



## REAL ESTATE INVESTOR'S GUIDE

*by*

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Designated Broker*

Thank you for considering ProFusion Real Estate as your guide to real estate investing in the Phoenix-Metro area. With any new introduction, we'd like to make sure that we let our clients know that their trust and confidence is of utmost importance as we work together on building a Real Estate portfolio. Our ultimate success as a Real Estate Investor's resource is entirely dependent on your success!

### **Why choose ProFusion Real Estate as your guide to the Phoenix market place?**

ProFusion Real Estate is a small "boutique" office composed of a rich team of Real Estate Professionals that work closely together in managing the needs of its clients. Our team has on staff:

- Individuals with over 20 years in the business;
- A licensed Real Estate Appraiser to help confidently know values going into a deal;
- A licensed Interior Designer to help know what the trends are for features of a home, as well as aid in staging homes for rent or sale;
- Seasoned Loan Officers who are constantly seeking out aggressive mortgage lenders and programs for our investors;
- Several investors whose experience includes large multi-family investments, large portfolios made up of single family residences, fix-n-flips, pre-foreclosures, and land development.

Our Broker knows the valley very well as a native of Phoenix, and comes from a family who has been investing in the valley for over 4 generations. He currently has a portfolio of 12 homes and a land development project, and is very passionate about helping others invest in Real Estate. With his real estate portfolio alone, he expects to have a multi-million dollar retirement funded within the next 10 years. His philosophy with our investor base is simple: If he wouldn't buy it for his own portfolio, we won't sell it. So you can trust in our commitment to "put our money, where are mouth is."

Besides our market and financial expertise, we have aligned ourselves with the very best in meeting your real estate needs: whether it be 1031 Exchange Services, financing, or simple home maintenance. We can also refer you to good Property Managers, and even help you market your properties for rent. We are truly a "one-stop-shop"!

## WHY INVEST IN REAL ESTATE?

In this day and age of infomercials dominating much of our TV programming, and 100's of get-rich-quick through real estate investing, there is no shortage of people out there wanting to get into real estate investing. The good thing about these programs, is that they create an interest in one of the most profitable wealth building techniques. The down side, is that they often make it seem too easy, and of course don't set realistic expectations. The truth is, real estate investing will take work, creativity, time, and will even cause stress; but as you will find, there is little else one can do to see the kinds or returns one can gain in real estate.

**It's been said that real estate has generated more millionaires in this nation than any other form of investment. Even during our strongest Bull Market in the history of our country, the average American made more money owning a home than they did in the stock market!**

**Let's look at the benefits of real estate as an investment:**

- It's a tangible asset. It's tough being comfortable in investing in something you can't see and touch.
- It's insurable. You can have insurance to protect you if your investment home burns down, or you suffer rent losses. Can you buy insurance to protect yourself from stock losses? No! (Think Enron.)
- It's a limited commodity. As the old saying goes, "they don't make land anymore". Home ownership will always be "The American Dream". When you factor in Population Growth with a limited amount of space for all to live, the law of supply and demand dictates that property values will always grow over time. Sure property values can go down during certain economic conditions, but over time, the trend will surely be upward. In one study of recorded real estate history, real estate has averaged 5.5% appreciation over the last 100 years!
- Passive loss rules. The rich stay rich by learning how to keep as much of their money as possible, i.e. paying less taxes. What other investment can you make money, yet still be able to show a paper loss on your tax returns? ...thus saving you money from taxes on other income.
- There are tax saving strategies you can take on your real estate earnings.
  - You can sell and reinvest your real estate earnings tax deferred if you follow the IRS 1031 exchange rules.
  - You can borrow against the equity growth in a property as often as you'd like, and guess what? You don't pay taxes on borrowed money! Meanwhile, someone else is paying back the loan you took!
  - There are Real Estate IRA's you can set up.
  - When you hit the big time, you can even set up Trusts to move your properties in, creating further tax shelters.
- Leverage! Appreciation growth is calculated on the property value, not your investment. So when you figure appreciation earned on your property in terms of dollars, as compared to your investment, your returns can be huge!



## WHY INVEST IN PHOENIX?

If California is any kind of indicator, currently only about 23% of the population can afford to own a home there. Phoenix grew by about 1 million people over the last 10 years. Now transpose this over the next 10 years... if and when our geographic growth slows, home values will soar. Demand will simply out pace Supply. We need only look at Cities like Los Angeles and San Diego to know this is a very real scenario.

