

Investing In Real Estate

Introduction

Over the past few years investing in real estate has become a popular subject in our culture. Countless news stories and television programs have come out on the subject motivating everyone and their dog to want to seek their fortune in real estate. This has brought on an onslaught of companies trying to capitalize on the opportunity created by this demand. There are innumerable educational products from books to live seminars designed to help the novice get started on their journey into the wild west of real estate investing.

As a real estate agent I see the inside of all that is going on in real estate. It is difficult if not impossible for an individual getting started to know what represents a real opportunity and what is another scam designed to transfer your wealth to the unscrupulous purveyor.

The main issue is money. Even the person with the greatest intentions in the world will not help you to be successful at investing in real estate unless they have some way to monetize that time. It is important that you identify the motivations of anyone you are seeking real estate investment advice from, and make sure that the person you are relying on only benefits when you make money. We will talk more about this later, but now lets get started.

Two Kinds of Investment

Generally speaking there are two different ways to monetize your investment in real estate. You can make money by selling the property or you can make money by renting the property. We will generally refer to making money by selling the property as a flip, and we will generally refer to making your money by collecting rent payments as cash flow.

Flipping properties is about velocity. Time is money. You will quickly come to realize that the properties that show the greatest profit potential are almost always sold immediately. It is common for a hot property to sell the day the price is reduced to the magical price, or if it comes on the market at the rice price it will go under contract the first day out. You have to have your financing in place, gather your information quickly, and pull the trigger as soon as a good deal is identified. You will loose the overwhelming majority of bids you submit. This means that anything you can do to reduce the response time on flip offers should be done. Once the property is yours speed is still a major issue. You have to get the property rehabbed quickly, so that you can get it on the market quickly, so that you can find a buyer quickly, so you can close quicker, to reduce your carrying cost and increase your profit. The best way to control timing is to buy properties at a price that you can still afford to rehab with excellence, and yet still sell the home at a reasonable market price. Do not try to skimp on your rehab, or hold the property to attract a

buyer willing to pay an above market price. These things will end up killing your profit by increasing your carrying costs.

Profiting through cash flow is about reducing tenant turnover and controlling make ready/repair costs. Every time you lose a tenant you have to pay property-carrying costs, pay to make ready the property for the next tenant, and pay to find a new tenant. You have to anticipate these expenses when evaluating cash flow properties. I have seen countless situations where an investor shared with me the financial aspects of the property they bought and I immediately realize that they will actually lose money if they have to find a new tenant. The best way to control these issues is to take good care of your tenants. Promptly resolve property issues and treat your tenant with respect. Do not give your tenant any reason to want to live somewhere else. The second strategy is to rehab the property with durable materials that are as low cost as possible. Don't put in high cost materials and put yourself at risk of a large make ready bill.

Finding Discounted Properties

You make money in real estate investing when buying not when selling. You can always choose not to buy a property because on paper it does not look like a good enough deal, but once you own the property you cannot choose to ignore profitability issues. The big question is how big of a discount can an investor get.

First of all, let's dispel the myth that you can find properties that are deeply discounted and turn around and sell or lease the property for a large profit with little to no additional investment or risk on your part. That does not happen. There are far too many buyers in the market looking for good deals to allow a property to sell for a price that is drastically out of alignment with its condition. If there were a property priced out of alignment with its condition another buyer would just come along and outbid you. It is possible to buy property for 25-40 cents on the dollar, but most of the property will be fire damaged or in some other way destroyed. It is possible to buy a home for 45-55 cents on the dollar but the home is going to need a complete cosmetic overhaul, foundation repair, systems work, and have undesirable characteristics that are scaring other investors off. You can buy property for 60-70 cents on the dollar that only needs cosmetic work. The point is there is an inverse relationship between price and condition with surprisingly small variability from property to property.

