Are You Clear On What Is A Good Deal?

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So often, in the beginning, investors focus on real estate investing techniques, and lose sight of the important issue - is this a good deal? Learning to recognize a good deal takes research, education and, above all, experience. Here's a good formula to determine whether a potential real estate purchase is a deal. It's a simple acronym called "C.L.E.A.R."

• **Cash Flow** Ask yourself, will this property cash flow? Well, that depends on a lot of factors, such as the strength of the local rental market, the interest rate on the financing and how much of a down payment you contribute. Also, it depends on whether it is a single family or multi-family dwelling. Considering all of these factors, ask yourself, "Will this provide income for me?" Also, ask yourself the question, "How will this property cash flow compare to other potential properties?" For example, a $150,000 house that rents for $1,000/month has better income potential than a $300,000 house that rents for $1,600/month. A four-unit building that costs $400,000 may bring in $3,000/month in the same neighborhood.

Now, of course, whether the property will provide income to you begs the question of whether income is important to you. Is it? Do you earn other income? Do you need more income now, or is future equity growth more important? There's no right answer to these questions, but all are factors to consider when looking at a potential purchase.

• **Leverage** Leverage is important in investing, because the less cash you put down on each property, the more properties you can buy. If the properties go up in value, your rate of return goes up exponentially. However, if the properties go down in value and you have a lot of debt on the property, this can result in negative cash flow (see above). Since real estate is generally cyclical, negative cash flow is only a short term problem and can be handled, if you have other income or a cash reserve to pay the shortfall. "Nothing down" investing is very attractive for the high-leverage investor, but should be approached with caution. If you are a long-term player, leverage will generally work in your favor, if the markets in which you invest appreciate over the long run, and your income from the properties can pay for most of the monthly debt service.

• **Equity** Does the property you are purchasing have equity? Equity can take a number of forms, such as:

• A discounted price
• A potential fixer upper
• A re-zoning opportunity
• A poorly managed property
• A foreclosure

There are many ways to create equity, but buying into equity is your best bet. Find a motivated seller that wants out of his property, and is willing to give up his property for less than full value. Or, buy a property that needs work and can be done for 50 cents on the dollar or less. In other words, if the property needs $10,000 in work, make sure you get a $20,000 discount on the price, or better.

• **Appreciation** Buying in the right neighborhoods, and in the right stage of a real estate cycle, which will result in appreciation and profit. However, timing a real estate cycle is difficult and can be very speculative. If you buy properties without equity or cash flow, solely for short-term appreciation, you are engaging in a very risky investment. Buying for moderate to long-term (10 to 20 years) appreciation is safer and easier. Look at long-term neighborhood, and city-wide trends, to pick areas that will hold their values and grow at an average of 5 to 7% per year. Combine this tactic with reasonable cash flow, and buying into equity, and you will be a smart investor.

• **Risk** Risk is a consideration that too few investors consider. Ask yourself, "What if my assumptions are wrong?" In other words, do you have a "plan B"? If you bought for short term appreciation, and the property did not appreciate in value, can you rent it out for positive cash flow? If you bought with a variable rate loan and the rates go up, will this put you out of business? If you have a few vacancies, can you handle the negative cash flow, or will it break the bank for you? Expect the best, but prepare for the worst.

Remember, whenever you look at a property to purchase, think "CLEAR"ly.