Keep in mind that rental rates have a direct link to the First Time Home Buyer Market. The present is still an opportune time for many first time home buyers with interest rates still low. We should be reminded that 15-20% interest rates on mortgages is a very real market scenario for our future. A payment on a house that can be bought today could double just from rising rates. How many people would this eliminate from the market place? The future may be bad for first time home buyers, but good for real estate investors who get in the market today!

The Phoenix metro area is home to nearly 4 million people, and growing by 10,000 more every month! That's over 300 people moving here per day! The simple economic law of supply and demand dictates value growth. **Buy now**, and the growth becomes earnings to you. **Buy later**, and you'll have to pull more money out of your pocket to get in the game.

### GROWTH

- Phoenix is the fastest growing metro area in the country
- Phoenix is now the 5th largest city in the US
- Phoenix surpassed Philadelphia in June 2004
- Phoenix is expected to surpass Houston by 2030 to become the 4<sup>th</sup> largest
- Phoenix is still growing at a steady pace.
- 3 of top 5 fastest growing cities over 100,000 are part of the Phoenix market
- Growth estimates at 300+ people per day (over 10,000 per mo)
- US Census bureau estimates a new housing unit needed for every 2.5 people

### PRICING

- Valley home prices still rising at a steady pace
- Valley home prices **doubled nearly twice** over the last 10 years... but Phoenix housing is **still low compared with West and East Coast values**
- Median home pricing still below other major southwest cities
- The median price of an existing home in San Diego is three times higher than in Phoenix, two times higher in Los Angeles, Las Vegas is almost \$90,000 more, and Denver is \$70,000 higher.

### ECONOMY

- Labor force grew 8.5% in past two years – ½% for nation
- Unemployment over 1% less than US average
- Arizona was 2<sup>nd</sup> in US for job growth through June 2006
- Arizona was 3<sup>rd</sup> in US for new job creation in 2006
- 120,000 jobs were added in 2006
- Over 180,000 total new jobs expected in 2007 & 2008

**OTHER**

- AZ one of top 3 states in country for attracting Baby-Boomers
- #1 for Average Percent of Possible Sunshine 86%
- No natural disasters: Tornados, Hurricanes, Tsunamis, Earth Quakes, Etc
- Tenant Landlord Laws are Fair to Landlords
- Typical eviction can be accomplished in less than 35 day
- Location, Location, Location: Phoenix is conveniently located to Anywhere, USA with the 6<sup>th</sup> busiest airport in the US
- State motto: "It's a dry heat!"

**Will there be a housing bubble?**

While there is a lot of talk about the subject, most Maricopa County analysts say, "no". The main factors to a housing bubble are inflated values of homes in a region with no, or limited, economic and population growth. Phoenix suffers from neither. Housing bubbles can also happen in a city with an economy based on a narrow industry base. Take Silicon Valley for example... When the economy slows down, and people have less disposable income to spend on computer based products, the semiconductor industry slows down dramatically. High wage earning Engineers lose their jobs by the thousands and are forced to sell below market value their high priced homes that were driven up during times of prosperity and limited inventory. Also consider a once hot market like Las Vegas, which is already showing signs of being an over inflated market driven by Investors, and not economic growth which is mainly dependent on tourism. Maricopa County has no such industry dependency. It has a truly diverse economy, with more large Employers moving here everyday for our large and diverse population.

Despite the recent increases in property values, in 2005, Maricopa County's average home price barely reached the national average for major metropolitan areas! **Averaged out over the last 30 years, Phoenix homes have seen about a 7% appreciate rate per year. This means the average home will double in value every 10 years.**



## HOW ONE MAKES MONEY IN REAL ESTATE

There are three ways a person can make money from a real estate investment. In terms of “value”, I believe these to be in the order of largest gains one should consider from their investments: Appreciation, Tax Savings, and Net Cash Flow.

**Appreciation** – The improvement in value over time without any added capital to your investment. Maricopa County happens to have one of the hottest growth rates in real estate values in the country. Phoenix is one of only a few, non-coastal metro areas to make the top 25 cities in growth rate. Based on data from the U.S. Census Bureau and the Office of Federal Housing Enterprise Oversight, the average home in Maricopa County appreciated by over 80% from 1995 to 2000. Without current U.S. Census Bureau data available yet, it is currently estimated to be about 100% appreciation over the last 7 years. Outside of California, we have seen the fastest appreciation rates in the nation. The edge we have over California is the affordability of property values. The edge over Las Vegas is our size and diverse economy.

