What Every Investor Needs to Know

One of the best or worst financial endeavors a person can make is in the area of real estate investing. Late night T.V. ads, newspaper articles, local seminars and other get rich quick programs are just some of the RED FLAG items the savvy investor should be aware of. There are so many people out there claiming you can make easy money, it is hard to sort out the truth from the fiction. I have been working with investors for over a decade and this has allowed me to help you sort out what is true and what is not.

The first thing an investor needs to know is that there is no *legal*, *"**get rich quick**"* method: whether you are going to be a landlord or a "Fix-Up" specialist. While there are indeed, some really good opportunities for the patient buyer, there are all too many bad buys that can cost you money. Further, while everyone gets excited and wants to jump in with both feet, there are a couple of early "MUST DO'S" an investor has to accomplish before starting. *The investor must get a written loan approval from a bank, mortgage company or other source, as all repo or distress sales will require a written approval with offers. I've had investors lose thousands over the years simply because they tried to buy before lining up financing. And, the investor should have a full plan including a budget for repairs, time frames, insurance coverage and plans for advertising when ready to sell or rent to name a few.* Depending on what your plans are for investing, the following will outline what may be best for you and what you should avoid.

<u>The Long Term Investor</u>

For the long term investor (usually a landlord holding a home for over 5 years), the market is ripe with below market value sales, as Indiana remains near the top of foreclosure and distress sale States. This means your chances for getting a home 10-30% or more below market is pretty good if you do some committed footwork. Homes tend to rent for .8-1% of market value per month in the suburbs and for 1-2% of their market value in the areas closer to the inner city of Indy. With repo's and other distress sales in the suburbs, it is not uncommon to see homes priced 10-30% below market values in the area. This means you can buy a home that would normally sell for around $100,000, for $70,000-$90,000. If the home would rent for $800-$1,000 per month, you can buy and rent at a profit so long as you qualify for a good interest rate.

Many variables determine how much you can profit. The amount you put down on the home, the home's desirability and proximity to shopping and schools, etc. Homes in more stable areas also tend to appreciate at a more predicable rate making it is a little easier to forecast (although never certain) a home's appreciation over a certain number of years. If you buy a home for $85,000-$90,000 that is worth $100,000, and the area's appreciation rate is 2-3% per year, in 5 years the home should gain $10,000-$15,000 in value. Also, the rents should be raised as value goes up, further increasing your profits.

It is odd more people do not consider this method, as the long term profits can be large. The landlord investor does have to employ some care and patience in getting the correct renter. I have spoken to a few landlords that have had tenants for 20 or more years! The landlord also has to factor in upkeep of the home (also largely affected by the type of renter you get). *As a rule, a landlord should figure in a $1,000-$2,500 per year for common maintenance depending on home and tenant.*

Another consideration is whether to allow pets or smoking in the home. Both greatly affect the amount of annual expense you will have for repairs. If you allow pets for instance, you can bet you will have floor coverings to replace after the tenant leaves. Smokers mean paint and more cleaning before being re-rented, as many people are sensitive to smoke.

The landlord and "fix up" buyer will both need to make contacts in the construction/handy man fields to help them control costs. A good general contractor can do a lot of basic repairs (i.e. carpet, paint, drywall, and minor plumbing). *The right repair person can save you thousands, but you should be sure that they are licensed or at least very experienced.* For more safety related issues like electrical, gas lines, etc. "*Always use a licensed and bonded company*", the few extra dollars are worth it for the safety of potential buyers and/or renters and to reduce your liability.

Liability is a major concern for the landlord, as you will have tenants in a home you own. *Interviewing insurance agents to get the best company (not always the cheapest) will be important.* Also, the Lease Form you use is extremely critical, as this will set out your expectations from the tenant as well as the terms of the agreement. Forms are available at most office supply stores, *but I suggest you spend a good amount of time to really go over different forms until you find one that most protects you and your tenant.* You may even have an attorney review the lease to make sure it covers all the elements you feel are important or that the attorney may feel is important to protect you.

