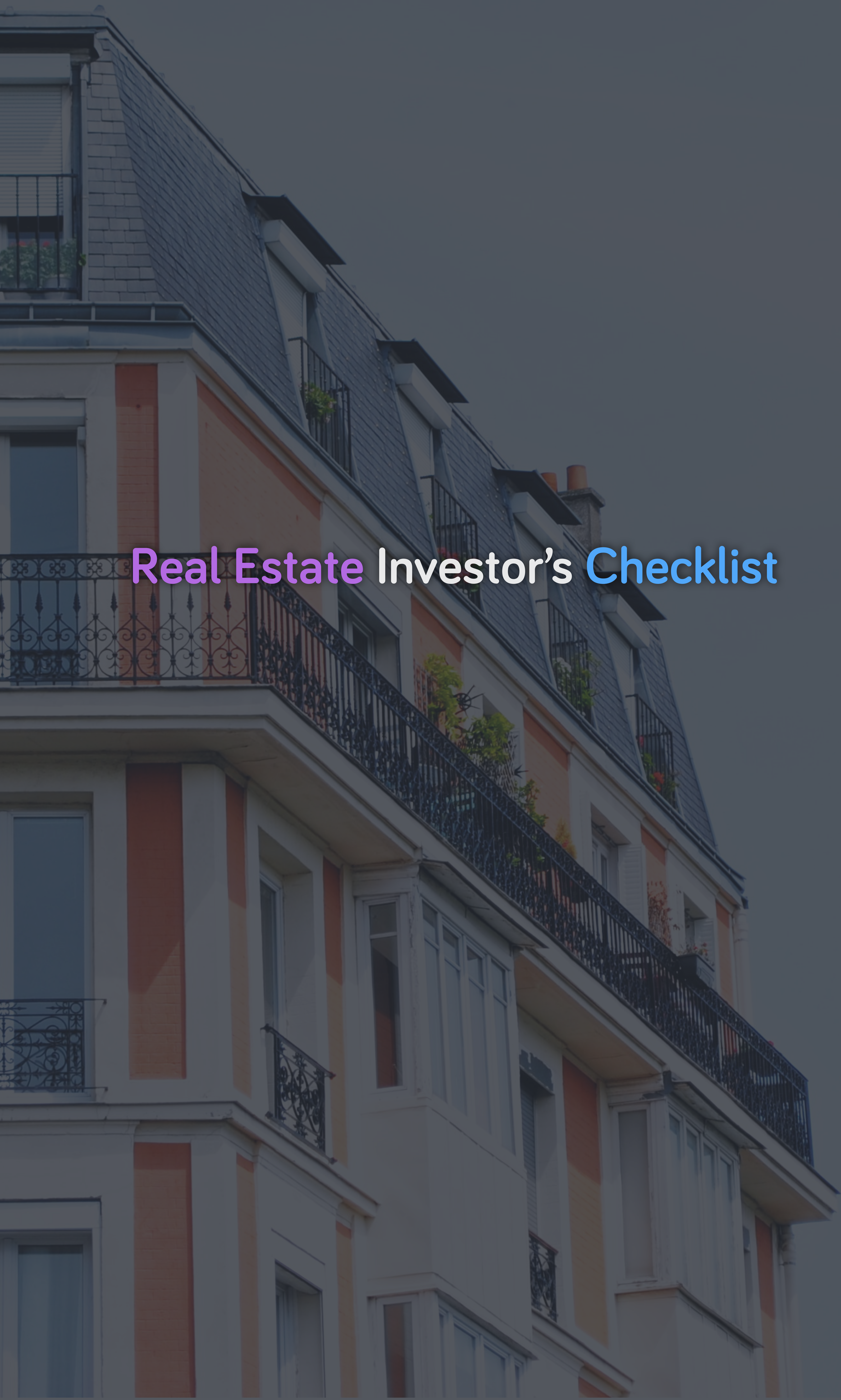
LOCATION INC

Real Estate Investor's Checklist



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Welcome

If done wisely, real estate investing can be a great way to earn income. Whether you're a novice investor, or you've made some deals already, there are several fundamental real estate investing concepts that can help you succeed.

While this guide is not an all-encompassing manual about every aspect of investing in real estate, it provides an overview of the most important elements of a successful real estate investment.

What is This White Paper About?

This white paper examines the key elements of making a successful real estate investment. It covers topics such as how to find the right location by making use of demographic and market data, and how to avoid the most common real estate investing mistakes.

Who is This White Paper for?

The information in this white paper provides a great primer on real estate investing. While novice investors may benefit the most, experienced investors are sure to find a lot of value as well.

Why Should You Read it?