Often times, would-be investors place the “value” of an investment in cash flow, not realizing the largest gain they will make on a property is likely in appreciation. A property breaking even from month to month in cash flow is still making you money if it’s appreciating each year. The beauty of real estate investment is that you measure your rate of return based on your investment into the property, not the appreciation rate. For example: If you buy a \$100,000 home and put 5% down, and your home appreciates at 6%... you will earn \$6,000 on a \$5,000 investment. That’s a rate of return of 120% your first year.

**Tax Savings** – Unless you are cash flowing really well, or you’ve owned a property for a long time, you are likely able to show a loss each year for your real estate investment. Every dime you put into your property is tax deductible: everything from repair expenses to mileage on your car for visiting your property. What makes real estate investing even more lucrative, is that you can depreciate your property, even if it’s gaining in value. By time you add up all of your mortgage, maintenance, and depreciation expenses on a property, you likely have a paper loss. Which enables you to save money on your income taxes that you would otherwise be paying had you not owned the property. For people in higher income brackets, this can become quite a significant savings. You should consult your tax adviser about your individual situation.

**Positive Cash Flow** – This is simply the money you get to pocket each month from rents collected less your expenses. While cash flow is important on a property, one needs to factor in appreciation and tax savings into their overall analysis of a property’s value as an investment. I find it interesting how some investors consider an investment bad if they are pulling money out of their pocket each month, yet they are more than happy to do it to contribute to a stock or retirement portfolio??? Looking back at the \$100,000 investment with 5% down... What if one had to pull \$100 out of their pocket each month just to break even... In their first year this would mean a total investment of \$5000 for the down payment and \$1,200 to maintain the property. A total investment of \$6,200. If they earned 6% appreciation, this would be \$6,000. All their tax deductions may add up to about a \$5,000 loss. At 30% taxation, this would be a tax savings of about \$1,400. So their return would be \$7,400 on a \$6,200 investment, or a rate of return of nearly 120%. I don’t know about you, but I’d continue to contribute \$100/month for a 120% rate of return!



$$\text{Total Return On Investment} = \frac{\text{Appreciation Rate} \times \text{Value} + \text{Tax Savings} + \text{Positive Cash Flow}}{\text{Investment Amount}}$$

## Mortgage Financing for Investment Properties

Mortgage Lenders have undergone many changes in 2007, and they're not done yet. Many changes have occurred in the way of tighter guidelines and lending restrictions, largely in response to overall greater default rates than expected. That said, it's important that one must "qualify" for an investment mortgage, one is not entitled to an investment mortgage. It's important to maintain proper expectations of what it takes to qualify.

### Expectations

First and foremost, qualifying for a mortgage on an investment property is not the same as qualifying on a primary residence. If one reminds themselves that lending is risk based, it's easy to understand lending guidelines in terms of common sense. It also addresses why interest rates will be higher than what one may qualify for on their own home. It's an investment property, which means it's a higher risk to the lender. A person owning multiple homes is going to let a mortgage go on an investment property before they let it go on their own home if faced with economic hardship. Also consider that the less one puts down on an investment property, the greater the risk the lender has on the deal. Even just 5% down makes a huge difference to a lender, versus 100% financing. By risking some of your own money, it shows a lender that you are a bit more committed, and trust that you would be a bit more cautious about your investment choice when your own money is on the line.

We've seen a large number of investor applications who want to go "Stated Income" for no good reason other than to reduce the amount of effort required on their part for the mortgage process. Going "Stated" not only eliminates the availability of some mortgage programs to investors, but it costs them money. On average, the same mortgage program may be about a point higher in interest rate by going stated income versus full doc. On the \$100,000 investment property, that's about \$50/month. That's \$50/month less that you can use to qualify for the mortgage, or \$50/month more in your pocket just for a little inconvenience. It's worth the up front effort to go full doc if you can.

### Qualifying

There are many considerations that go into qualifying a person for a mortgage on an investment property. I will try and take this opportunity to outline them in order of importance.

- Property Type – Residential mortgage lending can be done on properties up to 4 units. Greater than 4 units is considered commercial. Many lenders also have restrictions on 2-4 unit properties. Remember: risk based. In the event of foreclosure, a single family residence may move faster for a lender than a multi-unit home that would be limited to attracting investors. Many lenders will finance condominiums as they would single family homes, however they do scrutinize the subdivision. They want to know the subdivision is complete in construction, and want to know the Home Owner's Association is operating within budget, not being sued, and that a vast majority of

the units are not rentals. There are a great number of subdivisions that are considered “non-warrantable” condos because the concentration of investment units is too high or even too many are owned by the same investor.