Let us talk about the word distressed. A property is physically distressed when it is in a condition that is not in alignment with the average market condition, or it is financially distressed when a property has lienholders and the owner is unable to satisfy the lienholders. The properties that represent the greatest investment potential are either physically or financially distressed. The greater the distress the larger the discount you get when purchasing the property. Some properties are only physically distressed and can be purchased at a substantial discount because the homeowners are either unwilling or unable to bring the property up to average market condition for a myriad of reasons. In this situation foreclosure is not a

concern because the home is either paid for or the mortgage is not delinquent. These properties are hard to find because there is no public notice that the property is in this unique situation, but these properties can be acquired at any time at a profitable acquisition price.

There is a timeline that represents the various stages of a financially distressed property. Generally speaking there is pre-foreclosure, foreclosure, and REO. Homes that are in financial distress almost always have physical distress too because the homeowner who does not have the money to satisfy lienholders also does not have the money for maintenance. Good investment properties can be picked up at each stage of the timeline, but there are pros and cons to each one.

Pre-foreclosure generally refers to financially distressed properties where there is a timeline for foreclosure. In this situation you are not dealing with one seller who speaks on behalf of the property, but every person and entity that has a financial interest in the property has to be brought into agreement for the buyer to get clear title. This is generally referred to as a short sale. When buying a short sale you execute a purchase agreement with the homeowner, then the listing agent goes around to all the other entities that have an interest in the home submitting large amounts of documentation to prove the homeowner can not make good on their promise to pay and that the offer the sellers have accepted is in the best interest of all interested parties. Because of the number of moving parts it can be assumed that the approval process will take 3-9 months. If all parties do not approve the offer the buyer gets their earnest money back. This type of investment is attractive because you have access to the property to gather information for due diligence, but due to the extended timeline many investors ignore these properties. There are also possible restrictions that can be placed on the investor that could limit their ability to liquidate the property. Care must be taken to avoid this situation and can only be evaluated on a case-by-case basis.

Foreclosure in the state of Texas is the act of trying to auction the property off on the courthouse steps the first Tuesday of the month following the required legal notices and timelines. The deed for the property is held in trust by an independent third party called the trustee. When a mortgage becomes delinquent the proper legal procedures are followed, and if the homeowner does not satisfy their financial obligation to the lienholder the trustee auctions the property off. The trustee is also going to bid on the property on behalf of the bank. This effectively creates a reserve bid and prevents properties from selling at ridiculously low amounts. The buyer of an auction property must pay cash and usually has 24 hours from the auction to pay the remaining balance after their \$10,000 deposit. This fact alone pushes out the overwhelming majority of buyers. The second major hurdle is no one involved in the buying or selling knows the true condition of the property. The buyer can drive by the home, but they do not have a legal right to enter the property unless invited to do so by the legal owner, who is the one being foreclosed on. For this reason the legal owner is usually not all that eager to help the would-be-investor. For the most part banks are the highest bidder and the property goes back to them.

Once the bank has bought the property back at the foreclosure auction the property is known as a Real Estate Owned property, or REO. Do not ask me why it is not a bank owned property, I do not know. Once the bank forecloses they have internal procedures they follow to liquidate the property to recoup the largest amount of their principle as possible. Generally speaking a foreclosure wipes out all subordinate lien holders, so you usually only have to get the bank to accept your offer to buy the home. In some circumstances there is a re-insurer that has to sign off on the deal, but this usually only adds a day or two to the process. REO properties represent the lions share of investment opportunities in todays market because they offer full access to the investor to vet the deal, have a reasonably short response time on offers, and the bank is not emotionally tied to a particular sales price. The bank does not care how much they loaned out on the property; all they care about is reducing their loss by selling the home for the most amount of money in the least amount of time.

