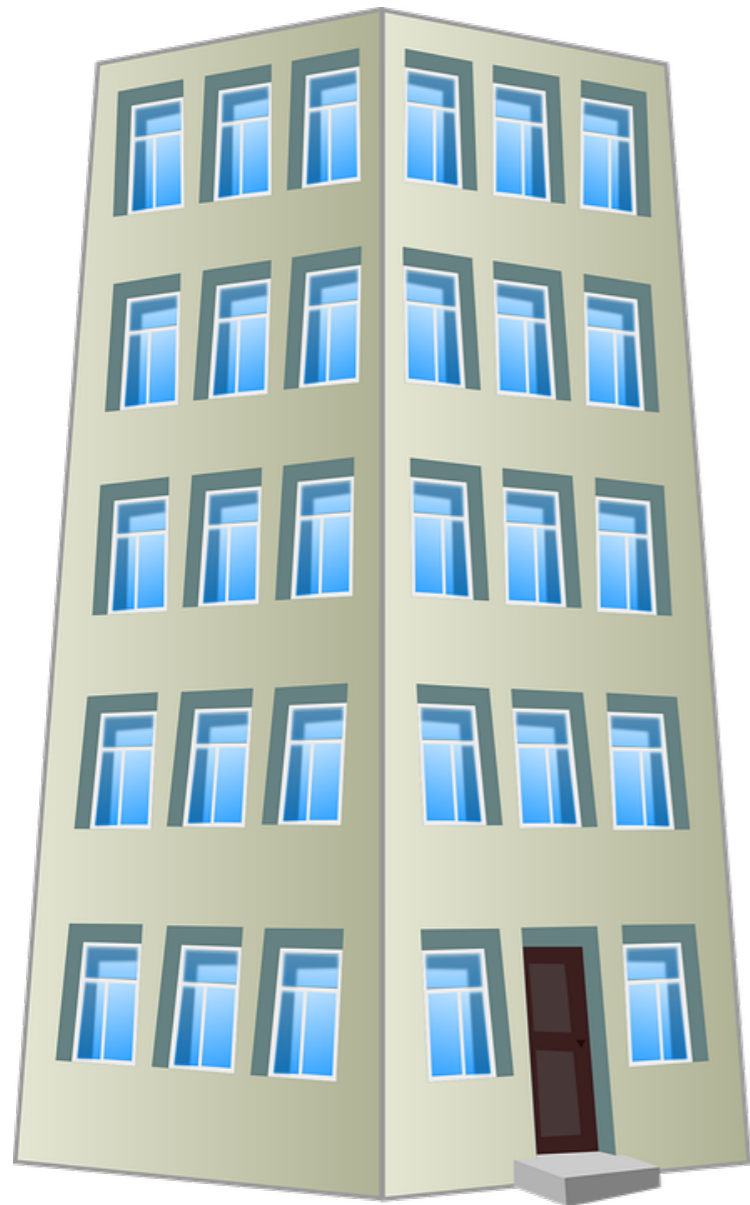
Therefore, investors have the security of ownership of the property, as they would from a traditional buy-to-let investment property.



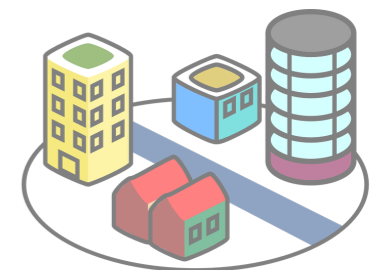
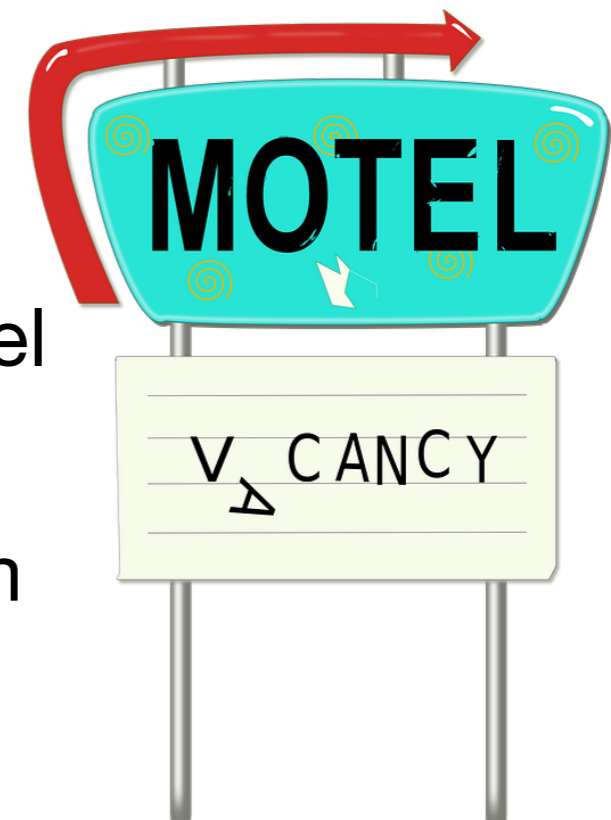
Unit 1

# Hotels and Motels

Hotel rooms are fully managed and maintained by professional and experienced hotel operators (often under well-known global brands).



Investors receive either **room revenue split** between investor and hotel operator or a **split of the net income accrued** from all guest expenditures attributed to the room, including food and beverage, conferencing and entertainment.



Unit 1

# Hotels and Motels

- Hotel operator is incentivized to maximize occupancy and room rates, benefiting both operator and investor
- Rooms are sold **fully-furnished** and with replacements
- Hotel operator usually responsible for soft furnishings
- Majority of hotels operate **a reservation system** ensuring rooms are rotated, providing even occupancy for fair distribution of income to hotel room investors, whilst managing the level of wear and tear of furniture, fixtures and fittings within the room.

## Section 2 Quiz

Name: \_\_\_\_\_

Answer the True / False questions below based on the information we covered in this Section.

1. Raw Land cannot be subdivided.\_\_\_\_\_
2. Investors consider Farm Land recession proof.\_\_\_\_\_
3. Single Family Homes are the best investment for first time investors everywhere.\_\_\_\_\_
4. Multifamily homes are harder to qualify for than Single Family homes.\_\_\_\_\_
5. Small apartments have anywhere from 1 - 50 units.\_\_\_\_\_
6. Large Apartments are ideal for more experienced investors.\_\_\_\_\_
7. Commercial properties carry with them much longer holding periods during times of vacancies.\_\_\_\_\_
8. Investing in Mobile Homes is more expensive than Single Family Homes.\_\_\_\_\_
9. Investing in notes involves the buying and selling of paper mortgages.\_\_\_\_\_
- 10.If you invest in a hotel you have to manage it.\_\_\_\_\_

## Section 2 Answer Key

1. False / page 94
2. True / Page 96
3. False / Page 99
4. False / Page 101
5. False / Page 106
6. True / Page 108
7. True / Page 112
8. False / Page 113
9. True / Page 119
10. False / Page 123

Created by Melvin Hubbard





# Section 3

**Real Estate Investment Financing**

# Real Estate Investment Financing Overview

## 1. All Cash!

- **Cash is King**

## 2. Traditional Financing

- **Finance Basics**
- **Conventional Loans**
- **FHA Loans**
- **203K Loans**

## 3. Alternative Methods of Financing Investments

- **Commercial Loans**
- **Private Money**
- **Hard Money**
- **Home Equity Loans & Lines of Credit**
- **Portfolio Loans**

- **Owner Financing**

- **Partnerships**

## 4. Understanding Types of Investor Financing

- **Conventional Mortgages**

- **FHA Loans**

- **203K Loans**

- **Commercial Loans**

- **Private Money**

- **Hard Money**

- **Home Equity Loans & Lines of Credit**

- **Portfolio Loans**

- **Owner Financing**

- **Partnerships**

# Why You Need to Understand Investment Financing

- Financing is a vital aspect of an investor's plan
- Understanding the way financing effects an investors plan is a vital skill for a Real Estate salesperson to possess
- Identifying properties that will be ideal for your client, based on the type of financing attained is a VERY valuable talent

The goal is to assist Real Estate Salespersons become more savvy of what an investor is looking for, based on the type of financing they have secured for their investment.

