Welcome to the Get Real Podcast, your high-octane boost and in the trenches tell-it-like-it-is reality therapy for personal, business and real estate investing success with your hosts, power-preneurs Angela and Ron. It's time to get real!

Ron Phillips: Hey everybody, this is Ron Phillips. Welcome back to another amazing episode of The Get Real podcast. I am here with Heather Marchant. Hey Heather.

Heather Merchant: Hello. How are you today, Ron?

Ron Phillips: I'm great. And so I guess before we get started, anyone who hasn't already done so, make sure you go ahead and subscribe. You can find us at GetRealEstateSuccess.com; you can find our other company, RP Capital at RPCinvest.com. There's more training. Look up my YouTube channel, connect with us on Facebook all of the above.

Heather Merchant: And we're really fun.

Ron Phillips: We are, we're a great time. So Heather, I was talking to you this week about some questions from some clients, and we also apparently got some feedback, which one love, about the podcast, right? So anybody out there listening, if you have some feedback for us, some topics that you want us to cover, or in this particular case, some actual constructive feedback for us. Let us know cause we take it to heart. So Heather, tell us what the feedback was. Tell us what the kind of questions that we want to respond to today are. And then let's kind of go from there and we'll just take it.

Heather Merchant: Awesome. So: "I use this podcast to help my clients and educate my clients on certain topics, so when they have a question I'll send them an episode. And so I have a client that has watched every episode and he gave... me some feedback and said, sometimes you guys take for granted the information that you have in your brains and you can not do a deep enough dive or go slow enough and explain terms and things like that so that people can follow more at their, at their pace", I guess. So that was the feedback.

Heather Merchant: And then another client had a good question this week, and Ron and I had a little discussion about it. He was asking about stocks. He's been all in, in stocks for years and he sees that real estate is the way to go for reasons we'll talk about today. But so he understands that piece. But he said, Heather, I want to be able to compare with what I've been doing in stocks. So I want to compare apples to apples. What can you do... How can you help me in understanding the difference and the similarities and give me a way, like a formula that I can compare this with stock? So that's what Ron and I were talking about this week in a way to explain that to this client ended up being, it's not apples to apples.

Ron Phillips: It's really not. It's, that's a really hard one. I actually sat, if you recall, I sat and I was silent for a minute. And I think you said, are you still there? And I'm like trying to figure out how to create this thing that this guy wants. And it's really

not apples to apples, it's just not at all. And so I think there are a lot of people, well that's not true. I know there are a lot of people out there who've been taught their entire lives, you know, by the stockbrokers and by the media, which is owned by the stockbrokers. And that's the way to go. And everybody understands the terminology that they use. And I think people don't understand the terminology we use as much. And so I was trying to figure out how to craft it and put it into terms that he would understand that are the similar terms.

Ron Phillips: But the terms don't actually mean the same thing. That's why there are different terms. And so that was really, really difficult for me. And finally, my answer was what you said: that they're not apples. Yeah. Real estate. If stock is apples, then real estate is not an apple. It'd be some other fruit. I don't know which one it is, but it's not an apple. So I think to go into this, you know, one of the things that I think is really, really different and you know, maybe in the next several episodes we'll start kind of putting some of these out there, but there's just some, there's some really interesting differences in how people talk about the stock market and real estate. You know, one of them we were talking about earlier, Heather, is this whole average... it drives me nuts. People are like, yeah, I average like 10% in my stock account over time. And I'm like, really? Like if I opened up your statement from the day that you opened up your account, you're going to have a consistent 10% average annual? There was no way. It just doesn't happen.

Heather Merchant: Yeah. I think that a lot of people... And my clients that I talk to, a lot of them will admit this, that they don't really understand. They just know that that's what you're supposed to do is invest in stock. And they kind of breeze over their statement and say, I'm making 10% and don't really understand the nuts and bolts of how it works.

Ron Phillips: Let's talk about the apple real quick and let's talk about averages, right? And so everybody understands what average means, I think. But here's the definition of it: constituting the result obtained by adding together several quantities and then dividing this total by the number of quantities. Not sure that that was very helpful, but basically we just divide by the number of end of year, like, so if we're talking about average annual year's, right? If we're taking a 10 year time span, we take each one of the years and what the return was and then we divided it by the number of years 10 in this case, and you would get an average, right? But it is perfectly acceptable somehow in the stock world for the averages to be done this way.