- ❑ Documentation Type – There is Full Documentation where basically the borrower shows all his cards. There are also Stated Income/ Verified Asset programs, Stated Income/ Stated Assets programs where they don’t even verify you have the cash to close, and there are even No Doc programs. The less you reveal to the lender, the greater the risk to them. One thing also to expect, is that the less you reveal, the lower the loan-to-value you may qualify for.
- ❑ Loan-To-Value – How much you want to borrow versus how much the property is worth. Lending criteria typically works in increments of 5%. Starting with 100% financing (Zero Down), programs and rates change at 95%, 90%, 85%, 80%, and so on. The more you put down, the less risk to the lender, the more programs will become available, and the lower the interest rates you will see.
- ❑ Debt-To-Income Ratio – This is calculated simply by dividing what you owe on a monthly basis, by your gross monthly income. For investment loans, the highest tolerance for most lenders is 42%. Bare in mind that the whole mortgage of the investment property is not counted against you. Only the difference in the net operating income of the property and the mortgage. If you are earning \$100/month on the property, this will be added to your income. If you are pulling \$100/month out of your pocket, this will be added to your monthly liability total.
- ❑ Credit – At a minimum you should have a 680. Anything less, and you could be expected to put a large down payment, or may not even qualify for most programs. The two most important factors in determining one’s credit score is payment history and balance to limit ratios on revolving accounts (credit cards). Pay your bills on time and keep your credit card balances low, and you should be in good shape. One thing you can count on: you must ABSOLUTELY never be late on any existing mortgages in order to qualify for a new mortgage on an investment property. A mortgage late will pretty much put you out of the running for any investment program. Besides scores, lenders all look at any unsatisfied derogatory items in your past, such as: bankruptcies, judgments, collections, tax liens, etc... If you plan on getting into real estate investing, you should really seek to bring closure to any unresolved issues.
- ❑ Assets – Assets must be seasoned and sourced. Seasoned implies you’ve had the money in your accounts for at least 2 months, and sourced implies its in a verifiable account in your name. You must show that you have the necessary funds to close including down payment and closing costs, AND have at least 6 months reserves: meaning funds left over after closing to cover at least 6 months worth of mortgage payments on the investment loan.



## USING HOME EQUITY TO INVEST

While most people question, “why?” We ask, “why not?” There is a certain comfort most people have in the equity they have in their home. They even have the ambition of paying off their home some day. There is nothing wrong with this hope. However there is a far better way of achieving this than simply contributing more towards principal reduction on your current mortgage.

The problem with contributing more towards your current home mortgage versus your investments, is that you putting money away into an “idle savings account”. The money you give towards principal reduction no longer has the ability to earn you more money! It’s like taking your money and burying it in your back yard for future savings. Understand your home will appreciate (or depreciate) regardless of how much you owe on your home. Its value stands alone from your mortgage balance on it. Sure you are reducing the amount of interest you are paying, but you are also likely reducing the amount of tax savings on your earnings by shrinking your tax deduction on mortgage interest paid.

### **The big picture:**

If you can borrow money at 6% (or whatever you are currently paying on your home mortgage), and invest that money at a higher rate of return, does it make sense to do it? Of course it does! ...this is how banks make their money. They pay you 2% on your money that you are letting them hold in a savings account (a short term loan from you to the bank), and they turn around and invest this money. Say... in a mortgage to someone else at 6%!

There are some key concepts here that you will grasp as you begin to “think” like an investor.

**Leverage** – Having your money make you more money.

**Other People’s Money** – Using borrowed money to make more than you are paying.

**Return On Investment** – Putting your money and borrowed money into an investment that’s making you more money.

### **The optimal solution:**

Consider a \$200,000 single family residence for investment. Say you could take out a line of credit on your own home for 20% down and closing costs. Here’s the math...

Sales Price:	\$200,000
Down Payment:	\$40,000
Closing Costs:	\$6,000
Financed Amount:	\$160,000

You would take out \$46,000 on a line of credit. Assuming 9.5% interest on this loan:

HELOC Payment: \$46,000 @ 9.5% interest only = \$364/month



Using a Pay Option ARM to finance the investment with a 3% minimum pay option:

1<sup>st</sup> Mortgage Payment: \$160,000 @ 3% (over 30 years) = \$675/month

Total monthly payments on the investment:

1 <sup>st</sup> Mortgage	\$675
HELOC	\$364
Taxes	\$100
Insurance	\$50
HOA	\$30
Management (7%)	\$70

Total \$1,289/month

What would a \$200,000 home rent for? ...anywhere from \$1,000 to \$1,200 /month

Let's assume on the low end... at only \$1,000/month in rent, you would have to pull \$289/month out of your pocket.

