

Chapter 1

Wrapping Your Brain Around the Idea of House Flipping

In This Chapter

- ▶ Understanding the concept and challenges of flipping
 - ▶ Flipping the right way — legally and ethically
 - ▶ Developing a winning strategy and the right connections
 - ▶ Surveying money matters and savvy renovations
 - ▶ Marketing and staging a house properly to maximize your profit
-

Flipping sounds easy. You can flip a pancake. You can flip a coin. Without too much effort, you can even flip out. Flipping a house, on the other hand, requires a level of knowledge, expertise, and sticktoitism unrivaled by any of these mindless tasks. It requires access to cash, and lots of it. It demands time, energy, vision, attention to detail, and the ability and desire to network with everyone from buyers and sellers to real estate professionals, contractors, and lenders.

In this chapter, I offer a broad overview of what flipping houses is all about. I introduce the overall strategy of flipping houses — buy low, renovate, and sell a property at fair market value to earn a fair market profit. I reveal the difference between flipping the right way — legally and ethically — and flipping the wrong way — ripping off buyers, sellers, and lenders for a quick wad of cash.



Throughout this chapter, I recommend a strategy that's worked for me during my over-30-year stint as a house flipper and real estate professional. I've built my approach on a strong foundation of honesty, integrity, dedication, and hard work, and I recommend that you do the same. With a positive mindset, a strong commitment, and the right approach, you have a much better chance that your first flip won't flop.

Grasping the Concept of Flipping and Its Challenges

In investment circles, the secret to success is cliché — buy low, sell high. This same principle applies to flipping houses. To succeed, you buy a house 25 to 50 percent below market value, repair and renovate the property to make it a more attractive purchase, and then turn around and sell it at market value. That three-step process — buy, fix, and sell — certainly sounds easy enough, but each step carries with it a host of unique challenges, as I point out in the following sections.



To buy low, you have to be in a position to buy quickly. The trick is to have your financial ducks in a row before you go house hunting. Chapter 6 reveals various ways to finance your flips.

Spotting distressed property . . . and property owners

Homeowners don't exactly line up around the block waiting to sell their homes for less than they're worth. As a house flipper, your job is to hunt for the homes in your area that are *don't wanners*, as in "the owners don't want her." These orphan homes usually appear bedraggled. The yard looks like a weedy wasteland, the gutters are hanging off like a pair of old false eyelashes, the paint's peeling, and the interior is completely trashed. These properties are often referred to as *distressed*, and their appearance indicates that the owner is distressed, as well. The home has become an albatross around the owner's neck.

When the homeowners need to shed the burden of home ownership, they're more likely to work out a deal with a serious investor. In Chapter 9, I point out several successful techniques for scoping out distressed properties.



The average house hunter wants a nice house. When you're flipping houses, you want the ugliest house on the block. To succeed in finding potentially profitable homes, you may need to change your perspective, so you can see the beauty in a beast.

Making a few minor (or major) alterations

When you buy a house at a bargain-basement price, it usually requires some tender loving care to make it marketable. In some cases, a thorough cleaning along with a fresh coat of paint (inside and out) and new wall-to-wall carpeting does the trick. In a matter of days or a couple of weeks, and with a small investment, you can often boost the value of a home just by making it *look* brand-new again.

Other houses require more extensive renovations to make them marketable and boost your bottom line. You can transform a two-bedroom house into a three-bedroom house by converting unused attic or porch space into a bedroom; knock out a wall or two to combine the kitchen, dining room, and living room into a great room; install all new replacement windows; or even build a second story. The chapters in Part IV cover everything from quick-flip cosmetic jobs to extensive renovations and provide plenty of tips and cautions to prevent you from sinking money into home improvements that offer little payback.



Avoid the temptation to over-improve a house. You may be able to convert a \$100,000 house into a \$1 million mansion, but if a buyer wants a \$1 million mansion, she buys a house in a neighborhood with \$1 million homes. Shoot for making the house you buy competitive with other houses in its price range. Don't go overboard.

Reselling your rehabbed property for big bucks

The old adage of house flipping is that “You make your money buying in.” But you realize your profit only after selling the house. Assuming you purchase the property at the right price, you don’t overspend on repairs and renovations, and the housing market remains relatively stable, you should have no trouble selling the house at a profit simply by selling it at or near market value.



