

# The biggest mistakes real estate investors make

## 1. Getting information from get-quick infomercial gurus

This would not have been on the list before 1980, nor would it be on the list if this were a list of mistakes made by, say, people trying to improve their golf game. But the real estate investment information business has uniquely been taken over by dozens of criminal, sociopath con-men who charge thousands of dollars for seminars or “mentoring” services that simply tell you attractive lies about how easy it is to get rich quick in real estate. Their knowledge is how to run a **con game** on you, not how to run an investment program.

Their goal is to part you from your money. Their advice is not only worth less than it costs, it is **dangerous**. Most **will not work**. Much of it is **illegal** or **unethical**. Much of it is likely to cost you your **good credit rating**. The good information on the subject comes from legitimate trade associations, experience, and a few good gurus. The good gurus generally will not do seminars or “mentoring.” They only write books or newsletters. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#).

## 2. Ignoring risk management

The two sides of investment are **risk** and **reward**. But there is virtually no discussion of risk management in current books or seminars about real estate investment. The only risk management the vast majority of real estate investors do is hope for the best. Since the risks in real estate far exceed those in the stock market—like getting sued and having to pay a judgment that is far more than the value of the property that caused the lawsuit—risk management is far more important than in the stock market. Risk management involves things like **refusing to agree to balloon payments** or **personal liability on a mortgage**, using **options** instead of deed ownership, and so forth. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#).

## 3. Overuse of leverage

Real estate investors are fascinated with the notion that a **nothing-down** purchase has infinite return. Actually, it doesn't because of transaction costs and the value of your time, more of which is required to

do nothing-down deals. Real estate investors also love the way leverage **multiplies return**. But they forget it's a two-edged sword. Leverage amplifies both profits and losses. Investors tend to use more leverage than they can handle and to use high leverage too long in their careers. Investors should use lots of leverage **early** in their careers as long as they make sure they can make the payments in the worst case scenario like during a periodic, cyclical downturn in the rental market. And as they get older and closer to their net-worth goals, real estate investors should **reduce** their loan-to-value ratios and focus on making the net worth they achieved more secure. See my books, [How to Buy Real Estate for Little or No Money Down](#) and [Fundamentals of Real Estate Finance](#), for more information.

## 4. Fail to choose a strategy that matches their strengths, weaknesses, and resources

Not everyone is cut out to be a landlord. Landlords have to evict drug dealers and 6'4" bikers and raise rents on little old ladies. Not everyone can do those things. Not everyone is handy enough or patient enough with contractors to engage in the **fixers** strategy. Not everyone can get cashiers checks for hundreds of thousands of dollars that are necessary to buy at foreclosure auctions, yet many beginners with meager net worths are paying thousands to learn how to buy at such auctions. There are dozens of different ways to approach real estate investment. You need to choose the one that **matches your strengths, weaknesses, and resources**. See my books, [Succeeding](#) and [How to Get Started in Real Estate Investment](#), for more information.

## 5. Overstate your return

Fishermen have a well-earned reputation for telling fish tales, that is, exaggerating how many fish they caught or how big they were. Real estate investors are worse when it comes to talking about their cash flow or resale profits, but no one seems to recognize it. Your actual cash flow is what you put on Line 22 (“Income or loss from rental real estate”) of your Schedule E plus the depreciation you claimed

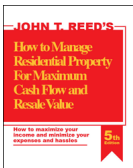


on Line 20 minus the totals of line 19c and 20c on Form 4562, Depreciation and Amortization (“Basis of assets placed in service during the most recent tax year”). It’s a big negative isn’t it? So stop telling others at cocktail parties, and yourself, that you have **positive cash flow**. In your dreams you have positive cash flow. Maybe if you own the building **free and clear** you have positive cash flow. But if you have a mortgage of about 50% or more of the value of the property, you almost certainly do **not** have positive cash flow, even if you paid some bad guru \$5,000 to **teach** you how to get positive cash flow. Similarly, your actual, not imaginary, resale profits in real estate investment are found by subtracting all the depreciation deductions you claimed on the property in question during your holding period (Schedule E Line 20 for the property in question) and all the unamortized costs of financing and acquisition (Form 45562 Part IV Line 42c) from the gains you reported for that same property on lines 1f and 8f of your Schedule D. By using your tax-return numbers as I am advising, you stop **overlooking capital expenditures and many other expenses** in your cash flow calculations, and you **stop overlooking transaction costs** in your resale profits. I talk about this extensively in my newsletter, [Real Estate Investor’s Monthly](#).