**Is this a good deal???** ...let's look at the big picture:

Remember the formula:

**Total Return On Investment** =  $\frac{\text{Appreciation Rate} \times \text{Value} + \text{Tax Savings} + \text{Positive Cash Flow}}{\text{Investment Amount}}$

Let's continue to assume on the low end... Let's say you only earn 6% appreciation

$\$200,000 \times 6\% = \$12,000$

Tax savings... At a minimum, this property should show up as a \$7,000 tax loss due to depreciation. In a 30% tax bracket, this translates into a \$2,100 tax savings to you.

Net cash flow =  $-\$289/\text{month} \times 12 \text{ months} = -\$3,468$  (which is all you are investing)

Total Rate of Return =  $\frac{\$12,000 + \$2,100}{3,468} = \frac{14,100}{3,468} = 407\%$

*Remember: The only thing you've pulled out of your pocket is the \$3,468 for the year! If your stock portfolio manager said he could give you 407% on your money, would you be willing to contribute something monthly? **Absolutely!** How many people contribute more than this every year to their 401K's and IRA's? Do they see these kinds of returns?*



### **What's the catch?**

First off, the numbers don't lie. This is very realistic long term return on your money. The catch is that it will require some time and effort, and sometimes, even a little stress on your part. You will have to deal with tenant issues from time to time. You will not see spendable money immediately. This is not get rich quick. It's get rich slow and methodically.

Is it worth it? ...can you think of any other way to earn 407% on your money?

DO NOT COPY

## THE OPTION ARM

THE OPTION ARM is an Adjustable Rate Mortgage, often based off of some of the slowest moving mortgage indexes around. One popular Option ARM Index is the Monthly Treasury Average, which often lags behind market rate trends. The wealthy use such a mortgage based on two principles: First, the interest rate paid on an OPTION ARM has been historically lower than a comparable 30 year fixed at any given time over the last 40 years! Second, they know that money spent towards principal reduction is far better invested elsewhere. Did you know the S&P 500 has averaged an annual rate of return of 10% over the last 100 years??? If you could borrow at 7% and invest at 10%, shouldn't you? This is how banks make money? Why aren't we in the habit of making money this way? Money applied towards principal reduction is like putting money under the mattress versus investing.

We are currently advising investors on going with the 5 year, fixed HYBRID Option ARM. This loan provides a good compromise between cash-flow management, reducing cash into an investment, and having a reasonable fixed rate term. The minimum pay rate and actual charge rate are both fixed for 5 years, provided you don't reach the cap for negative amortization. From a cash-flow, cash-on-cash, and return on investment stand point, this provides the best financing option for Investors entering the single family residence market in Phoenix. Other financing options would result in negative cash-flow or larger down payments to avoid the negative cash-flow. Either would result in larger investments into each single family investment property, ultimately reducing your return on investment.

**What happens in 5 years?** Your loan will recast itself to be paid off over the next 25 years, based on what you owe after 5 years. At the end of the day, it's still a 30 year loan. Don't let this worry you, odds are you won't still have the loan at that time. Should you still desire to maintain the property, you can simply refinance into a similar product. Keep in mind rents should go up during this time, and odds are you may want to refinance the property anyways to pull cash out to re-invest elsewhere. This mortgage product has been around for over 40 years. It promises to be around in another 5.

**Shouldn't I worry about accruing negative amortization?** No. Negative amortization just means that you are not fully paying your interest accrued each month. The unpaid amount is then being added to your mortgage balance. All this means is that you are borrowing more money against the property. Don't people refinance their properties and pull cash out all the time? That's all that's happening here, only in this way there are no added costs involved in borrowing the money. Remember how an investor thinks: If I can borrow money at one rate, and earn on it at a higher rate, it makes sense to do it! So don't worry about paying towards principal reduction if you are doing something more advantageous with that money. Keep in mind, it's a necessary tool for current market conditions. Investment strategies will continue to change in light of market changes to come.

**Should I worry about having a fully adjustable interest rate?** No. Most Pay Option ARM's are based off of some very slow moving indexes. That's important when considering an ARM. Having a slow moving index means two things: low volatility and lower than normal rates during any economic condition. By the way... if your mortgage index is going up, what do you think is happening in the equities market (stocks)? They're going up too! In other words, another opportunity to make money off your investments. Again, if you can borrow money at one rate, and earn on it at a higher rate, it makes sense to do it! So don't worry about paying towards principal reduction if you are doing something more beneficial with that money.

