Chapter 11 Summary
Residential Income-Producing Properties
California Real Estate Finance

Residential properties include single-family homes and multiple-family properties such as apartments, condominiums and co-ops. There are two main reasons that investors purchase residential property:

- Some investors purchase property to keep, meaning that they will buy the property and hold it for the long term. An investor purchases property to get income, to see the property appreciate in value, and sometimes to gain tax benefits.
- The other reason investors purchase property is to flip it. A property purchased to flip is one that is intended to be resold as soon as possible. Investors that intend to flip properties feel that they can make a profit either with or without renovation, repairs, or improvements.

If you look at the income from a single-family home against the price that the investor paid for it, it might appear to be a poor investment. However, income is not the only measure. A more important measure is how the home appreciates.

Financing is a major advantage offered by single-family homes. Most lenders will offer a conventional loan of 75 percent of the lower of the appraised value or the purchase price of a non-owner-occupied home. Total seller financing is also a possibility for an investor.

Single-family homes usually have the lowest interest rates and the best overall terms of all the residential rental properties. The most important advantage of investing in a single-family home is that this kind of investment is more liquid than other kinds of property. The greatest disadvantage to single-family home investment is the fact that most single-family homes generate a negative cash flow for at least the first few years.

Vacation homes, condominiums and fixer-uppers can also be good investments under the proper circumstances.

Duplexes, triplexes and fourplexes are sought after investment vehicles because an investor can choose to live in one of the units, while renting out the remaining units.

Some lenders will allow the investor of a two-to-four unit dwelling to put down 15 percent and then obtain a second loan for the remaining 10 percent as long as there will not be a large negative cash flow.

It's also less likely that an investor could obtain seller financing for a first loan on a property of the size, since most owners would still owe on the property.

One of the advantages to investing in a two-to-four unit dwelling is the fact that tenants often pay all of their own utilities and do repairs. One of the disadvantages is that sometimes the rental income lags behind inflation or operating costs, which results in a smaller net cash flow to the owner.

When the supply of larger apartment buildings is greater than the demand, an investor may be able to obtain an apartment house at an extremely fair price. However, when this happens, an owner must be able to withstand the temporary financial losses he or she might incur due to excessive vacancies.
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Lenders typically offer conventional loans from 60 percent to 75 percent of a property's value. As the size of the building increases, the loan ratio is usually reduced from 75 percent to 60 percent or less. Most lenders require at least 15 percent down even if the investor has a seller carry-back as a second loan.

Conventional lenders look more closely at the cost of operating a property of this size and are more concerned with the location than they are with smaller-sized properties.

When deciding to take a listing of an investment property, an agent needs to do a detailed analysis of the property with regard to the seller's motivation to sell and the current and future financing of the property.

In order to give an owner proper financing advice, an agent must know the real reason the owner wants to sell.

If the property carries more than one loan, the agent should get the information for each loan, including name, address and phone number of the lender, the loan number and the exact current loan balance.

The agent should also request a copy of the note and deed of trust from the owner for each loan he or she has. For each note, the agent should determine the monthly payments, interest rate and due dates.

Once the agent has collected the information on all the loans on the property, then he or she should meet with all of the lenders for each of the loans to collect information about possible future financing.

After an agent obtains all of the pertinent information from the lender, he or she should meet with the sellers to explain all the information that he or she has collected.

How do financing conditions affect property prices? When interest rates go up, the net income of a property after deducting the interest expenses decreases, so the value of the property also decreases. Conversely, when the interest rates decrease, the owner's yield is increased and the value of the property also increases.