You will learn how to uncover the best new business opportunities by analyzing location-based data, including block or neighborhood-level conditions, trends and forecasts in demographics, real estate values and appreciation rates, school quality ratings, and crime rates, to name a few. You will also learn about the most common traps investors should avoid.

Location

“The biggest financial risk when investing in real estate isn’t the condition of the property, but it’s location. You can change everything else.” - *Dr. Schiller, CEO, Location, Inc.*

Location is the most important factor to consider in real estate investing. Buying a property in the right location will maximize the chances of it’s value increasing and generating profitable returns.

Most of the time, tenants and buyers will overlook the shortcomings of a property if it has an excellent location. However, no amount of money spent after the purchase will make up for a poor location.

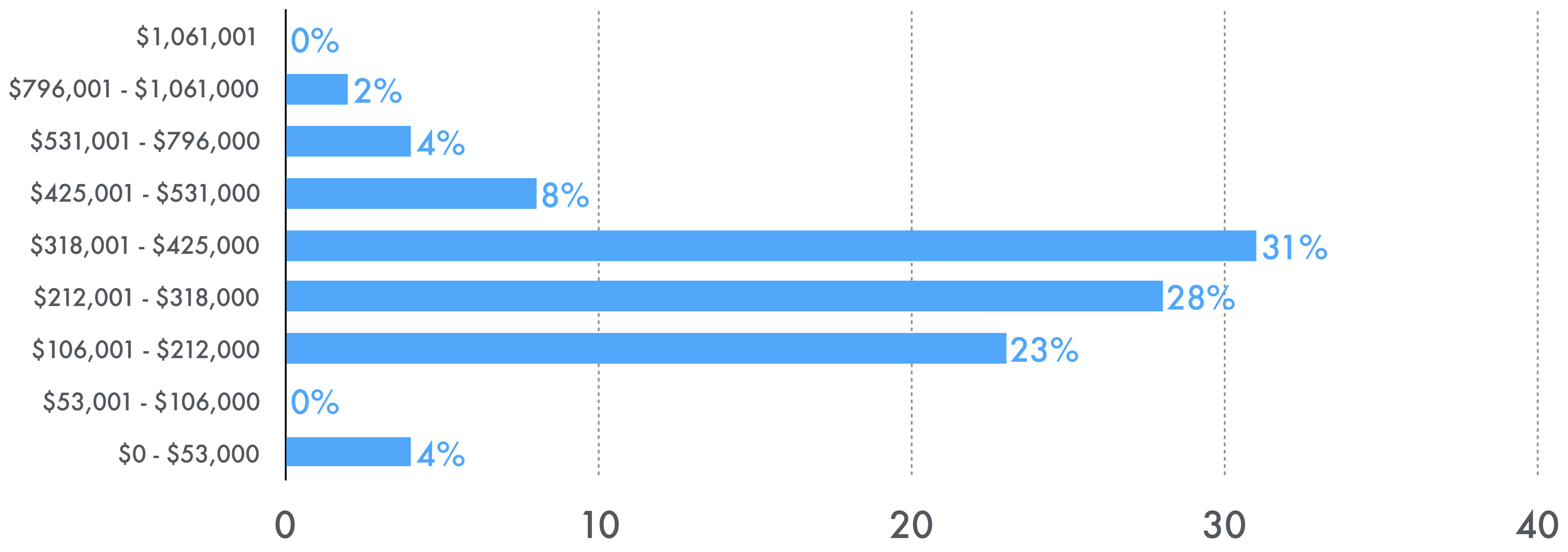
While there are a number of factors that help determine the best location for your investment, the availability of high-paying jobs and the value of nearby neighborhoods can have the largest influence on the future value of your property. In short, access to opportunity (high-paying jobs) and amenities in the location (such as quality schools, educated neighbors, nice architecture, or an ocean view, to name a few) will increase your investment's value.

Let’s take school quality, for example. When determining where they can afford to live, most families try to balance Median Home Value with school quality ratings. From an investment perspective, focusing on neighborhood and district school quality rankings can help you locate pockets of potential. Consider Worcester, MA, the second largest city in New England, where overall school quality is low (nearly two-thirds of school districts in the U.S. are of better quality than the Worcester school district.)

Among the 40 different neighborhoods in Worcester, however, one of them in particular stands out: Westwood Hills boasts a top school quality rating (better than 80% of US neighborhoods), and its Median Home Value is the highest ($316,893) out of all of the Worcester neighborhoods. (See the graphic below). For an investor looking to purchase in this area, Westwood Hills could offer the greatest potential increase in value over time, due to demand from families who want access to quality schools in Worcester.

