SPECIAL REPORT

FIVE SECRETS to MAXIMIZING the Most Overlooked GOLDMINE in Today's Real Estate Market!

by Stacy Kennedy, CPA

5 Secrets to Maximizing the Most Overlooked Goldmine in Today's Real Estate Market

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I'm very excited to share with you a secret that I've uncovered over the past several years of my real estate investing experience. I'll be sharing with you five secrets that will open your eyes to the most overlooked goldmine in today's real estate market and show you can you can take advantage of that goldmine!

In this report, we'll be covering the following five secrets:

- Competition in Multi Unit Investing
- The Transformation Opportunity
- What Buyers Want
- How Multi Units are Valued
- How to Create Equity

Let's begin by talking about your current level of real estate know how. If you're reading this, chances are you've spent time at one or more free or inexpensive three day seminars where they sprinkle you with little bits of information about many different areas of the business of real estate investing. When you're brand new, these events are extremely valuable as they help to lay a foundation for what this business is, what it has to offer and what options you have in exploring a venture into real estate investing.

Most seminars keep the information shallow since (1) their audience is so new to the business, going into any depth on that many different subjects would overwhelm the listeners and (2) the seminar already knows they will be selling a more in depth educational program at the end of the weekend which always range from $15,000 - $35,000.

How do I know? Well, I'm a product of that system. I was once in your shoes, and sat in that audience and heard that message. I had read everything about real estate I could get my hands on. I was hungry for knowledge and I wanted to understand this business so I could make a successful foray into it and make lots of money. And most importantly, I knew I needed someone who had "been there, done that" to guide me on my journey. Am I saying that making an investment of that size is a bad idea? Absolutely not…if you're serious about making a career of real estate investing or making big money in real estate, it makes sense to invest in your knowledge.

After passing through the "student" phase, into the full time real estate investor phase, people began asking me to show them how to do what I did. I started teaching what I had learned to the next group of real estate investors. I am a huge advocate of education in the area you want to grow your business! There's always someone who has gone through the challenges you're about to face and they have already figured out ways to minimize errors and maximize profits. I always always always prefer to invest in someone else's learning curve than go through my own. That investment has consistently been a much better deal for me over the years!

With general real estate trainings you scratch the surface of many types of transactions, such as wholesaling, lease options, buying to rent, rehabbing, retail flipping, investor flipping, pre-construction, etc.

What is the one thing that ties all of these things together?

The type of real estate they're attaching these exit strategies to…single family homes. Once in a while I'll hear a brief mention of some other buzz words such as "passive income, mailbox money, multi family, apartments, or multi units". But it's usually a quick mention since most new investors don't feel they have sufficient information, experience or know how to delve into the world of large multi unit properties. The audience liked the "passive" part of what they heard, but the idea of making larger chunks of money through wholesaling or "flips" is more appealing and sounds easier. The companies holding the seminars focus on those "easy" areas, leaving the subject of multi unit investing for the more advanced seminars…and even then, most of the reports I hear from my coaching students is that the trainings they previously received were good, but left them feeling incomplete. They felt frustrated by attending training after training; only to leave feeling they still don't have the actual information they need to do the deal. My coaching students find me because they want to get the specifics…they invest in their education so they can piggyback off my learning curve and get the important details that can make or break their deals.

SECRET #1 – COMPETITION IN MULTI UNIT INVESTING

Because the majority of new investors never invest in their education, they're completely unaware of the huge opportunities for large profits in the area of multi units.

What this means for you is that there is far less competition in the area of multi unit investing compared to residential investing.

Sometimes I'll get the question, "How did you learn so much about multi units in such a short time?"

Have you ever heard the saying "Never say never"?

I'll give you MY never say never story and how it taught me about the most overlooked area of today's real estate market…

Back in 2001, my husband and I were ready to sell our house and move into a bigger one. At the time, the market wasn't really moving and we decided to go ahead and keep it as a rental property. We only moved 5 miles away, yet I was adamant about finding a property manager because…AND I QUOTE…"I would NEVER do *property management*".

Fast-forward three years to October 2004, when my husband and I made a business decision to start a *property management* company from the ground up. We worked with a business mentor and coach who helped us implement a system for fast and substantial growth. We started the company, built it up to approximately 400 rental units and sold it two years later to focus on new business opportunities.

I went on to teach a three-day boot camp that covered creative financing, cash flow and *property management*. GO FIGURE.

More recently, I was recruited to work with a 1,000+ unit *property management* and development company as their Chief Financial Officer, followed by a six month consulting project where I created a *property management* company for an investor coaching client with 100 units spread over 25 buildings, who desperately needed to morph his company into one that was run as a professional organization, with systems and controls in place.

