

LIVE FOR

FREE

... to be free to live !

version 3.0

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Preface

- Are you tired of the stock market roller-coaster ride?
- Do you want more control over your investments?
- Are you looking for a proven long-term income opportunity where you can make money each month and see a potentially high return when you sell?
- Do you feel as if you're spending too much each month on mortgage payments?
- Would you like to put more of this money back in your pocket every month?

Would you like to live for free?

Naturally, we would all like to lessen the financial burden of putting a roof over our heads. If you want to live for free or for as little a month as possible and still own a high quality home, residential real estate investing may be for you. For the investor who is looking to broaden his or her portfolio or the owner who understands the utility of bringing in rental income to offset mortgage expenses, "living for free" can be a profitable and exciting approach to home ownership. Try and make it your goal to embrace the key concepts that will allow you to financially benefit from home ownership. Use this guide to learn how to free up cash flow each month and start your journey towards minimizing your monthly housing costs.

PART ONE: To Buy or Not To Buy!

I used to think that buying a house didn't make a lot of sense. My reasoning was simple. According to a 1999 survey by Lyons Consultants for the Greater Toronto Home Builders' Association, the average monthly carrying cost of a two-bedroom apartment is \$881. Even when the rental supply is depressed and vacancies are lower, there are always going to be apartments of some description available in this price range. You might have to hustle harder to find them, or you may not be able to negotiate a lower rent, but your local Saturday paper will always have listings. Regardless, you usually shouldn't have to pay much more than \$1000 per month for reasonable accommodations.

Location	Average Vacancy Rate (%)	Average Monthly Rent (2-bedroom apartment)
Montreal	1.5	\$509
Ottawa	0.2	877
Toronto	0.6	979
Calgary	1.3	740
Vancouver	1.4	890

¹Figure 1.1

Here's a bit of quick math. In order to have a net mortgage payment of \$1000 on any type of dwelling, based on a 7% mortgage rate, you would have to book a mortgage for around \$135,000. Depending on how much you are able to put down, the highest price that you would likely be able to afford for your new home is about \$180,000. Where and what you can buy becomes quite limited.

Location	Average Price for 2 Storey (Jan. 2001)
Toronto	\$267,083
Vancouver	\$339,500
Victoria	\$248,000
Calgary	\$180,000
Ottawa	\$172,200
Edmonton	\$125,250
Regina	\$110,000
St John's	\$145,000
Halifax	\$172,000
Charlottetown	\$132,000
Montreal	\$166,750
Winnipeg	\$108,000

²Figure 1.2

Now say you rent a complete three-bedroom house for \$1500 a month. To buy the same house would cost, on average, about \$225,000. The cost of the mortgage plus heat, hydro, water and maintenance would certainly exceed \$1500. If you're the landlord of this property, unless it is paid for or close to it, the cost of carrying the mortgage plus expenses is likely to be more than what's collected in rent. It becomes clear that the cost of owning a house can be significantly more than renting one. And that's before paying property tax or before the closing costs necessary to get your name onto the deed.

¹ The Globe and Mail, May 22, 2001

² <http://monopolyinvest.freeyellow.com/page8.html>

Renting often turns out to be less expensive than carrying a mortgage. A small two-bedroom bungalow may cost \$200,000. At a mortgage rate of 7½%, the house will carry for about \$1100.00 per month, plus heat, hydro and other applicable expenses. The bulk of your monthly mortgage payment is interest to the bank. Your mortgage principal is only reduced by a very small amount with each monthly payment – or at least initially for the first few years when your payments are fixed. So at the end of your mortgage term, if you take the full amortization period to pay (most often 25 years), your \$200,000 home may end up costing you as much \$375,000.

A few years ago, when I was renting, I was able to rent an entire townhouse for \$1275 a month including hydro. To buy that same townhouse for what it eventually sold for – \$225,000 – would have cost approximately \$1000 a month to carry at 5% with a conventional first mortgage. Add to that maintenance fees and property taxes at another \$600 per month. Owning that same townhouse would have cost me another \$325 per month. Where's the logic in that?

In a 1996 edition of the CMHC publication *Canadian Housing Markets*, financial consultant Jim Leach used a software program called "Buy or Rent Decision Model" to calculate whether a typical couple buying their first home would be farther ahead financially buying a \$150,600 home or renting the same house for \$1,375 a month and investing half of the money saved. His calculations show that after the first year, the decision to rent would yield greater value. Whilst the value from owning will increase over a longer time period, it is still interesting that in the short term, renting makes more financial sense.

