Chapter 1: The Transactioneering Mindset

Transactioneering isn't a strategy. It's a philosophy that you bring to bear on every deal you come upon.

It's not a tactic. It's a skill set.

It's not a process where b always follows a, c always follows b, and so on: in fact, one of the defining characteristics of creative deals is that, unlike a strategy like wholesaling or retailing, Transactioneering is nearly impossible to turn into a "cookie cutter" that works the same way every time.

Transactioneering is more of a mindset than it is a thing; it's an approach to dealing with sellers (and partners and private lenders and anyone else that might be involved in a deal) that asks:

"What do I want from this deal, what does the other person need, and IN WHAT WAYS might these things be achieved?"

That seems like a simple enough question on the surface, but to a true Transactioneer, it takes on a series of deeper meanings that affect every step of a transaction, from how you evaluate the deal, to how you speak to the seller, to what forms and contracts, in the end, are used to memorialize and tie up your deal.

So, let's break it down.

"What do I want from this deal?" Part 1: The Benefits

One of the defining characteristics of the Transactioneering mindset is that it thinks about real estate less in terms of bricks and mortar or of ownership, and more in terms of rights, benefits, and responsibilities and how to distribute them.

One key understanding that Transactioneers have—and run of the mill "real estate investors" don't—is that these benefits, and these risks and responsibilities, can be distributed among multiple parties by the use of contracts, agreements, and entities.

More importantly, the Transactioneer understands that by taking some of the benefits and responsibilities for himself, *and leaving some for the seller, or partner, private lender*, *or even the end user*, he can get a deal that makes both the Transactioneer and the other party happier with the deal overall.

If you're new to Transactioneering, you may never have considered all of benefits of controlling a piece of real estate as "things" separate from ownership itself.

But they are, and here's a list of the most common ones we see in residential investment real estate:

- Cash flow/income
- Mortgage pay down (AKA amortization)
- Appreciation in value over time
- Control of equity, which translates to additional tax-free wealth while you own it, and can be converted to cash by selling or refinancing the property
- Use of the property (meaning getting to live in it)
- Tax benefits (depreciation, ability to exchange tax-free)
- Right to transfer (assign or sell) the rights and benefits you have to someone else

The risks/responsibilities that SOMEONE takes on along with ownership or control of any piece of real estate include:

- Management
- Rehab and maintenance
- Personal or corporate liability for debts and expenses like taxes and insurance
- Personal or corporate liability for damages and losses to life, limb, or property

Now, you may be wondering, "How in the world can I get the cash flow from a property without also having the appreciation? Or control the equity without getting the mortgage pay down? Or receive rent without the responsibility for management or maintenance?"

The answer is simple: you contractually separate and distribute these things to the parties who want them, and who you want to have them. It's done every day in the real estate world, although you may never have realized what you've been seeing.

For instance, take a look at the 2 lists above and think about them as they relate to one of the simplest real estate contracts there is: a lease.

A lease conveys just one of the "bundle of rights" to another person: the use of the property. It also conveys a small portion of one of the responsibilities: the responsibility for maintenance.

When a landlord signs a lease with a tenant, the landlord gives up his right to **use** (which is to say, occupy) the property for the duration of the lease agreement.

While the tenant doesn't take on the responsibility to fully maintain the property, he is bound by the lease to not damage it.

The landlord retains all of the other benefits and responsibilities—he gets the cash flow, the tax breaks, the increase in value, the amortization, and has the responsibility to pay the taxes, insurance, mortgage payment, licensing fees, and for repairs and maintenance.[1]

[1] Unless, of course, the landlord contractually separates his responsibility for management and maintenance from his ownership by hiring a property manager to take care of those things. This doesn't alleviate his LEGAL obligation to do these things—if the property manager neglects his contractual duty to maintain the property, the powers that be will ticket and fine the owner, not the manager—but it does remove the practical hassles of these things. The property manager of course, gets compensated through part of the owner's cash flow. This is actually a good, though non-creative, example of how benefits and responsibilities can be passed from person to person by the structure of

So ask yourself this: **is there an agreement that conveys MORE rights and responsibilities to the tenant, and yet still leaves them in the legal and contractual position of 'tenant'**? The answer is yes—several, in fact.

