

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 persistence 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, we offer a broad overview of what flipping houses is all about. We introduce the overall strategy of flipping houses: buy low, renovate, and sell a property at fair market value to earn a fair market profit. We 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 we 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, we point out several techniques for locating distressed properties and motivated 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 through the courts or some other unconventional avenue, research the property carefully to make sure you know what you're buying. Research includes visiting the property, reviewing the title deed, and checking out other key documents.
- » **Estimate costs of repairs and renovations.** Knowing how much you likely 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 9, we explain how to inspect a property with an eye for repairs and renovations and estimate the renovation 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 10, we walk you through the calculations.
- » **Negotiate the price and terms in your favour.** 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 11, we 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. Some 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, we 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 neighbourhood with million-dollar homes.

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

Flipping Legally and Ethically

Flipping has earned a bad name for itself in recent years, thanks to a growing shortage of affordable housing. Housing that used to be affordable no longer is, thanks to a host of factors. But politicians and housing advocates have been quick to point the finger at speculators. This has resulted in numerous laws aimed at limiting the misunderstood practice of flipping.

Also bear in mind that any business activity that turns a quick profit is likely going to attract the scrutiny of Canada Revenue Agency (CRA), so be sure to check with your accountant so that you know the rules about investing in real estate generally — and flipping especially — so that you are never offside.

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 the final buyer delivers the payoff to the previous owners. This kind of scheme is relatively rare in Canada, but it's not unknown. In fact, it led to calls for greater transparency around property ownership and tighter regulation of the real estate sector.



WARNING

The dark side of flipping undermines neighbourhoods and helps put home ownership beyond the reach of people who legitimately want a home where they can live, raise a family, and feel secure. 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 neighbourhoods, and provides quality housing for those who need it. It's entrepreneurial and community minded.



REMEMBER

Throughout this book, we encourage you to flip the right way and avoid the grey 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 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 condo board, neighbourhood association, or municipality rejects every single one of your planned improvements, forcing you to rejig your planned improvements and hold the property for longer than you intended.



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 provided in this book.
- » **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; others find living in the work zone 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 22), and others flip a house once every month or two for quick profits. Many investors focus on a niche market, such as court-ordered sales 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, undertaking cosmetic improvements, 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 (Part 1) 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, we describe the role that each of these valuable individuals plays on your team and also provide some criteria for selecting the best of the bunch. We also devote an entire chapter (Chapter 12) 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. A standard rule of thumb for investors is to buy the worst house on the best street; buy a lousy house in a lousy neighbourhood 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 neighbourhood — often an area with homes that are at least 20 years old.**
See Chapter 5 for details.
- 2. Zoom in on a dontwanner — a 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. (Shoddy or non-existent 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 we explain in Chapter 11.**
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.

Renovating 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, we 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; we give you all the tools and tips you need in Chapter 13. 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, siding, or a new roof.

Applying makeup

The ideal house for a first-time flipper is one that requires only cosmetic work. Cosmetic work, covered in Chapter 14, 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 that applies contemporary colours to dated kitchen cabinets can add that extra punch to a property at minimal cost.

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 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

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. According to the Appraisal Institute of Canada, kitchen and bathroom renovations deliver top value if you're looking at your home's value. A survey by real estate brokerage Re/Max Canada in 2021 found that homeowners reported a 75 percent to 100 percent return on kitchen renos, and an average 62 percent return on bathroom renos. 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.

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 it has a beautifully landscaped backyard with 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 18 takes on some of these major renovations, which may inspire your own creative visions.

Choosing an Ownership Structure

Given the greater attention flipping has received from regulators, including the Canada Revenue Agency, you need to give greater thought to how you're going to own the properties you're planning to flip. A great deal will depend on the number (and frequency) of flips you plan to do. If you're buying the occasional property and intend to use it as your principal residence for a couple of years prior to selling, then you can own it as you would any other home. But if your plans call for a faster turnaround time or envision the development of a small portfolio of rental properties, then you may want to consider setting up a company for buying and selling your properties. (This will also clarify the fact that your flips are a business venture, and subject to the business tax rate.)

The following sections discuss your main ownership alternatives for your real estate holdings, including sole proprietorship, joint ownership, a partnership, and a corporation.



REMEMBER

Regardless of the ownership structure you choose, if you're doing business with other people, be sure to have a written agreement among the partners or shareholders that outlines their interests and responsibilities in the business. This helps avoid legal disputes and may defuse arguments arising from

misunderstandings regarding each person's role or entitlements — especially if family is involved. An accountant and lawyer can advise you regarding the specific structuring of the agreement.

Sole proprietorship

A *sole proprietorship* is the simplest form of ownership and the de facto ownership structure when you hold and operate property under your own name rather than through a partnership or corporation. Your personal income and income from your real estate investments will flow together for tax purposes, meaning you could end up paying a lot more money in tax because you're taxed on the marginal tax rate for your personal income. In some provinces, the marginal tax rate at writing was approaching 55 per cent.