Lauretta Stewart, in her book "Do It Right", when discussing owning vs. renting, reiterates that owning real estate should be a long-term commitment to truly appreciate the financial benefits from owning. "The alternative to purchasing a home is to continue to pay rent and, at the same time, discipline yourself to save and invest in stocks, bonds, mutual funds or a savings account"³.

The difference in your monthly payment between buying and renting a property is only one factor. You have to be able to afford the down payment. Essentially, you can't buy a house in most major Canadian cities without at least \$10,000 in your pocket. I don't agree with buying a house with no money down so that the bank finances the whole thing. Most of the time, a condition of their loan is that you put some of your own equity into the house as security. You'll also need additional cash upfront for closing costs. I believe that if you are unable to accumulate enough money to come up with a deposit, you'll likely continue to have a hard time coming up with your mortgage payment every month. Yet with that said though, CMHC has made it very possible to buy real estate without a sizable down payment.

If coming up with a large cash deposit isn't difficult enough, what about the other costs involved in buying a home? Land transfer tax. Legal fees. Moving costs. You may also have to pay a mover even if you rent, but you must pay the land transfer tax and any outstanding adjustments right up front. No matter how you slice it, it's going to cost you.

There's also the obvious difference between owning and renting once you have moved and settled in. What if something goes wrong? What if a pipe bursts or the heating system fails? If you just bought the house, take a deep breath and get out your chequebook again. But if you're renting, all you have to do is pick up the phone and call up your landlord. It's his or her problem, not yours!

There are property taxes, maintenance costs, and insurance that you will have to pay. Most banks make property insurance mandatory so that they are covered in an accident. You then have to consider content insurance to cover your personal belongings. It can all add up quite quickly.

³ Do It Right, Lauretta Stewart, Strategic Sales Alliance Inc., 1995

Many homeowners tout pride of ownership as a reason to buy. I suppose it's a nice feeling to sit in your living room and say to yourself "Ah, I own this." But think about it. If you're renting and you want to improve your surroundings by doing a bit of work, what landlord in their right mind would say no to you? If one of my tenants approached me and said they would like to paint the bathroom, I wouldn't argue. In fact, I'd happily pay for the paint. And you know what: the bed that you sleep in at night is just as comfortable whether the walls around you are in your name or some one else's.

So why bother owning?

It seems to not make a lot of sense on the surface. Yet we all know that a large percentage of Canadians own their own homes. According to the *CMHC's Mortgage Market Trend Report*⁴ (Real Estate News, July 28, 2000), nearly two-thirds of Canadian households own their own homes. Of the entire housing stock in Canada, only 37% (3.7 millions units) are rental units. Clearly, more people own than rent. The profitability of our banks, based on the huge amount of mortgage interest collected, suggests that most of us haven't fully paid for our properties yet either. A little less than half of all homeowners in Canada have mortgages. I would expect that many owners' equity or net worth are tied into their homes. Most people's money only exists on paper as the difference between what their house is worth today if sold on the open market vs. what they still owe on it. In other words, the current market value less the outstanding mortgage is your equity in the property. This makes it somewhat difficult for you to become liquid fast if your money is tied to your home. You've probably heard the old saying, "house rich and cash poor". Many people fall into this home-buying trap. You scrimp and save to get your deposit together and then struggle month to month to make the mortgage payments. Most of your income goes towards making the monthly mortgage payment leaving little money for discretionary spending. Your home becomes a never-ending cash grab. Does it not just make sense to rent and not have to worry about any of this?

It does, in fact, make sense to buy real estate when you consider an owner-occupied residential income property. How would you like to live for free, or at least pay as little possible each month to live? Now this type of home ownership is quite desirable indeed. It certainly beats renting! If you didn't have to pay a mortgage each month, think of the money you could save or have left over to do other things with. You could **live for free to be free to live!**

⁴ Real Estate News, July 28, 2000

PART TWO: The Secret

The secret to living for free is to own a residential income property where your monthly costs are offset by the income received from tenants. If you live in a house and rent out one or more of its apartments, you can eliminate or greatly minimize your monthly housing costs. Admittedly this type of home ownership isn't for everyone. Being a landlord is a big responsibility. Besides, who really needs the aggravation? There can be times when being a landlord can be quite trying. I've had radiators not work on bitterly cold nights. I have had mice turn up in my basement suite. As a landlord you have to respond to every tenant complaint, and fast. There are a lot of regulations that govern the landlord-tenant relationship in each Canadian province. As a landlord, you have to be dutiful to your tenants 24 hours a day.

