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MAKE AN EXTRA $90,000 WITH...

Multi-unit residential properties

Investor **Paul Kondakos** demonstrates how investing in just three multi-unit residential properties can more than meet a lofty investment income goal

Paul Kondakos

Financial freedom is something we all aspire to achieve. The problem is that most people are at a loss as to how to actually break out of their 9-to-5 daily grind and achieve that goal. Throughout history, real estate has been the single greatest vehicle for wealth creation and financial freedom. The good news is that this still holds true today for those who are willing to take advantage of the benefits real estate investing has to offer.

In order to be successful in real estate investing (and just about anything else), you need to commit to it. This step is both the easiest and toughest one at the same time. If I had a dollar for every person who approached me saying they wanted to build a real estate portfolio, yet did absolutely nothing about it, I would be a very wealthy man.

BUILDING YOUR PORTFOLIO

To demonstrate how to build a portfolio, we'll look at a fictitious average Canadian investor, 'Johnny.' Our first step in helping Johnny invest his way toward generating an additional $90,000 in wealth annually is to analyze his financial situation.

- Profile: Moderate-aggressive
- Annual salary: $80,000
- Principal residence: Single-family home in Toronto
- Mortgage: $300,000
- Value: $700,000

Like most Canadians, Johnny's biggest asset is his home. He can refinance his existing mortgage and go up to 80% LTV. This would take his new mortgage up to $560,000, thus freeing up $260,000 in equity to use toward his first income property.

After the refinance (five-year term, 25-year amortization, and 3% rate), the new mortgage payment will be approximately $2,650/month. Johnny should be able to service this debt with his $80,000 annual salary. On the investment portion of $260,000, Johnny will be paying 3% interest, which works out to $650/month.

Given Johnny's desire for wealth creation and his moderate-aggressive investment profile, the parameters used for him to achieve his goal are based on the following criteria:

> In order to be successful at real estate investing (and just about anything else), you need to commit to it

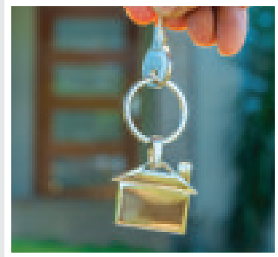
INVEST IN MULTI-UNIT RESIDENTIAL [MUR] PROPERTY.

MUR properties offer economies of scale and are also considered one of the safest asset classes, as multiple tenants contribute to the income of the property. A mid-size 12-unit MUR typically offers better cap rates and stronger cash flow than smaller MURs such as duplexes and triplexes. This allows the investor to hire a superintendent and/or property manager to manage the property, should they choose not to manage it themselves.

INVEST IN SMALLER URBAN CENTRES WITH STRONG FUNDAMENTALS. Real estate prices in major urban centres such as Toronto, Vancouver and Calgary have become so expensive that they leave little room for positive cash flow. As such, Johnny should be focusing on smaller cities that have strong fundamentals and offer higher cap rates (6% to 7%), which will translate into stronger cash flow.

USE LEVERAGE. Many believe that debt is a four-letter word. However, when used responsibly, debt can be an investor's best friend. As such, it is recommended that when purchasing the MUR, Johnny use enhanced leverage – either a vendor take-back [VTB], where the seller holds up to 10% of the purchase price as a second mortgage, or CMHC insurance,

PAUL KONDAKOS' KEYS TO INVESTOR SUCCESS



- The government and banks are trying to clamp down on professional real estate investors. Most Schedule A banks now will not provide a residential mortgage to someone who owns more than four doors. As a result, investors need to focus on bigger commercial properties in order to get financed.
- In order to be successful as a landlord, you have to be good with numbers. Managing your cash flow can be tough in months where you have above-average expenses.
- Being a landlord can be stressful at times. You need to be prepared to remove emotion and deal with the issues at hand, whether it be late rent payments or a leaky roof.
- The tenant profile is one of the most important factors to long-term success. Screen new tenants very carefully. Run credit checks, call previous landlords and verify employment.
- Ensure that you stay on top of regular maintenance and repairs. Failing to do so in a timely manner will cost you significantly more in the long run and will be a catalyst for good tenants to move out.
- Make sure all your paperwork (invoices, contracts, leases, rent rolls, applications, etc.) is organized and accessible.
- Stay on top of your superintendents and have regular communication with them to ensure all tasks are being completed and to learn of any new issues in a timely manner.
- Conduct regular site visits to your property to ensure that everything is in order and working properly.

where the investor, after paying an insurance premium added to the mortgage, can put down as little as 15% on their purchase. The CMHC route is preferable, as it provides the investor with cheaper interest rates for the life of the mortgage. Even with the premium added to the mortgage, the investor still comes out ahead in the long run.

