

WINDERMERE INVESTMENT KIT

A Tool for Building
Wealth Through Real Estate



The Windermere Investment Kit

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INTRODUCTION

Anyone who has ever considered investing in real estate understands the ultimate benefit of doing so: a source of income long after they have paid off their mortgages. It sounds almost too good to be true ... but it isn't! In fact, reaching that goal is fairly simple, whether you are still in the exploration phase, have dabbled in real estate investment or are a seasoned investor.

Before stepping out into the real estate investing world, buyers need to understand the best process to analyze and evaluate properties. They need to know exactly what kind of properties they should consider purchasing and what both the properties and the numbers should look like. Last but not least, they need to know what their wealth goals are and how real estate investment can help achieve them.

Brokers at Windermere Real Estate in Colorado have created an analysis tool – the Investment Kit – that takes what sounds like a complicated process and simplifies it for investors of every caliber. Using the kit, they help investors find the home that meets the criteria they are looking for; purchase it; find and put renters into it; and then sit back and start collecting the passive income or cash flow.

It really is that simple.

BENEFITS OF INVESTING IN REAL ESTATE

Investment properties offer much more than just having tenants pay the mortgage until the house is paid off in 15 or 30 years. Multiple tax benefits accompany owning investment real estate, as does the passive income from rental property. Whether you are a first-time investor with more modest goals or an investor who wants 20 or 30 or 50 properties by retirement, it is a scalable benefit.

Whatever people do in their regular, day-to-day lives, whether teachers or stock brokers or real estate agents, investment property can supplement their income. If they need cash flow to make up for irregular income from their jobs, they should consider investing in real estate. If their income does not support the finer things in life, or finance the things they would like to do, rental properties can open those doors.



While rents increase over time, investors will likely pay for the property with a fixed-rate mortgage. This means their tenants are paying them more and more rent as time goes on while the payment, principal and interest payments remain the same. Eventually they will pay off that home and realize a continual, residual income or “mailbox money,” as real estate investors call it.

Perhaps the biggest benefit investment real estate offers is the potential income during the retirement years. Imagine collecting a passive income from five or 10 properties, or even a more aggressive 50-property goal, when your working years have come to an end. That passive income will provide for a great retirement – and maybe even an earlier retirement, which many hope to realize. If the vision is to own a collection of properties that are paid off and filled with tenants who are paying rent every month to live in those homes, it is time to start investing.



WHY NOW

With prices reaching unprecedented heights in today's hot real estate market, many may think that the numbers do not work to see a return on their investment. They assume that ship has sailed and they missed the boat. But it is still a good time to explore the waters of investment real estate. Here's why:

Rents have increased dramatically over the last couple of years while interest rates remain historically low. This means buyers have more purchasing power: they can buy more house for the same money. Add increasingly higher rents, and they are looking at higher investment returns on a monthly cash-flow basis and on a yield basis than a decade or more ago. While prices were much lower then, real estate investors are actually seeing higher cash flow when they lock in their mortgage loans at a 30- or 15-year fixed rate. This provides more stability and better numbers regardless of the fact that home prices have increased here in Colorado.

When compared with other investments available today, real estate offers more stability. The stock market is often volatile. For those wondering whether to invest in stocks or real estate, they cannot go wrong with diversity, and that is what real estate provides. Windermere's Investment Kit has convinced many to invest for the long term in real estate, helping them become savvy investors with multiple properties in their portfolio. By doing so they are realizing a more secure financial future for their families – a satisfying accomplishment for both the investors and their Windermere brokers.

FINDING THE RIGHT PROPERTY

The first step to investing in real estate is finding the right property. The criteria include not only what the property looks like and its condition, but also its location, the available tenant pool and whether the numbers add up. Investing in real estate is not all about the price of the property. While it is one criterion – and an important one, at that – it is really about the cash flow or the yield. It is about the numbers.

So how does an investor pick the right property to buy? A few components go into this decision, starting with location – just as it is with any property. When analyzing different areas within the community for investment properties, consider whether it is close to:

- A university
- A larger employer
- Quality schools

All of these aspects take into consideration the “big tenant pools.” In other words, from where are the tenants who are going to live in these homes going to come? The most desirable location is one located near one or more of the community’s biggest tenant pools. University towns are great for investing in real estate because they have a built-in tenant pool – college students. Large employers are attractive, as well, for the same reason. Schools also play a big role, especially in the higher-end rental properties, because parents are looking to locate within the attendance boundaries of what they consider the best schools to which to send their children.

A Windermere broker will look at the long history of vacancy rates in the communities in which customers are considering investment properties so they can know what to expect in vacancy rates over time. Colorado has and should continue to have a healthy economy and, for the most part, strong or low vacancy rates over the long term. This has made the numbers work well here for real estate investors.



When considering properties to buy, do not just look at those that are “move-in ready.” If a property is priced right and has potential, it might need a little bit of love, time and money put into it to make it ready for tenants. It is the potential that counts.

