"If you purchase a house hack by applying this book's principles, you have an extraordinary probability of becoming a millionaire within the next ten years... Maybe five!"

—**Scott Trench,** BiggerPockets' CEO and best-selling author of *Set for Life*

THE HOUSE HACKING STRATEGY

HOW TO USE YOUR HOME TO ACHIEVE FINANCIAL FREEDOM

CRAIG CURELOP

Foreword by **BRANDON TURNER,** best-selling author of *The Book on Rental Property Investing*

BiggerPockets® PUBLISHING

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THE POWER OF HOUSE HACKING

America's Biggest Misconception

What is your largest expense? The majority of the United States population would not hesitate to reply with "housing." Whether you are paying rent or paying down a mortgage alongside with taxes, insurance, maintenance, and all the other expenses associated with owning a home, your house is likely what you spend most of your money on each month.

If you ask these same people what they feel is their largest "asset," I would bet that you would get the same answer, "my house." If you have read *Rich Dad Poor Dad,* you know that our definition of "asset" is much different than the conventional definition. The conventional definition is something like "property owned by a person or company, regarded as having value and available to meet debts, commitments, or legacies."

My definition, taken from Robert Kiyosaki and Sharon Lechter's, *Rich Dad Poor Dad,* is much simpler. An asset is something that puts money in your pocket every month. A liability takes money from you every month. For example, when you own a rental property, stocks, or bonds you will get paid rental income, a dividend, or interest each month. These are assets because you receive income from owning them. Buying a car, on the other hand, is a great example of a liability. You are making monthly payments on a vehicle that depreciates over time and costs money in terms of gas, insurance, and maintenance.

Arguably, the biggest misconception that most Americans have is that their home is their largest asset. When, in fact, it is their largest liability. However, there are some exceptions. A few of them are exemplified at the conclusion of each chapter. You will read fellow house hackers' stories in this book who have used strategies outlined here to turn what could be their largest liability into their largest asset.

They strategically designed their lifestyle so housing is not their largest expense. As a matter of fact, through the strategies I talk about in this book, they have completely eliminated housing as an expense and they make money from their living situations every single month. And yes, their lives look just like yours. From the outside, you would not think that they are any different because they have day jobs, errands to run, and families to care for.

Rather than talk about these people as a mysterious cult, let's get into an example. Meet my imaginary friend Steve. Sick of paying $800 a month in rent to some mystical landlord, Steve decided to take action. He read *Set for Life: Dominate Life, Money, and the American Dream* by Scott Trench, and he found strategic ways to pinch his pennies until he could save enough money for a down payment on a duplex. After 18 months, he had saved $20,000! He found a duplex in an up-and-coming area of a major U.S. city for $350,000. The duplex was side-by-side units, each with two bedrooms and one bathroom.

With the money he saved, he put down a 3.5 percent or $12,250; he found a tenant to occupy the second unit, and a friend to occupy the second bedroom. His monthly payment to the bank was $2,000 and he was collecting $3,000 in total rent. The total rent fully satisfied his mortgage, and he was still making $1,000 over the mortgage. Now, not only has he eliminated his living expense, he is *making* money every single month on his living situation. How many people can say that?

In case you're like me and got lost in all of those numbers, here is a recap:

Purchase price: $350,000

Down payment: $12,250

Monthly rent: $3,000

Monthly mortgage payment: $2,000

Money in Steve's pocket every month: $1,000

Money saved from not paying rent: $800

Total money in Steve's pocket every month: $1,800

This is all happening while the property is appreciating and he is paying down his mortgage. This strategy is what BiggerPockets has coined house hacking. Sound familiar from the introduction? House hacking comes in all shapes and sizes. You can take Steve's strategy, which is the most popular, by purchasing a duplex while occupying one unit and renting out the other one. You could also purchase a property with a mother-in-law suite and rent that out as a short-term rental—whatever is best for your situation.

House hacking is certainly the easiest for young, single individuals who do not have families, are flexible, and can move easily. However, this is not to say that middle-aged or older people with a family can't house hack. They absolutely can! It's just that they may find it more difficult, and will likely be restrained to the "short-term rental" strategy if they do not want to significantly change their lifestyles. I'll get into more details on the different strategies later. Just trust me when I say that anyone can do it!