# All Cash!



Unit 1

# Cash is KING!

- Approximately 24% of U.S. investors use 100% of their own cash to finance their Real Estate Investments
- This is the easiest form of financing
- There are typically no complications



# Cash is KING!



- For most investors, **all cash** is not an option
- **Return** on all cash investments will not be the same as when leveraged



# Cash is KING!

## ALL Cash vs. Financing



### Investor 1

\$100,000 to invest

1 House = \$100,000

Rents for \$1,000

per Month

\$12,000 per year

\$12,000 = 12% ROI

### Investor 2

\$100,000 to invest

20% down payment on 5 houses listed for \$100,000

\$80,000 mortgage on all 5 houses

Approx. \$300 each month per house

\$18,000 per year

\$18,000 = 18% ROI 50% better



Unit 1

# Traditional Financing



Unit 2



# Finance Basics

Approximately 24% of U.S. investors use 100% of their own cash to finance their Real Estate Investments.

Being able to identify the type of deal based on the financing is a invaluable skill.

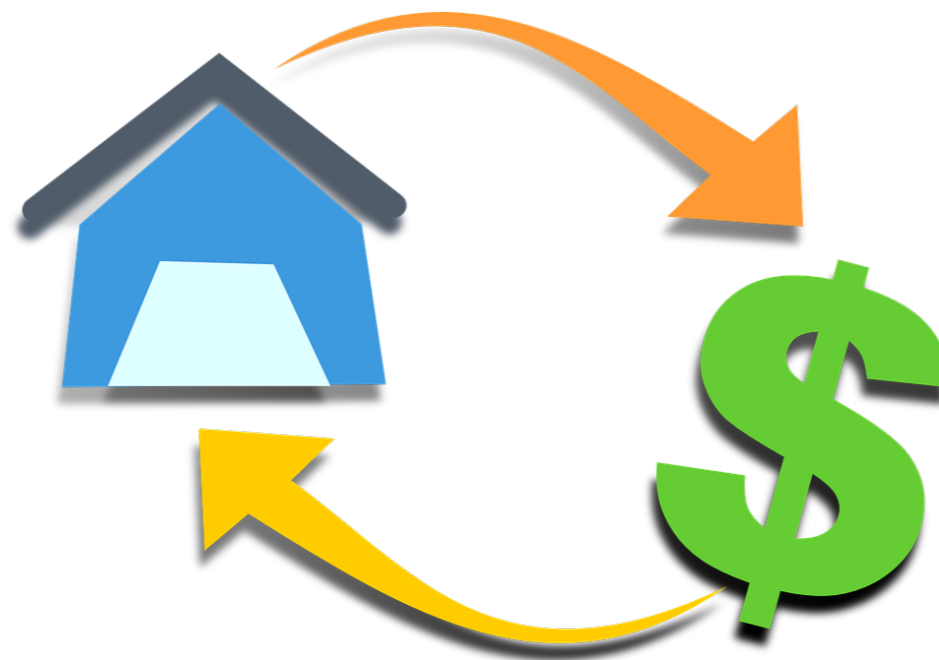


There are typically no complications with this method.

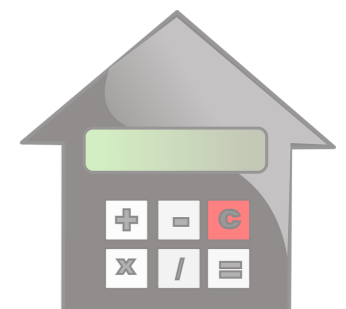


# Finance Basics

Understanding the basic differences between financing for residential clients and financing for investing clients is VERY important. This is the most important aspect of the deal for your client. **It's the easiest form of financing.**



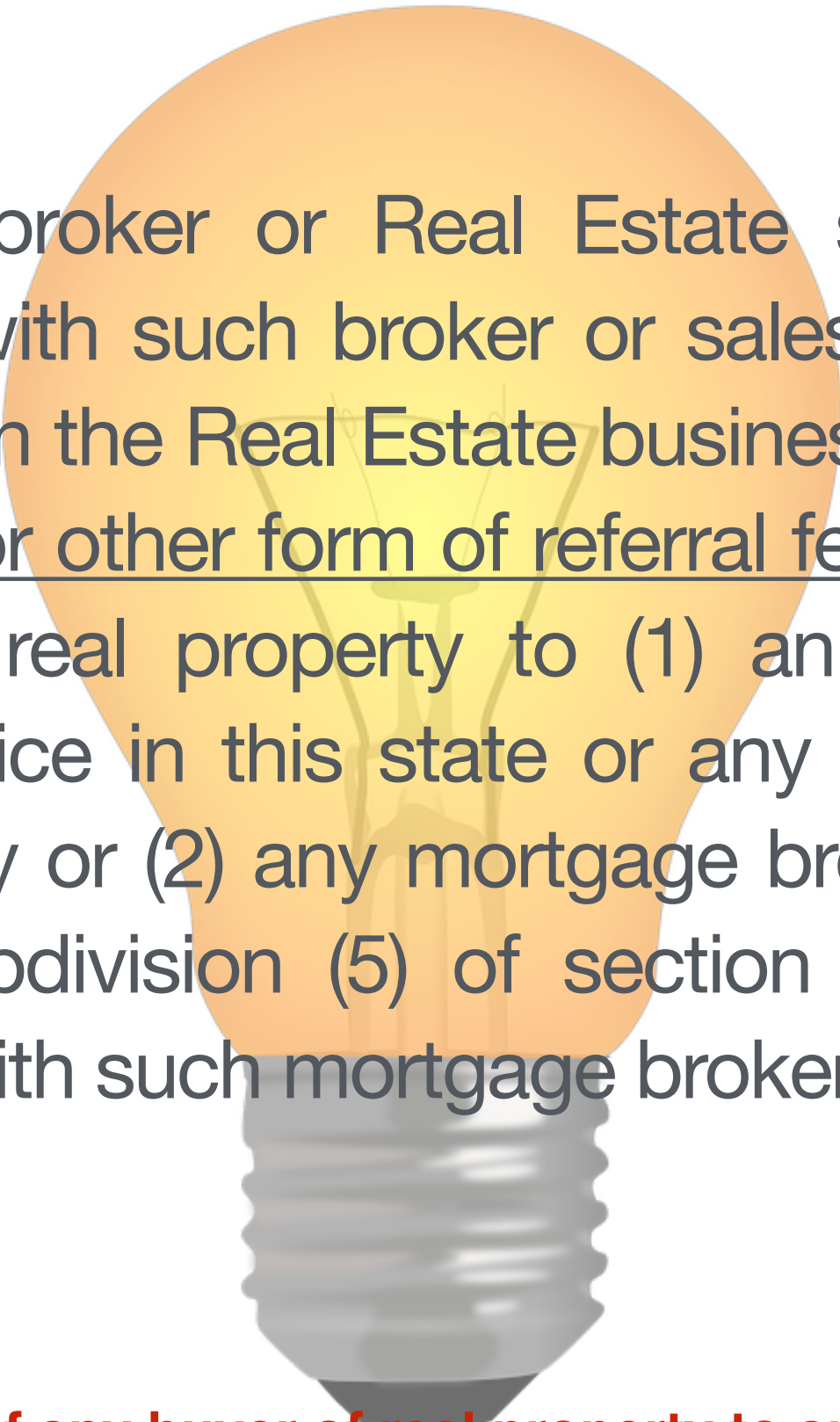
There are typically no complications with this method.