The last category of investment grade property is wholesale properties. There are companies out there that monitor all the real estate inventory, and when they see a good deal they write an offer on it. They spend about half of their time acquiring investment grade properties in this way. The other half of their time is spent developing relationships with investors. Once they have a property under contract they do preliminary analysis and provide a financial summary for the property to their investor database. It is like a feeding frenzy, and the first person to put up \$3,000-\$5,000 non-refundable deposit wins. When the investor purchases the property they buy it from the wholesaler who purchased it from the original seller the day before. The wholesaler makes their money off of the spread between their purchase price and the investor's purchase price. At first glance this appears to be a third party adding expense to the transaction without bringing any value to the table, but this is not the case. There are literally thousands of foreclosures in any major market area every month. It takes experience and manpower to sort through them all to determine which ones will work. This is work that most investors do not have time to do, and most real estate agents do not have the experience or financial motivation to do. Most investment transactions are tiny and a seller paying 3% to an agent to marry an investor to the property just does not make good financial sense if that is the agents only way to monetize that time. Wholesale properties provide great visibility to investors because they usually bring in experienced contractors to give estimates for repair, and give access to the property by offering showings. They also take the guesswork out of what the investor will have to pay for the property because it is almost always sticker price. The wholesaler makes their money off the spread so it is almost always the case that they are inflexible on price. The only downside of wholesale property is the speed with which they sell. Frequently there is pressure to make a snap decision, and once you put up your deposit money there is not way to get it back.

Financing

How an investment property is funded has a profound impact on the profitability and risk. There are not as many funding options for real estate investing as there once were. Generally speaking there are three categories: cash, permanent financing, and temporary financing.

Cash Investing

In real estate investing cash is king. Many of the expenses associated with closing on a property go away when the buyer is using cash. It also reduces the carrying costs of a property because you are not paying interest. This means you can pay more for a property beating out other buyers and still have higher profit, but at a lower ROI percentage because there is no leverage. There is no risk of foreclosure and the investor has flexibility to do what they think is best with regard to the property because there is no other entity that has a financial interest.

Permanent Financing

In financing a cash flow property you must have permanent financing. Most of the loan programs that people are familiar with like FHA, VA, USDA, Texas Vet, etc. are for owner occupants, and cannot be used to acquire a cash flow property. This leaves Conventional financing as the only permanent financing option for investors. For a homeowner buying a home they plan to live in a conventional loan only requires 5% down. For an investor most lenders require 20-25% down payment. This pushes the loan to value percentage below 80% so the investor is not required to pay for private mortgage insurance. An investor is limited to 5 financed cash flow properties unless they can find a bank that plans to carry the loan and not resell it. There are also additional requirements that prevent an investor from acquiring more than 2 properties in their first year of investing. The limiting factor that affects most investors is the fact that the full payment goes against the investor's debt to income ratio used to qualify them for additional mortgages until the investor can show on their income taxes that they made a profit renting the property. Then the lender only counts 25% of the mortgage against them. If they are showing a large enough profit they can counteract the negative effect of the property on their debt to income ratio.

Permanent financing is a credit-based loan. This means that if you have the opportunity to buy a home that is worth \$200,000 for \$50,000 the bank will only loan you the money if you are deemed credit worthy. You must first meet their underwriting requirements and then the property itself must pass inspection. The underwriting process is very involved because they are looking at many detailed factors about the borrower that require tons of documentation. This means it is difficult to close on a property using permanent financing in much less than 30 days.

Permanent financing does not usually work on flip properties. Lenders who make permanent loans usually make their money by reselling the loan to a mortgage investor. The mortgage investor pays above the loan balance to the original lender in anticipation of future interest payments. Most if not all mortgage investors require that they collect at least 4 months worth of payments before the loan is paid

off. If they do not get their 4 payments the original lender is charged back by the mortgage investor.

The second problem with the original lender wanting to resell the loan is that the property has to be in a certain condition before the mortgage investor will buy a loan that is secured by it. This means that properties that are severely physically distressed (as discussed before these are usually the ones that show the greatest promise to return a profit) usually do not qualify for permanent financing. The permanent financing industry is highly regulated and this is where many of the roadblocks for permanent financing come from. This is no problem for flippers because they were not planning on using permanent financing anyway, but it present a huge problem for cash flow investors. You have to find an extremely rare property that will both cash flow and qualify for permanent financing if you want to have one closing (we will discuss two closings later). When one comes available you had better move quickly because if you do not you are going to miss out.