MEDIAN HOME VALUE

(Worcester, MA; Westwood Hills neighborhood)



How to Find the Right Location

Neighborhood

This may differ based on your preference but if you're going to invest in a metropolitan area, choose a large one. The main reason for doing so is the depth of the economy and access to high-paying jobs. While high-amenity small towns are everywhere, their values remain low because their access to high-paying jobs is low. There are investors who don't consider cities with populations less than 500,000.

It is also important to take into account the demographics of a neighborhood. What is it like? Is it hip and trendy? Is the city vibrant and popular among tourists? It it successful at attracting businesses? What are the future development plans for schools, hospitals, public transportation and so on?

Amenities

Amenities like proximity of schools, shops, and hospitals also impact property values. Which amenities are most important will depend on what kind of investment properties you're interested in. Look at your tenants or prospective buyers. Families care about schools. Professionals care about proximity to work, the freeway, and/or public transportation options. Businesses consider everything from infrastructure and proximity to suppliers to local taxes and regulations.

It's not just present amenities that matter, but future ones as well. Development plans can have a big impact on future real estate values.

Infrastructure & Utilities

The availability of lower-cost energy and water sources, high-speed data access, and a developed infrastructure also influence location choice. Some tenants and buyers must have the fastest Wi-Fi, cable TV, and satellite access and they're willing to pay a premium for it.

Consider the cost of energy: About 10% of properties in the U.S. rely on oil heating, but fortoday's for buyers, the availability of natural gas is becoming an absolute requirement. Well and septic vs. city water and sewer can be an issue too. The the condition of the septic system and well will have an effect on the property value.

Transportation & Access

According to recent survey of 440 top public and real estate leaders from around the world by Ernst & Young, 88% rate infrastructure quality as the top factor influencing real estate investment. The quality of roads and public transportation, as well as proximity/easy access are key drivers of real estate investment growth.

Again, it's both present and future developments that matter. If the area is undergoing or planning an infrastructure investment, you can expect it to impact the real estate value dramatically.

Noise and Smells

Highways, fire stations, hospitals, airports and other high-traffic areas will guarantee noise. Noise affects real estate prices, and possibly a lot more. If an airport is close by, jet engines are going to be north of 110 decibels (sounds above 85 are already harmful).

There are similar concerns regarding smells – specifically, are there any? If so, does the smell change throughout the day? If there is a chemical factory nearby,a smell will most likely be present during the –weekdays, not on the weekends.

Government and Courts

The local government is another important aspect to consider: Is the leadership strong, and does it have a clear vision for the city or neighborhood? Is it efficient? Is it favorable to real-estate investors or do they have plans to increase taxes and regulations?

Pay special attention to the state and city courts. Are they favorable to landlords and real estate investors? Specifically, find out how much liability you will have as a landlord.

Demographics

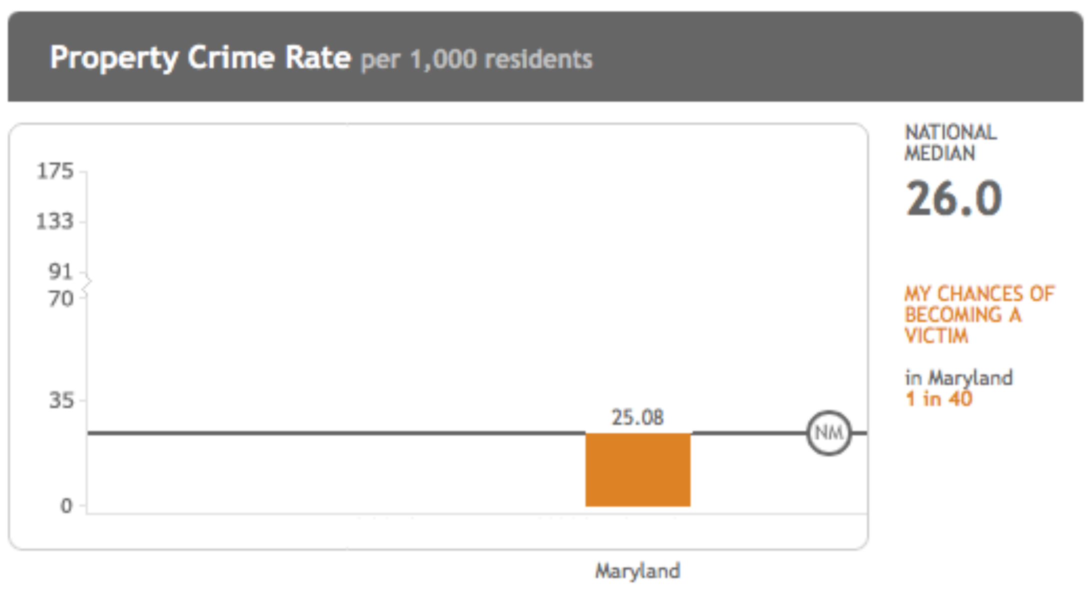
When it comes to real estate investment, there are many factors smart investors should assess before making decisions. Demographics, are often overlooked in favor of proximity of the location, but they are just as important.