In a "Triple net" lease, common in commercial properties, the tenant agrees to pay for and take on all responsibilities of real estate taxes, insurance, and maintenance of the property.

In a lease with option to buy, the tenant not only gets the usual use of the property, but controls the future appreciation (since his price is locked in at the agreed-upon option price, any appreciation over and above that amount belongs to him) and, generally, takes on the responsibilities for ALL repairs and maintenance, not just for damages the tenant himself has caused.

A lease/option can also be written in such a way as to give the tenant/buyer the advantage of amortization, simply by basing the option "strike price" on the mortgage balance at the time of the exercise of the option. For instance, you could agree to lease a property with an option to buy it at the mortgage balance on the date of the purchase, or at the mortgage balance + $5,000 on the date of the purchase.

Is there a way to confer the benefit of cash flow to the tenant?

Sure—through a lease with a right to sublease. The tenant is responsible for paying his rent, but if he gets MORE rent from someone else, it's his to keep. He's still a tenant—he has no title interest in the property—and yet he has the benefit of at least some income from the property.

And on it goes, ad infinitum.

In fact, in theory, it would be possible to transfer each of the benefits of ownership to a completely separate person, so that one had the right to live in it, a different one got the amortization, yet a third got the tax benefits, and so on.

Which leads us to the next thing that Transactioneers do: they set out, long before talking to any specific seller, the benefits and responsibilities that they want and are willing to shoulder, and which they don't—and how much they need to "get" from a deal to do it in the first place.

"What do I want from the deal?" Part 2: Decide in Advance

"What do I want from this deal?" is a question that shouldn't be answered on the spur of the moment, during the heat of the negotiation.

You should know well in advance of interacting with any particular seller which—and how much—of the benefits and responsibilities of the control of real estate you want, and how much risk you're willing to take on to get them.[2]

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the deal.

[2] I know, I know—you want ALL of the benefits and NONE of the risks or responsibilities. But

In other words, it's important that you decide, in advance and on purpose, which benefits you can and can't live without, and which risks and responsibilities you do and don't want to deal with.

If you don't make this decision consciously, several bad things can happen as a result:

1. You fall prey to the "Any low money down, no qualifying deal is a good deal" fallacy embraced by less-sophisticated investors, and end up making deals that you later regret. You should never do a creative seller-financed deal just because you can: you should to it because it works for you. "Works for you" is a definition that may change over time, and even depending on the deal you're considering; you might avoid buying a property, even at 0% down and 0% interest, if the payment is too high for the rent to cover, in the beginning when you don't have enough cash flow from other properties to make up the difference. Later in your career, you might do that same deal, because it pays off in 8 years, and because you don't need every property to cash flow because you have plenty that do, and because you'll be 65 in 8 years, and because having that property paid off in that time is incredibly attractive.

2. You get locked into the overly-simplistic formulae and "rules" you learned as a beginning investor, and pass up good deals because they don't fit those formulae.

Let's look at a real-life example of the latter.

I'm sure you've heard the "what to pay for a retail property" rule of 70% of after-repaired value less repair costs. You may have also heard that, when buying a property that has a loan on it, you should never "take over" a loan with an adjustable rate, due to the risk that the payments will, at some point, exceed the payments you can get from an end user.

These are both excellent rules to follow—to a point. But what if you ran across this situation:

A seller has a house that was completely renovated 12 months ago. With $1,000 worth of painting and cleanup, it would be in perfect condition for the area. It's worth $88,000; he owes $66,000 on a 5/1 ARM with a 2/6 cap, meaning that in 4 more years, the rate could rise by up to 2%, and that it could rise up to 2% per year after that until it reached a rate 6% above what it is right now

1: This is the house that was the subject of this deal

At the moment, the interest rate is 5% and the principal, interest, tax, and insurance payments are $490/mo., but they could easily rise to nearly $800 if the interest rate on the loan increased to 11% in the next 6 years.

unless you're a lottery winner, or a scam artist, you're not going to find that particular combination of elements in any business, so, yeah. Move on.

The house will rent for $1,100 a month, which creates a positive cash flow of $390 a month at the current payment (assuming 20% of gross rents go to maintenance and vacancy), but only $80 a month at the potential payment of $800/mo.

The owner won't accept your cash price of $60,600, because he paid $88,000 for it and doesn't want to bring $6,000 more to the closing to pay off his loan, in addition to walking away from his down payment. What he WILL do is sell it to you for $66,000 and let you take over his payments.

