

IN THIS CHAPTER

- » Understanding the concept of flipping houses and appreciating its challenges
- » Flipping the right way — legally and ethically
- » Developing a winning strategy and the right connections
- » Marketing and staging a house to maximize your profit

Chapter 1

Brushing Up on the Basics

Progress always involves risk. You can't steal second base and keep your foot on first.

—FRED WILCOX

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, though, 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 also 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.

Grasping the Concept of Flipping

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 substantially below market value, repair and renovate the property, and then turn around and sell it at market value — for a profit that makes it worth your time and effort. That three-step process — buy, fix, sell — certainly sounds easy enough, but each step carries with it a host of unique challenges, as I point out in the following sections.

Spotting distressed properties

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 false eyelashes the morning after a party, the paint is peeling, and the interior is 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 homeowners need to shed the burden of a home they can no longer afford or simply no longer want, they may not have the time or resources to repair and renovate it, place it 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 buyer who has the financial resources to close the deal. How do you discover opportunities like this? In Part 2, I point out several techniques for discovering distressed properties and their distressed owners.

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, research the property carefully to make sure you know what you're buying. Research includes a visit to the property and to the register of deeds office to research the title and other key documents. See Chapter 9 for details.
- » **Estimate costs of repairs and renovations.** Knowing how much you likely need to spend to make the property market-ready is the key to knowing how much you can afford to pay for the property and still earn a profit. In Chapter 10, I explain how to inspect a property with an eye for repairs and renovations and estimate the rehab costs.

- » **Calculate the maximum purchase price.** Before you make an offer on a property, you need to calculate the most you can pay for it to earn the desired profit *after* costs, including closing costs, renovation expenses, *holding costs* (interest, insurance, property taxes, utilities, and maintenance), and agent commissions. In Chapter 11, I walk you through the calculations.
- » **Negotiate the price and terms in your favor.** The maximum amount you can afford to pay for a property probably isn't the amount you *want* to pay — you want to pay as little as possible. In Chapter 12, I help 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, a fresh coat of paint (inside and out), and new carpeting do 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* and *smell* brand-new again.

Not all homes are created equal. Other houses require more extensive renovations. You may be able to convert 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 new windows; or even build a second story. In today's technology-centric world, you can measure the house and build a 3D rendering of your property on a computer. Some companies, like landscapers or cabinet wholesalers, are also willing to help you maximize your home's square footage by plugging measurements into a system that generates multiple floor plan options that make the best use of your space. In Part 4, I explain how to assemble and manage a rehab team to do everything from quick-flip cosmetic jobs to extensive renovations and provide plenty of tips to stay on budget.



WARNING

Avoid the temptation to over-improve a property. You may be able to convert a \$100,000 house into a \$1 million mansion, but a buyer who wants a \$1 million mansion will buy a house in a neighborhood with million-dollar homes.

Reselling your rehabbed property

“You make your money when you buy” is a guiding principle in the realm of real estate investing. But you realize your profit only after selling the house. Assuming that you purchase the property at the right price, avoid overspending on repairs and renovations, and flip in a relatively stable market, you should have no trouble selling the house at a profit by pricing it at or near market value. (See Part 5 for details.)



TIP

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 the asking price is too high, *holding costs* will chip away at your profit over time.

Flipping Legally and Ethically

In September 2001, the US Department of Housing and Urban Development (HUD) released FR (Final Rule)-4615 Prohibition of Property Flipping, which made “flip-ping” illegal.

So why am I writing a book that promotes this illegal activity? Because I'm writing about *legal* flipping, not *illegal* flipping. The word *flip* has a double meaning, as the following sections reveal.

Flipping illegally

Criminal minds have invented countless ways to milk 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 team 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 via 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 homeownership. It's unethical, immoral, and illegal. And it's not what this book is about.

Flipping legally: Buy, fix, 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. Dotting your *i*'s and crossing your *t*'s will put you on the right path.

