

Real Estate Notes

Lessons Learned



Ladislav Šulák <laco.sulak@gmail.com>

April 28, 2021

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1 General

- There are two things you can/want to focus on in real estate - **cash flow** and **equity**.
 - *Equity* - what a given property is worth at the moment minus what you owe.
- Real estate (not REITs, but physically own a property)
 - **Cons:** money, expertise, diversification, bad liquidity (the ability to turn an asset into cash) passiveness (bad tenants, maintenance, wasting time), time. If you have money, expertise and time, you can earn more money with real estate than with REITs (but REITs are much more flexible).
 - **Pros:** better control (you can increase a value of your property by tuning it)

1.1 Types of Properties

Flats

- Pros
 - generally cheaper
 - higher ROI
 - building maintenance
- Cons
 - you often can't add value
 - some can have high service charges
 - harder to finance
 - you might not be able to convert it to HMO
 - slower capital gains

Houses

- Pros
 - finance available
 - longer term tenants
 - capital growth in some areas

1 General

- potential to add value
 - no high service charges
 - larger appeal
- Cons
 - higher investment
 - more maintenance
 - lower cash-flow
 - vandalized if empty
 - garden maintenance

2 Strategies And Tips

- The process of searching for real estate property:
 1. There are many types of properties. Focus just on one category when you are beginner:
 - Single family home
 - Small multi-family properties
 - Large multi-family properties
 - Commercial properties
 - Vacation properties
 - Flats - some people recommend to stay away from flats, because of the lease-hold property - so you don't own the land on the property
 2. Define/search for your market (location) and find as much as possible about the market
 - crime, where the people like to live, streets or parts of the city, population growth, ...
 3. Figure out your financing
 4. Start analyzing deals. Don't forget - real estate is numbers game
 5. Build your real estate team - agents, lenders, property managers, contractors
 6. Analyzing specific deals in person in detail
 7. Negotiate - your real estate agent can help you with this
 - Try to provide multiple options rather than yes or no type of questions.
 8. Due diligence, close and manage
 - A good property manager should be able to deal with some tenant difficulties and relationships
- Buy or Rent a property? ([ref](#))
 - $RV + \text{Population Change (faster growing cities have bigger number)} + \text{Historical Prices (adjusted for inflation)} + \text{Cost of Construction (can you buy under the cost of construction? If so by how much)}$
 - You scale each of these on scale from 1 to 10.

2 Strategies And Tips

- TODO RV ratio - monthly rent collected from a property divided by your cost basis (how much money you put out of your pocket into that property)
5% is bad, 1% is good
- *BRRRR strategy*
 - **Buying a property**
 - * find out ARV (after repair value)
 - * $PP = \text{purchase price, it is simply } ARV * 0.7 \text{ (repair costs)}$
 - **Rehab it** - bringing it to original or a better condition than it already is
 - **Rent it out**
 - **Refinance it with a bank** - pulling out money and putting a mortgage or placing debt on that property
 - **Repeat this process**
- *Four Square Method* ([source](#))
 - This is for analyzing properties.
 - 1. Income (per month):
 - Rental income
 - Laundry machine
 - Shared storage
 - Misc
 - 2. Expenses (per month)
 - Tax
 - Insurance
 - Utilities (electricity, gas, water, garbage)
 - Fees (HOA, council tax)
 - Vacancy (you need to set aside some money because at some point it's gonna be vacant), ideally 2-5% of the rental income
 - Repairs
 - Capital expenditures (big things - new roof or so)
 - Property management (typically 10% of the rent)
 - Mortgage
 - 3. Cash Flow (per month)
 - Total income minus total expenses
 - 4. Cash on Cash Return on Investment (what % are you earning?)

2 Strategies And Tips

- a) Calculate total investment (sum of the following):
 - Down payment
 - Closing costs (loan documents etc, can be a couple of thousands or dollars/pounds/euros)
 - Repair money
 - Misc
- b) Calculate ROI:
 - $3) * 12$ (Annual Cash Flow) divided by $4a)$ and compare with other deals, stock market, etc

2.1 Rules of thumb

These are not hard rules by no means! Do the analysis first.

The 1% (or 2%) rule

- Monthly rent divided by the value of the property.
- This is a quick view about whether a property will produce a positive cash-flow. Higher is better.
- The best is above 2%. Below 1% won't probably produce a positive cash flow.

The 50% rule

- How much cash flow to expect.
- On average and over time, half of the income of the property is spent on operating expenses. Taxes, insurance, utilities, repairs, vacancy, others. But this doesn't include mortgage payments. But some properties will require a tenant to pay for the utilities.

