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.

REMEMBER

Throughout this chapter, I recommend a strategy that's worked for me during my over-30-year stint as a real estate professional and investor. 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 stand 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 at 20 percent 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 5 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 *dontwanners,* as in "the owners don't want 'er." 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 their owners are distressed, as well. Their dream home has become a nightmare.

When the homeowners need to shed the burden of home ownership, they may not have the time and resources to make repairs and renovations, place the home on the market, and wait for months or even a year for a buyer to make a reasonable offer. In such cases, they're often willing to sell at a greatly reduced price to a serious investor who has the financial resources to close the deal. How do you discover opportunities like this? In Part II, I point out several techniques for scoping out distressed properties and their distressed owners.

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.

Doing your homework

Flipping houses is a risky venture, but you can minimize risk and maximize profit by doing your homework:

- **Research the property.** If you're buying a property in foreclosure, probate, bankruptcy, or a similar situation, you need to research the property carefully to make sure you know what you're about to buy. Research includes a visit to the property and to the register of deeds office to research the title and other key documents. See Chapter 10 for details.
- **Estimate costs of repairs and renovations.** Knowing how much you're probably going to need to spend to make the property market-ready is key to knowing how much you can afford to pay for the property and still earn a profit. In Chapter 11, I explain how to inspect a property with an eye for repairs and renovations and estimate your rehab costs.
- **Calculate and stick to your maximum purchase price.** Before you bid on a property or make an offer, you need to know the most you can pay for the property in order to earn a 20 percent to 30 percent profit. When calculating your maximum purchase price, you need to figure in your desired profit and then subtract costs, including closing costs, renovation expenses, holding costs, agent commissions, and so forth. In Chapter 12, I walk you through the calculations.
- **Negotiate the price and terms in your favor.** At this point, you know the most you can pay for the property to earn a decent profit, but that's probably not what you *want* to pay for the property; you want to pay the least you can to get it. In Chapter 13, you discover various strategies and techniques to negotiate a better price and terms.

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 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 when you buy." 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, 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 likely to spend your lunch break at a cozy table for one. The reason for this cold shoulder from the real estate community is that way back in September 2001, the U.S. Department of Housing and Urban Development (HUD) 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 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 homes from one another, increasing the 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.

WARNING!

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.

REMEMBER

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 enables 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 20 percent 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, including the following:

- **Time and energy:** Flipping houses requires considerable time and energy for house shopping, lining up financing, scheduling and overseeing repairs and renovations, and more. If you have a day job, plan on working nights and weekends on flipping. If you already feel overwhelmed and overworked, maybe this flipping thing isn't for you.
- **Focus:** Distractions can quickly derail a flip, so you'd better be able to focus in the midst of chaos, especially if you have a full-time job, a spouse, children, and a host of other factors that complicate your days. Without focus, you won't have the attention to detail required for success.
- **Ability to follow instructions:** You don't need to know everything about flipping houses to get started, but you do need to know how to follow instructions, including the instructions I provide in this book.
- **Ability to perform basic math:** Basic math skills (addition, subtraction, multiplication, and division) are essential when you're comparing financing options and crunching numbers to gauge how much profit you can wring out of a house. If you're not good with math, you at least need to know how to use a calculator.
- **Organizational skills:** A large part of flipping houses is about organization. When you're renovating a property, you need to be able to coordinate contractors and material so the work gets done as efficiently as possible. Remember, time is money.
- **People skills:** Being able to work with people and resolve any differences is key in many aspects of flipping, including convincing people to loan you money, negotiating lower prices for property, and managing contractors and work crews. If you prefer working alone to working with others, flipping probably isn't your thing.

- **Sticktoitism:** Flipping houses involves a great deal of failure and disappointment. Those who succeed at it don't give up. If you have sticktoitism, you probably have the perseverance to overcome any limitations you have related to other items on this list.

See Chapter 2 for additional guidance in deciding whether you have what it takes to flip houses.

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 properties, or For Sale By Owner (FSBO) 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. 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 to 5 help you lay the foundation for a successful flip.

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 on holding costs by hiring a slightly more expensive contractor. Overlooking the clock is easy when you're staring at dollar signs, but in flipping, time really is 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 20 percent 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 6 for details.

2. **Zoom in on a dontwanner — 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 Chapters 7 to 9 for various ways to find distressed properties.

3. **Research the property carefully and calculate the most you can pay for it and still earn a decent 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. See Part III for more about researching and evaluating properties and calculating a maximum purchase price.

4. **Haggle with the seller to purchase the house at a price that virtually ensures that you'll profit from the flip, as I explain in Chapter 13.**

   In some cases, you won't be haggling with sellers but bidding at an auction; see Chapters 8 and 9 for details on finding and buying properties in foreclosure and other special markets.

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 or hasn't the time or money 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 repairs and renovations in order

Repairs and renovations require careful planning and execution to keep them on schedule and within budget. Before you begin, prioritize your repairs and renovations so you know what's most important; I give you all the tools and tips you need in Chapter 14. Invest your time and money in the repairs and 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 15, 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 looks disheveled, 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. It must have *curb appeal* — a fresh, well-manicured appearance that draws people into the home.

Chapter 16 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

Depending on their condition, kitchens and bathrooms sell houses or sink deals. 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.

REMEMBER

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 17 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 18 lays out your options.

TIP

According to the National Association of Realtors' 2013 Cost versus Value Report, you get the most bang for your buck on renovations by replacing the front door.

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 maybe it has a beautifully landscaped backyard that has no easy access 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 19 takes on some of these major renovations, stimulating your own creative visions.

Profiting from Your Venture

Although this book focuses on the buy-fix-sell approach to flipping houses, you can profit from a flip in numerous ways, including the following:

- Sell the property.
- Sell to an investor who's better equipped and more motivated to flip the property (you're essentially earning a finder's fee, also known as the bird-dog fee).
- Refinance to cash out the equity in the property, usually to help finance repairs and renovations or use the money for other investment properties.
- Sell the property on a lease option, essentially collecting rent with the hope that your tenants will eventually purchase the property.
- Lease the property — become a landlord!
- Sell property on a contract — you become the bank and collect the interest.

See Chapter 20 for details on the various approaches to profit from a flip. In Chapters 21 and 22, I explain how to market and sell your home for top dollar. And in Chapter 23, I explain certain tax considerations that may help you keep more of your profit, instead of turning it over to your rich Uncle Sam.

TIP

Your options for profiting from a house flip basically fall into two categories depending on your goals: cash or cash flow. In other words, do you want to receive your money all at once by selling the property or keep the property and use it to generate a steady cash flow (by leasing the property or selling it on contract, for example)?