THE REAL ESTATE GAME AND HOW TO WIN IT

A nuts-and-bolts, no-nonsense guide for the amateur or professional interested in making big money in real estate

JIM RANDEL

The Real Estate Game

And How To Win It

by
Jim Randel

Facts On File Publications
New York, New York • Oxford, England

The Real Estate Game
And How To Win It

Library of Congress Cataloging-in-Publication Data

Randel, Jim.
The real estate game, and how to win it.

Includes index.
1. Real estate business. 2. Real estate investment.
I. Title.
HD1379.R37 1986 332.63'24 85-25277
ISBN 0-8160-1312-8

Printed in United States of America

10 9 8 7 6 5 4 3 2 1

Composition by Facts On File/Circle Graphics

Note to the Reader

The Real Estate Game is written in the masculine gender. Nothing is meant by the exclusive use of "he," "him" and "his." The real estate game, although in my opinion sexy, is asexual in that it can be played equally well by women and men. In fact, as the only barriers to entry and hurdles to success are *one's own* knowledge, desire and creativity, the real estate game is a great avenue for personal expression and growth—without sexual restrictions or bias.

Acknowledgments

I hope that in reading this book you'll feel my sense of excitement with the real estate game. That excitement derives not only from my own involvement in the game but also from an association with many players/entrepreneurs whose passion is contagious. I thank these people for sharing their ups (and, at times, downs) with me.

I'd also like to thank the following more sedate (but also exhilarating) friends: Bob Connolly, for extending me my first loan and for having an open mind and a creative spirit; John Dougherty, for his advice on the present and proposed tax laws; Josh Gaspero and Mike Morris for believing in this book; and Kate Kelly for her excellent editorial comments and counsel.

Introduction

> "Ninety percent of all millionaires became so through owning real estate. More money has been made in real estate than in all industrial investments combined."
>
> Andrew Carnegie

Whether or not Mr. Carnegie's numerical estimate is exact, in my opinion, his premise is indisputable: real estate[1] is far and away the road most often traveled to self-made wealth. This book is about that road—how to get on it, how to travel it.

This book is written as an introduction, addressed to anyone with an interest in real estate. It does not assume prior knowledge, education or experience. It presumes only a willingness to learn and a strong determination to better your situation. The key is desire, for, in my judgment, success with real estate is more a function of diligence, creativity and perseverance than unusual intelligence or extensive education.

The intent of the book is to open your mind to the proposition that you can achieve financial independence with real estate. Thousands of people have, many starting with little (or no) capital and no special education or experience. And thousands more will do so in the future; perhaps you will be one of them.

This book describes a specific program designed to achieve real estate wealth, an approach I call the "real estate game." Participants in the game are "players" who "score" with a successful deal.

The real estate game is not the exclusive route to real estate wealth. However, I believe that it is the style of "investment"[2] used by the great majority of real estate's self-made millionaires. And it is without question the approach to real estate investment most likely to yield the maximum reward in the minimum time.

The real estate game is a style of acquiring, financing, leasing and/or selling real estate which is active, creative and ambitious. The real estate player, seeking quicker[3] returns far greater in amount than traditionally expected from real estate,[4] views real estate with a unique perspective. The real estate player sees a piece of real estate as an opportunity—as an asset to be *actively used* to turn little money into lots of money in short periods of time. While most real estate investors acquire real estate with the hope that inflation and other natural forces will increase its value (see chapter 2), the real estate player doesn't wait for outside forces—he attempts to make his property's value increase immediately.

The real estate game is not necessarily high risk. Some of the ideas described in this book involve considerable risk; most do not. What really makes the real estate game distinguishable is its viewpoint:

1. Look at each deal as a chance to double, triple, etc. your cash quickly; don't be satisfied with anything less.
2. Take an active, aggressive approach toward each deal; don't wait for inflation or other forces to increase value—*create value.*
3. *Use* your real estate as an asset to make money; don't stop with acquisition—explore all possible *post-closing* opportunities to make money.

The real estate game is not just a theory. There are thousands of players throughout the United States who are right now making money with real estate faster and in greater amounts than anything even hoped for by the average investor. This book aims to put you in that group.