Unit 3

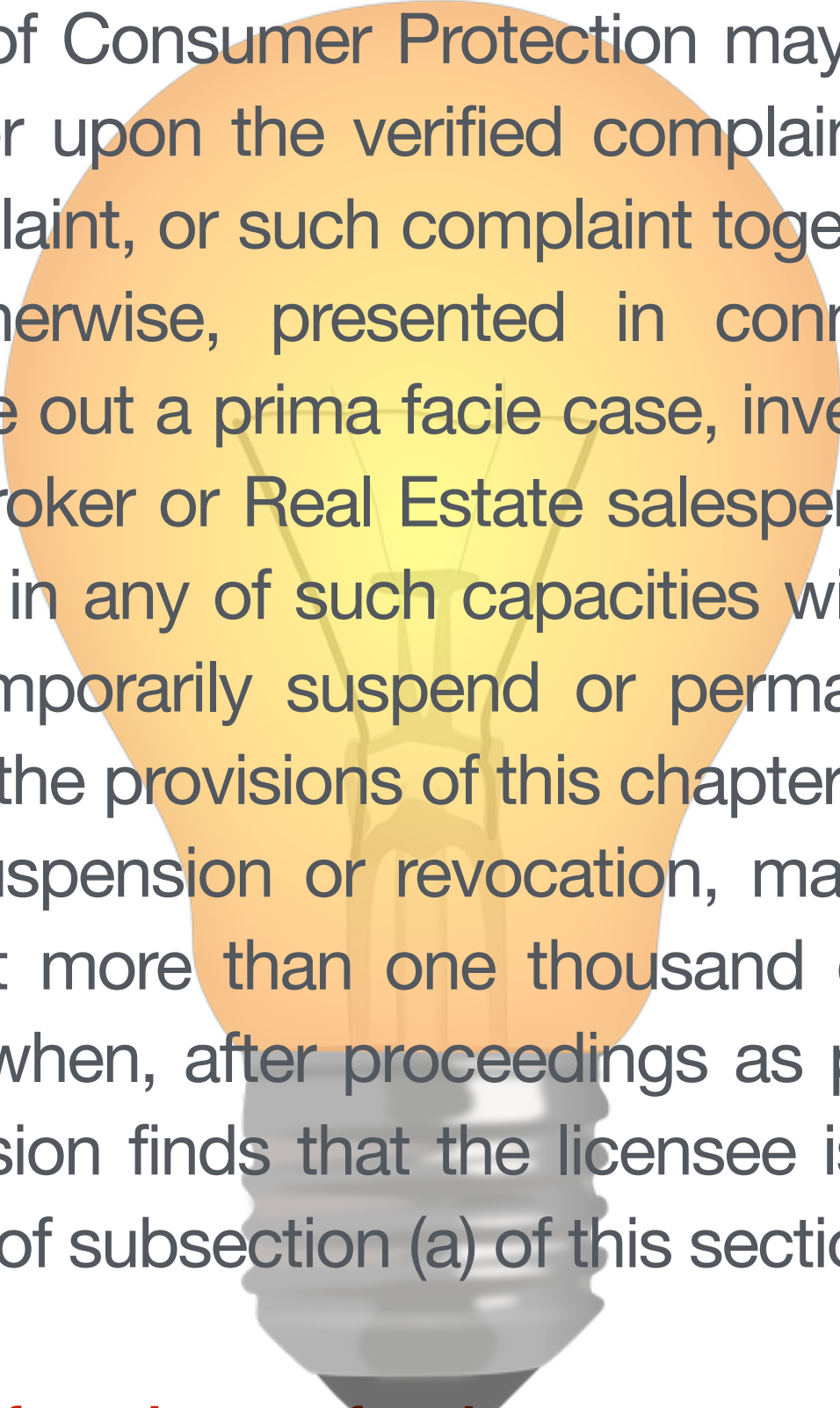
# Finance Basics

<b>Mortgage Companies</b>	<b>Traditional Banks</b>
Access to more loan products	More conservative
More costs or fees	Better Rates
Higher rates	Confidence in bank
Lower credit cores accepted	Don't charge fees or points in some circumstances
More flexibility for borrower	More critical of credit score



**No** Real Estate broker or Real Estate salesperson, no person affiliated with such broker or salesperson, and no person engaging in the Real Estate business may receive a fee, commission or other form of referral fee for the referral of any buyer of real property to (1) an attorney-at-law admitted to practice in this state or any person affiliated with such attorney or (2) any mortgage broker, any lender, as defined in subdivision (5) of section 49-31d, or any person affiliated with such mortgage broker or lender.

**Sec. 20-320a. Referral of any buyer of real property to an attorney or mortgage broker prohibited, when. Suspension or revocation of licenses. Fines.**



(b) The Department of Consumer Protection may, upon the request of the commission or upon the verified complaint in writing of any person, if such complaint, or such complaint together with evidence, documentary or otherwise, presented in connection with such complaint, shall make out a prima facie case, investigate the actions of any Real Estate broker or Real Estate salesperson or any person who assumes to act in any of such capacities within this state. The commission may temporarily suspend or permanently revoke any license issued under the provisions of this chapter, and, in addition to or in lieu of such suspension or revocation, may, in its discretion, impose a fine of not more than one thousand dollars for the first offense at any time when, after proceedings as provided in section 20-321, the commission finds that the licensee is guilty of violating any of the provisions of subsection (a) of this section.

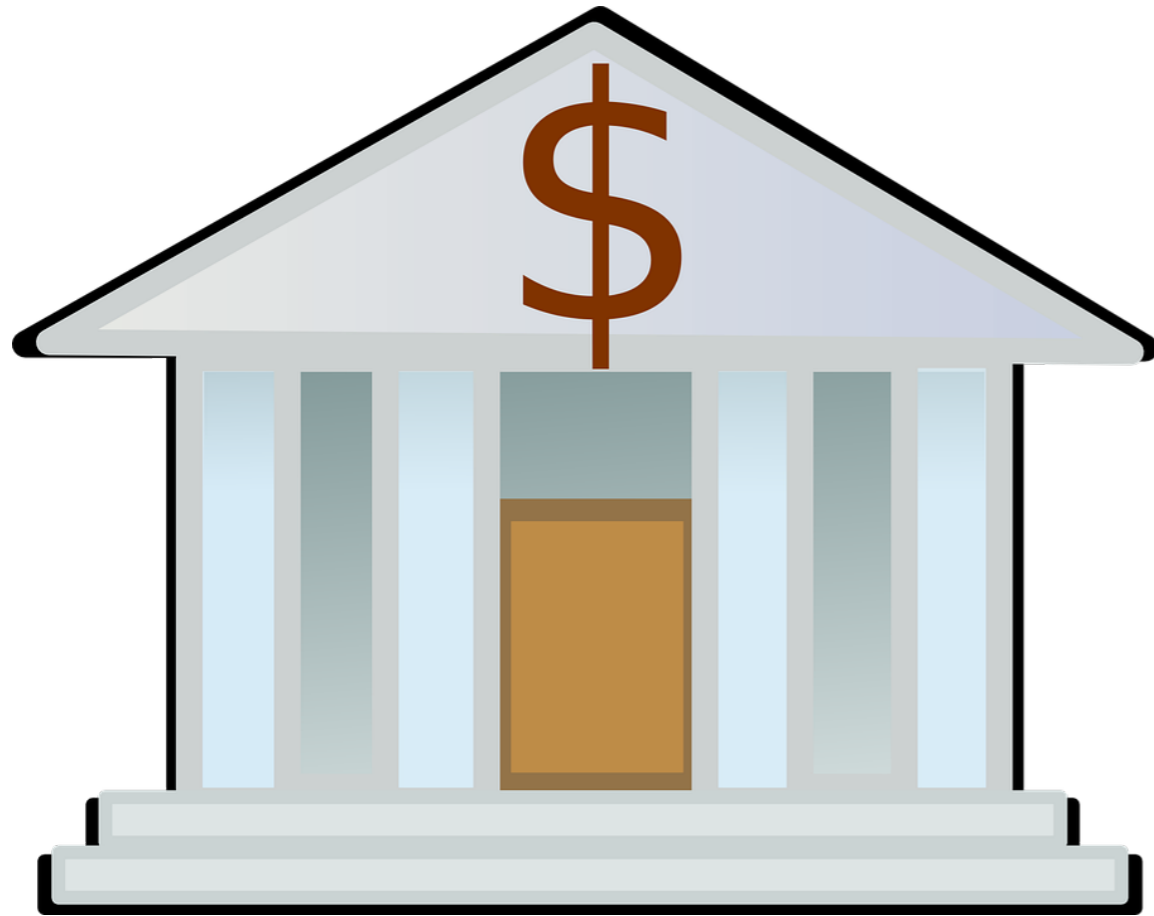
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# Conventional Loans

- Most of your investors will be financing their investments with a cash down payment and conventional mortgage
- **Conventional mortgages** are not government-backed
- Viewed as more secure because their LTV ratios are the lowest



# Conventional Loans



- **For Owner-occupied borrowers** the down payment is usually 5% - 10% down
- **For Investors** the down payment is between 25-35% depending on the lender
- **Private Mortgage Insurance (PMI)** is not required

# FHA Loans

- Federal Housing Administration guaranteed loans
- ONLY for homeowner that are going to live in the property
- FHA loans can not be used to purchase a pure investment property
- Lending standards are more lenient



Unit 2



# FHA Loans

- Down payment for a FHA loan can be as low as 3.5%
- Helps get started much sooner because it doesn't require the 20%
- Private Mortgage Insurance (PMI) is **required**



Unit 2

# FHA Loans

## Mortgage Insurance Premium (MIP)

- The FHA requires Mortgage Insurance Premium on their loans
- It is **based on** their up front payment
- Borrowers who offer a down payment of 5% or higher **must pay 1.7** of the outstanding balance annually
- This is **due within 10 calendar days** of the mortgage



# FHA Loans

Pros	Cons
Smaller down payment	Mortgage insurance premium
Lower credit scores are accepted	Loan limits
No prepayment penalty	Must use an FHA-approved lender
Potentially covered closing costs	Minimum Property Standards



(a) **A Real Estate broker or Real Estate salesperson licensed under this chapter** shall not influence residential Real Estate appraisals. For the purposes of this section, "influence residential Real Estate appraisals" includes, but is not limited to, refusal or intentional failure to refer a homebuyer, or encouraging other Real Estate brokers or Real Estate salespersons not to refer a homebuyer, to a mortgage broker, as defined in section 36a-760, or a lender, as defined in section 36a-760, based solely on the fact that the mortgage broker or lender uses an appraiser who has provided an appraisal reflecting a fair market value estimate that was less than the sale contract price.

