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How to Generate Fast Cash in Real Estate

Wholesale Housings for a Generous Part or Full Time Income

By William Bronchick, ESQ.

ABOUT THE AUTHOR

William Bronchick is a natonally-known attorney, author, entrepreneur and speaker. Mr. Bronchick has been practicing law and investing in real estate since the early 90′s, having been involved thousands of real estate transactions. He has trained countless people all over the Country to become financially successful, speaking to audiences of as many as 16,000 at mega-events, sharing the stage with names like Rudy Guliani, Steve Forbes, and Colin Powell.

His best-selling book, "Flipping Properties,' was named one of the ten best real estate books of the year by the Chicago Tribune.

William Bronchick is also the author of the highly acclaimed books, "Financing Secrets of a Millionaire Real Estate Investor","Wealth Protection Secrets of a Millionaire Real Estate Investor", "Defensive Real Estate Investing" and his latest work, "How to Sell a House Fast in a Slow Real Estate Market".

William Bronchick is the co-founder and President of the Colorado Association of Real Estate Investors and the Executive Director of the College of American Real Estate Investors. He is admitted to practice law before the bars of New York and Colorado and is a member of the Colorado and American Bar Associations. He is also a licensed real estate broker in Colorado.

Introduction

Wholesaling, flipping, quick turning — whatever name you call it, this type of real estate investing is attractive to novice and experienced real estate investors alike. Whether you are just getting started or have a few deals under your belt, are looking for cash flow, security or long-term wealth, I can help you reach your financial goals.

But how, and more importantly, where do you get started? If your real estate investing experience extends to your personal residence, your mind may be brimming with unanswered questions about every aspect of wholesaling — from locating the deals to negotiating the terms to selling the contract. Where can you find answers to these ever-important questions that will take you from an interested observed to an active and successful investor? This book, of course!

This book is arranged in 15 chapters to answer your wholesaling questions in logical progression. You'll learn step by step how to generate cash by finding, buying and quickly reselling (flipping) properties. You can read it straight through, cover to cover, or jump around to get the answers to the questions that are at the forefront of your mind. Let this book be your guide as you navigate the always exciting, but sometimes intimidating, world of wholesaling real estate.

The principles in this book work. They work all the time and in every market. The variable, in most cases and with most deals, is you. If you've done your homework, built your buyer's list, found a truly motivated seller, and priced the property right, wholesaling can be the start of a whole new career for you and the source of profits and personal satisfaction.

Perhaps the most important question you'll be able to answer yourself after reading this book is how you'll spend your newfound profits. Whether you want to pay off a mountain of debt, fund a dream vacation or even replace your present 9-to-5, go-nowhere career, this book will help you earn the cash you need to accomplish your goals.

Chapter 1: Why Wholesaling?

The lure of real estate investing has always been seductive, but never more so than right now. The proliferation of real estate television shows (*Flip this House*, *Get it Sold*, and others of their ilk) has captured the imaginations of the American public. Couple this with the current market of bargains galore and you have an entire segment of the population salivating to "get in the game."

What tempers that rabid enthusiasm for *traditional* real estate investing is usually a heaping helping of reality. The realization of what's needed besides excitement and drive — cash and credit, to name just a couple of things — is a sobering thought.

However, traditional real estate investing is not the only way to participate in the real estate industry. Sure, "buy and hold" is a great strategy, but most certainly not the only path to profits.

A more important question for novice real estate investors is not "Can I get in the game?" but "How can I get in the game?" There's more than one way to skin a cat and there's more than one way for you to invest in real estate.

To see which method might be right for you, let's take a look at some investing approaches. Remember, this is not an "either-or" scenario. You may want to start down one path and then add another as your skills, resources, and knowledge increase.

What Are the Principles of "Buy and Hold?"

Buy and hold is what most people think of when they think of real estate investing. That's the traditional approach to real estate. You invest money into a property, keep it maintained and rented, and then sit back and wait. If you bought well, the rent more than covers the debt service. You have positive cash flow and appreciation. Then, 30 years later, the mortgage is paid off and your rental house investment will fund your golden years.

Why is this a good strategy? Historically, property values in the United States have appreciated at a rate greater than inflation. If you buy in the right neighborhoods, your annual appreciation may reach double digits. You can use properties with equity as collateral. You can provide rental income for your retirement years, and you can pass property down to the next generation. Once your properties are owned free and clear, you have passive income that pays you even when you are not working.

All in all, buy and hold is a good approach. It usually works and many people have become wealthy following this path. Rental properties continue to be an excellent vehicle for creating long-term wealth and income for retirement. However, as mentioned previously, acquiring and managing rental properties requires cash for down payments, credit to obtain financing, and time to deal with tenants.

However, buy and hold is not without its drawbacks. The main disadvantage is that your assets are not liquid. Unlike stocks or bonds, real estate is not easily converted to cash. When selling real estate, you have to locate a buyer, then pay closing costs, title insurance, real estate commissions, and possibly a local property transfer tax.

If you must sell when the market is down, you will not get the best price. If you have a tenant in your property under a lease, you cannot simply kick the tenant out. You have to wait until the lease expires, pay the tenant to leave early, or hope to find a buyer who doesn't mind having someone living in the property. And, of course, the future is always uncertain. While real estate may have appreciated in a particular area an average of 10 percent over the last 20 years, it may not do so in the future.

If you hold properties, you also risk running into negative cash flow. There may be times when your properties are vacant or need repairs, and you have to dip into savings to feed the proverbial "alligator."

If you are a beginner, you may want to get some experience and working capital before venturing into buying and holding rentals.

What Is Speculating?

Speculators are the gamblers of the real estate investing industry. They buy property or invest in development projects they expect will go up in value, creating a good return on the capital invested. The increased value depends largely on factors outside their control, such as rezoning, surrounding developments, and market inflation. Although many people have made millions of dollars on real estate speculations, just as many have gone bankrupt. You can see how speculating is a roll of the dice and not the best path for inexperienced investors.

What Is the "Nothing Down" Approach?

Anyone who has had a sleepless night or two in the past decade has probably seen the late night television gurus espousing a "nothing down" philosophy. These smiling salesmen trot out successful students to provide anecdotes attesting to the veracity of their "nothing down" investing principles.

The people who invest with nothing down usually do so because they have nothing to put down. That means most of the funds for the acquisition price are borrowed. Highly leveraged real estate purchases can often lead to negative cash flow when vacancies arise or when repairs or even routine maintenance is required. These people have no cash reserves when the going gets tough and may lose their properties during difficult times.

That doesn't mean you can't buy properties with nothing down. Just be wary of exaggerated claims that real estate investing is a fast or easy way to get rich. In real estate, a general rule is you can get a good price or good terms, but usually not both.

When it comes to investing, you can always try different approaches, but in general, real estate is like any other business, not a get-rich-quick scheme. It takes time, knowledge and hard work to accumulate wealth. In fact, most start-up companies actually lose money their first year or two. The companies that survive past the first few years, however, often become profitable and continue to grow. While you may make money right away in your real estate business, you may not see a substantial profit for several years.

If you are going to treat real estate investing like a business (something we heartily recommend), pay attention to basic business principles. Watch your cash flow. Generate working capital before you buy properties that are keepers. While a comfortable retirement is a worthy goal for all real estate investors, we all have to pay bur bills along the way; equity will not feed you and your family. A sound businessperson focuses first on generating cash flow, then on growing the business. The real estate business is no exception.

What About Wholesaling?

I'm glad you asked! Obviously, we feel wholesaling — quick turning or flipping properties rather than holding long-term — is a viable and profitable real estate investing strategy. After all, we dedicated this entire book to the practice.

The main advantage of wholesaling is that you get your cash out now rather than later. For many people, the certainty of getting a paycheck right away is highly appealing. Wholesaling takes the real estate market out of the equation; if you buy a property correctly, the market is almost irrelevant except concerning how long it will take to resell the property. Of course, if you buy cheap in a soft market, you can afford to hold a property six months instead of two.

Wholesaling is generally good for your cash flow, which is important in any business. However, if you purchase houses and acquire too much equity and not enough cash, you may get into a cash crunch if you don't have additional income.

Don't forget that you can wholesale houses as a part-time or full- time business. You can do as much or as little as you want and can take a break from your flipping business when you desire. In short, once you empty your inventory, you are not tied to your business. You can take long vacations or pick up and move to another city and start over.

Now for the "flip" side (if you'll forgive the pun). The primary disadvantage of wholesaling properties is that it is "hands-on" income. Once you stop wholesaling, you stop making money. If you are young and like to work for a few months, then take a few months off, that's fine. But at some point, you will realize that, if you keep spending the profits, you don't accumulate wealth.

Also, wholesalers lose the benefit of market appreciation. While gauging the market is a risky venture, a good market timer can gain wealth quickly with little effort by buying properties at the right time in emerging markets. We have seen many investors get rich simply by being at the right place at the right time. On the other hand, if you buy a property in the wrong place at the wrong time - particularly for the wrong price - you can end up with a property you cannot get rid of quickly enough. You could also get in over your head in a rehab project and have to bail, losing tens of thousand of dollars.

In some cases, holding property will generate more long-term wealth for you than wholesaling. Therefore, you may consider wholesaling some properties and holding others. Or you may consider wholesaling for a while, then begin holding properties later. The nicest thing is that as a smart and educated real estate investor you have options. How great is that?

To determine whether wholesaling or holding is better for you, ask yourself these questions.

- Do I need additional income now or in the future?
- Am I in a high income tax bracket and so would be adversely affected by earning more income now?
- Does my local real estate market present opportunities to acquire bargains, while still commanding high rents that would cover my expenses if I needed to hold onto the property?
- Do I have other income or savings that I could tap into in case my rental properties become vacant or need repairs?
- Do I have the time and patience to deal with tenants?
- Is the local real estate market rising or falling at this time?

Most investors start out wholesaling houses, then gradually work into managing rental houses or becoming involved in larger, more complex real estate projects. Some people don’t have the temperament to deal with tenants and the headaches that come with rental properties. Some look for side income by flipping. Others want to quit their jobs and make flipping houses their full-time business.

Consider all options, including a mixture of flipping and holding properties. Be sure to reevaluate your financial goals on a regular basis and adjust your real estate strategies to support your goals. If you need help, a coach can provide invaluable assistance in defining your approach and executing your strategy. Visit realestateinvestortraining.com for more information.

Chapter 2: Will Wholesaling Work in Your Market?

The title of this chapter represents a question we hear often. So often, in fact, that if we had a dollar for every time a nervous novice investor uttered these words, it might replace income from wholesaling itself.

People are constantly looking for reasons why something won't work, and when it comes to why this wholesaling approach won't work, *their* market seems to be an ideal whipping boy.

Well, we have news for them and for you. Wholesaling — buying low and selling high — works. It works in our market, your market, every market. However, you need to learn your market and adapt the techniques in this book that it requires.

There are many ways to describe real estate markets, including "hot" versus "flat" or "rising" versus "falling" or "buyer's" versus "seller's." Remember, to survive and profit as a flipper, you must buy at an appropriate discount, allowing you to sell the property for a profit. Real estate markets are subject to fluctuations, but these fluctuations typically do not greatly influence the ability for the informed wholesaler to make a profit.

In fact, wholesaling can be the least risky way for a beginning investor to make a profit in an uncertain market simply because of the relatively short amount of time he or she will own the property. Unlike the stock and commodities markets, real estate markets don't rise and fall rapidly.

Is there an Ideal Market for Wholesaling?

In a word — no. That being said, you may find it more difficult to locate bargains in rising markets. That's because if the market keeps rising, the probability of selling the property quickly for a large profit increases. In contrast, when property values are falling, more so-called bargains become available. Yet you need to assess the true value of these properties based on when you expect to sell the property. Thus, your purchase must be made at a steep discount to allow for a profitable sale later, whether that eventual sale occurs days, weeks or months later.

Some basic strategies can be used successfully in virtually all market conditions. Most of the following discussion is based on selling properties to owner-occupants, although similar rules apply to wholesaling properties to other investors.

Become educated in your local market first by understanding the large-scale trends— from global down to national, regional, and specific neighborhoods. Learn about target neighborhoods, enlisting the aid of successful real estate professionals along the way. These professionals will help interpret market indicators, such as the average length of time houses are sitting on the market this month versus last month or last year. Armed with this type of information, you will be able to make good decisions.

How Do Rising Markets Impact Wholesaling?

Many would-be wholesalers complain about the high-priced, limited-supply markets that typically favor sellers. The white-hot real estate boom of a few years ago created rising markets in many parts of the country. Some markets are still relatively vibrant today.

These markets can provide certain challenges to acquire properties at below-market prices. However, once a property is secured at an attractive price, you have a great chance of success to sell it at a healthy profit. Even if it takes a relatively long time to renovate and sell a property, you have the advantage of being able to ask a higher price in a rising market.

What Does "Inventory" Mean When Talking About Markets?

Inventory, defined as the number of properties offered for sale, is a good indicator of current market trends. If inventory is low because of building restrictions or geography, then high demand will lead to rising prices. In rising markets, sellers often capitalize on the excitement of new listings to get properties under contract quickly, at premium asking prices.

There are also seasonal fluctuations in inventory, such as fewer listed properties in the winter months than in summer and a surge of listings in the spring. Some areas, such as resort destinations, follow seasonal trends. Generally, seasonal drops in inventory reflect the trend to market properties more aggressively in spring and summer months when real estate markets are more active. Properties sell year-round, though investors should plan to reduce the price for winter listings or at least know that properties take longer to sell during those months.

How Do Falling Markets Impact Wholesaling?

Often, property values are flat or falling in a particular area. This type of market offers great opportunity to the savvy investor. When property values are falling, inventory often rises, and many sellers become highly motivated when their properties *fail* to sell quickly. Motivated sellers will do whatever it takes to sell their property. Whether sellers need to move from the area, are struggling financially or have other pressing reasons to sell, they may well accept a below-market offer.

Investors know that a weak market can offer extraordinary deals, though wholesalers need to proceed with caution. In a falling market, even a few months' delay can turn a sound deal into a headache. It always pays to know the market and purchase the property at a price low enough to net an eventual profit, even if the market continues to fall. The common myth is that you cannot make money by flipping properties in a bad real estate market. In a bad real estate market, you can often buy "junker" properties for 50 cents on the dollar and sell them for 60 cents. It's all in how you do the math.

It is also worth noting that markets can and will change. If the market rebounds after a purchase, then all is well for the investor. However, if the market takes a downturn after a purchase, there can be trouble ahead. Markets commonly show signs of slowing or turning over several months. Sometimes the early signs come from national economic trends, such as rapidly rising interest rates or sweeping changes in tax policies that affect homeownership or investment (e.g., the rapid change in depreciation rules for real estate investors in the late 1980s). More likely, clues come from local market conditions, such as unemployment, oversupply, or a change in demand because of living conditions.

Sellers often choose not to believe the market is changing, making it difficult to convince them to accept a low offer. In these cases, it is best to move on to the next deal, even if it means fewer purchases for a few months. It is also worthwhile to follow up with sellers who weren't highly motivated. Sellers' attitudes and situations can change over several weeks or months of trying unsuccessfully to sell their properties. Eventually, reality may set in and these sellers will be forced to discount their prices.

When it comes time to market a property in a weak market, yours will need to stand out in its price range. The property can still sell quickly, but buyers have a larger selection of homes to choose from, so you need to do several things to assure success. First, your budget must allow for a longer time to sell. Second, the finished product must be better than the other listings being offered, both in appearance and price. Third, you must have a good marketing plan, ideally with multiple exit strategies.

Most likely, the property will sell quickly if it fits this description. However, if it does not sell, then the low purchase price allows room in the budget to carry the property for a longer period of time. Ideally, if it simply did not sell and is not showing signs that it will sell anytime soon, you would have the option of holding the property as a rental. That is a better option then being forced to "give it away." In many cases, if you cannot sell the property in a few months, you can hold it and rent it for several years, then sell it at a profit.

What Does the Term "Balanced Market" Mean?

Real estate markets are usually closer to being balanced than they are to being at either extreme. In a balanced market, prices are rising at or just above the pace of national inflation. Houses within the median price range for the metropolitan area will sell, on average, within 60 days. While markets are constantly changing due to circumstances beyond anyone's control, an equalizing effect exists in a free market economy. Often, a market will exhibit some tendencies of each of the balanced, falling, or rising classifications. And within a particular market, houses will be selling better or worse in some pockets than in the metropolitan area as a whole.

There is profit to be made in a balanced market, following the buy-low/sell-high premise. Remember, as soon as you have the market figured out, it will change. Experienced investors may have an advantage in seeing trends, but no one can foretell the future, and short turnaround deals usually involve the lowest amount of risk.

Chapter 3: Where Do You Fit in the Wholesaling World?

When you become a wholesaler, you get a property under contract with the intent to sell quickly for a profit. Usually, that means finding an investor-buyer and flipping the property to him. However, this tends to be an oversimplification of the wholesaling concept. There are actually three distinct roles you can play in any flipping transaction. Which you choose at any given time or with any given deal may have to do with your individual preference, time availability, or personal skill set.

The three roles are scout, dealer, and retailer. All are components of the wholesaler role. As a wholesaler, you'll accomplish the same basic task that real estate agents accomplish. You'll buy properties at substantially less than the going or retail rate. In doing so, you act as both principal and middleman, buying at one price and reselling at a higher price.

If a deal is marginal (with not much profit in it) and you add no value to the property, your profit is commensurate with that of a real estate agent. Unlike an agent, however, you may have only a few hours of time tied up in the deal. Furthermore, your upside profit potential is much higher than an agent's commission, because an occasional bargain purchase can bring a tremendous return.

You don't need a license to wholesale nor must you work under the watchful eye of a government agency. Advantages to being a wholesaler vs. a real estate agent include low overhead and the ability to work flexible hours.

Within your wholesaling endeavors, you may want to work as a scout, a dealer or a retailer. Or, depending on the deal, you may want to act as a dealer on some transactions and a retailer on others. It's up to your personal tastes.

Let's look at each of these roles in detail. As we do, think about the one you think you would be most comfortable assuming.

Scouts: Scouts are information gatherers. They find potential deals and sell the information to other investors, much like a bird dog that brings ducks back to its master. (In fact, scouts are sometimes called bird dogs.)

Scouts find a property for sale, gather information, and then provide this information to investors for a fee. The fee varies, depending on the price of the property and the profit potential. Scouts can expect to make $500 to $1,000 each time they provide information that leads to a purchase by another investor.

You may want to get started as a scout for other investors because looking for deals does not require any cash or prior knowledge. It's a great, no-risk way to get your feet wet and learn the wholesaling ropes.

To be a good scout, you need to gather specific information about a property. The more information the better, but at the very least get:

- Complete property address
- Owner's name and telephone number
- A photograph of the house
- Financial information including the asking price, loan balance, and whether the payments are current
- Details on any property liens
- Summary of information about the condition of the property
- Information about the owner's motivation to sell (e.g., foreclosure, needs repairs, divorce, etc.)

You may choose to get most of this information directly from the owner or obtain much of it from public records or other means.

Your most important job as a scout, however, is to identify a property owner who is motivated to sell at a discounted price. Keep in mind that the owner of a house in need of repair is not necessarily motivated to sell. Many property owners can afford to fix a property or let it sit vacant for months or even years. The motivated seller does not have the means or the desire to handle the problems presented by the property.

For example, a scout drives by a boarded-up house with an overgrown lawn and old newspapers piled up on the stoop. The scout speaks with a neighbor and learns the name and telephone number of the owner. The scout then talks with the owner and discovers the property is in foreclosure and the owner does not have the means to repair the property or make the mortgage payments. The owner is open to all suggestions, but the scout has neither the means nor the experience to solve the owner's problem. The scout sells the information about the property and its owner to another investor.

Don't worry about providing too much information to an investor who then steals the deal. This rarely happens. Experienced investors know the unhappy scout will not bring any future deals their way.

Dealers: Dealers, like scouts, locate deals for other investors, but they take the process a step further. They find a bargain property and sign a purchase contract with the owner. Dealers then can close on the property themselves and sell it outright, or just sell their contracts to another investor. Dealers are providing more than just information; they are controlling the property with a binding purchase contract. Dealers often put up earnest money to secure the deal, so they assume more risk than the scout does. Because dealers control the property with a purchase contract, they have greater profit potential than the scout does.

Dealers often resell the property in its “as is” condition. Dealers, however, can sometimes increase their profits by cleaning up their properties. In fact, a simple cleanup job may increase the dealer’s profit by several thousand dollars. While most investors can see past the mess, a spruced-up property is psychologically more appealing to any buyer, even an experienced one. The dealer does not need to perform repairs or upgrades but simply cleans up the appearance of the property by removing junk and debris, cleaning windows, and cutting the lawn. This type of labor can be hired out for a few hundred dollars.

Dealers can flip as many deals as they can find. On a full-time basis, a dealer can make well over $20,000 a month without ever fixing a property or dealing with a tenant. On a part-time basis, a dealer could easily make an extra $5,000 a month flipping a property or two. The lifestyle of dealers is that of true entrepreneurs; they can work as much or as little as they like with no boss, no employees, and the freedom to do as they please.

Retailers: Retailers are not wholesalers bit rather usually buy a property from a wholesaler or with the assistance of a real estate agent or scout. The retailer’s goal is to fix up the property and sell it for full retail price to an owner-occupant. Compared to other flippers, the retailer puts up the most money, takes the most risk, and stands to make the largest profit on each deal. However, it may take the retailer months to realize a profit, unlike the scout and dealer who make their money in a matter of days or weeks.

To become a successful retailer, you need to have a working knowledge of renovating homes, particularly the cost of doing so. A good dealer also should have a rough idea of the cost of repairs to buy properties at the right price and resell them to the retailer. A dealer who pays too much for a property will have a difficult time reselling it to a retailer. Likewise, the retailer who pays too much will have a difficult time making a profit upon resale to an owner-occupant.

Retailers are limited by their financial resources and the number of properties they can rehab at once. Each deal should be evaluated separately; it can be sound business to act as a dealer at some times and as a retailer at other times.

If retailing appeals to you most, you may want to begin by working with a more experienced partner. This arrangement allows you to share the workload and the risk. Equally important, a knowledgeable partner can help determine the property’s existing and after-repair value more accurately.

A partner with contracting experience can help prevent the underestimation of improvement costs and keep you from getting in over your heads. Veteran investors should know what to fix, based on the expected return, and the features that other houses for sale offer. They should also have the resources to get the work done quickly at a fair price.

When forming a partnership, always clarify roles and expectations in writing. Include a project budget, how many hours are expected from the partners, and if partners' hours will be billed as an additional cost to the project. Lastly, check your partner's credentials and referrals. If possible, inspect previous projects.

What's Your Exit Strategy?

As important as knowing your wholesaling role, you should also know what you want to do with each property. Understanding how to sell properties quickly and having the means and resources to do so is a critical skill for wholesalers.