What do you do?

This situation fits none of the "rules"—it's not cheap enough to pay cash, and the adjustable rate nature of the loan isn't attractive—but it seems a shame to walk away from a deal with $22,000 in potential equity and, at least for now, almost $400 a month in cash flow, doesn't it?

But Transactioneers don't get into deals simply because there's one on the table in front of them, and "it seems like a shame to walk away."

And they don't do deals that are good for now, but could turn sour later.

They do deals where the benefit/risk profile makes sense to them—and because they've thought through how much risk they're willing to take for how much benefit.

In this case, the clear benefit is the cash flow, the risk is that the cash flow could drop to a pittance as the interest rate starts to adjust upward.

The additional potential benefit is in the equity—the property could be sold on lease/option at, say, $90,000, with a total up front and back end profit of $24,000. But the risk, of course, is that the optionee DOESN'T buy, the house has to be turned over at some expense, and by that time, rising interest rates may have negatively affected the value of the property.

So the question is, how do you approach the deal? Grab the benefits now, and hope that the risks never materialize? Bet on the worst case scenario, and pass on the deal? Something else?

I'll tell you what I did in a moment, but the important point here is that, as a Master Transactioneer, you need to think through some basic criteria for deals BEFORE you start making them.

These minimum criteria are called limits.

How to "Set Your Limits"

Limits are a way of saying, "There are certain things I MUST have in order to bother with a deal, and if I can't get them, the deal is a non-starter for me".

Some limits will be set FOR you, based on your exit strategies. For instance, if the only 2 things you're really interested in doing are retailing and lease/optioning houses, no junker property in a warzone will interest you at any price or terms.

Some limits will be based in your personal preference, or practical considerations. If you live in Cincinnati, and you get a call about a great house in Toledo[3] that the owner is literally ready to give away, there's a pretty good chance you won't be interested in it despite the great price and terms.

Or maybe you've scratched condos off your list of "interesting" deals because they don't appreciate in value where you live. Or perhaps you avoid houses that are too large, or too small, because of the increased turnover costs, or the decreased market for renters and buyers.

The more difficult limits you'll set as a Transactioneer, though, involve the risk/reward balance, and the balance between the various benefits available.

Some of these limits are of the go/no go variety ("I won't buy a property subject to a home equity line" or "I won't buy a property subject to the loan if the owner is behind in his payments"), but some are of a more complex, three dimensional nature ("I won't buy a property subject to the existing loan where the loan balance is more than 80% of the value, unless the cash flow is greater than $200 a month." "I won't buy a property with terms that create zero or negative cash flow, unless the loan will fully amortize in 7 years or less").

You certainly can't come up with limits for every possible situation by sitting around and thinking about them[4], but you can come up with enough definite, well-thought out criteria to achieve what setting limits is SUPPOSED to achieve, which is to:

1. Set boundaries on any given negotiation, so that you don't incrementally give up so much of "what you want" that the deal is no longer a win for you by the time you've made an agreement.

2. Create a clear point at which you can confidently walk away from a deal, without torturing yourself over whether you made a mistake by doing so.

3. Force you to find out whether what the SELLER wants is in harmony with what you need.

4. Force you to try to move the DEAL, rather than to move your requirements for a deal.

[3] If you're a California seller of an Ohio property, please get out a map and look at how far Cincinnati is from Toledo, and Akron, and Youngstown, before you call me and ask me whether I'd be interested in buying a house there. Yes, I KNOW that 4 hours is your daily commute to and from work in L.A., but no, I'm not going to drive that far to see your rental.

[4] And, by the way, you won't set limits one time and then never change them. When I was a wee real estate investor, I had a phobia about buying properties creatively that didn't have at least 20% equity, out of a fear of getting into a situation where I couldn't make the payments and needed to sell the property fast. Now that I have no real fear of being able to cover a monthly payment, even if the tenant doesn't pay me for months, and then sues me when I try to evict her (yes, that happened), I'll cheerfully pay 100% of the current value of a property I really like, if the monthly payment results in cash flow of, say $400-$500 a month for the next 20 years. On the other hand, I used to buy properties in low-income, high-drama areas a LOT, and now I don't because I don't like to manage them.