Holding costs (insurance, property taxes, and utilities) can chip away at your profit. I estimate daily holding costs at \$100, so for every month that your house lingers on the market, you’re out about \$3,000. To sell the house quickly at a fair price, set a price that’s competitive with the prices of comparable houses in the same neighborhood. If your asking price is too high, it’ll cost you.

The chapters in Part V show you how to set an asking price, market the property, properly stage the home for a successful showing, and ultimately close the deal.

Flipping Ethically: The Good, the Bad, and the Illegal

In real estate circles, the word “flip” is often construed as just another four letter word. Utter the F word at a real estate conference or seminar, and you’re liable to be spending your lunch break at a cozy table for one. The reason for this cold shoulder from the real estate community is that back in September of 2001, HUD (the federal department of Housing and Urban Development) released FR (Final Rule)-4615 Prohibition of Property Flipping, which made flipping illegal.

So, why am I writing a book that promotes this illegal activity? Because the word “flip” has a double meaning, a split personality, a sunny side and a sinister side, as the following sections reveal.

Flipping illegally: Real estate fraud and other scams

Criminal minds have invented countless ways of milking the real estate industry, and one way is to flip houses. This sinister type of house flipping typically relies on some form of fraud — lying or misrepresenting information. In some cases, the con artists hook up with crooked appraisers who artificially inflate home values and then sell overpriced homes to ill-informed buyers.

Another way con artists scam the system through flipping is to build a team of buyers, none of whom intends to own the property for any length of time. They buy the home off one another, increasing its price with each sale. False appraisals or crooked appraisers make the price hikes look legitimate, and corrupt loan officers often expedite the loan approval process. As the value of the property increases on paper, the amount of equity in the property increases. The final buyer takes out a whopping loan to pay the previous owner and then defaults on the loan. The team splits the proceeds, sticking the lender with the bill and leaving a legacy of foreclosures and vacancies.



The dark side of flipping destroys credit ratings, raises interest rates, and ruins neighborhoods. Over the long haul, it threatens to squash the American dream of home ownership. It’s unethical, immoral, and illegal.

Flipping legally: Buy, fix, and sell

Flipping the right way is a perfectly legitimate strategy for making money in real estate. You buy a property below market value, fix it up, and sell it for more than you invested in it. Do it well, and you can earn a handsome profit. Make a serious blunder, and you suffer a loss. This fix-it-and-flip-it approach has a positive effect on the real estate market. It increases property values, improves neighborhoods, and provides quality housing for those who need it. It's the American way — capitalism at work.



Throughout this book, I encourage you to flip the right way and I caution you to avoid the gray areas that can get you into trouble. Flipping the right way allows you to legitimately profit from the system without having to tiptoe through legal minefields. It ensures that you establish the solid reputation you need to flip profitably for however long you want.

Determining Whether You're Ready for Flipping

Although anyone can profit from flipping houses, it's not quite as easy as it looks on TV. Buying a house that's brimming with potential for 25 to 50 percent less than you know you can sell it for is a huge challenge in itself, but after you take possession of the property, the real fun begins. Your contractor disappears after collecting your deposit. The landscapers hack through a buried cable. You find out that the septic system needs to be replaced. And the neighborhood association rejects every single one of your planned improvements.



To successfully deal with the unexpected twists and turns you're sure to encounter, you need to have the right stuff, as I describe in Chapter 2: time, money, personality, family, and tools.



Novice real estate investors often become unnecessarily overwhelmed by all the work that they think is involved in flipping a house. Flipping requires time and effort and it has its share of aggravation, but it's only overwhelming if you try to take on too much. Start with a relatively easy house at first — a property that requires only cosmetic work. (In Chapter 14, I show you exactly how to give a house a quick makeup job.) Then, slowly move up to more involved projects. Don't be afraid to call for help. You can often save money and aggravation by calling a professional.

Devising Your Own Surefire Flipping Strategy

No two investors follow the same flipping strategy. Some investors choose to live in the house they flip, while others find that too stressful. Some flip a house every two years to maximize their tax savings, while others flip a house once every month or two for quick profits. Some fly solo, while others team up with real estate agents. Many investors focus on a niche market, such as foreclosure properties, HUD (Housing and Urban Development) properties, or FSBO (For Sale By Owner) homes.