<u>The "Fix Up" Investor</u>

This refers to the Investor (buyer) who simply wants to buy a home well under resale value, spruce it up and sell it for a profit. Recent opportunities in the repo market and other distress sales (anyone needing to sell quick to avoid foreclosure or for other reasons) have allowed many people to profit from a very unfortunate market reality. Just a few years ago, these listings were somewhat rare, around 1-3% of all homes listed for sale on the market. The current market has 10%-35% of current listings in such a state depending on the area. While there are hundreds if not more investors looking for such deals, there are just so many homes listed that *your chances of getting a good buy are decent if you are willing to put in some time and effort.*

Another fortunate occurrence for the Fix Up investor is that many of the "distress" sale homes are not in bad shape. The old stereo type of a foreclosed home was that it was in very poor condition and would cost a lot to fix up. Today, because of a number of different variables, this stereo type can be thrown out the window. While many foreclosures or "short sale" homes are not perfect, a large percentage are actually fairly nice. I have sold many such homes that were in move-in shape. The reasons are many, but the main one is that so many new construction homes end up in foreclosure within a few years. These homes often come about because the people that bought them did not really consider the actual monthly mortgage payments they would have 1-3 years down the road from buying. Other causes such as divorce, lose of job, relocation and others have left a market saturated with these homes.

Patience is the key, as with any investment. Most really good deals will sell quickly, and often there is an advantage given to "owner occupants" as with HUD and VA repos. However, as noted above, there are so many listed, that a few will slip through the cracks. That is where the investor has to act. If you find a home that appears to meet your general determined investment criteria, do not hesitate. If you do, other savvy investors will likely beat you to the purchase. It is very common to have multiple offers on homes in a short time, so it is all the more critical to try to get in early with an offer. That way you may get it before anyone else can and secondly, if other offers come in, you should be notified you are competing. This multiple offer situation allows you to determine whether you want to offer more for the home or to stand on your initial offer. Also, as noted earlier "Pre Approval" is a must with all offers. Even if you offer more than others, only offers with approval letters will be looked at by seller (bank).

Like any job, you will reap what you sow as an investor. I highly recommend that you study (via discussion and work with your Realtor) the area markets where you want to focus. You and your Realtor will thus be able to know when a price is really right on a home. I've actually seen some repos or distress sale homes listed for way above market value, so never assume they are a good buy. In a few of these cases unwise investors (thinking they were a good buy) actually paid above market value!

The "Fix Up" investor needs to be a little more careful than the landlord or long term investor in a quick evaluation on a home. Mistakes made by a long termer can be slowly absorbed over the years due to rents and appreciation. In the fix up game, missing a major defect or over bidding on a home can be costly. Careful study of the area sales can help with the valuation process (if there is time for this), but only a thorough home inspection can detect major defects. Some investors forego inspections or inspect the homes themselves. These are all decisions an investor must make on his own, but I do urge caution in assuming everything is O.K.. Although the repo or distress sales are usually sold "as is", that does not mean you can not assess the home condition (this will be discussed more below).

<u>The Process of Buying</u>

You have read some of the basic concepts of investing, now we will look at the purchase itself. How does it work? Most (90-95%) distress sales occur through the Multiple Listing System (MLS) as established by the Metropolitan Indianapolis Board of Realtors (or what ever MLS is in different areas). Banks, Mortgage Lenders, HUD, VA, and individual sellers hire Real Estate Brokers to sell the homes. The agent or the seller will decide on a price and they offer it for sale to the public. Many people falsely believe they can call lenders or banks and try to buy homes before they go on the market. This is rarely ever possible due to local and national laws dealing with property transfers and the avoidance of lender improprieties. Basically, the lender is required to do the most to get the most for the home to help keep the bank's loss at a minimum.

Even given the above, the sheer volume of distress sales have left sellers scrambling to sell as fast as they can, often at below market prices. After meeting with your Realtor, you can determine what your **investment profile** is. If you are a long term investor you may say , "I'm looking for homes from $30,000-$60,000 for rentals. I want to buy them 20% or more under market value and I want them in certain geographic location". With this set, your agent can set you up a profile and call you (or e-mail) when something comes up. If you're the "Fix Up" investor, you may say, "I want homes 30% or more under market in the $100,000 to $150,000 range, no older than 15 yrs, in a certain area." Of course, every profile will be different for each investor. You may even mix and match and do a little bit of long term as well as fix up stuff. In any case, communication with you Realtor is the key.

You and Your Realtor

If you are really motivated to buy within a certain time frame, let your agent know, so they can focus on your needs. Keep in mind, Realtors get *hundreds of requests* from people who say "*call me if a good deal comes up*". Not many agents have unlimited time to watch the computer 24 hours a day for a hundred different people. It is so daunting many agents do not work with investors because of the time involved. Also, you must choose an agent that you can trust. If the agent is an investor themselves, there may be a conflict of interest when a really nice buy comes available. And, if you happen to stumble onto something before your agent, you want to be sure you will not be competing with your own agent. Simply ask who ever you work with if they are an active investor to avoid any problems. Also, lay out specifically what your short and long term plans are for investing with your agent. This will allow them to even better advise you in a number areas concerning your needs.