Don't enter into a real estate transaction without knowing your exit strategy. Are you going to flip the property to another investor, or are you going to fix it up and sell it retail? How much money or labor will you put into the property? How long do you expect to hold it? How long do you think it will take to sell? Answer these questions *before* you make an offer to purchase a property.

With each property you encounter, you need to have a clear plan in mind for how that property will (either immediately or eventually) leave your possession and control. Depending on the deal, you may want to assign a contract, having never taken title to the property. On the other hand, you may want to take title and then wholesale the property to another investor within a few days. Maximizing your profits (and possibly your risk), you could rehab the property and sell within a few months.

True wholesalers want in and out of a deal quickly, but the entire process of purchasing and reselling a house can take a varying amount of time. Usually the quickest turnaround comes from selling to another investor, either through assignment or double closing.

Let's take a look at a few different exit strategies you might choose to use.

Rehab: Rehabbing a property can cover everything from cosmetic work and minor touch-ups to down-to-the-studs remodeling. In the hottest markets, you can flip properties to retail end-users with little or no rehab work. If the property is in relatively good shape, it may only take paint, carpet and simple decorating to get it ready for resale.

Houses that need a moderate amount of work can be offered as minor fixer-uppers. You can perform some of the tasks yourself and save a few for the end user. A good cleanup and painting often do the trick. Usually that process takes just a few days; then you are ready to offer the property for sale.

Remember, too, that as an investor, your choice of financing should be based on the expected time from loan initiation to loan payoff. It can make sense to use a credit line with a high interest rate and low closing costs if you plan to flip the property in a few days or weeks. However, tying up readily available funds for months can create an opportunity cost of turning down other deals, and interest costs can get quite expensive.

If possible, try either to buy rehab properties subject to existing financing or simply tie up the property with a purchase contract that gives you the right to enter the house and start doing rehab work.

Offering terms: The details of the deal itself can be a form of exit strategy. Attractive financing terms have been used to move products in a variety of markets—from cars to furniture to computers. Likewise, you can move difficult-to-sell properties by offering attractive owner-financing terms.

By having alternative financing available, you attract buyers with limited choices. These terms may include helping with the down payment or financing some of the purchase price with a seller carryback note and mortgage. Making prearrangements to help buyers with financing can prove quite valuable in selling your properties. In addition, sellers who offer attractive terms can get a higher price than sellers who ask for all cash to buy a comparable house.

One caveat about asking price when offering terms: don't raise the price beyond the legitimate appraisal figure. While it is possible to get a higher price for a property when offering terms, you may run into unethical dealings, including false representations of property values, loan fraud, and other questionable practices sometimes associated with flipping. We do not support those practices and recommend seeking representation by legal counsel regarding the way loans are structured.

Look for advantages of flipping not only for cash, but also for terms. In other words, instead of buying and flipping for all-cash profit, you accept a note for some or all of your profit.

The going rate for an owner-financed note is generally much higher than what big lenders offer and certainly more than you could earn in a CD or money market account. For example, if the going rate for a mortgage is 7 percent, you could get 9 percent or higher. And you can sell the note for cash at a later time, so you still have liquidity in your investment.

The bonus of taking "paper" (an owner-financed note) for your equity is that you can demand a higher price. Cash always buys a discount, so if you can offer a buyer a way to get into the property with less money down, you can raise the price.

The risk of taking back a note, of course, is that the payor could default. The note will generally be secured by a lien (mortgage or deed of trust) on the property, but this lien will be junior to another lien, so you risk losing your position if the senior lien is in default. When you sell, make sure you have all your cash out of the deal, so you are not reaching into your pocket if the borrower defaults.

Lease option: Another variation may be to refinance the property after you have rehabbed it, getting all your money out. Then, you could sell the property on a lease with an option to buy. If your tenant exercises the option after one year, you will fare better on taxes then if you had sold it quickly. You can do a 1031 tax-deferred exchange, which allows you to roll your gain into another property purchase and defer paying taxes, or just pay the capital gains rate rather than the ordinary income rate. In the meantime, you may be able to enjoy positive cash flow.

Keep in mind that, if the tenant does not exercise the option to purchase, you are stuck with the property. If you are at or near the top of your real estate market cycle, you may end up with a property you cannot sell right away, becoming a long-term landlord.

Renting: While acquiring rental properties is not the foremost goal of most flippers, the subject deserves some attention. Many mainstream properties targeted by flippers (starter homes) can make excellent rental properties. If you have money tied up in the deal, you can refinance it to recoup most of your capital and lower your monthly payment. The option of holding onto a property that fails to sell in the desired time frame can be a good Plan B. Then, you can place the property on the market at a later date or hold it indefinitely. There are sound reasons to consider building wealth through equity as part of a flipper's long-term plan. Armed with the knowledge of multiple exit strategies, you can increase your opportunities for success.

When you are getting started, you can sell your first few deals to investors to generate working capital. Don't get greedy. Remember, the key is to move in and out of the deal quickly. Conservatively, you can expect to make $1,000 to $3,000 on your first wholesale flip. You do not have to own a property to make money from it; you simply need to control it by putting it under contract. Once you have located a potential deal and secured it with a purchase contract, you can sell your deal to another investor for a profit.

What Do the Numbers Look Like?

Sometimes it helps to see the numbers in black and white to appreciate how powerful wholesaling can be and how it can propel you quickly toward your goals.

Let's imagine you find a property worth about $100,000 in its current state. Renovations will require $10,000. In its best condition, the property is worth $145,000. You negotiate a purchase price of $80,000 and sign a purchase contract with the owner. You find another investor who is willing to pay $82,000 for the property and do the necessary repairs. Thus, you can sell your deal to another investor and walk away with, a $2,000 profit using no money of your own**.** The other investor will make a nice profit as well. In this example, the property was purchased at a 20 percent discount from its current market value. This discount may vary widely, depending on the property, the neighborhood, the condition of your local real estate market, and how many repairs the property needs.

Keep in mind that the retailer to whom you sell the property will make more money than you on the deal. Don't let that person's profit potential bother you. There is enough room for both of you to profit, and, unlike a retailer, you assume little risk.

Chapter 4: What Are the Steps in a Real Estate Transaction?

Whether you are a novice investor or an experienced one, you must have a working knowledge of the paperwork and legal aspects of real estate transactions. Otherwise, you are at the mercy of those who do know. Furthermore, your risk of making an expensive mistake or missing an opportunity increases tremendously. Let's take a look at the pieces and parts of a typical real estate transaction and what they mean to you.

What Is a Deed?

A deed is a written instrument used to convey ownership to property. You must know how to draft a deed, because at times you may need to get one signed in a hurry. If you are dealing with a seller in foreclosure, a "kitchen table" deed is commonly used, so you need to know how to draft and execute one. If another investor is offering you a deed received from someone in foreclosure across a kitchen table, you must make sure that deed was drafted and executed properly.

What Are the Different Types of Deeds?

Deeds differ, usually by the type of guarantee or warranty that they give. Following are descriptions of four different types of deeds: general warranty, special warranty, bargain and sale, and quitclaim.

General Warranty Deed: Also referred to as a warranty deed, this is the most complete guarantee of title. The warranty deed promises that the grantor (seller) has full and complete title and forever warrants against any claims against the title. If anyone makes a claim to the property, no matter how old the claim is, the grantor of a warranty deed must fix the problem. If you are receiving a deed, you must insist on getting a general warranty deed. There are exceptions to this rule, but a general warranty deed is the best deed. If a title company is insuring the transaction, it will probably insist on having a warranty deed.

Special Warranty Deed: This type of deed only warrants that the grantor has acquired title and did nothing to impair it while holding the title. This is roughly the equivalent of a grant deed (used in California). Public officials, such as a sheriff, use a special warranty deed after a foreclosure sale.

Bargain and Sale Deed: This type of deed has no express warranties but usually contains a statement of consideration paid and an implication that the grantor has some title or interest in the property. This deed is commonly used with variation in northeastern states such as New York and New Jersey.

Quitclaim Deed: A quitclaim deed contains no promises or warranties. The grantor simply gives up whatever claim he or she may or may not have. A quitclaim deed is commonly used to transfer an interest between spouses or to clear up a title defect. A seller with a good title can transfer the property with a quitclaim deed the same as with a warranty deed. However, the grantor makes no guarantee that title is good. You should consider using a quitclaim deed whenever you give title.

What Are the Elements of a Deed?

A deed must contain certain elements to be considered a legal and valid transfer. When you execute a deed or pay someone else for a deed to real estate, make sure that the following elements are present.

The deed must be in writing. Generally speaking, any instrument affecting an interest in real estate must be in writing to be enforceable. It does not necessarily need to be typed, but it may not be accepted for public recording if it is not legible.

The deed must list the parties to the transaction. The deed must state the giver of the deed (grantor) and the receiver of the deed (grantee). The grantor's name must be spelled exactly as it appears on the deed that gave that person title, even if that spelling is incorrect. In community property states (Arizona, California, Florida, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington), the law presumes that both spouses own all marital assets, regardless of how they are titled. Thus, you also need a separate quitclaim deed from the grantor's spouse, even if that person's name does not appear on the title.

The deed must show "consideration." The deed must state that the grantor received consideration, even if no actual money changed hands. You can insert the purchase price or simply the words: "The grantee has received ten dollars in hand and other good and valuable consideration, the sufficiency of which is hereby acknowledged."

The deed must contain the legal description. The legal description of the property must appear exactly as in the previous deed. It will usually read something like "Lot 25, Block 21, Harris Subdivision, County of Barrington, State of Illinois." This designation comes from a plat map that was previously filed in the county records. If the description is more complicated than a simple lot and block or government survey description, simply photocopy the description from the previous deed and insert it into the new deal.

The deed must contain words of conveyance. This language spells out what type of deed is given. It usually reads something like, "The grantor hereby grants, conveys, and warrants" (warranty deed) or "the grantor hereby remises, releases, and quitclaims" (quitclaim deed).

The grantor must sign the deed. The grantor must sign his or her name exactly as it appears above in the document. If the grantor is not available for signature, an authorized agent or attorney-in-fact may sign on the grantor's behalf. This process is accomplished by a power of attorney that authorizes an agent to act for the grantor to sign a deed. The power of attorney should include a legal description of the property and should be recorded in county records with the deed that is signed by the agent. The agent does not sign the grantor's name but rather signs his or her own name as attorney-in-fact for the grantor.

The deed should be acknowledged before a notary public. An acknowledgment is a declaration that the person signing is who he or she claims to be and is signing voluntarily. The notary signs the deed, affirming that the grantor appeared and that the notary either knows the person or was provided with sufficient proof of identity. Although acknowledgment is not required to make a deed valid, it is usually required for recording. The proper form of acknowledgment differs from state to state, so make certain your deed complies with your state's law.

Hint: As a wholesaler and real estate investor, you should have a notary on call to assist you with this task. From time to time, you may buy a property with a seller signing a deed over a kitchen table. Because the signature of the seller must be notarized, you need to have a notary on call. Look in your local phone book under Notary Publics. Virtually every city has a notary with a pager who will show up on 30 minutes notice.

What Does "Delivery" Mean?

Title does not pass until a deed is delivered to the grantee. Thus, a deed signed but held in escrow does not convey title until the escrow agent delivers the deed. Many people are under the mistaken impression that title passes when a deed is recorded. While recording a deed is common practice, it is not required to convey title to real estate.

How is a Deed Recorded?

The recording system gives constructive notice to the public of the transfer of an interest in property. Recording simply involves bringing the original document to the local county courthouse or county clerk's office. The original document is copied onto a computer or microfiche and then returned to the new owner. In addition, the county tax assessor usually requires filing a "real property transfer declaration," which contains basic information about the sale. The filing fee for recording the deed usually runs $6 to $10 per page. In addition, the county, city, and/or state may assess a transfer tax based on either the value of the property or the selling price (often called documentary stamps).

A deed or other conveyance does not have to be recorded to be a valid transfer of an interest. For example, if John gives a deed to Mary, then he gives it again to Fred, who records it first? Or if John gives a mortgage to ABC Savings & Loan but the mortgage is not filed for six months, and then John borrows from another lender, who records the mortgage first? Who wins and who loses in these scenarios?

Most states follow a race-notice rule, which means that the first person to record the document wins, as long as he or she:

- Received title in good faith

- Paid value, and
- Had no notice of a prior transfer.

Since the first person to record a document wins, can you decide who holds the first mortgage in the example below?

John buys a home by borrowing $75,000 from ABC Savings & Loan. He signs a promissory note and a mortgage pledging his home as collateral. ABC messes up the paperwork, and the mortgage does not get recorded for 18 months. In the interim, John borrows $12,000 from XYZ Mortgage Company, for which he gives a mortgage as collateral. XYZ Mortgage Company records its mortgage, unaware of John's unrecorded first mortgage to ABC Savings & Loan. As a result, XYZ Mortgage Company will have a first mortgage on the property.

What's the Difference Between Notes and Mortgages?

Most people think of going to a bank to get a mortgage. Actually, people go to the bank to get a loan. Once they are approved for the loan, they sign a promissory note to the lender, which is their promise to pay. They also give (not get) a mortgage as security for repayment of the note. A mortgage (also called a deed of trust in some states) is a security agreement under which the borrower pledges the property as collateral for payment. The mortgage document is recorded in the property records, creating a lien on the property in favor of the lender.

If the underlying obligation (the promissory note) is paid off, the lender must release the collateral (the mortgage). A release is accomplished by signing a release of mortgage, which is recorded in the county property records. The release will remove the mortgage lien from the property. If you search the public records of a particular property, you will see many recorded mortgages that have been placed and released over the years.

About half the states use a document called a deed of trust rather than a mortgage. The deed of trust is a document in which the trustor (borrower) gives a deed to a neutral third party (trustee) to hold for the beneficiary (lender). A deed of trust is worded almost the same as a mortgage. Thus, the deed of trust and the mortgage are essentially the same, other than in the foreclosure process. Foreclosure is a legal proceeding by which a lender attempts to force the sale of a property to recoup the money lent to the homeowner.

What Does Priority of Liens Mean?

Liens, like deeds, are "first in time, first in line." If a property is owned free and clear, a mortgage recorded will be a first mortgage. A mortgage recorded later in time will be a second mortgage (sometimes called a junior mortgage). Likewise, any judgments or other liens recorded later are also junior liens. Holding a first mortgage is a desirable position, because a foreclosure on a mortgage can wipe out all liens that are recorded after it (called junior lien holders).

What Happens in a Basic Loan Transaction?

At the closing of a typical real estate sale, the seller conveys a deed to the buyer. Buyers usually obtain loans from conventional lenders for most of the cash needed for the purchase price. The lender gives the buyer cash to pay the seller, and the buyer gives the lender a promissory note. The buyer also gives the lender a security instrument (mortgage or deed of trust) under which the buyer pledges the property as collateral. When the transaction is complete, the buyer has the title recorded in their name, and the lender has a lien recorded against the property.

What if the Seller Will Hold the Loan?

Rather than receiving all cash for the purchase price, a seller may accept a promissory note for all or part of the price. If the seller owns the property free and clear (i.e., no mortgage) and accepts a promissory note for all or part of the purchase price, the buyer will execute a mortgage or deed of trust to the seller. When the transaction is complete, the buyer has the title recorded in the buyer's name and the seller has a lien (mortgage or deed of trust) on the property.

In some cases, the seller may already have a mortgage on the property. If this is the case, the seller may require the buyer to pay most of the purchase price in the form of cash so that the seller can satisfy the loan balance. The difference between the loan balance and the purchase price (equity) is paid in the form of a promissory note. Assuming the buyer borrows the cash from a conventional lender, the note to the seller will be secured by a mortgage that is junior or subordinate to the lender's mortgage. When the transaction is complete and all documents are recorded, the buyer has title recorded in the buyer's name, the lender has a first lien, and the seller has a second lien on the property.

What Is a Double Closing?

A closing is a ceremonial process during which title is delivered by deed from the seller to the buyer. In some cases, you will buy the property from a distressed homeowner and sell the property to a retailer in a back-to-back double closing (also called double escrow in some states). You do not need any of your own cash to purchase the property from the owner before reselling it to the retailer in a double closing.

Here's how it works in eight steps:

1. The dealer signs a written agreement to purchase a property from the owner.

2. The dealer signs a written contract with the retailer under which the retailer agrees to buy the property from the dealer at a higher price.

3. The only party coming to the table with cash is the retailer. Assuming the retailer is borrowing money from a lender to fund the transaction, the retailer's bank will wire the funds into the bank account of the attorney, escrow agent, or title company (called the closing agent) who performs the closing.

4. The owner signs a deed to the dealer, which is not delivered but deposited in escrow with the closing agent.

5. The dealer signs a deed to the retailer that is deposited in escrow with the closing agent.

6. The retailer signs the bank loan documents, at which point the transaction is complete.

7. The closing agent delivers the funds to the owner for the purchase price and delivers the difference to the dealer.

8. The closing agent records the two deeds, one after another, at the county land records office.

As you can see, the dealer brought no cash to the table and received funds from the proceeds of the second sale. If the second sale does not happen, the first transaction, which is closed in escrow, is not complete. The deal is dead.

In the past few years, there has been a lot of negative press and misinformation about double closings. Many people have been indicted under what the press has labeled "property flipping scams." Double closings are not the same as these illegal schemes, despite what some misinformed lenders, real estate agents, and title companies may tell you

Double closings are not the same as the so-called "illegal property-flipping schemes." These unlawful transactions work like this.

Unscrupulous investors buy cheap, run-down properties in mostly low-income neighborhoods. They do shoddy renovations to the properties and sell them to unsophisticated buyers at inflated prices. In most cases, the investor, appraiser, and mortgage broker conspire by submitting fraudulent loan documents and a bogus appraisal. The result? The buyer pays too much for a house and cannot afford the loan. Because the Federal Housing Authority (FHA) insures many of these loans, the government authorities have investigated this practice and arrested many of the parties involved.

Despite the negative press, neither flipping nor double closings are illegal. The activities described above amount to loan fraud, nothing more. The media has inappropriately reported the activity as illegal "property flipping" rather than "loan fraud." So whenever you hear a real estate agent or mortgage broker say that flipping is illegal, you know they are misinformed.

Unfortunately, this misunderstanding has not been without consequences. Many title and escrow companies will not do double closings anymore because of the risk of *potential* fraud. Other title companies simply require all parties to sign additional disclosures, so that all parties understand the transaction involves two closings, the second of which will fund the first.

A "title seasoning" caveat…

Some lenders have placed seasoning requirements on the seller's ownership. That means if the seller has not owned the property for at least six months, the lender will assume that the deal is fishy and refuse to fund the buyer's loan. This may be a problem if you bought a property at a low price and are reselling it quickly for a profit, and even more of a problem if you are double closing.

However, lender guidelines are not law; they are just guidelines. By going up the chain of command, you can generally get approval from loan underwriting. It's up to you to prove that the property is being resold for a higher price because either it was purchased in a distress situation (e.g., foreclosure) or substantial repairs were made. Keep good records of your repairs to show to the lender.

A smart investor stays on top of the process and anticipates these issues. If you are buying a property and reselling it quickly, particularly in a double closing situation, be sure to anticipate this problem and deal with it. Let the buyer and his or her real estate agent and lender know there may be a seasoning issue. If you stay in control of the loan process and steer your buyers to a mortgage company that doesn't have a problem with double closings, then seasoning won't become an issue.

Generally speaking, only FHA and subprime lenders have the "seasoning hang-up." Fannie Mae underwriting guidelines don't prohibit funding a purchase money loan when the seller has not owned the property for a minimum period of time.

Understanding FHA's antiflipping regulations

Part of the "flipping is illegal" hoopla is a result of the Federal Housing Authority's new antiflipping regulations. FHA regulations, which are part of federal law, prohibit the funding of a purchase in which the seller has not owned the property for at least 90 days—no exceptions. Also, if the seller has owned the property between 91 and 180 days, and the new sales price exceeds the previous sales price by 100 percent or more, the lender will require additional documentation validating the property's value.

If the buyer is getting an FHA-insured loan, there is no way around the seasoning issue. This generally should not be a problem in a fix-and-flip situation, because your ownership will likely extend past 90 days by the time you acquire, rehab, and sell. But if you are planning to buy the property and resell it in a double closing, the end buyer cannot go with an FHA loan. If your end buyer is another investor, he or she will not be using FHA financing, so this should not present a problem. Don't confuse FHA-insured loans with Fannie Mae (FNMA) loans. FHA loans represent a small portion of residential loans, as compared with Fannie Mae loans, which are the majority of residential loans. Fannie Mae does not have seasoning restrictions.

A word of warning: Beware of deed restrictions. Once in a while, a seller may place a deed restriction that prevents the buyer from reselling within a certain time period. This restriction is a covenant in the deed, which cannot be circumvented because no title company will insure it. You may find this in new subdivisions, particularly in condominium complexes where the developer is trying to prohibit flippers.

How Do You Assign a Contract?

Another way to accomplish the same task as a double closing is to assign your purchase contract. Assigning a contract is similar to double-endorsing a check—you assign your rights under the contract to another investor for a fee. The investor closes directly with the owner in your place, like a pinch hitter. This is also a solution to the lender seasoning issue. If the buyer closes directly with the owner, the seasoning issue is resolved.

However, an assignment will not work if the seller has a standard contract that contains a prohibition against assignment commonly found *with* bank-owned or government-owned properties. In such cases, you can still do a double closing with one small catch—-if the seller selects the title or escrow company (this is common with bank- and government-owned properties), that title or escrow company may not permit double closings. No solution to this problem exists, but you should be aware of it up front so you can avoid problems later.

Using the contract assignment has several advantages over a double closing. First, your name does not appear on the title for the world to see, allowing your business affairs to be kept private, as they should be. Furthermore, the sale at a lower price does not appear on the MLS, which can skew the appraisal when the retailer resells the property. Also, you save on closing costs by not having a regular closing. Finally, you get your money fast, whether or not the other investor closes on the property. (Note: The assignment will not prevent the FHA flipping ban, because FHA rules say the seller must be the "owner of record.")

The main disadvantage of the contract assignment is that it is hard to sell. A closing is usually conducted at a title company or attorney's office, while a contract assignment may not be. Unless the investor knows you personally, he or she may be wary of buying your contract. The contract assignment requires the investor to conduct due diligence regarding the title to the property, the legality of the contract, and whether the seller will live up to it at closing time. Thus, you may not get as much money for a contract assignment as you would if you did a double closing and gave the investor a bona fide deed.

The second disadvantage of the contract assignment is that the investor knows what you are paying for the property. An unscrupulous investor may try to go around you and deal directly with the property owner. The solution to this challenge is to record a Memorandum of Agreement in county land records. This form is an affidavit signed by you that states you have a contract with the seller. Once recorded, this affidavit becomes a cloud on the seller’s title. A cloud is an uncertainty regarding ownership. This uncertainty makes it difficult to insure the title.

If the seller and the unscrupulous investor try to close the deal, the title company would discover the cloud on the seller’s title and would probably refuse to insure the transaction. The cloud on title will effectively prevent the seller from selling the property to anyone but you, the party the seller originally agreed to sell the property to. In this situation, the seller or the unscrupulous investor would have to pay you ransom to step out of the deal (which, by the way, is done by you signing a quitclaim deed).

