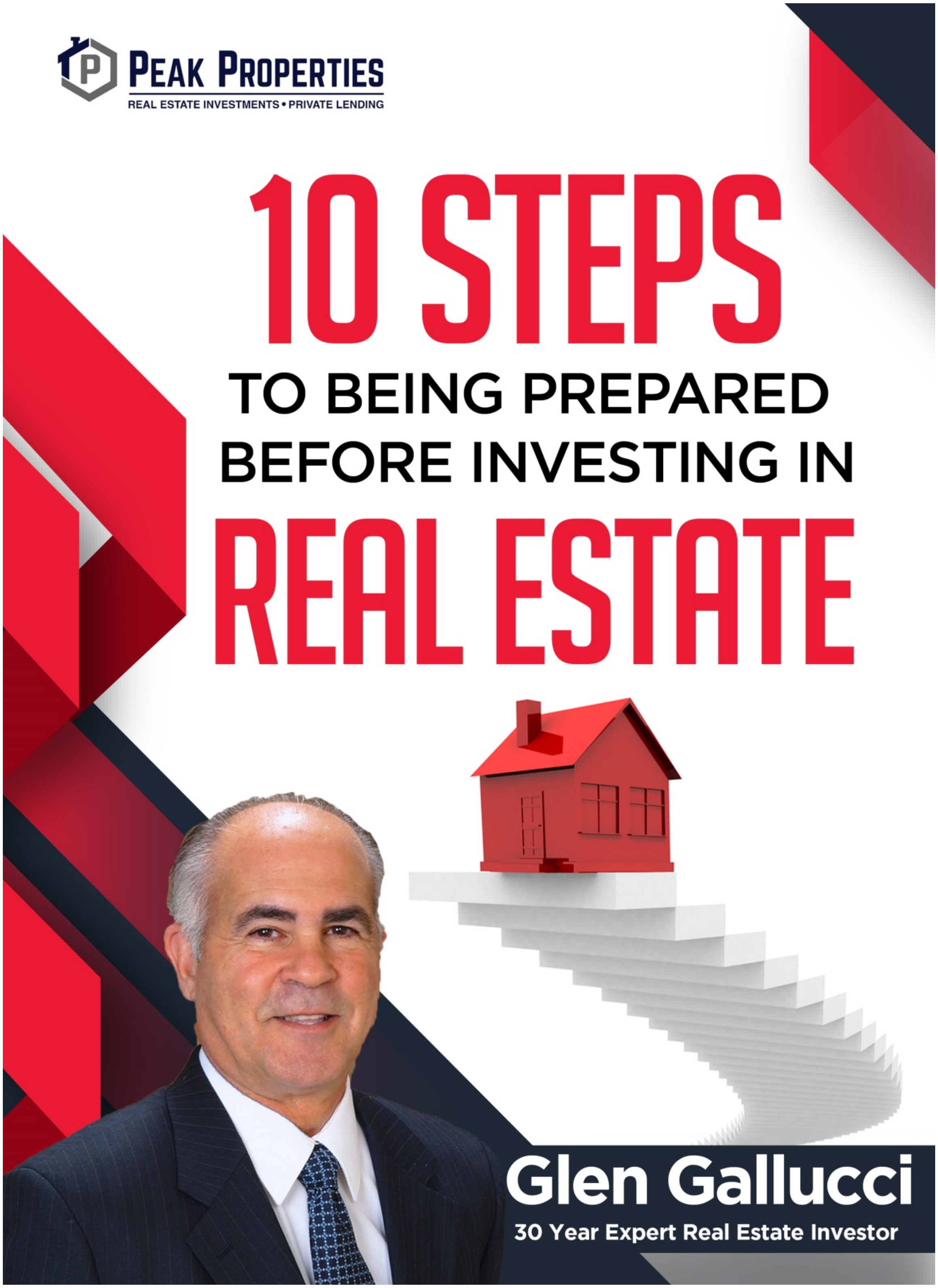
PEAK PROPERTIES
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10 STEPS
TO BEING PREPARED
BEFORE INVESTING IN
REAL ESTATE
Glen Gallucci
30 Year Expert Real Estate Investor

10 Steps Before Investing in Real Estate

by Glen Gallucci

I am often asked; **"what is one of the most important things to do before investing in real estate."** My answer has always been the same. And that is to be properly prepared before making any offers on properties. While real estate investing can be very rewarding, for the unprepared, it can be very risky as well.