Another downside to permanent financing that does not affect temporary financing is there is usually not a way to roll the rehab costs in with the mortgage. This means that in evaluating the property you must account for rehab as an all cash expense, which lowers your leverage ratio and cash on cash return. There is only one exception to this rule for cash flow buyers and that is a HomePath Renovation mortgage. Most investors do not know that an investor can use a HomePath loan, but they can as long as they put down at least 10%. The only properties that this loan can be used for are Fannie Mae REO properties. This is such a specific situation that it must be evaluated on a case-by-case basis.

Temporary Financing

Temporary financing comes in several forms, but the most common form is generally referred to as hard money. Temporary financing is usually used for flipping homes or rehabbing cash flow properties to a condition that qualifies them for permanent financing before the investor refinances (this is the two closings situation alluded to earlier). The distinguishing characteristics of temporary financing are 6-12 month loan, works on highly distressed properties, usually will fund the properties purchase and the rehab, is an asset based loan, closes in much less time than permanent financing, and is much more expensive.

Hard money is usually a non-bank loan that is made by an individual or some other entity with large amounts of liquid capital. The lender will start off by taking an application, but they are much less interested in credit worthiness of the borrower than permanent finance lenders. Their approval process is more to establish that the borrower has enough capital to take substantially all the risk out of the investment for the lender. This is because they will usually only lend 65-70% of after rehab value. Lets look at an example. The target property has an after rehab value (ARV) of 150K. You buy the property for 85K and are going to put 35K in it for rehab. This means that your total cash need is around 120K, but the investor will only loan you 65% of 150K or 97.5K. You will still need to bring the difference of

120K and 97.5K to the closing table, plus pay your other closing expenses. If you do not make your interest payments or you do not sell the property before the loan expires they will take possession of the property, and sell it to satisfy the debt. In this scenario they would only need to sell a 150K home for 97.5K to make back every penny they have invested. Because of this process the hard money lender has very little risk. In fact, I have heard stories of a hard money lender foreclosing on a flip property and then immediately lending money to the same investor on another deal because they did not lose any money when they foreclosed. This is why a hard money loan is considered an asset-based loan where the main determining factor in a credit decision is the strength of the underlying asset as an investment.

The hard money lender does not care how damaged the property is. They are going to do their own due diligence to confirm that your rehab budget is large enough to bring the property up to market condition, and then make you escrow that amount of money at closing. They are not going to sell the loan so they are not under any compulsion to underwrite to any standard except that which they think best. Hard money is expensive. You will usually pay around 2-5% of the financed amount at closing and then pay 13-15% interest only payments until the property sells, is refinanced into a permanent loan, or is repossessed by the hard money lender.

There are all different sources and types of hard money loans, but the above explanation is a good illustration of the most common type. There are some hybrid programs out there that are a mixture of hard money and conventional financing. There are some banks that have more rigorous approval than a standard asset based hard money lender that have much cheaper origination and interest. I know of a couple of institutions in the local area that might represent a solid opportunity for investors, and we can discuss that personally when you are ready.

Randall Sullivan Home Selling Team Investment Process

My goal is to build relationships with real estate investors, provide them resources to help make them successful, partner with them to work together through to the end to help make sure they make money, and to do repeat business.

I am a TREC licensed real estate agent. Most agents are on the "transaction treadmill". Every month they have to find a new person who will buy or sell a home with them. This is because once you help an owner occupant buy or sell a home their motivation for doing business with you is satisfied. This is not the case with investors. Once you successfully complete the investment process the investor's motivations only strengthen. This is why working with investors in doing repeat business is a major pillar in my business.

I am a big believer in the idea that with any business problem there is an opportunity. As an agent I started meeting hundreds of people who had an interest in real estate investing, but they just didn't know how to get started. I also met a hand full of investors who had bad experiences and lost money. In nearly every case

that an investor lost money I was able to identify the missing piece of information that, had they had it before they bought the home, would have prevented them from losing money. My opportunity ideal and these encounters prompted me to develop an investment system that would provide virtually all the information that is available about the advisability of a particular investment, along with the post acquisition contacts to help the investor carry the property through to a successful sell or lease.