**Sec. 20-320b. Prohibition against influencing Real Estate appraisals. Violation, penalty.**

# 203K Loans

- Used to finance construction of improvements
- ONLY for homeowner that are going to live in the property
- Before each payment the lender inspects the work
- Funds are disbursed during construction also known as draws



Unit 2

# 203K Loans

- Draws are made to the general contractor the owner
- The general contractor must provide adequate waivers that release all mechanics' liens rights for the work
- Private Mortgage Insurance (PMI) is required



Unit 2

# 203K Loans

Pros	Cons
One mortgage, one payment, tax deductible	Many lenders do not understand the process
Finance desired home improvements	Only eligible for primary residences
Replace missing appliances like a furnace	More paperwork involved than other mortgages
Makes a house eligible for FHA financing before the work is done	Contractors must be vetted by lender



# Alternative Methods of Financing



Unit 3



# Finance Basics

**This type of financing is only for commercial properties.** Commercial properties usually have **higher interest rates and fees** with shorter terms and different qualifying standards.



The income of the borrower is not valued highly in terms of qualifying.



Unit 3

# Finance Basics

- Qualified based on several factors (one of the main ones being Net Operating Income or **NOI**)
- Commercial lenders **often extend a business line of credit** to finance flips or other investments
- Private Mortgage Insurance (PMI) is not required



Unit 3

# Commercial Loans

Pros	Cons
Normally offer the lowest mortgage rates on the market	Rigid down payment, income verification and credit score requirements
Traditional loan qualification guidelines lower a borrower's risk of default	Won't lend for certain property types
Loans can be long-term, spread out over 20 years or more	Lengthy approval process, with money taking as long as 90 days to be secured
Commercial loans can be used for very large sums	High pre-payment penalty fees



# Private Money

- **Not** a professional lender
- Usually looking to realize **higher returns**
- Usually has **fewer fees**
- Points and term lengths **can be easy** to negotiate
- Investment is secured by a promissory note or mortgage on the property



# Private Money



The **interest rates and specified period of time** are usually established up front.

A **private lender** typically does not receive any equity or stake in cash flow.



# Private Money



Private money is generally financed by one investor.

Private money is used when there are **multiple exit strategies.**

A private lender can be:

- A **friend**
- A **family member**
- An **associate**
- A **local organization**



# Private Money

Pros	Cons
Funding can be secured rather quickly	Significantly higher risk
Interest rate not tied to London Interbank Offered Rate (Libor) or other index	Lack of formality and rigor
No background or credit check required	Loss of control
Flexible terms	End of a relationship?



# Hard Money

- Private business/individual that loans money for the purpose of investing in Real Estate
- Loan based primarily on the value of the property
- Shorter term lengths
- Higher than normal interest rates and loan points
- No income verification or credit reference required
- Deal can be funded in within days





# Hard Money

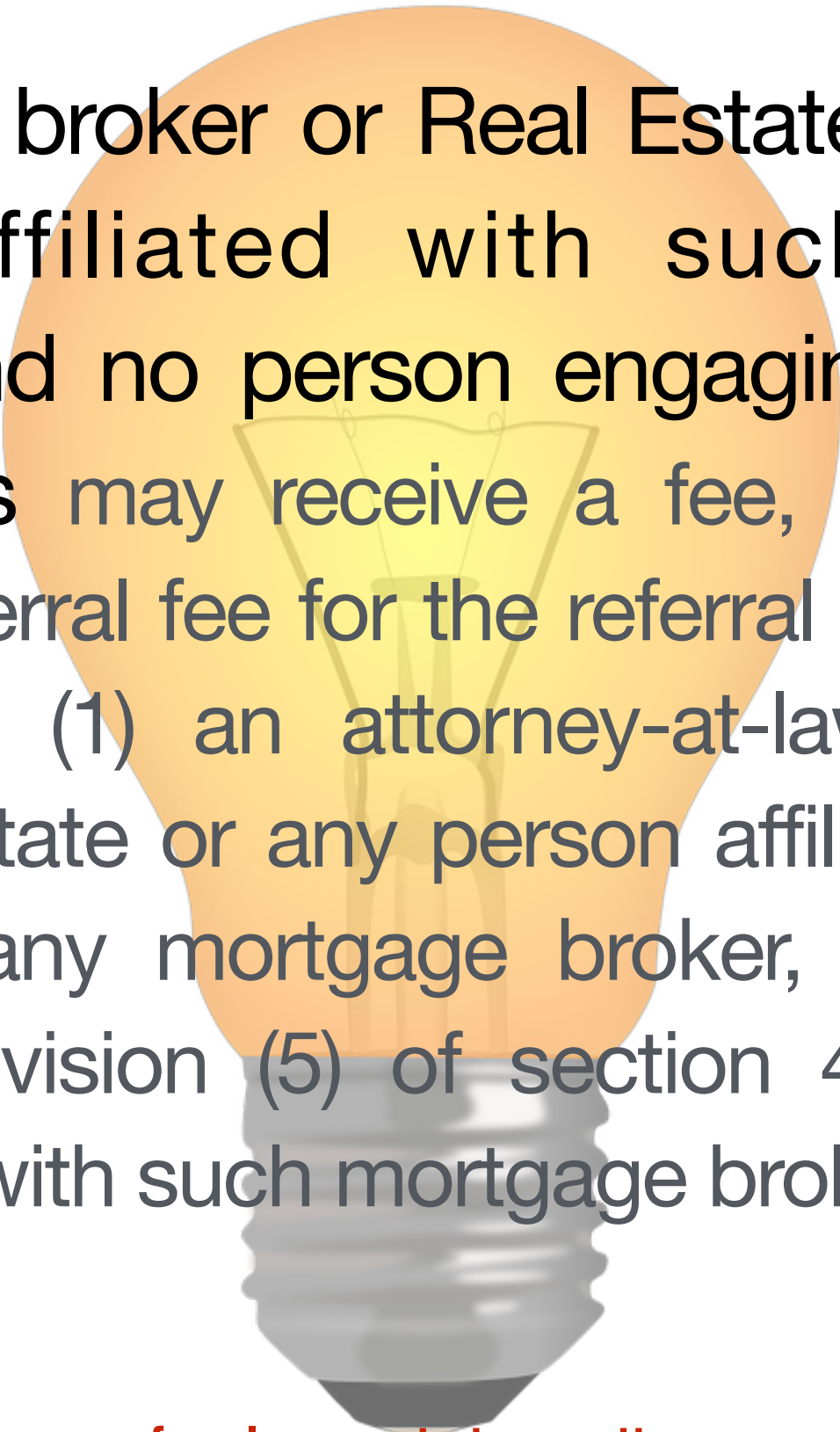
Hard money is used when there are multiple exit strategies. The requirements are less stringent which makes them more attractive to some investors.



# Hard Money

Pros	Cons
Flexible with credit and repayment options	Higher points and more closing costs and fees
Will lend to business	65% - 75% LTV of the ARV
Lend on property	Repayment terms usually shorter
Build relationship	Adds more pressure to deadline





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# Home Equity Loans & Lines of Credit



Investors use the **equity** of their primary home to help finance the purchase of their investment properties .

This requires **equity** in their primary home.

The interest rate can be either fixed or adjustable, but the rate is **typically low interest.**



# Home Equity Loans & Lines of Credit

The **interest rate** can be either fixed or adjustable, but the rate is typically low interest.



There are **some lenders that will lend 90%** of the value of the home. (The percentage differs between each lender.)