## 6. Ignoring the value of your time

If you invest in U.S. federal bonds and low-cost, broad-based stock index funds like the Vanguard S&P 500 Index, which you should with part of your money, you spend **zero** of your own time on the investments. On the other hand, if you invest in **real estate**, you spend dozens or hundreds of hours to find, finance, acquire, improve, do the accounting on, and sell or exchange your properties and about 3.6 hours per unit per month (residential—a little less on most non-residential) managing those properties in between. It is apples and oranges to compare returns on the three asset classes without first subtracting the value of the time you spent on your rental properties from the cash flow and resale proceeds. I talk about this extensively in my newsletter, [Real Estate Investor’s Monthly](#) and my book, [How to Manage Residential Property for Maximum Cash Flow and Resale Value](#).



## 7. No exit plan

You invest in real estate to make money which is a **means to an end**. But most investors think very little about how they are going to **extract** the money

they make so they can **spend** it. Neither do they think about the probability they there will come a time as they age when they no longer want to, or no longer have the health to, manage, acquire, and sell rental properties. You need to schedule **both** putting money **into** your real estate investments **and** liquidating those investments when you have achieved your monetary goals or you want to or have to exit for other reasons. I talk about this extensively in my newsletter, [Real Estate Investor’s Monthly](#) and will cover it more in my forthcoming book on real estate investment fundamentals.

## 8. Rely totally on market wide appreciation for profits

The “profit strategy” of the vast majority of real estate investors is to simply buy a property for current market value and wait until it goes up in value. That’s not a profit strategy. That’s **speculation**, like passively owning stocks. There are dozens of ways to make bargain purchases or to improve properties profitably. You should be using one or more of those strategies to make profit on purpose with your **intelligence** and **diligence**. You should **not** be using a strategy that would work as well for a chimpanzee, that is just buy and hold. For one big thing, real estate does **not always** go up in value and downturns are not always brief. Because of down-zoning, rent control toxic contamination, neighborhoods going bad, and so forth, some properties drop in value and **never** come back up. Also, that strategy is precisely the one most likely to give you huge negative cash flow. If your negative cash flow is large enough, even decent increases in your property value will not be enough to overcome all the cash flow losses during the holding period. I talk about this extensively in my newsletter, [Real Estate Investor’s Monthly](#), my books [How to Increase the Value of Real Estate, Fixers](#), and [How to Buy Real Estate for at least 20% Below Market Value](#), and my forthcoming book on real estate investment fundamentals.



## 9. Paying huge transactions costs

Transaction costs amounts in real estate are a scandal. They are grotesquely higher than those for buying other asset classes like federal bonds or low-cost index funds. Real estate’s high transaction costs dramatically reduce the returns of real estate investors, but, as I said above, they are very big on forgetting they paid them when bragging at cocktail parties about how much profit they made on a property. To avoid them, **refrain from ever selling**, invest in real estate through **derivatives**, or use the many little **tricks** like

binder title policies that reduce transaction costs. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#).

### 10. Misunderstanding inflation

Real estate investors think inflation is their friend. Not really. It reduces the real value of the mortgage payments you owe, which is good. But it also reduces the value of the profits you make from cash flow (rare) or resale (common). Much of the bragging that real estate investors engage in at cocktail parties is really about how much the **value of the dollar** went **down** while they owned the property they are bragging about, **not** how much the **property** went **up** in value in real terms. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#) and my forthcoming book on real estate investment fundamentals.