So now you should be clear on the concept of house hacking. To summarize, it is when you purchase a one- to four-unit property, live in one part, and rent out the others so that the rent from your tenants is fully covering your mortgage. Your largest expense (housing) is likely eliminated or drastically reduced, allowing you to save more money and propel yourself toward financial independence.

Why Is House Hacking Powerful?

Are you excited about the idea of building extreme amounts of wealth; and about not having to spend five days a week, fifty weeks a year, for thirty to forty years stuck inside a cubicle? Rather than waiting for the weekend or your next vacation, your entire life will feel like a weekend or vacation. Once you escape that 9–5 grind, your life opens up. You can travel, spend time with family, start a business, volunteer . . . the possibilities are endless! We call this escaping from the rat race.

If you are excited about breaking free from the rat race, house hacking is the most powerful way to make this a reality. I have yet to hear of a strategy that provides better returns without the help of winning the lotto, receiving an inheritance, or of course the usual 9–5 grind. If you can challenge this assertion after you have fully read this book, please email me at craig@biggerpockets.com.

One of the biggest benefits of real estate is the ability to use leverage otherwise known as debt. Let me explain. Let's say that you are trying to move a 2,000-pound boulder to reach a pot of gold. You can try to push, pull, and jerk that boulder with your hands, but unless you are Hercules, that boulder is not going to budge. You need help. So, you get this long metal, crow-bar looking tool called a "lever." You shove the lever underneath the boulder. You push (or pull) on one end of the lever, which will help you move the boulder. The longer the lever, the more "leverage" you can gain, and the easier it will be to move the boulder and obtain your pot of gold.

Think of this "lever" as your mortgage, and your strength as your down payment. The longer the lever, the less energy you need to move that same boulder. The larger the mortgage (less of a down payment), the less money you will need to purchase that property.

Good riddance to the days where you can purchase a property with no down payment. We do not need another 2008 crash. From all of the networking that I have done over the years, the largest hurdle for most people who want to purchase a property is coming up with the 20 percent down payment.

What many people don't know is that the government likes to reward people who are buying homes where they intend to reside. How? Fannie Mae and Freddie Mac. These two government-owned operations purchase mortgages from banks, accept lower priced mortgages and require a smaller down payment from people who purchase a property with the intention of living there for at least one year.

As of this writing in 2019, there are several different loan products that adhere to these terms ranging from 1–10 percent down payments. The most common amongst house hackers seems to be the 3.5 percent Federal Housing Administration (FHA) loan. I will go into depth later about financing. For now, just know that rather than putting $50,000 down on a $250,000 property, you can put less than $10,000 down for that same property when you house hack. You are using a longer lever to move that boulder.

Not only does that lower down payment give you higher purchasing power, but it exponentially increases your return. With such a low initial investment, your return on that investment is much higher. I'll go into depth about the numbers and the returns you will receive later.

Cash Flow & Loan Paydown

Let's talk briefly on how mortgages work. A mortgage is just a fancy word for "loan on a property." An owner-occupied mortgage is that same loan, but requires you to live there for a more favorable price or terms. With house hacking, you are likely going to obtain an owner-occupied loan. For the purposes of this discussion, let's say that you are getting a 3.5 percent FHA loan.

If you purchase a property for $100,000, you will be responsible for putting $3,500 down in exchange for a $96,500 loan to be paid back monthly over the next thirty years. Assuming a 5.25 percent interest rate, the monthly payments would be $532.88 per month. Each monthly payment will be a combination of principal and interest. The principal is the actual balance of the loan the bank gives you—in this case $96,500. The interest payment is the amount that you are paying the bank for lending you money.

In the first month, the concentration of interest payment will be highest, and as you continue to pay down the mortgage every month, an increasing amount of that $532.88 payment will be applied toward the principal. Take a look at the amortization schedule below to see how each payment over the next twelve months is comprised.