Loan is based on the **value of the primary residence** **not** the newly purchased property.

This comes along with **certain tax benefits** (such as the ability to deduct the interest paid on that loan).



# Home Equity Loans & Lines of Credit

Pros	Cons
Flexibility of interest-only payments during the draw period	Adjustable-rates
Cheapness	Closing costs
Fixed-rates	Tapping the equity in your home can work against you if property values in your area decline
Interest paid is (usually) tax deductible	Rising interest rates can increase your payment



# Portfolio Loans



Some banks and credit unions have the ability to lend **from their own funds** entirely so they finance portfolio loans.

They are lent at any terms that are acceptable to the lender. Because the money is their own, they are able to provide **flexible loan terms** and qualifying standards.





# Portfolio Loans



Conventional lenders do not use their capital to fund the loans, but are actually acquiring or borrowing funds from another party. They have to adhere to more strict qualifying guidelines.

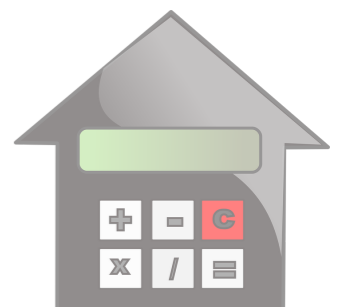
**Most lending institutions** do not advertise **that they are a portfolio lender**.



# Portfolio Loans



Pros	Cons
Easy to qualify	Higher rates potentially for the leniency and convenience
GREAT for unique income scenarios	Not as easy to find



# Owner Financing

Banks and other financial institutions aren't the only lenders investors utilize. The **owner** of the property that they want to buy **will fund the property** and the investor makes the payments to the seller.

The seller has to own the property **free and clear**.



Unit 3

# Owner Financing

Pros	Cons
A seller might OK you even if a bank or other traditional lender turned you down	You can sell the promissory note
The closing process is faster and cheaper.	You could be turned down if you're a credit risk.
The down payment can be whatever amount the two of you agree upon	Taxes could be complicated



# Partnerships



An **equity partner** is used to **help finance the investment.**

Partnerships are structures in many different ways from using a partner's cash to finance the entire project to using a partner to simply find the down payment.

# Partnerships



There are no set rules with equity partnerships and each is different in regards to how the deal will work and how the profits will be split.

An equity partner usually receives, in accordance with their ownership percentage, a return on their investment (ROI) that includes cash flow, appreciation, depreciation, and profits when the property is sold.

# Partnerships

**Equity partners** do not receive any interest on their money, instead receiving the the percentage of what the property generates.

If it **makes a lot of money**, their **return will be higher**.

If the investment **loses money**, then they **may have to contribute** money to keep the property afloat.



# Partnerships

Equity partners take a higher risk than a financial institution might. In return, they have the potential of making significantly more if the investment is successful.





# Partnerships

Pros	Cons
Shared business risks and expenses	Shared profits
Skills and additional contacts of each partner can lead to the achievement of a goal that wouldn't be possible apart	You do not have total control over the business
Mutual support and motivation	A friendship may not survive a partnership
Pass-through taxation	Unlimited liability



# Understanding Types of Investor Financing



Unit 4

# Cash

**Cash can be used to purchase:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



Unit 4

# Cash

**Cash can be used to purchase:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties
- Retail Centers



# Conventional Loans

**Conventional Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties
- Investment Properties
- New Construction



Unit 4

# FHA Loans

**FHA Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties
- New Construction



# 203K Loans

**203K Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties

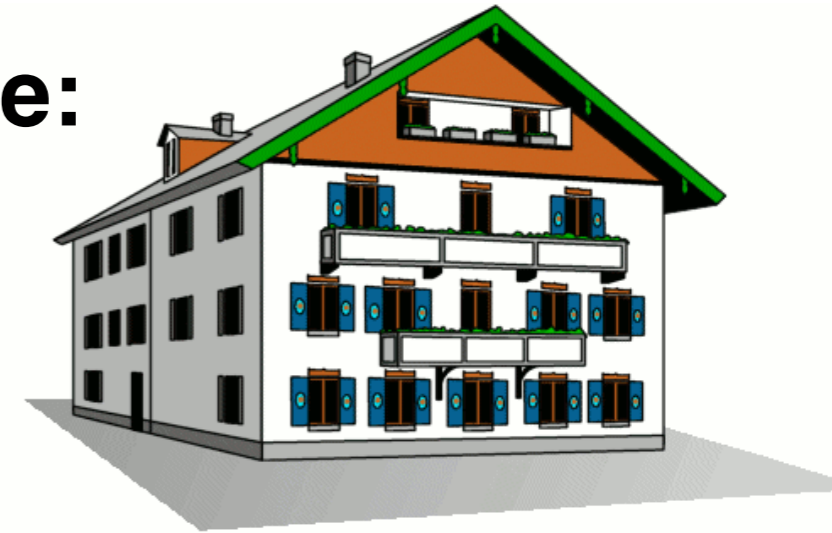


Unit 4

# Commercial Loans

**Commercial Loans can be used to finance:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Hotels
- Industrial Properties
- Retail Centers
- New Construction

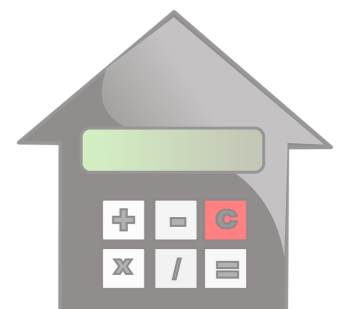




# Private Money Loans

**Private Money Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



Unit 4

# Private Money Loans

**Private Money Loans can be used to finance:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties
- Retail Centers
- New Construction



# Hard Money Loans

**Hard Money Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



# Hard Money Loans

**Hard Money Loans can be used to finance:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties
- Retail Centers
- New Construction



# Home Equity Loans & Lines of Credit

**Home Equity Loans can be used to finance:**

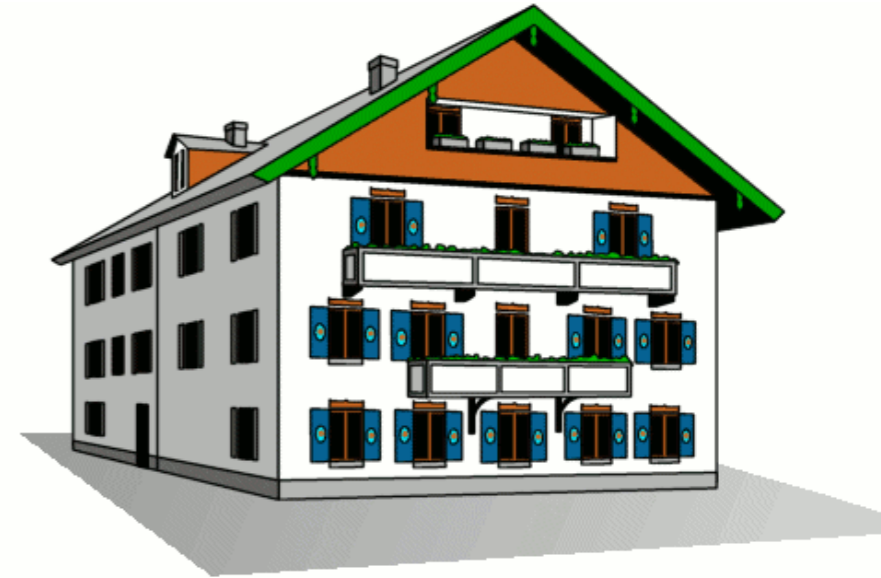
- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



# Home Equity Loans & Lines of Credit

**Home Equity Loans can be used to finance:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties
- Retail Centers
- New Construction



Unit 4

# Portfolio Loans

**Portfolio Loans can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



Unit 4

# Portfolio Loans

## Portfolio Loans can be used to finance:

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties
- Retail Centers
- New Construction