Here are some tips on what to be aware of before investing in any properties, especially if they are going to be properties you plan to quickly sell and not hold for a long period of time. Remember the quick turn real estate market doesn't allow the investor the advantage of time for the properties to increase in value. Buying and selling in a four to eight-month period requires precise market data.

Here are some of the things to avoid and the areas that can make an investment a nightmare without the right preparation.

#1

The first thing many unprepared investors do is pay too much for the property. This happens when an investor doesn't do his or her homework on what similar properties in the immediate area have sold for recently. If someone or real estate agent hands you some comparable market data and says something like, "see all the houses that have sold recently for $325,000? Yours should sell for the same amount or higher". This is the "kiss of death" if you just accept it without going through each one very carefully to make sure it is comparable with you house.

It is up to you to evaluate what the person/agent has given you. It is up to you to ask questions like, this one sold for $325,000 but has a driveway and garage and the one I'm looking at is an attached house with no driveway and garage. Or these are 3 and 4 bedroom houses where mine is 2 with a room up stairs with slope ceilings and no closet or heat. Even though someone may use it as a bedroom, do I compare that with a legal 3 bedroom? I think not!

Another thing is you must be able to negotiate the price of the house to where you are comfortable buying it. Don't let anyone talk you into paying more just because the seller will not come down on their price. Let someone else make the mistake of overpaying. And you will see many times if it is not a deal for investors, most will not pay the asking price either and the house will sit. Don't worry and go on to another deal that makes you comfortable. But keep an eye on that house as sure enough the price will eventually come down to where it makes sense to buy. Distressed houses sit for a few reasons such as title issues, structural issues, environmental issues, location, funky style layout and mainly it is just priced too high for investors to buy, renovate and sell for a profit.

Paying a high price for the house and figuring you can make it up with a lower renovation budget doesn't work either! First of all, most renovations go over budget anyway. And skimping on renovation finishes never proves worth while as buyers are well educated in todays market. A cheap looking house will sit as well as buyers will gravitate to the experienced investors houses where they offer a better-quality product.

#2

A <u>second</u> mistake many newbie investors make is buying houses in a less desirable neighborhood and location. One of the reasons they do this is because the price is more in their range of investment. Another words, it's cheap and affordable for them. This is not a good reason to buy a house. You don't have to be in the best neighborhood but certainly in a neighborhood that has a family atmosphere and evidence of homeowners keeping their property in nice clean condition. There are plenty of houses in bad neighborhoods that you can buy cheap. But a cheap house in a bad neighborhood spells "agaita". That's Italian for aggravation and heartache. Pass on these houses as well.

We all know location, location, location sells houses. But the house doesn't always have to be in the "best of the best" neighborhood. But you must consider some of these facts about the location of the house:

- Is it in a flood zone? This requires flood insurance which can be costly.
- Is it next to a gas station, auto body shop, busy restaurant/bar?
- Is it in an extremely rural area?
- Is it on a very busy main road / highway location?

And remember, you can't use a comparable house that is in a nicer location such as a quiet cul-de-sac with a house near any of the locations above. They simply are just not worth the same amount.

You also must be careful not to compare houses from one side of town to houses on the other side of town. A simple park, or main road, or train track separation could mean all the difference in your sales price compared to another in a more desirable part of town. Houses that border a less desirable town can also affect the sales price of your house compared to houses on the other side of town bordering another nice town. This is why "experienced investor friendly" real estate agents are so important when it comes to giving comparable sales. These other factors must be considered. This is a very common oversight and I've seen too many investors get caught in this trap.