Month	Beginning Principal	Payment	Principal Portion	Interest Portion	Ending Principal
1	$96,500.00	$532.88	$110.69	$422.19	$95,967.12
2	$95,967.12	$532.88	$111.17	$421.71	$95,855.95
3	$95,855.95	$532.88	$111.66	$421.22	$95,744.29
4	$95,744.29	$532.88	$112.15	$420.73	$95,632.14
5	$95,632.14	$532.88	$112.64	$420.24	$95,519.50
6	$95,519.50	$532.88	$113.13	$419.75	$95,406.37
7	$95,406.37	$532.88	$113.63	$419.25	$95,292.74
8	$95,292.74	$532.88	$114.12	$418.76	$95,178.62
9	$95,178.62	$532.88	$114.62	$418.26	$95,064.00
10	$95,064.00	$532.88	$115.12	$417.76	$94,948.88
11	$94,948.88	$532.88	$115.63	$417.25	$94,833.25
12	$94,833.25	$532.88	$116.13	$416.75	$94,717.12

Do you see how the interest portion of the payment decreased over time, but the amount applied to the principal increases? When you are paying down your principal, you are building equity in the property by paying back the balance of the loan.

The best part about house hacking is that you are not actually paying the loan: Your tenants are! Not only are you living for free, and maybe even cash flowing, you own more and more of your house each month.

Equity through Appreciation

Fortunately, paying down your loan is not the only way to build equity in your property. You can also do this through appreciation. There is natural appreciation and forced appreciation.

Real estate has essentially been around since the beginning of time. In fact, the word "landlord" comes from medieval times when there was a "lord of the land." Since I started tracking United States real estate values back to the early 1900s, the average growth rate for a property in the U.S. is about 6 percent. The differences are based on the location throughout the country, but we are going to use the U.S. average of 6 percent. By doing absolutely nothing, you are building equity in your property by 6 percent of its purchase price each year. This is natural appreciation.

Forced appreciation is when you do something to the property to improve the value. House flipping is a great example since house flippers buy distressed properties at great values, fix them up, and then sell them for a profit. Let's say a flipper purchases a property for $100,000. They put in $50,000 worth of repairs so the total all-in cost is $150,000. They turn around and sell the home to a buyer for $200,000. That $50,000 beyond the costs that the flipper paid can be seen as forced appreciation. To recap:

Purchase price: $100,000

Rehab: $50,000

Total cost: $150,000

Sales price: $200,000

Forced appreciation: $200,000 - $150,000 = $50,000

When you are house hacking, you do not need to redo the entire property. You can force appreciation by adding a bedroom or a bathroom, redoing the kitchen, or sometimes just changing the cabinets and painting.

Appreciation builds the most wealth through real estate investing. A 6 percent interest rate on a $100,000 property will net you $80,000 in appreciation over ten years whereas the property itself may only cash flow $100 per month or $12,000 over ten years.

Learn to Landlord

One of the caveats of using a low down payment loan is that you need to live in the property for at least one year. While this may seem like a hindrance, it is actually working out in your favor. As a house hacker, you are likely new to the real estate game. What better way to transition from tenant to landlord than to be a landlord that lives amongst your tenants?

By living in the property, you drastically reduce the probability that something will go unfixed for an extended amount of time. Your tenants, who you will either live with, or see frequently, will have no qualms telling you about a leaky faucet or an outlet that may not be working. You can then fix the problem or call someone to have it done for you when you go home rather than having to make a separate trip to your rental property.

Not only will you be one of the first to know if anything goes wrong with the property, you will also end up building a relationship with your tenant(s). If you are a nice person who tends to get along with most people, then this will work to your advantage. Your tenants will start to feel like you are friends, and more likely pay rent on time each and every month.

Tax Benefits

Anyone who talks about taxes who is not a certified public accountant (CPA) will always cover themselves by disclosing that they are not a CPA. I am no different. I am not a CPA, and I am not legally able to give tax advice. What follows is not tax advice; it is simply how I've used the tax code to my advantage when purchasing properties.

Buying a home is considered part of the American dream. Uncle Sam and the United States government love to see people buy property, and they reward them accordingly. When you purchase real estate (including house hacking), you can take full advantage of the tax code in three ways:

1. Tax write-offs
2. Depreciation
3. 1031 exchange or 2-of-the-last-5-year rule

When you are collecting rent on a property, you have started a business that generates income and has expenses. As a business, you are taxed on the bottom line. For example, if you generate $10,000 in rental income and have $8,000 in expenses, you will be taxed on the $2,000 difference. If you are in the 33 percent tax bracket, you will have to pay $660.