The Real Estate Game, however, is not just about money, for there is another dimension to the real estate game—an excitement, a magic, an allure. Perhaps it is the magnitude and force of real estate, or its stability and substance, its visibility and glitter, the competitive interaction with other real estate players, the satisfaction of a successful project. Whatever the reasons, the fact is that you may well find the real estate game to be addictive.

Harry Helmsley, one of the wealthiest individuals in America,[5] and all self-made in real estate, speaks for many others when responding to a question about retirement:

> As long as I've got my health, I'll just keep right on going. I'm having so much fun, I don't know what I could do that would give me as much pleasure.[6]

Mr. Helmsley's endorsement should tell you something. Here is a man with the financial ability to do anything in the world he wants, yet he continues to "slug it out" in the real estate game—because it is *fun*. The fact is that Helmsley is only one of the hundreds of real estate players who, although having long ago gained financial independence, continue to play the game.

Any book which guarantees results is a hoax. I do, however, submit that it is extremely difficult to achieve independence/real wealth by earning a fixed income; after living expenses and taxes, there never seems to be enough left. And I can affirm that a large number of ordinary people have attained financial independence (and in many cases substantial wealth) by directing their time and energy into the real estate game.

I suggest that you think of your time and energy as capital—as an asset which can be invested to earn you a return. As with any asset, there are many ways to invest your own time and energy—some more rewarding than others. Although most people don't think of it as such, going to work every day and earning a salary is an investment decision, for it is a specific use of your time and energy. Since it, to some extent, precludes other uses, one must analyze and review this investment. Are you investing your most valuable asset—your own time and energy—in that endeavor most likely to lead to your financial goals? If not, I suggest that you give the real estate game a serious look.

First you must have a game plan. Chapter 1 describes ways to play the game, outlining different approaches being used successfully by real estate players across the country. It will give you some ideas about the best ways for you to play the game.

Chapters 2 through 8 describe the basics of the game: knowledge and information. The rules and concepts of the real estate game must of course, be learned before one attempts a deal, but they are not overly complicated and, once mastered, will stand you in good stead to try any deal, no matter what the size.

Chapter 9 speaks to the art of selling—in its broadest sense, the art of persuading others to act as you'd like them to. Needless to say, an ability to convince others to buy, to sell, to loan or to lease is a great plus for the real estate player.

Chapter 10 reviews entrepreneurship and its role in the real estate game. The premise is that playing the real estate game is entrepreneurial in nature and that the stronger your entrepreneurial instincts, the greater the commitment you may wish to make to the game. The chapter analyzes entrepreneurship in an attempt to help you identify the level of commitment to the game with which you're most comfortable.

Chapter 11 summarizes the book with some concluding thoughts which I call the Ten Keys to Success at the Real Estate Game.

One final note on reading this book. I have used notes throughout, which appear at the end of each chapter. More than citations of reference material, these notes are meant to provide additional or explanatory information.

The Real Estate Game aims to start you thinking about real estate and to suggest that your financial objectives are very attainable if you are willing to make a commitment to success. The real estate game has worked for many people; I hope that you will give it a try.

Notes to Introduction

1. "Real estate": land and the improvements thereon.

2. The real estate game—a *very active* involvement with the asset acquired—is quite different from most investments, in which the investor's role is passive once the investment decision is made.

3. The real estate game might be called the microwave approach to real estate wealth.

4. Or from any other type of investment.

5. The 1984 *Forbes* 400 issue lists Mr. Helmsley as one of America's wealthiest individuals, with an estimated net worth of $900 million.

6. Robert L. Shook, *The Real Estate People* (New York: Harper & Row, 1980).

Contents

1

Game Plans

There are a lot of different ways to make money in the real estate game. The approach you take should depend on:

1. the amount of time you have to commit to the game
2. the financial objectives you set for yourself
3. the time frame in which you'd like to achieve your financial objectives and
4. the amount of risk you are willing to accept.