Distress Sales 101

I use the term "Distress Sales", somewhat interchangeably with repos, short sales etc. Let's define what makes up these sales.

HUD and VA repossessed homes: These homes are ones that were bought using HUD or VA insured financing and hence their resale upon foreclosure is governed by the regulations of HUD or the VA. These homes, when placed on the market, give a ten day priority period for "Owner Occupant" buyers. This means, the **investor** must wait until the owner occupant period is over to try and buy the home. These homes vary in condition from terrible to like new, so make no assumptions in this area. Recent times have seen the HUD repos selling for well below historical averages, due to the volume of repossessed homes all over. HUD and VA repos draw a lot of attention as people often assume they are automatically a great deal. Sometimes they are and sometimes not. Also, on really good buys, it is fair to assume there may be multiple offers, so you will want to bid what your highest comfort level on the home may be if you really want it. You just have to use good judgment and not over bid and loose profit or under bid and loose out altogether. It is extremely critical for you to have all of your paperwork ready before pursuing a HUD or VA repo. Any offers without a full approval letter is rejected. Also, you will be putting down earnest money $500 to $1,000. As an investor, this is none refundable if you do not close and they are selling "as is'.

Short Sales: These are homes that are pre foreclosure. They are sold at a loss with the permission of the bank or lender to avoid costly court fees associated with foreclosure. Lenders will generally take 82-85% net or higher for what they appraise the home at. If they have a $100,000 appraisal, they will want at least something in the $90,000 range in order to net the 82-85% (keep in mind they are paying selling fees of 7-9%). Short sales by their nature are generally better deals for owner occupants or long term investors as they usually sell for closer to market value. Occasionally, a lender will get desperate and go lower than the standard, so any investor should not totally rule these sales out.

Bank or Lender repo's: These are simply foreclosed properties that were bought using conventional financing, not using government backed loans. They may also be from non conforming lenders (those issuing credit to people with lower credit ratings). These homes are a little hit and miss to, but many are some of the best buys going. Like FHA & VA loans, they are sold generally "as is". However, it is not as set in stone with all these lenders. Some will allow inspections and some will not. Most will not do repairs. These lenders generally want quick closing sales, so you'll want to be ready to close within 3-4 weeks. That means your loan, cash or other means of financing should be quickly available and you should start lining up insurance immediately upon the acceptance of an offer on the home.

Auctions and Sheriff Sales: Auctions: Some people use the Auction process as a quick way to sell a home. The investor however, must use extreme caution when trying to buy an investment home at an auction! While most auctioned homes sell a little under market, occasionally just the opposite happens when unprepared and uninformed buyers are present. People can get emotional and start bidding properties up. I have also been at auctions where friends of the sellers were in the crowd bidding stuff up (it is unethical, but it happens).

Sheriff sales occur either where a property is taken back for unpaid property taxes or where the sheriff has foreclosed on a home through the suit of a lender and the lender has the sheriff do an auction to clear the property's title. Here is the catch, 95-99% of the time the lender buys the home back and resells it themselves. Here is partially why: Say a lender has a $100,000 mortgage on a home worth $110,000. At the auction, unless someone bids over the mortgage amount, the lender will likely buy the property back (as they are effectively paying themselves for the home). Then the lender hires a Realtor to sell the home. The true property tax sales do happen, but not like the ads on late night T.V. make you think (at least not in Indiana). These sales are published, so multiple investors are ready to bid on the homes. Also, in Indiana some tax sales require a holding period of a year or more (in accordance with Indiana Homestead Laws), before you can resale or take actual possession of a home. The previous owner of the home often has up to a year to pay up all back taxes and penalties, and reacquire the home. The investor buyer is paid interest for the time their money is held up, but there is no guarantee that they will actually get to own the home at the time of purchase (auction).

There may be additional information on Sheriff sales I have left out, as I do not claim to be an expert on such sales. You can visit the website at http://www.indygov.org/eGov/County/Clerk/Court/sheriff-sales.htm for more details.

Finish: This pamphlet of some of the basics of investing is designed to give you a starting point on your way to considering your investment strategies. Investing in real estate is serious business and can be as good or bad as you allow it to be. A realistic approach and reasonable goals will go a long way in protecting you from the worst. Knowledge is the key, as with any investment. Study the markets, study repair cost evaluation, make good friends of contractors and most importantly a good Realtor. You will learn to hone your investment strategy and to adjust as time passes. The more you learn, the further you will be on your way to fulfilling your investment needs.