Santa Barbara Independent
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How to Make Money in Real Estate

Not a Paid Advertisement. Results May Vary.

By Kevin Bourke

Sunday, May 11, 2008

I see commercials on TV about how to make money in real estate. Do those really work? How do some real estate investors make so much money?

- Vince from San Luis Obispo

Vince, there are so many programs that promise to make the average person rich, it is hard to know which one you are referring to. Generally speaking, those programs only work for a very small percentage of people who try them. The testimonials shown on the TV commercial are the exception, and usually the disclaimer at the bottom of the screen discloses this.

Money Talks

So then, can the average person make money in real estate? Of course, but how?

There is an unlimited variety of ways to make money in real estate, so let's just talk about one of the most common methods. It involves the use of leverage. Leverage is defined as "the use of a small initial investment, credit, or borrowed funds to gain a very high return in relation to one's investment, to control a much larger investment, or to reduce one's own liability for any loss."

Let's see how leverage works in real estate. By the way, this is a hypothetical example and is not representative of any specific situation. Your results, Vince, will vary:

Joe buys a house and makes a down payment of 20%. Joe rents the house out for enough to cover his payment. Joe is probably upside down some months because he is responsible for repairs and maintenance, and occasionally the house sits empty. But he is in it for the long haul, so he keeps it going like this for several years.

In 7 years, we'll assume the house appraises for a larger value than his purchase price, so Joe refinances and pulls just enough equity out to purchase another home. He does the same routine with this second house, rents it out, hopefully for enough to cover his payment. Note that the rent on his first house has hopefully increased enough to cover his new higher payment. So, he is still just covering his cost.

After another 7 years, both houses have appreciated in value. Now he has considerable equity in each house and does the same thing again. He refinances both, and uses the money to invest in more property. Except this time, he might be able to afford a down payment on two houses.

So, in year 15, Joe owns 4 houses.

Note that the appreciation on the houses is not based on Joe's investment, but rather on the sales price of the house. This is where leverage becomes important. With the first house, Joe actually invested $50,000, but the house is appreciating based in its sales price.

Now, after 14 years, Joe has built a $50,000 investment into several homes, each of which has the potential to increase his net worth and contribute to his cash flow.

Vince, there are great risks associated with leverage such as potential adverse real estate market forces, regulatory changes, and potential real estate illiquidity, and there are no assurances the strategy's objective will be attained.

So do your homework, investigate your options, and ask those more experienced than yourself for help.

Kevin Bourke is a registered principal with and offers securities through LPL Financial, Member FINRA/SIPC.