The strategy you ultimately settle on is yours to invent. What's important is that you have a strategy and the system and resources in place to execute it. With an effective strategy and the proper advance planning, you have a much better chance of avoiding common snags and hooking a profit. Before you make an offer on your first house, you should already have the essentials in place:

- ✓ Financing not only to purchase the house but also to cover holding costs and the cost of repairs and renovations
- ✓ A plan for repairing and renovating the property (such as buying low, applying makeup, and selling high, or living in your flip while you renovate it)
- ✓ A realistic estimate of the costs of repairs and renovations and the monthly expenses for holding the property
- ✓ A schedule for completing the project
- ✓ Reliable contractors who are available to begin working on the property immediately
- ✓ A date on which you plan to put the house back on the market



Flipping a house is like taking a vacation. You have to know your destination before you book your flight. Before you buy a house, know exactly what you're going to do to improve the property, how much the improvements are going to cost, how much you can sell the house for, and an estimate of your net profit. Chapters 3 and 5 can assist you in developing an effective plan.

Assembling a Team of Advisors and Experts

You probably won't find a course on flipping houses at your community college. The only school that offers such a course is the college of hard knocks. You learn by doing. But when you're gambling with more than \$100,000 of

your own or someone else's money, learning by trial and error can be catastrophic.



A safer way to develop the skills and foresight needed to reduce costly mistakes is to learn from the mistakes of others. Develop your own house flipping team and rely on the following professionals to guide and educate you:

- ✓ Real estate agent
- ✓ Financier/lender
- ✓ Accountant
- ✓ Title company
- ✓ Appraiser
- ✓ Home inspector
- ✓ Real estate lawyer
- ✓ Contractors

In Chapter 4, I describe the role that each of these valuable individuals plays on your team, and I provide some criteria to show you how to select the best of the bunch.



Time is money, and your time is valuable. If you can make more money doing your day job than you'd pay a contractor, you're usually better off hiring a contractor. In addition, if one contractor charges a little more but can complete the job on schedule, you may save money by hiring a slightly more expensive contractor. When you're flipping houses, overlooking the clock is easy when you're staring at dollar signs, but in flipping, time really is money.

Managing the Moolah

The ultimate goal of house flipping is to make money, and the way to accomplish that is fairly simple — you need to sell the house for more than it cost you to buy it, fix it up, and sell it. The process becomes a little more complicated, however, when you begin attending to the details.

At each stage of the project, you have numerous opportunities to make money, save money, and waste money. By remaining vigilant, you can cut expenses and beef up your bottom line, as I explain in the following sections. I show you how to estimate the profit on a flip, secure funds for your flip, and handle taxes smartly.

Estimating your profit

Never buy a property unless you're sure that you can profit from it . . . at least on paper. By jotting down a few numbers and doing the math, you can project your profit well in advance to determine whether the potential profit is worth the risk, not to mention your time and effort. Your goal is to earn at least a 20 percent profit on your total investment. To ensure a 20 percent profit, you need to adjust your goal based on whether current market conditions are increasing, flat, or decreasing.

In Chapter 5, I give you more information on each of the three main types of market conditions, and I guide you through the process of estimating your profit upfront and provide you with a profit projector to help you determine how much you can afford to offer for a house.



If you get in over your head and stand to lose money when the time comes to sell the house, consider going with plan B. Plan B is to hold onto the property and lease it until the market improves and you can sell the property at a profit. In Chapter 25, I provide ten tips for surviving in a slow market.

Getting your mitts on some ready cash



In the land of house flipping, cash is king. By making a cash offer on a house, you give yourself a strong platform for negotiating a lower purchase price and closing the deal in a matter of days or weeks rather than months. With cash on hand, you can begin renovating the property as soon as you take possession of it. Cash also enables you to hold the property, so you're not forced to accept the first low-ball offer you receive from a buyer.

How do you get your hands on this cash? You can tap into any of several resources:

- ✓ Borrow against the equity in your home. This isn't exactly cash, but it's the next closest thing.
- ✓ Hook up with a private lender.
- ✓ Ask family members or friends.
- ✓ Establish an effective partnership.
- ✓ Secure financing through the seller.
- ✓ Convert your IRA or a portion of it into a self-directed IRA.

In Chapter 6, I reveal the pros and cons of these financing options and show you various ways to gather the cash to finance your flip.