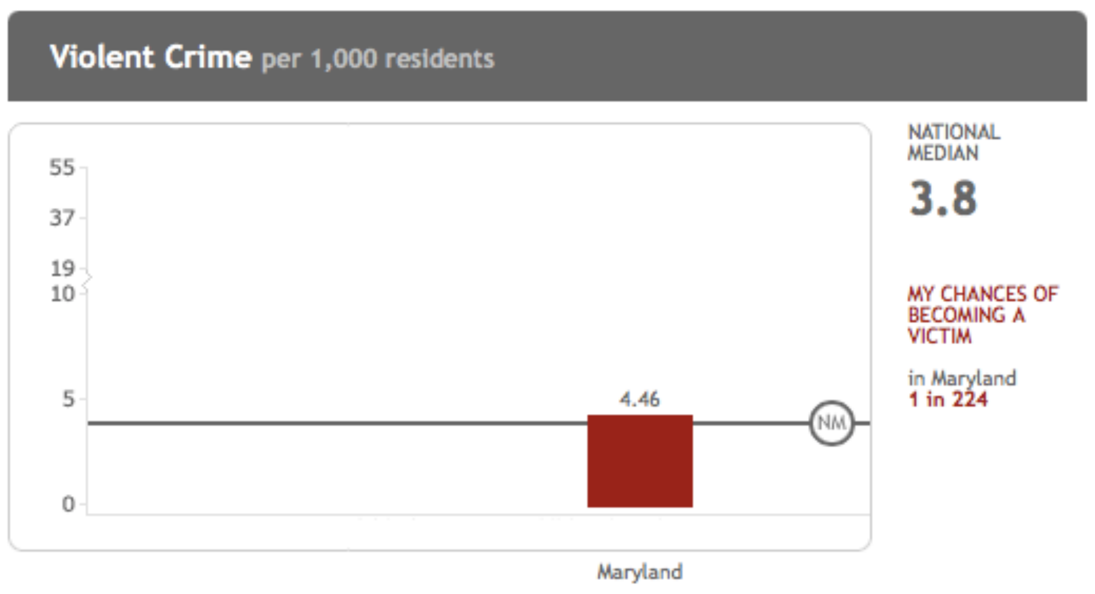
Demographics data, such as age, race, gender, income, crime risk, school quality, migration patterns and population growth, come together to create the special characteristics of a neighborhood. As a result,major demographic shifts can have a large impact on real estate trends for several decades to follow.

When finding the right property, demographic factors like those previously listed should all be trending in a favorable direction.

Understanding your location's demographics will provide you with important insights into everything from your prospective rental pool to possible maintenance issues to expect. For example, lower income markets and markets near colleges will likely incur higher turnover and maintenance costs.

Another example is marketing your property. If the market predominantly consists of single adults, highlighting amenities that appeal to families isn't going to work.





Maryland property crimes — Population 5,976,407

	BURGLARY	THEFT	MOTOR VEHICLE THEFT
REPORT TOTAL	28,012	108,745	13,102
RATE PER 1,000	4.69	18.20	2.19

United States property crimes — Population 318,857,056

	BURGLARY	THEFT	MOTOR VEHICLE THEFT
REPORT TOTAL	1,729,806	5,858,496	689,527
RATE PER 1,000	5.43	18.37	2.16

Maryland violent crimes — Population 5,976,407

	MURDER	RAPE	ROBBERY	ASSAULT
REPORT TOTAL	365	1,619	9,544	15,133
RATE PER 1,000	0.06	0.27	1.60	2.53

United States violent crimes — Population 318,857,056

	MURDER	RAPE	ROBBERY	ASSAULT
REPORT TOTAL	14,249	116,645	325,802	741,291
RATE PER 1,000	0.04	0.37	1.02	2.32

Source: NeighborhoodScout

Crime rate can have a dramatic impact in property values. Studies show that 10% reduction in crime adds around 1.7% to the selling price.

Demographics: Key Factors to Consider

Crime Risk

Everyone wants to live in a good neighborhood where they can feel safe and secure. Some areas are more subject to criminal activities than others, and local crime rates can impact risk exposure, real estate values and investment and insurance rates.

Crime rates can be easily overlooked by investors. Different thieves tackle different areas, so more professional thieves will target affluent homes just as there is plenty of low-level crime in less privileged areas.