Ron Phillips: So... and this is numerically correct. Okay. But in return it doesn't work out. So, Heather, I'm going to try to explain this. You tell me if I've done this correct, it's really, really hard to do without a whiteboard or some of the visual. Let's say you have a 100,000 stock account, right? This year your stock account goes down by 10%... what are you left with?

Heather Merchant: 90,000.

Ron Phillips: 90,000. Everybody understands the math there, right? So we lost 10% next year. If we gain the 10% back, then we should be whole, right? And now if you average those numbers out, okay, no, they're not bad. Why are we not back hole Heather? Because if the stock went right back up to where it was, then why are we not whole?

Heather Merchant: You've gone back to square one, number one, but number two you have,... if you're at 90,000 and you're saying you're adding 10% to 90,000 that's still not 100,000.

Ron Phillips: No, it's... 99,000 We're missing a grand. Now, if we do that, let's say, you know, we, we gain 100% in our stock, right? We'll go up to 200,000 and then we lose 50% and then we, you know, we keep doing that. The average return is substantial, but your account is sitting at below zero. You haven't actually made any money. You're losing money, right? You have to string together years like we have over the last, you know, 10, 12 years. You have to be able to string together years of positive growth. But what is legal is for them to say when we have downturn years, just to average it all out over a 10 year period, or a 15 year period or whatever the period is that they want. And then the average number, the numerically correct number does not take into account the fact that when you lose the money and you gained back what should be you breaking even, you don't break even.

Ron Phillips: In addition to that, the entire time you're going up and the entire time you're going down, your paying your broker. Your mutual fund or whatever else it is. So the $99,000 isn't even $99,000 is $99,000 minus fees. So you got to pay for the opportunity to lose money. And so I think people when they open up their statements, when and if they ever do, right, cause you're supposed to just drop money in this thing and it's supposed to just run according to all of the talking about it, right? But when you open it up, you go, wait a second, shouldn't it be more than this now? Now the last 10 years have been a great run. But when you actually factor in some of you who are my age and you've had money in the market since you were 25 or 30, and you look at it and you go, oh, I looked at some of this not not too many years ago and it was equivalent to what they had actually started with. However, all the ups and downs and in betweens and everything else, you hadn't really made any money, but the average annual return showed that they should have made money. And they were trying to figure out how the hell does this actually happen? And the way that it happens is they're illegally allowed to report the average annual as a, you know, and if you actually do the calculations, the math works out, it just doesn't ever show up in your account.

Heather Merchant: Yeah, I mean, I think the only way, according to that news, right, the only way that you can really know your rate of return is to take the amount you've put in and the value that you've gained, and then divide it by how many years you've been actually waiting, and having that money in the stock market.

Ron Phillips: Let's take, yeah, let's take just a second and let's talk about return on investment again. And let's go through the calculations because this is not just a calculation you do for real estate when we talk about it in real estate terms, but this is any investment; doesn't make any difference. Okay. So again, you have, let's make the math really, really easy. Let's say that you have a 100,000 investment and next year you open your statement and it's 110,000 how would we calculate our return on investment?

Heather Merchant: How long have you had it in?

Ron Phillips: Okay, so we've been in there for a year.

Heather Merchant: Oh, it's only a year. I missed that part.

Ron Phillips: This year's return, we got $10,000, above our 100,000 so the calculation, super simple, you just take $10,000 divided by $100,000 and it gives you 10%. It doesn't actually give you a percent. It gives you a point, okay? Whatever, whatever. Right? So in this case it's 0.1 and if everybody remembers from school, you just move the two decimal places over and you're left with 10. That's 10% right?

Ron Phillips: So that's how you calculate it. It's the same in real estate. You buy $100,000 property, next year the property is worth $110,000. Same, right? Stocks the same. Real estate's the same. Everybody would assume that that's an apple and that's an apple. But it's really not, because I don't know very many people who pay cash for real estate.