Rental income: $10,000

Expenses: $8,000

Net income: $10,000 - $8,000 = $2,000

Taxes paid: $2,000 × 33% = $660

If you are looking to save on taxes, the goal is to look for methods that can increase your expenses so that the bottom line number is reduced. I'm not saying go out and spend money on random things for your business that are not needed. If you earn $1 that is 67 cents after taxes, it is still better than spending the dollar, and having zero dollars in the end.

Instead, it is best to make sure you are recording each expense appropriately. There is an entire book dedicated to saving on taxes for real estate investors called *The Book on Tax Strategies for the Savvy Real Estate Investor* by Amanda Han and Matthew MacFarland. I highly recommend you check it out to see what you are able to write off so that you can reduce your tax liability as much as possible.

Let's talk about depreciation. It sounds bad, right? Who likes something that depreciates? After these next few paragraphs, you surely will!

As of this writing, the IRS requires the real estate investor to spread out the cost to purchase residential real estate over 27.5 years for residential buildings. The fancy word for this is "depreciation."

Depreciation is a non-cash expense, which means that it does not come out of your bank account like your mortgage payments, insurance, maintenance, and repairs. It only shows up when you are displaying your financial statements to your accountant and the IRS at the end of the year.

Yes, you read this correctly though I understand that it can be confusing. Although your property will likely "appreciate" in value over time, the government requires you to take a "depreciation" expense. This means that you have an added expense and a lower taxable number as described above.

Let's get back to our example of buying that $100,000 house. At the end of the year, before our depreciation expense, we have taxable income of $2,000. Now, we must include the depreciation expense. To do this, we remove the estimated value of the land and divide over 27.5 years. We will assume the land is worth $5,000 so dividing $95,000 ($100,000 - $5,000) by 27.5 gives us:

($100,000 - $5,000) / 27.5 = $3,454 depreciation expense

Now, we subtract this depreciation expense of $3,454 from our taxable income of $2,000.

$2,000 - $3,454 = -$1,454

Whoa, so rather than showing the IRS that we earned money last year, to them, we actually lost money. Luckily, you are not going to be paying taxes on money that you lost. Instead, if you make under $150,000 (in 2018 tax code) in your normal W-2 or 1099 job, you will be able to offset your income by $1,454, which thereby reduces your overall tax liability.

Isn't depreciation a wonderful thing?

Tax write-offs and depreciation are two of the major tax benefits when it comes to buying and holding real estate investments. There are also tax benefits when you sell a property from the 1031 exchange and the 2-of-the-last-5-year rule.

The object of the 1031 exchange is to defer capital gains taxes upon the sale of your property. A capital gains tax is incurred when your property appreciates and you go to sell it. For example, we bought that property for $100,000. Over the course of ten years, let's say it appreciated to $150,000. You will be responsible to pay taxes on the net $50,000. Those taxes are called capital gains taxes.

Section 1031 of the tax code says that a real estate investor is allowed to sell a property, purchase another, larger property, and defer the capital gains taxes that were incurred on the sale until the investor sells the larger property. The caveat to a 1031 exchange is that the investor must identify a larger property within forty-five days and close on that property within 180 days of close. It is not forty-five days plus an additional 180. You have forty-five days to identify the new property, and then an additional 135 days to close, making the entire transaction 180 days.

Notice that I have been saying "defer" capital gains. Unfortunately, you will be responsible for paying these taxes eventually, or will you? If you decide to sell the larger property at any time for cash or any non-real estate investment, you will be responsible to pay the capital gains tax. However, if you continue to do 1031 exchanges or hold the property until your death, the capital gains expense gets wiped away.

There can be an entire book written on 1031 exchanges, but I digress.

Let's talk about the 2-of-the-last-5-year rule. This is another strategy many house hackers and other homeowners use when selling their property.

This part of the tax code says that if you live in a property for two of the last five years, you are able to sell the property without any capital gains tax up to $250,000 if you are single, or up to $500,000 if you are married.

If we purchase that property for $100,000 and decide to house hack, we are already required to live in it for one year. If we just live there for one more year, we could turn around and sell the property and owe no capital gains tax. Don't let the rule mislead you. It does not have to be two consecutive years. You can live in the property for one year, move out, and come back in three or four years to live in it for the last year. You can then sell with no capital gains tax owed. Not a bad deal, huh?

