Seven Questions to Help You Find a Knowledgeable Agent when Buying or Selling Income-Producing Property

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One of the biggest challenges for consumers in the real estate industry is to find a real estate professional that they can trust and rely on to best represent them in the purchase or sale of property. This challenge is fueled by licensing law and requirements in every state what allows every real estate licensee to help you buy or sell ANY type of real estate- residential, investment, commercial, industrial, vacant land, land for development, etc.- AND THEY DO!

With that in mind, I have developed the following seven "tougher than average" questions that you can use to help separate out real estate professionals that you are considering to help you with the purchase or sale of income producing properties. For many looking to build wealth, buying and selling is a constant process, and making the wrong decision can cost you thousands, and even keep you from ever investing again. For buyers, a knowledgeable agent should be able to lead you to the higher performing ROI properties in the best areas with limited vacancy potential. For sellers, it will be to use the financial performance of the property along with market statistics, to create the selling and marketing strategies. A great agent will save or make you more than you could ever pay them so it is important to find one that meets your requirements. By no means are these the only questions you would want to ask but these can certainly help separate agents based on knowledge and experience.

7 Questions and Answers Investors should use when Interviewing Agents BEFORE Hiring Them.

Q1: Over the past 5 years, what percentage (per year) of your real estate business comes from helping people buy and sell investment or income producing property?

Q1A: I would hope that at least 25% of their business would be derived from helping people invest in real estate however a good agent will typically be a good agent no matter what they do. But it isn't about who will do a good job, it's about who can do the best job for you in your current situation. Also, after they tell you their answer, ask them to talk about two of their most recent transactions (when) that worked out well (what was their clients goal and how did these properties get them there sooner) for their clients and any that didn't- and why.

Q2: How many income-producing properties do you personally own?

Q2A: If you're looking for someone to help you buy or sell income producing property, that meets the investment needs of the investor, doesn't it make sense that they have had the experience of investing in real estate themselves? There are major differences in real estate disciplines. Buying and selling residential property has a very different purpose than investing in income producing properties which has a very different purpose than buying large commercial complexes- with each one having their own goals, and success points. Each discipline has their own language, structure, contracts, criteria, lending requirements, zoning issues, etc. and because your potential agent may be doing well in one discipline, it doesn't mean they have what it takes to maximize your return on your investment (and the reasons for these questions).

Q3: What is a capitalization rate and what number should I be targeting?

Q3A: Capitalization Rate (or cap rate) is an estimation of a property's value by consideration of net annual income as a percentage of a required rate of return on an investment. It is calculated using the following formula: CR= Income / Value. Now another question might be which "income" do you use (GAI [Gross Annual Income], NOI [Net Operating Income], or CFAT [Cash Flow After Taxes]?) and what is value (here it is the asking price for the property) or are there better, more conservative ways to use factors that give a more realistic picture of the property. I would use the acronyms in my question to see if they can understand the common language.

To answer the question, what number should I be targeting? **If you get any answer** you're working with the wrong agent. A knowledgeable agent will give you a range of cap rates that are typical for a given area. They should also bring up that a cap rate, on its own, is worthless (although the major decision-making criteria used by most FAILING investors), and that the only way to discriminate between properties in a given area is to use that areas "market cap rate." This will take some real knowledge to calculate (we do it all the time for our clients) or provided by an appraiser. It is calculated based on taking the average of other like properties sold in the area in the last six months and comparing it to the target properties cap rate.
Rarely will you ever talk to an agent that understands how to properly use or calculate a cap rate let alone being able to provide you the explanation of why and how to properly calculate a cap rate and the critical importance of using a "market cap rate" analysis which would show how the target property compares to other properties that have sold in that area over the past six months. If they can tell you how to calculate a "market cap rate", then they should go to the top of your list!

Q4: In what areas can I find properties with that capitalization rate?

Q4A: If the interviewed agent tries to answer this question with specific areas great. Now ask them why they think that to make sure their answer isn't a general answer with no reason behind it. The real answer should be- everywhere. To provide an answer that can show you EXACLTY WHICH PROPERTY IN THAT AREA can get you to that rate is a whole new level of expertise (and again, something we do every day for our clients). See "market cap rate" analysis at bottom of Q3A.

