PRINCIPLES OF CREATING PASSIVE INCOME

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Let me just say it. There is nothing "passive" about creating passive income. If you are one of the few that enjoy the reality of passive income, it is because you researched it, sought it, and created it. Once created correctly, then the "passive" part has a chance to live, but there is nothing "passive" or non-deliberate about its creation. It seems that the world is in search of it, but their hope lies in getting there with little to no effort. This will not happen. There is no magic wand, no business, no stream of green that will just happen to you out of nowhere. This hope and thinking is what I call "Lotto mentality", and we all know the odds of winning here, and yet it continues to amaze me how many buy the ticket. Creating passive income requires hard work, knowledge, and a well thought out business plan to set up. It requires a knowledge far beyond entry level business thinking. The motivation is obvious. If we do not think on creating streams of passive income, we become more and more vulnerable. If we are trading hours for dollars, we will never have financial freedom. As we grow older, it becomes more important from a disability and hopeful retirement perspective.

A Non-Specific view of "Passive Income"

The Cost of Time:

If an income stream requires your time, it is not passive. Time is the greatest and most valuable of all resources. "The unforgiving minute" as Kippling described it, becomes the defining measure of what true "passive income" is all about. Weekly I hear of people analyzing the net gain from an investment, and yet rarely in that "net gain" calculation is the value of time considered. Specifically, when we look at owner managed real estate that is fortunate enough to have a net positive monthly cash flow, the first question that runs through my mind is this: How much time and effort is the owner of this property spending monthly to create this "passive income stream". If the net cash flow of a property is $500.00 per month, but the management and ownership responsibilities of this property takes the owner a half day a week, then not only is the income stream not passive, the owner is declaring their time is worth less than $29.00 an hour. Valuing time when thinking on the topic of "passive income" is the first and most important consideration. In this scenario, if all owner responsibilities and management could be completely eliminated by hiring someone for $300.00 a month, then the remaining $200.00 a month would truly be passive. Looking at what your income streams create without your involvement is looking at the true definition of passive income.

<u>Different Levels of "Passive"</u>

Truly Passive

The most passive forms of income are completely hands off. Often times even the choosing of the source is hands off. Investments such as dividends, stocks, mutual funds, bonds are the most pure form of passive income or passive loss, which ever the case may be. Having no opinion on which vehicle to choose is a dangerous proposition. Rule one of any investment is responsibility and control. If this vehicle is your choice, educate yourself to the point of at least having an opinion regarding the companies and vehicles your money is married to. Completely passive income does not mean it has to be brainless income.

Residual Income

As already stated, setting up "passive income" is not passive. However, once set up properly, little time and effort is expended going forward to maintain the income stream. Versions of this abound. Residual income is the ongoing payoff of work that was done once. Examples of this are an insurance agent who gets paid as a policy that was sold once renews, or a photographer, author, or songwriter that gets paid every time their creation is used or purchased. The book was written once, but the revenues keep coming in for years. The song was recorded once, but every time it is played a royalty check is paid. Residual income works this way.

Recurring Income

Residual income is not to be confused with "recurring income". Recurring income is a good client that keeps wanting your services over and over again. You are a massage therapist, and every Monday at noon is a standing client for the last three years. This is recurring income. Great to have, but it is anything but passive. It not only requires your time, it often times creates obligation based imprisonment.

Margin Income

Making money off of other peoples time and effort is another form of partially passive income. The concept is simple. I get a contract to mow a lawn for $50.00 a week. I hire out the job to a competent person who will do it for $25.00 a week. I make $25.00 a week "doing nothing"? Well…you can tell by the question mark that there is more to consider, but at least you are not pushing a mower. The liability and responsibility of the job is still yours, but in rough theory, leveraging the work of others to make money for yourself is a form of passive income.

Compounding Income

Leveraging your own time is another variation of the same game. If every day I walk my dog at the same time wouldn't it be great if the neighbor would hire me to walk theirs and pay me to do so at the same time. I have leveraged my time. If I can charge for a lecture, it is the same lecture whether one person or ten people attend. The latter is a higher leveraging of my time. Leveraging of time is not technically passive income but rather active income compounded.

Passive Income in the Real Estate World

Appreciation

I know this is not cash flow, but over time demand real estate appreciates….end of story. What we do to receive this gain is simply to own or control the asset when the wave of appreciation is swelling. It is a bonus and it is passive in that we cannot control it. Appreciation is a bonus, however it differentiates the potential of real estate investment over many other forms of investment. We cannot ignore the long term benefit.

Leveraging our financial negotiations

This form of making money in real estate has nothing to do with Value. It has everything to do with the negotiation of contract terms. The sandwich lease or the wrap note both work the same way. We negotiate terms X, and we hand over with terms Xplus. We negotiate a lease of a house for $500.00 a month, and we sub-lease for $800.00 a month.
We sign a private note for 4% and sell it on a wrap note for 6%. Leveraging our financial negotiations once completed creates an inarguable form of passive income.

Opportunities as a lender

There is no shortage of opportunities, when you are in the circle of real estate investors, to create enormous returns as a lender of short term capital. Once the money is lent out, the income stream is secured and relatively passive until it is due and needs to be put back into circulation again. Using self directed IRA funds to lend on real estate projects is a way of not only creating great returns, but by putting the profits back into your IRA fund, these profits become part of your tax free IRA portfolio.

Relatively passive forms of income from real estate centered investments

This list could be endless, but with real estate as the anchor, there are many “expandable” up-sells that can take the passive net operating income to a different level. The success of any of these builds off the principle of demand. It is hard to sell parking out in the middle of nowhere. We can only sell parking in areas where parking is scarce. The principle of demand is a thread that runs through any form of passive income stream. We need to have what people want and are consistently willing to pay for. Fortunately under the umbrella of real estate, there are many such forms. Examples are:

-Coin Operated Laundry
-Selling parking to tenants and adjoining property owners or businesses
-Creating and selling storage. Often times the businesses, amenities, surrounding properties scream of storage opportunities. If your building is across the street from a lake with a three mile bike trail, then creating storage for bikes would be a no-brainer. People could store their bikes, versus packing them up and taking them to and from the lake trail every time they want to ride.
-Vending machines
-Offering washer and dryer in the unit for a rent up-charge.
-With daily rentals, offering pay for view movies.
-Offering space for a cell tower or switching room on your property
-Trailer and RV parking and storage
-Special event rental. An example would be to rent Bell Street parking by the hour during the taste of Edmonds.
-Offering the unit furnished at an up-sell price and sandwich leasing the cost of furniture
-Pet fee vs deposit

-Additional occupant rent up-charge
-Payments are “interest only or more” versus amortization commitments so in the event of a principle pay down, income stream and cash flow improves versus stays the same.

I am hopeful that this article gets the juices flowing and the motivation peaked. Passive income is the mantra of the entrepreneur, but as you can see, setting it up is challenging, illusive, and anything but passive. At Reach Returns, it is our goal to give you the tools and motivation to make concepts such as passive income a reality in your life.