**Should I worry about not locking in a fixed rate while they are still low?** No. Despite the fact that many people have been proud of the fact that they locked in their wonderful 5.5% 30 year fixed, the truth of the matter is that the average mortgage only lasts 3-7 years. People move and people refinance all the time. People's needs change. So in all likelihood, that wonderful 5.5% rate is going to eventually be replaced by something higher when they refinance or move in the future. Putting our investor hat on once again... wouldn't it make sense to refinance your property in about 5 years time to leverage that accrued equity earned through appreciation. Remember, you've got to have that money working for you earning more money. The beauty of it all, is that you don't pay taxes on borrowed money. So you could pull money out of your properties indefinitely, tax free! ...and have your tenants cover your debt service for you.

## UNDERSTANDING OPPORTUNITY COST

Often when I meet new would-be investors just getting into the game, they give me two criteria to meet when finding them an investment property: “find me a good deal” and “I want something that cash-flows”. I cannot tell you how many people have missed tremendous opportunities to build wealth because of this instinctive, but misleading mindset.

**The problem with waiting for the “good deal”** is something called opportunity cost. An investor experiences opportunity costs when they miss out on earning a return on their money that they held and did not invest, **and** when they tie up too much capital or time in any one deal, and miss out on another.

I personally know fellow investors who only look for “good deals”. These individuals spend a tremendous amount of time searching for these good deals, and when they finally found their “good deal”, it usually requires more capital to get in. A seller is rarely willing to sell a home below market unless it requires extensive repair costs. Let’s examine the following scenario...

Suppose you have \$50,000 to invest. Now let’s consider whether to buy one of two homes. House A has a fair market value of \$200,000 and is great condition. House B **would be** worth \$200,000 with about \$20,000 in repairs put in it. Because it needs work, the seller is willing to sell the home at \$170,000. So buying this home at the sales price and making the repairs would net the Buyer an instant \$10,000 in equity... is this a better deal than buying house A? Let’s look at the numbers:

	House A	House B
Market Value	\$200,000	\$200,000 (after repairs)
Sales Price	\$200,000	\$170,000
10% Down	\$20,000	\$17,000
Repair Costs	\$0	\$20,000
Closing Costs	\$5,000	\$5,000
<b>TOTAL INVESTED</b>	<b>\$25,000</b>	<b>\$42,000</b>

Assuming a 10% appreciation rate for the 1<sup>st</sup> year, each house would be worth \$220,000. What is the ROI (Return On Investment) on each home...

	House A	House B
Invested	\$25,000	\$42,000
Return	\$20,000	\$30,000
Equity	\$40,000	\$67,000
<b>ROI</b>	<b>80%</b>	<b>71%</b>

**House A yields a better ROI by nearly 9%!!! ...but wait, it get's better...**

Remember: You have \$50,000 to invest... and you only invested \$25,000 in House A. You could buy a 2<sup>nd</sup> property similar to House A with another \$25,000. Going with 2 homes like House A would require an investment of \$50,000. Buying House B requiring an investment of \$42,000 would limit you to 1 property. Let's compare buying 2 houses at Full Market Value, or buying at a "good deal" on house B.

	House A	House A x2	House B
Invested	\$25,000	\$50,000	\$42,000
Return	\$20,000	\$40,000	\$30,000
Equity	\$40,000	\$80,000	\$67,000
<b>ROI</b>	<b>80%</b>	<b>80%</b>	<b>71%</b>

Let's look at the numbers that really matter to you: how much money will you make...

Buying 2 House A's would require an investment of \$50,000, and would make you another \$40,000 after the 1<sup>st</sup> year. Continuing at 10% appreciation, after 5 years of holding these two homes, you will have \$284,000 in equity! A 568% ROI!

Buying 1 House B would require an investment of \$42,000 (almost the same as 2 House A's), and would make you only \$30,000 after the 1<sup>st</sup> year. This would have a \$10,000 opportunity cost associated with it, since you didn't buy the 2 homes needing no repair costs. In 5 years, your single home would only have \$152,000 in equity. Only a 362% ROI. After 5 years, your opportunity cost would be \$132,000!!!

Both options require nearly the same initial investment amount... which would you choose?

This doesn't even take into account the carrying costs while you are getting the home repaired, nor the additional time investment to manage contractors while the repairs are being performed. Which would you choose?



## CASH-FLOW VERSUS LEVERAGE

You just got a sense of how a “good deal” can be very expensive in terms of opportunity costs. Let’s see how focusing on cash-flow versus leverage also has opportunity costs associated with it...

Consider the purchase of a \$250,000 home in the Phoenix market right now.... If you insisted on that property generating cash-flow, you would be looking at putting at least 40% down and still using an Option-ARM for financing...

