

November 1, 2019

Ask These 7 Important Questions When Investing In Real Estate

- Find out the most common way to value property…
- When interest rates are low, more people buy homes…



Robert Kiyosaki

Editor, *Rich Dad Poor Dad Daily*

Dear Reader,

There will always be a real estate market. In a civilized world, a roof over your head is as essential as food, clothing, energy, and water.

Real estate investors are essential to keeping this vital human need available at a reasonable price. In countries where investing in real estate is limited or excessively controlled by the government, such as it was in former Communist Bloc countries, people suffer, and real estate deteriorates.

There are many different ways a person can participate and prosper with real estate. Rental properties are a great way to build long-term wealth. They allow you to generate income with minimal time. Rental properties or apartment complexes appreciate over time which gives you equity in the property. During this same period of time, your tenants are paying down the mortgage, so you have even more equity in the property. In addition to building equity, you have monthly cash flow and annual tax deductions.

In late 1974, I purchased a small condominium on the fringes of Waikiki. It was one of my first investment properties. It was a nice two-bedroom, one-bath unit in an average building. The price was $56,000. It was a perfect rental unit, and I knew I could fill it quickly.

Rich dad then began to tear my investment deal apart by asking questions that I had failed to ask.

1. Why was the interest rate so high?
2. How did the deal fit into my long-term investment strategy?
3. What vacancy factor was I using?
4. What was the cap rate?
5. Had I checked the HOA's history of assessments?
6. Did I factor in repair and management costs?
7. Did I know that major construction was scheduled outside the building?

I felt defeated that I hadn't factored any of these things into my

calculations. "It looked like a good deal," I said.

Rich dad smiled, stood up, and shook my hand. "I'm glad you took action," he said. "Most people think, but never do.

fewer residents. But on the plus side, when lending gets tighter and it becomes harder to qualify for a home mortgage, renting becomes the only option and the demand for rental homes increases.

Investors have made a lot of money in this area of commercial real estate by buying right and managing efficiently. Like all commercial real estate, the value of a multifamily property increases based on increased operating performance. In other words, buying a property and then managing it and filling up the vacant space better than the previous owner can create an automatic bump in value.

My Rich Dad Advisor on real estate, Ken McElroy, says this about interest rates: "If you are an investor who already has your eye on a specific property on the market, you'll be interested in the interest rates. Again, if interest rates are high and you are using debt to finance your real estate deal, it may not be a lucrative return as higher rates tend to reduce returns. Lower interest rates tend to stir more real estate activity and create more lucrative deals."

Interest rates can also have an effect on whether you decide to purchase a property or to sell a property.

Evaluating Your Cap Rate

The most common way to value a property is by using a capitalization (cap) rate. In any given market, cap rates will vary. You don't have to worry about how to figure out what a market's cap rate is; you can get that number from a knowledgeable broker. You do have to understand how cap rates are used to estimate the current value of a property. Tom Wheelwright, my Rich Dad Advisor on Taxes, says:

> *"Your cap rate (or capitalization rate) is simply your net operating income divided by the value of your property.*

Remember that this figure represents the value of the property, not the cost of the property. Let's look at an example. Suppose your property produces $10,000 per month in rent or $120,000 for the year. And suppose your operating expenses (remember, this doesn't include mortgage interest or principal payments, or depreciation) are $70,000. This means that your net operating income (NOI) is $50,000. If your property is worth $500,000, then your cap rate is 10 percent.

You can use this information to make decisions. Let's suppose that you have a loan on the property with a 7 percent interest rate. If your cap rate goes below 7 percent, then you need to think about selling the property. Why? Because now you have what is called "negative leverage." Negative leverage occurs when your return is less than you are paying on your loan. At this point, it is actually costing you money to borrow because the cap rate is lower than your borrowing rate."

When Investing In Rental Property, Consider The Following:

Fixed is better than floating. I believe it's a much better idea to take out a fixed-rate mortgage rather than a floating rate mortgage, even though a fixed-rate mortgage will have a higher interest rate. There is a very real possibility that inflation (and, therefore, interest rates) will rise sharply in the US during the next decade or two. In that scenario, if you have borrowed at fixed rates, inflation would be to your advantage. Your rents would go up, but your mortgage payments would not.

Shorter is better than longer. Take out a 15-year mortgage

instead of a 30-year mortgage. You will save an enormous about of interest expense that way.

Location, location, location. If you buy a rental property, you had better be absolutely certain that it is in an excellent location so that you can find tenants even if the economy becomes much worse than it is now.

It's better with land. You will also own a piece of something they aren't making any more of, land. When the government prints money, hard assets like gold and land appreciate. Land is an excellent store of wealth.

Watch the leverage. Each investor must strike the right balance between borrowed money and equity. Keep in mind that the global economic crisis is far from resolved. There is a chance that the world economy will collapse into a new great depression. If it does, your rents will drop sharply. Of course, the price of everything else will drop sharply too, so you will be no worse off—so long as you can still service your mortgage.

Regards,



Robert Kiyosaki
Editor, *Rich Dad Poor Dad Daily*