Chapter 5: How Do You Find Buyers for Your Deals?

Finding buyers? You haven't even found a house yet! Aren't we putting the cart before the horse? Absolutely not! The key to being a successful wholesaler is to have the buyers lined up even before you have the deals. If you start looking for your investor after you have the contract, you are working against a ticking clock.

Wholesalers who hope to assign a contract or arrange a double closing may only have 30 or 60 days to find their buyer and tie up the loose ends. In many cases, that may not be enough time to properly market the property and attract interested purchasers.

Every day that you don't have a buyer, you limit your options. As the closing date approaches, you may be forced to exercise an "escape clause" or you may choose to line up financing and close on your own, hoping that you can find a retail buyer before too many payments trickle from your pockets. Neither option is desirable.

What is desirable is knowing what your exit strategy is (or "who" your exit strategy is) before you even begin looking for your first deal. That means meeting investors who want to buy properties and learning their likes and dislikes.

Where Do You Find Investors for Your Deals?

A real estate investors club in your area is an excellent place to meet other dealers and retailers. If no clubs are in your area, consider forming one. You can find other local investors by reading the classified ads section of your newspaper under the "Real Estate Wanted" and "Private Money to Loan" sections. You can also run a classified ad under the "Investment Properties" section. In addition, ask some local real estate agents and landlords or apartment associations for names of investors in your community.

If you don't have an investment club in your area, you may want to run a classified ad in a local newspaper. The ad can be fairly generic. Something like, "Investors wanted! Properties available way under market value! Call XXX-XXXX."

You don't even need to list the geographic area or price range. You can find that out after you get the phone ringing. When the calls starting rolling in, take the time to qualify the callers as well as ascertain their investing preferences. Here are some good sample questions to ask.

- How many houses do you buy each year?
- Do you have preferred locations and/or types of properties?
- What type of discount do you usually look for on properties?
- Do you have your own cash to close or will you borrow it?

- How big a renovation can you handle?
- If I find a bargain, how quickly can you close?

Asking these questions will quickly generate a list of investors to call when a new project comes along.

Try a few different newspapers and ads. Use the Internet to expand your advertising base. Some Web sites will advertise your property for little or no cost. Log the calls you receive to track the effectiveness of the ad. More important, keep information about the people who call and the types of properties they like. Don't waste too much time with inexperienced investors, because they probably don't have the means to buy properties from you.

From the people you meet and the calls you receive you will build a master buyer's list. Input names and contact information into a database. Ideally, you will use email addresses almost exclusively. Time is of the essence when a deal comes your way and nothing beats informing 100 investors at the click of a mouse!

If you plan to rehab and retail your properties, you may want to use the services of a real estate agent to sell your properties. As a matter of fact, one mistake beginning investors make is trying to sell their properties themselves to save money on commissions. Even when they do use an agent, often they fail to include the amount of commission in their sales costs thereby slicing deeply into their profits.

If you are selling a property retail to an owner-occupant, failing to use an agent is a mistake. In fact, a majority of sellers who start out selling their properties without agents end up listing the properties with agents after being unsuccessful on their own, resulting in a loss of precious time and money.

Most real estate agents don't aggressively market properties; however, they place the information on the multiple listing service (MLS) used by all other real estate agents. Because most properties are sold through the MLS and the largest pool of qualified buyers work through real estate agents, the odds of finding a qualified buyer quickly are greatest when the property is listed on the MLS. That approach allows you to focus your efforts on finding more deals rather than waiting for buyers to show up at your property. Contrary to what agents would like you to believe, most do little to market your particular property other than post a colorful sign and list the property on the MLS.

Today, you have several options to list your property on the MLS without paying full brokerage fees. Many areas have programs that let the seller take on some of the responsibilities that were once handled exclusively by real estate agents in exchange for a lower fee. Internet Web sites such as http://www.forsalebyowner.com have created additional options for listing properties for a lower price. However, if you are inexperienced, you may consider hiring a full-service real estate agent on your first few deals. As your advocate when negotiating offers, your agent will make sure the contracts are in order and executed according to plan. Indeed, an agent’s actions can make or break a deal. Find one you like to work with who is willing to give you a discount for repeat business and help you find other potential deals. If you are doing business in a state in which the real estate agents draft the purchase contract, make sure your agent is competent and experienced and can guide you through the paperwork as a beginning investor. In some cases, it may be cheaper and more effective to use a low-cost listing service and hire an attorney to help you through the details.

You’ll be surprised at how many different ways exist to find purchasers. The folks who know the most are those who have “been there and done that.” Experienced real estate coaches can expose you to unique and creative ways to build your buyer’s list.

Chapter 6: What Makes a Good Wholesale Deal?

Not every property can be resold or flipped quickly. You may get stuck with a property for a few months, but this rarely happens if you do your homework. If you cannot resell a property within 30 days, you probably made a mistake—you either paid too much, underestimated repairs, or picked the wrong neighborhood.

Recognizing a profitable deal takes experience. Of course, experience usually comes from making lots of mistakes. Use this book to learn from our mistakes, so you don't lose money the hard way. Be aware of local and regional market trends, but do not be paralyzed by these trends. The concept of wholesaling properties works in every market, in every city, whether the market is hot or in the pits.

Let's step through the process of finding good deals to see how one home can be a "home run," even when the one right next door could be a "strike out."

On Which Neighborhoods Should You Focus?

You can flip houses in any neighborhood, but start with the low- to middle-priced areas that are 15 to 50 years old.

Because of the extreme low-cost, you might be tempted to look for deals in the "rough areas." In the beginning (if at all), it's not wise to buy in gang-ridden, high-crime areas. Your resale market is very small for these properties. Rather, buy in working-class areas where housing is affordable and desirable.

Beware of the so-called median price or some figure that real estate agents use. This figure may be skewed by higher-priced, newly constructed homes around the corner. Furthermore, stay with the populated areas that are in high demand. You can make a profit in other areas, but this approach takes more experience and involves more risk. As a beginner, follow these guidelines, and you can't go wrong.

What Types of Homes Should You Target?

The key to finding deals is to find motivated sellers. And, motivated sellers sell all types of homes — low-end, high-end and everything in between. It's safe to call whatever type of property being sold by a motivated seller a "distressed property."

The term "distressed property" can be a bit of a misnomer, since some distressed properties are pristine and in need of no repairs. A better phrase might be "distressed owner." However, distressed property is the term in common usage. A distressed property is one that creates emotional or financial distress for its owner. Distress may be caused by the owner's financial problems or the fact that the property is in need of repair. Either way the owner is motivated to sell the property at a discounted price.

A good rule of thumb for you is to look for starter homes that are consistent with the neighborhoods in which they are located. A description of these characteristics follows.

Starter Homes: Concentrate on purchasing starter homes at first. These homes are the least expensive single-family homes (and possibly condominiums) in each area. Usually they will be two- or three- bedroom ranch-style houses. If possible, choose an area close to where you live. Staying close to home means you know the neighborhood and its current trends. The neighborhood does not need to be in a location where you would choose to live, but it should not be in a slum, either, If you are not sure about an area, check the local police departments for available crime statistics. Other resources include the local chamber of commerce, planning department, real estate agents, and census reports. You should also subscribe to (and read!) local and regional newspapers.

Neighborhood Consistent: Choose houses that are consistent with the neighborhood. For example, don't buy one-bedroom houses unless there are several in the area. If you are in a warm, humid climate, make sure the house has air conditioning. If every house in the area has two bedrooms, don't buy a five-bedroom home; it may be overpriced for the area. You are always better off buying the cheapest house in a better neighborhood than the highest-priced house in a poor neighborhood.

A word of warning: Be wary of poorly designed houses. It is okay to buy a house that needs work or remodeling, but don't buy houses with basic design problems, such as five bedrooms and only one bath and no tub. Beware of the odd-man-out house on the block. For example, if every house has a garage and the subject house does not, you could have a problem when you try to sell it. If each house on the block was built in the 1950s, don't buy the old farmhouse that was built in 1890, unless you plan on demolishing it. Finally, keep in mind that the house may eventually be purchased by a retail buyer with FHA or VA financing (the Federal Housing Administration insures FHA loans and the Department of Veterans Affairs guarantees VA loans). The house must conform to strict guidelines for the government to guarantee the loan. You can learn what these guidelines are by contacting your local HUD or VA office and by talking to appraisers in your area.

What Is a Good Deal?

No one formula works in every neighborhood and in every market. It takes experience to recognize the potential in a real estate transaction. The catch-22 is that lack of experience will make it harder to recognize a good deal. More often than not, investors pay too much for properties. People who buy for speculation often get hurt financially, because they are depending on factors beyond their control, such as the market, the neighborhood, favorable zoning, or other long-term factors.

Wholesalers who are reading this book should not be concerned with factors beyond their control. Make your profit when you purchase, by buying right!

Don't make the mistake of paying too much for a property. Believe it or not, most investors know what they want to pay for a property but are afraid to ask. They are also afraid that the seller will be offended and refuse to negotiate further. A seller will only be offended if you ask in the wrong way.

Does Speculation Ever Work?

In chapter 1, we discouraged your acting as a real estate speculator. However, there is one scenario where speculation may be beneficial. What's more, you may be able to speculate in this fashion and still profit. We call it "Speculative Flipping" and here's how it works.

In certain inner-city neighborhoods, developers and speculators are willing to pay full price and more for properties—not for the house, but for the land value. Often homeowners in the path of a new development are stubborn and refuse to sell to these developers and speculators. These homeowners may, however, sell to you, simply because they like you! Thus, you can sign a purchase contract for full price and flip it to a developer for more money.

In some areas of the country, new developments are sold out before the houses are built. This lack of supply may increase the value of properties in the development by as much as 20 percent by the time all the houses are finished. With as little as $1,000 down, you can sign a contract with the developer to purchase a home before it is built. By the time the house is complete, you can find an owner-occupant to buy the house from you in a double closing. This is one of the few times you will act as both a dealer and retailer. Speculative flipping is just that—speculative. With speculation comes greater risk, and beginners should avoid doing it.

A word of warning: Don't be the "greater fool." Flipping is a hot topic these days, so plenty of unscrupulous people are trying to make money on the "greater fool" theory. Investors are buying properties and flipping them to inexperienced investors by telling them, "This is a wholesale deal," when they know it is a marginal deal. New investors end up with properties they have paid nearly full price for, and they have no way to get rid of them. This commonly happens when properties are located away from the new investor's hometown and the newbie relies on professional advice from real estate brokers and developers.

Some operators even charge you to get into an exclusive "network" in which they supply you with unlimited deals. The idea that an unlimited number of wholesale deals are waiting for someone to find is specious at best. Finding really good deals is not easy—it takes a lot of work and a bit of good luck. Approach anyone who promises a shortcut to that process with a great deal of skepticism. A sucker is born every minute—don't be one of them.

Finally, to answer the question posed in the chapter title, we present the following "Good Deal Checklist." While not an ironclad rulebook, answering no to one or two of the questions should cause you to carefully reconsider purchasing the selected property.

If you answer no to three of these questions, then definitely do not do the deal. As a beginner, leave the larger risks to the experienced investor who is willing to roll the dice. As an alternative, perhaps you can sell your contract to another investor with different needs or goals.

- Would I feel safe here at night?
- Does the house fit in with others in the neighborhood?
- Is the house in a residential neighborhood (one with more houses than businesses or apartments)?
- Is the house worth saving?
- Would the house conform to FHA lending guidelines after renovations?
- Is the purchase price 25 percent less than similar homes have sold for in the neighborhood?
- Could I complete renovations in less than two months?
- Could I pay someone less than $25,000 to bring it up to satisfactory condition?
- Is the average property listed for sale in the area selling in fewer than 90 days?
- Would the house make a good starter home for a family?
- Is the block free of boarded-up houses?
- Can I fully inspect prior to closing?
- Will the owner deliver the property with a general warranty deed?

Chapter 7: How Do You Find Wholesaling Candidates?

Previously, we discussed the importance of buying distressed properties, which in reality means finding distressed owners. Locating these owners is an art that takes years to master. Finding motivated sellers requires advertising, marketing, salesmanship, and, like any business, keeping your nose to the ground. Over time, wise investors establish a referral network, which allows them to find more deals with less effort.

The most common problem new investors face is finding bargain properties. Many who start out in real estate investing quit without ever buying their first property. They go through the motions of looking for deals for a few weeks or months, then decide it doesn't work. They forget that finding motivated sellers is similar to a salesperson's finding that first customer—it takes persistence and hard work.

You cannot put together a deal without a motivated seller, and you can convince only a motivated seller to accept unusual terms or sell at a discounted price. A motivated seller has a pressing reason to sell the property below market price. Before you start looking for motivated sellers, first realize that the vast majority of property owners are not motivated to sell.

What Makes a Seller Motivated?

Motivated sellers want or need to sell their property quickly. They have a problem that needs to be solved. Typically, any real estate problem can be solved with time, money, or effort, but the motivated seller is lacking in any one or all three of these areas. Couple that with emotional situations that motivated sellers are often in and you have a person who wants out NOW!

Some of the issues that motivate people to sell include:

- Divorce
- Lack of concern
- Inexperience with real estate repairs
- Time constraints
- Death of a loved one
- Job loss/job transfer
- The headaches of being a landlord
- Impending foreclosure and other financial problems

Can you see how someone facing one or more of these issues would be willing to negotiate the right price and terms?

How Do You Find Motivated Sellers?

Within this chapter, you'll find a grab bag of ways to find people in one or more of these "motivating" situations. Make a commitment to try all of them. Go back to the ones that work best for you.

For some of the methods for locating wholesale candidates outlined below, you may take a farming approach to finding your motivated sellers and distressed properties. Successful real estate agents use *"farming"* to increase their business activity. They pick a neighborhood or two and focus their marketing efforts within that area. You should try the same technique. Start with a neighborhood that is relatively convenient for you. If you decide you want to do drive-arounds or work with bank-owned properties, focus on your farm area.

Over time, you may expand your farm area, but stay within areas that contain the type of homes you plan to purchase.

Ways to Locate Wholesale Candidates

- Classified ads (placed by you or others)
- Real estate agents
- Mortgage brokers
- Drive the area
- Open Houses
- Direct Mail
- Flyers and door hangers
- Magnetic car signs
- Referrals
- Scouts

Classified ads: An obvious, yet often overlooked, place to look for deals is in the classified ads. These can be print ads in your local newspaper or on the Internet on sites like Craig's List. Whichever you use, follow the same approach when identifying and approaching motivated sellers.

Be prepared to make a lot of calls, because finding properties is a numbers game. Do not waste much time with each seller; just ask basic questions to gather information about the property and the seller's needs. Most people you call cold will not be responsive. Don't take it personally; just keep calling. Remember that each time you hear a no, you will be one call closer to a yes, and you will be learning along the way. If you live in a large metropolitan area, start with the ads for the areas you know. If you live in a more rural area, call every ad in the newspaper.

Within the ads, you'll find three distinct categories: Private owner or FSBO ads, those placed by real estate agents, and those advertising properties "for rent." All three can provide you with valuable information and/or opportunities.

Definitely call on the ads that are for sale by owner. (They don't all say "for sale by owner," but you will learn to detect these by other clues) You will notice that real estate agents place many of the ads. Most areas require that real estate agents identify their licensed status within the ad. However, agents often ignore that requirement. You do not need to call on most of those ads. We'll discuss a better way to deal with real estate agents later in the chapter.

If you are not inspired to call on every ad, then at a minimum, call on the ads with key phrases. Examples of these key phrases are *must sell, fixup, needs work, handyman special, vacant, motivated,* and so on. Unusually long ads listing every detail about the property are probably from inexperienced or motivated sellers, so these ads also warrant a call.

As for real estate agent ads, believe it or not, many are teaser ads designed to get you calling about a particular type of house or neighborhood in which the agent works. Agents often pull the old bait-and-switch. Once you call, they try to get you into their office so they can show you other properties.

If the ad is for a property in one of your target neighborhoods, then call the agent for a different reason—to let this agent know what kinds of properties you like. Call on all of the ads that advertise fixer properties in your target areas and ask for the agents' e-mail addresses and fax numbers. Send these agents a brief letter, alerting them that you are an investor, you are looking for fixer properties, and you can close quickly if the price is right. Send this letter to no fewer than 25 real estate offices in your first month of doing business. This letter will get the agents calling you for properties, rather than the other way around.

Another way to find deals is by calling the classified ads offering houses for rent. Most cities have more properties for rent than for sale. One reason is that some people become accidental landlords for one reason or another. For example, they may have inherited the property from their parents, or the owner may be recently widowed and their spouse had handled the properties. These people rent out the properties because they don't know what else to do with them.

Calling rental ads can be lucrative, because some landlords are simply tired of dealing with tenant and property management issues. These landlords may want a way out of handling their problem property. You just don't know what the landlord's needs are until you ask, so consider calling on these ads for rent. Just pick up the phone and say, "I saw your ad in the paper for a property you are renting. I am an investor. Are you interested in selling the property?" If the answer is no, give these landlords your name and telephone number and ask them to call you when they decide to sell. Also, ask them if they know any other landlords in the area who may be interested in selling.

Making a lot of telephone calls does not excite most people, but the telephone can make you a lot of money.

Remember, too, that you can run your own classified ad on the Internet or in the paper to encourage motivated owners to call you. Many distressed sellers won't take the time or make the effort to advertise their property, so you need to flush them out. Run a simple three-line ad, such as:

We Buy Houses for Cash
Any Condition, Fast Closing
555-555-5555

You can run this ad under the "Real Estate Wanted" section in the major newspapers and small, local all-advertisement papers, such as Pennysaver and *Thrifty Nickel.* You can also run it under "Money to Loan" to attract property owners in foreclosure.

Classified ads should be run every day of the week, not just on Sundays. Call your newspaper and ask for the bulk or long-term rate. This rate may require you to commit to six months or more of advertising. You should consider running the ad for at least six months to determine whether it is worthwhile. Do not be discouraged if you see seven other ads just like yours. McDonald's and Burger King do more business when they are next door to each other; so do home-improvement giants such as Home Depot and Lowe's. Likewise, your ad will pull just as many calls next to similar ads. Sometimes a motivated seller will choose to do business with you over someone else because of the sound of your voice or the fact that you like the Yankees. You just never know what motivates people, so place your ad in the newspaper and keep it there.

Anytime you embark upon a concentrated call plan, you need to have a strategy for handling the return calls you hope to get. Unless you have a business office, set up a separate telephone line in your home to handle incoming calls. If you are not available during the day to answer calls, have the calls forwarded to your cell phone. (Don't even consider *not* having a cell phone.) If you are working full-time at another profession, use a voice mail that screens out unmotivated or partially sellers. For example, the message could say: "Thank you for calling Real Estate Solutions, Inc. If you are calling about a house for sale, please leave your name, telephone number, the property address, and why you are selling." This message separates the truly motivated sellers from the marginally motivated sellers who are simply looking to shop their properties.

When calling others, or receiving calls, it makes sense to develop a script to use—especially when you are new to the business. Be honest with sellers and let them know you are not a large company. You can explain that you take a personal interest in their specific needs and circumstances. Also mention that you have the resources to handle cash transactions, while your low overhead allows you to pay a fair price for their property. It is okay to gather information about the property and establish that the seller is motivated. However, it is best to minimize the discussion. Use the call to set up a personal meeting.

Real estate agents: Real estate agents can be either a great source of potential deals or a big stumbling block, depending on how you deal with them. They are among the most informed people regarding properties for sale, and they have access to more information than investors do. Agents also have many contacts and may know of potential deals that are not advertised on the MLS (called pocket listings).

Much of the information that was once exclusively available to MLS subscribers is now available to anyone with Internet access. However, consumer real estate sites are not typically as good as the sites real estate agents can access. The agents-only sites provide better search engines and more data; they are also usually updated more frequently than consumer sites. Although the gap has narrowed, real estate agents still have the upper hand in watching market activity.

Before we talk about how real estate agents can help you find good wholesaling candidates (both the sellers and the properties), let's talk a little bit about the real estate profession in general.

In most states, a person must be licensed as a broker to list property. A listing is an agreement between the seller and the broker that permits the broker to sell the property for a fee. In most cases, this fee is 6 or 7 percent of the sales price. The broker who signs this agreement with the seller is called the listing broker or sometimes the managing broker.

The listing broker usually hires several agents (sometimes called salespersons) to help sell their listed properties. An agent, like a broker, must be licensed to sell real estate. In most states, however, only a broker can list a property. Thus, if the agent finds a buyer for the property, the listing broker and the agent split the commission for the sale. While a broker and an agent are different, this book refers to them synonymously as *agent.* (Note: Each state has its own requirements for agent commissions, so learn about your state's requirements.)

Agents can also represent buyers or sellers in different capacities, such as buyer's agent/broker, seller's agent/broker, or transaction agent/broker. Some states actually require attorneys to provide services that are offered by agents in most of the country. It pays to understand the various agency relationships allowed in your area.

The word REALTOR® is a registered trademark term reserved only for members of the local board of Realtors, which is affiliated with the National Association of Realtors. The boards are private, self-regulating agencies that govern rules of conduct for their members. Most agents belong to one or more local boards; membership is usually a requirement to obtain access to the MLS computer system.

Real estate agents can earn additional designations. Typically, serious agents will undergo continuing education to earn such titles as Graduate Realtor Institute (GRI), Council of Residential Specialists (CRS), or a multitude of others. When evaluating potential agents, ask about their credentials and why they chose a specific educational track. Of course, formal education is only one way to assess your agent's value and does not guarantee that the individual has the skills you need.

A buyer's agent represents a buyer looking for properties. Most listing agents will offer a co-op fee to any buyer's agent who procures a buyer to purchase the property. This co-op is a part of the listing agent's commission.

The buyer's agent's loyalty and representation belong to the buyer, although the buyer's agent is paid by the listing agent. Because buyer's agents usually procure the buyers to make the sale, they are often referred to as the selling agents.

Using a good buyer's agent will help you find a lot of deals. The agent can check the MLS for new properties for sale on a regular basis. Also, ask your agent to search through the MLS for the motivation buzzwords, such as *must sell, needs work, estate sale foreclosure, divorce, rehab,* and so on. These buzzwords will locate distressed properties. Remember, distressed properties are those that create emotional or financial distress for their owners.

Make offers only on the distressed properties that are already priced below market. You may find it hard to believe, but many agents list properties in need of work at full market price. In addition, ask your agent to search the MLS in your target areas by price per square foot, which can also generate leads for bargains.

Although a buyer's agent can be an excellent source of leads, don't use the agent as your primary source of leads when you get started. Agents are businesspeople and their time is valuable, so they may not be willing to spend much time with new investors. Busy agents do not want to waste their time with a beginning investor making frivolous offers that don't get accepted. In a strong market, they can work with plenty of qualified conventional homebuyers. They don't need to deal with creative offers and nothing-down, pie-in-the-sky promises.

