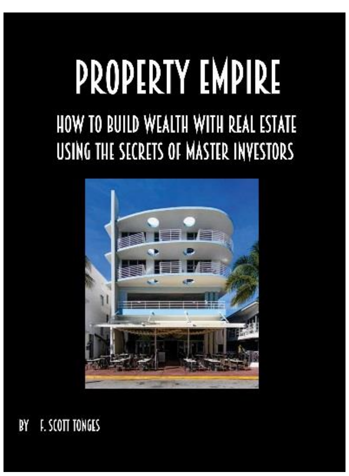
SOUTHWEST PROPERTY TRUST

Real Estate Since 1976

THE $10K REPORT

HOW TO PARLAY $10,000 INTO A DEBT FREE PROPERTY GENERATING $75-$150K PER YEAR IN PASSIVE CASH FLOW

A COMPANION TO THE BOOK, PROPERTY EMPIRE – HOW TO CREATE WEALTH WITH REAL ESTATE USING THE SECRETS OF MASTER INVESTORS



BY F. SCOTT TONGES

INTRODUCTION

Before we get started, let me tell you some short cuts to understanding what's ahead. If I had to define what the most successful investors I came to know did, in one phrase, it would be this: "rapid value creation followed by leveraging one property into another with a goal of growing cash flow". So, what does this mean?

Let me ask another question first. How did my friend Darby Suiter grow from 170 units of apartments to 720 units and with the cash flow he generated, buy 150 homes in two cities as a side line? How did Jerry J. Moore acquire 100 shopping centers when most investors can't imagine how you could acquire one? How did Ron Legrand do over 3,000 residential deals over 33 years? How did the immigrant client who was referred to me have $ 1 million in cash to spend on an investment and still own 3 convenience stores that gave him ongoing, passive cash flow ? (He sold 4 of his 7 stores to generate the $1 million, but the point is, he had them to sell).

<u>CONCEPT ONE</u> - Let me show you two simple things to make a point.

750 x 1.2 = 900

750 ---- > 1,000

The first set of numbers refers to what I call a "Situation B" which I explain in the book. It's the idea of buying an undervalued property for which you can increase the value by 20% in short order. Add as many zeros as you like; $750,000 x 1.2 = $900,000 or $7,500,000 x 1.2 = $9,000,000 or $75,000,000 x 1.2 = $90,000,000. The value increases are, respectively, $150,000 / $1,500,000 / $15,000,000.

So, if you could acquire the $750,000 property and turn it into a $900,000 property, then sell it, you'd have your original investment back, say you bought with 20% down ($150,000), plus $ 150,000 in profit. You've doubled your money. $150,000 became $300,000.

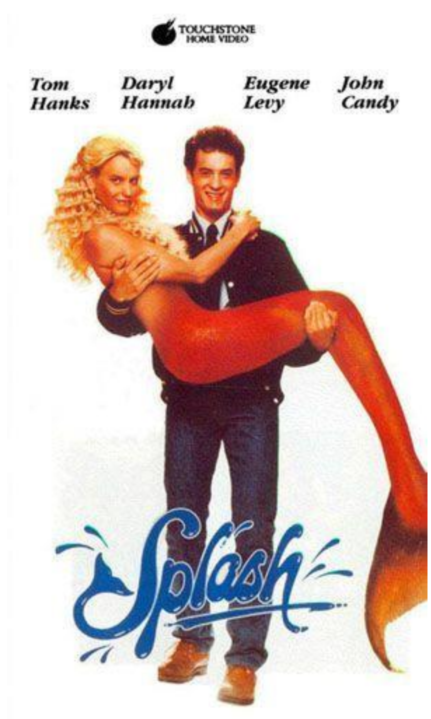
The second number is about buying a Situation A (a turnaround property) in which your all in cost to buy and upgrade is 75% of the end value. So, you invest $750,000 and end up with a $ 1 million asset. The attraction here is that you can refinance 75% of the new, $ 1,000,000 valued property and get back 100% of your invested capital. You have $ 250,000 in new equity plus $750,000 to go do it again.

The average investor buys the $900,000 or the $1,000,000 property that the master investor has created. He is left with waiting on inflation, if it comes, to make his profit, in the distant future.