Q5: What are the criteria most investors use when investing in real estate?

Q5A: This answer should take many paths. From our interviews and interactions with investors, they report using capitalization rate (most used, most misused and just might be the major cause for poor investing) as the calculation that helps them make buying decisions. Our clients use our 12 Criteria to Building Wealth through Real Estate to help them make the best decisions for themselves. To achieve lending some banks use GRM or Gross Rent Multiplier but the best ones will use DSCR or Debt Service Coverage Ratios (for regular residential properties his figure is usually 1.2 or greater) to make decisions on how much money to lend on a project. **The bottom line**- to have whomever you decide to hire, structure the sale or purchase of a property, showing all the cash flow benefits (cash flow after taxes and tax benefits) and equity benefits (principal reduction and appreciation [market, forced, and financial] of buying the property, to the investor.

Q6: How to I compare returns on income rental property to other investment classes?

Q6A: This is a very important question for any investor looking to continuously build net worth though the management of their investment portfolio. The answer to this question will help the investor decide how to invest that returns the greatest ROI over time. To make the necessary comparisons, you would have to analyze every piece of real estate you look at, and provide the same metrics used by each asset class being considered. For example, if you want to compare rental real estate to a balanced annuity, you would need to calculate the Before-Tax Internal Rate of Returns (BTIRR) or After-Tax Internal Rate of Returns (ATIRR) for the property as those are two factors that are typically provided by financial advisors. Knowing the returns for each type of asset (here it is rental real estate and balanced annuity) will help the investor make better investment decisions. A good analysis would also calculate metrics used to measure returns of other asset classes like money markets, certificate of deposit, commodities, stocks and bonds, precious metals, etc.

To answer those questions for my clients, and because I could not find any analysis tools that could provide the necessary metrics for better investment decision making, I developed the only after-tax financial performance analysis report to answer those client questions years ago. I named my report the REIA Report (Real Estate Investment Analysis Report). To find out more about REAI Reports, and some of its most popular versions, see our page: Grow Your Investment Portfolio with Residential Rental Properties, then scroll down to Finding High ROI Properties with Research and Analysis. For an example of any of the reports, please contact me, Max Wilson at 412-552-9811 to request an example of the report version of interest.

Q7: What documents will I need to provide to my lender to get funded for the project?

Q7A: Every income producing property has the potential to build net worth across four pillars at the same time. The four pillars for building wealth are: 1) Cash Flow; 2) Tax Benefits; 3) Principal Reduction; and 4) Appreciation (market, forced, and financial). To know how any give piece of property will perform, you the investor, and your lender, will need to see certain financial documents from the seller. The answer to this question by an agent MUST be 1) the last 3 years of IRS 1040 Schedule E's or 8825's, 2) last 3 years P&L (profit and loss) statements, 3) last year's and current year-to-date rent rolls, 4) copies of all leases (noting security deposits) to support the Gross Operating Income you have reported, and 5) copies of all occupancy permits along with any current violations.

A follow up question might be: How do you make sure we get those documents from the seller and what happens if they will not provide them? An experienced agent will make sure that your sales contract includes language as to the date by which the documents above will be provided to the potential buyers. If they just add the TOP (Tenant-Occupied Property Addendum to the Agreement of Sale) to the contract, all the seller agrees to turn over with this addendum are the leases. The best process would be to write it in and provide the TOP, however, in the end, it is really the agents ability to speak the language of the investor and the lender to retrieve such documents from the seller- even when they don't want to. I also provide sellers an option to provide such data using my form: REIA Seller's Financial Disclosure Statement.

In conclusion:

Please note that just as important as getting the questions answered correctly will be the behaviors of the interviewee as you ask the questions. If they try and side step any of the questions or really get flustered, it's time to close the interview process. Please don't hesitate to call me **Max at 412-552-9811** or by email at MaxWilson@MaxBusinessGroup.com with any questions you might have about any of the questions and answer I have provided in this article or for answers to any other questions about buying, selling, or investing in real estate.