While this view does not always represent reality, it is how most agents think. As a beginner, you will get discouraged dealing with a buyer's agent who possesses this attitude, so make sure you approach your agent in the right way.

When meeting or working with a real estate agent, observe these ground rules.

- Dress nicely. You want to look "money."
- Be respectful of the agent's time. For example, ask the agent to have an assistant fax or e-mail you the listings you are looking for.
- Drive by the properties you are interested in before asking the agent to show you the inside of each property.
- Don't come off as a hotshot, but do let the agent know you intend to buy more than one property and can offer repeat business. If you intend to sell the property retail, offer the agent the listing (and, of course, ask for a discount on the fee for this listing).

Mortgage brokers: Mortgage companies spend thousands of dollars every week for advertisements and telemarketers to generate leads. They often receive hundreds of dead leads from people in distress with no equity and no ability to qualify for a new loan. Contact some local brokers and offer to pay them for these names. Many of these borrowers are behind in their loan payments and may be facing foreclosure. This information is invaluable, because it is not made public until the lender commences foreclosure.

These borrowers may have little choice but to deal with you. But don't take advantage of them, because doing so will only hurt you in the end. Make a deal that is profitable for you, but be fair.

Drive the area: Spend a few weekends driving around a selected area. At first, your goal is to learn about the area, the style of houses, and the average prices. It is not necessary to begin your investment career by learning every square mile of a large metropolitan area, but it is important to learn the value of typical homes in your target areas. This knowledge will enable you to make quick decisions about whether a particular prospect is a bargain.

While you are driving around neighborhoods, remember to keep a sharp lookout for vacant, ugly houses. How can you tell if a house is vacant? Look in the window! Of course, you should use a fair amount of discretion; this practice may get you shot, bitten by a dog, or arrested. First look for the obvious signs of vacancy: overgrown grass, no window shades, boarded windows, newspapers, garbage, mail piled up, etc. If you are not certain whether the property is vacant, knock on the door. If the owner answers, be polite and respectful and ask if he or she is interested in selling. In many cases, the home may be a rental property, so ask the occupants for the name and telephone number of the owner. Obviously, you should not visit these properties alone, especially at night.

If the property is vacant, ask the neighbors if they know the owner. Most neighbors are helpful, for they know ugly houses hurt their own property values. In addition, ask the mail carrier, who knows all of the empty houses on the block. Leave a business card and write down the address of the ugly or vacant property'. When you get home, look up the name and address of the owner. Finding the owner of a vacant house can be difficult, which is why the persistent people who find the information make the most money. To determine the name of the owner, call your local tax assessor's office or look up the deed recorded with the county land records.

Contacting the owner takes a little more digging. Try speaking with the neighbors or asking the post office for a copy of a change-of-address form on file for the property. Online services such as http://www.infousa.com will search public databases, such as the Driver's License Bureau and the Department of Motor Vehicles, for a small fee.
Some cities, towns, and counties will tag a house with code violations. This is often a sign of a neglected or vacant property. Ask your city if you can obtain a list of such properties or find where this information is publicly recorded.

Open houses: Visit open houses and for-sale-by-owner (FSBO) properties on weekends. Speak directly with the owners and their agents. Pass out your business cards. Make friends. Word of mouth and referrals are a big part of any business. Take a good look at the property and its physical features. After going to a couple dozen open houses in the neighborhood, you will get to know the value of the properties and the different styles of houses.

Direct mail: Direct mail marketers are masters at working the numbers game. They mail postcards, flyers, brochures, and catalogs by the tens of thousands to prospective customers. Believe it or not, direct mail success is about 1 percent. That means a 99 percent failure rate! Here's a little secret: you can get filthy rich on a 1 percent success rate in direct mail.

Consider that a typical subdivision may have more than a thousand homes. If you were able to make $35,000 flipping 1 percent (ten homes) in that subdivision each year, you could operate a good little side business. Expand your efforts into five areas, and you have a very nice living.

Postcards are the cheapest and most effective way to cover a neighborhood. Go to the post office and buy a couple thousand postcards. Take them to a printer and have a simple message printed on the postcard, such as "We Buy Houses." You can also do the entire process online at http://www.USPS.gov. Don't expect to get all of the calls at once; sometimes people call months after receiving your cards. Try mailing to the same people two or three times a year. You may get as many calls the second or third time around.

The technique described above would be defined as a blind mailing to a targeted area. You might also consider mailing to specific lists, such as:

- Out-of-state owners (these could be motivated landlords or job transferees)
- Homeowners with poor credit
- People with federal tax liens

- People in foreclosure or bankruptcy within the past year (they may have been bailed out but still be in financial distress).

The names of these people can be purchased from a mailing list broker. Look in your local phone book under “Mailing List Companies.” You should expect to pay 10 to 30 cents per name. In addition, keep a running list of the vacant houses, people who call on your ads, and other leads. Mail postcards to these people on a regular basis.

When it comes to direct mail, many novice investors wonder exactly what the mailing piece should look like. Marketing companies have done exhaustive studies on the most effective color, size, and wording of marketing pieces. In other words, the particulars that get people to respond to one postcard over another. While this information is somewhat useful, don’t get caught up in it—the most important part of marketing is repetition. Keep sending the mail until the recipients ask to be taken off your list or a postcard comes back marked deceased; then find out who the heirs of the estate are.

Flyers and door hangers: In addition to sending postcards, blanket the neighborhoods you choose with other marketing materials such as flyers and door hangers. When funds become available, consider more aggressive advertising, such as bus stop benches and supermarket shopping carts. When homeowners in the area are thinking of selling, they may call you before listing their property with an agent. By saving these people a real estate commission, you may be halfway to your desired purchase discount.

Don’t spend your time passing out flyers and door hangers; rather, hire kids to do it for you. Go back and check to see if the job is done properly before you pay them. Instruct them not to place anything inside a mailbox; rather, put materials inside a screen door or fence, so as not to run afoul of postal regulations.

Door hangers are more expensive than flyers, but they are easier to distribute.
Carry door hangers and flyers in your car when you cruise neighborhoods. Whenever you see people in their yards or a for sale-by-owner sign, stop and talk with the owners, then hand them a flyer.

Magnetic car signs: You can get magnetic signs to place on your car, truck, or van, making it a traveling billboard. We’ve seen entire vans and trucks with “We Buy Houses” all over them. These investors may deduct the entire vehicle as a marketing expense on their income taxes.

A helpful hint: Other unrelated businesses may be marketing their products or services in the same neighborhood using the same advertising means. Offer to split the expense to share your message. For example, if a pizzeria is distributing single-sided flyers, offer to pay for the printing if your message can appear on the back of the flyer. Also, check with local companies that send coupon mailers in bulk. It is much cheaper to mail information when multiple advertisers are involved.

Referrals: As an individual you can cover only a limited amount of ground looking for bargain properties. Because your greatest profit is made at the purchase end of a transaction, it makes sense to enlist others to help you find deals. In fact, you will find that after a few years in the real estate business, your greatest source of deals will be from referrals.

To obtain referrals, you need to pass out contact information. That means getting a nice business card. No, get a really nice business card. Don't be cheap and use the basic white ones from Office Depot, and don't even think about making one on your computer. When you are dealing with a $200,000 asset, look professional. Don't be shy about spending $100 or more on your business cards.

Your card should be double-sided, with a complete message about what you do. Your business should have a catchy name that tells what you do. CTM Investments tells people nothing, but Real Estate Solutions, Inc. tells a lot more. In addition, form a corporation for your business as soon as possible.

Start by passing out your business cards to everyone you know, including business contacts. Let them know what you do, hand them your card, then ask, "Can you think of anyone you know who may have a run-down property?" The best salespeople always use this technique—you should, too.

The next group of people who should get a business card are those who are out working in your target neighborhoods each day. Mail carriers, delivery people, contractors, insurance agents, city building and zoning inspectors, carpenters, and painters all could provide referrals. Introduce yourself to these people and explain that you are looking for run-down, deserted, and ugly properties.

Scouts: You may start out in this business as a scout, but you will soon be a dealer or a retailer in need of a scout or two. You can offer people a referral fee for information leading to a property you purchase. This amount can be anything from $500 to $1,000, depending on how good the deal is. A friend who just stumbled across information about properties will be happy to comply. If you are looking for real scouts, however, it will be difficult to keep them motivated if they only get paid when you buy a property.

Unfortunately, most beginners at any sales job quit after a few weeks, because they lack the mental discipline to stick it out until their first commission check comes. Scouts are no different, so you need to set up a modified payment structure to keep them interested. For example, you can pay $20 for each ugly, vacant house they find. The information should include a photograph of the house, the complete address, the owner's name, and information about the owner's distress (such as foreclosure, bankruptcy, divorce, etc.). You can also give them a couple hundred dollars as a bonus after you purchase the property.

What Types of Properties Tend to be Distressed?

Now that we've talked a bit about ways to find motivated sellers, let's take a look at the types of properties that tend to be sold at a discount. In other words, properties where you are most likely to find bargains. These are bank-owned properties, probate properties, foreclosure properties and government-owned properties.

Bank-owned properties: Properties that are foreclosed by a bank are called REOs (short for real estate owned). Contact your local banks and ask for the REO department. Let them know you buy properties. Some may have special financing available for these properties. It is not easy to establish relationships with these banks. However, once you reach the right people and establish yourself as a serious investor, they will call you with deals.

Probate properties: Every year, countless people die owning real estate in your city. Often, these properties are in a state of disrepair, because the owners neglected them during their final years or because they sat vacant after their death. When someone dies with real estate in his or her name, the ownership does not automatically vest in the heirs of the deceased's estate. The deceased's will must be processed through a court proceeding known as probate.

Probate proceeding can take as much as a year or more in some areas, depending on the backlog of court cases, the amount of the deceased's assets, and the battling between the heirs for their share of the estate. The typical heirs to an estate are no different than the average person; they have no experience in fixing or selling real estate. If the heirs have no emotional attachment to the property, they will be eager for the administrator of the estate to liquidate the property quickly, so they can receive their inheritance in cash.

The easiest place to find probate properties is in the newspaper. The obituaries can be cross-referenced with real estate records in your county. If your county tax assessor has free online listings of properties, run the names of the deceased through the database to find a match. Once you have a match, contact the local probate court to find out the name of the administrator of the estate. Even though particular situations may not present a deal for you, administrators can keep your name on file in case they are the administrator of other estates.

Foreclosure properties: *Chasing foreclosures* is slang for following properties through the foreclosure process while attempting to entice the owners to sell, Foreclosure properties can be the best or the most frustrating source of leads. The information is public, so every seminar junkie in town is competing with you. To work the foreclosure market successfully, you must understand how the foreclosure process works.

Foreclosure is the legal process of the mortgage holder taking the collateral for a promissory note in default. The process is slightly different from state to state, but there are basically two types of foreclosure: judicial and nonjudicial. In mortgage states, judicial foreclosure is commonly used, while in deed-of-trust states, nonjudicial foreclosure is the most common. Many states permit both types of proceedings, but standard practice in most states is to use exclusively one method or the other.

Judicial foreclosure is a lawsuit that the lender (mortgagee) brings against the borrower (mortgagor) to get the property. About half of the states use judicial foreclosure. Like all lawsuits, foreclosure starts with a summons and a complaint served upon the borrower and any other parties with inferior rights in the property. (Remember, all junior liens, including tenancies, are wiped out by the foreclosure.)

If the borrower does not file an answer to the lawsuit, the lender gets a judgment by default. A referee is then appointed by the court to compute the total amount (including interest and attorney's fees) that is due. The lender then must advertise a notice of sale in the newspaper for four to six weeks. If the total amount due is not paid, the referee conducts a public sale on the courthouse steps. The entire process can take as little as 3 months and as many as 12 months depending on the volume of court cases in that county.

The sale is conducted like an auction, because the property goes to the highest bidder. Unless significant equity is in the property, the only bidder at the sale will be a representative of the lender. The lender can bid up to the amount it is owed, without actually having to come up with cash out of pocket to purchase the property.

If the proceeds from the sale are insufficient to satisfy the amount owed to the lender, the lender may be entitled to a deficiency judgment against the borrower and anyone else who guaranteed the loan. Some states (e.g., California) prohibit a lender from obtaining a deficiency judgment against a borrower.

In nonjudicial foreclosure, many states permit a lender to foreclose without a lawsuit, using what is commonly called a power of sale. Rather than a mortgage, the borrower (grantor) gives a deed of trust to a trustee to hold for the lender (beneficiary). Upon default, the lender simply files a notice of default and a notice of sale, which is published in the newspaper. The entire process generally takes about 90 days. The borrower usually has a right of redemption after the sale. (See the following section on redemption rights.) In some states, mortgages also contain a power of sale.

A few states permit strict foreclosure, which does not require a sale. When the proceeding is started, the borrower has a certain amount of time to pay what is owed. Once that date has passed, title reverts to the lender.

Many states permit a borrower to "cure the loan" before the date of sale. This process simply requires paying the amount in arrears, plus interest and attorney's fees. It is certainly more desirable for a defaulting borrower to reinstate a loan rather than pay off the entire principal balance. Most deed-of-trust states permit the borrower to reinstate the loan before the sale.

Some states give a borrower the right to redeem the amount owed and get title to the property back after the sale. The length of the redemption period varies from state to state. Obtaining a deed from the owner during the redemption period gives you the right to redeem the property.

The easiest way to deal with a foreclosure is to get the owner to deed you the property. Once you have the deed to the property, you are the owner. You can now try to negotiate a discount on the amount owed to the foreclosing lender. Many lenders will not deal with you unless you have written permission from the owner, because releasing such information may violate Fair Credit Reporting Laws. It is a good idea to get a written authorization or a power of attorney from the seller along with the deed. Check with your state law for the proper form.

Visit your local courthouse to find names of property owners in foreclosure. Better yet, subscribe to one of the local foreclosure listing services. These companies gather this information each week and sell it for a reasonable fee, saving you a great deal of time. The information you want to buy is the list of people in foreclosure, not properties that have been already foreclosed and have been taken back by the bank. Check your local phone book and ask other investors in your area which services are reputable.

If the homeowner is too far along in the foreclosure process when you locate him/her, you may have to buy the property at the foreclosure sale. In a foreclosure, there is a public sale of the property in all but strict foreclosure states. Contact your local courthouse and ask where this sale will happen. Visit a few sales to watch the action before engaging in a bid. Don't be surprised if no one bids but the foreclosing lender.

Most properties in foreclosure don't have enough equity to justify a bid from an investor. To buy at the foreclosure sale, you must bring certified funds for a portion of the bid price. The balance is usually due within a few weeks of the sale. You need some experience to buy properties at auction, so consider holding off until you have a few deals under your belt or have a partner who can show you the ropes.

At any time during the foreclosure process, you can buy the mortgage from the lender and finish the foreclosure. If the first mortgage is relatively small compared to the value of the property, it may be worthwhile to buy it. This method, of course, requires a lot of capital and experience.

In states that have a redemption period, many of the deals happen during that time. Remember that redemption is the right to purchase the property out of the foreclosure for the entire balance owed. The highest right of redemption is from the owner, borrower, or guarantor on the note. If none of these people redeem, the junior lien holders, who are in danger of being wiped out by the foreclosing senior lien holder, can redeem the property. Thus, if there are two mortgages on the property and the first mortgage holder is foreclosing, the second mortgage holder can redeem the property by paying what is owed on the first mortgage, plus late fees, court costs, and interest. The second mortgage holder then becomes the owner of the property. This process is technical and tricky, and it often attracts crooks and scam artists who create phony liens in an attempt to redeem the property.

Government-owned properties: The federal government becomes the owner of tens of thousands of properties each year. Many can he purchased at good discounts, if you know how to find them.

One type of government-owned property is the FHA "repos." Certain loan programs are guaranteed or insured by the federal government. The Federal Housing Administration (FHA), which operates under the Department of Housing and Urban Development (HUD), insures certain loans targeted at first-time homebuyers in lower income neighborhoods. When these loans are in default, the government ends up with the properties.

Most of these properties are listed and sold through real estate agents. The property is first offered to potential owner-occupants in a bid process. When no suitable owner-occupant is found, the properties go on an extended listing, which is offered to everyone, including investors. You can place a bid on these properties with as little as $1,000 as earnest money, and, if your bid is accepted, you have about 45 - 60 days to close. You can even extend that date a few weeks by paying a reasonable fee.

The bidding process is difficult, and you need a savvy real estate agent to help you along. As you may have guessed, the great thing about the HUD process is that you have a long time to close and are only required to risk $1,000 in earnest money. However, the HUD contract has no "weasel clauses," so you will lose your earnest money if you fail to close.

Furthermore, the HUD contract is not assignable, so you have to do a double closing to flip the property to another investor. If you get the property at the right price, 60 days is more than enough time to make things happen.

Finding good deals is the linchpin of all real estate investing. Don't go it alone at first. Have a seasoned coach by your side.

Chapter 8: How Do You Value the House?

It is extremely important to establish the value of a property before making an offer. Base your offer on what the house will sell for after necessary repairs. Remember to learn the area first, and buy in your “farm area” when possible. Always take a conservative approach until you gain experience in dealing in a particular market. Start with a few neighborhoods within a subdivision that contain similar houses, because dealing with similar houses makes price comparisons much easier.

Should You Use an Appraiser?

An expensive but accurate way to determine the value of a home is to hire a licensed appraiser. The appraisal will cost you around $300. This amount is cheap compared to what you could potentially lose, but appraisals can be costly if you are making multiple offers. It may be worthwhile to pay an appraiser on your first purchases to verify your assumptions of value (but not until you have the properties under contract). In addition, follow appraisers as they inspect the properties and ask a lot of questions to learn how they arrive at their figures.

Basically, licensed appraisers look at the three most similar houses in the vicinity that have sold recently. They then compare square footage and other attributes. The number of bedrooms and baths, age of the property, improvements, physical condition, and the presence of a garage will affect the price, but square footage is usually the most important factor.

As you might expect, there are exceptions to this rule. For example, the style of house, its location and proximity to main roads, and whether it has a view or beach access will greatly affect the value. Of course, you probably will not be flipping many beachfront properties. For the most part, however, if you leave these issues aside, square footage, number of bedrooms and baths, and physical condition are the most relevant factors.

Can You Do Your Own Appraisals?

Doing an appraisal yourself is not that difficult. You start by accessing information about houses sold recently. Until recently, access to this information was limited to licensed real estate agents through the Multiple Listing Service (MLS). In today’s Information Age, this data is available through various channels such as the county tax assessor, Internet Web sites, or paid providers.

Armed with information about properties sold in the area, you can drive by these houses and compare them with the subject property. You will not be able to see the inside, so you need to adjust your numbers a bit. Also, public records may have inaccurate information about square footage, additions, number of beds and baths, and basement versus above-ground living space. In addition, public records do not offer much detail, and the property may have been improved or expanded after it was built.

All of these variables aside, you can still assess the style of property, whether it has a garage, its general condition, and appearance. Only look at houses sold in the area within the past six months. Try to acquire information about the type of financing on the house, because terms can influence the sales price. For example, an owner-carry sale (one in which the seller takes all or part of the purchase price in the form of a note) at an inflated price should not be considered in your figures, because these prices tend to be artificially high.

Keep in mind that seasons affect sales prices. Most people prefer to buy in the summer when their children are out of school. Additionally, if you are in a resort area, prices may fluctuate drastically between the summer and the winter.

How Can You Get Comparable Sales Figures?

A practical but less accurate way to establish value is by asking a real estate agent for comparable sales or "comps." If the property is listed or you are using a buyer's agent, agents will gladly provide this information free of charge. Some listing agents will have prepared a written comparative market analysis (CMA) for the property. You cannot always rely on the MLS information about the inside, however, because agents' property descriptions tend to be exaggerated. Furthermore, the information on the comparable properties that agents give you may only contain the ones they want you to see. The lesson here is to never rely solely on an agent's comps or CMAs but do your own due diligence.

If the property was refinanced in the past year or so, take a look at the seller's appraisal. Keep in mind that some appraisers will inflate the value of the property if they are in close with the mortgage broker handling the refinancing. This practice is legal within limits, because the appraiser is required to determine property value based on certain guidelines. Sellers want a high appraisal, so their appraiser will employ the highest comps. A person fighting a high property tax assessment can instruct the appraiser to find low (while still conforming) comparable sales.

There is an old saying among real estate vets that a house is often its own best "comp." If a particular house has been listed on the local MLS longer than the average listing period, chances are the house is priced too high. A seller may show you an appraisal from a refinance process six months ago, showing a price even higher than that. Don't be fooled; the market will determine what a house is worth. Thus, if a house is appraised for $200,000 and has been sitting on the market for six months, the obvious conclusion is that it's not worth $200,000. In short, be careful of appraisals that don't jibe with reality.

Keep in mind that certain features may not necessarily raise the value of the property, but may impact the appeal and, ultimately, the salability. For example, renovating a kitchen should not affect the appraisal value of a property, because it doesn't add living space or functionality. But if the kitchen looks horrid, then the house is not in marketable condition and will attract fewer buyers, take longer to sell, and command a lower price.

Also, keep in mind that bedrooms and baths on the main level add more value than bedrooms and baths in a basement or attic Thus, while a finished basement may add some appeal and functionality, it may not raise the appraisal value of the property by much, Whether it is worth finishing a basement depends on a lot of factors, including what is customary for the area. For example, a new ranch house with a walkout from the basement will have much more value with a finished basement than a three-story 100-year-old Victorian.

All of these variables will impact the market value of a property. Once you have an idea of the market value or after repaired value (ARV), you need to determine the wholesale price that you are willing to pay.

Presumably, you will start out as a scout or dealer, so you need to find out what kind of discount the retailers are looking for and you have a starting point. For example, a retailer may be willing to pay 70 to 80 percent of the property's market value. Subtract from that discounted price the estimated cost of repairs, leaving a healthy margin for error. Then subtract your profit in the deal. Your profit may be anywhere from $1,000 to $5,000, depending on the price of the property and your marketplace.

When figuring in your profit, don't expect too much. Many amateur and some experienced, albeit foolish, investors expect more profit than they deserve out of a deal. Be realistic. If you want to sell a property quickly to another investor who will do a lot of work, you can't expect to make as much as the investor.

The corollary to *don't be greedy* is to remember to make your offer with two investors in mind. A lot of beginning dealers forget that there must be enough profit in the deal for both themselves and the retailer to make money. Thus, you must offer the seller the wholesale price minus your anticipated profit.

It is relatively easy to find a starting point as a dealer; simply ask the retailer what he or she is willing to pay you. Thus, being a retailer takes a little more experience in estimating the following factors:

- A market value of the property after resale
- Acquisition and financing costs
- Labor and material costs (include cost overruns)
- Time required to complete repairs, weather factors, and availability of labor
- Estimated time on the market;
- Time involved for supervising construction
- Real estate agent commissions and other sales costs

No magic formula works in every market, in every neighborhood, for every house. In our market (Denver, Colorado), the market is rather flat, so we buy properties at 70 to 80 percent of the market value or less. In hot markets, you can pay as high as 85 to 90 percent and still profit, because the property is likely to appreciate another 5 to 10 percent by the time you have rehabbed it. You don't need to be in an up market to make a profit flipping properties, but it is important to know where your market currently is and where it is going.