High-Paying Jobs

Job growth is one of the biggest factors in choosing an investment location. Simply put, if employers aren't hiring and people cannot find a good job, they are not going to buy or rent a home.

As an investor you want to take a good look at the trends in employment and income in and around the area/s you've targeted for investment. Look at the hard data and as well as indicators in job growth and income trends and opportunities.

Age and Spending Habits

Spending habits correlate with age. You may think that a younger demographic, like Millennials, have more disposable income than Generation Xers or Baby Boomers. However, Millennials are also more likely to have a huge student debt and little savings. So your assumptions may be wrong. For example, research by Harry S. Dent shows that the peak age for spending on housing is age 44.

Thus, age demographics can be a good indicator of a viable market, especially if you're interested in flipping an investment property.

Population Growth

Typically, population growth is a result of other favorable factors, such as low unemployment rate, affordable cost of living, entrepreneurship, and a wide range of industries, to name a few. Simply put, if people moving to an area the number of potential buyers and tenants goes up.

With rising population and growing demand your property will appreciate. And likewise, growth translates into shortages of rental inventory and rising rents. For buy and holds, rising rent means better cash flow and higher profits.

Tenants vs. Owners

Another key demographic factor is the ratio of rental vs. owner-occupied homes. Some areas just have more renters. If you're looking for income property, rental-oriented areas are naturally the best fit. But if you're looking to fix and flip, same area will make it harder to sell. In such cases, you'll want to look for areas where the owner occupancy is high.

You'll want to look at average rental rates and sales prices to make sure the numbers make sense and you can recoup your investment.

Community

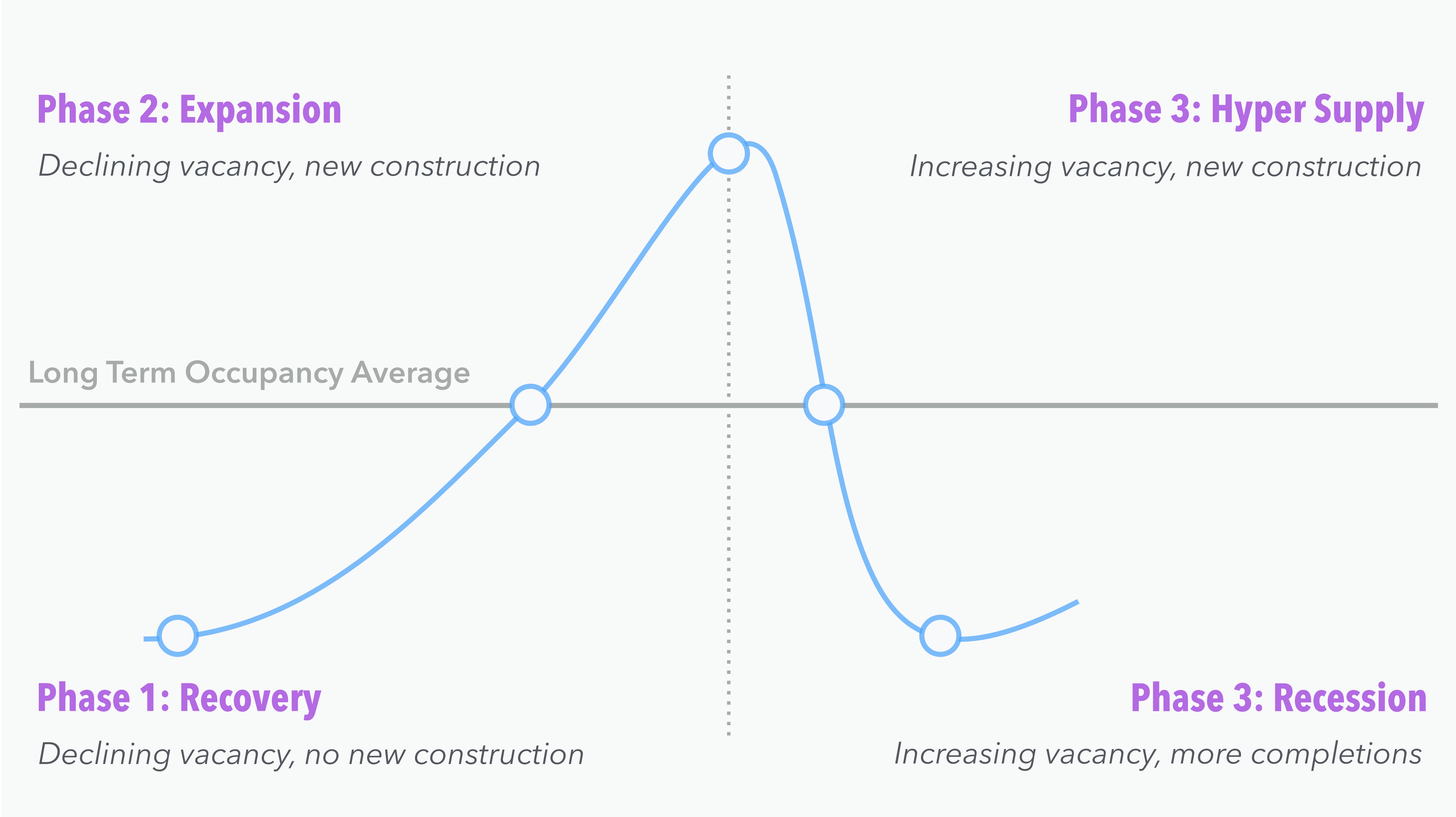
If you're investing in multifamily apartments a community of many young families will give you a much better outlook and return on investment. Likewise, if your property is commercial property, you're more likely to get tenants if the area is full of other businesses.