But I tell you honestly, and maybe I have been really lucky, that having tenants isn't really that bad at all. Sure the odd thing like I just mentioned does come up, but not often if your property is in a good state of repair. If you treat your tenants well and look after their concerns they will respect you. If you live in the same house as your tenants and have to go away for a night or two, it's nice to know that there is someone around to keep an eye on things. If we're away, our tenants are more than happy to feed our pets while we're gone. I've never really been disturbed by noise either. If you screen your tenants carefully before they move in, and treat them well once they arrive, chances are that things will work out quite well.

Once you make the decision to be a landlord, the purchase of a house makes a lot more sense. So much so, that you really can't afford to not consider the benefits. There are a number of situations where buying an income property and renting out a portion of it is ideal:

- Are you single? If you travel light, you can make moves without the concern of inconvenience for others
- Is this your first house and are you reasonably sure that this is not your final resting place, but simply a property to get you started? This could be an opportunity to purchase real estate that would be difficult to afford otherwise.
- Are you retired and looking to put your savings into a vehicle that's safe and have your cost of living drastically reduced? Wouldn't it be nice to have a few hundred (or possibly thousand) dollars of positive cash flow each month?
- Do you enjoy spending your hard-earned money on other things than mortgage interest to the bank? Remember, if you buy a house and live in the whole thing, you have to pay the entire mortgage each month on your own.

If you answered yes to any of these questions, then owning an income property may be right for you. There are many details that you have to be prepared for when you begin thinking about owner-occupied income properties. By being informed and learning as much as you can you will certainly maximize your chances for success. I have consistently found that if you follow one simple rule that you will greatly improve your chances for success and the money that you are able to bring in.

Find a property with rental potential in an optimal location and make it as attractive as possible, outside and in!!

Now I know that this may sound obvious. But I think that this is where most landlords often slip up. They don't clean up the premises or keep their buildings in tip-top shape to maximize their rental potential. What do you think of when you hear the words duplex, triplex or multiplex? Normally the image that comes to mind is of some tired looking, dilapidated house where the rich landlord lives far away in the nice part of town. The only time you ever see them is when something goes wrong or when they come around to collect the rent at the beginning of the month. You don't often think of a beautiful two or three story home where the landlord lives in a suite and rents out the other floor(s). There is a widespread opinion within the development industry – specifically builders and their associations that development economics are best for luxury rentals. As a result, any new purpose-built rental supply will generally have rents that are considerably higher than in the older rental stock. It is for this reason that I advocate doing everything within your means to bring your property to as high a standard as possible. If your home is clean and

tastefully finished or decorated, it will always attract more desirable tenants and command higher rents. Owner-occupied investment properties can be made into beautiful homes and can offer you a very enjoyable standard of living.

PART THREE: The 5-Step Plan

So where do you start on this journey to living for free? There are several steps that I recommend that you follow. As I outline them, remember these ideas are based on how I have observed other people using their homes to positively impact their financial situation. This is an effective strategy for people looking to free up capital to invest elsewhere. If you're looking to buy a building strictly for an investment, in most Canadian real estate markets you have to be very lucky to find a property that gives you a great return. A residential income property can be a great investment when you live in the house. You have to live somewhere so why not turn that into something that can be profitable for you. Isn't it better to have your tenants pay your mortgage each month – slowly but surely reducing your overall debt on the property? Every month when you make your mortgage payment, the interest portion of it will never be seen again. This comes right off the bottom line of your net worth statement. Imagine being able to keep that same amount each month to spend on other things.

The information that I'm presenting here is not new. I didn't invent any of this. In fact, there isn't anything revolutionary about this at all. It's largely common sense and has probably been written about many times before. This information should get you thinking positively to get out there and do something to improve your life situation. If you read my plan and put these words into action you can reap many rewards in the future. If more and more homeowners begin to look at their property as an investment rather than just a place to live, the overall market for income properties will improve, and your chances for success in this arena will increase. We all know that real estate in Toronto has been booming over the past few years and interest rates have hit all-time lows. The time is now, before rates start to creep back up to take advantage of a residential real estate investment.