### 11. Little real expertise

Most experienced real estate investors **think** they know what they are doing. They probably **do** know a few things like how to **manage** property and how to **shepherd a transaction** through acquisition, financing, improvement and such. But such expertise produces **few, if any profits**. The expertise they need to make real profits is in **finding bargain purchases** and/or **making profitable improvements** and **managing risk** so that their profits are not lost to events beyond their control. The most important expertise mistake that real estate investors make is erroneously thinking they know many pertinent things that are, in fact, **unknowable**, like what property values will be in the future. You must recognize what you can know, and recognize what you cannot know, and protect yourself against bad things that you can neither forecast nor control. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#) and my books [How to Buy Real Estate for at least 20% Below Market Value](#), [How to Increase the Value of Real Estate](#), [Aggressive Tax Avoidance for Real Estate Investors](#), and [Fixers](#).

### 12. Underestimating the value of a good reputation

At seminars run by criminal gurus, investors learn unethical things like **lying** on mortgage applications and putting **weasel clauses** or **assigns clauses** into purchase agreements. That sort of behavior gets you a bad reputation in your local real estate investment community and that, in turn, makes it harder for you to find good deals. I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#), and my forthcoming book on real estate investment

fundamentals.

### 13. Failure to know the history of real estate investment

Since World War II, real estate has been through many ups and downs including nationwide rent control, energy crises, recessions, the REIT crash, the S&L debacle, the sub-prime crisis, the tax-shelter crisis, the Tax Reform Act of 1986, extremely high inflation and interest rates in the late 1970s and early 1980s, etc. Yet new investors come into the business every day, look around at how it is right now, and conclude that is the way it **always** has been and **always will be**. No way. You must **force** yourself to study the history of real estate including interest rates, appreciation rates, regulatory changes, recessions, vacancy rates, technological changes, changes in fashions relating to real estate, and so on. We older investors behave differently and more intelligently from younger ones primarily because we know the history. As Sir John Buchan, the First Baron of Tweedsmuir or George Santayana said, "Those who do not study history are condemned to repeat it." I talk about this extensively in my newsletter, [Real Estate Investor's Monthly](#), and my forthcoming book on real estate investment fundamentals.



### 14. Being too wimpy about raising rents, firing unsatisfactory employees, and enforcing leases

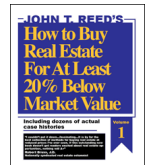
Your rents should always be at current market. Unsatisfactory employees need to be counseled and then, if they don't improve to a satisfactory level, fired. You need to enforce every clause in your lease promptly. You can turn a decent investment into a **disaster** if you are wimpy about these things. For more information, see my book, [How to Manage Residential Property for Maximum Cash Flow and Resale Value](#).

### 15. Overimproving properties

There is no profit in fixing fixers. Cosmetic renovation does not make money. The profit is in buying disasters really cheap and turning them into fixers which you then sell as fixers. Too many investors overpay for fixers. Don't be one of them. **Sell** to them. (See my book [Fixers](#) for more.) Get the fast buck not the last buck.

### 16. Not getting big enough discounts on purchases

You have to buy real estate for at least **20% below current market value** to make a profit on a bargain purchase. I have talked to many investors who were very



proud of buying for 5% to 15% discounts. That's not enough. The **transaction costs** alone in real estate will wipe such discounts out when you buy and sell.

### **17. Relying on an accountant to do tax returns**

Do your own taxes with the help of my book [\*Aggressive Tax Avoidance for Real Estate Investors\*](#) and the TurboTax computer program.



### **18. Procrastination**

Real estate investment is full of people who decided years ago to become real estate investors, but they cannot pull the trigger because they are waiting until they feel more certain that it is the right thing to do. Welcome to the NFL, rookie. If you keep waiting until it feels comfortable, you will **never** invest. It **never** feels comfortable.

Older experienced investors who read this list of mistakes probably nod in agreement as the list triggers painful memories. Brand new investors probably think it's too wimpy—that using all the leverage you can get is great, what's wrong with balloon payments, etc. They will learn either by believing this list of mistakes or by repeating them.

Remember, this is only a list of the **biggest** mistakes. There are many other **smaller** ones like failing to appeal your property tax assessment when it gets too high, not wiring mortgage payoffs to save the interest that accrues when slower payoff methods are used. You should start with my book, [\*How to Get Started in Real Estate Investment\*](#). **JTR**