This last point is pretty crucial, and draws a bright line between the typical real estate entrepreneur and the Transactioneer.

In a deal like the one outlined above, a run-of-the-mill "real estate investor" is as likely as not to say, "Damn the torpedoes, full steam ahead" and jump into the risk of that adjustable rate loan with both feet. They'd buy the property subject to the loan, pray that the interest rate didn't go up, or that the property sold before it did, and figure that if the worst happened, they'd figure out how to deal with it in 4 years.

I, on the other hand, have certain limits that keep me from doing that, and force me to look for another way to make the deal work—and one of those is that I don't buy properties subject to adjustable rate loans unless the rate has already adjusted as high as it can go (and the resulting payment is still acceptable), or unless the highest rate it can reach still leaves me with at least $200 a month cash flow, or unless my exit strategy for the property would mean that the loan would almost definitely be paid off before any adjustment would happen.

Given these limits, the only thing that made sense for this deal was to control it without committing to make the payments, whatever those might be, for the next 29 years, and the deal I struck was this:

I signed a 4 year lease with an option to buy for $66,0000, with monthly payments equivalent to his $490/mo PITI payment.

In order to assure that I could continue to control the property, if it were to my benefit, the lease and option both contain a unilateral renewal clause—once a year after the 4th year, I can decide to renew at a lease payment of whatever his new payment is, and at the same option price.

This way, I get the cash flow, potential back end profit, but NOT the risk of the payments increasing to beyond a number that I find it beneficial to pay; if they do so, I simply surrender the option and give him back the property.

If this seems rather one-sided to you, notice that I left the seller with several important benefits:

1. He gets the benefit of amortization—I make his payments, but as the loan pays down, the option price remains at $66,000.

2. He gets the tax benefits—he can write off his mortgage interest, taxes, insurance, and depreciation against the "income" of the rent I pay him.

3. He also gets the soft benefit that was most important to him—someone else to worry about the property, the people who might live there, the maintenance, and so on, while he moved out of town.

See, I told you that the question "What do I want?" was more complex than you probably thought. And so's the 2nd part of the Transactioneer's question: "What does the seller need?"

What Does the Seller Need?

In the real estate education business, there's a lot of lip service given to the idea of the "win-win" deal.

You'll often hear real estate folks say things like, "I got a great deal and the seller got what he wanted, so it was a win-win!"

But it's rarely true in ANY investor transaction that the seller gets what he WANTS. What he WANTS is to not have overpaid for that property in the first place, for his last tenants not to have trashed it, or, failing the acquisition of a time machine, for you to give him every dime of what he has in it, all in cash, right now.

MOTIVATED sellers are the ones who both have a problem, and are anxious to put it behind them and recognize that they'll have to adjust their "ideal" price and terms to something more reasonable in order to convince someone else to take said problem on.

But even the most motivated sellers rarely recognize the difference between what they want, and what they need.

And a big part of your job as a Transactioneer is to help them do that.

It's a real skill to do this, because saying to most sellers, "No, let me tell you what you REALLY need" isn't especially rapport-building. Instead, we typically work to that conclusion along with the seller, by:

1. Asking questions to suss out what the whole situation—property, financial, and personal—actually is. These are the usual questions about where the property is, its condition, whether there's an underlying loan, and if so of what nature, why the seller is selling, and so on.

2. Asking additional questions to lead the seller to expressing his own limits. These questions take the form of "it sounds like what you're telling me is…" or "would it work for you if…"

3. Educating the seller, in plain English, about any options you might be able to offer, and how they'd help him

So, a conversation that a Transactioneer might have with a seller might go;

Seller: "I owe $132,000 on the property, and I need $10,000 extra to pay off a hospital bill"

Transactioneer: "So all the money from the sale price is going either to the bank or the hospital?"

Seller: "That's right"

Transactioneer: "So if I took over payments on your loan and paid your hospital bill for you,

would that work for you just as well?"

Seller: "So, you're not going to pay off my loan, but you're going to give me $10,000 for the hospital bill?"

Transactioneer: "Well, if we're agreed in spirit, what I'm going to do it take the house of your hands, make the payments on your loan going forward, and with your written permission get with the hospital and make a payment plan, which I'll also pay. That way you get both debts off your back, I pay the same amount for the house, but I don't have to run around trying to find $142,000 in cash to do it with."