Follow this step-by-step approach. Read over each step carefully. I'm assuming that by this point you have given some thought to buying a new property and are looking hard at how you can significantly reduce your cost of living. It doesn't have to be your first home. You just have to investigate further how possible it is for you, given your current life circumstances, to get into an investment property where you can live for free or at least as inexpensively as possible each month.

STEP ONE: Establish your down payment

Take a long hard look at your finances. How much money do you have to put down on your new home? Don't worry about how much you can afford each month. If you find the right property, that monthly amount should turn out to be very little. I'm not really concerned too much with the purchase price either. With the flexibility of financial products available on the market today, you can put down as little as 7 ½% for a deposit. You need to determine how much cash to contribute to the down payment and clean-up costs (if necessary). How much do you have in your savings? How much equity do you have in your existing house? What else do you have tucked away? You are going to have to decide how much of your savings you are willing to invest. All of it? Half? It's difficult to advise you how much, because it varies from property to property and everyone's financial situation is unique. If you make the right choices, your money will be safe in the property. In other words, you will be investing in a home that maintains its value. It may not appreciate, but if you find the right property it may even give you a better than average return on this initial investment at some time in the future. There are always houses that have this potential, but quite often you have to look long and hard to find them. There are many successful real estate speculators and developers, who do this on a regular basis, waiting for the same property as you. Carefully determine what you can manage to put down. You are going to have to do this even if you plan to buy a single-family residence so this is definitely a good place to start.

STEP TWO: Define your living needs & desires

This is where you define what kind of home is right for you. Differentiate between what you must have (a need) vs. what would be nice to have (a desire). There are many questions that you will have to address. I will outline three but there definitely are others. Your agent will likely be able to pose more for you to ponder once you have made the decision to start investigating income properties.

1. What part of town do you want to live in? You should be as flexible as possible when choosing an area to look for an investment property. This is because there usually aren't too many good ones to choose from. You know that it will be difficult to start in the exclusive areas of town without a larger down payment. You probably don't want to live in a high crime area either. You have to take a long hard look at the neighbourhoods in your city and make sure that you can see yourself living comfortably in the areas in which you choose to search. Most major Canadian cities offer a lot of choices. Determine if you'd prefer to be downtown or in the suburbs. You'll always be reasonably close to schools, shopping or places of worship. I don't think that it's prudent to start eliminating areas (unless they're simply too expensive) because you never know where the next opportunity may be. A good buy could come up in any area of your city at any time. I recommend getting familiar with all the areas of your town. There are city guides available that will broaden your knowledge of your city's neighbourhoods. They gave you crime statistics, demographical information, and detailed market information. This is all great information that will definitely help you wisely set your parameters. The more you know about your city and market trends, the better equipped you will be to make a smart buying decision.

2. What type of physical space do you want? You will have to determine your spatial requirements. How many square feet do you need for your apartment? How many bedrooms do you need? Do you need an office or working space? What kind of look or feel do you want your new suite to have? You have to determine your own unique living requirements. I said earlier that owning an income property works well if you're single. Here's why. I find that in order to do things right so that you are really cashing in on your home through the revenue stream that it has created for you, you need to be flexible. If you have a family, this whole exercise can be difficult. Not impossible - just difficult. You have to look at what conveniences you require (bath tub, dishwasher, garage, fireplace, etc.) It is your home after all, so make sure that you can be comfortable there. Now of course you can add things that are missing which leads directly to a third very important question when you are defining your parameters.

3. Do you want to renovate? Home renovation is often a key factor when considering an owner-occupied investment property. If you are unfamiliar with this subject you need to seek out more information and learn as much about construction as possible. Your agent should be able to guide you through the maze of rules, regulations and the dos and don'ts of successful home improvements. If you find a desirable income property that is not turn key (already set up with independent units) you essentially have to look at whether it can be turned into an investment property without gutting the whole thing or doing major reconstruction. For example, if a house has a loft or a basement with a bathroom in it, is there enough space to do a conversion? Will the basement, if you add a kitchen and close it off, make a suitable separate dwelling unit? Determine whether a property is in a good state of repair and whether the potential return is worth the risk of renovations.