#3

A third area to be very careful when investing is making sure you factor in all the costs involved in purchasing and fixing the house as well as the holding costs and closing costs on both sides of the transaction. Let's discuss a few of the costs that come up when investing as some of us tend to forget about a few of them.

- Appraisals, when you need an extra unbiased opinion on your after repaired selling price.
- Home Inspections when you think there could be problems with the house or just want a trained eye to give you a full report, which I always suggest for newbies.
- Financing costs if you are borrowing money. Any up-front costs on the loan.
- Closing costs including realty transfer tax. On higher priced houses this could be many thousands of dollars.
- Legal costs on the purchase and sale.
- Title Insurance, recording fees
- Property Insurance – Hazzard Insurance
- Quarterly taxes at purchase depending on the month in the quarter you are closing on the property.
- Taxes post purchase
- Real estate commission
- Utility holding cost – gas & electric
- Maintenance costs – Lawn cutting and or snow removal

Other costs often not figured into the deal:

- Final deep cleaning of the house
- Staging the house
- Buyers home inspection punch list for added repairs

Then we have the rehab estimate. You must get two or three estimates to make sure you weren't quoted a low price by one contractor to get the job only to try to increase his price once the rehab started because he left some things out and didn't charge for them. Yes, unfortunately this happens. By getting two or three estimates, you will see if there is a large spread between the prices or are they fairly close to each other. When all finished with what you think it will cost, you might want to add about 10% for what you missed. And yes again, it does almost always happen!

One thing many investors do not do is get a complete scope of work on the renovation. Many get a ball park number only to find out later all the things the contract says was not included. Having a detailed scope of work does two things:

1) It clearly outlines what the contractor is including in his estimate
2) You now have a complete scope of work you can give to other contractors to get estimates where they will be giving you an estimate based off the exact same scope of work the other contractors gave you. Now you can compare "apples to apples."

In fact, you should make your own scope of work detailing exactly what you want to have completed in the renovation work and give it to your contractors to bid on. Give each contractor the same scope of work to compare their estimates.

Tip: After you receive each estimate ask the contractor this simple question: **"what is NOT included in this estimate".** This way you can get the required estimate from others to add to your total renovation estimate. An example would be:

- "We don't do any chimney repairs"
- The estimate for a new kitchen does not include the cost of appliances. We will install only.
- Estimate for the windows does not include replacement of the front bay window.
- The furnace will be serviced and not replaced. Replacement of the furnace will be an extra cost.

Basically, the point here is the try to eliminate the "surprises" early.

#4

The <u>fourth</u> area to be concerned with is not negotiating the best terms with the seller if you are not paying cash for the house. And please….you never will make any repairs on the house while the sellers are living in the house or if they still own the house. If you are paying the back owed payments to the bank to bring a foreclosure current and taking the house “subject to” the existing mortgage, get the house in your name, get them to leave the house and then start any repairs. I’ve seen investors pay the back payments, give the seller some money and low and behold, the sellers decided to keep the house and guess what? Yep, not give the investor back any money.

If there is an underground oil tank have the sellers arrange for a soil test to determine if there is any contamination from a possible leaky oil tank. If there is any contamination, pass on the deal if you are not experienced dealing with contaminated soil. This is a very risky area for investors. In fact, I would recommend you have the sellers remove the tank before closing on the property. You can also say you would reimburse them for the removal if there is no contamination and the inspections pass with the town.

If there are any other issues you are not comfortable with, negotiate with the sellers and always try to get the best terms, which will be your terms, or pass on the deal.

#5

The <u>fifth</u> area is not having your financing in place before making the offer. If you are required to put down a deposit and can’t get the financing, unless you have a contingency clause which states that your contract is subject to you obtaining the funding, you will lose your deposit. I’ve seen this happen many times with investors making offers on bank owned properties. And with bank owned properties, they don’t let you make your offer contingent upon getting the funding. Actually, they don't usually give contingencies period! It's buy it cash, as-is condition, and on time! Yes if you don't close on their date, they actually keep your deposit and have no hard feelings about it either. And bank owned properties usually require a substantial deposit of three, five or ten thousand dollars. So be very careful here.