This chapter discusses five different game plans, several of which overlap and each of which is being used successfully by many game players. The five selected plans are in no way exclusive. One of the great things about the real estate game is that there are innumerable ways to play it. The five plans are just suggestions—outlines you may wish to refer to in devising your own strategy.

Game Plan 1: Maximum Leverage—Then Ride with the Tide

The plan is to acquire as many properties as you can, using the principles of leverage and creative financing, and then enjoy the ride of inflation/appreciation. Because single-family houses or small multi-family buildings are generally easier to find and acquire than larger multi-family or commercial[1] properties, most Game Plan 1 players buy houses or multi-family buildings of, say, five units or less.

Our company started in the real estate game buying and renting single-family houses. Eventually, we moved into multi-family housing and then commercial properties. Many people start and stay with single-family houses[2] or small multi-family buildings.[3]

Getting familiar with one geographical area (usually a town, city or county), Game Plan 1 players eventually become expert in spotting and acquiring good values. They learn the rental market and know on sight what a home or apartment should rent for. They establish a relationship with one or two lenders—which usually isn't too difficult, as most savings banks and savings-and-loan associations are very comfortable loaning against single-family houses or small multi-family buildings. The brokers in the area soon learn what these players are looking for and begin calling them first whenever the right property becomes available. Soon the players are well positioned to acquire two to three rental houses or small multi-family buildings per year.

The Game Plan 1 players generally finance quite aggressively in that they spread their capital as far as possible and acquire as many properties as they can. Their logic is to maximize the return on their money by spreading it into as much real estate as possible, then benefiting in multiples as inflation increases value.[4] Notwithstanding this aggressive financing, I believe that Plan 1, if well executed,[5] involves limited risk for several reasons: First, people always need housing. So long as the properties are reasonably well located and fairly standard[6] in size and livability, there should be a steady stream of potential tenants.[7] Second, these properties are usually very marketable. Therefore, if a player needs or desires to liquidate his equity by selling,[8] there is almost always a demand for these types of properties.[9]

Although the returns from Game Plan 1 are tied to inflation and thus arguably limited,[10] if you are able to acquire just one or two properties a year (and get them to or near breakeven),[11] after just three or four years you will find that you have built up quite a nice net worth, which will increase dramatically every year. The reasons are quite simple: if you buy property with 5% down and the inflation rate is 5%, *then you will at least double your original investment every year.* The key is leverage, for inflation increases the value of 100% of your asset, even though 95% of it was acquired with somebody else's (that is, borrowed) money.

Game Plan 1 is a good, steady approach to the game. It is not time consuming and doesn't require that you leave your present job. Compared to earning a salary, it's a great way to accumulate wealth, and once you've got the system down, you will find that acquiring a property or two a year is not that difficult. What often happens, however, is that Game Plan 1 players—experiencing how lucrative and enjoyable the real estate game can be—begin to look for ways to increase[12] and accelerate their returns. Sooner or later, most of them venture into one of the other game plans, where the objective is to *create value* and earn returns far in excess of anything tied to inflation or any other traditional economic force.

Game Plan 2: Renovation

Game Plans 2, 3, 4 and 5 involve the creation of value through post-closing activity. Unlike the game players using Plan 1, who buy and then let inflation take over, game players using Plans 2, 3, 4 and 5 view acquisition as only the first step.

In these game plans, the risk may be higher than in Game Plan 1, but so is the potential upside and the speed with which financial objectives can be met. The essence of all of these plans is the act(s) of *doing something* to real estate which increases its worth—that is, *creates value.*

Game Plan 2 involves renovation—the physical alteration of a building. Renovation can run the gamut from repainting to extensive structural changes. The objective is to create value in multiples of the cost of the renovation.

In 1977 I started buying single-family houses. My objective was to buy property which was undervalued[13] because of easily correctable reasons—problems which could be overcome without major renovation.[14] I would then buy[15] and renovate, the general approach being to try to limit renovation to cosmetics.[16] Once the property was renovated, I would either resell or refinance, hoping to overfinance based on the new value. The key was to do renovations which would cost $X but would add value at least four to five times $X.

