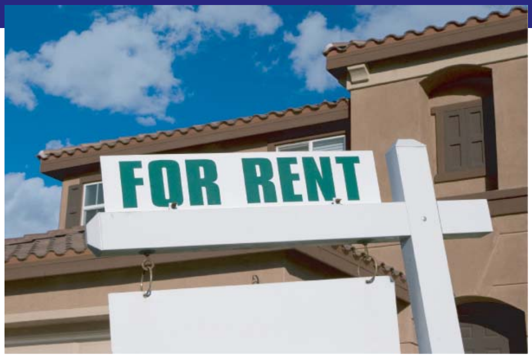
the Property report



FALL 2010 A PUBLICATION OF THE PROPERTY LEDGER ISSUE 6

Upside Down? You Can Still Refinance!

– *By Brent Sullivan*

*This issue's **Feature Wealth Team Member™** article is by Brent Sullivan of Home Owners Financial Group related to programs available to refinance existing real estate.*

I receive calls every day from people who want to refinance their home but who are upside down. In other words, they owe more than the value of their home.

On February 18, 2009, President Obama's administration came out with a national strategy aimed at helping homeowners to restructure or refinance their mortgage loans to prevent foreclosures. This comprehensive plan is known as the Making Home Affordable Program (MHA).

MHA consists of two separate components:

1. The Home Affordable Modification Program (HAMP) assists homeowners already behind on their mortgage payments.

2. The Home Affordable Refinance Program (HARP) enables eligible homeowners to take advantage of today's low interest rates—even if they are upside down.

Both programs are offered by Fannie Mae and Freddie Mac, the government owned housing giants that finance the vast majority of mortgages in America and package the loans into mortgage-backed securities.

While there has been much publicity about the HAMP, not much has been written about the HARP.

To qualify for a HARP refinance, you must first determine if your property is owned by either Fannie or Freddie. Do this by going to either *http://www.fanniemae.com/loanlookup/* or *https://ww3.freddiemac.com/corporate/*.

If your property appears on one of these websites, here is what you can expect with a HARP refinance:

- The refinanced mortgage balance cannot be more than 105% of the property's value. If your current mortgage was originated or is serviced by MetLife or First Horizon, you can go to 125%;
- The property to be refinanced must have been purchased on March 1, 2009 or earlier;
- Maximum loan amount is $729,750;
- If your current mortgage does not have private mortgage insurance (PMI), the new mortgage will not require PMI;
- Second mortgages or Home Equity Lines of Credit (HELOCs) may not be paid off in the refinance and must be resubordinated--in other words, left alone. There is no limit on the size of your second mortgage or HELOC compared to your home's value.

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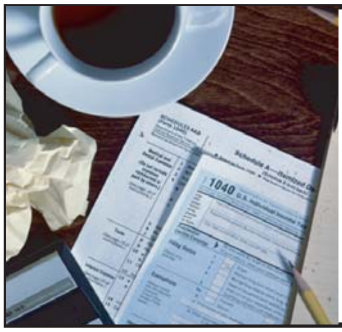

The Tax Corner

Given the huge operating deficit of the United States, our politicians in Washington D.C. have been kicking around the idea of abolishing the interest deduction on first and second homes as a means of generating $143 billion in additional tax revenues. While no decision has been made in relation to this matter it is important to bring this issue out into the light so that home owners and real estate investors may voice their opinion to their representatives. Stay tuned for more information in relation to this matter.

(cont. Pg. 1)

Upside Down?

- All property types are eligible including single family, multi-family, PUDs, condos, mobile homes;
- All occupancies are allowed including owner-occupied, second homes and investment properties;
- No cash can be taken out of the transaction;
- An appraisal is required but can be waived in some situations;
- Minimum FICO score of 620 and no mortgage late payments within the last 12 months;
- If refinancing an owner-occupied property, there is no limit on the number of owned financed properties. If refinancing an investment property or second home, the maximum is four owned financed properties;
- Full income documentation required;
- Closing costs may be rolled into the new mortgage.

I have been able to assist many borrowers who, before they spoke with me, never thought they could take advantage of today's record low interest rates.

I will admit the usefulness of the HARP in states hard hit by the economic downturn, is somewhat limited when compared to other states simply because residential real estate values are down to a greater degree. However, lowering mortgage rates for the vast majority of Americans who continue to honor their mortgage obligations is good for our homeowners and our economy.