It seems that *property management* has infiltrated every part of my life…and I'm fairly certain it's due to my NEVER say NEVER instance back in 2001. Now I just laugh because I love the business of multi unit real estate and *property management*.

Based on all my years of experience, I see more opportunity in multi unit investing than in any other real estate. **Multi unit investing is the most overlooked area in real estate investing today.**

But not just ANY multi unit investing!

SECRET #2 – THE TRANSFORMATION OPPORTUNITY

What is it about a junky single-family house that has a rehabber drooling? Is it the totally overgrown lawn? The ugly paint job? The outdated cabinets? Or maybe the lime green shag carpet? Is it the funky flea infestation? The answer is yes, yes, yes, yes, and yes! But WHYYYYYY????

Because of the potential for turnaround transformation! Because of the opportunity to take something that NOBODY wants and work some magic-rehab-mojo to take this property and turn it into something that a homebuyer would want and pay handsomely for.

How does the rehabber make money on this house?

They got a great deal when they purchased it BECAUSE of the fact that it was a junky, ugly, stinky house that nobody wanted. Once they transformed that house from junky, ugly, stinky to ooooh-la-laaaa, they created a product that their customer (aka homeowner) would be attracted to.

SECRET #3 – WHAT BUYERS WANT

In the world of multi unit investing, what is it that the buyers of multi unit apartments are attracted to?

When I coach investors who are looking to set up a stream of income that provides them a monthly "salary" without reporting to a j.o.b. everyday, what is it they're looking for?

PASSIVE CASH FLOW. Multi unit buyers aren't looking to facilitate a management turnaround and receive a large chunk of money. Multi unit buyers are looking for a property that is already performing.

What that means for you is there's a HUGE, UNTAPPED SIX FIGURE opportunity for transforming underperforming multi units into performing, cash flowing, turnkey buildings to sell to investors seeking passive cash flow.

The GOLDMINE of the most overlooked area in real estate investing today is the UNDERPERFORMING (i.e. run down, foreclosed, sick owner, etc) multi unit building.

Do you realize that by taking an underperforming multi unit building, facilitating a management and building turnaround on it, and re-selling it, you can create an extra six figures for your bank account? SIX FIGURES! When I work with my coaching students, I make sure they know how to find and do this…that is not to say that you have to do projects that limit your profits to only $100,000. Feel free to take on projects where you can clear $250,000. I won't try to stop you. So "How is this possible?" you ask…. I'll explain a little later when we discuss how multi unit buildings are appraised.

I know some of you are not yet comfortable with six figures as a profit margin. Sometimes when you're venturing into a new business, going for the six figure profit right of the bat can feel overwhelming. Oftentimes my coaching students ask me whether it's feasible to try out my system on a smaller project and shoot for a smaller profit, one that is within their comfort zone. Of course! Everyone has a financial "thermostat"…a level at which you feel comfortable. As time goes on and you start making larger chunks of money in your real estate business, you'll start to feel more comfortable moving up your profits. The real question is…does my system work for smaller projects as well. The answer is <u>yes, absolutely</u>. The system is scalable no matter what the project size is.

Other coaching students have expressed a desire to use my system but weren't interested in getting rid of the building at the end. Their desire was to have a performing cash flow property when all was said and done. They asked whether they could use the principles I teach to create a well performing cash flow building to hold in their portfolio. The answer is <u>yes, absolutely</u>! The only difference is the exit strategy - arranging for permanent financing at the end of the project instead of marketing the property for sale.

WHY is there such a large profit margin in these kinds of deals?

For starters, it's important for you to understand <u>how different kinds of properties are valued</u>.

<u>Residential Properties</u>

Residential properties are valued using the sales comparison method. That means an appraiser looks at the sale of other, comparable properties to determine the value of the property. In the world of real estate financing, lenders cut off residential financing at four units, so when I say residential, I mean one to four units. Technically, two, three and four unit properties are multi unit. You can certainly apply many of the same multi family concepts of my system to those, but for the purpose of this discussion, we're going to make the assumption that the deals we're working on are at least five units, for the sake of the appraisal type.

SECRET #4 – HOW MULTI UNITS ARE VALUED

Commercial Properties

Commercial properties (5+ units) are valued using the income approach. That means the appraiser looks at the Net Operating Income for the property, along with the market cap rate (which we'll discuss shortly) to calculate the value of the property.