It is very important that you are cautious about renovating your home and that you plan and budget very carefully. If you are handy and can do most of the work on your house yourself you will save money and the hassle of dealing with contractors. It is imperative that you know your city by-laws and its rules and regulations for basement and accessory apartments as well as laws for additions or conversions. You need to know where your local municipal office to obtain building permits if necessary. You should also be intimately aware of the fire code in your region. Improper fire safety precautions are often identified as being a factor in fire related accidents. Be careful and seek expert advice before contemplating an ambitious renovation project.

A carefully planned renovation will often pay itself and can add thousands of dollars to your resale value. Conventional real estate wisdom states that a single-family residence will always attract a higher price on the open market than an income producing property. I don't always agree with this. First of all there are very few duplexes or triplexes in Toronto that come up for sale that don't have some sort of upgrade potential. As the population ages they don't need as much space and could enjoy benefiting in a hot market by getting into an investment property and renovating it. There will always be need for houses like this. As the baby boomers retire, an opportunity exists for quality owner-occupied income properties on nice streets. If you're able to improve upon the property, it will allow you to attract higher rents and give you a better resale value. So conversion can certainly be good for the caliber of your living space and also good for resale.

You can't add more land in the nicer neighbourhoods of a city. The only thing that you can do to create additional value in existing properties is to fix them up. Many older homes that come up for sale that have income potential

haven't been touched in decades. The easiest problems to correct are cosmetic. If the cost to renovate is offset by the potential gain when you sell, homes with such upgrade potential are excellent opportunities. Remember real estate's three most important rules: Location, location and location. This applies to owner-occupied income properties - the stronger the location, the higher the rents and ultimate resale. If the land value is high, then the dwelling on it should be at that same level.

While living for free each month is your ultimate goal, your home's resale value is definitely another factor to keep in mind. Say you buy a duplex for \$250,000 and over time you sink \$25,000 into it to create a basement apartment or to upgrade some of the existing rooms. Now pretend that your life situation changes in a couple years and you decide to sell. The potential purchaser who looks at your home knows exactly what you paid for it when you bought it. This information is available through the Multiple Listing Service (MLS) so their agent will certainly let them know when they are determining what to offer you for it. They know you paid \$250,000 but they have no idea how much you spent on the renovations. They have no before and after to go by. If the market has appreciated and the quality of the work that you had done is desirable, perhaps you can vend your home for upwards of \$300,000 (or potentially more – there are so many variables that go into valuating a home). You can make a nice profit in addition to the fact that you have been living there rent-free. This makes your home very attractive to the savvy homebuyer. Never discount capital appreciation or debt reduction when doing your analyses as these will be key components to your success.

STEP THREE: Engage a good, knowledgeable agent

There are many real estate agents out there but how many are familiar with investment properties?

A good agent will do the following for you:

1. Show you properties with income potential that are currently listed for sale
2. Have a good idea of whether a home that you are interested in is properly priced
3. Help you determine your mortgage requirements
4. Draw up an offer and negotiate a good deal

A great real estate agent will:

1. Give you compelling statistics on the number and value of investment properties in a given area
2. Introduce you to lenders who understand the type of income property that you want to purchase
3. Introduce you to general contractors or tradesmen as may be required
4. Educate you on market capitalization rates and how it will apply to the income property that you are considering. Cap rates vary and for the shrewd investor are key for making purchase decisions. A cursory understanding of what they are and how they work is recommended.
5. Draw up an offer and negotiate a strong deal

Also, make sure that you are made aware of CMHC guidelines for high ratio financing. It is key that your realtor understands the mechanics of how living for free works. Your agent's broker (the office that they work for) can also be a valuable resource. Utilize the experience and varied skill sets of other agents at your representative's office to get as much benefit as possible. They are there to help you – so make good use of them. They can play a vital part and really increase your chances for success.

Get as much information as possible on a property from your realtor before you even start going to look at houses. Ask questions and challenge your agent to find out the answers for you if they are unsure. It is imperative to get all your ducks in a row. This starts by choosing an agent who you feel comfortable with and who will give you all that you need to know in order to accomplish your goal.

