The Passive Income Manifesto

WORKBOOK
(part 2)

A SPECIAL GIFT TO NOTEWORTHY MEMBERS

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Risk & Volatility

Complete the exercises below. There may be multiple correct answers. NOTE: We recommend you watch the webinar replay for help with any questions you're unsure of. Check your email for the webinar replay link.

1. "Volatility" and "Standard Deviation" are a measure of
   a. Risk
   b. Waves
   c. Surfing Index
   d. My neighbor's snoring pattern

2. Low volatility means
   a. Less risk
   b. Medium risk
   c. High risk
   d. No risk

3. A larger spread between CAP RATE and LOAN CONSTANT lead to…
   a. Higher cash-on-cash return
   b. Less cash-on-cash return
   c. More cushion to handle volatility
   d. Less cushion to handle volatility
   e. Upset stomach

4. The more leverage (debt financing) …
   a. The more volatility
   b. The less volatility
   c. The more risk
   d. The less risk

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e. The more borrowed money
f. The less borrowed money

5. Buying an asset with leverage requires breaking up the financing into 2 main sections: Down payment and a mortgage (for real estate).

   The safest way to structure the down payment for you is by using:
   a. Debt financing
   b. Equity financing
   c. Rob a bank

   The riskiest way to structure the down payment for you is by using:
   a. Debt financing
   b. Equity financing
   c. Robbing another bank

6. When cap rate drops below loan constant, we then have
   a. Negative Leverage
   b. Positive Leverage
   c. Neutral Leverage
   d. This does not tell us anything

7. To minimize risk in a deal, there are a number of things I can do. These include (circle correct answers and underline correct words):
   a. (Maximize/Minimize) spread between cap rate and loan constant
   b. For using OPM as down payment, use (Equity/Debt) financing
   c. (Maximize/Minimize) number of deals i.e. spread borrowed money across (many/few) deals
   d. (Maximize/Minimize) number of investors in a deal.

8. You find a nice deal that you can rehab lightly and flip in 90 to 120 days. The property requires $15,000 to fix up. You have that money. You can use the money. You like the profit potential. You calculate the cap rate to 9% and loan constant to 12%. Purely based on the financing, would you do this deal? Why or Why not?

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9. The highest risk money in real estate is the:
    a. Down payment
    b. The 1st 80% LTV loan
    c. The money that I did not use in buying the property
    d. I have no idea what you are talking about

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Scenario 1B:

You decide to buy an apartment building after much due diligence. Your offer is accepted. You are happy with the negotiated deal. You are working on the financing. The seller had agreed to carry up to 20%. The lender requires a minimum of 10% down (your money or OPM).

Here is the data you have:

- The cap rate on the building is 9%
- You can get up to 80% mortgage from bank at 7% loan constant.
- You can get up to 20% from seller at 6% loan constant
- You have to have a minimum of 10% down payment (required by lender).
- You can borrow the down payment at 8% loan constant from people you know (up to 20% of price)
- You can raise the down payment from equity partners in exchange for 50% ownership (up to 20% of price)
- You have no money to put into the deal.

A "financing stack" is the various sources of money you use to buy an asset. For example, a financing stack for a deal could look like this:

Mortgage: 80% of the price
Seller Financing: 10% of the price
My Money: 10% of the price.

Remember, the "financing stack" should add up to 100%. Here is another example:

Mortgage: 70% of the price
Seller Financing: 10% of the price
Partners: 20% of the price.

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The way you structure the financing stack affects returns, risk, among other things. Savvy investors know how to do this to maximize return while managing risk.

Answer the following questions:

How would you structure the financing stack on the deal to be the SAFEST (least volatile deal)? Remember, the "financing stack" should add up to 100%.

MORTGAGE:

SELLER FINANCING:

DOWN PAYMENT:

How would you structure the financing on the deal to be the BEST for YOU in terms of both returns and safety?

MORTGAGE:

SELLER FINANCING:

DOWN PAYMENT:

How would you structure the financing on the deal to be the BEST for your INVESTORS in terms of safety and returns?