Once I developed the system to gather information to make a decision, and the resources to execute on the decision I started telling investors I met about it. The system was universally praised by all as the most comprehensive and lowest risk solution to the real estate investment dilemma.

In a way I am just a real estate wholesaler like the ones discussed earlier. There are a couple of key differences that make my value proposition quite different from traditional wholesalers.

Most investors are either buying investment properties through an agent or a wholesaler. Let's discuss how each works and then we will talk about how my system is different.

Buying Investment Property Through an Agent

Real estate agents usually make their money through real estate commissions. Traditionally an agent gets 3% from the seller when they help the investor buy, and 1-3% from the investor when they help them sell. Agents usually do not make anything on the back end when they help an investor purchase a cash flow property unless they help them lease it then they get 50-70% of one month's rent.

As I write this there are 41,905 homes for sale in the local MLS. Of those probably 50 represent a good investment value. The big question is who is going to do the work to determine which of the nearly 42,000 properties are good investments. To accomplish this task you first need access to all the data, which you cannot legally have unless you are a licensed real estate agent who is paying Realtor and MLS dues. The legal restrictions and added liability that is placed on agents when selling real estate makes the prospect of becoming an agent seem like a bad one to most investors, so most investors do not have legal access to the data. Ironically there are almost as many licensed agents in our MLS area as there are listings, so there are plenty of people who have the access. The question then becomes what do they have to know to be able to find the needle in the haystack. It turns out they need to know quite a lot.

First you have to have the average market statistics to be able to filter through the few thousand listings in each prospective investment area to the 20 or so that might work. Then you have to have the skill to accurately predict what a property would lease or sell for after rehab. All agents should know this but surprisingly few really do. You have to then know on average how much it would cost to rehab the

property. Ask any agent how much the average cost per square foot the rehab is for a cash flow vs. flip property and you will almost certainly get nothing but blank stares. Then you need to know all of the various expense associated with the different financing methods and the associated other expenses (i.e. a cash buyer purchase a foreclosure may opt to have a title search done with no insurance to save money but a person using financing will have to buy title insurance for themselves and their lender). In the case of a cash flow property they will need to know how to estimate vacancy, make ready and repair costs, and leasing fees. They will need to know how to accurately calculate the cash required for each investment so they can give an estimated rate of return. All of this just to identify a few properties that MIGHT work as an investment.

Then someone has to go to the property. That person will need to be able to put together a rehab plan that is in alignment with the ARV or lease price. They will then need to be able to accurately estimate rehab based on this plan for that particular property. This is not as simple as an average number multiplied by the square footage. Since the profit from most of these deals is \$8,000-\$15,000 being off on one line item can have a profound impact on profitability. The rehab budget also needs to take into account foundation repair, which virtually no one can predict, even in a physical inspection. Once you have all this information a person can reasonably evaluate investment opportunities.

Supposing that the agent was able to take it this far chances are they do not have the contacts necessary to help the investor execute the plan. You need to know lenders and all types of contractors to successfully pull off a real estate investment.

The bottom line is agents do not have the skills or contacts necessary to accomplish this feat. There is a very good reason why agents do not go out and acquire these skills and contacts. IT DOES NOT PAY THEM ENOUGH. If you had to do all that work just to get a measly 3% commission on a \$60,000 acquisition you would go broke.

Due to this financial reality most investors have to acquire the skills themselves and rely on agents only to send them tons of listings. The investor then sifts and sorts, does their own calculations, and tells the agent what they are and are not willing to do. For this reason most investors see the agent involved in the transaction as a cost center eating up their profit and bringing nothing to the table. Realtors that have worked with investors know this and therefore avoid working with investors.