Ron Phillips: Yeah. Now almost everybody I know pays cash for their stocks, their mutual funds, their CDs, whatever it is they're buying. All of those are paid with cash. But stock... but real estate is not that way. So let's throw a little wrinkle in here, Heather. So the calculation is a little different when you throw into the equation that we're going to... We're going to finance finances thing, right? So on $100,000 property, tell us how the financing works really quick, Heather, and we'll do some calculations.

Heather Merchant: So we prefer to use conventional Fannie/Freddie loans. So it's just the cheapest investment loans out there. So it's 20% down on a single family home, 25% down on a multifamily over it's two to four units for those loans. And so a duplex up to a fourplex, it's 25% down. So if we go back to a single family at $100,000, it's 20% down. It's fixed over 30 years. Rates right now or around 5%. so when we look at return on investment on real estate, we are only using your down payment to calculate that, because that's your cash.

Ron Phillips: Why would you do that? Well, I don't understand. We're talking about a 100,000 house, Heather. Why would we only use $20,000?

Heather Merchant: Because that's the money that you actually spent of your own money to buy the property. And the cool part about real estate, because we're getting into the four returns already, I guess, is that the tenant is paying the mortgage, they're paying you rent, and then you pay your mortgage. So you shouldn't, theoretically, unless you have a vacancy, you shouldn't really have to put a lot of your own money additionally into the property. It should maintain itself if you have a good cashflowing property.

Ron Phillips: Okay, so let's rewind just a minute. We've got our first type of... and we're going to try to keep this as apples apples as possible, right? So we've got this yield in our stock account, it was 10,000 on a 100,000 investment. I think everybody would agree that's a really good return. So let's keep the same thing for, for real estate: $100,000 property, it's going to appreciate, which is the same term. It's not different terminology. It's same thing, right? It went up value at a gain of $10,000 so now our house is worth 110,000 but using what you just said, we only put $20,000 cash into the property. How do we calculate this? Right? We, it's the same calculation, but we have to use the cash in number, which for our stock was 100,000 but for our real estate is 20,000, which makes our return what?

Heather Merchant: 50%.

Ron Phillips: 50% okay. Same gain, different return. Dramatically different return.

Heather Merchant: And because it's calculated off the down payment, it confuses people a lot. If you paid cash for the property, then you'd be back at the same apples to apples is stock.

Ron Phillips: Same exact return, right? No difference.

Heather Merchant: Yeah. And the other way I help people understand this concept is a percentage of your down payment you're making back in your pocket. So if you have appreciation of that 10,000 and you paid 20,000 for the property, theoretically you made half your money back. Right? So that's where that 50% comes from.

Ron Phillips: Yeah. Yeah. Now again, these are not apples and apples because a stock, I can call my stockbroker tomorrow after I gained that $10,000 and I can say, sell the stock and all the cash goes back into my account and now I actually have 110,000. Well, with real estate, you can't call your real estate broker and go, Hey, sell the house so I can get my 110,000. There's costs associated with that. It gets a little more complex because the 20,000 we put down is really all the money we're going to put in either cause there's going to be some closing costs. Right. And when we sell the property, we're going to have some costs as well associated with selling the property. Okay. So again, they're not apples to apples when we're trying to make this as simple as possible just to compare the two. Okay. So it's not as liquid of an investment.

Heather Merchant: Yeah, it could take 30 days. Yeah.

Ron Phillips: There are a few other pretty decent perks to owning real estate. There's three specific different perks. Because I don't know very many growth stocks that that continue to perform at, you know, a quote, average annual return of eight to 10% over time. That also throw off an eight to 10% dividend, which is the word that the stock broker, you know, apple over here uses for what we call cash flow. It's the same thing. It is a cash influx into your account

Heather Merchant: Every month.

Ron Phillips: Yeah. Yeah. And both of them have the potential to be able to do that. It's just that in the stock world, if you're getting a dividend, typically the stock doesn't really grow that well. And if you're not getting a dividend, that's when you get a growth stock. Right? So to have both of them happening in the stock world is it basically doesn't happen.