The Drawbacks of House Hacking

I am writing a book about house hacking, so I am going to obviously advocate for it—especially because the house hacks that I have completed have had a significant impact on my life. I want you to experience the same life changes. Like anything in this world, there are common objections to house hacking. I am going to touch on those objections, and explore how I overcame them.

1. More Work

House hacking is essentially a small business. While it is mostly passive, there are times when you need to do some work. For example, filling a vacancy, accommodating a maintenance request, or keeping track of rent, security deposits, etc. are all things that must be done as a landlord.

Not only is it more work on your day to day lives, but your taxes also become that much more difficult to complete. Rather than taking the W-2 you receive in January, you will also have to fill out a Schedule E (Form 1040) and remember to account for all expenses for the maximum tax savings.

Overcoming

Becoming a landlord sounds like a lot of work and stress. Who wants to be answering calls in the middle of the night when a toilet is clogged? Let me tell you something, I have a lot of friends who are landlords and not once have I heard of anyone having to deal with an incident at odd hours.

Most things can wait until the morning.

I am not going to deny that it is more work on you than renting. It absolutely is. Most of this work is up front or during the first few months of buying the property. Once you are settled with tenants renting your unit(s), you might find yourself working an additional three to five hours a month. That's only a small amount of time for a large payoff. The tasks you do for the house hack are hundreds of dollars per hour tasks.

2. *Living with (or Next to) Others*

There are many ways to house hack. You can purchase a single-family residence and have roommates/tenants. You can live in a duplex, triplex, or fourplex and rent out the other units. You can also purchase a single-family residence with a basement unit or auxiliary dwelling unit that you rent out short term. Either way, if you are living by yourself in a nice, one-bedroom apartment, it is going to be very difficult to go back and start living amongst a bunch of people. Naturally, you will lose some privacy. Even if you are not living in the same unit as your tenants, it is likely that you can no longer throw any large parties without first inviting (or asking) your neighbors.

Living with others can become an issue if you have a family. Do you want a complete stranger living in your house with your kids? I am a firm believer that most people in this world are nice. However, it just takes one jerk to sour the experience of house hacking for you. This might not be a risk you are willing to take.

Overcoming

If you are accustomed to living by yourself, living with others can be difficult. But try to look at this situation in a positive light. Living by yourself can be lonely. Why not make a few more friends? Now you have someone who can help clean. If you are house hacking while using a long-term rental strategy, you need to make sure to properly screen your tenants. You do this to not only confirm they will pay their rent on time, but also to make sure that they will be good roommates.

It makes sense to purchase a place with a basement unit that has a separate entrance, or a property that has an auxiliary dwelling unit if you really value your space. That way, you can rent out this space without ever running into your tenants. Both you and the tenants will appreciate this arrangement.

You can consider nontraditional options if you do decide that you want to pursue a short-term rental strategy, but do not have the ability to be separate from your tenants. I posted my bedroom on Airbnb and met friendly and interesting people. You will have a revolving door of strangers coming and going every few days. Maybe this sounds unappealing to you, but remember, the situation is temporary. A guest who bugs you will be gone in a few days. I really enjoyed having travelers stay with me as I learned about their lives and gave recommendations of what to do in my city.

3. Keeping a Professional Relationship

This tends to be more of a problem when house hacking a single-family home and renting by the room. There is a lot of ambiguity surrounding whether the people you live with are "tenants" or "roommates" when you do this method. In many cases, they start to feel like "roommates," but be careful of this. You do not want to get too close to your tenants because they might begin taking advantage of you. This has not happened to me, but I have heard stories of tenants asking to pay rent late, or not cleaning up around the house.

Overcoming

Remember that when you house hack, your tenants are tenants, and are NOT roommates. You can make them feel like roommates by getting along with them and being cordial, but be careful about getting too close.

My advice is to be friendly to your tenants in passing, but don't hang out with them too frequently outside of the property. This obviously does not apply if your tenants were your friends before you started house hacking. (In which case, you hope that they are good enough friends to always pay their rent.)

4. Live in a Crappy Investment Property

When you house hack, you are doing it primarily for the overall financial impact. For that reason, you will try to buy a relatively inexpensive space that you can charge the highest possible amount for—that is reasonable for the location and condition of the property. If you are buying an inexpensive property, it is likely a bit run down or in a less desirable area. Either way, you will be scaling back your lifestyle. This means moving out of the high-rise downtown and settling into a place that is much more modest.