Sales Price: \$250,000  
Down Payment: \$100,000  
Amount Financed: \$150,000

Rent:	\$1,000/month
Payment (\$150,000 @ 3% over 30 years):	\$632/month
Taxes + Insurance + HOA Dues	\$200/month
<hr/>	
Monthly Cash Flow	\$168/month

Let’s look at the big picture... Remember the formula:

**Total Return On Investment** =  $\frac{\text{Appreciation Rate} \times \text{Value} + \text{Tax Savings} + \text{Positive Cash Flow}}{\text{Investment Amount}}$

Appreciation (assume 10%): \$25,000  
Tax Savings (estimated): \$1,713  
Positive Cash Flow: \$2,016  
Investment Amount: \$100,000

**Total Return On Investment** =  $\frac{25,000 + \$1,713 + \$2,016}{\$100,000} = 29\%$

29% is not bad! Most people would be happy with this in other investment vehicles.

...but could we have done better by not focusing on cash flow...



Let's look at only putting 20% down and buying 2 houses...

Sales Price: \$250,000  
Down Payment: \$50,000  
Amount Financed: \$200,000

Rent: \$1,000/month  
Payment (\$200,000 @ 3% ): \$843/month  
Taxes + Insurance + HOA Dues \$200/month

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Monthly Cash Flow (\$43/month) *negative*

Does buying a rental home with a negative cash flow seem like a good deal? Let's see...

On one property...

Appreciation (assume 10%): \$25,000  
Tax Savings (estimated): \$2,473  
Net Cash Flow: (\$516)  
Investment Amount: \$50,000 + \$516 = \$50,516

**Total Return On Investment =  $\frac{\$25,000 + 2,473}{\$50,516} = 54\%$**

**The big picture:**

- ✓ ROI for the 1<sup>st</sup> year is 54%, versus 29%, almost doubled!
- ✓ Investment cost for the 1<sup>st</sup> year is \$50,000 + \$516 = \$50,516 (versus \$100,000)
- ✓ Buying 2x \$250,000 houses at 10% appreciation would earn another \$50,000 in just appreciation, versus only earning \$25,000 on one property. Think opportunity cost!

We don't expect that any Investor would put \$100,000 down on an investment property. The idea of the above illustration was to demonstrate the opportunity cost often associated with focusing on the wrong thing in real estate investing. By the way, while our illustration shows a negative cash flow, consider that the tax benefits can be realized immediately by simply adjust one's with-holdings from their income in anticipation of a reduced tax liability created by the investment. This means: there would be no negative cash flow since the tax benefits exceed the difference between the rents and the carrying costs of the investment.

You see... focusing on cash flow in real estate is not necessarily the best way to make money. Focusing on leverage generates opportunity on other investments, giving you the maximum opportunity with your money!!! This of course translates into improved **RETURN ON INVESTMENT!!!** The most difficult thing for most people to accept with this strategy is purely psychological. They see non cash flow investments as weak investments. They see negative cash flow properties as bad investments. Funny, considering they are often the ones with the negative cash flow on their 401K's. Right? Which way is the money flowing? People are OK with this because they see it as a long term investment, which is how you should recognize your real estate holdings.

## OUR CURRENT MARKET STRATEGY

A slow down in the market, largely as a result of “frenzied” buying over the last couple years has created a tremendous window of opportunity for long term investors looking to still invest in the Phoenix-metro area.

We are often able to locate properties in great condition at 10% below market value. While there are opportunities in our valley at greater discounts, these are often properties in need of repairs. Based on our strategy of minimizing cash into an investment, to maximize return on investment, we recommend to our investors property in good condition to avoid repair costs after closing.

We regularly find distressed sellers with near new homes who put lots of “love” into their homes, then find themselves unable to keep them. These are the homes we want. We prefer resale properties less than 7 years old. In our opinion, they are better than buying new, in that:

- We are negotiating terms with private individuals, often in distressed situations, willing to negotiate. While there may be good builder incentives from time to time, the red tape for a transaction is often more hassle than it’s worth.
- The current owner is often the first owner, who has already installed landscaping, window coverings, ceiling fans, and re-painted the home with custom colors. These would otherwise be added costs for an investor buying new.