Ron Phillips: But in real estate it absolutely happens. Happens all the time. So now let's talk about cash flow and cash return on investment really quick. Let's try to break this down again a little bit more in depth than we probably did last time. So we have this 100,000 property. We've got a payment on it, right? What else we got? I mean, inside of that payment we got principle, interest, taxes and insurance. Just like everybody's home loan that they have on their personal house. It includes taxes and insurance, and includes principle, and it includes interest, right? So we have all of that on this payment. In addition to that though, Heather, we have some other costs. What are they?

Heather Merchant: Yeah, so we have property management and we always recommend professional property management that you don't manage the property yourself. So that will depend on the market average. I would say nationwide average is probably gonna be close to 10% of the gross rent. So if the property is rented for $1,000 you're gonna pay $100 to your property manager to manage it. So we negotiate that down with our property managers because of volume that we send. So our average is probably closer to 7%, 8% somewhere in there of property management fee. But that is a real, that's a fee that they are going to collect your rent, they're going to handle any maintenance issues on the property. They're going to take those phone calls when there's a problem...

Ron Phillips: That you don't want to do. We have a whole podcast segment just on property management. So you should look that up if you're interested in learning more about it, look it up. We talk about all the ins and outs of property management, but they're well worth paying even the a hundred dollars a month.

Heather Merchant: And then the other expense is potentially homeowners association. I would say most of our properties don't, but multifamily typically does have a HOA that you need to pay a monthly or annual fee there. And then sometimes, depending on the property, if the tenants lawn care is not included, if they're, if they're not in

charge of it, responsible for it, then the owner pays for it and maybe charges the tenants. So that may be an additional expense that's a fixed every month, expected, anticipated expense.

Ron Phillips: Okay. And then we have vacancies and maintenance, which are just percentages that we, anything that you would put on a proforma and, you know, some years you're gonna have very little, some years you're going to have more. And they average out. Except for their actual expenses and the averages are real dollars, unlike the stock market. So anyway. So after all of those expenses, so let's say the rent's 1,000 and after all those expenses, which add up to be maybe 700 this property is going to cashflow 300 a month or 3,600 a year, right? So we're going to calculate the return on investment exactly the same way, right? And so if you take the that 3,600 which is your return, right? That's your gain, that's actually your cash gain. So that would be kind of like your dividend with your stocks and you divide 3,600 by 20,000 I mean the numbers pretty impressive, Heather.

Heather Merchant: Yeah, it's 18% because I have a calculator,

Ron Phillips: 18% cash return on investment. Now, we say cash ROI, cash return on investment. Well they don't use that in the stock world. But that would just be your dividend return. So if you have a stock that's producing a dividend and it's producing an 18% dividend, which I know it's not, that's that's what it would be. Okay. All right.

Ron Phillips: So now we have an appreciation or a gain and we have this cool cash that's getting put into our bank account all the time. We have two returns, and one of those returns is a 50% return, which you know people are going to think is not even believable. So cut it in half. I don't give a crap. Go ahead and cut it in half. Say we only got 5% on our, on our appreciation. Right. Say we only got 2%. I don't care. Put whatever number you want in there. It doesn't make any difference. It's still going to be a really, really high number.

Heather Merchant: Cause you, cause you only paid 20% down.

Ron Phillips: Right. Right. So now you've got two, but there's still what? Wait, there's more, there's more. So on these properties we also have... It's cool cause we've got this mortgage. And some people think that, that's a a downer, right? Well we got this mortgage on there and you said earlier, Heather, who's paying the mortgage?

Heather Merchant: The tenant pays the rent, the rent pays the mortgage. So the tenants paying your mortgage payment.

Ron Phillips: Okay, so I've said this before on this show, but find me a stock that I can have someone else pay my fixed payments over 30 years and pay the thing off for me; find me one and I'll buy it. Okay. Yeah, so again, not apples to apples. We actually have a person or group of people who are paying our payment on this

thing. And when they make that payment, part of the payment is interest, which just is spent, it's just gone. But part of it is principal. Principal actually lowers the amount you owe on the property and it increases thereby your equity position in the property. And that is a real gain.

Heather Merchant: Yeah. Again, not one you realize until you sell or refinance, like you mentioned on the appreciation, but it's still there. Right.