The next big problem with this screwed up system is the learning curve for the start up investor. I have met one investor that has lost more money investing in real estate than he would have spent getting a business degree from Harvard. That is one expensive education. Since the average person with money got it by being prudent in their financial decisions they lack the propensity for risk they would need to put themselves in learning situations that are necessary to become a good investor. They hear the stories of the people that did, and how much money they

make, but very few ever take the plunge. The ones that do are usually so beat up after their first experience that they give up.

Buying Investment Property Through a Wholesaler

An investor buying through a wholesaler is not plagued with all of the issues listed above. The wholesaler has the experience and resources to sift and sort the inventory to find the few good investment opportunities. They also have the resources to help the investor to be successful. Because they monetize their effort they put into the deal differently they are able to make enough money to motivate them to go through the herculean effort.

The downside of wholesalers is that they do not have any back end monetary reward, so in some ways they are motivated to sell properties that are marginally profitable. This may turn off an investor, but it is easy to find new investors and they have to sell a large volume of property to support the huge administrative staff it takes to run the system. In short, some of the time the slice of the pie they take is so large that there isn't any left for the investor.

Buying Investment Property Through The Randall Sullivan Home Selling Team

My investment system is a hybrid system. I do have the experience to identify potential investments along with the contacts to carry out the investment plan.

I am financially motivated to help the investor through the entire process because I guarantee their estimated profit amount. I cannot afford to over estimate the ARV or underestimate the rehab/other costs producing marginally profitable properties because my guarantee states that I do not get paid if my investor does not get paid.

This highlights the main difference in my investment system. I get paid on the backend. I do all the work that a wholesaler does, plus stay involved through the rehab and sale/lease process because my investor pay me 3% plus a \$695 transaction fee on the back end for flips and 60% of the lease fee for cash flow properties. In most instances investors will not pay a full 3% commission to an agent on the back end, because the investor is doing all the work, but in my case I do all the work and guarantee the outcome with my commission.

Some of the time I monetize my effort by wholesaling properties, but this is usually because I did not have a specific buyer in mind for a property when I found the opportunity. I have to put it under contract to keep anyone else from getting it, and to protect myself from unscrupulous investors who might make it into my database. I can not email out property details for an investment property unless the individual I am sending it to has already committed to use me to buy and sell/lease the property, or I have it under contract so that no one receiving the email can go around me.

My Evaluation Process

I spend countless hours monitoring real estate inventory and doing preliminary desk analysis on properties. They are all added to my tracking spreadsheets and I update the projected acquisition price each time there is a price reduction so that I know when the property gets into the profit zone. When I deem a property to be close enough to the profit zone I go out and look at the property by myself. At this point I have already formed a tentative rehab plan based on the condition of comparable homes and I take all the necessary measurements to know how much the rehab is going to be. I have been trained by my contractors on how to quote out the work. While I am at the property I get out a device called a ZipLevel. This unit is the same one used by structural engineers and foundation repair companies to measure deviations in foundations. I then shoot elevations of the foundation to try to determine if the home needs foundation repair or not. Let me be clear so no idiot tries to sue me. I AM NOT A STRUCTURAL ENGINEER. The information I provide is not to be considered your sole source of confirmation of the sound nature of a foundation. I simply do this because it gives me the information I need to estimate how many piers a property needs, if any, in the rehab budget. We are going to get the opinion of a foundation repair specialist or a structural engineer after the property is under contract. I then take all this data back to the office and plug it into the evaluation spreadsheets I have built. At this point I know if the property will work as an investment or not.

If a property is deemed a good investment by my analysis I will either contact the next investor in line who has committed to my system, or write the offer for the property myself. If I buy the property I will either wholesale the property to another investor, or complete the investment process myself.