Our recommendation is to flip a few properties first, then review the numbers on those properties with the retailers who sold them to the owner-occupants. After reviewing a dozen or so deals with several retailers, you will get a feel for what kind of discount is necessary.

After establishing the retail price, the appropriate discount, repairs, and your profit, you finally arrive at your offering price, right? Wrong! This price is the maximum you can afford to pay. Leave enough room in the equation for the seller's counter-offer. This brings us to the next topic: negotiating!

Chapter 9: What Do You Say When You Make Initial Contact?

You've found and valued the property. Now what? You need to talk to the homeowner to find out what he wants, share what you want and possibly make a deal. In other words, you need to *negotiate*.

Negotiating the right price and/or terms for your properties is the most important part of the profit-making process. Many people are either afraid to negotiate or inept at the negotiating process. Other so-called investors pay too much for a property and then are left with no way to make a profit other than the "greater fool" theory. Learn to negotiate a good purchase price quickly, or you will face a tough road ahead.

The biggest mistake you can make is negotiating with someone who is not highly motivated to sell. Once in a while, you will run across the "garage sale" seller—that is, someone without a clue about the value of the property. These opportunities are rare, and pursuing them will not make you a living. Rather than taking advantage of ignorant people, deal with people who *need* and *want* to sell quickly.

What Should You Do First?

This may sound overly simplistic, and in some ways it is, but your very first job is to find out what the seller wants.

The necessity of speaking to motivated sellers, and motivated sellers only, can't be overstated. Talking to sellers who are marginally motivated is the biggest mistake beginning investors can make. Every minute you spend speaking to an unmotivated seller is time wasted.

You must speak to the seller and find out what he or she wants. Don't burn precious hours driving by the house and looking for comps without even talking to the seller first. Many novice investors spend countless hours researching the property, the needed repairs, the taxes, and other information without first finding out the seller's motivation.

Never leave your home before speaking with a seller over the telephone. Gather as much information as you can, asking the six basic questions: who, what, where, when, how, and why? Listen for clues. Sellers won't always tell you what they really want, so you have to dig a little and be patient.

Once you have established that someone is motivated, dig deeper. Find out exactly what makes this seller tick. Why does this person need to sell? By when does the individual need to sell? Is price more important than terms? What will the seller do with the proceeds? You need to get these questions answered before you even consider making an offer—even before going to see the property. Instead of jumping right in with tough questions that may offend the seller, start by asking a few questions about the property.

Don’t be too concerned with the physical aspects of the property when talking with a seller on the phone. Your goal is to determine whether the seller is motivated enough to make you a deal. Talk about the weather, sports teams, how much you hate politicians, etc. When you sense the seller is opening up a bit, ask the following questions:

- “Why are you selling?”
- “How long have you owned the property?”
- “What did you pay for it when you bought it?”
- “When do you need to sell it by?”
- “Have you listed it with a real estate agent? Why/Why not?”
- “What are your plans after you sell?”
- “After paying all the closing costs and paying off your loan, what is the minimum amount of cash you need in your pocket?”
- “What will you do with the proceeds from the sale of your house?”
- “If I were to close in a week and pay all cash, what is the very best you can do in terms of price?”

Continue to develop your phone skills and experiment with new questions. You need to communicate in a way that works with your personality. No one can tell you all the perfect things to say for each situation. Just be yourself; develop rapport and zone in on what the seller needs. The best salespeople are those who find what their customers need and present their product in a way that fulfills those needs.

Successful investors are essentially problem solvers. Problem solvers are among the highest-paid individuals in the world. The problems homeowners face may seem insurmountable to them. With experience and practice, however, you will learn many approaches to solving their problems. It is just a matter of time until you, the investor, will earn a profit while helping homeowners solve their problems in an ethical way.

Just for practice, record your telephone conversations with motivated sellers (as long as it’s not illegal in your state). Use these recordings to improve your sales pitch. Track your results, and you will soon find an effective approach for making your calls.

How Do You Introduce a Dollar Figure?

The short answer to this question is: You don’t! Let the seller make you an offer. Most novice investors make the foolish mistake of always making the first offer. While in some circumstances, this approach may be appropriate or desirable, if your offer is too low, the seller may be offended. Let the seller make the first move. “Mr. Seller, what is the best deal you can offer me on this property?" This statement puts the pressure on the seller who may be afraid of driving you away by asking too much. Whatever your prospect offers, you ask him or her to do better. Henry Kissinger was the master of this technique. He would routinely send back proposals without reading them, saying, "You can do better." Get the seller to go as low as possible, then negotiate from there.

Once you get a contract accepted at the price you like, it may still be too much. Leave room for error or for things you overlooked. Always have an inspection clause in your contract that allows you to dicker with the seller and to renegotiate if necessary. Please understand—we are not advocating that you beat up people after you agree on a price. However, sometimes you will discover problems with the property that were unknown to either party or that the seller conveniently forgot to tell you about. As a real estate agent friend used to say, "All sellers are storytellers!"

Which Is More Important to the Seller: Price or Terms?

You never know until you ask. In some cases, price isn't everything. You need to know what it is that motivates your particular seller. Some sellers want the highest price, but many just want their problems solved quickly. That's where you can truly help. Here are some ways to do so.

Offer a fast closing. Offering a fast closing with few contingencies will often perk up the seller's ears. If the seller says, "A real estate agent told me the property is worth more," you respond with, "Does the real estate agent have a buyer ready to close next week?" Sometimes offering a contract with no contingencies is your strongest offer, especially when dealing with real estate agents. Of course, a real estate contract with no contingencies is risky, because you will lose your earnest money deposit if you fail to purchase the property.

Purchase "subject to" the existing mortgage. When retailers quote you the appropriate discount they want, they are including the cost of financing the property. Most retailers use credit lines and/or conventional bank financing to purchase properties. These loans have certain costs associated with them, which reduce the net profit in the deal. Whether you are a dealer or a retailer, you can save money by avoiding these new loan costs, thus offering the seller a higher price (or more net cash in the seller's pocket).

Chances are the seller has an existing loan on the property. Offer the seller the cash difference between the purchase price and the seller's loan balance. At the closing, you take the title subject to the existing mortgage. You make the monthly payments directly to the seller's lender and pay off the balance of the mortgage when the property is sold to the retail buyer. Even if you are buying the property with "subject to" conditions as a dealer, you can pass these savings on to the retailer who buys the property from you. Another benefit of the "subject to" transaction is that it allows you to close without a third-party lender, which translates to a faster closing.

Split-fund the sale. A seller you are negotiating with may own a property outright or may have a very small mortgage. Thus, the seller may receive more cash from closing than needed (which you have already established by asking good questions). If this is the case, offer to split-fund the purchase price. Split-funding means you will pay the seller "some now, some later" Offer to pay 20 percent at closing, followed by another 20 percent in 60 days, and the balance in 6 months. Be creative with your offers and conserve your cash whenever possible.

Make multiple offers. When you make an offer, the seller has two choices: take it or leave it. When you make two alternative offers, the seller has more choices. For example, you can offer the seller all cash and a 30-day closing or a split-funded purchase that closes next week. In some cases, it doesn't even occur to the seller that he or she doesn't need to accept either offer!

No matter how creatively you structure your deal, keep one hard and fast negotiating rule in mind. If you make a concession, get something in return. This strategy is one of the most underused in the negotiation game. If the seller asks for more money, you ask for more time. If the seller asks for a shorter closing date, you ask for the appliances. Never give a concession without getting something in return.

A special note on working with owners in foreclosure:

When making contact with homeowners in foreclosure, you may not be able to telephone them first. (If they aren't paying their mortgage, isn't it possible they aren't paying the phone bill either?) That means your first contact may come after you knock on the door. This is not only gutsy, it is risky. You may be dealing with a bitter, belligerent person. More than likely, you will be dealing with people who are not being honest with themselves about the situation.

Don't try to bully the sellers into giving you the deed. Just let them know you are available, give them your business card, and check back from time to time. The more you follow up, the greater the chance that you will make a deal. At some point, the sellers in foreclosure will face reality, and they will usually sell to the first person who comes banging on their door. The more you stay in touch, the greater the chance that you will be that person. (Note: Before you get a deed from a seller in foreclosure, you may need to have a written contract with certain disclosures mandated by the law of the state. At this printing, those states include California, Maryland, Minnesota, and Missouri; several more states are considering similar legislation.)

Because many people in foreclosure delude themselves into thinking a better offer is right around the corner, you may want to offer a buyout contract. In essence, your written contract will give the sellers the right to cancel if they obtain a written offer better than yours before your closing date. A "buyout fee" goes along with that right to cancel, however. In essence, you are getting paid not to buy the house. The buyout fee is negotiable, but make sure it is enough to make it worth your while.

How Do You Handle Real Estate Agents During the Negotiation Process?

Real estate agents have access to a valuable source of potential deals for the investor—the Multiple Listing Service (MLS). Unfortunately, real estate agents have a monopoly on this information, so they may be a necessary part of an investor's game plan.

Dealing with real estate agents can be difficult as an investor. Agents prefer homebuyers with cash for down payments. They also prefer to work with buyers who have good credit and conventional buying power. The agent's priority is getting a commission with as little hassle as possible. Most agents have never conducted a creative real estate transaction with an investor. These agents are not very receptive to unusual offers. Most agents equate a nothing-down offer with a buyer who is not serious. Here are some things you can do to get an agent's attention and streamline the process.

Offer reasonable earnest money. You cannot present an offer with a $50 earnest money deposit and expect an agent to take you seriously. Expect to pay at least $500 to $1,000 earnest money, depending on the purchase price, to get the agent's (and seller's) attention. Offer more earnest money when presenting an all-cash offer. If you are concerned with losing your earnest money, consider using a promissory note.

Offer a short closing date. Another way to get an agent's attention is to offer a fast closing. Nothing makes an agent more excited than the thought of a commission check in ten days. When deciding between two offers, the agent will usually advise the client to accept an offer with more earnest money and a faster closing over a higher-priced offer.

Present creative offers in person. When you present an offer to an agent, the agent then presents it to the seller on your behalf. If you present a creative offer, the agent probably will not represent your offer to the seller in an enthusiastic fashion. As stated previously, agents do not like creative offers; they like conventional offers from solid buyers. If you want the owner to understand all the benefits of your offer, insist on personally presenting the offer to the seller.

Appeal to the agent's greed. Let's face it. Real estate agents are in the game to make money, just like people in other businesses. If you offer agents an opportunity to make money out of the transaction, you will get their cooperation. If you present an offer that does not provide enough cash to pay the agent, then the agent has no reason to cooperate with you. For example, if you present a nothing-down offer on a listed property, how will the agent receive a commission? You must include a means to pay the agent, even if you pay out of your own pocket.

Do your own comps. Sometimes you will deal with the opposite of an uncooperative agent—an overzealous agent. Be suspicious of agents who tell you what a deal you are getting on a property. If it is such a good deal, why didn't they buy it? Do not trust them to determine the property's value. Do your own assessment of value. Remember, agents are looking out for their commission, not for your financial well-being.

Fax preliminary offers first. Technically speaking, all offers presented by agents must be made on state-approved contracts. But don't waste time filling out a contract offer until you have preliminary approval. Most agents are willing to present any written offer to the seller. Simply summarize your offer in writing and fax it to the listing agent. Once you have an oral approval, take the time to fill out a contract and deliver an earnest money check. Never put up earnest money until your offer is accepted. Fax the offer with a copy of an earnest money check with originals to be delivered "upon acceptance of contract."

Most of all don't be bullied by uncooperative agents. Stand up for yourself. Some agents are unethical and will refuse to present your offer. These agents may lie, telling you that your offer was rejected when, in fact, it was never presented. If you suspect the listing agent is lying, go over that person's head to the managing broker of the office. If the managing broker is uncooperative, deal directly with the seller (unless, of course, you are also an agent). Be polite, but firm, and do not hesitate to report any unethical behavior to your state's agency responsible for regulating real estate agents.

Knowing what to say and how to say it comes with experience. Create a detailed script for yourself until talking to distressed homeowners becomes second nature. If scripting isn't your forte, get a coach to help you with that aspect. Go to www.realestateinvestortraining.com to learn more about coaching.

Chapter 10: How Do You Finance the Purchase?

As a property flipper, your ideal transaction would be to assign your contract or close simultaneously with a buyer's purchase, so you have no cash out of pocket. If you have no money and can't find a buyer before your closing date, you would lose your investment (i.e., your earnest money). Furthermore, if you intended to sell the property retail, you would need funds to close, carry, and rehab the property.

Acquiring loans to purchase properties is less difficult than you may think. Many beginning investors are afraid to make offers because they are uncertain how they will get the money needed to purchase. Have faith; if you can negotiate a good enough deal, the money will find you!

Having good credit will increase your financing choices, but it is not a necessity for buying real estate. You should line up your financing options as soon as possible. This may involve using your own cash, a partner's cash, or a bank loan—or finding another investor to whom you sell the property.

Having fast access to cash means having the ability to close quickly. Often, motivated sellers will accept the lower of two offers because that buyer can close more quickly. Other sellers may accept a lower offer because that buyer's ability to obtain financing looks more solid. As you begin to juggle multiple deals or aspire to purchase properties to hold, your financing knowledge, or lack thereof, can determine how successful you ultimately will be.

Should You Use Your Own Cash?

If you are in a market where junker houses sell for $50,000, you can certainly use all cash to buy properties. In New York City or the San Francisco Bay area, however, where junker properties often sell for more than $300,000, this may be more difficult.

Furthermore, using cash may not be an effective use of your money, because your ability to make deals will be limited to the amount of cash you have on hand. The sale of a house could be delayed for any number of reasons, resulting in lost opportunities. Rehab properties tend to take longer than originally expected and often go over budget. You should not use all cash unless you have an unlimited supply or have a guaranteed out within a short time. Even if you have a lot of cash, resist the temptation to use it.

Experienced investors often reveal that they make some of their worst decisions when they have a lot of cash on hand. In contrast, having little cash forces you to think creatively. No matter how much cash you have, pretend you don't have it!

One minor exception to the all-cash rule is to use your IRA/ SEP money to fund your purchases. You can use this money to buy and sell real estate tax-free. custodians will allow you to use your IRA to buy and sell real estate, make real estate loans, and do other creative deals that most IRA custodians will not allow. Your IRA can even be the buyer and seller of the property, earning the profits tax-free.

As with any start-up business, your cash is best spent in the areas of marketing and advertising. Use your available cash to get the phone ringing with motivated sellers. You may lose a few deals for lack of cash for buying properties, but you will have more overall business. You don’t need to worry about disappointed customers, because there are rarely repeat sales in this business.

What Are the Options for Using Other People’s Money (OPM)?

An unlimited supply of private money is available for profitable deals. Of course, when you go outside of your own cash reserves for money, you must give up some of the profit. If you do not have enough cash, three options are available:

1. Borrowed money

2. Partners

3. Seller financing

Let’s discuss these three options.

Borrowed money: Your financing needs will vary depending on the type of property you select and on how long you intend to keep the property. The focus of this book is on flipping properties, so we won’t spend time on borrowing money the old-fashioned way. Whenever you borrow money, you increase your risk of loss, so get your feet wet by flipping a few deals before thinking about borrowing money.

If you have spotless credit and a substantial salary or other source of income, borrowing money from institutional lenders is easy. You can easily obtain low-interest loans for investment properties with a 20 percent down payment or more. Some loan programs will permit you to put as little as 10 percent down or even 5 percent down, but these programs are stringent, have high closing costs, and generally require good credit.

If you intend to sell the property to a retail buyer within a few months, you should not be concerned about the interest rate but rather about the cost of the loan. Lenders charge points, which is a fancy name for profit. Each point is a percent of the loan; for example, on a $100,000 loan, 1.5 points amount to $1,500. This fee is paid when you originate the loan. Beware of other hidden charges, such as origination fees, loan review, underwriting, and other garbage fees. They all mean cash out of your pocket at closing. Also, make sure your loan does not have a prepayment penalty, another fee that must be paid when you pay off the loan early.

Once you are more experienced at estimating repair costs, fixing properties, and marketing them for resale, then consider using institutional lending. It is a reliable way to purchase properties.

Friends and relatives are obvious choices for borrowing money, but they may be as skeptical as an institutional lender if you have no experience in real estate. They may also try to boss you around and nag you about repaying the money you borrowed. Do yourself a favor and wait until you have more experience before approaching friends and relatives. Once they see that you're making money, they will come to you.

Private money can be found by looking in the real estate classified section of your local newspaper under "Money to Loan." You will find dozens of advertisements for private moneylenders. The rates they charge are almost criminal—as much as 18 percent with 10 points in fees! While these rates may seem absurd, keep in mind that the availability of the money counts more than the cost of borrowing it. It can actually be cheaper to borrow "hard money" than to use a partner and give up half of the profits.

Many of these lenders (called hard money lenders) will lend without proof of income or a credit report. Their loan criteria are based on the value of the property. They will usually lend anywhere from 50 percent to 70 percent of the appraised value of the property. If you have negotiated a price that is 80 percent of the market value of the property, you don't need to come up with a lot of cash. Institutional lenders, on the other hand, penalize you for negotiating a good deal by basing the loan on the appraised value or the purchase price, whichever is less.

You can also tap into credit cards and credit lines to finance properties. You may already have more available credit than you realize. Credit cards and other existing revolving debt accounts can be quite useful in real estate investing. Most major credit cards allow you to take cash advances or write checks to borrow on the account. The transaction fees and interest rates are fairly high, but you can access this money on 24 hours' notice. Also, you won't have to pay the loan costs normally associated with a real estate transaction, such as title insurance, appraisals, pest inspections, surveys, and so on. Often, you will be better off paying 18 percent interest or more on a credit line for six months than paying 9 percent interest on an institutional loan, which has upfront costs that would take you years to recoup.

Promotional interest rates are often available on your credit cards, but again, beware. These rates often skyrocket after several months. Chances are, if you have a good credit history, you will be able to raise your credit limits on your existing cards. Creditors do not need to know you will be using your credit cards for the business of investing. Ironically, these creditors would rather see you using credit line increases for typical consumer purchases that depreciate in value and produce no income.

High interest debt must be approached cautiously, and your personality type may not embrace the idea of tens of thousands of dollars in revolving debt. However, avoiding mortgages saves you time and often money, so keep credit cards in mind. You can also benefit by using department store cards with no cash advance features. These cards are available through all the major lumberyards, hardware store chains, and home improvement stores. They will allow you to finance your materials costs, which can add up to thousands of dollars. The interest you pay for the use of this money is tax deductible, so be careful to separate your business from your personal credit card use.

A home equity line of credit (HELOC) can be an excellent financing tool when used properly. A HELOC is basically a credit card secured by a mortgage or deed of trust on your property. You only pay interest on the amounts you borrow on the HELOC. If you don't use the line of credit, you don't have any monthly payments to make. You can access the HELOC by writing checks provided by the lender. In most cases, it will be a second lien on your property.

The HELOC only should be used as a temporary financing source, which can be repaid when you refinance or sell the property. Do not use your HELOC as a down payment or any other long-term financing source—it will generally get you into financial trouble. If you don't pay the HELOC, you can lose your home!

Some institutional lenders won't lend you the balance if you borrowed the funds for the down payment. However, smaller commercial banks that offer "portfolio" loans have more flexibility and may allow you to use HELOC money as a down payment. Once again, use caution when borrowing money in this manner; only do it if the deal is a steal and you can pay off the HELOC money within a few months.

There are limits on the deductions you can take on your personal tax return for interest paid on your HELOC. Generally speaking, you can only deduct that portion of interest on debt that does not exceed the value of your home and is less than $100,000. But if you do your real estate investments as a corporate entity, you can always lend the money to that entity and have the entity take the deduction as a business interest expense. This transaction must, of course, be reported on your personal return, and it must be an "arm's-length" transaction (i.e., documented in writing and within the realm of a normal business transaction). Consult with your tax advisor before proceeding with this strategy.

Partners: Bringing in partners is a good way to start if you are flat broke and lack experience. But choose your partners carefully. Don't select a partner who contributes the same thing you do—enthusiasm (but no money). Don't pick a partner because that person is your friend or you think it would be fun to be in business together. Instead, choose one who has money and experience in real estate and who can fund a deal that you have negotiated. If you are really green, consider flipping the property to your partner for a quick buck. If you want to see the process through to the retail buyer, and want to make more profit, then using a partner with money and experience can be a worthwhile venture.

Remember, partners are looking for a profit split. Every deal will be different, but start the negotiating with a 50-50 profit split. The partner putting up the money and doing the work, such as supervising contractors, may insist on more of the profit. Based on the estimated sales price, purchase costs, and repair costs, you can make a reasonable estimate of the total net profit. If your projected percentage is not sufficient, consider flipping the property to the investor and moving on to another deal.

If you choose to take on a partner, you've created a joint venture, which is a limited-purpose partnership. Develop a written joint agreement with your partner that spells out, among other things, the duties of each party and the manner in which money is contributed. For a long-term partnership arrangement, consider forming a corporation or limited liability company.

Seller financing: Having the seller finance the sale, even in part, is the best way to purchase a property. This approach does not require bank qualification, credit, personal liability, or garbage fees. Realize that, if you don't have loan costs involved in the transaction, you can afford to pay the seller a higher price.

Two types of seller-financed sales are the owner-carry sale and buying subject to the existing loan.

An owner-carry transaction or installment sale occurs whenever the seller takes less than all cash for the purchase price. Keep in mind that all cash does not necessarily mean you paid cash out of your pocket; it can also mean borrowed money. The less of the purchase price you have to pay, the better the deal becomes—even if you flip the property to another investor. The ideal scenario would be if the seller owned the property free and clear, then took a small cash down payment and a note for the balance of the purchase price. In the real world, however, this rarely happens.

When you transfer title to a property without paying off or assuming the existing loan, you are taking the property subject to the existing loan. In most cases, the mortgage or deed of trust securing the existing loan contains a due-on-sale restriction, allowing the lender to call the balance owed immediately due and payable.

Some misinformed real estate "professionals" will tell you that transferring ownership of a property without notifying the lender is illegal. At the time of this writing, no such federal law exists, although the state of North Carolina was considering mandating such a disclosure. Remember that the lender has the *option* to call the loan due but won't necessarily do so. Because you will have title only for a short period of time, this issue is (at least to you) wholly irrelevant. You will have sold the property long before the lender discovers the transfer and decides to initiate foreclosure proceedings. However, check your state law to make sure it does not require written disclosure to the seller or to the seller's lender.