It is recommended that all contracts with bank owned properties is reviewed by your attorney. They can add things like the contract is subject to clear and marketable title (which is an absolute must!) and satisfactory reports on any environmental inspections and structural issues. In fact, all contracts on properties should be reviewed by your attorney.

Having your financing in place makes you a much stronger buyer. You can make offers with more confidence by not worrying about how you are going to fund the deal. Making offers and then trying to find the financing can be a little dangerous as if you win the bid and don't close for any other reason than stated above, you will quickly lose credibility with the real estate agent who has been making offers for you.

#6

The <u>sixth</u> area I see very often is right up there with the number one area of over paying for properties. And that is **not having an exit strategy**. Having an exit strategy almost ensures how much profit you will make. You should know if the property will be fixed up for rental or fixed up for resale to a homeowner. You can do a lot less work on houses that will be for rental than if you are selling to a new homeowner. Don't get the two confused or you will have potential buyers walking out and never buying.

Other factors with the exit strategy are:

- If for rental – Can you refinance your short-term loan for a long-term loan.
    - Holding investment properties with hard money loans is expensive
    - Is it marketable for buy and hold investors giving them a decent return on investment? If not, it will be difficult to sell

If you are planning on selling to retail buyers:

- What selling price will you start
- How long before you make your first reduction in price
- Will you offer any seller concessions?

#7

The seventh area is don't fall in love with the house. Realize that you are investing in a property. The house is not yours to keep. They are yours to buy, rehab, and then sell or rent for a profit. That's it. Don't let your emotions effect your decision when it comes to buying for investment. This is a business, and your investment should be judged solely on the numbers and not on your feelings about the house. But unfortunately, some investors fall hard and fast for properties, and it doesn't usually end well when they do. Keep it a business.

Not only is falling in love with the house not a good idea, making the house the way you would want it usually doesn't work out either. By that I mean you should renovate the house the way the majority of buyers would want it. That means, don't put exotic tiles in the bathroom and kitchen that is only to your taste. Or loud paint schemes, ornate light fixtures and shag carpets!

Tip: Give the buyers what they want! Ask your real estate agent what buyers look for and what absolutely excites them when they are searching for houses to buy.

#8

The <u>eighth</u> area is to be cautious when choosing a partner. Be careful when choosing friends as they might not know about investing anymore than you. Real estate investments can go either way and you don't want to ruin a friendship over a sour deal. Partner with people who understand the real estate investing business. An uneducated partner can become a problem after the project is underway. Try to work with partners who can complement your skills.

Whether it's a friend or business associate, always have a written plan from purchase to exit. Also specify the roles of each partner. You don't want any surprises about a lazy or incompetent partner after you enter the partnership.

#9

The <u>ninth</u> area is to know your capabilities as a leader.

Motivation:

Motivation is what pushes us to achieve our goals, feel more fulfilled and improve overall quality of life. Being motivated comes easily to some people. But to others it can be quite a challenge. Even to get out of bed in the morning can sometimes be difficult. Becoming a real estate is always a challenge when we don't have any motivation.

Do you love the real estate investing business? We all have a tendency to work better when we love what we are doing. It's easier to get out of bed in the morning, we are happier in our work, and happier in general. Research shows that this is particularly important when we're under stress. It's much easier to cope with stress and long hours if we generally enjoy the work.

When thinking about what motivates you to perform a certain task, think about both intrinsic and extrinsic motivators – if you have trouble getting motivated to perform specific tasks it may be useful to write them down and list the motivators for each.

Accountability:

Like motivation, accountability is another character trait shared by successful leaders. Accountability shows not only responsibility, but acceptance to own one's actions and to lead by example.

Accountability is not a one-time, sometime thing; it's an all-time thing. Whereas when people take ownership if things start to go wrong, then they step into solution mode. They start to try and figure out what is going wrong and try and fix it. Investors that are successful are people that go into solution mode. In my experience, accountability is the single biggest differentiator between successful and unsuccessful real estate investors.