In any case, the property usually ends up being placed under contract by an investor. We then go into the inspection period. I will usually have the investor pick their own inspector. We show up at the end of the inspection and I schedule all the contractors to show up right when we are finishing with the inspector. We take everything in the rehab plan and anything not in the rehab plan identified by the inspector and gets fixed bid quotes from the contractors. We then know if the deal is as profitable as we anticipated. If it is great, we move forward with the purchase, if it isn't and the investor does not want to move forward we terminate the purchase agreement. If the investor loses their earnest money in this situation I have a written guarantee that I will reimburse them. In the event that the property is a wholesale property from another wholesaler I will not guarantee all the earnest money, but the investor would know this before they entered into the contract.

Now the deal is fully vetted out and there are only two areas of risk for the investor. The first would be unknown conditional issues that were not discovered by the inspector, investor, the contractors, or myself that will be discovered in the rehab process. These items tend to be relatively small, but they are not always small and the investor is on the hook for them 100%. The second area of risk is that the ARV or estimated lease price is wrong. I have a second guarantee. It is written and all investors will receive a copy, but the abridged version is I do not get my backend

money until the investor makes all their profit. Remember that I do not make enough money on the front end to sustain myself, so I have to make the backend money to monetize all the time I am investing. Not only am I morally opposed to selling an investment property that would not make the investor money, but also I am financial sunk if I do so.

At this point the investor moves forward with the purchase and executes the rehab plan. I am there to provide advice and support during the rehab process. I will help make color selections and help to deal with any unforeseen items that come up.

Once the property is rehabbed and ready for market I send a professional photographer to take photos of the property, and I list the property. I use that same marketing strategies that have worked for me in the past and we sell the property. During the active listing period the investor and I are communicating about how the market is responding to the property. We discuss price adjustments along the way and there are some restrictions that are clearly line out in my profit guarantee.

Once the property is sold or leases I debrief with the investor and put together the go forward plan for any future acquisitions.

Prospectus Evaluation

The beginning of the investor's process with me is looking over the investment prospectus I provide. There are general two different types of investments so there are two different prospectus packets.

Flip Investment Prospectus Packet

Every flip investment packet will have an MLS print out, tax record, sales comps, comp condition report, comp seller concession report, ARV analysis, rehab worksheet, foundation elevations, and flip analysis.

Investors who are buying properties through me will need to know how to analyze the data in this packet. The two main areas that the investor must fully understand are ARV analysis and rehab worksheet. All the other documentation is either a known quantity, or back up for these two items.

ARV analysis is where we compare the after rehab condition of the target property with the average condition of the comparable active and sold properties. I say average because the spreadsheet assigns values to various conditional items and then establishes the average conditional adjustment for each category. For example, lets say we have 3 comparable sold homes and one has granite countertops, one has Corian countertops, and one has Formica countertops. Granite is worth 5K, Corian 3K, and Formica 0. It will add the three together and say the average comparable sold property has \$2,667 in countertop upgrades. It will then look to see if I indicated what type of countertops we are installing according to the rehab budget and say, the target property will have \$5,000 worth of countertop upgrades, but the average comparable sold property has \$2,667 so lets add \$2,333 to the average

comparable sold price. It does this for each adjustment category to provide an adjusted ARV. It is wise for the investor to compare this ARV to the comps and make sure it is in alignment with what is going on in the market. If the investor cannot get comfortable with the ARV they will not be able to invest. As a side note I would like to point out that you should NEVER dispute my highly scientific and detailed ARV with a stupid value estimate you get from Zillow or some other automated valuation model (AVM). They do not know how to pull comps and make no distinction for anything that will affect sales price. Don't be lazy. Look at the comps and ask questions and don't expect a simple computer program to do the work for you. Remember, that this analysis is the only one that we will not be able to get a fixed agreement on before you buy the home, so you must understand and be comfortable with the estimate.

Understanding the rehab worksheet is much simpler than understanding ARV. You simply look at each line item and you can tell what the rehab plan is by what we are doing in general to the home and then what we are doing in each room. No need to go any deeper than that. You are going to get the chance to get a fixed bid quote from contractors before you are at risk of losing any money so this one is not as big of a deal.