We are very selective in the location, neighborhoods, size and layouts of the homes we select for our investors. There is much to consider when selecting the right home:

- We research long term “desirability” of neighborhoods based on factors such as vicinity to commercial infrastructure, prestige, and even studying current investor concentration. An Investor not familiar with certain neighborhood, who is focused on price / square foot, could find themselves in a neighborhood concentrated with other investors. This is bad place to be. You’ll find yourself in a soft-resale market and a neighborhood that sometimes lacks pride of ownership.
- We also maintain a pulse on what people want to live in. Not only is it important from a rent-ability standpoint, but from a re-sale standpoint. When going into any investment, one must always consider their exit strategy if things don’t work out or they are in need of their investment capital back. We tend to ask where a property may lie on a bell curve with potential home buyers in the future. We want properties in the middle of the bell curve to ensure maximum desirability in a re-sale situation.



This is a characteristic west-valley (City of Avondale) home priced around \$250,000. We like single-story homes, 1,700 – 2,200 square feet, 4 bedrooms (or 3+den). Our typical rental is under 7 years old with ceramic tile flooring, custom paint interiors, all appliances, all window treatments, and full landscaping with sprinkler systems.



Our “safest” long term investment strategy appears as follows: We find a property fitting our overall criteria with a market value about 10% above our purchase price.

**Using a \$250,000 property example:**

We would write the contract at \$250,000 and have the investor come in with 20% down (\$50,000). Don’t be alarmed, half of this will come back to the investor. The reason is to obtain better financing terms at 20% down versus 10% down.

Purchase Price	\$250,000	
Amount Financed	\$200,000	
Down Payment	\$ 50,000	
Closing Costs	\$2,500	(assumes seller contributing 2% of sales price)
Cash To Close	\$52,500	(max allowed by most lenders)

Cash Flow Analysis

\$200,000 @ 4.75% I.O. =	\$792/mo	(based off of preferred Option ARM program)
Taxes and Insurance (est) =	\$150/mo	
<u>HOA + Management</u>	<u>\$135/mo</u>	
Total Monthly Payments	\$1,077/mo	
MARKET RENT	\$1,100/mo	

MONTHLY CASHFLOW IS VIRTUALLY ZERO.

\* We have a program/method for structuring the purchase contract such that the Buyer will receive 10% of the sale price back! Thus reducing it from a 20% down purchase to a 10% down purchase! Creating a break-even investment in which one controls a \$250,000 property with only \$27,500.

Due to financing with the Option ARM, one may realize negative amortization at a rate of \$6,000/year (3% of the loan amount). How does this affect long term ROI? Comparing against our long term average of 7%:

	Value	Loan Balance	Equity	Annual Tax Benefit (est)
Year 1	\$267,500	\$206,000	\$61,500	\$2,318
Year 2	\$286,225	\$212,180	\$74,045	\$2,318
Year 3	\$306,260	\$218,545	\$87,715	\$2,318
Year 4	\$327,699	\$225,102	\$102,597	\$2,318
Year 5	\$350,638	\$231,852	\$118,786	\$2,318

$$5 \text{ year ROI} = \frac{(\$118,786 - \$27,500 \text{ (init. Investment)}) + \$11,590 \text{ (tax benefits)}}{\$27,500 \text{ (init. Investment)}} = 374\%$$

Where else can one expect to make nearly \$103,000 in 5 years off of a \$27,500 investment?



We have found this to be a safe and conservative investment approach to our Phoenix market, while promising great returns.

Remember: we are buying nice, newer homes in great condition, in the middle of the buyer “bell curve”, with 10% instant equity. Even if the market didn’t move, or the investor had a change of heart in a year, there would still be enough equity in the property to sell it.

### **In closing...**

We hope we have given you some valuable insight into the world of real estate investing and the Phoenix market. It can be risky with the wrong strategy, but it can also be very lucrative with the right strategy and guidance. While we all enjoy our sense of security, it comes down to an individual choice in determining what kind of future one wants for themselves, and what they are willing to do to get it. One getting into real estate investing simply chooses that it’s far more risky not to do it, based on the kind of future they want for themselves.

Remember there is also risk in not investing: Such as in retiring with not enough, which is often too late for most of us to do anything about it. If this is a possibility for you based on your current retirement strategy, the time to act is now. If history is any kind of indicator, the average home in the Phoenix-metro area will double in value in 10 years or less. The question is: how much real estate do you need to own today, for your future tomorrow?

While you still may have lots of questions, we do make ourselves readily available. We are just a phone call away.

You have our utmost best wishes for success in whatever you decide!

Best regards,

Michael Samora  
Designated Broker  
ProFusion Real Estate

*All facts and figures deemed reliable but not guaranteed. One should seek financial, legal and tax counsel to determine their specific benefits and risks. Mortgage program and rate quotes are for illustration purposes only. Programs and rates are subject to individual credit qualifications and market availability.*