Borrowing money gives your personal investment more leverage. If you put up \$20,000 and borrow \$180,000, you can take on a \$200,000 project. Sell the house for \$240,000, and you've just made \$40,000 — a 200 percent return on your investment! If you put up \$100,000, borrowed \$100,000, and sold the house for \$240,000, your profit would be the same, but it would represent only a 40 percent return on your investment. Use other people's money to leverage the power of your personal investment, as I discuss in Chapter 6.

Keeping more of your hard-earned cash by handling taxes wisely

Whenever you make money, the government usually demands its cut. If you make a career of flipping houses, the IRS treats your profits as self-employment income and slaps you with an income tax . . . and perhaps even self-employment tax to cover social security and Medicare. Otherwise, your profits are taxed as investment income — short- or long-term capital gains. However, if you choose the slow-flip strategy and live in the house you flip for a couple of years, and depending on the tax rules in place at the time, your entire profit may be entirely tax exempt!

As you can see, this tax stuff can get a bit complicated. In addition, tax laws change from year to year, and taxes vary depending on your unique financial portrait. I offer some tax-saving advice in Chapter 7, but the only way to ensure that you're complying with current law and paying the necessary state and local taxes is to consult a CPA who's accustomed to dealing with real estate investment income in your area.



Paying a boatload of tax is a good thing. It means you're making a boatload of money.

Finding and Buying a Property Ripe for Flipping



The most critical stage of flipping a house is finding and buying the right house to flip. Buy a lousy house in a lousy neighborhood for more than it's worth, and you've already lost the game. Finding a house that's dripping with potential for 25 to 50 percent less than you can sell it for is quite a challenge, but as a flipper, that's the fun part. Flipping is an adventure, a treasure hunt, and a poker game all rolled into one. Finding and buying a property is a four-step process:

1. Scope out a fertile neighborhood — often an area with homes that are at least 20 years old and are ripe for rehabbing and reselling. See Chapter 8 for details.
2. Zoom in on a don't wanner — a distressed property that the owner obviously doesn't want or can't afford to keep. A distressed house usually has a distressed owner. See Chapter 9 for details.
3. Inspect the property closely inside and out and carefully estimate your potential profit. Before you make an offer on a property, you should be fairly certain that you'll earn at least 20 percent for your trouble. In Chapter 10, I provide you with a list of items to pack for your inspection mission along with a list of key features that give a property flip-appeal.
4. Haggle with the seller to purchase the house at a price that virtually ensures that you will profit from the flip, as I explain in Chapter 11.

Rehabbing Your Fixer-Upper to Maximize Your Profit

When you buy a house to flip, it's like buying a beat up antique at a garage sale. You got the house for a bargain because it needs work that the seller isn't motivated to do. By cleaning up the joint, fixing whatever's broken, and perhaps doing a few renovations, you can bring the property up to market standards and sell it for its full market value. In the following sections, I walk you through the types of renovations you can make.

Putting your renovations in order

Repairs and renovations require careful planning and execution to keep them on schedule and within budget. Before you begin, prioritize your renovations, so you know what's most important; I give you all the tools and tips you need in Chapter 13. Invest your time and money in the renovations that promise the most bang for your buck, and then if you need to trim costs, you can skimp on the less important stuff.



Schedule the work so that it proceeds logically. If you install new tile and carpeting before painting the walls and ceiling, you risk ruining the new tile and carpeting. A good rule of thumb is to work on the infrastructure first — the foundation, electricity, plumbing, heating, and air conditioning. Then, work from the top down, finishing with the floors. Don't paint yourself into a corner.

Applying a little makeup

The ideal house for a first-time flipper is one that requires only cosmetic work. Cosmetic work, which I cover in Chapter 14, includes the following low-cost repairs and renovations:

- ✓ A fresh coat of paint throughout the house
- ✓ New wall-to-wall carpeting in any rooms that need it
- ✓ New light fixtures
- ✓ New outlet and light switch covers
- ✓ A thorough cleaning inside and out
- ✓ Window washing
- ✓ Storm window and door repair or replacement
- ✓ Lawn mowing, weeding, trimming trees and shrubs, and other basic landscaping



Cosmetic repairs don't add as much real value to a house as, say, a new kitchen may add, but they attract buyers. Often a house is undervalued simply because prospective buyers can't stand looking at it.

Tidying up the exterior

Curb appeal is everything when you're trying to sell a house. If prospective buyers pull up in front of a house that doesn't look inviting, they're likely to pull away before you have time to open the front door. To sell your house for top dollar, the house has to make a good first impression. Chapter 15 shows you how to landscape and prepare the exterior of the house to make it draw passersby inside for a closer look.