While the sole proprietorship is the simplest of structures, it also exposes you to greater personal liability in the event something goes wrong. You not only have direct control over your dealings, but you also have full liability for debts and damages associated with the properties.



TIP

Sole proprietors should always maintain a separate bank account for their business dealings. This will clarify cash flows for yourself, your accountant, and the Canada Revenue Agency in the event its auditors decide to investigate you.



WARNING

A separate bank account won't be protected from claims during divorce proceedings. Developing a real estate portfolio while married or in a common-law relationship makes joint ownership, a partnership, or incorporation attractive options.

Joint ownership

When more than one person owns a property, a sole proprietorship is (by definition) impossible, and joint ownership occurs. Similar to a sole proprietorship, joint ownership allows direct ownership and exposes the owners to full liability for the property owned.

Two forms of joint ownership exist:

- » **Joint tenancy** gives each owner an equal share in the property with all other owners, who are listed on the title of the property equally. The main feature of a joint tenancy is the right of survivorship. This means that if one

of the joint tenants (owners) dies, the surviving owners each receive an equal portion of the deceased person's share. Joint tenancies are common arrangements between couples, but other parties, such as children, may also be included.

- » **Tenancy in common** allows owners to hold equal or unequal shares in the property. Tenants in common may sell, mortgage, or will their interest in the property. This is a good option when the partners want joint ownership but aren't investing equal amounts of cash or want to preserve their specific interests.



Death is not the only way joint ownership can end. Separation and divorce can also create the conditions for a disorderly end to the business relationship. In order to protect themselves, the partners should have an agreement in writing regarding the disposition of assets in the event the partnership ends. Consult a lawyer to ensure you have an agreement in place that protects your interests.

Partnership

A *partnership* is a proprietorship with two or more owners. Unlike joint ownership, the partnership — rather than the partners — holds the property and must file a tax return just like an individual. However, any taxes owed are paid by the partners based on their respective shares. Similar to a sole proprietorship, each partner is personally liable for the full amount of the business's debts and liabilities.

Partnerships take various forms in Canada, with specific rules governing each. Joint ventures are the most common form of partnership, allowing both individuals and corporations to join forces to undertake projects, including real estate investment.

A joint venture typically takes two forms:

- » **General partnership:** A joint venture best set up when just a few parties are involved, a general partnership leaves all partners exposed to claims against the partnership, legal and financial, even if the claims are against just one partner.
- » **Limited partnership:** Your interest in the partnership is in proportion to your investment and is represented by units that can be sold to other investors. A general partner oversees the partnership, with individual investors operating under its aegis. It's particularly suited to large, ongoing ventures.

Corporation (limited company)

A *corporation* is a business that operates as a legal entity separate from its owner or owners and therefore offers the greatest protection to its owners. Corporations are registered in a provincial or federal registry and must file annual reports, submit tax returns, and pay taxes.

Corporations may have one or more shareholders, who typically enter a shareholders' agreement setting forth the conditions of their involvement. Shareholders aren't personally liable for the company's debts unless they've signed a personal guarantee. A board of elected directors manages the corporation on a day-to-day basis. A company with a single shareholder often has just one director, but the shareholder is not personally liable for the corporation's debts and obligations.

Corporations are a convenient means for groups of two or more people to hold their investments. Partners hold shares in the corporation that can be bought, sold, or transferred, which provides a possible exit if you want (or need) to leave the partnership.

A corporate structure also has many tax benefits. In the case of a venture engaged in buying, renovating, and selling real estate, it clarifies that any income from your investments will be subject to corporate tax rates. However, the company will also enjoy a reduced tax rate up to approximately \$500,000 in taxable income if the corporation has no more than three employees and other criteria are met; the regular tax rate applies after that. The individual owners, unlike in other structures, don't pay any personal income tax until the company pays them (either a salary, bonus, or dividend). Your accountant can spell out the potential benefits for your specific situation.



TIP

Regardless of the type of ownership structure you establish for your portfolio, if you're offering services subject to the GST (or in many provinces, the HST) be sure to have a business number. Doing so will allow you to set some of the taxes you're paying against the taxes you're collecting. Any of the structures we discuss are eligible for a business number and can register to collect GST/HST. Services subject to GST/HST include parking fees, amenity fees, and land sales.

Profiting from Your Venture

This book focuses on the buy-fix-sell approach to flipping houses, but you can profit from a flip in numerous ways, including these strategies:

- »» Sell the property quickly, if the market is appreciating rapidly.
- »» Sell to an investor who's better equipped and more motivated to flip the property (you're essentially earning a finder's 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 under a rent-to-own arrangement, collecting rent from tenants who have an option to eventually purchase the property.
- »» Rent the property to long-term tenants, becoming a landlord and owner of an income-producing portfolio.

See Chapter 19 for details on the various approaches to profit from a flip. In Chapters 20 and 21, we explain how to market and sell your home for top dollar. And in Chapter 22, we explain the tax considerations you need to know in order to maximize your profit and reduce what you pay the Canada Revenue Agency (CRA).



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)?