Also look at benefits the community brings. Some business areas have many networking events around. Families will look for ongoing activities their children may join.

What Market Are We In?

Like every market, real estate is cyclical. While there's no reliable way to know what the real estate market is going to do, it's important investors are aware of overall market trends. Past and present trends reveal a lot about where we're heading.

The real estate market typically moves through four phases before repeating the cycle again. Knowing which phase the market is currently in enables you to make more educated assumptions regarding future investment opportunities.



1. Recovery

Arguably, this is the best market to buy in. The market is recovering from the last downturn, it's no longer in free fall and the trend starts to turn upwards. As the old advice goes; you want to buy low and sell high.

High unemployment, foreclosure rates and general uncertainty are typical for this phase. You'll hear most people saying, "Oh, I would never invest in real estate."

2. Expansion

During the expansion phase, employment starts to pick up and confidence in real estate is once again rising. Lower supply and increasing demand trigger the growth in real estate prices. Developers begin to build new homes.

This phase still presents a great time to invest. The problem is that speculators are also involved, so there will be fewer great deals.

3. Hyper Supply

This is the final stage of the real estate boom. It's characterized by skyrocketing prices, mass building projects, and high interest among the general public in investing in real estate.. First the supply and demand reaches equilibrium, then the supply overtakes the demand.

Everyone is making money and bragging about it. Even uneducated investors. This it time to get out of the market before it crashes.

4. Recession

This can be an exciting time to buy. After the real estate market bottoms out, it begins to rise once again. Timing of your regional market with regard to housing affordability is key.

This can be quantified and tracked by understanding the years of the average household income needed to buy the average house in your area. (See graph).

Market Factors to Look at

The first step to finding a good market to invest in is narrowing down your choices. For buy and hold properties in particular, it's imperative to find a market that will be profitable.

Below is a general list of factors to consider. One thing to bear in mind is that there will always be trade-offs. You can a great price in a market forecasting high returns, but the risk will be equally high. Or you can purchase expensive property with lower returns, but also less risk. You want to compare your options based on these factors and find the best ratio based on your appetite for risk.

Price-to-Rent Ratio

For rental buy and hold investments in particular, the primary factor the price-to-rent ratio. You have to be able to rent a property for enough money to cover the cost and expenses, and then hopefully have some left over for profit.

In general, you only want to be looking at markets that have good price-to-rent ratios to better secure a profit.

Price

Some markets are less expensive than others and some may have a very high entry prices. A good price is something that's determined by the risk to return ratio.

However, as an investor you may be limited by the amount of capital you have available to invest, so price is a deciding factor.

Cash Flow

This is one of the most critical market factors. If there is no potential to generate cash flow, there is no point in investing.

Since the price-to-rent ratios in of the markets you're looking at are good, all of the markets are expected to have positive cash flow. The key factor to look at the varying degrees of positive cash flow for each market you're interested in investing in.

Appreciation Potential

A top challenge of real estate investors everywhere is mitigating the risk and uncertainty in both known and unknown neighborhoods and markets.

While you shouldn't make an investment decision solely on appreciation potential, some marketshave significantly more potential for growth than others.

Age of Property

1The older the property the higher the maintenance costs. So if you have two equally priced markets to invest in, you want to factor in the age of the property.

Some markets have newer houses that the others.

Industry

Another key factor to look at is whether the market has an industry to support population sustainment and growth.

If you buy real estate in a market that has only one major industry, your investment is at much higher risk because of it goes down, the entire economy goes with it.

Property: Risk Factors to Look Out For

In most cases, investors are dealing with properties that aren't new. Even with new constructions, you want to perform stringent inspections: Flooring, wiring, phone, cable, and lighting are just a few of the big ticket inspection items.