STEP FOUR: Establish a rapport with your lender

I can't overstate how important your relationship with your bank or mortgage broker is. If this is your first home, this is likely going to be the largest single purchase of your life thus far. You are going to be borrowing a large sum of money and likely will continue to do business with the lending institution or individual for years to come. Once you take a mortgage from a bank, they give you a chequing account, probably set you up with line of credit and offer you a whole host of other financial services. It may start with your mortgage and then lead to your RRSPs, etc. The point is to feel comfortable with who you're doing business with. And don't lose sight of the fact that you are giving them your business, not the other way around. Banks sometimes make it seem like they're doing you the favour. They will make a lot of money from the mortgage interest that you pay each month. Remember too that there are often penalties for discharging a mortgage before the end of term, so make sure that you are aware of your lender's policies. There is fierce competition out there for your mortgage business – shop around and compare offers from different lenders.

Since you are going to be a landlord and will be generating income from the property that you purchase, this income will obviously help you meet your monthly mortgage obligations. Some banks when they are qualifying you for a mortgage factor in the rental income. Some only allow for a percentage in their calculations when determining your debt-coverage ratio (the relationship between net operating income and debt service). It is recommended that you secure a mortgage from a lender that has familiarity with residential income properties or investment real estate in general. Where possible try to deal with the decision maker directly. Quite often lending institutions have guidelines or minimum criteria that have to be met. When you submit your application it gets fed into a computer program and usually that's where the decision to lend gets made. Get to know your lender personally if possible and make sure that you are able to contact them whenever you need to. You are on a mission to make as smart an investment as possible - let your lender know this, be fair in your expectations and develop a bond that can lead to larger future business transactions.

STEP FIVE: Develop a Plan of Attack

This is the stage where you are ready to enter into your local real estate market. You have your down payment. You have determined all the pertinent parameters to start your search (what areas you're keen on, type of dwelling, willingness to renovate, etc.) You have signed a purchaser agreement with an agent who you feel comfortable with. You have shopped around and have been pre-qualified for a mortgage with a bank that knows you are looking for an income property. You now want to maximize your chances for not missing that one property that might be the "diamond in the rough". If you get there too late, it will be gone. In a hot market, great investment properties don't sit idle for too long. How can you ensure that you have done everything possible to find the perfect income, or potential income producing property? You should develop a more detailed plan of attack to search for the right property. You and your agent must be prudent insofar as uncovering all the stones that lead to the perfect property. Your agent will be invaluable in looking up properties because they have access to local listing information that you don't. Contemplate new and innovative ways to search for properties. Look for homes with more than one kitchen. Not all potential duplexes will be identified on the MLS as duplexes. Look for separate entrances that could lead to a potential basement apartment. Anything that will allow for the potential to produce an income property if it isn't as such already should be isolated. Put ads in newspapers outlining what you are searching for. Wherever possible, network with other investors or realtors to increase your pool of resources. Have your agent cold call property owners to see if they're interested in selling. Finding the right opportunity often takes lots of time and digging. You will be living in a nice suite, rent free – or at least as close to rent free as possible. Devise and follow a critical path that maximizes your chances to find the best income property possible.

Work together with your agent to develop this plan of attack. Be in constant communication with them to make sure that your plan is being adequately carried out. Understand what they are doing on your behalf and challenge them daily - but don't rely on them solely to do all the work. Rental property investors often have to rely on the financial statements that sellers and their agents prepare. In most cases, these statements contain lots of projections and best-case scenarios. Doing your part to be as informed as possible will make your agent's task much simpler. Just remember to be patient, and to develop your plan for finding the right income property and then stick to it!

PART FOUR: The Time Is Now!

Now that you're armed with a 5-step plan to increase your chances for living for free, you have to ask yourself if this is the right time to be thinking about doing this? They say that the second rule of real estate is after location, location, location is timing, timing & timing. Are the market conditions favourable? Are mortgage rates competitive? Is it a buyers' or sellers' market in your city? I firmly believe that it's always the right time for this kind of responsible financial planning. When is it not a good time to think about how you can improve your finances? Does the market suggest that in today's real estate market buying a residential income property is a good bet? Today the rental situation is highly competitive. In fact, many Canadian cities are experiencing all-time low vacancy rates. Also, given the fact that over time a real estate investment is likely to keep pace with or even outperform most other types of investment vehicles, you almost can't afford to not look at this type of opportunity closely. Toronto has seen an interesting situation over the past few years. Lower than average interest rates have allowed a lot of renters to become first time home-buyers forcing downward pressure on higher-end rents. Yet the vacancy rate remains at just under 3% - an all-time high! This means that 97% of everything that is available for rent is taken. Still not bad numbers if you ask me.