Ron Phillips: And it's not a ton in your first year, right. It may be 1800 bucks on 100,000 house. Not sure. Cause I really didn't look it up before this, but I mean that's still, that's so impressive. Because you do that calculation, you know, we know what 3,600 is. So let's say it's, let's say it's just a thousand. I mean if you have your mortgage pay down only a thousand dollars that year, it's still like... That's 5%. Which is I'm almost positive is better than any of the stocks are producing for a dividend right now. And it's real equity that is being paid down on your behalf by your tenant. It's fantastic.

Heather Merchant: And they're grateful to live there, right? Like you're not robbing somebody to get a rate of return there. You're filling a need, which is so awesome, too.

Ron Phillips: And it's real, like the market doesn't take that away. So you know, if your property appreciated 10% last year and then this year it drops 10% and you're a net zero gain on the appreciation scale, they still paid your house off $1,000 last year. And this year, and then every year it goes up, the amount that they pay off. And so that's real amount of money that's going into your zone. So add that you can, now you have to add all three of these together and it's starting to get really stupid.

Heather Merchant: Like where it's not really believable.

Ron Phillips: Unbelievable. But that's why so many people who finally figured this out really start to love real estate. I was talking to a stock broker the other day and he asked me where my money was and I said, well, it's in real estate. And he said, all of it? And I said, yes, all of it. And he goes, well, why? And I said, well, because I've done really well. And he goes, okay, well, so how much do you have? And I said, well, I don't really want to tell you. He said more than this much? And I said, yeah, way more than that. More than this much? Yeah, way more than that. Okay. How long have you been doing it? I said, about 20 years. He goes, wow. So why are we talking?

Ron Phillips: And I said, well, it's a good question. I don't know. You called me. I'm just talking to you. But wait, there's more. So there's four returns. The last one... and just so we're clear, we don't buy for the first one we talked about, which was appreciation and we don't buy for the last one that we're talking about either, which is tax benefits. Okay. But right now, and there's a reason for this. We don't buy it for the first one because nobody knows what's going to happen with the market. And you know, the market's been going up for the better part

of a well over a decade. So we don't know how much longer that's gonna last, right? Before we have some kind of a downturn. And we don't count on the tax part of this, Heather, because, well, you cannot count on the government for freaking anything.

Heather Merchant: Consistency there. We can count on it right now because the legislation is here now.

Ron Phillips: But that's right. I mean this year... We don't know how many years we're going to get it. But you should definitely take advantage of it while you can. I certainly am. I mean we, I think we've talked about in previous shows how it's really, really impressive what you can do right now with taxes. Cause we talked about cost segregation. We should probably do another show on that, too. Cause I think we got some feedback Heather, that we fed with that too. But this last one is really cool because while your property is going up in value or down in value, either way, you can depreciate it off of your taxes. So you have an asset and 3.63% of it every single year you can just write off. So that's another 3,600 the year that you get to just write off.

Ron Phillips: Now this is where it gets complicated because we already know that 3,600 is actually an 18% return. But we don't actually get 3,600 because it's a 3,600 write off. So this is where it maybe gets a little complicated because you have to actually use your... and it even got more complicated with the tax code now because they do it in tiers now, right? So you pay on your first X amount of money, you make, you pay whatever, and then on the second, anything over that you pay X up until a certain point, it gets really complicated. But call it 20% right? 20% of 3,600 is like 720. Okay, so it's 720 and you divide 720 which is the actual cash that you would put in your pocket. If you divide that by 20,000 it's what?

Heather Merchant: 3.6%.

Ron Phillips: So it's really not that much. Okay.

Heather Merchant: Yeah. It's not sexy, I tell you, but it adds up when you have four of them.

Ron Phillips: And then, I mean if you want, go back and listen to our podcast segment about cost segregation because then it gets uber sexy. I mean really, really sexy. Like Superbowl halftime show sexy. Yeah. Did I just, did I just say... Sorry, the chiefs just won the Superbowl. I'm a little stuck cause I'm from Kansas city. If you guys didn't know that and so you know, go chiefs, they did it this year. But yeah, the super bowl halftime show sexy on cost segregation.

Heather Merchant: And it's something that, I mean for me with what I've done, cost segregation on my properties, I've gotten my down payment back almost... I'm pretty close like within 1000 bucks.