Be an Investor – Not a Landlord!

Brent Sullivan may be reached at 480-620-7300 or via email at

The Buy and Flip Formula™

– Carter Froelich

While we recommend holding appreciating assets for the long term as the key to wealth creation, we do realize that many of the users of The Property Ledger™ implement the "buy and flip" strategy as a means of generating cash flow and/or to dispose of properties which do not meet their "buy and hold" strategy.

When purchasing properties to flip, it is our suggestion that you purchase properties which are located in high demand "enchanted areas" and are in the bottom 1/3 to1/2 of the value of homes in that area. When buying property to flip, the key is to be able to sell the property within an approximate 90 day window. As such, there are more people in the market looking for this type of property as opposed to million dollar mansions.

Obviously, the most important element in a buy and flip is the purchase price; one wants to be able to purchase a home which when renovated will sell quickly. As such, it is absolutely essential that one does not over pay for the home. A formula which has worked well over the years to evaluate a buy and flip is illustrated here:

The Buy and Flip Formula™

Description	Remarks	Example
Anticipated Sale Price (After Renovation/Fix Up)	What similar type homes have been selling for in the immediate area over the last 60 days? Remember to stay in the lower 1/3 to1/2 of the market	$300,000
Less: Purchase Price	The price you anticipate purchasing the property.	$175,000
Less: Renovation Costs	Costs of materials and labor to renovate the property. Be realistic in your figures.	$ 10,000
Less: Holding Costs	Costs incurred to hold the property while the renovation and sales activities take place including interest, taxes, insurance.	$ 3,000
Less: Sales Costs	Anticipated costs to sell the property including sales commissions, closing costs and any related taxes. This usually is around 10% of the sales price.	$ 30,000
Less: Profit Requirement	Use 30% of the estimated purchase price as your profit margin.	$ 52,500
Total	The resulting figure should be positive otherwise you may not be giving yourself enough cushion to make a profit.	$ 29,500

Creating an Effective Retirement Vehicle

– Carter Froelich

Ever since I can remember, the general public has been bombarded with ads from the financial services industry to begin planning for your retirement by establishing IRAs and other financial instruments. The overriding message of the ads was to purchase stocks and bonds and hold them for the long term and let them go up in value until you retire and then withdraw the funds from the account to support yourself in retirement. While I believe that it is absolutely imperative to plan for retirement I do not believe that stocks and bonds are the best vehicle to create wealth, security and a guaranteed cash flow. In my mind real estate the best vehicle to accomplish this goal. Let's take a look at two families who are saving for their retirement and determine which plan provides the most meaningful returns.

***Case Study* —The Smiths and the Greens**

The Smiths are a very conservative couple who prefer to invest their money in things that they deem are safe and easy, such as indexed stock funds. When the Smiths retire, they hope to use the money to fund their living expenses. Accordingly, on the first day of every year, the Smiths invest $10,000 in indexed stock funds. On average, the Smiths achieve the historic annual returns of the stock market of approximately 10 percent, or $1,000 ($10,000 x 10%), for their $10,000 annual investment. Over the next thirty years, the Smiths' investment portfolio will reach a value of $1,809,434, which equates to a cash-on-cash return of 10 percent over the thirty-year period.

The Greens' retirement goal is to spend as much time as possible traveling the world upon their retirement. Because the Greens do not want to sell their assets to pay for their traveling expeditions, it is important that their retirement assets generate a monthly income so that they can pay their monthly bills and spend the rest of their money for travel.

For these reasons, the Greens are intrigued with investing in real estate. The Greens also like the fact that they can take their $10,000 investment and purchase a home for $100,000, utilizing a 90-percent loan obtained from the bank. The Greens are also not afraid of the additional work required to invest in real estate, as long as it generates a higher return.

As such, and for the purpose of this example, let's assume that the Greens take their $10,000 investment, and on the first day of the year purchase a $100,000 home with a 90-percent, fifteen-year fixed mortgage with an interest rate of 7 percent.

Let's further assume that because the Greens will have some years of negative cash flow because they are paying off their mortgages over a fifteen-year time period, they will only purchase one home per year for the next fifteen years.

The Greens are able to rent out each home for $750 per month, and their homes will appreciate at an average rate of 5 percent per year (the historic average appreciation rate for homes in the United States is approximately 6 percent per year).