Determining Whether You Have What It Takes to Flip

Although anyone can profit from flipping houses, it's not quite as easy as it looks on HGTV. Buying a house that's brimming with profit potential for far 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. The 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.



REMEMBER

To successfully deal with the unexpected twists and turns you're sure to encounter, you need to have the right stuff, including being able to

- » **Carve out extra time and motivate yourself:** Flipping houses requires considerable time and energy for house shopping, lining up financing, scheduling and overseeing repairs and renovations, and more. If you already feel overwhelmed and overworked, maybe this flipping thing isn't for you.
- » **Focus in the midst of chaos:** 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, or other interests. Without focus, you won't have the attention to detail required for success.
- » **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 those I provide in this book.

HOW BAD CAN A HOUSE-FLIP BE?

We (Ralph Roberts and company) discovered a fantastic foreclosure property — a \$2 million beauty we could get for a cool \$900,000! Although the owners, whom we refer to as Mr. and Mrs. Rose, were divorcing, they seemed willing to work with us at first. They even persuaded us to let them stay in the house while we were rehabbing it. Letting people stay in the house is always a bad idea. We agreed to this request to seal the deal, but when you're flipping a house, you want to close on it only when it's vacant and broom-clean (free of debris, dirt, and rubbish) — and, in the case of foreclosures, the redemption period has expired. (See Chapter 7 for more about redemption.) Mr. Rose lived in one half of the house; the missus, in the other half.

As soon as the contractors showed up, the couple's version of *The War of the Roses* commenced. Mrs. Rose declared certain areas of the house to be no-work zones, and these zones changed daily. She tried to seduce the contractors, and when real estate agents arrived to show the house, she called the police. During the rehab, the Roses' son was caught doing drugs in the house.

Mrs. Rose moved out, only to be replaced by Mr. Rose's girlfriend. When the contractors returned to work, they found the girlfriend at the top of the stairs, dressed only in her nightie, drunk and in a jealous rage. She proceeded to fall down the stairs, shedding her wig along the way. By the time the Roses cleared out, the place was trashed.

We finally managed to take possession of the house, complete the rehab, and place the property back on the market. We were willing to sell for \$1.8 million, and when we received our first offer for \$2.2 million, we were ecstatic — though we weren't out of the rose bushes yet.

During negotiations, we found out that the instrument the buyer was using to pay for the property qualified as an illegal use of Treasury bonds. We informed the FBI, which set up a sting operation to nab the bad guys. The fraudsters showed up three hours early, discovered the sting, and split town.

We eventually sold the house for \$2 million and netted a \$250,000 profit — not bad for a year's effort, but not the quick and easy money we had expected.

- » **Crunch numbers:** Basic math skills 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 that calculator app on your smartphone.
- » **Organize, schedule, and oversee:** When you're renovating a property, you need to be able to coordinate contractors and material so that the work gets done as efficiently as possible. Remember: Time is money.
- » **Deal with different personality types:** Being able to work with people and resolve any differences is the key to many aspects of flipping, including persuading people to loan you money, negotiating lower prices for property, and managing contractors and work crews.
- » **Persist in the face of adversity:** Unless you're really good at flipping houses *and* really lucky, you're going to experience failure and disappointment. Those who succeed persist in the face of such adversity. They don't give up.



TIP

In addition to these fundamental traits, genuine enthusiasm and joy can significantly drive your success — being a curious, friendly face is encouraging to both sellers and buyers and can help you secure a fair deal. When you're dealing with sellers, especially, it can make them more open, enabling you to find out more about a property before you make an offer.

Devising a Reliable Flipping Strategy

No two flippers have the same strategy. Some choose to live in the house they flip, and others find that strategy to be too stressful. Some flip the house they live in every two or three years to take advantage of a lucrative federal tax exclusion (see Chapter 23), and others flip a house once every month or two for quick profits. Many investors focus on a niche market, such as foreclosure properties, HUD properties, or For Sale By Owner (FSBO) homes.



