

s p e c i a l r e p o r t

Foundations

for Successful Real Estate Investing

by Curtis Oakes & Peter Harris



Foundations of Successful Real Estate Investing — Guiding Principles of Investment

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*“It doesn’t matter how much money you have. What matters is how fast it’s moving.”
~ Curtis Oakes*

Once you have mastered the basic real estate terms and the use of them in analyzing deals, you will then need to determine what your personal guidelines for investing will be.

What types of properties should I consider making offers on and buying? That’s a very good question.

On what basis do I make my buying decisions?

What is a good cash flow?

What is an acceptable cash-on-cash return?

What is a decent cap rate?

How and when do I use gross rent multiplier?

These are all good questions that you or anyone contemplating investing in real estate should be asking.

First of all, you’ll need a working knowledge of the following: cash flow, cash-on-cash return, cap rate, and gross rent multiplier. You’ll need to know the definition and know how to calculate them. You should have this by now. If not, please review again.

We’re assuming that by now, you can define and calculate cash flow, cash-on-cash return, cap rate, and gross rent multiplier. So, what is left to learn is how each of these investment terms affects your investments and decision-making.

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The following investment terms are important in how you move forward in building your real estate deals:

Guiding Principles of Investment Terms.

- 1. Cash Flow**
- 2. Cash-On-Cash Return**
- 3. Cap Rate**
- 4. Gross Rent Multiplier**

Following is a working explanation of each.

Cash Flow

At the Oakes Group, **positive cash flow is king** and it should be one of your primary objectives. Positive cash flow creates and maintains your investments' momentum. What puts you in a good mood level – positive cash flow or negative cash flow? When purchasing an apartment building containing more than five units (then considered commercial), a bank's basis for lending is the building's cash flow abilities. Your credit scores are secondary. In addition, an apartment building with poor cash flow will almost always appraise much lower than its comparables for the area.

1st GUIDING PRINCIPLE:
POSITIVE CASH FLOW

Cash-on-Cash Return %

This is the velocity of your money. In other words, how long does it take for your money (your down payment) to come back to you? If your down payment was \$20,000, how soon does your cash flow add up to \$20,000? If your cash flow added up to \$20,000 in one year, then your cash-on-cash return is 100%. If it takes two years, then your cash-on-cash is 50%. If it takes three years, then it is 33%. Real estate can potentially produce phenomenal returns. Cash-on-cash returns of over 100% are not uncommon. Now, if you were to go to your local bank and deposit \$20,000 into their most aggressive CD investment for one to three years, what type of cash-on-cash return can you expect? 2%? 4%?

We need to put an emphasis on cash-on-cash return when we invest simply because you need to know how fast you can get your down payment back so you can invest it again ... and again.

2nd GUIDING PRINCIPLE:
DOUBLE DIGIT Cash-On-Cash Return%, 10% OR GREATER

Capitalization Rate %

A cap rate is used as a measure of a building's performance without considering the mortgage financing. If you paid all cash for the investment, how much money does it make? What's the return? Cap rate is a standard and is used industry-wide. It's used many different ways. Here are a few ways to consider: a **high cap rate** usually typifies a **higher risk investment** and a **low sales price**. High cap rate investments are typically found in poor, low income regions. A **low cap rate** usually typifies a **lower risk investment** and a **high sales price**. Low cap rates are typically found in middle class to upper income regions. Therefore, neighborhoods within cities have "stamped" on them their assigned cap rates. With that said, if you know what the NOI is, and you know the given cap rate, then you can calculate what the sales price should be. $\text{Sales Price} = \text{NOI} / \text{Cap rate}$.

3rd GUIDING PRINCIPLE:
CAP RATE OF 8% OR HIGHER

Gross Rent Multiplier

Gross rent multipliers are used as a measure to compare income properties in one area or neighborhood. Let's say there are three rented duplexes in a neighborhood. One of them goes up for sale. If you know the gross rent multiplier for the neighborhood, then you can gauge if it is comparable to the other two duplexes. If the gross rent multiplier of the duplex being sold is higher than the other two, then you may be paying too much. If the gross rent multiplier of the duplex being sold is lower than the other two, then you may be getting a property under market price.

Gross rent multiplier is also a good indicator of the investments' ability to cash flow. As the gross rent multiplier lowers, your cash flow increases in most cases. And the opposite is true. As the gross rent multiplier increases, your cash flow decreases, typically.

4th GUIDING PRINCIPLE:
GROSS RENT MULTIPLIER OF 9 OR LOWER

Important Note: When you are looking at income properties and analyzing them, it is absolutely necessary to have your four Guiding Principles of Investment. Listed above, are our guiding principles by which we consider every single deal we analyze. You must have established your *starting* guiding principles. Without them, you will wander aimlessly in the real estate investment game. No working goals = a very weak game.

Your established guiding principles of investment are your standards. If an income property does not match up to your guiding principles, then the property must be passed on. Go on to the next property in search of one that matches.