According to HUD's 2013 American Housing Survey, the average owner-occupied structure is about 37 years old. With older properties, there's always a risk one of the following problems.

! Construction Style and Quality

Generally, prefabricated and mobile homes use lower-quality materials than brand new and older homes. Mass-produced houses can have quality issues as well. Custom-built new homes may be on par with older homes in terms of quality Regardless of the construction style, it all comes down to the quality of the materials used, and the skill and diligence of the builders.

! Climate, Geology and Position

Humidity, temperature extremes, and storms accelerate the aging process making property "wear and tear" more likely. Seismic activity, sinkholes and limestone geology, and high water tables are among some of the geological factors that can accelerate the aging process. Position matters too. For example, a house on the top of a hill or with a steep driveway is much harder to sell.

! Renovations and Additions

Previously made renovations can hide many problems with the property. Know what's been added and renovated and always make sure all structures on the property are legal structures.

! Foundation or Structural Problems

Fixing foundation problems can be costly and inconvenient. Signs include visible wall cracks that grow over time, cracked tile or concrete floors, doors that jam or fail to latch, persistently stuck windows, and floors that are clearly off-level.

! Roof Problems

Problems stemming from a compromised roof can cost tens of thousands of dollars to fix and may not be covered by homeowners insurance. Some of the problems include pest infestations, interior water damage, and inefficient insulation.

! Inefficient Windows

Inefficient windows result in higher electricity bills. According to the Federal Government's ENERGY STAR program, installing the most efficient class of windows can reduce your annual electric bill by $126 to $465, depending on where the property is located.

Property: Risk Factors to Look Out For

Plumbing Problems

Old or substandard plumbing system can cause major water damage in the walls and floors. This can make the property uninhabitable and cause longer-term problems, such as mold infestations. Although a failure is often covered by homeowners insurance, it can cost tens of thousands of dollars to clean up.

Inadequate or Unsafe Electrical Systems

This can result into problems of safety and convenience. Insulation, electrical service panels and circuit breakers are also prone to deterioration. The lifespan is about 70 years but water damage, fire, pest infestation, and other unusual events can speed up the aging process.

Failing or Inefficient Mechanicals and Appliances

Equipment near the end of its useful life is more prone to failure, raising the possibility of an inconvenient or dangerous situation. Mechanical and appliance lifespan varies by item, brand, and workload.

On average, water heaters last 10 to 15 years, furnaces last 15 to 30 years, central air conditioning units last about 20 years, refrigerators last 15 to 20 years, and washers and dryers both last 10 to 15 years.

Hazardous Materials

Lead and asbestos are two hazardous materials that were used in residential applications until relatively recently. If the property is older, from pre-70s era, the risk of finding these materials exists. Then there's Radon, a radioactive gas that occurs naturally in certain types of bedrock.

According to EPA, radon tends to persist at higher concentrations in the Northeast, Midwest, and Intermountain West, but it can occur anywhere.

Mold and Mildew Damage

Homes exposed to excessive moisture are likely to develop mold and mildew problems. The problem is can occur as result of wet climate or cracked foundations and leaky pipes. However, infestations can start inside walls. Thus, it's possible to walk through a mold-infested older home for sale without realizing there's a problem.

Unhelpful, Unfinished, or Outdated Updates

There may be costly updates that need to be fixed, including poorly designed, inadequate, or simply tasteless interiors and incomplete projects, such as a partially finished basement or partially laid patio.

Substandard or Unsafe Features

Older homes in particular may have many obsolete, even unsafe, features. Examples include steep staircases, low ceilings, blocked-off chimneys, and nonworking fireplaces.

Investment Deal

Once you’ve narrowed down some of the markets and found interesting properties, it’s time to evaluate deals. The first step to analyzing the value of a property is to understand what contributes to its value.

In general, good financial analysis is getting some basic data and feeding it into a financial model. Then, use that model to determine whether the investment is a good or a bad one.

It’s part of your job is to make sure you have the best information available when doing your financial analysis. Remember, it’s often in the seller’s best interest to provide numbers that are more “appealing” than they are accurate, so focus on getting hard data like previous year’s tax returns, property tax bills, and maintenance records rather than pro-forma statements. Here are some basic inputs.

Property Details

This includes information about physical design of the property, including number of units, square footage, utility metering design, etc. It should be available from the seller, but you’ll get more comprehensive and detailed information from your local County Records Office.

Purchase Information

This is basic pricing information, such as the purchase price, the price of any rehab or improvement work you’ll need to do, etc.

The seller is going to name a purchase price, but it’s worth having the property inspected by a professional building inspector to ensure that there are no hidden issues or problems.