<u>CONCEPT TWO</u> – **I refer to a first step, for many investors, as Seed Capital. That's making the money to become an investor, so you can do deals as noted in Concept One. Seed capital is about finding bargains, or structuring bargains, and passing them on to bargain hunters for a fee or marked up price. This is mostly about short term control. I'll make a point using a true Hollywood story.**

When aspiring, but unknown, Brian Grazer, wanted to conquer Hollywood, he set out to have lunch with someone in the business every day. The dream lunch was the king of Hollywood at the time, Lew Wasserman.

After months of persistent badgering of Lew's secretary, she relented and set up a 15 minute visit for Brian, as Lew road his limo from his office to a meeting. Both settled in the car, and Wasserman asks Grazer: "Kid, do you have money?". No. "Do you control a star?". No. "Do you have a script?". No. Then Lew said, "Kid, you got nothing! When you have any of these, call me." Well, it so happens Brian had been fooling around with a script about a comedy romance in which an ordinary guy meets and falls in love with a real woman who is also a mermaid. He soon finishes the script. Now he <u>controls</u> something; the script. With that, he finally gets funding to make his movie. The movie "Splash" gets made. It's a hit. It launched the producing career of Brian Grazer and the stardom of a then relatively unknown TV sitcom actor that Brian cast as in the lead role, Tom Hanks. You only need short term control of something attractive, or repackage it into something attractive, to make money. That short term control can be done with options, lease options, contracts, and letters of intent. Now, let's see how to build your empire.



REAL LIFE MONOPOLY & THE THREE STEPS TO BUILDING WEALTH QUICKLY

Here's how to play real life Monopoly, including getting the money to get started. I refer to this 3 step process as the "Real Estate Investing Science Plan".

STEP 1 <u>Seed Capital</u>

Profit with homes & commercial properties using <u>zero down or micro small</u> invested capital. A needed step if you don't have much money to invest or, if you already have money to invest or assets to tap, you can add this step to accelerate growth by generating more investment capital. A business in itself for some investors, a first or supplemental step for others.

STEP 2 <u>Create Wealth</u>

Seed Capital is then invested in high profit A&B Situations. You may start here if you have funds, but sticking with Step 1 gives you more capital to invest.

STEP 3 <u>Stabilize Wealth</u>

Use your Step 2 profits to buy or create C & D Situations. Creating them from A&B Situation purchases is what the most successful investors do. You now own solid, passive cash flow commercial properties

How to Use These Three Steps - A Short Story

From Knowledge & Zero $ To $406,560 plus Cash Flow

SEED CAPITAL (Step 1) Imagine you're dropped into a city you don't know. You want to make some money besides job income, and you want to become financially independent as soon possible. Stay with me here, even if these details don't fit your plans or seem too small. You put an ad in the paper seeking a tenant-buyer and offer "Rent to Own – No Bank Qualifying – 3 Bdrm- 2 Bth Home". Next, you call on homes "for rent" and ask if the owner would consider leasing to you with an option to buy and telling them you'd put down a $2,500 option fee, non-refundable to you. One owner agrees. You look for a tenant buyer calling on your ad with $10,000 to put down as their option fee to buy. You then lease from the owner, advising you're an investor and will sublease to a tenant buyer and pay all the expenses, in addition to giving them the $2,500 fee. Your option price to buy from the owner is for $200,000. Your deal with the tenant buyer is for a $230,000 option price and they pay all expenses. You put the deal together and **pocket $7,500** (the difference in the options fees). At final purchase by the tenant buyer, you'll pocket another $22,500 (the balance owed to you by the tenant buyer of $220,000 less the balance due the owner of $197,500). You do this 5 times, netting $37,500 in non-refundable deposits, and $112,500 when all 5 tenant buyers close. **The $37,500 is SEED CAPITAL (step 1) as is the additional $112,500 due you from the end sales to the tenant buyers in a year or two.**