Cash Flow Investment Prospectus Packet

The cash flow prospectus will have MLS print out, tax record, rental comps, rehab worksheet, foundation elevations, cash flow analysis, sales comps, comp condition report, comp seller concession report, ARV analysis, and equity analysis. We will essentially evaluate three things for a cash flow property: cash flow return on investment, liquidity, and equity.

Cash Flow ROI Analysis is similar to the flip analysis. We take the estimated rent we acquired by looking at rental comps and subtract the estimated expenses from the resulting annual rental revenue. We then calculate the cash required for the investment and use that information to calculate adjusted and unadjusted ROI. I say adjusted and unadjusted because most investors do not take into account vacancy, make ready/repairs costs, and rental fees. We use very conservative assumptions when evaluating property for cash flow, but when presenting the information I want you to be able to compare apples to apples. No other real estate agent or wholesaler is included these expenses in the projected rates of return, so I also show you the anticipated ROI that is not adjusted for these estimates so that you can get a feel for how this property might compare to others you have seen from other sources.

It is great to find a property that has a good return on investment, but it is important to know that there is a secondary market for properties that are similar to the target property so you can liquidate the asset if need be. This is why I pull sales comps for similar owner occupant sales in the area. If we discover that homes of this type are not selling it does not make it a bad investment, it just means that you need to be prepared to hold the property for the long term. Given that the intention for a cash flow property is to hold it for the long term it should not be an issue, but I like to my

investors to at least know if they could sell if they wanted to. There are other considerations when looking at liquidity like the properties ability to qualify for traditional financing. There are certain areas where you can pick up a condo for next to nothing that will lease for an attractive amount, but a large enough percentage of condos in the HOA are non-owner occupied so the property does not qualify for FHA financing. This is important to know, not because it shows that you cannot sell, but that you can only sell to a person who does not need financing. This situation is rare and something I would communicate to you before you purchased the property.

Lastly, we want to know if we did liquidate the asset do comparable sales indicated that there would be a loss of principle or gain in equity. This too is analyzed in the form of a percentage of invested capital. Some of the properties indicate that you would realize a gain on liquidation and some indicate that there could be a loss of principle. Again, this does not make the investment good or bad since the goal is to hold for the long term, but it is something the investor should know when making a decision.

How I Make My Money

The way I make my money is different from wholesalers and agents working with investors. This is good because it puts me in a position to make more money by adding more value and sharing in the risk with my investors, and in some ways makes me a partner with the investor because I cannot make my money unless they make their money.

As discussed before the risk comes in for investors when estimates for ARV/rental rates are high and estimates for rehab are low. In the section entitled My Evaluation Process I explain my two guarantees: Earnest Money and ARV that protect the investor from these two risks. I do not mean to recap, but it is the most important element for an investor to grasp in understanding my system.

Wholesale

In instances where I do not have an investor to bid on a profitable property or there is clearly enough money in the property for me to make a little more than 3% buyer commission I will buy the property and wholesale it to the investor. In this instance I make my money off of the spread between my purchase price and the investors purchase price. As with any wholesaler the closing costs are covered by the investor for both closings. In this instance I am not paid a buyers agent fee or any real estate transaction fees.

Buyers Agent

In instances where I represent the investor as a buyer's agent I make 3% paid by the seller and a flat real estate transaction fee of \$545 paid by the investor.

Listing Agent

If I am helping an investor liquidate a property as a listing agent I make 3% of the sales price plus a flat real estate transaction fee of \$695. The total commission paid is 6%, but 3% of that goes to the buyers agent. On a flip it is a requirement that the investor list the property with me or I will remove them from my database. As discussed before I am able to spend the time I do vetting out property because of the money I make on the backend. If someone were to rob me of that opportunity it would prove to me that they are unscrupulous and I would not do business with them in the future.

Leasing Agent

If I am helping a cash flow investor to find a tenant I will make 60% of the first months rent. The total commission paid by the investor is one month's rent, but 40% of that goes to the tenant's agent.

Summary

I hope that this information was helpful. If you would like to discuss investing in real estate further please contact me using the information below.

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