When taking "subject to," be sure that you:

- Get a power of attorney so you can deal with the seller's lender for payoff information, or in case you did something wrong with the execution of the original deed and cannot get in touch with the seller

- Get the seller's payment booklet or last monthly statement and send in a change-of-address form, so the statements get mailed to you

- Have the seller sign a "CYA" acknowledgment about the fact that you are not assuming the loan, which will remain on the seller's credit report until you pay it off

If you can buy a property subject to the existing loan, you will save thousands of dollars in loan origination costs, closing costs, and other garbage fees. Ideally, you could find out what the seller wants to net in cash from the transactions, then pay the seller that cash and have him or her deed you the property subject to the existing loan. Of course, the total purchase price would have to be low enough for you to make a profit. If the property is in foreclosure, it won't be difficult to convince the seller to deed you the property in exchange for cash and your promise to make up the back payments on the loan and continue making payments.

The problem, however, is convincing a seller who is current on loan payments that you will make payments after the seller deeds the property to you. Remember that, once the seller deeds you the property, the seller has no recourse if you fail to make the payments on that loan. His or her credit will be adversely affected if you fail to make timely payments. So your issue becomes: "How do you convince the seller to deed you the property?" The issue for the seller is: "How do I know you'll make the payments?" The seller wants finality—to have the loan paid off completely and removed from his or her credit report.

You could start by simply telling the seller your intentions— that you will fix up the property and sell it to a retail buyer, at which time you will pay off the seller's loan. In the meantime, you will continue making payments. If your word is not good enough, simply insert a clause into the purchase contract that states:

Purchaser agrees to satisfy seller's loan with ________________ bank loan #__________ on or before __________ , 200_, and further agrees to make timely monthly payments required by said lender, including tax and insurance escrows as they become due. This clause shall survive closing of the title.

The payoff date should be at least six months out, preferably one year. Of course, the seller's legal recourse is to sue if you don't perform, given that the seller has no recourse against the property. If the seller is savvy enough (or concerned enough) to understand the legal position, offer a second mortgage on the property. This mortgage is for a nominal amount, such as $10, but states that your failure to make payment on the seller's underlying mortgage places you in default of the second mortgage. Thus, if you failed to make payments, the seller would have the right to foreclose against the property to get the title back.

Another way to make the seller feel more secure would be to set up a third-party escrow with a collection company. This company would collect payments from you each month, send them to the lender, and send a copy to the seller. A more practical way to accomplish the same task would be to set up a bank account with a direct deposit to the lender. The bank would send the seller duplicate copies of the bank statements each month. Many banks also have online automated banking services, which require only the borrower's loan number and Social Security number. Either you or the former owner can log in and make or verify payments online.

If the seller won't hand over the deed to the property, consider using an installment land contract. This creates a wraparound transaction in which you make payments to the seller, then the seller makes them to the bank. This is similar to the way banks handle car loans; they hold title as security for payment until the loan is paid off. For tax purposes, an installment land contract is a sale, but it puts the buyer in a weaker legal position. If the seller refuses to convey title when you tender the balance of the purchase price, you must sue the seller in court.

Investors don't make money in court; lawyers do. Make sure you approach a land contract with caution and have an experienced attorney review the documents.

Chapter 11: How Do You Write a Contract?

Talk is cheap. Without a written agreement, you don't have a deal. At some point after negotiating with a seller (or buyer), you need to get things in writing. A well-written real estate agreement will save you a lot of headaches, arguments, and legal problems, so having good legal counsel review your deals and your business practices is important. However, your lawyer won't always be there when you need one, so you have to learn how to draft your own contracts.

Real estate contracts are based on common contract principles, so it's important to understand the basics of contract law.

The process begins with an offer. A contract is formed when an offer is made and accepted. In most states, real estate agents and attorneys use standardized contracts drafted in the form of offers. The offer is usually signed by the buyer (the offeror) and contains all the material terms of a contract, with the exception of the seller's signature.

The basic building block of a contract is mutual agreement. The contract is not binding until the seller accepts, creating a meeting of the minds. An acceptance is made if the offeree (the seller, in this case) agrees to the exact terms of the offer. If the offer comes back to the offeror with changes, there is no binding contract but rather a counteroffer. Thus, if the seller signs the purchase contract but changes the closing date to five days sooner, there is no agreement. Furthermore, if the offer is not accepted in the time frame and manner set forth by the offeror, then there is no contract. For example, if the contract specifies that acceptance must be made by facsimile, an acceptance by telephone call or mail will not suffice.

What Is the Difference Between a Unilateral Contract and a Bilateral Contract?

A real estate sales contract is a bilateral or two-way agreement. The seller agrees to sell, and the purchaser agrees to buy. Compare this agreement with an option: an option is a unilateral or one-way agreement by which the seller is obligated to sell, but the purchaser is not obligated to buy. On the other hand, if the purchaser on a bilateral contract refuses to buy, the purchaser can be held liable for damages.

A contract with a contingency is similar to an option. Many contracts contain contingencies (see the contingency section in this chapter), which, if not met, result in the termination of the contract. In essence, a bilateral contract with a contingency in favor of the purchaser turns a bilateral contract into an option because it gives the purchaser an out if they decide not to purchase the property. Though the two are not legally the same, an option and a bilateral purchase contract with a contingency yield the same practical results.

How Much Earnest Money Is Necessary?

A buyer will usually put up earnest money to bind the contract and show seriousness as a buyer. Most sellers ask for the earnest money deposit, because they are afraid of tying up the property and rejecting other potential buyers.

The law requires no specific amount of earnest money. In fact, if the transaction involves the buyer simply taking over a loan and the property has no equity, it may be appropriate for the seller to give the buyer consideration. When you are buying, you want to put down as little money as possible ($500 or less), though adding more will give your offer credibility. When selling, you should get as much as possible ($1,000 to $5,000). Of course, the amount of earnest money will depend on the motivation of the parties, the seller's representation by real estate professionals, the purchase price, and the length of time until closing.

If you are dealing with a seller represented by an agent, you may not be taken seriously with an offer that involves $100 earnest money. You should expect to put down at least 1 percent of the purchase price as earnest money or expect to get your offer laughed at. Also, when dealing directly with motivated sellers, the amount of earnest money you offer can often be a test of their motivation. Try verbally offering $100 earnest while negotiating and writing up the contract to see what response the seller gives you.

Should You "Pre-fill" the Contract?

Attorneys and real estate agents often pre-fill contracts before the parties meet. We think this is a mistake. If you show up with a pre-filled contract, the seller may get nervous and bail out on the deal. Instead, fill out the contract by hand in front of the seller as you negotiate each item. In sales circles, this is known as the "order form" close, commonly used by car salespersons.

If you are afraid of losing your earnest money as a buyer, you may consider offering a promissory note as earnest money. A seller may be reluctant to accept a promissory note rather than cash, because if you default, the seller must sue you to collect on the note. As a compromise, you can structure the contract so the seller receives a promissory note as earnest money that is paid in full after the property is inspected but prior to closing.

Who Should Hold the Earnest Money?

A big issue for the parties is who should hold the earnest money deposit in escrow. Theoretically, the escrow agent (the person holding the earnest money) must release the funds to the seller if the buyer breaches and to the buyer if the contract is canceled. However, the escrow agent will not usually release the funds without the permission of both parties, even in the face of a clear breach or cancellation. Furthermore, if the escrow agent is the listing broker, the agent may side with the seller and not release the money.

Listing brokers have an incentive to keep the earnest money, because their listing agreement usually gives them part of the forfeited earnest money deposit as a commission. The seller would obviously prefer to have the broker hold escrow, while the buyer would want a neutral or buyer-friendly title or escrow company to hold the earnest money.

What Type of Contingencies Should Be Built into the Contract?

As mentioned earlier, a contingency is a clause in a contract that must be satisfied for the contract to be complete. If the contingencies are not satisfied, the contract terminates, and the parties go their merry ways. The contract will usually provide that, in the event of termination, the buyer is entitled to a return of the earnest money.

Inspection contingency: Most standard real estate contracts contain an inspection clause, which gives the buyer a certain amount of time to inspect the premises. After inspecting the premises, the buyer should provide the seller with a list of potential problems or defects and give the seller a chance to remedy these problems, adjust the purchase price, or choose to terminate the agreement. Most standard inspection clauses place the burden of inspecting and disapproving on the buyer. Thus, the buyer’s failure to timely inspect and object will result in a waiver of this contingency. Used properly, the inspection clause will allow a buyer to terminate a contract that was signed hastily and later turns out to be a bad deal.

Inspection clauses can be written in a variety of ways. As the buyer, of course, you would prefer a more liberal, subjective approach, permitting you to perform the inspection without a licensed professional and disapprove of items in any manner you wish. However, you cannot use the inspection clause in an arbitrary fashion to cancel a purchase contract, for there is an implied duty of good faith on your part to deal fairly. For example, if you don’t inspect the property or you inspect it briefly and raise minor objections, then walk away from the deal, you could be in breach of your contract.

Loan approval contingency: Virtually every standard real estate contract gives the buyer a contingency to find a loan to purchase the property. Once again, there’s an implied duty of good faith here, so the buyer cannot simply sit back and say, “Oh well, I couldn’t get a loan.” The buyer is obligated to make reasonable efforts to apply to various lenders and comply with their demands for proof of employment, copies of tax returns, etc. The loan contingency will usually state a certain date by which the buyer must present the seller with a copy of a written loan commitment from the lender. If the deadline is not met, the seller can extend the deadline or the contract fails.

Proof of marketable title: The contract will usually provide that it is contingent upon proof of a marketable title by a certain date. The seller is usually required to provide the buyer a copy of a title report or a title commitment showing that the title is insurable. Even if the title report shows problems with the title, the contract is still in force if the seller can cure the problems before the closing and deliver a marketable title. For example, an existing mortgage lien or judgment is not fatal, because it can be satisfied by the seller from the proceeds at the closing.

What Happens When One Party Breaches the Agreement?

Breach of contract has many legal implications, but it is more important that you understand the practical side, for real estate litigation is usually a costly matter that should be avoided.

If the seller breaches the contract by failing to close the title, the buyer has three legal remedies:
1. Sue for specific performance
2. Sue for damages
3. Sue for return of the earnest money

Sue for specific performance: Specific performance is a remedy granted by a court, which forces the seller to sell to the buyer. If the property is unique and you feel like spending $10,000 in legal fees, then you will probably win the lawsuit if the seller refuses to close title. If the seller refused to close because he or she got "greedy" and found another buyer, you can record a copy of your contract or an affidavit (called a memorandum of agreement) in the public records. This will create a cloud on the title, which will alarm other buyers and title companies and may prevent the seller from closing with another buyer. Obviously, recording a contract or memorandum is a much more inexpensive and practical approach than suing.

A word of warning: Don't get sued for "slander of title." Be mindful that if you record the memorandum without sufficient legal cause, the seller can sue you for slander of title. We advise you to consider seeking legal counsel before filing such a document.

Sue for damages: If the property was to be purchased at a discount or was intended to be resold for a profit, you may be able to sue for your loss of potential profit. Of course, loss of profit is difficult to prove, for it is not clear exactly at what price you could have sold the property, how long the sale would have taken, and how much the deal would have cost in repairs. Even if you could prove these factors through expert testimony, the lawsuit could cost you $10,000 in legal fees.

Sue for return of earnest money: If the seller refuses to close and blames you for the incident, you may simply have to sue to get back your earnest money. Most local small claims courts can hear these types of cases, as long as the amount of earnest money involved is small. (Most small claims courts will only hear cases involving controversies of less than $2,000 to $3,000). If the earnest money is more (shame on you for giving so much!), you will need to proceed in the next highest court that usually conducts somewhat informal trials, similar to small claims court. You may need a lawyer to assist you with the court procedure.

What Are the Seller's Remedies for Buyer's Breach?

As you can see, the seller, who has title, is in a better position than the buyer. The seller has three legal remedies for the buyer's breach of contract:
1. Keep the buyer's earnest money
2. Sue for damages
3. Sue for specific performance

Keep the buyer's earnest money: The seller's best remedy is the ability to keep the buyer's earnest money. If the contract calls for the seller to keep the earnest money as liquidated damages, then the seller can keep it, even after selling the property to someone else for full price. In most cases, the buyer will walk away and cut any losses, especially if the earnest money is not significant. If the buyer objects and the money is held in escrow, then the seller and/or buyer will have to go to court to battle it out.

Even if the buyer is in breach, he or she may be able to argue that it is unjust for the seller to keep the earnest money. This argument is not usually successful, unless the amount of money is large and the buyer's breach was insignificant (e.g., the buyer was one day late in obtaining the loan commitment and the seller declared the contract in default). In the case of forfeiting an earnest money deposit, it may be cheaper for both parties to settle out of court.

Sue for damages: If the contract does not limit the seller's remedy to the retention of the earnest money, the seller can also sue the buyer for actual damages. For example, if the property is in the northeast and the seller took the property off the market for the summer, the seller may now be in a position of having to hold the property through the winter. If the seller can quantify the damages, he or she may be able to sue the buyer for failing to close. Of course, this lawsuit can be expensive, but at least the seller will have leverage if the buyer will not agree to release the earnest money deposit.

Sue for specific performance: The seller can also sue for specific performance to force the buyer to purchase the property. This may be futile, for the buyer may not be financially able to purchase the property. It may also be expensive in terms of legal fees and court costs.

How Do You Draft the Offer?

If you are making an offer without the services of a real estate agent and dealing directly with the seller, you may be able to use a standard purchase form obtained from an office supply store. (Make sure your attorney reviews the document and suggests any contingencies to protect you.)

If you are making an offer through a real estate agent, however, you must use their standard form. You cannot use your own contract when making an offer through a real estate agent.

The following is a checklist of items to look for when you are buying. Some of these clauses may be found in some form or another in the standard real estate contract that is used in your area.

Right to assign: As the buyer, you want to have the right to assign your contract. In the absence of a statement claiming otherwise, a contract is usually assignable. By placing your name with the words *and/or assigns*, you automatically give yourself that right. However, if the preprinted portion of the contract contains a provision forbidding assignment without the seller's permission, you must cross out that provision.

Inclusions and exclusions: Most real estate contracts have a clause that specifies what personal property is included in or excluded from the sale. Sellers and buyers often forget to specify certain items, which leads to arguments at closing. A few appliances could be worth $500 or more to you (or cost $500 out of your pocket if you have to replace them). As the buyer, you would prefer the clause, "Anything not specifically excluded will be included, whether or not affixed to the property or structures." As the seller, you would want to include a clause such as "All personal property, including appliances, furnishings, and decorations, is excluded unless specifically included in the purchase agreement."

Third party disclosure: Should you disclose that you intend to assign the contract to a third party? Legally, a purchase agreement is assignable in the absence of any provision that prohibits assignment, as long is the assignment does not unreasonably hinder the seller's rights and obligations under the agreement. For example, if the deal was for $200,000 cash, and the buyer assigned the contract to a third party who purchased the property, the seller is *not* inconvenienced in any manner. However, on discovering that you made a profit, the seller may be offended or get greedy. We have on occasion, seen lawyers threaten (unsuccessfully) to sue buyers for misrepresentation after their contracts were assigned for a profit. This effort to bully the investor is silly, of course, because the situation would be no different if the buyer purchased the property for cash, then resold it a day later for a profit. As a practical matter it may help to diffuse such an argument in advance with an explicit statement in the contract. "Buyer may assign this agreement to a third party for a profit."

Of course such a clause may also alert a seller into thinking, "Maybe I should ask for more." Whether such a clause is necessary is a tough call, and it depends on the particulars of the deal. For example, if the seller is in foreclosure, divorce, or some other motivation that requires knowingly selling the property below market, it wouldn't hurt to include the clause. But if the reason you got a killer deal is because the seller is ignorant of market conditions (such as an out-of-state seller), you risk blowing a good deal. If you are a licensed real estate agent, the seller may assume you are acting on his or her behalf to get the highest price, so you should disclose that you could get more if you listed the property.

Earnest money: As the buyer, your preference is for earnest money to be held in escrow by an escrow agent or a title company of the buyer's choice. Never let the seller hold the escrow. When selling, do just the opposite; keep the earnest money in your account of a title company of your choosing.

Cash required at closing: What happens if you are assuming or taking title subject to an existing loan and it turns out the actual balance of the loan is less than the seller thought? This may mean you have to come up with extra cash at the closing. To prevent such a disaster, insert the clause: "If the actual loan balance is less than as stated herein, the purchase price shall be reduced to reflect the difference; if the actual loan balance is more than as stated herein, then buyer's required cash payment shall be reduced accordingly."

New loan contingency: If you intend to obtain a bank loan to purchase the property, you should include a loan contingency in the contract. The loan contingency clause has been interpreted broadly by courts as putting the obligation on the buyer to make reasonable attempts to obtain a loan. Lenders are very aggressive these days, so virtually anyone can get a loan. The issue really becomes how many points and how high of an interest rate you want to pay. The buyer should have a clause that reads similarly to the following:

"Buyer is not required to accept a loan with an interest rate of higher than ________ percent over ______ years and payments exceeding /month, and buyer is not required to accept any loan that requires more than $_________ in points, closing, and/or other fees."

Waiver of escrow balance: Most lenders escrow taxes and insurance from the borrower each month in an impound account. Typically, the buyer reimburses the seller for the amount in escrow with the lender when assuming the seller's loan. Whether you take title subject to or assume an existing loan, insert the phrase, "Seller agrees to waive tax and insurance escrows held with lender." Using this clause will help you avoid having to come up with a couple hundred dollars in cash at closing to reimburse the seller for an escrow account, the proceeds of which you may not see for several years.

Owner financing: If the purchase consists of some owner financing, the buyer should look for the following:

- The loan should contain no due-on-sale clause, so the property can be resold to another investor on owner-carry terms

- The loan should be "nonrecourse," which means that it prevents a judgment against the buyer if the loan is in default.

The operative language is: "Seller's sole recourse in case of default shall be against the property, and there shall be no personal recourse against the borrower." Another way to limit your liability is to have a corporate entity, such as an LLC or corporation, sign for the obligation.

Appraisal provision: If the contract calls for an appraisal contingency, the buyer prefers one that does not require a licensed appraiser. This will give the buyer an out if he or she can find a local real estate agent who will vouch that the property will not appraise.

Right to choose the closing agent: There's an old saying about marriage that goes something like this: "Choose your spouse carefully, for this one decision can lead to 90 percent of your happiness or misery." For real estate transactions, substitute the words *closing agent* for *spouse.* We cannot tell you how much heartache and aggravation you will save by using a closing agent who understands the double-closing process. As the buyer, insist on the right to choose the title or escrow company so that you remain in control. If the property is listed with an agent, the agent may have a preference of title or escrow company. Offer to pay the full closing fee (usually about $300 to $500) for the right to choose—it is well worth it!

Right to extend the closing date: Most contracts call for a specific date for closing. If the buyer is not ready to close, the seller can hold the buyer in default. Here are some tips for buying time:

- Make the closing date "on or about" rather than "on or before." What does *on or about* mean? This is up to the judge, but we guarantee it will buy you some time. (Of course, when selling, make your closing date "on or before.")

- Have the right to extend the closing date if failure to close is not your fault: "Said date may be extended an additional fifteen (15) days if lender requires additional documentation, paperwork, or actions from the buyer and said delay is not due to the fault of the buyer."

- Have the right to extend for 30 days by paying the seller the equivalent of 1 month's mortgage payment.

Possession: As the buyer, you want possession of the property concurrent with the closing. Typical wording would be, "Possession by buyer to occur upon transfer of deed." If the sellers are living there, make sure you have the right to charge them a hefty daily rent if they are in possession after closing. Because you probably do not want to become a landlord and attempt to collect rent from your seller, it is best to inspect the property immediately preceding the closing and confirm the seller has vacated. If the contract calls for allowing the sellers to remain in possession after closing, consider holding back some of the proceeds to ensure you will get possession when you need it. Many sellers underestimate the time they need to move, and the longer they are in possession, the more money it costs you.

Also, the contract should state that the property be left "broom clean and free from all debris." A cleaning crew and a hauling truck could cost you several hundred dollars if the seller leaves a lot of unwanted property behind.

Seller's remedy limited to earnest money: Unless stated otherwise, the seller can keep your earnest money and sue you for breach. Give small earnest money deposits and use the language, "Upon default, seller's sole and only remedy shall be to retain buyer's earnest money." If the seller insists on a larger earnest money deposit, insert a phrase that entitles you to interest at the highest rate permitted by law on your money. That way, the seller will be less likely to hold onto your earnest money for six months while you sue to get it back.

Weasel clauses: A buyer wants as many contingencies or weasel clauses as possible. If the buyer can get out of a contract without breaching, then the buyer is entitled to the earnest money. The less earnest money you put down, the less you need a weasel clause. If you do need a weasel clause, here are two favorites:

"This agreement is subject to inspection and approval of the property by the buyer in writing prior to ________."

"This agreement is subject to attorney approval within seventy-two (72) hours."

Access to property before closing: If you intend to flip the property to another investor, you may need access to the property before the closing. If you intend to rehab the property, you have to get access to obtain contractor's bids. Try using the following clause:

"Buyer shall be entitled a key and be entitled access to show the property to partners, lenders, inspectors, and/or contractors prior to closing. Buyer may place an appropriate sign on the property prior to closing for prospective tenants and/or assigns."

If you are working with real estate agents on a regular basis in your deals, you might want to draft a standard addendum that contains your favorite clauses. You also will have to learn what specific clauses in the "standard" contract used by local real estate agents are favorable and unfavorable to you when buying and selling. Take time to meet with a local attorney to review the standard contract and help you come up with a standard addendum you can use as a template. It is amazing what clauses people (including real estate agents) will accept when part of a so-called "standard addendum." A few bucks spent with a savvy attorney can be a worthwhile investment.

How Should the Contract Read When You Sell?

Most of the discussion here involves drafting a contract slanted in your favor when buying. When selling a property to another investor, you should use the standard real estate contract that the real estate agents use in your area. This method will make financing easier for the buyer and for banks, and title companies are familiar with the form. Several words of advice:

- Limit the inspection contingency to 48 hours

- Have a short closing date
- Get as much earnest money as possible

A serious investor should have no objection to inspecting the property immediately, putting up $2,000 or more as earnest money, and closing within a few weeks.

Chapter 12: What Do You Do During the Due Diligence Period and the Closing?

The closing is nothing more than a delivery of cash by the buyer plus an execution and delivery of the deed from the seller. However, many significant events occur between contract and closing. Usually, the real estate agents, attorneys, and title company representatives handle most of these tasks. Whether you do your own closing or use a title or escrow company, become familiar with these tasks:

- Property inspections
- Titles and searches
- Existing liens and mortgages

Property inspections: If the contract calls for an inspection by the buyer, this should happen immediately, especially if a deadline is impending. If the buyer is not experienced, he or she should consider employing a contractor or a professional house inspector. For about $250 in most areas, a house inspection service will prepare a detailed report and provide a list the buyer can use to negotiate a lower price. The buyer can also use the inspection clause to kill a deal that turns out to be a bad choice. If the seller won't agree to make the necessary repairs or adjustments to the price, the buyer can cancel the contract and receive the earnest money back.

If you are planning to flip the property to another investor, be sure to bring interested investors with you when you conduct the inspection. Also, put a provision in the contract that allows you access to the property at reasonable times, so you can easily show it to prospective buyers.