CREATE WEALTH (Step 2). Now, you take the $37,500 and buy a 4 plex. You use $30,000 for a 15% down payment. The remaining $7,500 if for some fix up and reserves. Your price is $200,000 for the 4 plex. Your mortgage is $170,000 with payments of $1,131 /month. In time you raise the rents from $850 a month to $1025 a month. This brings the value to $326,824. You sell the property after 2 years for $326,824, due to the increase in value because of the rent raises (that's because this is a commercial property). You pay off your reduced loan balance of $166,421 and **pocket $160,403.** This happens about the time your 5 lease option deals pay off, netting another **$112,500. You now have $ 272,903 in cash.** (see calculations in Book Supplement)

STABILIZE WEALTH (Step 3). You take **$250,000** of your $272,903 to buy a strip shopping center that's not doing too well for $550,000. With all 6 tenants in occupancy, paying $1,400 a month each, it would be worth $665,000 but a couple of vacancies exist, so you make a good deal. You put down 40% or $220,000, get a short term bank loan for $330,000 until you get the center back to full occupancy and rents at $1,550 mo for each tenant. Upon getting all repositioned and full, you refinance your **$737,000 newly valued** center, and get a new loan of $550,000 (about 75% loan to value). You pay off your $330,000 loan.

You now have $220,000 in cash from the refinance, $186,560 in new equity, and still own the center with an annual cash flow of $16,662.

So, to get to a property that you own, debt free, generating $ 75,000 a year in net income, what would that look like? Take a look at this chart.

		Income Property - $75K Annual Net Income				**COMPARISON**			
		Retail		**Office**		**Apartment**		**Warehouse**	
Rent		$ 14.00	psf/yr	$15.00	psf yr	$ 725	mo	$ 3.50	psf/yr
Size		9200	SF	11000	SF	19	units	24000	SF
Annual income		128800	yr	$165,000		165300		84000	
Occupancy 90%		115920		148500		148770		75600	
Expense		35%		50%		50%		0	
NOI		**$ 75,348**		**$ 74,250**		**$ 74,385**		**$ 75,600**	
Value	8.25 cap	$ 913,309		$ 900,000		$ 901,636		$ 916,364	
		$ 99.27	SF	$ 81.82	SF	$ 47,455	unit	$ 38.18	psf

We're talking about a property, or properties if you prefer, that are worth about $900,000 when up and running at market rents and customary expenses. The challenge is to come up with $900,000 or, as I prefer, acquire a property for $750,000 that you can bring up to a $900,000 value. In the book I talk about A, B, and C situations. I call this a situation B: a property that is underperforming due to lower than market rents or higher than normal expenses, or some combination of both, and <u>its value can be increased by at least 20% by adjusting either or both of these two areas, income and expense</u>. There are far more of these than Situation A's which are properties that have fallen far short of just being below market operations. So, I'll use Situation B's at the prime targets to acquire.

In the final step, we're looking for an underperforming property generating a net operating income of $63,750 a year that can be increased to $75,000 a year: an increase of $11,250 a year, or $937 a month. For our 19 unit apartment, as an example, that's $937 a month divided by 19 units, or a $50 a month increase per unit. This might also be a $35 increase in rents and an overall $15 per unit average decrease in expenses. If you remember the many P&L examples from the book, there are numerous line items of expense, each of which can be looked at for possible reduction. In short, the goal is not that daunting.

So, we need $750,000 cash to acquire an underperforming Situation B property. There are two avenues we could take.

AVENUE ONE – MORE SEED CAPITAL DEALS: **In the original example, we start with next to nothing and do a sandwich lease option on 5 homes. We make $150,000 on five house deals over appx a two year period. Alternatively, we could set up "terms" deals on some homes (a seller who will accept a low down payment and carry the balance, so no new loan needed). If we can create enough equity spread we could stay in the deals and perhaps generate a similar $30,000 per house. There's the spread between the down payment to the owner vs what our end buyer pays us and the spread between what we buy the property for from the owner and what we resell it for to the end buyer. Also, if there is not enough spread to stay in, we could assign this attractive "seller financed" contact to the end buyer for a fee, say $10,000.**

Of course, we'd have to do more of these, 15 at $10,000 each to reach $150,000, but it's your choice. Similarly, we could do sandwich or assignments with commercial properties. As shown in the book, $25,000 to $100,000 in assignment fees are achievable on modest, under $2 million valued properties. Whichever deal types we pursue, residential or commercial, ownership or leases or assignments, we've got to do a number of low down, usually "terms" deals to get to $750,000 in cash.