Innovation:

Innovation, in this context is about showing an adaptability for change. In today's world, being agile is one of the important skills you can acquire. The ability to recognize agility and being open to change course to achieve better outcomes, is also a respected and desired trait in leaders and real estate investors as well.

#10

The tenth area is to have your team in place. You don't need to be alone in this business. Let's take a quick look at assembling your team of real estate experts to assist and guide you through your investing career.

Real Estate Agents:

First, get connected with a knowledgeable real estate agent in the area you are looking to invest. They can be very valuable giving you a lot of information on the area, school systems, transportation and more about the town and area. They will give you comparable sales to help you with hour ARV (after repaired value of the house). They can give you great insight to what buyers are looking for when house hunting. Agents can assist you with any town issues, violations and more.

Attorney:

Having a real estate investor friendly attorney is a must. They will review your contracts, protect you and your deposits and insure you adhere to any and all legal requirements as a buyer and seller of your projects.

Title Agency:

Although your attorney can set you up with a title company, you can also request title work on properties directly from a title agency to check on any title issues before trying to wholesale or purchase the property.

Insurance Company:

Always get an insurance policy before you purchase the house. And remember, you need to get a policy that covers Vacant Houses! Don't fib and tell the insurance company it is rented when in fact it is not. You will not be covered if anything happens to the house when they find out if was not occupied. And worse yet, you could be subject to legal charges for trying to defraud the insurance company!

Home Inspector:

This is an invaluable team member as they will preform a complete inspection on the house. This will usually include termite inspections. If not, you can hire a termite inspection separate from your home inspection. Most importantly the home inspector can alert you to any structural issues as well as any other potential problems that could be a costly repair. And best of all, after the inspection you will know exactly what to show your contractor to repair as well as your normal renovation for the project.

Contractor:

Your contractor will be able to give you estimates for the renovation work after submitting a complete scope of work. Only work with licensed contractors who are reputable and can give you at least 3 references.

In summary, let the professionals guide and work alongside with you in your real estate career.

A Bonus Tip:

This should be a no brainer. Get educated on the type of investing you will be doing. If you are buying and holding while renting, know your rental market and what the market rental prices are in your area. Don't think by adding a high-priced toilet and whirlpool tub that you will get more rent than the market prices. Or, should you always put in a washer/dryer or even a dishwasher in the rental unit. Here again it depends on the area. I've put these in rehab houses I've done only to have the new landlord take it out! Why? Either the landlord pays for water and since both use water it's an expense to the landlord, or the landlord doesn't want another liability on the second or third floor from a washing machine hose busting loose to flood all three floors. Now on higher end units, it just may be not only a nice feature, but a necessity to justify the rent. But here again, you need to be educated in this area.

If you are flipping properties, learn how to evaluate the deal so as to always make a profit. That is knowing how to buy it at the right price, having the rehab costs nailed down (no pun intended) and know what your lowest selling price can be while still making a nice profit.

So, read, study, read some more, study some more, ask questions, double check with the professionals on your team, see what other successful investors have done and don't try to carve your own path. Follow the successful path others have taken.

<u>One last thing</u>. Don't get over leveraged. If you have good credit and a few bucks, don't go on a buying spree buying properties just because you can. Believe it or not, it does happen as I get many calls from investors where this has happened to them. If you are buying a rental property, try to be certain the area will attract the type tenants you want. This happens when investors go out of state to invest because, again, it's cheaper than here on the northern east cost. Don't get me wrong, there are plenty of investors who do this but they are a little more experienced and are able to travel and watch their properties. But I would still recommend investing in your area so you can keep an eye on things.

If you are buying rehab properties, you will also need to be careful of not buying more than you can handle. Remember the holding costs continue to add up each day on each house that is not sold. If you can handle a few, fine. If not, don't give yourself unneeded "agaita". (Italian for stomach ache)

To your investing success!

Glen

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