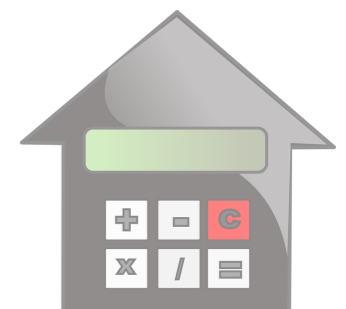




# Owner Financing

**Owner Financing can be used to finance:**

- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



Unit 4

# Partnerships

**Partnerships can be used to finance:**

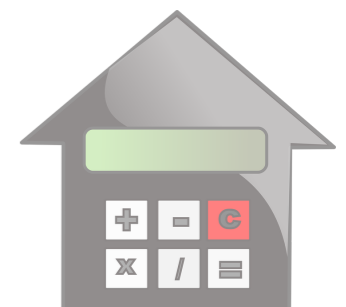
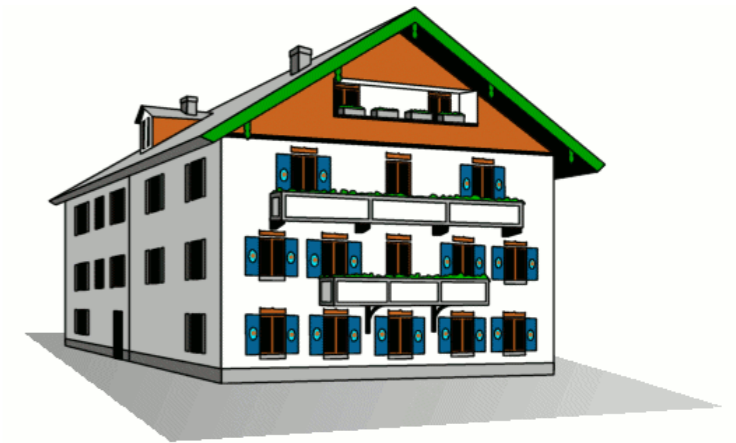
- Single Family Properties
- Duplex Properties
- Triplex Properties
- Four-Plex Properties



# Partnerships

**Partnerships can be used to finance:**

- Apartment Buildings
- Office Buildings
- Shopping Centers
- Industrial Properties



Unit 4

## Section 3 Quiz

Name: \_\_\_\_\_

Answer the True / False questions below based on the information we covered in this Section.

1. You can 100% LTV on the mortgage for a single family house. \_\_\_\_\_
2. An investor that is using a FHA loan can finance an office building. \_\_\_\_\_
3. Shopping centers are considered multi family properties. \_\_\_\_\_
4. An investing client can purchase a single family home with a commercial loan. \_\_\_\_\_
5. 203K Loans are released at one time. \_\_\_\_\_
6. Private money lenders are professional lending sources. \_\_\_\_\_
7. There are strict laws and regulations governing partnerships. \_\_\_\_\_
8. Conventional loans have the lowest interest rates. \_\_\_\_\_
9. Home equity loans & lines of credit can not be used to purchase properties. \_\_\_\_\_
10. Portfolio lenders advertise the fact that they are a portfolio lender. \_\_\_\_\_

# Test Answer Key

1. False / page 13
2. False / Page 14
3. False / Page 42
4. False / Page 21
5. False / Page 18
6. False / Page 22
7. False / Page 31
8. True / Page 12
9. False / Page 26
10. False / Page 29

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# Section 4

**Real Estate Investment Mathematics**

# Real Estate Investment Financing Overview

## 1. Property Valuation

- Three Approaches
- Cost Approach
- Sales Comparison Approach
- Income Approach

## 2. Loan To Value (LTV)

- What is Loan To Value? (LTV)
- Formula
- Examples

## 3. Net Operating Income (NOI)

- What is Net Operating Income? (NOI)
- Formula

- Examples
- Capitalization Rate (Cap Rate)
- What is Cap Rate? (Cap Rate)
- Formula
- Examples

## 4. Debt Yield Ratio (DYR)

- What is Debt Yield Ratio? (DYR)
- Formula
- Examples

## 5. Return On Investment (ROI)

- What is Debt Service Ratio? (DSR)
- Formula
- Examples

# Property Valuation



Unit 1



# The Three Approaches

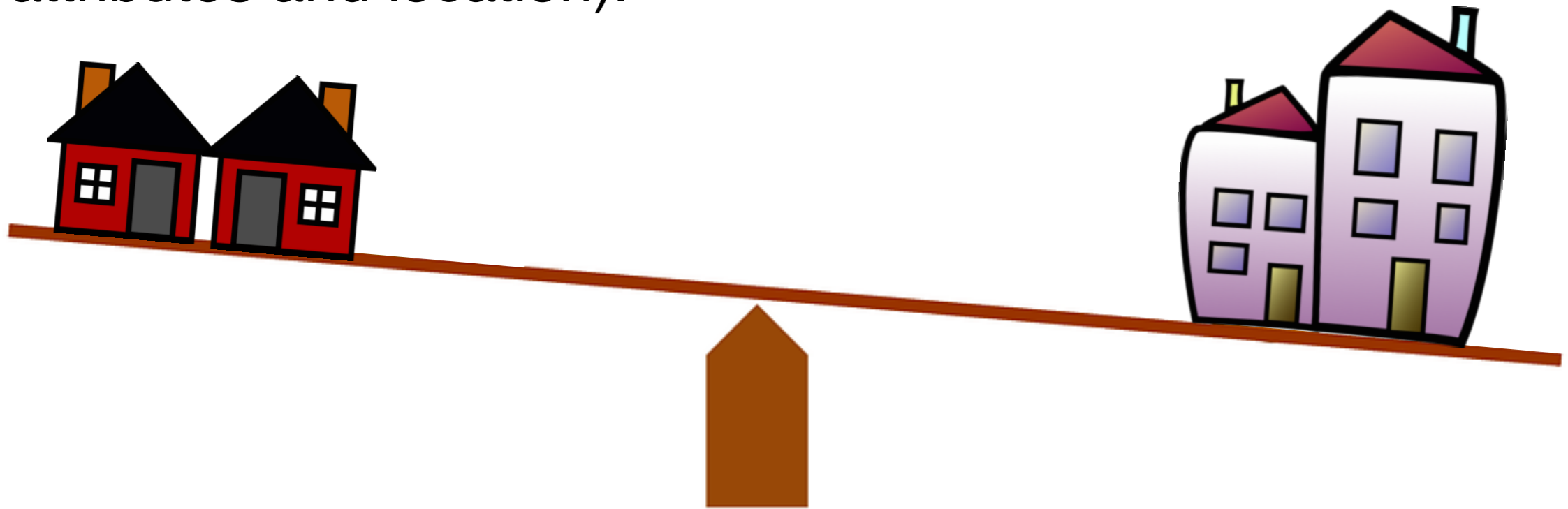
To arrive at an accurate opinion of value, an appraiser traditionally uses one of **three basic valuation techniques**:

- Sales Comparison Approach
- Cost Approach
- Income Approach

The three methods **serve as checks against each other.** (Using more than one approach helps the appraiser narrow the range of the final conclusion of value. **Each approach is most useful with a specific type of property.**)

# Sales Comparison Approach

The **Sales Comparison Approach** is also known as the market data approach. Value is obtained by comparing the property being appraised (or **subject property**) with recently sold comparable properties (similar physical attributes and location).



The sales price of a comparable is adjusted to reflect the impact on value of any differences between the subject and comparable.

# Sales Comparison Approach

The elements of comparison for which adjustments must be made include the following:

- Property rights
- Financing concessions
- Market condition
- Conditions of sale
- Market conditions



The **Sales Comparison approach** is usually considered the **most reliable** of the three approaches appraising single-family homes.

# Cost Approach

The **Cost Approach** to value is based on the principle of substitution (which states that maximum value of a property tends to be set by how much it would cost to purchase an equally desirable and valuable substitute property).



Unit 1

# Cost Approach

The **Cost Approach** consists of the following five steps:

- Estimate the value of the land as though it were vacant and available to be put to its highest and best use
- Estimate the current cost of constructing and improvements
- Estimate the amount of accrued depreciation (loss in value) resulting from the property's physical deterioration, external depreciation and functional obsolescence
- Deduct the accrued depreciation estimated in Step 3 from the construction cost estimated in Step 2
- Add estimated land value from Step 1 to the depreciation cost of the building and site improvements derived in Step 4 to arrive at the total property value

# The Income Approach

The **Income Approach** value is based on the present value of the right to future income. It assumes that the income generated by a property will determine the property's value.

The **Income Approach** is **used for** valuation of income-producing properties such as apartment buildings, office buildings, retail stores, and shopping centers and is based on anticipation.



# PROFIT



Unit 1

# Loan To Value (LTV)



Unit 2

# What is Loan To Value?(LTV)

**Loan To Value (LTV)** is the **ratio** of the total loan amount borrowed in relation to the value of the property (percentage loan to the value of the home).

The LTV is **important** because the down payment amount will depend on the LTV that is approved for the loan.