But, this seems like the hard way when compared to what we did in the next two steps. Let's look at another route to get to our $750,000.

AVENUE TWO – SELL THE SECOND SITUATION B WE ACQUIRED: In the example, we earned seed capital for the purpose of acquiring a true income property in which we could increase value by at least 20%. A classic Situation B. After doing this with the four plex, then selling that we acquired the strip shopping center.

So, using this second property, the strip center, let's just do this once again. We sell the strip center and now have $406,560 (the $220,000 in cash from the refinance and the $186,560 equity we realized by selling).

There are a number of ways we could parlay the $406,500 into a $750,000 free and clear property netting $75,000 after we bring it up to market operation. In short, we need another $343,000 ($750,000 less $406,500).

The quickest way to do this is to repeat the search for another undervalued deal. Let's use $375,000 of the $406,500 and save the $31,500 for reserves. So, if $375,000 represents 25% down for another Situation B property, here's what that looks like.

Since $375,000 is 25% of $ 1,500,000 that's what we're looking for: a $1,500,000 Situation B. We then increase it's value by 20% and now have a $1,800,000 property ($1.5 million x 1.2 = $1.8 million) on which we owe appx $1,125,000. Our new, achieved equity is now $675,000.

Repeat the same step as we did before. Sell this $1.8 million property and pocket $675,000 profit. Use $550,000 of that for the next to final purchase before we buy the end property we seek. $550,000 is 25% of $2,200,000. Buy the Situation B property for $2,200,000 and increase its value by 20% so it's a $2,640,000 valued property. Sell it for $ 2,640,000 and pay off the $1,650,000 loan balance and net $990,000.

You now have two choices – buy an up and running $900,000 property with this money, netting $75,000 a year (remember the chart) of buy a final Situation B property and you'd have more than $75,000 a year cash flow. With either choice, you have $75,000 a year in cash flow with no debt.

If $75,000 a year is not enough income, just repeat the process with the $2.2 million property. Using $900,000 as 25% down, you get a $3,600,000 Situation B property which you improve to a $4,320,000 property. Sell this and net $ 1,620,000 ($4.32 million less loan of $2.7 million = $1.62 million). Now you can buy ANY TWO of the suggested properties in the chart or one larger one and you have $ 150,000 a year in passive income.

HERE'S A SUMMARY

	THE $!0 K STEPS		
	Arrange for 5 Sandwich Lease Option Homes	**Capital Created**	
SEED CAPITAL	Collect $36,500 in Option Fee Spreads - By the 4 Plex	$37,500	
	Collect another $112,500 in Profit Spread When		
	Tenant Buyers Purchase the Homes	$112,500	
	You could also do residential or commercial		
	assigments		
Commercial Investment Focus			
Investment ONE	4 PLEX PURCHASE		
Goal	4 PLEX SALE PLUS $112,500 Profit From Home End Sales	$272,903	
Investment TWO	Purchase Strip Shopping Center with profits from		
	4 plex sale and final home profits		
	Bring the Market Performance & Sell the strip center	$406,560	
Investment THREE	Purchase any Situatiion B commercial property		
	Bring to Market Performance then Sell	$675,000	
Investment FOUR	Purchase any Situatiion B commercial property		
	Bring to Market Performance then Sell	$990,000	
Investment FIVE	Using the proceeds from selling Investment 4		
FINAL	buy an up and running $900,000 property (all cash)	**$75,000 / Yr or More**	
Keep this Property	generating $75,000 a year or a Situaion B	**Cash Flow**	
	and create a greater than $75K in income	**Debt Free Property**	
		worth $ 1 mllion +	

Q & A's

How long would all this take?

It is a fact today, due to technology, that you can invest anywhere and even do deals, certainly the seed capital deals, without running out to look at properties. In my medical condo deal, the sports bar deal, and the four plex deal, I never met any of the end buyers or sellers face-to-face. I only saw the four plex once when I drove by it after I had it under contract. To this day, I've never seen the other properties. I was never planning to be the buyer, so had no interest in seeing anything other than photos of them.