REMEMBER

The strategy you ultimately settle on is yours to invent. What's important is that you have a strategy and the system and resources ready to execute it. Before your first flip, you should have these essentials in place:

- » Cash or financing to not only purchase the house but also cover holding costs and the cost of repairs and renovations (see Chapter 4 for more about financing your flips)
- » 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 can begin working on the property immediately
- » A date on which you plan to put the house back on the market

Plan your flip at least as carefully as you would plan a two-week vacation. Other chapters in this part can help you lay the foundation for a successful flip.

Building an All-Star Team

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 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
- » Contractor

In Chapter 3, I describe the role that each of these valuable individuals plays on your team, and I provide some criteria for selecting the best of the bunch. I also devote an entire chapter (Chapter 13) to building and managing a rehab team.



TIP

Hiring professionals may increase your costs but can save you a considerable amount of money in terms of time, doing the job properly, and avoiding costly mistakes. Just be sure to calculate the cost of those professionals into your investment when determining how much to pay for the property.

Finding and Buying a Flippable House



REMEMBER

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 with substantial profit potential 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.**

See Chapter 5 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 6, 7, and 8 for various ways to find distressed properties. (Landscape maintenance is typically a good, early indication of a distressed property.)

3. **Research the property carefully and then calculate the most you can pay for it and still earn a decent profit.**

You should be fairly certain that you'll earn at least 20 percent for your trouble. See Part 3 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 you'll profit from the flip, as I explain in Chapter 12.**

In some cases, you won't haggle with sellers but bid at an auction instead; see Chapters 7 and 8 for details on finding and buying properties in foreclosure and other special markets.

Rehabbing Your Fixer-Upper

Buying a house to flip is like buying a beat-up antique at a garage sale: You got the house for a bargain because it needs work that the seller hasn't the time, money, or desire to take on. By cleaning up the joint, fixing whatever is broken, and making 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 repairs and renovations you can make.

Planning repairs and renovations

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 that 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.



TIP

Schedule the work so that it proceeds logically. If you install new tile or carpeting or refinish the floors before painting the walls and ceiling, you risk ruining the new tile, carpeting, or flooring. 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, starting with the roof and finishing with the floors. Likewise, depending on the location, you may need to schedule curb appeal renovations in the spring, summer, or fall — such as new landscaping or siding or a new roof.

Applying makeup

The ideal house for a first-time flipper is one that requires only cosmetic work — what I call *makeup*. Cosmetic work, covered in Chapter 15, includes the following low-cost repairs and renovations:

- »» A fresh coat of paint throughout the house, including base trim
- »» New siding, fresh paint, gutter replacements, and other external tweaks
- »» 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, and trimming trees and shrubs



REMEMBER

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 it's unkempt and not drawing any buyers to look at it. For example, a do-it-yourself paint job on older kitchen cabinets can add that extra punch to your property without sinking any additional cost into your kitchen.

Making a good first impression

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 drive off before you have time to open the front door. To sell your house for top dollar, it 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 have the ability to 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 an inviting 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 always pay for themselves by adding real value to the property and making it more attractive to buyers. In fact, according to the National Association of Realtors' 2019 Cost Versus Value Report, Realtors rank a kitchen remodel as the top renovation that appeals to potential 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.

Tackling structural enhancements

Some houses are begging for a few major overhauls. Maybe the house has an unfinished attic that's perfect for an additional bedroom or 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, which may inspire 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 these strategies:

- » 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 to use the money for other investment properties.
- » Sell the property on a lease option (rent-to-own), essentially collecting rent with the hope that your tenants will eventually purchase the property.
- » Lease the property — become a landlord.
- » Sell the property on a contract, acting as a bank and collecting 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 by paying less of it to your rich Uncle Sam.



REMEMBER

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 do you want to keep the property and use it to generate a steady cash flow (by leasing the property or selling it on contract, for example)?