Focusing on kitchens and bathrooms

Kitchens and bathrooms sell houses or sink deals depending on their condition. A spacious kitchen with plenty of counter space and all the essential amenities — a clean range, refrigerator, microwave oven, and dishwasher — creates an impression that the kitchen is a great place to prepare meals and hang out with friends and family members. A sparkling clean, well-lit bathroom with plenty of storage space creates a sense of comfort and cleanliness that permeates the house.



Although you should never over-improve a property, renovations that bring the kitchen and bath up to market standards in your area always pay for themselves by adding real value to the property and making it more attractive to buyers. See Chapter 16 for the full scoop on renovating kitchens and bathrooms.

Making moderate changes

Somewhere between painting a room and building a room addition are moderate changes that you can make to a house to improve its value and draw more buyers. These improvements include installing replacement windows, replacing the screen doors or entry doors, and refinishing wood floors or installing tile or vinyl flooring. Chapter 17 lays out your options.

Overhauling the structure

Some houses are begging for a few major overhauls. Maybe the house has an unfinished attic that's perfect for an additional bedroom or it has a beautifully landscaped backyard that has no easy access to it and no deck or patio. In some cases, you may discover a dinky house surrounded by mansions. By raising the roof and building a second story, you can double the living space and boost the house into a higher bracket. Chapter 18 takes on some of these major renovations, stimulating your own creative visions.

Selling Your Renovated Pad

As soon as you take possession of the house and begin renovating it, you draw attention to the house and fire up your marketing machine. A brief visit with your closest neighbors ignites the flames of word-of-mouth advertising, and by throwing a few more marketing logs on the fire, you can fuel a successful and fast sale. The following sections highlight the main factors that ensure success.



Every day your house remains on the market costs you about \$100 in holding costs. To maximize your profit, you not only want the house to sell for a good price, but you also want it to sell quickly. Holding costs vary, so calculate the actual daily or monthly holding costs for each property individually, as I demonstrate in Chapter 5.

Setting the right price

A key mistake that many homeowners make when they're trying to sell their house is to set the price too high or too low. Set the price too low, and you cheat yourself out of some extra dough. Set it too high, and the property is liable to languish on the market for several months.

To sell a house quickly for the going rate, you need to offer a house that's in as good or better condition than comparable houses in the area at a price that's at or slightly below market value. Don't get greedy. Chapter 19 has tips on setting an appropriate asking price.

Marketing your property



The more people are aware that you have a house for sale, the better chance you have of selling it quickly at a handsome price. In a strong market with more buyers than sellers, a savvy marketing campaign can even trigger a bidding war that drives the price beyond your expectations. As I point out in Chapter 19, every marketing campaign should include the following:

- ✓ An attractive and informative For Sale sign planted on the front lawn
- ✓ A listing with all the MLS services in the area
- ✓ An online listing
- ✓ Flashy flyers that highlight the most attractive features
- ✓ A classified ad in the local newspaper
- ✓ Word-of-mouth advertising

Sprucing up your house for a showing

For a house to sell, the buyers have to picture themselves living in it. Nobody wants to live in a cluttered pigsty, so remove any clutter, clear off the kitchen and bathroom counters, and make sure the house is impeccably clean. Remove the family photos. Hide any religious icons. Open the windows and set out a beautiful bouquet of fresh-cut flowers. And then clear out, if possible, when prospective buyers show up to tour the property. Chapter 20 features many more tips on properly staging your house for a showing.



Some clever entrepreneurs have created businesses that specialize in staging homes. They actually deliver oriental carpets, furniture, and other décor designed to transform an ordinary house into showpiece. You can even take a course in home staging!

Making the big sale

First time home buyers often are completely unaware of what they want in a house until someone tells them. As you or your agent is showing prospective buyers the house, you may need to prod them a little to convince them that your house has all the features and amenities they're looking for.

In Chapter 21, I offer several suggestions on how to spin your marketing pitch to appeal to a wider range of buyers. Then I go on to show you how to negotiate the sales price and terms and complete the necessary paperwork to seal the deal. Whether you choose to sell the property yourself or with the assistance of a real estate agent, as I recommend, this chapter can help you sell your house quickly for top dollar.