The 70% rule

- For those who like to flip houses, this helps to determine how much to pay for a property.
- The most you should pay for the property should be 70% of the actual fair value. Minus repairs.
- So property with value \$300k (its selling price) $\times 70\% = \$210k$, minus \$50k for repairs = \$160k.
 - So you shouldn't pay more than \$160k.
 - 30% should include holding costs, closing costs, and some profit an investor wants to make.

The 5% rule (ref)

- It's about taking into account unrecoverable costs. However, this rule is just an oversimplification.
- 1% - Property taxes - generally it's 1% of the value of the home
- 1% - Maintenance costs - 1% of the property value per year on average
- 3% - Cost of capital - this has to be broken down into 2 pieces:
 - Cost of debt - mortgage interest, it can be usually around 3%

2 Strategies And Tips

- Cost of equity - you put usually 10-20% down and you made a choice to invest in a real estate asset.

Alternatively, you could continue renting and invest the down-payment. So this is an opportunity cost.

Return from real estate from 1900-2017 was 3% (or 1.3% in nominal terms), while stocks returned 6.9% (or 5.2% in nominal terms). So the expected return difference between real estate and stocks is 3.9%. So to keep things simple and to be a bit conservative, let's round that down to 3%.

- Take the value of the home that you are considering, multiply by 5%, and divide by 12. If you can rent for less than that, then renting is better.
- It works the other way around too. Multiply your rent by 12 and divide by 5%. So if your rent is \$1,000, then paying \$1,000 in rent is financially equivalent in terms of unrecoverable costs to owning \$240,000 house.

2.2 Questions to Ask

([source](#))

To seller

- Why are you selling? Because it's a really lovely house.
- What's your time scale?
- Have you had much interest?
- Is this property just in your name?
- Do you have a copy of tenancy agreement that I could have a look at please? (there must be one, be careful to proceed if there isn't any)
- What are the neighbors like?
- Is there any allocated parking?
- Do you mind if I turn on the taps to check the water pressure?
- If it's a flat - who are the block managing agents? Do you know if they've got a sinking fund? What are the service charges?
- What's the lowest you'd be willing to accept and still be happy?

To neighbor

- Is it a nice area to live?
- Do you know if there are any problems with the neighbors?
- What's the area like at night?
- Are there any traffic or parking problems around the place?
- So what's the public transport like around here?
- Do you know if there are any new buildings/development works going on?

To agent

- How long has this place been on the market?
- Why do you think it hasn't sold yet?
- How keen are they to sell?
- How did they come up with the asking price?

2 Strategies And Tips

- What do you think it's really worth?
- Has anything sold recently that's similar?
- Do you know how many years are left on the lease?
- Is it on with multiple agents or is it just yourself that's marketing this property?
- If I buy it and hand it back to you, what kind of rent do you think I would get?

2.3 Some Tips

- Some recommendations from Graham Stephan:
 - Don't fall in love with your investment property!
 - Always buy property that has significant upside potential - improvements, and so on.
 - Long-term outlook and fixed-term loan. Buy once and hold.
 - Cash-flow first!
 - Be friendly, but not friends!
 - Have cash reserves from 3-6 months, and some reserves for repairs and mortgage. (Graham is using checking account)
 - Don't pick a bad tenant!
 - Leaks are # 1 things that need fixing ASAP - have a plumber available!
 - Stick to the contract! Strict responsibilities on landlord's side and tenant's side. Find and buy good and durable things.
 - Anything that can break ... will break! Beautiful shiny expensive glass, door, ... you need to "baby-proof" the house.
 - Bathroom ceiling fan must be turn on at the same time as lights automatically - otherwise, sooner or later, moisture's gonna build up in the bathroom and that's going to create mold.
 - Graham doesn't like condos he prefers single family houses, duplexes, or triplexes, so 2-4 units.
 - 90% of properties suck and produce no cash-flow.
- Don't buy investing property
 - Flat <30m2 and with no sinking fund and no management. Also try to avoid high void areas (over supply and under demand).
 - In areas with declining population.
 - Don't buy property in which you can't add value in it.
 - Don't buy property that will not give you any cash flow or low ROI.

3 Taxes

4 Glossary

- *PITI* - Principle, Interest, Taxes, Insurance TODO
- *Return on Cash Employed (ROCE)* ([source](#))
- Mortgage calculator TODO

5 References

Some of those YouTube channels helped me enormously, especially during my first year. But still, books cannot be replaced by any means.

Disclaimer: I knew nothing about the topic and had no background, my journey started around the beginning of 2021.

5.1 YouTube Channels

1. [BiggerPockets](#)
2. [Jamie York](#)
3. [Property Hub](#)
4. [Your First Four Houses](#)
5. [Meet Kevin](#)
6. [Graham Stephan](#)

5.2 Portals And Tools

- [BiggerPockets](#)