During tours of potential investment properties with a Windermere broker, together they and customers can spot major issues before the inspection period allowed during the buying process. It is clear whether a roof is about to go. They can identify whether appliances are old or whether the current owners recently replaced them with new



ones. They will know whether the kitchen or bathroom need updating or remodeling. The broker can factor in any and all of these fix-up costs up front, before the inspector takes a look at the property. If the home is in great shape, it will lower maintenance expenses down the road. That initial walk-through allows investors to spot issues that can they can start dealing with right away.

Included in the Windermere Investment Kit is a checklist of all the important items by which an investor, along with the Windermere broker, can evaluate potential investment property.

THE NUMBERS

But when it comes down to it, location and condition drive the numbers, and the numbers are what it is all about. However, the numbers are about much more than the price of the home. It is easy and even understandable to get wrapped up in the price of the home or an investment property, but buyers have to factor much more into their calculations, such as:

- Is the property going to have above- or below-average maintenance demands?
- Could the property become vacant more often because of a less-desirable location?
- Does the property have an above- or a below-average potential for appreciation down the road? This factor is then calculated into the yield numbers covered later.

KEY TERMS

The Investment Kit ultimately clarifies the process to analyze and evaluate potential investment properties. In order to understand just how this kit – or tool – works, it is important to know certain key terms.

Cash Flow

The most exciting part of investing in real estate is cash flow – the check that shows up in the mailbox every month, either from the property manager or the tenant directly. The cash flow is what is left after accounting for the costs of the property, such as the monthly mortgage payment, which probably includes taxes and insurance. It may also include the fees of a property manager who handles the management and tenant aspect of the investment property. The cost also covers any maintenance of the property, because it is imperative that it remains in good shape.



How much cash flow to expect from a property – or the “target” – is based specifically on the area in which it is located. A decade or so ago, targets were lower than they are now, even when home and rent prices were significantly lower. In Fort Collins today, the target for single-family homes is \$250 or more after costs, including management, maintenance and potential vacancy. That is \$100 more than it was 11 years ago, even with much higher prices. But the target is specific to the area – or “hyper local” – and depends on the part of the community the property is in, and the benefits and amenities the area offers the tenant population. Your Windermere broker will discuss current cash-flow targets for the homes you are looking at.

The whole point is to have money flowing in. Investors set their targets but should understand that they are all local. If their returns are around or better than the local cash-flow average for rental properties, then they have invested wisely.

A multifamily unit, such as a duplex or a triplex, offers some efficiencies, resulting in even more cash flow. For example, a duplex in Fort Collins right now should result in a cash flow of \$600 or more per month, or \$300 per unit. Whether investors should purchase a multifamily property depends on their goals, how many doors they might want and how much cash flow they desire. A Windermere broker can help with deciding whether investing in a multifamily property is right for each investor.

Yield

We now calculate the “yield,” or what the property is expected to earn annually on average after taxes. Calculating this figure allows the investors to analyze real estate investments against something like stocks or bonds or other types of investment vehicles.

This figure is specific to an area, as well, but in Fort Collins for example, the expected yield on investment properties should hit 14 percent or higher – compared with a decade ago or more, when 10 percent was considered a good number. Colorado has seen a significant increase in appreciation, resulting in higher yields. The 14 percent factors in the cash flow and any appreciation.

Cap Rate

The cap rate is the price of the property divided by the net operating income, which is the gross income or rent minus all of the costs such as debt service, maintenance on the property, vacancy, etc.



Many investors love the cap rate because it allows them to compare apples with oranges. While it is useful to a certain point, it does not tell the whole picture.

Currently investors in Fort Collins are purchasing at a cap rate of 5.5 percent and above. That target has gone down a bit recently and, again, it is a function of price, but it has hovered between 5.5 percent and 7.5 percent for more than a decade in Metro Denver and Northern Colorado.

THE INVESTMENT KIT: SIMPLIFYING THE COMPLICATED

This sounds complicated and may leave many wondering how to do these calculations. The good news is that the Windermere Investment Kit does it all automatically.

Windermere brokers work with clients to plug in the real numbers and the kit generates the results, so together they can look at the numbers and measure them against investors' targets.



It may appear daunting, but this tool breaks down all the data needed into small, simple pieces. The Windermere broker inputs the data – the basic information about the house – for the investor and can then show why a property is or is not a good investment. This kit splits up the value of the property between the land and the house, because the investor may realize tax benefits or deductions that come with the depreciation of the improvements to the building itself. This makes it a little easier to determine the tax benefits down the road.

When determining whether a property is worth investing in, start with the price, adjust the variables, and then incorporate the financing data. Most investors are opting for a 30-year option in a mortgage. Few borrowers are choosing adjustable-rate mortgages anymore, but because some buyers may choose this route, the Investment Kit provides the ability to analyze different financing.