YEAR 1

Johnny now needs to do some legwork and find a property that fits these parameters.

PURCHASE PROPERTY #1 (12-UNIT MUR)

Purchase price	$1,200,000
Down payment (15%)	$180,000
CMHC-insured mortgage (85% LTV + 4.5% premium)	$1,065,900
Monthly mortgage payment (five-year term/25-year amortization/1.9%)	$4,460
Closing costs	$36,275
Credit (last month's rents on deposit)	$11,000
TOTAL CASH REQUIRED	$205,000
Cash flow	$21,000
Mortgage pay-down	$35,000
Appreciation (2% annually)	$24,000
ANNUAL WEALTH CREATION (MINUS INTEREST ON HOME EQUITY)	$72,200

Johnny was able to find a property with a 6% cap rate. With a CMHC-insured mortgage and an ultra-low rate of 1.9%, the spread is a very healthy 4.1%, which means the property will cash flow very nicely.

Johnny leveraged his home and withdrew $260,000 in equity. (After the purchase, he is left with an additional $55,000, which can be set aside as a reserve fund should the property require any major repairs or renovations.) His interest cost on the $260,000 works out to $7,800 annually, which can easily be covered by the investment property cash flow. When you back out the interest costs, Johnny's first property still generates more than $70,000 in annual real estate wealth.

With just one smart purchase, Johnny is nearly generating the equivalent of his annual salary and has almost hit his goal of $90,000 in annual wealth creation.

YEAR 3

With real-life property management experience and one income property in his stable, Johnny's next move is to start attracting investor money to use a joint venture for his next acquisition. He can leverage family, friends and the networks he has established to seek out JV partners. Johnny will locate the property, structure the financing, and supply the expertise and management, while the JV partner will supply the capital required to close on the deal.

Johnny should seek to acquire a property similar to the one he has already purchased, and in the same area if possible. It will be an easier sell to a prospective JV partner, as he already has experience with that type of building in that particular area with an established network of employees and contractors.

Given that it is a JV partnership, the profits and cash flows are divided equally between the partners. The JV partner will get back their initial down payment from the refinance when the mortgage matures.

PURCHASE PROPERTY #2 (12-UNIT MUR) USING A JOINT VENTURE

Purchase price	$1,200,000
Down payment (15%):	$180,000
CMHC-insured mortgage (85% LTV + 4.5% premium)	$1,065,900
Monthly mortgage payment (five-year term/25-year amortization/1.9%)	$4,460
Closing costs	$37,235
Credit (last month's rents on deposit)	$11,000
TOTAL CASH REQUIRED	$215,000 (put up by JV partner)
Cash flow	$15,000
Mortgage pay-down	$34,000
Appreciation (2% annually)	$25,000
ANNUAL WEALTH CREATION (PER JV PARTNER)	$37,000

YEAR 6

The mortgage for Property #1 matures after five years, which allows Johnny to refinance. He is also able to draw his original investment from the property without any tax consequences. This will allow Johnny purchase his third income property.

REFINANCE PROPERTY #1 AND PURCHASE PROPERTY #3

PROPERTY #1	
Current value	$1,320,000
Current mortgage	$891,000
New mortgage	$1,122,000 + CMHC premium
Equity drawn	$231,000
PROPERTY #3	
Purchase price	$1,320,000
Down payment (15%)	$198,000
CMHC-insured mortgage (85% LTV + 4.5% premium)	$1,172,500
Monthly mortgage payment (five-year term/25-year amortization/3%)	$5,550
Closing costs	$38,675
Credit (last month's rents on deposit)	$11,000
TOTAL CASH REQUIRED	$225,000
Cash flow	$14,000
Mortgage pay-down	$34,000
Appreciation (2% annually)	$26,500
ANNUAL WEALTH CREATION	$74,000

In just over five years, Johnny has purchased three income properties – two that he owns 100%, and a third that he owns 50%. The numbers are impressive: By Year 6, Johnny has created annual wealth of $185,000, blowing through his initial goal of generating $90,000 in real estate wealth. ■