One small aside, when you're purchasing two to four units, it is not uncommon for the lender to require the appraiser to include both the income and market approaches on the appraisal, but typically the lender will ultimately use the market approach in deciding what value to lend on. Likewise, when purchasing a 5+ unit building, the appraiser will also include comparable sales for the lender's review, but typically the lender will use the income approach in deciding what value to lend on.

The key to understanding how to unlock SIX FIGURES from a real estate deal is knowing how the shifts and changes you make in the operations of the building ultimately affect the value.

When I teach a three day boot camp, the one area I always make sure is clear in the minds of my students is the foundation needed for their success.

Let's begin by laying some basic foundation:

- Income
- Expenses
- Net Operating Income
- Cap Rate

These are the four primary components that will drive your SIX FIGURE real estate decisions.

Income

All businesses must take two primary things into account in making all business decisions. The first is income and the second is expenses, which I'll describe in greater detail in the next section.

Income is the money that comes into the business. In the world of multi unit investing, what do you think the equivalent of income would be? When does money come into the business?

That's the right…around the first of the month, in the form of rent. Your first, and very important, component of determining a building's value is the income the building generates. In general, the monthly rent is the largest portion of a building's income. Can you think of any other areas in running a multi unit building that could generate income? What about on-site laundry? What about offering storage? What about renting space on the side of your building as advertising (check with your city planning and development department for rules and regulations in your area)? What about using the top of the building as a site for a cell tower? What about vending machines? What about premium parking? What about cable or internet?

Every building you consider must be looked at from the standpoint of, “How can I increase the income of this property?” You can use the list above as a guide, however it is in no way exhaustive. When I work with my coaching students, I show them that we are problem solvers. Each time you look at a building, ask yourself if there is some problem that could be solved that could bring in extra income. Your ability to increase the income on a building will have HUGE and VERY PROFITABLE implications for you when it’s time to sell the property to another investor.

<u>Expenses</u>

The other area that every business owner or manager looks very carefully at are the expenses of the business. If the expenses of the business exceed the income, the business will not last long. Similarly, if there isn’t enough of a difference between the income and expenses, the investors or business owners may decide it’s not worth the effort or continued investment.

In the world of multi unit investing, some common expenses are: property insurance, real estate taxes, property management, utilities, and repairs and maintenance. There can be a multitude of other expenses, but these are some of the more common ones.

When I’m working with one of my coaching students, evaluating the opportunity in a multi unit building, we assess whether there are any areas for decreasing expenses. For example, if you have a building with a high water bill, you can assess the possibility of installing low flow showerheads and toilets, which will decrease the amount of water used, and subsequently lower your bill, which in turns lowers expenses.

When I’m looking at taking over a multi unit building, I literally go line by line to review each expense and to assess whether there is any opportunity for decreasing the expense. I show my students how to uncover the hidden gold in a deal. For example, one area I always review is insurance. In general, I’m not a fan of making any kind of insurance claim unless it is one monster claim. If you’re in the business of real estate and start making claims (even one), it affects your insurance score and thus your premiums on any future real estate purchases (and not in a good way!). With that being the case, I will ask for deductible options and see how different deductibles affect the premium. I’m not going to buy an insurance policy with a deductible in excess of what I could come up with should we have a claim, but I’ll always get as high a deductible as I can afford in order to decrease the insurance premium. Decreasing my insurance expense has the same effect as increasing my income. It directly affects (in a fantastic way) the value of the property.

Your ability to be a detective and find the hidden money in a deal will make you one of very few people who know how to turn a regular real estate deal into a SIX FIGURE real estate deal.

Net Operating Income

Net operating income, better known as "NOI" in the investing community, is the capstone of determining the profitability of a building. It is made up of just two things…income and expenses. The net operating income is what is left at the end of the year, after you've collected all income and paid out all expenses.

Net Operating Income = Income - Expenses

The one expense that is not included in the NOI is any debt service payment.

What is debt service?

It is any payment you would make if you financed the building.

Why wouldn't debt service be included as an expense in NOI?

If you think about the performance of a building, without taking into consideration who owns it and how they paid for it (cash or financing), you have to realize that the income and expenses…in order to be comparable…must leave out any factor that changes just because the owner changes. The building itself performs a certain way, regardless of how it is or is not financed.

Where does debt service come into the mix?

Although debt service is not considered in the performance of the building, it is an essential part to our decision-making when we're purchasing a building to hold long term. Why? Because it affects the building's cash flow. To break it down simply, cash flow is a function of NOI and debt service.

Cash Flow = Net Operating Income – Debt Service

Capitalization Rate

The capitalization rate, better known as "cap rate" to the investing community, is a ratio to calculate the profitability (NOI) of a building with respect to its asking price or value.