Financing Details

Financing details include the total loan amount, down payment amount, interest rate, and closing costs.. Your lender or mortgage broker is the best source to gather this information. Ideally through letter of approval.

Income

You will get this information from the seller, but don’t rely on pro- forma data for final analysis. Talk to the property management company currently running the property (if there is one) to get this information.

Expenses

This is the detailed information about costs of maintaining the property, including property taxes, insurance, maintenance, etc. This information should come from the seller or property management company, but you’ll also want to get your building inspector’s perspective.

Investment Deal: Key Metrics

Once you have all of your data you want to feed it into some of the key financial models. In general the real estate investing involves a lot of simple math. Understanding real estate finance includes knowing some of the key formulas and ratios.

Here are some of the most common real estate formulas and metrics you should use to evaluate your investment deals.

Net Operating Income

Also known as "NOI," this is one of the key metrics of the financial analysis.

It is the total income the property generates (after all expenses), not including debt service costs (loan costs).

Cash Flow

Cash flow is the total profit you will see at the end of the year from this property. To determine the cash flow, simply subtract the total expenses from the total income.

The higher your debt service payments (the larger your loan, higher your interest rate, or shorter your amortization period), the smaller your cash flow.

Cap Rate

The capitalization rate, also called the cap rate, is used determine what a property is worth. It takes into account vacancy, credit losses, other income, and operating expenses.

Because the Cap Rate is independent of the buyer and the financing, it is the most pure indication of the return a property will generate.

Cash-on-Cash Return

Cash-on-Cash (COC) return is directly related to the amount of cash you put down on the investment.

It's the equivalent measure of how much return you would make for each dollar you put into the property.

Internal Rate of Return

Internal rate of return (IRR) for an investment is the percentage rate earned on each dollar invested for each period it is invested.

IRR is also another term people use for interest or yield.

Net Present Value

Net present value (NPV) is an investment measure that shows whether the investment is achieving a target yield at a given initial investment.

It also quantifies the adjustment to the initial investment needed to achieve the target yield assuming everything else remains the same.

Real Estate Investing Mistakes to Avoid

Real estate investing is not as easy as it seems. First time investors, in particular, have to be very cautious not to make too many mistakes. And even experienced investors make mistakes.

On the other hand, there's market timing. To wait and analyze forever can result in losing the best deals. Of all mistakes you can possibly make, here are some of the most common ones.

! Bad Financing

Bad financing can be one of the worst mistakes possible. Typically, bad financing includes a combination of the following: High interest rate, adjustable interest rate, high monthly payments, balloon payments and personal recourse.

! Misjudging Resale or Rent Value

The number one job of an investor is to understand how the end customers (renters and buyers) make buying decisions and then to translate that knowledge to a value. If you don't do your homework, you'll have hard time making investments that earn a profit.

! Underestimating Repair Costs

First time investors have little idea how much it costs to renovate a property. They take advice from home inspector or real estate agent who may just throw out a generic number. Always do a lot of homework and be very conservative in your budget estimates.

! Underestimating Renovation Time

Additionally, inexperienced investors are often overly optimistic when it comes to renovation times. They think it can be done in 30 days, or 60 days. More often than not, things can go wrong.

! Underestimating Maintenance Costs

General maintenance of a property can cost a lot of money eating into your profits. Roofs, HVAC systems, wiring, siding, appliances, flooring, and so on can cost thousands. Be extra careful estimating the maintenance costs of older properties.

! Bad Tenants

One of the fastest ways to lose money is having bad tenants. Always check with your insurance policy and see if it covers tenant damage. If you have a mortgage, you also want to be sure you have tenants that pay on time.

Real Estate Investing Mistakes to Avoid

Running Out of Cash

Usually investors run out of cash for two reasons: Underestimating repair costs or underestimating future capital expenses on a rental property. Either way can prove to be a large mistake.

Letting Emotions Drive Your Decisions

The hardest thing about investing is managing one's fear and greed. It's easy to become overly enthusiastic and start believing your own fantasies. While enthusiasm is good, it should always be balanced with cold, hard, and objective analysis.

Choosing Bad Contractors

Finding contractors who will do good work, finish on time, and clean up after themselves can be as hard as finding a treasure on the beach. Bad contractors quickly become expensive, eating away most, if not all, of your profits.

Planning as You Go

Inexperienced investors buy a house because they think it's a good deal and then try to figure out what to do with it. Successful investors first create a plan and then find an investment property to fit that plan.

Not Using a Tax Professional

Laws change so often, impacting your write-offs and ways to properly report the numbers. However, if you do your taxes correctly, you're likely enjoy some tax benefits. Finding an experienced CPA is critical.

A good CPA who specializes in real estate will be up on all of the latest much more than one who only has one or two real estate investor clients.

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