The financial piece of the kit breaks down the loan terms, interest rate, down payment, closing costs and any other information that will affect the mortgage payment. It also factors in loan origination fees as well as upfront repair or improvement costs, such as replacing the roof before tenants move in, so the investor is not having to change the maintenance numbers over time. Investment properties often require 20 percent or more as a down payment, so mortgage insurance is not required, but a line is provided for it, just in case. The Windermere broker will then fill in the total monthly payment.

This formula allows the calculation of the annual interest on the property, and then the investor can estimate the tax advantage of writing off interest. Check with an accountant on this, but owning an investment property offers great tax benefits.

Some of the simple yet significant revelations from completing this part of the kit include how much cash someone is coming up with at closing between the down payment and closing costs, and what the monthly payment is based on the loan term and interest rate.

OPERATING DATA

Having the expertise of a Windermere broker comes in handy when completing the Operating Data section, which requires property-record information and factoring in rental increases every year. It is best to keep these numbers conservative so if all of the numbers look good, they are only going to get better. Here are the figures required for the Operating Data section:



- Rent: Plug in the rent amount for that specific property, then average the monthly rent over the time the investor plans to own the house, called the holding period.
- Potential vacancy rate: Fort Collins currently has a nearly 0 percent vacancy, but that is an unrealistic guarantee, so factor in a 1 percent or 2 percent vacancy as a worst-case scenario, depending on location.
- Annual tax expense: This information comes directly from property records, where it shows what the property taxes on the home were the previous year. That is going to come out of the gross income and help calculate the net operating income.
- Homeowner's insurance: This figure is based on the purchase price.
- Utilities: If the property is a duplex, this number will include some shared utilities that the landlord may pay. But in this market, tenants are often paying for all of the utilities.
- Maintenance: The Windermere broker is an expert when it comes to maintenance costs and whether those for a particular property will exceed or fall below the average of 8 percent or 9 percent in this market. If it is an older house, factor in higher maintenance costs. If it is a newly constructed property, maintenance costs should be lower.
- Property management: A first-time investor buying a condo may not need a property manager, but someone with eight or 10 properties will likely find hiring one well worth the cost.
- Homeowners association: If the property is within an HOA, plug in the dues and any special fees.



After filling in all the blanks on the previous page, the investor will know what the total monthly costs or operating expenses are for a particular property. Your broker will enter this total in the yellow space on the first page of the Investment Kit.

INVESTMENT PERFORMANCE

Now is the fun part of the evaluation, when the investors see whether the property in question is a good investment and how much money they are going to earn over the holding period.

The first number is the cash flow after tax, which is higher than the before-tax cash flow because of depreciation and the ability to write off the property's interest. Sometimes on a duplex, triplex or other multifamily properties, the owner makes "too much money," resulting in higher taxes and lower after-tax cash flow.

The next important figure is the after-tax annual average yield over a five-year holding period. We factor in a conservative appreciation, all of the cash flow and the ability to re-invest that money. We typically see an attractive number when compared with either stocks or bonds, or if that money is in the bank and getting a small return in a CD or a savings account. The real estate investment numbers will consistently outperform those.

And unlike investments in stocks, bonds or CDs, real estate is a tangible investment its owners can drive by and know it is helping them meet their goals.

The key to knowing whether to invest in a property is in this kit. Just have your broker plug in the numbers and the results will help you make a good decision.



TAKE THE FIRST STEP

Investing in real estate is powerful. It can create a great deal of freedom in people's lives. Windermere brokers love helping customers take control of their financial futures with the help of the Investment Kit. Investors from all over the globe have used the Investment Kit to purchase properties, sometimes without even seeing the property in person. Though buying a property without seeing it first is not recommended, some investors are confident in doing so because the numbers have worked for them time and time again.

The information provided here and the results given by the Investment Kit are based on fact and research by Windermere brokers, but they are not the only experts investors should rely on when taking the plunge into

real estate. Windermere brokers advise their customers to consult with attorneys and accountants and make them part of their investment team because of the tax and legal components involved.

Those intrigued by the idea of investing in real estate and want to learn more should connect with a Windermere broker, who should ask first and foremost, "What are your goals?," then discuss the price point that makes sense: "What will you be comfortable with?"

Investing in real estate does not have to be a big, complicated process. Windermere brokers have helped everyone from savvy investors to those testing the waters of real estate investment: they are not on Wall Street or playing the stock market, but they like real estate because it is a real-life, tangible investment. People need homes to live in and investors can help them by buying rental properties and offering them a great place to live.

Windermere agents will direct potential investors to a lender to find out what their qualifications are, and then the brokers will look at properties with them, analyzing them with the Investment Kit. Using this checklist, they will help investors reach their goals and build wealth in their lives.

CONNECT WITH A WINDERMERE AGENT TO:

1. Receive our Investor Checklist, which shows you everything you need to know to purchase investment real estate.
2. See a detailed analysis of your potential investment property.

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Before investing in real estate, be sure to consult with your legal and tax advisors.





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