At the very beginning we did 5 house deals that took, say two years, in order to pull together the $150,000 in seed capital. You could do fewer deals, each for more money in less time, but let's stay with that.

We bought the 4 plex early on with the $37,500 from the deposit spreads money, so that was underway before we fully cashed out of the homes. After fully cashing out of the homes within two years, we also sold the four plex and bought the strip center starting, say, early in year 3. From there, it was only two more deals: the $1.5 million purchase and the $2.2 million purchase. So, maybe two or three years, but what if it took five? It's just a function of the lease terminations and that's usually a function of the property types. Commercial properties usually have 3 to 5 year leases, and apartments one year, so it's just a function of how fast the existing leases come up for renewal or any vacancies are filled.

In truth, how many years do you expect to sit in traffic at a near stop going to and from a 9 to 5 job, if that's your situation?

Where Does the $10,000 Come In ?

Glad you asked. If you allow $2,500 for education in this, it's a must, and I've got a recommendation I'll be making in that regard, that leaves $7,500 for initial investments. Remember the first 5 homes in the example? If you put down $2,500 for a deposit and first months rent, that's 3 homes there. But with some education on clever ways to do this, $5,000 could get you the first five homes in short order. Even more. Alternatively, you could keep this plan going. No reason to stop at 5, and after the first few, it becomes a self funding process. With the commercial seed capital ideas in the book, you don't need a dime. So you really don't need $10,000 – just $2,500 to get educated, but some back up is always a good idea. Learn more about Seed Capital ideas in the book.

WHAT IF I ALREADY HAVE MONEY TO INVEST ?

Remember, the seed capital step is always good to learn. It can increase the capital you have to invest, but that's your call. So, if you have the money to make the first commercial property investment, you're ahead in the process. The seed capital step was used to generate $150,000 in this example.

HOW DO YOU MANAGE THESE PROPERTIES

As to management, you pay someone to report to you. When I had 100 employees and we managed 1,860 apartments and 500,000 SF of commercial space in five cities, everything was overseen by others, day to day, and I got the reports. When I was helping Howard Ruby, I saw the weekly reports on total revenues of 25,000 apartments. A client/friend of mine owns a small, boutique hotel in Santa Fe that has been voted one of the top 50 in the world by Travel and Leisure magazine readers. Room rates start at about $550 a night. As he shifted from running it himself, he hired a management company. Actually, he tried several, all disappointing. Finally, he discovered all he needed was a good GM (general manager). You need to take off your "I'll do it all" hat and start thinking about systems. Ron Legrands' book <u>The Less I Do, The More I Make</u> is a hand book on delegation and systems. So, what have we done here?

IS IT THIS EASY, SEED CAPITAL THEN 5 PURCHASED DEALS TO $75K A YEAR ?

I know, this sounds like that save a penny and each day double it and in 30 days you'll have a zillion dollars. Of course, nothing works perfectly, but even if things don't work out to the penny in your plans, you now have the knowledge to create the cash to get to your goal. As to the seed capital step, the 5 homes, why not keep the plan going ? Don't forget systems. My residential investing mentor, Ron Legrand, still does 3 or 4 deals a month, but all he does is review a sheet on each prospective buyer and say "yes" or "no". That's it. All else is delegated. You could do 10 or twenty, increasing your capital to invest and not worry if a deal or two does not work out as planned. These "Systems" are the key. That is, to delegate 90% of the work. You'll learn about that in the courses I suggest you study.

The fact is, this idea of buying undervalued properties and creating value in short order, not paying top retail and waiting on inflation, is the bed rock of building a real estate portfolio. <u>It's what master investors do.</u> The never pay retail !! My friend Darby Suiter created enough cash flow from his turnaround apartment properties that he acquired 150 homes over the years, as a side line. Jerry J. Moore acquired 100 shopping centers, all in the same city, Houston, using cash flow from his early acquired properties.

Using this plan to generate $75K a year, and not have it as your main source of income, but an investment, you could by another 4 plex, every two years as in my example, and repeat this whole process, over and over. As you see in my book, I assigned a 4 plex deal I contracted to buy for $ 110,000. With $20,000 worth of fixes and fully leased, it was a $250,000 property. That's a $120,000 profit. This is the game, done right – value creation.