Titles and searches: A real estate contract usually requires that title to the property be marketable—that is, it must have no serious defects that would prevent it from being mortgaged or sold at a later time. Buyers also want a marketable title, so they can feel secure that no one will sue them or claim an interest in their properties.

A title search is an inspection of the public records that relate to a particular property. While a deed is evidence of ownership, it is not the complete picture; a title is proof of ownership. For example, a deed held by a seller on a land contract is not complete ownership, because the land contract buyer has equitable ownership.

Every county in the United States has a place where records of title are publicly recorded. In most cases, it's the office of the county clerk and recorder or the county courthouse. Records are copied onto computers or microfiche, then recorded in large ledger books. Most areas of the country have begun using computers to index documents.

The giver of any interest in real estate is called the grantor; the receiver of the interest is the grantee. On some documents, the grantor and grantee are called by other terms. For example, on a deed, the grantor is also the seller, the grantee the buyer. On a mortgage, the grantor is also called the mortgagor and borrower, and the lender is the grantee and mortgagee. On a deed of trust, the grantor is sometimes called the trustor, and the lender is the beneficiary.

The most common indexing system is by grantor and grantee. All documents conveying property interests are recorded by the grantor's last name in the grantor index. The same transaction is cross-indexed by the grantee's last name in the grantee index.

Why Should You Conduct a Title Search?

A title search is important because it will determine if a property's title is good and marketable. To determine that, you must follow the chain of title as it changed hands over the years. A break in the chain of title creates a gap, which can result in confusion over ownership. Theoretically, the chain of title must be followed back to the Native Americans, or at least as far as the ascertainable records will show. In practice, the chain of title is only searched back about 50 years.

A title search can be conducted with a title company for a fee. Or, as an educational exercise, you can do it yourself. If you hang around the county recorder's office, you can usually find a title company employee who would be happy to assist you for a few bucks. In addition to the chain of title, make certain you also check for unpaid property taxes, assessments, homeowners' association dues, water and sewer charges, restrictive covenants, court judgments, bankruptcy petitions, and other possible liens that are not recorded in county land records. If this process sounds confusing, don't worry—it is! Be smart and pay for a title search the first few times you buy property. Do not, however, waste time checking title until you have a signed contract with the seller.

How Can You Save Money on Title Insurance?

Title insurance, like any insurance, defends and pays claims against the insured. In the case of real estate, the buyer is the insured. Thus, if anyone makes a claim against the buyer's interest in the property, the title insurance company must defend that claim and pay any damages suffered by the buyer because of the claim. Consequently, the title company may seek damages against you, the seller. Many sellers have a false sense of security when buying title insurance because they think they are being protected. Holding title in a land trust can help limit your liability on these deals because the title company will not have recourse against you personally.

Typical claims involve liens not discovered until after the closing, forgeries, errors from previous deeds in the chain of title, and easements or rights-of-way that were not known. While purchasing title insurance may seem reasonable, it can, in some cases, be a waste of money.

If you have little money invested in a transaction, you have very little to lose. For example, if you give a seller $1,000 to deed you the property, what is the limit of your loss? The answer is obviously $1,000, so why would you pay $700 for a title insurance policy if no risk of a title problem was apparent? As you become more experienced, you will see that purchasing a title insurance policy is not always necessary, particularly when you intend to flip the property to another investor for a quick buck. Undoubtedly, that investor will buy title insurance if he or she intends to resell the property after putting up several thousand dollars for repairs.

If the deal is a little thin on profit, simply assign your contract, in which case title insurance won't be necessary.

Let's be clear, however, that we do not recommend you buy and sell property as a beginner without checking title or buying title insurance. This technique must be learned through experience and knowledge. Always do things the conservative and safe way when starting out.

If you do purchase a title policy when doing a double closing, ask for a discounted rate. If the property was sold or refinanced within the past few years, most title insurance companies will offer a discounted rate due to lower risk. Make sure you ask; they won't always offer it up front.

If you intend to resell the property when you buy, whether in a double closing or within six months, ask for what's usually called a "hold-open" policy. The policy may be called by another name in some states. This type of policy costs an extra 10 to 20 percent up front and will cover title on resale within 12 months. Some companies will cover you up to 24 months. Because the seller usually pays for title insurance, your cost will be 10 to 20 percent of a full policy.

Existing liens and mortgages: If you are paying off existing mortgages or other liens, contact the holders of these mortgages or liens for payoff information. Verify that the holder of the lien or mortgage has an original document that can be delivered to you when the underlying obligation has been satisfied. Be sure to get original promissory notes back marked "paid in full." If you are dealing with private mortgage or lien holders, remember to ask for a discount.

If existing liens are in default as in the case of mortgage foreclosure, you can generally build additional profit into your deals by negotiating "short sales." This process involves appealing to a lender to take its losses early rather than completing the foreclosure process and spending money on legal fees. Short sales an not easy to accomplish on first mortgage liens, particularly in hot real estate markets where lenders know they can resell the property and recoup their money. However, second mortgage holders are often receptive to discount offers.

To do this, you will have to go through the arduous task of finding someone at the bank with authority to make a decision. Be patient and make sure your phone has a speakerphone button because you may be put on hold for the better part of a day.

How Is the Closing Handled?

Generally, title companies perform three services: searching title, selling title insurance, and performing the closing, which is the ceremony of executing and delivering deeds, signing loan documents, collecting and disbursing funds, and recording documents. In some states, attorneys do the title search and the closing. In other states, a separate escrow company performs the closing services. In any case, make certain that the closing agent, attorney, or company is familiar with the double closing process. If you are told it is illegal, unethical, or impossible, contact another service. Double closings are transacted in every state, every day of the week.

The formal closing usually involves sitting at a big oak table at a title or escrow company or in an attorney's office. Both buyer and seller—not necessarily at the same time—sign documents that are held by the closing agent. When the buyer's lender approves the transaction, it funds the loan. The transaction is complete when the funds are distributed and the documents are recorded.

In most states, closings are table funded; that is, the funds are distributed at the table when all the parties finish signing documents. In table-funded cases, both the seller and buyer are present. If you are doing a double closing, you are acting as both buyer and seller. A double closing is really two separate transactions and can be handled in two phases if you don't want your retail investor to meet the seller you purchased the property from. Obviously, you cannot give the seller funds until your investor gives you funds. Thus, one of the two transactions must be closed in escrow until the other is complete. Often, this escrow may last an hour, although sometimes it takes as long as a week. The bottom line is that if your investor does not deliver funds and sign all the closing documents, you can't close with your seller.

Should You Disclose?

Should you disclose in your contract or closing documents that your funds from one closing are coming from the funds of a second closing to a back end buyer? I don't see a problem doing this. In *fact*, many title and escrow companies are requiring it because of fear of being sued by the seller or the back-end buyer's lender particularly if the back-end buyer is a retail buyer and not sophisticated. It doesn't seem logical that a double closing should be a problem, because it's not really any different than closing with cash, then reselling *a* day later. But with lawyers on the hunt for potential defendants, you can never be too careful.

Chapter 13: What Are Some Liability Issues Involved in Wholesaling?

While legalities and liabilities should never keep you from getting involved in real estate investing, the prudent investor learns everything he can about these issues.

Real estate is a high-risk business, particularly when dealing with motivated sellers in foreclosure and when dealing with rehab projects. There are a lot of ways to mess up a deal and lose not just your investment, but potentially more if someone has a good lawyer.

We live in a litigious society where many people seek to place blame on others. Some people believe if you treat people right and carry sufficient insurance, you will be fine. That naïve thinking can get you into a lot of trouble, and one silly lawsuit can ruin everything you've worked hard for.

Contained within this chapter are some good suggestions for protecting yourself when it comes to legal issues.

Start by knowing the law. The old expression, "Ignorance of the law is no defense", is surely true. You are expected to know the law as it applies to your business. If your state, county, city, or village has particular laws, codes, and regulations, you must learn them.

Discuss your business practices regularly with a local attorney. Review your forms, agreements, and contracts to make sure the disclosures and clauses are appropriate for the particular way you do business. Although the practices described herein are generally legal and appropriate in all 50 states (and many foreign jurisdictions), if you tweak one little element in a contract, you may change the entire contract's legitimacy. An investment in good legal advice and forms is an investment in protection from future legal disasters.

Carry a sufficient amount of insurance. We suggest insuring each property you buy with plenty of liability coverage. You may even consider a "builder's risk" policy if you do a lot of rehab projects. If you are concerned about cost, get insurance with a large liability portion and a high deductible. If you carry your property liability, personal residence, and business insurance with a single carrier, the company may offer you an umbrella policy for several million dollars of additional coverage at a reasonable price. However, certain claims, such as breach of contract, discrimination, and misrepresentation, are not covered by insurance. In fact, most insurance won't cover any intentional act so, while having insurance is a good thing, it's only your first line of defense to lawsuits.

Do not do business in your own name. You cannot expect to reduce your risk of getting sued to zero, but you can take steps to reduce your risk as much as possible. In any situation where your money is at risk, ask yourself, "Is there a better way?" Know the legal and financial risks of the situations in which you place yourself, your business, your family, and your assets.

What Form of Business Should You Use?

Most people starting their own businesses do so as sole proprietors. This means they are doing business as individuals or under fictitious names or d/b/as (doing business as). Sole proprietorships are something we strongly discourage. This scenario offers absolutely no protection, not to mention poor tax benefits.

If your business gets sued, all your personal assets are at risk when you are a sole proprietor. If you are the buyer or seller on a real estate contract, you (not your fictitious d/b/a) will be sued in the case of a breach of contract. If you sign a warranty deed as seller and any problems arise with the title, you can be sued for breach of warranty. If workers are injured on your property while you are rehabbing it, say hello to their lawyer. The fact is, dozens of scenarios can lead to liability, and you are fully exposed by doing things in your own name.

The best way to protect yourself is to avoid getting sued personally—that is, form a legal entity to wedge between yourself and the liabilities that your business creates. This could be a corporation or limited liability company (LLC). For less than $100 in most states, you can form a corporation or limited liability company (LLC) to do your business or trade. For you, that means wholesaling.

If properly maintained, a corporation or LLC will shield your personal assets if the business gets sued or goes bankrupt. A corporation can also provide you with some tax benefits. (See next chapter.) Furthermore, a corporation or LLC gives you a more professional look when dealing with people in business. A corporation can be formed with a single owner, as can an LLC, although an LLC with just one owner will be treated as a sole proprietor for federal income tax purposes, which can be detrimental if you are a dealer, also discussed in the next chapter.

What's the Difference Between an LLC and a Corporation?

Both a corporation and an LLC are formed under state law by filing papers with your state department of corporations or secretary of state. Both limit the liability of their owners but are taxed differently. You should discuss appropriate tax issues with your CPA or tax advisor before proceeding.

Is Limiting Your Liability Ethical?

Some people may think that incorporating your business to limit your financial exposure is somehow unethical. Others think that lawsuits are the equivalent of legal extortion. Whether to limit your liability is a call you'll have to make. But if you do incorporate your business, you will have greater protection.

How Should You Title Your Properties?

A good rule of thumb is to not put real estate in your own name. You wouldn't walk around with a financial statement taped to your forehead, would you? So why would you have your most valuable assets exposed to public scrutiny? In every county in the United States, copies of deeds to real estate are recorded in the public records. Anyone can go to the county courthouse or recorder's office and look up the owner of any property.

Even if you just flip properties, your name will continue to appear on public record, leaving an easy paper trail for everyone to follow. While a corporation will protect you from liability, it will not keep your affairs private. If you value privacy in today's information age, consider doing business discreetly. Even if you do everything above board, there's a good chance someone will want to tear you down, whether it is a newspaper reporter, an overzealous government agency, or an idealist plaintiffs lawyer. The lower profile you keep, the less likely you will show up on their radar screen.

Consider holding title to every property you purchase, even the ones you flip, in a land trust. A land trust (aka "Illinois Land Trust") is a revocable living trust used to hold title to property. A trustee is appointed who is a "dummy" (in legal terms, a nominee) to hold title for your benefit. The trustee cannot reveal the identity of the beneficial owner of the trust unless the trustee is brought into court and forced to by a judge. The land trust requires no filing fees, no attorney's fees, and no tax reporting, so it is inexpensive and easy to use, We suggest holding title to property in a separate trust, so it will be difficult for the public (especially lawyers) to follow your trail.

Does Doing Business with Partners Provide Legal Protection?

Doing business with a partner can be even worse than doing business as a sole proprietor. A partnership is formed when two or more people decide to do business together for profit. It does not require a formal partnership agreement or filing any official documents, although it is often formed that way. A partnership can be created even if you did not intend to, as explained below.

Here is the problem with partnerships: if your partner does something foolish, you are liable. If you allow your partner to commit the partnership to a contract, the partnership and its partners can be held liable for that debt. If your partner slanders someone, commits a negligent act, or incurs a debt on behalf of the partnership, you are on the hook—even if your partner files for bankruptcy. This is the doctrine of "joint and several liability." Regardless of the percentage of fault between you and your partners, a judgment by a creditor for any tortious acts is 100 percent collectible from any one of the partners. Joint and several liability can be particularly disastrous if you are the silent partner with all the money.

If you only want to do a one-shot deal with a partner, consider drafting a joint venture agreement. A joint venture is basically a partnership for a specific purpose. If you intend to do business with partners for the long term, consider forming a limited liability company (LLC) or limited partnership.

Chapter 14: What Are Some Tax Issues Involved in Wholesaling?

Tax preparation may take place on or about April 15th, but tax planning should be a year-round initiative, especially by wholesalers and other real estate investors. Be sure to plan for your taxes at the beginning of the tax year and consult with your tax advisors throughout the year. People who say the tax system isn't fair are just ignorant of the rules. Taxes will eat up a large percentage of your money over your lifetime, so learn how to make the rules work for you.

Many people wrongly assume that flipping properties causes an investor to incur a tax "penalty" or other negative tax consequences. This assessment is not completely accurate. If you buy an investment property and hold it for 12 months or more, it is considered a long-term capital asset. When sold, a long-term capital asset results in a long-term capital gain (or loss).

In the United States, individuals and corporations pay income tax on the net total of all their capital gains just as they do on other sorts of income, but the tax rate for individuals is lower on "long-term capital gains." The tax rate on long-term gains was reduced in 2003 to 15%, or to 5% for individuals in the lowest two income tax brackets. Short-term capital gains are taxed at a higher rate: the ordinary income tax rate. The reduced 15% tax rate on eligible dividends and capital gains, previously scheduled to expire in 2008, has been extended through 2010 as a result of the Tax Increase Prevention and Reconciliation Act signed into law by President Bush on May 17, 2006. In 2011 these reduced tax rates will "sunset," or revert to the rates in effect before 2003, which were generally 20%.

If you held the property as a rental and took depreciation, the depreciation is "recaptured" at sale, resulting in a gain. The depreciation recapture is taxed at 25 percent. And these are just federal taxes; don't forget about state income taxes! Some states charge additional gains tax on the profit, giving a lower rate for long-term investments. Most states charge a documentary transfer tax based on purchase price, but this is the equivalent of a sales tax and is generally paid by the buyer.

If your role in wholesaling is generally that of a scout, your tax issues are different. Scouts essentially sell information, not property, so a scout's income is treated the same as a real estate commission for income tax purposes. It would be reported as ordinary income on Schedule C of the scout's federal income tax return. The scout can deduct expenses related to this activity on the return to offset the income. Business deductions may include travel, automobile expenses, education (such as this book or a seminar) and meals (stopping for fast food while scouting around for properties).

Dealers and retailers have a different approach to taxes. The dealer who assigns a contract is not selling real estate but rather a contract, which is a commodity. This would be reported as ordinary income on Schedule C of the dealer's federal income tax return.

The dealer can deduct expenses related to this activity on the tax return to offset the income.

Dealers who sell properties by double closing are selling real estate. Because each property is held less than one year, the property is not a long-term capital asset. Dealers who only sell a few properties here and there can report this income on Schedule D of their income tax return as a short-term capital gain. They can deduct expenses directly related to the acquisition and sale of the property. They cannot, however, deduct general business expenses on Schedule D. These must be reported on a Schedule C. This may open a Pandora’s box, as discussed later in this chapter.

If you pay a scout for information or a dealer for an assignment of contract more than $600 in one year, you must send that individual an IRS Form 1099 by January 31 of the following tax year. Also, send a copy of the forms to the IRS, along with IRS Form 1096, by February 28. Failure to file the required form could result in a penalty of $50 per unfiled return or $100 if the non- filing is proven to be intentional.

If the seller takes a promissory note for all or part of the purchase price, the seller can elect to use the installment sales method under Internal Revenue Code Section 453. By using the installment method, the seller can spread out the tax on the profits over several years. In this fashion, the gain is taxed pro rata as it is received. An installment sale is defined under the Internal Revenue Code (also called the Code or IRC) as a disposition of property in which the seller receives one or more payments after the close of the tax year in which the sale occurred. Installment sales are reported on IRS Form 6252.

The definition of a dealer in this book is someone who buys properties with the intent of reselling them. The IRS uses a similar definition of a real estate dealer. The capital gains and installment sales rules apply for principal residences and properties held for productive use (IRC § 1234).

If you are actively buying and selling real estate on a regular basis, you may be considered a dealer in real estate properties. A dealer is one who buys with the intent of reselling rather than for investment. In our terms, this applies to both the dealer and the retailer. There is no magic formula for determining who is an investor and who is a dealer, but the IRS will balance a number of factors, such as:

- the purpose for which the property was purchased,
- how long the property was held,
- the number of sales by the taxpayer in that year,
- the amount of income from sales compared to the taxpayer’s other income,
- how many deals the taxpayer made in that year, and
- the amount of gain realized from the sale.

If the IRS pegs you as a dealer, then you cannot use the installment sales method under IRC §453. The installment sales will be disallowed, and the entire paper profit is reported as ordinary income in the year of sale. Furthermore, the sale of property cannot be reported on Schedule D; it must be reported on Schedule C as inventory. Thus the gains from the sale of real estate will be subject to self-employment tax, which is currently 15.3 percent of the first $72,600. If the IRS recharacterizes this income several years after the transaction, you may also be subject to additional interest and possibly a penalty.

Just to be sure you are clear on the issue of deal status with the IRS, let us reiterate. If you have been classified as or choose to represent yourself as a dealer to the Internal Revenue Service, then you will pay additional tax. If you do file a Schedule C, careful planning may help you avoid becoming classified as a dealer. Work with your tax advisor to avoid dealer status, if possible.

As you may have discerned by now, doing business on a Schedule C as a sole proprietor is not recommended. Why? Because your liability is unlimited, you are subject to self-employment tax on earnings, and your chances of being audited as a small business are higher than if you are incorporated.

As discussed previously, you should consider forming a corporation to buy and flip your properties. An S corporation is fine to begin with, but consider the tax benefits of a C corporation when your business gets going full-time.

In the United States, an S corporation files an election under subchapter S of the Code by filing IRS Form 2553. The S corporation files an informational tax return, and the profits and losses from its business flow through to the shareholders. A C corporation files a tax return and pays taxes on its profits. Distributions (called dividends) to the shareholders are taxed again on the shareholders' personal returns. Of course, a reinvestment of profits rather than a distribution will not result in double taxation. Also, corporate income tax rates are lower than personal rates, up to about $100,000. Thus, using a C corporation for flipping properties could save you money in taxes if you reinvest rather than distribute profits each year. One type of corporation is not necessarily better than the other; you need to review your personal situation with a qualified tax advisor to see what is best for you.

Have a good certified public accountant knowledgeable in real estate transactions as a key player on your team. When sourcing an accountant, make sure that professional serves many real estate clients and, ideally, owns investment real estate, too.

One other tax issue that should be discussed is that of using tradespeople or handymen in your real estate or rehab projects. The IRS and your state department of labor are on the lookout for employers who don't collect and pay withholding taxes, unemployment, and/or workers' compensation insurance.

If you have employees off the books, you're looking for trouble. If you get caught, you will have to pay withholding taxes and as much as a 25 percent penalty. Intentionally failing to file W-2 forms will subject you to a $100 fine per form. The fine for failing to complete Immigration and Naturalization Service (INS) Form 1-9 is from $100 to $1,000 per form. The corporation will not shield you from liability in this case, either. All officers, directors, and/or responsible parties are personally liable for the taxes, and this obligation cannot be discharged in bankruptcy.

If you have people who do contract work for you on a per diem basis, the IRS may consider them employees. If any workers fail to pay their estimated taxes, you may still be liable for withholding. If these workers are under your control and supervision and only work for you, the IRS may consider them employees, even if you don't. If this happens, you may be liable for back taxes and penalties as described previously.

If you want to protect yourself, at a minimum you should:

- Hire only contract workers who own their own corporation, or be sure to get the business card and letterhead of any unincorporated contractors you may use to be able to prove these workers are not your employees

- Require proof of insurance (liability, unemployment, and workers' compensation) in writing

- Have a written contract or an estimate on the worker's letterhead that states that the contractor will work his or her own hours and that you will have no direct supervision over the details of the work

- Have letters of reference from other people for whom the contractor worked in your file to show that this person did not work solely for you

- File IRS Form 1099 for every worker to whom you pay more than $600 per year

In addition to possible tax implications, an independent contractor can create liability for you if a court determines the contractor is your employee.

For example, if your independent contractor is negligent and injures another person, the injured party can sue you directly. If facts show you exercised enough control over your contractor, a court may rule that this contractor is your employee for liability purposes. As you may know, an employer is vicariously liable for the acts of its employees (i.e., liable as a matter of law without proof of fault on the part of the employer). Make certain you follow these guidelines for hiring contractors, paying particular attention to the issue of control.

Finally, be aware under your state law which duties are considered inherently dangerous. These duties cannot be delegated to an independent contractor without liability on your part, regardless of whether the person you hire is considered an independent contractor or an employee.

Lastly, keep good records of your property dealings, particularly the rehabs. Plan ahead, so you can document everything if you are ever audited. In addition, many businesses fail due to poor accounting practices, so doing your books the right way will help you succeed.

If you are an active flipper, tracking the expenses between properties can get confusing. The key to keeping good records is to set up simple procedures you can follow. A good CPA or bookkeeper can help you set up your accounting so your records are clean and follow Generally Accepted Accounting Principles (GAAP).

Chapter 15: What's Your Next Step?

Together, we've walked through the wholesaling process — from finding motivated sellers to negotiating the deal to closing the transaction. All that's left is for you to get out and, as the Nike commercial says, "Just do it!"

However, before we part company, there are some closing thoughts I'd like to share with you about wholesaling in general and your career specifically.

What Sort of Items Should You Provide to Your Buyer's List?

When you have a property under contract and you are shopping it to your buyer's list, remember presentation is important. In addition to the "nuts and bolts" of numbers, comps, and repair estimates, provide photographs and tidbits of information about the property that might not be evident in the cold, hard facts.