Ron Phillips: In one year, people. Okay. So anyways, so there are four returns and let's just say you don't do cost, you just keep it simple. There's little over 3%, 18% and then what was the other one, like five, 5%?

Heather Merchant: And I think we're almost 80%.

Ron Phillips: I mean, everybody's going there is no freaking way this is possible. So just do the calculations without the 50 just take that out because nobody believes that anyway.

Heather Merchant: Okay. So without any the appreciation gain, it's 26.6%.

Ron Phillips: Guys, I... Look, cut it in half. Yeah, cut it in half.

Heather Merchant: Still killing it. And you have a physical asset that can't be just taken away.

Ron Phillips: Not only could it not be taken away, but you control it. So here's the other piece of the whole stock market, right? You're buying a stock that you have zero control over. Everybody can get super pumped that they bought Tesla stock at 100 bucks and now it's at 700 or whatever I saw on Facebook that it was the other day. Good for you. You know, three months from now that stock could go down significantly, because of some kind of malfunction in a car and all of a sudden, through no fault of your own, you just lost a ton of money.

Heather Merchant: Yeah.

Ron Phillips: Well I mean the real estate doesn't go anywhere and if it does go somewhere, it was either blown somewhere, it was burnt somewhere, both of which you have replacement cost insurance on it, which means it's, you have more insurance on it then you owe on it. I dunno, maybe I should add that to my stock speech. Find me stock that I can insure for the full value in case some stupid CEO does something that destroys the stock's value.

Heather Merchant: Yeah, that's true. You just came up with that on the fly, Ron.

Ron Phillips: In addition to that, I can do things that will change the value of that property. I can actually physically do things that are going to change the value of it.

Heather Merchant: And you can raise rent.

Ron Phillips: Yeah, I can do whatever I want with it right now. Don't want to raise it too much, otherwise you'll have vacancies forever. But the point is you're in control. Okay, you're in control and you're getting, you know, healthy returns. So why could I not give this guy a simple, easy way to calculate an apples to apples return based in real estate and a stock? Well, hopefully you guys can all see why now. They are not comparable things. They're just not. There are a couple of

things that are comparable. We talked about them. But when it all comes down to it, they're not at all comparable.

Heather Merchant: Yeah. And those gains that you have in stock and the gains you have in real estate... On the real estate side of things, that's like not even what we count on. As our philosophy that's like we call that a gift and not a given.

Ron Phillips: Throw the 50% out the window, Heather, just chuck it right out the window onto the highway and let it die. Eventually you're going to look at it, and you can go back and listen to our podcast episode about return on equity, and you can go, Oh my gosh, I have all of this equity, what to do now? Well you just take the gift and you go do more of the same thing you've been doing. It's the biggest no-brainer ever. And so hopefully because the last, the last time we actually talked about this, Heather, we only talked about just the returns. That's all we talked about. And we didn't compare it to stock. I think that actually was a mistake. And I don't think people really understood, comprehended the difference. Or what the difference in the vocabulary is because we use these things, we throw these terms around that people don't really probably even know or know where they correlate, because appreciation and yield are living, not the exact, they're not the same word, but they're used for basically the same thing it's called a gain.

Ron Phillips: Anyway, I hope this was helpful. Did we get everything in that gentleman asked us?

Heather Merchant: Yeah, and I think we should have more questions like that that gives that have us debate for a minute how to answer the question cause it will yield some great podcast episodes.

Ron Phillips: Yeah. We really appreciate the feedback, and give us more. I mean, you know, you guys have the reigns on this show most of the time. Sometimes Ron's is going to come on here and rant. There's nothing you can do about it but we love the feedback so give us the feedback. You can reach us on our website RPCinvest.com. We actually have a chat feature on there. You can just get on there and chat with us. You can call our office, you can find us at GetRealEstateSuccess.com. You can subscribe to the podcast and you can share it on Facebook or you know, Twitter or wherever you, wherever you reside socially online and share with all your friends. Don't keep us a secret. So yeah. So until next time, everybody, thanks for joining us, Heather. Thank you. Appreciate it. All the math that you did on my behalf today. That was great. Appreciate it. Till next time peeps.

Heather Merchant: Bye.

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