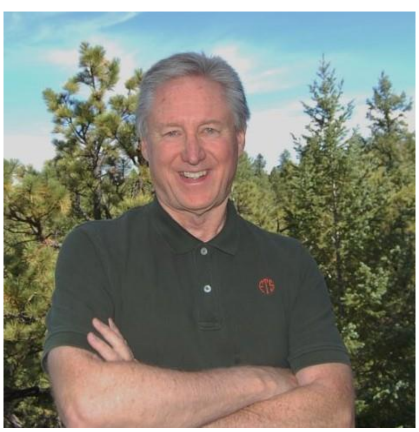
SOME KEY POINTS

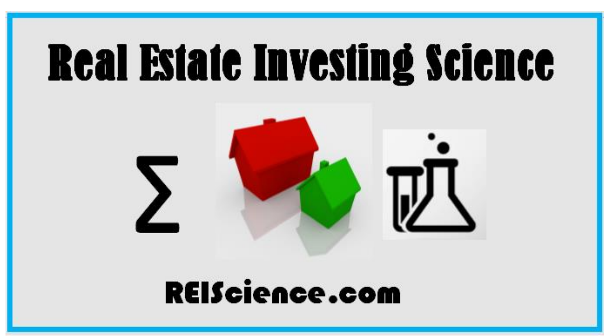
1. **Homes are fine for short term profits. In my opinion they are not the best long term investment, say over 5 years. Two reasons. Unless you are doing rehabs for short term, fix and flip profits, long term rental homes are dependent on home value inflation. By the time you subtract upkeep, tenant turnover costs, and vacancy & collection losses, they returns may be far less than you expect. Rent rates in homes have nothing to do with value.**
2. **The reason I suggest moving into commercial properties for a first investment, the 4 plex example, is that the values are determined by rents, net rental income to be precise. With a commercial income property, you'll likely pay far less per unit, due to this income dependency, than you would for a rental home. As an example, what you pay for a home that would rent for $1,400 a month could vary all over the map: $150,000 or $200,000 or $275,000 or more. There is no association with income. As to a commercial property, $1,400 a month per unit for a 4 unit strip center, may run $150,000 per unit: $600,000 for a 4 unit property. You have much more control over value when rents drive price.**
3. **Master investors never pay "retail" but seek out properties for which they can increase value (net income) with physical or operational improvements, often both.**
4. **Commercial properties, especially under $10 million in value, are popular, but not overrun as homes seem to be. Many owners in this range do not understand value creation.**
5. **Commercial tenants, excluding apartments, tend to be more stable. Also, the tenants usually have a bigger financial commitment than home or apartment tenants.**
6. **Commercial properties (not apartments) have far less costs to operate as you're not "rebuilding them all the time" as George Ablah told me: you're not always replacing carpets, appliances, painting, landscaping, or the myriad other items that residential tenants go through.**

THE REAL ESTATE INVESTING SCIENCE PLAN ILLUSTRATED

So, what next? See further below. Here's to your success.

F. Scott Tonges





WHAT NEXT ?

1. **If you've not done so already, request my <u>Property Empire</u> book, free, offered at this site.**
2. **If you have $250,000 or more to invest, get the <u>Ascension Report</u> on my company web site (home page) <u>www.SouthwestTrust.com</u>. You'll learn specifics on how I help investors duplicate what master investors do.**
3. **If you want to make quick money, and become a wizard at earning Seed Capital by learning the residential investing business the right way, and you should, get Ron Legrands' course, "Pretty House Terms". Also, join his Gold Club monthly membership. You can get it through my training site: see the blue, "RL" button on the "Home Study" page at www.ReiScience.com**
   If you go through the link at my site to get Ron's course, I'll know and can supplement it, to your benefit.
4. **If you want to learn the complete real estate investment business, I will recommend both my own course and Ron's, too. Mine focuses on commercial investing but has plenty on residential investin ideas too. Ron's course will allow you a quick start to making money but will also serve to help you learn what I teach.**