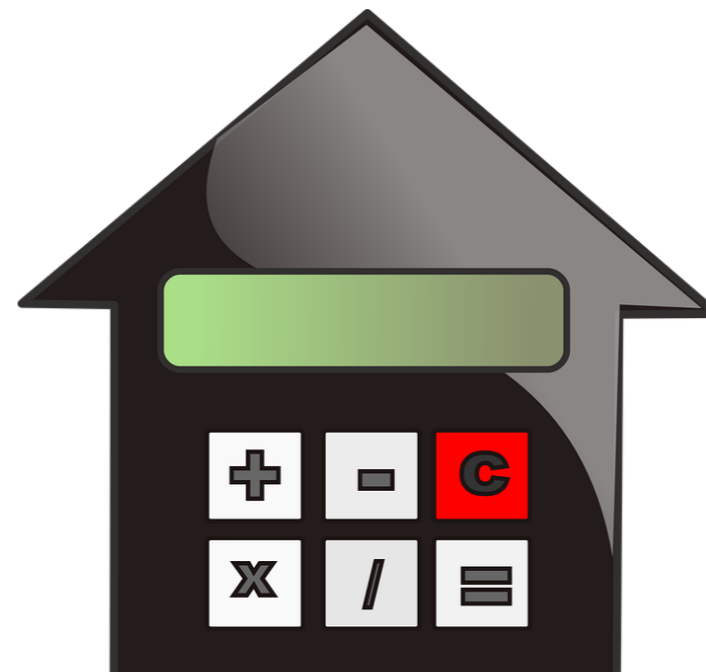
Unit 2



# What is Loan To Value?(LTV)

Different banks have different but similar LTV requirements. The LTV is impacted by many different factors such as:

- Credit Score
- Value of the house
- Experience



Unit 2

# Loan To Value (LTV) Formula

$$\text{LTV} = \frac{\text{Loan Amount}}{\text{Property Value}}$$



Unit 2

# LTV Example 1

The requested loan amount for a commercial Real Estate property is \$1,000,000 and the appraisal value is \$1,250,000. What is the LTV?

$$? = \frac{\$1,000,000}{\$1,250,000}$$

The LTV would be 80%.



# LTV Example 2

The requested loan amount for a commercial Real Estate property is \$2,800,000 and the appraisal value is \$3,100,000. What is the LTV?

$$? = \frac{\$2,800,000}{\$3,100,000}$$

The LTV would be 90%



# Net Operating Income (NOI)



Unit 3

# Net Operating Income (NOI)

**Net Operating Income (NOI)** is a **calculation** used to analyze Real Estate Investments that generate income. NOI equals **all revenue from the property minus all reasonably necessary operating expenses.**



If the value is **positive** it is called the Net Operating Income.

If the value is **negative**, it is referred to as Net Operating Loss.

# Net Operating Income (NOI)

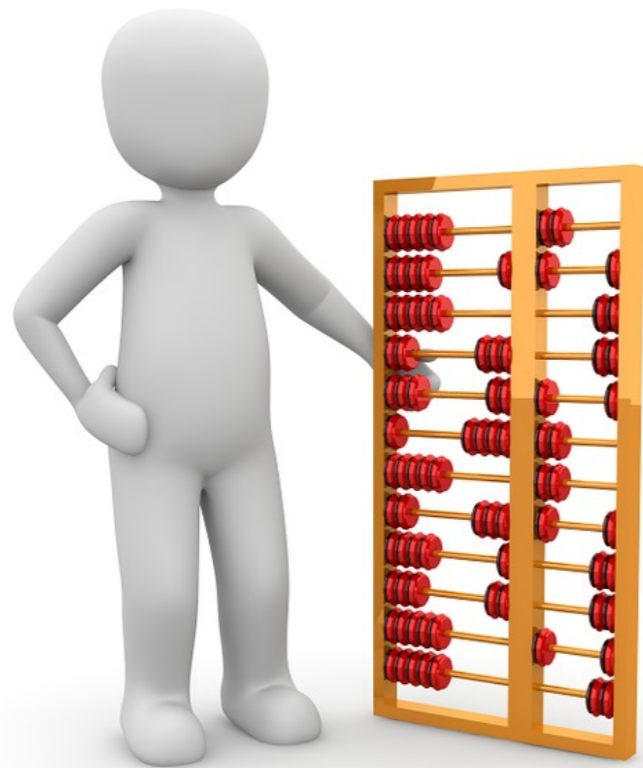
Aside from rent, a property might also generate revenue from:

- Parking
- Vending
- Laundry machines
- Workout Facilities



# Net Operating Income (NOI)

**Operating Expenses** are those required to **run and maintain the building and its grounds**, such as:



- Insurance
- Property management fees
- Utilities
- Property taxes
- Repairs
- Janitorial fees

NOI is a before-tax figure; it also **excludes** principal and interest payments on loans, capital expenditures, depreciation and amortization.



# Net Operating Income (NOI) Formula

$$\frac{\begin{array}{c} \text{Gross Lease Income} \\ \text{Other Income} \end{array} - \begin{array}{c} \text{Vacancies and Expenses} \\ \text{Credit Losses} \end{array}}{\text{NOI}}$$



Unit 3

# NOI Example 1

If a property has \$565,500 in Gross Lease Income and \$91,500 in Vacancies and Expenses. What is the NOI?

$$\begin{array}{r} \$565,500 \\ - \$91,500 \\ \hline \end{array}$$

?

**The NOI would be \$474,000.**



Unit 3

# NOI Example 2

If a property has \$1,657,778 in Gross Lease Income and \$995,785 in Vacancies and Expenses. What is the NOI?

$$\begin{array}{r} \$1,657,778 \\ - \$995,785 \\ \hline \end{array}$$

?

**The NOI would be \$661,993.**



Unit 3

# Capitalization Rate (Cap Rate)



Unit 4

# What is Capitalization Rate? (Cap Rate)

**Capitalization Rate** is the rate of return on a Real Estate Investment property based on the income that the property is expected to generate.



Cap Rate is also referred to as **Return On Investment (ROI)**.

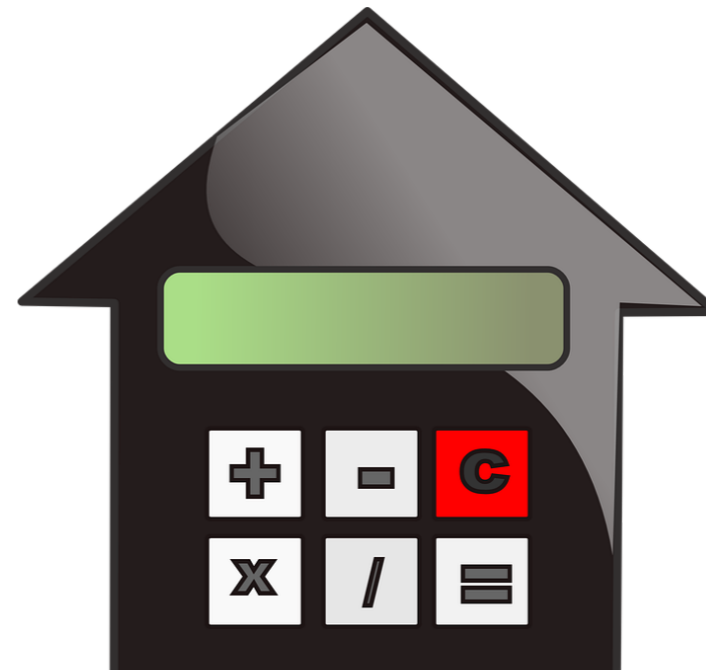
The capitalization rate is used to **estimate the investor's potential return** on his or her investment.



Unit 4

# Capitalization Rate (Cap Rate) Formula

$$\text{Cap Rate} = \frac{\text{Net Operating Income}}{\text{Market Value}}$$



# Cap Rate Example 1

We are researching the recent sale of an office building with a stabilized NOI of \$1,000,000 and a sale price of \$17,000,000. What is the CAP Rate?

$$? = \frac{\$1,000,000}{\$17,000,000}$$

The CAP Rate would be 0.058 or 5.8%



Unit 4

# Cap Rate Example 1

We are researching the recent sale of an office building with a stabilized NOI of \$300,000, and a sale price of \$19,000. What is the CAP Rate?

$$? = \frac{\$300,000}{\$19,000}$$

The CAP Rate would be 0.1739 or 17.39%



Unit 4



# Explanation

The **Capitalization Rate** is very useful in that it **streamlines information about Real Estate Investments** and makes it easy to interpret.