You might want to mention the spacious eat-in kitchen, the heart of pine floors that just need a light refinishing or the easy-to-convert bonus area above the garage. Besides the property features, you could include information on the fabulous school district, the up-and-coming shopping enclave that's around the corner, or the bus stop just one block away.

Create an "online brochure" with all the photos and facts. Save it in PDF format and then email it to interested buyers.

Remember, you did plenty of good marketing to find the property. Do an equivalent amount to wholesale it to the right buyer.

What Happens if a Property Just Won't Sell?

Sometimes you may sign up a marginal deal and have a difficult time reselling it. Even though you want quick cash, you can find other ways to make a profit. For example, you can take a promissory note (a written, legal promise to pay) from your investor-buyer for part or the entire purchase price. You would secure this note with a lien on the property with interest payments.

Or you can tell the investor you will accept a promissory note for the purchase price with no payments due until the investor resells the property. If a deal is thin and needs a lot of work, the retailer who buys it may not have enough cash to pay you. In that case, become partners with that retailer. If you are flipping to an investor who will rehab the property, you can offer the property as your share of the partnership, while the investor offers the materials and the work as his or her share. When you sell the property, you split the proceeds. It's possible you may have to take less than half of the net profit to make the deal work.

Worst case scenario, you may simply have to cut your losses on a bad deal. Sometimes you sign a purchase contract for a “bad” house that you cannot sell for a reasonable profit. The problem may be a combination of paying too much, bad market timing, unforeseen repairs, or just plain bad luck. Keep in mind that you can always sell the house for what you paid or even take a loss if you have a lot of cash invested. Sometimes you have to move on and stop the financial bleeding.

Remember that when you make an offer, you have to include enough room in the deal for someone other than you to make a profit. Many beginners fail to do this. You cannot resell a property to another investor and make a profit if the investor cannot profit as well. If you want too much profit and hold onto a property too long, you can lose out in the long run. When you are flipping properties as a dealer, the goal is to move them fast—don’t get greedy! Do your homework and go into every deal prepared. Then you will come out ahead.

Who Should You Have on Your Team?

At a minimum, you need a good real estate attorney, title or escrow company, tax adviser, a good contractor or handy person, mortgage broker, and partner or mentor. Below is a description of each and the role he or she plays in your success. One tip: Don’t wait until you have a deal brewing to build your team with the right players. Find them before you need them.

Real estate attorney: Finding a good attorney is difficult, because most attorneys are not investors or are unfamiliar with creative real estate transactions. Most attorneys will give you just enough advice to keep them from getting sued, but not enough advice to show you how to make more money out of a deal.

A good real estate attorney advises you of the risks, suggests alternative ways of handling a transaction, and charges a reasonable fee. A poor real estate attorney either says nothing, points out problems without offering solutions, or systematically kills deals. Ask other investors in your area who they use as an attorney. When interviewing a potential attorney, ask the following questions:

- Do you own rental property?
- How many closings do you handle per year?
- What kind of unusual transactions have you dealt with recently?
- Have you conducted any foreclosures, double closings, or installment land contracts?

Get a feel for the experience and personality of the attorney. Good attorneys are worth their weight in gold.

Title or escrow company: A competent title or escrow company can make closings run smoothly for you. Avoid using big-name companies. Instead, find a small, local firm that caters to investors. Make sure this company understands double closings. You can usually obtain a good recommendation on a title or escrow company from other investors by joining a real estate investment group. In some states, only attorneys perform closings, which can be a blessing or a nightmare.

Tax advisor: In our experience, most CPAs and accountants are rank amateurs when it comes to real estate transactions. Most firms hire clerical help during the tax season, so less-experienced personnel might prepare your return. Tax return preparation is the easy part of taxes; the hard (and more important) part is using good planning and aggressive strategies. Read voraciously on how to save money on taxes. Your time will be well spent.

Choose an accountant, CPA, or tax lawyer who can expertly help you plan your business taxes for the year. Consult whenever you have questions about an unusual transaction. Once you have the advice you need, consider doing your own return using a computer program, such as TurboTax by Intuit.

Good contractor or handy person: A capable all-around contractor or handy person is essential to your success, especially if you don't have extensive rehab knowledge. You can find this person by looking in the "Services Directory" of your newspaper. Interview several people to find one who will give you free estimates and knows how to cut corners in all the right places. Also, ask other local investors for a recommendation.

Mortgage broker: As a dealer, you won't need to borrow money. Once you start retailing, however, you may need cash to fund your deals. Be careful to find a mortgage broker who is savvy creative, and experienced in working with investors.

Partner or mentor: While this book is an excellent resource for getting started in flipping properties, it is not an exhaustive reference for every situation. You'll benefit from having partners and mentors to work with on your deals. After all, cookie cutter deals are rare; every situation is unique. The more you can tap into other people's knowledge and experience, the fewer mistakes you will make.

If you start out as a part-time investor, you can probably find a partner to be involved in your projects. This partner may already have a rehab property you can assist with, or perhaps you can team up with a contractor or another investor to help with a property you find. Either way, look at your first projects as an apprenticeship that allows you to "earn while you learn."

Look for a knowledgeable and trustworthy mentor. The investment business should be approached with integrity; most of the people who continue to succeed do business in an ethical way. Finally, don't be a leech for information. Respect other people's time and be willing to pay for it.

What Is the One Personal Characteristic that Will Serve You Best?

If I had to choose one personality trait found in the most successful real estate investors, it would be persistence.

Anyone who has ever been in sales will tell you that few deals are ever made on the first try. In fact, most deals are made after contacting a prospect for the fourth or fifth time. Never underestimate the value of hard work. Diligence is a key to success, regardless of your background.

Employ a follow-up system for potential deals. Consider using a contact-management software program to help you schedule follow-up phone calls and action items. It also keeps a running history of calls and conversations. Microsoft Outlook works well in conjunction with a hand-held PDA or personal digital assistant. If you don't (or won't) use a computer, buy a package of index cards. Write information on each card about the property, its owners, and conversations you have had with them. Stick them on a bulletin board as follow-up reminders. No matter how you do it, just remember to follow-up.

When Should You Go Full-Time?

Depending on the person, the answer to this question could be today or never, and every possible answer in between. The truth is full-time investing is not for everyone. Even people who find great success in this business, keep it as a part-time endeavor. Let's discuss some pros and cons of full-time versus part-time investing.

Investing full-time: Entering the real estate profession on a full-time basis offers several advantages over a part-time commitment. Being successful requires you to develop knowledge in many aspects of real estate, and more time focused on real estate leads to greater knowledge. The more you learn, the more you earn, because you need not rely on as many professional services or partners for help. You also learn to recognize a deal (or a dud) faster, which gives you more time to do more business or to spend with your family.

As a full-time investor, you work your own hours. When we say full-time, we may mean as little as 20 hours a week if you are good at finding deals. The rest of your time can be spent pursuing other vocations or hobbies. Or, if you are so inspired, you can work 40 or more hours and use the extra cash flow to buy rental properties or diversify your holdings in the stock market. The point is that you must satisfy your cash flow needs before you can start investing your money.

One final point you should consider is whether you want to be self-employed. If you have always worked for someone else, being your own boss sounds very attractive. In some respects, this isn't quite the truth. Being your own boss means being an accountant, bookkeeper, stock clerk, receptionist, and office manager all in one. You have to deal with tax returns, payroll, office supplies, customer service, bills, and all the other hassles that come with a business. You don't have friends to chat with at the water cooler. You don’t have paid health insurance, a company car, and a 40 1(k). You take your problems home with you every night.

Sound like fun? It is, once you learn how to manage your time and run your business. Being the master of your own life and career is well worth the other hassles of dealing with your own business.

Investing part time: The part-time investor holds a regular job. This may be by choice or only for the time being, until real estate ventures bring in enough cash to enable quitting the day job. If you can relate to the latter reason, don’t quit your job because a real estate guru told you so. Quit your job when it is not worth the income that it brings you. In other words, if you are making more money per hour flipping properties on the side, you are at the point where your regular job is costing you money. Only then is it time to quit.

One of the advantages of starting out part-time is that you can maintain your cash flow while learning the business. It may take weeks or possibly months to find your first deal. That same deal may take several months to turn around, especially if you decide to fix it and sell it retail. Think twice before telling your boss you’re leaving; you will have plenty of time to make the career switch once you have acquired more real estate experience. You may, on the other hand, enjoy your occupation. If so, continue to work at it and invest in real estate on the side.

The best-case scenario, if you are married, is for one spouse to work a regular job. The other spouse works the real estate business to create wealth, retirement income, and a college fund for the children. Of course, in today’s market, you could be laid off due to unforeseen circumstances. If you earn additional income flipping houses and invest the proceeds in rental properties, you will have money coming in even if your main income is lost. This is especially the case for married women who often forgo careers outside the home to raise families, only to find themselves divorced with no means of making a living. We don’t want to sound cynical about marriage, but with a 50 percent divorce rate in America, it never hurts to have a system for making money.

Someone with a full-time job tends to have little free time to focus on real estate. A part-timer should learn most of the same skills as a full-timer. Thus, the key disadvantage to flipping properties on a part-time basis is learning that the business takes sacrifice. Something has to give—television, lazy weekends, hobbies, and even some family activities. As with any education, time spent learning about real estate will bring its own rewards, especially if the people in your life understand your goals and your plan to achieve these goals. If you are married, make sure your spouse reads this material with you and participates in the fun process of making money.

What's the Key to Continued Growth in Real Estate Investing?

With real estate investing, there's always more to learn. So, keep up your education. When new opportunities are presented to learn something, embrace them. If you think a particular book, home-study course, or training is expensive, ask yourself, "Compared to what?" You will lose more money with a mistake than you will spend learning how to avoid one.

Remember, any time you spend studying is time well spent. Don't buy something just to use it as a paperweight that collects dust. No matter what the price of a book, seminar, or training program, it is always worthwhile if you put it to use and make money. However, the corollary to this statement is also true: a $20 book is a waste of money if you don't apply anything you learn from it (or if you don't ever read it!).

Congratulations and good luck in your real estate investing endeavors. Study hard, apply yourself and above all make offers to purchase. You can't buy a property by studying everything about it. Too many people suffer from analysis paralysis when approaching a potential deal. They spend so much time going over minute details that they fail to take action. If you look at a potential real estate deal long enough, you will find enough reasons to talk yourself out of it for fear of losing your money. Of course, risk exists in every venture, but don't procrastinate forever. Take a chance and just do it.

Glossary of Terms

Abstract of Title

A compilation of the recorded documents relating to a parcel of land, from which an attorney may give an option as to the condition of title. Also known in some states as a "preliminary title report."

Acceleration Clause

A condition in a financing instrument giving the lender the power to declare all sums owing lender immediately due and payable upon an event such as sale of the property.

Acknowledgment

A declaration made by a personal signing a document before a notary public or other officer.

All-Inclusive Deed of Trust

See "wraparound mortgage.”

ALTA

American Land Title Association.

Amortize

To reduce a debt by regular payments of both principal and interest.

Appraised Value

The value of a property at a given time, based on facts regarding the location, improvements, etc., of the property and surroundings.

Arrears

Payment made after its due is in arrears. Interest is said to be paid in arrears since it is paid to the date of payment rather than in advance.

Assignment of Contract

A process by which a person sells, transfers and/or assigns his rights under and agreement. Often used in the context of the assignment of a purchase contract by a buyer or the assignment of a lease by a tenant.

Assumable Loan

A loan secured by a mortgage or deed of trust containing no "due-on-sale" provision. Most pre-1989 FHA loans and pre-1988 VA loans are assumable without qualification. Some newer loans may be assumed with the express permission of the note holder.

Assumption of Mortgage

Agreement by a buyer to assume the liability under an existing note secured by a mortgage or deed of trust.

Attorney-in-fact

An agency relationship where a person holds a power of attorney allowing him to execute legal documents on behalf of another.

Balloon Mortgage

A note calling for periodic payments which are insufficient to fully amortize the face amount of the note prior to maturity, so that a principal sum known as a "Balloon" is due at maturity.

Basis

The financial interest one has in a property for tax purposes. Basis is adjusted down by depreciation and up by capital improvements.

Beneficiary

One for whose benefit trust property is held. Also known as the lender under a deed of trust.

Buyer's Agent

A real estate broker or agent who represents the buyer's interests, although typically his fee is a split of the listing broker's commission. Also known as the "selling agent."

Chain of Title

The chronological order of conveyancing of a parcel of land, from the original owner to the present owner.

Closing

The passing of a deed or mortgage, signifying the end of a sale or mortgage of real property. Also known in some areas as "passing papers" or "closing of escrow."

Cloud on Title

An uncertainty, doubt or claim against the rights of the owner of a property, such as a recorded purchase contract or option.

Commitment

A written promise to make or insure a loan for a specified amount and on specified items. Also used in the context of title insurance ("title commitment").

Comparables

Properties used as comparisons to determine the value of a specified property.

Condominium

A structure of two or more units, the interior space of which are individually owned. The
common areas are owned as tenants in common by the condominium owners, and ownership is
restricted by an association.

Contingency

The dependence upon a stated event which must occur before a contract is binding. Used both in the context of a loan and a contract of sale.

Contract of Sale

A bilateral (two way) agreement wherein the seller agrees to sell and buyer agrees to buy a certain parcel of land, usually with improvements. Also used to reference to an installment land contract (see below).

Contract for Deed

See "installment land contract."

Deficiency

The difference between the amount owed to a note holder and the proceeds received from a foreclosure sale. The lender may, in some states, obtain a "deficiency judgment" against the borrower for the difference.

Delivery

The transfer of a deed to the Grantee so that the Grantor may not revoke it. A Deed, signed but held by the Grantor, does not pass title.

Depreciation

Decrease in value to real property improvements caused by deterioration or obsolescence.

Documentary Tax Stamps

Stamps, affixed to a deed, showing the amount of transfer tax. Some states simply charge the transfer tax without affixing stamps. Also known as "doc stamps" or “transfer tax.”

Double Closing

A closing wherein a property is bought and then sold simultaneously. Also called "double escrow" and "flipping."

Due-on-Sale Clause

A provision in a mortgage or deed of trust that gives the lender t the option to require payment in full of the indebtedness upon transfer of title to the property (or any interest therein).

Earnest Money

A good faith deposit or down payment.

Encumbrance

A claim, lien or charge against real property.

Equity

The difference between the market value of the property and the homeowners mortgage debt.

Equitable Title

The interest of the purchase under an installment land contract.

Escrow

Delivery of a deed by a grantor to a third party for delivery to the grantee upon the happening of a contingent event.

Estate

From the English feudal system, this defines the extent of one's ownership in a property.

Estate for Years

An estate limited to a term of years. An estate for years is commonly called a "lease." Upon the expiration of the estate for years, the property reverts back to the former owner.

Fee Simple

The highest form of ownership. An estate under which the owner is entitled to unrestricted powers to dispose of the property, and which can be left by will or inherited. Also known as "Fee" or "Fee Simple Absolute."

Federal Housing Administration (FHA)

A federal Agency which insures first mortgages, enabling lenders to loan a very high percentage of the sale price.

Foreclosure

A proceeding to extinguish all rights, title, and interest, of the owner(s) of property in order to sell the property to satisfy a lien against it. About half of the states use a "mortgage foreclosure," which is a lawsuit in court. About half use a "power of sale" proceeding which is dictated by a deed of trust and is usually less time-consuming.

Good Faith Estimate

A lender's estimate of closing costs and monthly payment required by R.E.S.P.A.

Grant Deed

A deed commonly used in California to convey title. By law, a grant deed gives certain warranties of title.

Grantee

A person receiving an interest in property.

Grantor

A person granting or giving up an interest in property.

Grantor/Grantee Index

The most common document recording indexing system is by grantor (the person conveying an interest, usually the seller or mortgagor) and grantee (the person receiving an interest, usually the buyer or mortgagee). All documents conveying property or an interest therein (deed, mortgage, lease, easement, etc.) are recorded by the grantor's last name in the grantor index. The same transaction is cross-indexed by the grantee's last name in the grantee index.

Heirs and Assigns

Words usually found in a contract or deed which indicate that the obligations assumed or interest granted or binding upon or insure to benefit of the heirs or assigns of the party.

Impound Account

Account held by a lender for payment of taxes, insurance, or other payments. Also known as an "escrow" account.

Installment Land Contract

The ILC is an agreement wherein the buyer makes payments in a manner similar to a mortgage. The buyer has "equitable title." However, the seller holds legal title to the property until the contract is paid off. The buyer has equitable title, and, for all intents and purposes, is the owner of the property. Also known as a "contract for deed" or "contract of sale."

Installment Sale

A sale which is involves the seller receiving payments over time. The Internal Revenue Code contains specific definitions and promulgates specific rules concerning installment sales and tax treatment of them. Also known as an "owner carry" sale.

Joint Tenancy

An undivided interest in property, taken by two or more joint tenants. Upon death of a joint tenant the interest passes to the surviving joint tenants, rather than to the heirs of the deceased.

Junior Mortgage

Mortgage of lesser priority than the previously recorded mortgage.

Land Trust

A revocable, living trust primarily used to hold title to real estate for privacy and anonymity. Also known as an "Illinois Land Trust" or "Nominee Trust." The land trustee is a nominal title holder, with the beneficiaries having the exclusive right to direct and control the actions of the trustee.

Lease/Option

An agreement by which the lessee (tenant) has the unilateral option to purchase the leased
premises from the lessor (landlord). Some lease/option agreements provide for a portion of the rent to be applied towards the purchase price. The price may be fixed at the beginning of the
agreement or be determined by another formula, such as an appraisal at a later time. Also referrred to as a "lease/purchase."

Lease Purchase

Often used interchangeably with the expression "lease/option," but technically means a lease in conjunction with a bilateral purchase agreement. Often used by real estate agents to mean a purchase agreement whereby the tenant takes possession prior to close of escrow.

Lien

An encumbrance against property for money, either voluntary (e.g., mortgage) involuntary (e.g. judgment) or by operation of law (e.g. property tax lien).

Life Estate

An estate in real property for the life of a living person. The estate then reverts back to the grantor or to a third party.

Limited Liability Company

A creation of state law, which provides liability protection for its owners and flexible tax treatment. Also known as "LLC."

Liquidated Damages

A contract clause which limits a party to a sum certain in lieu of actual damages. In the case of a real estate purchase and sale contract, the seller's legal remedy is limited to the buyer's earnest money deposit.

Marketable Title

Title which can be readily marketed to a reasonably prudent purchaser aware of the facts and their legal meaning concerning liens and encumbrances.

Mortgage

A voluntary lien filed against property to secure a debt. The borrower is also called the
“mortgagor,” the lender the “mortgagee.”

Multiple Listing Service

A service performed by the Local Board of Realtors that provides information to aid in the sale of properties to a wide market base.

Notary Public

One authorized by law to acknowledge and certify documents and signatures as valid.

Note

A written promise to repay a certain sum of money on specified terms. Also known as a
"promissory note."

Option

The unilateral right to do something. For example, the right to renew a lease or purchase
property. The optionee is the holder of the option. The optionor is the grantor of the option. The optionor is bound by the option, but the optionee is not.

Performance Mortgage

A mortgage or deed of trust given to secure performance of an obligation other than a
promissory note (e.g., an option).

Periodic Tenancy

An estate from week-to-week, month-to-month, etc. In the absence of a written agreement (or upon the expiration of a lease once payments are accepted), a periodic tenancy is created.

PITI

Principal, Interest, Taxes and Insurance.

Power of Attorney

A written document authorizing another to act on his behalf as an attorney in fact.

Prorate

To divide in proportionate shares. Used in the context of a closing, at which such as property taxes, interest, rents and other items are adjusted in favor of the seller, buyer or lender.

Quit Claim Deed

A deed by which the grantor gives up any claim he may have in the property. Often used to clear up a cloud on title.

Realtor

Any member of the National Association of Realtors.

Recording

The act of publicly filing a documents, such as a deed or mortgage

Redemption

The right, in some states, for an owner of lien holder to satisfy the indebtedness due on a mortgage in foreclosure after sale.

Release

An instrument releasing a lien or encumbrance (e.g., mortgage) from a property.

RESPA (Real Estate Settlement Procedures Act)

A federal law requiring disclosure of certain costs in the sale of residential property which is to be financed by a federally insured lender. Also requires that the lender provide a "good faith estimate" of closing costs prior to closing of the loan.

S Corporation

A corporation electing to be treated as a pass-through entity.

Seasoning of Title

Formerly used in the context of a payment history on a promissory note, now used to mean a seller's history of ownership in connection with the sale and financing of property.

Second Mortgage

A loan secured by a mortgage or trust deed, which lien is junior to a first mortgage or deed of trust.

Security Instrument

A document under which collateral is pledged (e.g. mortgage)

Settlement Statement

A statement prepared by a closing agent (usually a title or escrow company) giving a complete breakdown of costs and charges involved in a real estate transaction. Required by RESPA on a form HUD-1.

Special Warranty Deed

A seller warrants he has done nothing to impair title but makes no warranty prior to his ownership.

Specific Performance

An action to compel the performance of a contract.

Statute

Written law enacted by a state or federal governing body.

Sublet

To let part of one's estate in a lease. A subtenant is not in privity of contract with the landlord and neither can look to each each for performance of a lease agreement.

Subject-To

When transferring title to a property encumbered by a mortgage lien without paying off the debt or assuming the note, the buyer is taking title "subject to."

Summary Proceeding

A special lawsuit to obtain possession of property. Usually commenced in a special court with fast or "summary" procedures.

Tenancy in Common

With tenancy in common, each owner (called a "tenant") has an undivided interest in the
possession of the property. Each tenant's interest is salable and transferable. Each tenant can
convey his interest by deed, mortgage or by a will. Joint ownership is presumed tenants in
common if nothing further is stated on the deed.

Title

Title is the evidence of ownership. In essence, title is more important than ownership because having proper title is proof of ownership. If you have a problem with your title, you will have trouble proving your ownership and thus selling or mortgaging your property.

Title Insurance

An insurance policy which protects the insured (purchaser and/or lender) against loss arising from defects in title. A policy protecting the lender is called a "Loan Policy," whereas a policy protecting the purchaser is called a "Owner's Policy." Virtually all transactions involving a loan require title insurance.

Title Search

An examination of the public records, to disclose facts concerning the ownership of real estate.

Truth in Lending

Federal law requiring, among other things, a disclosure of interest rates charges and other information about a loan.

Trustor

One who creates a trust by granting property to a trustee. Also known as the borrower on a deed of trust.

Unlawful Detainer

A legal proceeding to evict someone is possession of real property.

VA LOAN

A long-term, low or no down-payment loan guaranteed by the Department of Veterans Affairs, which is offered to individuals qualified by military service or other entitlements.

Warranty Deed

A deed under which the seller makes a guarantee or warranty that title is marketable and will defend all claims against it.

Wraparound Mortgage

A mortgage that is subordinate to and incorporates the terms of an underlying mortgage. The mortgagor (borrower) makes payments to the mortgagee (lender) who then makes payments on an underlying mortgage. Also referred to as an "all inclusive deed of trust" in some states.