Sellers are, not surprisingly, unable to come up with this sort of creative solution on their own; they are, surprisingly, often unable to understand what their real needs (pay off the hospital bill and stop making payments on the house, in this example) actually are.

As a Transactioneer, it's your job to lead them there.

IN WHAT WAYS can this be accomplished?

For any given set of circumstances, there are typically several strategies for documenting your agreement with the seller.

And while these strategies may appear similar on the surface, they have very different tax, legal, and control consequences—and the terms of each can be manipulated in various ways to meet different goals and fill different needs for different deals.

In the example above, for instance, what technique did you think would be used to memorialize the agreement that you'd make the seller's payments plus pay his hospital bill? Because I can think of several:

1. You could buy the property subject to the existing loan, then sign a promissory note with the hospital for a payment plan—but this wouldn't protect the seller from your default on either debt (and he'd still be legally responsible for both).

2. You could buy the property subject to the $132,000 mortgage and give the seller a $10,000 second mortgage, with payments made directly to the hospital. This way, if you default on the hospital bill, the seller could theoretically foreclose on the property.

3. You could give the seller a $142,000 wrap-around mortgage on the house with what would probably turn out to be a complicated higher-at-first-lower-later payment schedule, which would allow him to foreclose on you if you defaulted on either the 1st mortgage or the hospital bill.

4. You could lease/option the house from the seller at an initial rent that included the underlying mortgage payment and the amount of the hospital bill, then later adjusted downward to cover just the mortgage payment, and which had an option price equal to whatever the total remaining balance of the 1st mortgage and the hospital bill are at the

time of exercise of the option.

5. You could negotiate with the hospital for a lower total payoff for cash (as long as they also agreed not to ding the seller's credit for it) and pay a lower overall price, taking over the first via a subject to, wrap around, lease/option, or land contract.

And so on.

Which of these mechanisms is the "best" one?

That depends on a lot of potential factors not revealed in the example, like whether the first mortgage has a fixed rate, or what your exit strategy for the property might be, or whether the seller was willing to give you the deed to the property before that loan was paid off, and a dozen others.

The point is, true Transactioneers learn and study all of the various control and financing strategies, and their variations and implications, and have more than one ready answer for any "problem" that presents itself. They're serious about acquiring proper paperwork for any given deal, and making sure that it fully reflects and protects the agreement as they meant it to be.

And they aren't afraid to explore new ways to use familiar strategies, playing with the various terms available to create a new and better deal for everyone involved.

How YOU Can Get Into the Transactioneering Mindset

So, how do you keep all of these moving parts straight in your head?

That's a great question, because even the best of us sometimes get "brain locked" in looking at a particular deal. Eventually, you'll have internalized all of the various strategies thoroughly[5] enough that

When it seems as if there's no solution but should be, ask yourself these questions:

1. **Is the REAL problem that the seller isn't really motivated to sell**? If you seem to be beating your head against the wall with a particular seller, it might be time to step back and ask yourself if that seller really seems to want to sell. If not, no amount of creative engineering is going to make a deal that makes him happy—you're just trying to lead a horse to water that isn't thirsty.

2. **Is the REAL problem that the deal can't be made to fit YOUR limits**? You did already set those, in writing, right? Because if so, the issue may be that there just isn't a

[5] And, if you're smart, listened to enough deals that other people have done to have a library of examples in your head that you can access when your own experience fails you. If you've ever wondered why people who've been in business for YEARS and done HUNDREDS of deals still pay to attend classes in creative finance, it's for this reason. Walk into a Pete Fortunato seminar sometime, and you'll be amazed at how many gurus and near-gurus are sitting there taking extensive notes while listening to deals Pete has constructed. Then walk into a Dyches Boddiford or Gary Johnston class, and you'll find Pete doing the same.

way to make it a "win" for you, no matter how motivated the seller might be.

3. **Have you asked yourself, and gotten the answer to, the question "What do I want, what does the seller need, and what are ALL THE WAYS in which it could be accomplished?"** If not, do it: you'll often find that just walking through that exercise frees up your brain to find a way to make it happen.

Action Steps:

- To the best of your current ability, set your limits about the deals you'll do going forward. If you've already done some, think about which you like best, and what it is about them that you like. Then think about the ones you like least, and what they have in common that you don't like.