For simplicity's sake, we will also assume that the Greens' tenants agree to pay all operational charges, including property taxes. As an offset to not including the payment of operating expenses, I have not taken into account the positive tax benefits of owning real estate.

Assuming the facts above, at the end of the thirty-year period, the Greens' fifteen homes will be debt free and will have an estimated net value of $4,710,330. Additionally, these homes will generate a net income for the Greens of $11,250 per month, which can be used for living and travel expenses. This equates to annual cash-on-cash return of 3,081 percent. In summary, the difference between the Smiths' and the Greens' investment portfolios at the end of thirty years is outlined below.

If you had the ability to select the retirement strategies of either the Smiths or the Greens, whose strategy would you select? It is my belief that we would all select the Greens' strategy, as it not only produces the highest net worth at the end of thirty years, but it also generates a monthly income of $11,250, or $135,000 annually, on which to fund the Greens' living (and traveling) expenses. While some of the assumptions utilized related to the illustrate the Greens' real estate portfolio are very simplistic and do not cover all of the costs with property ownership, the fundamental concept of the example holds true—that real estate provides superior investment returns and ongoing income streams vis-à-vis other forms of investments.

Unfortunately, most individuals and families in the United States and other countries around the world are following the Smiths' strategy. As such, it is highly unlikely that the vast majority of people in the world will enjoy a comfortable retirement at their current living standard with sufficient disposable income to enjoy some of the finer things in life, such as travel and giving back to the community.

I hope that this article has given you a wake-up call. Stop and look at your retirement strategy. If you do not have a significant portion of investment in real estate, you may want to consider shifting a portion of your investment funds toward real estate in order to reap the financial rewards in retirement that the Greens will be enjoying. No matter what your age or financial situation, there is still time to make real estate a meaningful component of your investment portfolio and make ***The Property Ledger™*** the command center of your real estate investing infrastructure. The Property Ledger™ was created to assist real investors analysis properties and to track the performance of their investments overtime as they move towards their Retirement Vision™.

Description	Smiths	Greens	Difference
Investment Vehicle	Stocks	Real Estate	N/A
Yearly Investment	$10,000	$10,000	$0
Value of Portfolio Yr 30	$1,809,434	$4,710,330	$2,900,896
Cash-on-Cash Return	10%	3,081%	3,071%
Monthly Income	$0	$11,250	$11,250

What's Your Plan B?

Over the years I have seen many real estate investors purchase property with only one exit strategy in mind. For instance, an investor may purchase a property with the idea of fixing-up the property and selling the property for a quick profit. As we all know the market can take quick and dramatic turns which can lay ruin to even the best laid plans, the prudent real estate investor always has multiple plans on how to deal with changing economic or personal situations.

Plan A – Buy and Hold

When purchasing a property it is important for the investor to have performed their due diligence and to have structured the purchase in such a manner so as to ensure that the revenues from the property will cover monthly operating expenses as well as the debt service obligations of the property so as to ensure that the property cash flows from day one. This is a prudent move as it is always in the investor's best interest to hold the property for the long term with no further cash infusions should they be unable to sell the property if their strategy is to buy and sell. This should always be Plan A.

Plan B – Equity Share

If Plan A does not work out as a planned and the property begins to deplete the financial resources of the investor, rather than sell the property at a loss; the investor may want to enter into an equity share transaction whereby a portion of the property is sold to another investor and the cash proceeds and/or the support of the new investor, the on-going obligations of the property are paid based upon their equity share agreement.

Plan C – Sell The Property / Lease Purchase

Plan C relates to the original intent of selling the property for a quick profit assuming that the market conditions are favorable for this type transaction. If for some reason that the sale and flip is not feasible, the investor may want to consider selling the property on a lease purchase option. In this scenario the buyer puts down a sizeable non-refundable deposit to purchase the property, in the case that the buyer exercises his or her option to purchase the property, the deposit is applied against the purchase price of the property. If the option is not exercised, the deposit is lost. In this scenario the costs of owning the property are transferred to the buyer who pays for utilities, property taxes, insurance, etc. allowing you realize a sizeable infusion of cash as the result of the deposit while at the same time shifting all of the operating expenses to the buyer.

When investing in real estate always plan for the unexpected by making sure that in a worst case scenario, one can live with the financial ramifications.