As an example, my first purchase was a house bought for $60,000. The house had been lived in for many years by an elderly man and showed very poorly—it appeared dark and dirty—even though it was basically a very nice house. The building inspection revealed no structural problems and a contractor friend estimated that the cosmetic changes which I wanted to make would cost $10,000.

I asked a lawyer friend to introduce me to a senior officer in a good local bank and I went to see this person. He indicated a willingness to loan me $60,000 to buy the house on a one-year "construction" loan but only if I could get someone with a good financial statement[17] to cosign the loan. I was in town just a couple of months and didn't really know anybody whom I could ask to cosign, but a friend of mine knew someone and thus my friend became my partner,[18] his job being to bring in the individual with the strong credit to cosign the loan. My partner's credit contact cosigned as a favor, after we convinced him that there was minimal risk and that he'd be off the loan within three months.

We now had the $60,000 to buy, but we still needed $10,000 for the renovation. I went to a local commercial bank to obtain a loan but could get only $5,000 and for just 90 days. I took it and then went to see my contractor friend and asked him whether he'd do the $10,000 worth of work—with $5,000 down and the balance in three months. I offered him an extra $1,000 if he would wait for the second $5,000. He agreed.

The day we closed we immediately started renovation, for we were under a tight time schedule:

- one-year construction loan

- 90-day $5,000 loan
- 90-day obligation to contractor
- promise to cosigner to get him off the loan within 90 days and
- interest running on the $60,000[19] and $5,000 loans and no money to make the payments.

The objective of the renovation was to change the look and feel of the house—to open it up and "show off" its good features. The work was cosmetic: painting, sanding and staining the wood floors, new bathroom fixtures, rebuilding a porch/deck.

While the renovation was under way, I lined up a few brokers to appraise the finished house. The day the renovations were done, the house was advertised for rent and the brokers were brought in to do their evaluations. My partner and I anxiously waited for their numbers.

The three valuations were in the $110,000 range and we breathed a sigh of relief. I asked the brokers to put their appraisals in writing (one paragraph), took them to the bank and asked for a permanent mortgage, based on the brokers' valuation.[20] Based on my new value, the bank offered me a permanent loan of $80,000, at a fixed interest rate of 9% (the going rate at that time), with monthly payments of about $650. As the bank was comfortable with the equity in the house ($30,000), they did not require a cosignature. So, we immediately refinanced (within 90 days) and used the additional $20,000 (the amount over the $60,000 construction mortgage which we repaid) to:

- pay the interest due on the $60,000 loan
- repay the $5,000 commercial loan plus interest
- pay the contractor $6,000 and
- buy the cosigner a gift.[21]

We still had about $8,000 left, $2,000 of which we put in the bank to cover debt service and taxes until we could rent the house. The balance ($6,000) we divided up, each of us putting $3,000 (nontaxable[22]) money in our pockets. As the house now showed very nicely, we soon located a tenant willing to pay $750/month plus utilities, which covered our debt service, real estate taxes and insurance.

As a result of this deal, my partner and I:

- each made $3,000 (after taxes)
- controlled an asset worth $110,000, giving us total equity of $30,000, which asset was appreciating
- were receiving depreciation which sheltered other income (we were both starting out as lawyers)
- were repaying the $80,000 mortgage with someone else's money, that is, the tenant's payments (rent) were being used to make the mortgage payments and we were building equity by paying down the mortgage
- had established credibility with the local brokerage community
- had established credit with a local contractor and
- had established credit with a lending institution.

Not only had we laid the framework to do more and bigger deals, but—counting the equity in the house—we each made $18,000 ($36,000 total) in 90 days on an investment of zero. Needless to say, this deal whet our appetite for more of the same.

In subsequent years, what became a real estate company acquired and renovated several commercial properties, using the same principles as described here. The effort was always the same: to create value through renovation by changing the appearance of a property. The technique has worked for us—and many others—time and again.

Game Plan 3: Finding Your Niche

One of the ways to create value in real estate is to approach it in a way most other people can't. In other words, identify a niche with regard to some use or application of real estate and become expert at it.

The best way to make money in business is to do something which nobody else can do. Because this is an ideal (since sooner or later others will fill the vacuum), the next best thing