For example, if Stephan buys a property for \$900,000 and expects that the property will generate \$125,000 per year after operating costs, the capitalization rate for his investment is 13.89%. ( $\$125,000 / \$900,000 = 0.1389 = 13.89\%$ ).

**Stephan is earning 13.89% profit yearly.**



# Debt Yield Ratio (DYR)



Unit 5

# What is Debt Yield Ratio? (DYR)

The **debt yield** provides a measure of risk that is **independent** of the interest rate, amortization period, and market value.

- **Lower debt** yields indicate higher leverage (higher risk)
- **Higher debt** yields indicate lower leverage (less risk)
- Debt yield is used to ensure a loan amount isn't inflated (due to low market cap rates, low interest rates, high amortization periods)
- Debt yield is used as a common metric to compare risk relative to other loans

# Debt Yield Ratio (DYR) Formula

$$\text{DYR} = \frac{\text{Net Operating Income}}{\text{Loan Amount}}$$



Unit 5

# DYR Example 1

A property's net operating income is \$100,000. The total loan amount is \$1,000,000. What is the DYR?

$$? = \frac{\$ 100,000}{\$1,000,000}$$

**The DYR would be 10%**



Unit 5

# DYR Example 2

A property's net operating income is \$640,889. The total loan amount is \$1,554,892. What is the DYR?

$$? = \frac{\$ 640,889}{\$1,554,892}$$

The DYR would be 41%



Unit 5

# Return On Investment (ROI)



Unit 6

# What is Return On Investment? (ROI)

**Return on Investment (ROI) measures the percentage return on a particular investment.** By applying the return on investment formula, we can determine **a % change in monies** on an investment (which is synonymous with a % return on investment).



The ROI return on investment formula is used loosely in finance and investing.





# Return On Investment (ROI) Formula

$$\text{ROI} = \frac{(\text{Investment Gain} - \text{Investment Cost})}{\text{Cost Of Investment}}$$



# ROI Example 1

Net Operating Income (NOI) is \$120,000 per year and total debt service is \$100,000 per year. What is DSCR?

$$? = \frac{\$120,000}{\$100,000}$$

**The DSCR would be 1.20x**



# ROI Example 1

Net Operating Income (NOI) is \$642,070 per year and total debt service is \$223,985 per year. What is DSCR?

$$? = \frac{\$642,070}{\$223,985}$$



The DSCR would be 2.86x



# Gross Rent Multiplier (GRM)



Unit 7

# What is Gross Rent Multiplier? (GRM)



The **Gross Rent Multiplier** is a measure of a property's performance used to compare alternative investments. GRMs will be different for properties in different locations. There is no one magical gross rent multiplier figure that can be used as a rule of thumb.

# What is Gross Rent Multiplier? (GRM)

Using the GRM is essentially **like using revenue** for a corporation as a measure of value.



The **problem** with this approach is that when you purchase an investment property, **your return isn't based on top line revenue**, but rather it's based on cash flow.

The GRM is **best used when comparing** to other properties located in the same trade area.

# Gross Rent Multiplier (GRM) Formula

$$\text{GRM} = \frac{\text{Price}}{\text{Potential Gross Income}}$$



Unit 7

# GRM Example 1

A commercial office building with a Year 1 gross potential income of \$100,000 and a price of \$1,000,000.

Find the GRM.

$$? = \frac{\$1,000,000}{\$ 100,000}$$



The GRM would be 10x.



Unit 7



# GRM Example 2

An apartment building with a Year 1 gross potential income of \$165,560 and a price of \$890,223.

Find the GRM.

$$? = \frac{\$890,223}{\$165,560}$$



The GRM would be 5x.



Unit 7

## Section 4 Quiz

Name: \_\_\_\_\_

**Answer the True / False questions below based on the information we covered in this Section.**

1. The Cost Approach consists of seven steps.\_\_\_\_\_
2. The Income Approach is best used for evaluating income producing properties.\_\_\_\_\_
3. The Sales Comparison Approach is used to on commercial property.\_\_\_\_\_
4. All banks have the same LTV requirements.\_\_\_\_\_
5. Operating Income includes janitorial services.\_\_\_\_\_
6. You need the Market Value to calculate Cap Rate.\_\_\_\_\_
7. Lower debt yields indicate lower leverage and therefore lower risk.\_\_\_\_\_
8. You need to know the Cost of the Investment to calculate ROI.\_\_\_\_\_
9. The Net Operating Income is 100,000 and the Loan amount is 1,000,000 so the Debt Yield Ratio is 10%.\_\_\_\_\_
10. The Gross Rent Multiplier is the sum of the Potential Gross Income and the Return On Investment.\_\_\_\_\_

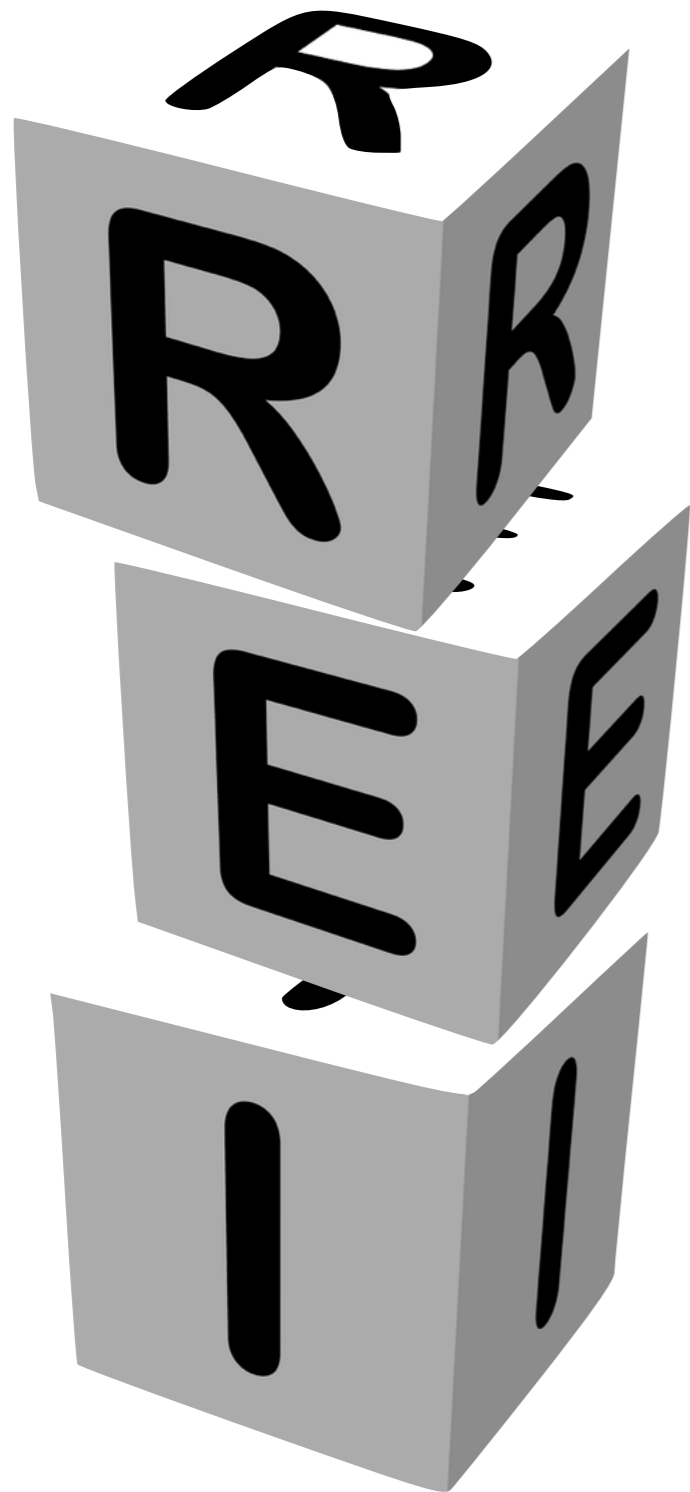
# Test 4 Answer Key

1. **False / page 210**
2. **True / Page 211**
3. **False / Page 207**
4. **False / Page 213**
5. **False / Page 221**
6. **True / Page 227**
7. **False / Page 223**
8. **True / Page 240**
9. **True / Page 233**
10. **False / Page 246**

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- Chapter 392 Real Estate Brokers and Salespersons Sec. 20-329t. Annual financial report; Page 40
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# Building Blocks of Real Estate Investment

**Melvin Hubbard**