It's time to capitalize on these opportunities. When I was still renting plenty of people kept telling me that I should purchase my own home but for the reasons that I mentioned at the outset, I was hesitant. Suddenly, we were forced to move. I was fortunate enough to realize, as we were frantically searching for a house, that we really didn't need a lot of space. I then started investigating how owner-occupied income properties work and determined that it would work well for us. It also allowed us to purchase a house for \$50,000 more than I was prepared to spend since we would be bringing in rental income. Owning a home then became a business venture for me.

As an entrepreneur you have to look for angles all the time. How can I make a little more money by doing things a little differently? What ideas can I put into play that could put me a little bit ahead of the game? What are the successful real estate investors doing that I could be doing? Or better yet, what are they doing that I could be doing better? Given that I have to live somewhere and it is going to cost me, whether I own or rent, what can I do to minimize the financial burden?

Most agents know that home ownership can be a money making proposition. If you are paying \$2000 a month on your mortgage you may not have that same cash available to invest elsewhere. There is an opportunity cost to not being able to spend money in stocks, business ventures or even personal items for you. I consider discretionary spending on yourself and your family very important, because after all, that's why you're trying to get ahead. How many times have you seen people doing without or suffering because all of their after tax earnings are being plunked down on their mortgage? If all that you're left with after paying a large portion of your money to the government in income tax is going to your mortgage and you barely have enough left over for groceries and perhaps your car and gas, then you're probably not going to be too happy in your new home. Pride of ownership doesn't mean a thing if you're living paycheque to paycheque. The secret is to free up some of that capital, so that the squeeze isn't always quite so tight. This financial squeeze may never completely go away, but by being able to reduce your overhead (cost of living) you will be able to enjoy certain additional pleasures in life.

Being financially responsible should always be your goal because you work hard for your money. You have to work even harder to keep it. In this country most middle-income earners pay a lot of income tax. All Canadians are subject to a 7% GST on all goods and services we purchase with after-tax dollars. Most provinces have an additional retail sales tax. If you have additional payroll deductions like benefits or union dues, your net pay is deflated further. You then have to allow for car payments, leisure spending and your cost to live. According to the 1996 Census, 32% of all 1.5 million households in the greater Toronto area were paying more than 30% of their household income on housing; up from 27% in 1991. Today "mortgage payments account for about one fifth of a household's disposable income for those who have a mortgage" states Ali Manouchehri, a senior economist at CMHC's Market Analysis Centre. Clearly, there's not going to be a lot left to pay for your mortgage at month's end. This is why reducing that monthly obligation may be critical to your future financial success.

Sound financial planning alleviates some of the burden of today's high cost of living. Traditionally real estate has been considered a good investment strategy. Having real estate holdings in your portfolio of assets is prudent since

it is rare for a market to not appreciate over time. In the long run, the rate of return from good real estate investments is comparable to that available from investing in the stock market. A study by the University of Western Ontario in 1991 was able to bear this fact out. Basing their report on data from four housing markets in Ontario, this study showed that “during a recent 30-year period, with all its economic ups and downs, housing produced a better return on investment than treasury bills, government bonds, the Toronto Stock Exchange 300 index, or gold,”⁵. The two professors from the School of Business Administration at the University concluded their report by stating that “Overall, as an investment, residential housing in Ontario has a proven track record superior to that of other personal investments.” There are pros – you can leverage to buy; limited land increases value; you can add value through renovation, etc. and cons – it’s time intensive; carries greater risk; limits accessibility to your money, etc. – as there are with all investments. Your best bet for real estate investing is to purchase residential income properties because people, including you, always need a place to live. Residential housing is easier to learn, buy and manage than industrial or commercial properties. Most importantly, income properties allow you to generate positive cash flow. When you sell a stock or mutual funds investment that you hold outside a retirement account, you must pay tax on your profits. By contrast, you can avoid paying tax if you sell a rental property that is your principal residence. As Laretta Stewart argues “There is no other investment quite like a home that allows you to leverage your way in with a small down payment and then pay for the asset over the term of the mortgage as you enjoy living in it.”⁶ And when interest rates are at the lowest point that they’ve been at in fifty years, it really becomes a no-brainer. Capital gains from other investments are subject to tax, but not your home, or at least the portion of it that you occupied. Your accountant will be invaluable for giving you professional tax advice. The decisions that you make about your finances today will have a positive impact on your future if you invest wisely.