Cap Rate = Net Operating Income / Purchase Price (or Value)

Cap rate will be a percentage. As a rule of thumb, the higher the cap rate, the better. For example, let's say we're looking at a building with a cost of $1,000,000. If that building has a NOI of $100,000, the cap rate is 10% calculated as follows:

Cap Rate = NOI / Purchase Price

10% = $100,000 / $1,000,000

Let's say we're looking at a building with a cost of $1,000,000. If that building has a NOI of $90,000, the cap rate is 9% calculated as follows:

9% = $90,000 / $1,000,000

If you have $1,000,000 to invest and you have one building that pays you back $100,000 over the course of the year compared to a building that pays you $90,000 over the course of the year, with all else held constant, which would be the obvious choice? Of course, the building paying the $100,000 – a ten percent return on your money.

Another way to look at cap rate is: it would be the equivalent to Return on Investment (ROI) if you were purchasing the building with cash.

A market cap rate is a figure derived from reviewing sales of comparable buildings in a market and seeing what price they sold at along with what their NOI's were…and ultimately what their cap rates were. In some areas of the country, you'll be working in markets with a 9% cap rate (these tend to me more affordable, higher cash flowing areas). In other areas, you'll see markets with a 5% cap rate (these tend to me more expensive areas that are more difficult to cash flow…unless you're putting down a massive down payment).

SECRET #5 - HOW TO CREATE EQUITY

Now that we've laid out all the pieces, I'm going to show you how having this knowledge will show you how you can go out and create SIX FIGURES in a multi unit real estate deal.

<u>What this means for you is</u> you'll be one of only a small percentage of investors who understands how to take an underperforming building, facilitate a management turnaround on it, and re-sell it for a SIX FIGURE profit!

In a market with a ten percent market cap rate, we can say that for every operating change we make (either increase income or decrease expenses) that brings us in an extra dollar per year, the value of our property increases by ten dollars. For example, if we took a building in a market with a 10% market cap rate and increased the NOI on the building from $100,000 to $110,000, we'd have increased the value of the building by $100,000 (originally the building was worth $1,000,000; by increasing the NOI to $110,000, you've increased the building's value to $1,100,000, an increase of $100,000).

Wait, that sounds too easy. What's the trick?

There is no trick. It's just the way things work in the world of multi units. This is why I say it's imperative that you understand how appraisals and valuation work, so you can be more specific in your activities to maximize your profit.

How do I increase the NOI by $10,000 in a year?

There is no one way to do it, but let me know you a few examples:

- EXAMPLE 1:
    - Get two previously vacant apartments with a monthly rent of $420 rehabbed and rented
        - $420/mo * 12 months = $5,040/yr
        - $5,040/yr * 2 units = $10,080/yr increased NOI
- EXAMPLE 2:
    - Get one previously vacant apartment with a monthly rent of $420 rehabbed and rented
    - Install five storage units in utility room or basement, charge $50/mo rent each
    - Decrease water bill by $10 per unit on a 17 unit building by installing low flow equipment
        - $420/mo * 12 months = $5,040/yr
        - $50/mo * 5 storage units * 12 months = $3,000/yr
        - $10/mo * 17 units * 12 months = $2,040/yr
        - $5,040 + $3,000 + $2,040 = $10,080/yr increased NOI

There are literally hundreds of combinations of ways to increase a building's NOI by $10,000 per year. If you really want to break it down and make it simple, realize that $10,000 per year is $833.33 per month.

You are the Creative Investor…you are the detective. It is your mission to find $833.33 of either missing revenue, or overpayment of expenses, or a combination of both. When you do that…then multiply your efforts out over the course of a year, you've reached your $10,000/yr increased NOI and in the example of a 10% cap rate, you've reached your $100,000 of increased value.

Now, you're ready to cash in on your newfound knowledge & skill set by re-selling the property to an investor looking for a performing, cash flow property!

Welcome to the world of SIX FIGURE REAL ESTATE.

Note from the author:

Dear Investor & Friend:

I look forward to being your coach and mentor in the years to come. You absolutely have the ability to make this happen…and I'll come alongside you to provide the guidance and coaching you need to maximize YOUR real estate profits!

In February 2011 a home study course on this topic was released: *How to Make it BIG Flipping Apartments Using None of Your Own Money*. If you'd like to capitalize on the step-by-step recipe for finding, financing, closing, facilitating a turnaround and creating a BIG PROFIT, check out our website at www.100krealestate.com or email me at skennedy@100krealestate.com.

I look forward to serving you in the years to come!

Stacy Kennedy, CPA
Creator of "How to Make it BIG Flipping Apartments Using None of Your Own Money"