7 Wealth Building Rules for Real Estate Investors

Over my 26 years career I have observed that successful people will typically have built at least a portion of their wealth by investing in real estate in addition to their home. I have also learned that real estate investing is challenging and risky. The 7 Wealth Building Rules for Real Estate Investors is an easy to follow guide to enhance the chances that a real estate investor is successful and able to increase their wealth while avoiding pitfalls.

I. Establish Goals

The advice to establish goals is a cliché and can be found in any number of books, articles, speeches, interviews, and podcasts. It is an extremely impactful cliché though. A real estate investor needs to establish goals and they need to be thinking short, mid and long-term. Far too many people will set a long-term goal but fail to set short and intermediate goals, which are just as important.

There is no exact definition of short, intermediate or long, but a rough breakdown is:

1-3 Years	Short-Term
3-15 Years	Intermediate-Term
15 + Years	Long-Term

There is ample academic research showing that you are more likely to achieve your goals if you write them down, so that is a must. For example, the Harvard MBA Program conducted an excellent study on goal setting. They asked graduate students if they had set clear, written goals for their futures. They also asked if the students had made specific plans to make the goals a reality. The study found that only 3% of the students had written goals and plans to accomplish them. An additional 13% had goals, but they were not written down. The remaining 84% had no goals at all. What do you think happened after 10 years? The 13% of the class that had goals but did not write them down earned on average twice the income of the 84% who lacked goals. That should get your attention. The 3% who had written their goals were earning, on average 10 times as much as the 97% of that class combined. That should not only get your attention, but get you to establish goals and write them down.

II. Be Prepared

I believe in being prepared. Be prepared for putting in the time and doing the homework. A little time spent on the front-end will save you from future headaches. Fortunately, there is a vast amount of information and educational tools in the real estate investing community. Investors need to be good at their craft because the real estate investing world is risky, complex and filled with tenacious competitors. Participating in this market while unprepared will likely lead to bad results. How to be prepared? Here are some terrific examples:

- Research a slew of properties using online tools like realtor.com and Zillow.com
- Tour lots of properties with multiple real estate agents, ask a lot of questions, and take notes
- Interview various lenders and learn about the programs they offer
- Read books on the subject
- Listen to podcasts on the subject
- Attend local real estate investing clubs
- Network with other real estate investors and professionals involved in the real estate field
- Write down your strengths and weaknesses and figure out who can help you with your weaknesses

III. Build a Team

Real estate investing is a team sport, so you are going to need to build your network. You can't know everything and you can't do everything yourself, so your team will help you achieve your goals. A strong team for a real estate investor might include:

- Certified Financial Planner
- CPA
- Lawyer
- Real Estate Agents
- Lenders
- Tradesmen (General Contractors, Plumbers etc.)

IV. Track Your Progress

To be successful, you are going to need to track your progress. The 7 Wealth Building Rules for Real Estate Investors calls for you to track your progress using three commonly used financial documents:

- Net Worth Statement
- Income Statement
- Profit & Loss Statement (P&L)

The preparation of these documents can range from simple to complex depending on the size and scope of your financial status.

Your net worth statement will list all of your assets and then all of your debts. Calculate the sum total of the assets and the debts. Your net worth is calculated by subtracting the total assets. The net worth statement is the ultimate scorecard to track your wealth building progress.

Your income statement tracks your source of income and it helps with cash flow analysis. Your income statement needs to track income from all sources, but many investors will also have income statements by property, property type, or by entity depending on how they are set-up. You will use your P&L to track the performance of your real estate investments.

V. Diversification

Investopedia tells us that "Diversification is an investment approach, specifically a risk management strategy. Following this theory, a portfolio containing a variety of assets poses less risk and ultimately yields higher returns". Real estate investors should be mindful of diversification as they invest in real estate and execute on their plan to accumulate wealth.

First off, I do not believe 100% of an investor's wealth should be allocated to real estate. A basic example is that an investor should have an emergency fund in place before investing in real estate. An emergency fund is a stash of money that can be used in an "emergency". The emergency fund should be in a liquid account, meaning it is in a place you can get to quickly. It should also be in a safe account, preferably a bank savings account or money market. A good rule of thumb is to have an emergency fund of 3 to 6 months of household expenses and this calculation should include the carrying costs of real estate investments.

Secondly, investing outside of real estate will increase diversification and help mitigate the risk of your overall nest egg. Investing in 401(K)'s, Individual Retirement Accounts (IRA's), 529 College savings Plans, mutual funds, stocks and bonds are some examples of other opportunities to help build wealth. Of course, these investment options all have risk associated with them so please do your homework before investing in them, or anything for that matter.

My mantra is that I am not going to invest in any one thing that can blow-up my wealth building plan. I strongly recommend that you use diversification to your advantage and avoid doing anything that could blow yourself up.

VI. Be Careful with Debt

My views on debt and leverage have changed over time and what I have learned is that real estate investors need to be very careful with debt. There are differing opinions in the real estate investing education community about the use of debt when investing in real estate. Some advocate for borrowing as much as you can, employing the strategy of OPM, which stands for other people's money. Other advocates, which are a minority in this community, advocate for not using debt at all and only paying cash for real estate investing.

Robert Kiyosaki is a best-selling author and is best known for his book "Rich Dad Poor Dad". I highly recommend this book. He is a big proponent of using debt and OPM. He says "Using OPM gives huge to-infinite returns, creating amazing velocity of cash, and requires a high financial intelligence". An example on the other end of the spectrum is best-selling author and successful radio show host Dave Ramsey. He is best known for his book "The Total Money Makeover" and his radio show "The Dave Ramsey Show". I highly recommend his book too. He advises people not to use debt at all. The only exception is borrowing for a home mortgage, but then he says you should plan to pay that off inside of 10 years. He recommends that real estate investors save up cash and buy properties without debt because that poses the least risk. The thing about debt, OPM and leverage is that it magnifies gains which is very appealing, but it also magnifies losses so be mindful and understand the risk involved.

My position is more nuanced. Responsible and well thought-out use of debt is appropriate in real estate investing. With that said, the reckless use of debt is a bad idea. Having a debt that approaches 100% of the equity is not a proven path to success from what I have seen. In summary, consider using debt, but be reasonable and sober about it and make sure you are not over extended and at risk for blowing yourself up.

Investing in real estate is a worthy goal as it can be a great way to build wealth. There are pitfalls and the 7 Wealth Building Rules for real Estate Investors can help guide you on best practices to help you avoid pitfalls and increase the chances you are successful.

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