If you haven’t thought about improving your financial status, now’s the time to do so. You should always look for new ways to be more responsible with your money. Earning money is only half the battle. Keeping it and somehow growing it is the other half. If you have been thinking about a real estate purchase, and your set of circumstances slots you into the profile that I have outlined, then there may be opportunities in your city for you that you wouldn’t want to miss out on.

Once you have made this decision to become fiscally responsible, it’s time to start the process and barrel through any obstacles that may get in your way. You have to start your search to find the right house in the right part of town for the right amount of money that offers you an income-producing opportunity. One of the greatest teachers is experience. Look at as many income-producing properties as possible, so that you become familiar with the market in different areas of your town. The more duplexes, triplexes or regular homes with rental potential that you see, the more skilled you will become at finding the best deals. When you evaluate income properties, you need to put on your detective hat. If you’re creative and inquisitive, you’ll soon realize that this isn’t a hard game to play. It is imperative that you give the purchase of your new property the time, care and attention it deserves. Suppose you decided to buy a car today. Would you go down to the car dealership and buy the first car you see without looking around or asking questions about the performance and roadworthiness of the vehicle? I would imagine that most prudent people choose a model that they like and then do quite a bit of research to ensure the best purchase possible. You want to be sure of what options you require and I’m sure you want to pay the lowest price possible. Well figure that your house is likely going to cost at least five to ten times more than a car. For most people buying a new home is the most significant purchase they will ever make. You’ll be rewarded with the money you save each month for taking the time to do the proper research.

One other very important issue is timing. You have to be ready to strike quickly when the right property hits the market. Since there are many smart business people like you waiting for the right property to come up, you have to move fast when it does. If the potential is good and the house is priced well, it will likely sell quite fast.

⁵ Ontario Real Estate Association, 1991

⁶ Do It Right, Laretta Stewart, Strategic Sales Alliance Inc., 1995

I can go on telling you story after story of “the one that got away”. I can also recount countless tales of sales of duplexes, triplexes and multiplexes that just defy conventional wisdom. There are often multiple offers on a hot investment property. Quite often, in order to have a shot at obtaining the property, potential buyers waive their financial or inspection clauses. Vendors love to see clean offers – no conditions with a quick closing. Anything that you can do to improve your chances for not missing out is important. Do not omit your financing clause if you don't have all your money lined up. I also recommend always getting a building inspection. No matter how much you may think you know about houses systems or construction, a professional opinion is always valuable.

Another popular strategy of smart vendors is to under price the property to create a feeding frenzy of potential buyers. Just on the numbers alone, these properties should be priced higher. The seller wants to have as many people come through it as possible because they have been advised that the property is a “steal”. I've seen this happen many times. When there are multiple offers, the house will often trade for well over the asking price.

So it essentially all boils down to one thing – being there at the right time with money in hand and ready to make an offer. Patience may not a virtue when it comes to buying an income property. Good things will not necessarily come to those who wait. In this business, you create your luck and timing by always being ready. When the right property comes up, move on it because if you don't someone else will. And if you miss the ideal home, don't despair because another will come up eventually. Just don't blow your timing because you hesitated. Strike fast! Some investors make offers on income properties without even walking through the inside. Ensure that you and your agent have established what you think the property is worth so that you don't end up overpaying.

You now have the key ingredients to start the process of searching for an owner-occupied income property in your area. It is up to you to continue on a quest for more knowledge and information. Discuss your strategy with your agent so that they completely understand your intentions. Explain how you want to create value from your home. Tell them that you understand and are comfortable with the prospect of having tenants. Do the math on each property to determine your net operating income and what your return on investment will be in the first year. Get the all the facts on each property that you are exposed to in order to make a smart and informed purchase decision. It's a great feeling to have your mortgage paid down each month by someone else. You'll appreciate your improved cash flow position immediately. This extra cash will allow you to investigate other investment opportunities. It will allow you to do more and squeak a little more out of life. Hopefully, once you reach your goals, you can reflect back on your first income property as one of the first catalysts to turn your financial picture around. By applying the principles that have been outlined you will have developed a disciplined approach that will allow you begin your journey to **live for free to be free to live!**

Have fun and good luck!

Paul Anand
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Notes:

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