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MORTGAGE:

SELLER FINANCING:

DOWN PAYMENT:

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Exercise 2B:

You decide to buy another apartment building after much due diligence. Your offer is accepted. You are happy with the negotiated deal. You are working on the financing. The seller had agreed to carry up to 20%. The lender requires a minimum of 10% down (your money or OPM).

Here is the data you have:

- The cap rate on the building is 10%
- You can get up to 85% mortgage from bank at 7% loan constant.
- You can get up to 20% from seller at 8% loan constant
- You have to have a minimum of 15% down payment (required by lender).
- You can borrow the down payment at 8% loan constant from people you know (up to 20% of price)
- You can raise the down payment from equity partners in exchange for 50% ownership (up to 30% of price)
- You have no money to put into the deal.

Answer the following questions:

How would you structure the financing stack on the deal to be the SAFEST (least volatile deal)? Remember, the "financing stack" should add up to 100%.

MORTGAGE:

SELLER FINANCING:

DOWN PAYMENT:

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How would you structure the financing on the deal to be the BEST for YOU in terms of both returns and safety?

MORTGAGE:

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How would you structure the financing on the deal to be the BEST for your INVESTORS in terms of safety and returns?

MORTGAGE:

SELLER FINANCING:

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Exercise 3B:

You find an asset that would pay you 16% cash-on-cash return with the 80% financing you find to buy the asset. You are left with the down payment of 20%. You then identify the following sources (listed with the loan constants) to use as down payment. Which sources would you consider and why?

a. Line of Credit at 8% (adjustable)
b. OPM unlimited at 12% (fixed)
c. Credit Card at 24% (adjustable)
d. Your Cash
e. Free & Clear Car
f. HELOC $120,000 at 7.5% (adjustable)
g. Partial Seller Financing 5% (fixed)
h. Equity Partners at 50/50

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Exercise 4B:

An investor friend comes to you and says “this does not work. I lost $240,000 in investing. I had owned 5 single family rental properties.”

Upon further questioning, you realize that your friend used negative leverage to buy his rental single family properties. He had financed his properties with 7% loan constants on his mortgages of 80%, and his properties were all 2% cap rate. For his down payment, he had used a combination of credit cards of 24% loan constant and had maxed out his HELOCs at 6% loan constant (adjustable).

Identify the mistakes he made:

What is the COST of not knowing the information we are learning here (hint: it is the SUM of all his losses PLUS all the money he would have made by knowing this information):

If he had paid YOU $10,000 to help him out and fix his mistakes (thus saving him his $240,000), would that have been a good deal for him?

That is called “lost opportunity cost.” Many people lose 7-figures per opportunity by not having the right information. Do you think the lost opportunity cost for your investor friend is 7-figures over 10 years?

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Exercise 5B:

James learns the valuable secrets of bankers –lending. He then borrows $200,000 at 8% from private individuals and his HELOC. He then leverages that 4 times (i.e. he gets an additional $800,000 at 8%). He now has $1,000,000 he can lend. He decides to lend no more than 65% LTV on any real estate.

James then finds people in his local market to lend the money to at 15% with no more than 65% LTV.

Should James lend the $1,000,000 on one deal or multiple deals? Why?

Who takes on more risk, the property owner (borrower) or the lender?

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Exercise 6B:

You lend money to 30 hungry real estate investors secured by their real estate deals at no more than 65% LTV. They agree to pay you, the private lender, 12% interest AND 30% of their profits generated from their real estate deal. The real estate investors (borrowers) have to do all the hard work to pay you your money back your money, interest and a portion of their profits. You realize most of them have 1 to 3 deals at any given time. You have 30 deals going on at the same time while doing very little.

Who makes more money?

Who is in a SAFER position, you the private lender or the borrowers?

Who works harder, you or the borrowers?

After 12 months, you realize how much you enjoy being a private lender and the money you are making. You have made $147,000 from all these loans. Out of excitement, you share with your friend that he MUST become a private lender too. Out of ignorance, he says “it is too risky, besides I do not have the money” and decides not to pursue it. What is his lost opportunity cost?

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