# Buy or Sell Your Next Home Like a <u>Real Estate</u> <u>Heavyweight</u>

**Ten Fresh Ideas to Help Homeowners Leverage Their Assets, Avoid Trouble, and <u>Make Money</u> in Today's Residential Property Market.**

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Hello everyone.  I'm Tom LaRocque

One of my favorite financial reads of the past decade was "Trade Like a Hedge Fund," by James Altucher.  Its subtitle: "20 Successful Uncorrelated Strategies to Winning Profits."

Altucher was (and still is) a hedge fund manager known for frequent appearances on CNBC.  The book came out in 2004, four years before the collapse of Lehman Brothers and real estate prices and stocks and everything else financial. It also followed, by four years, the bursting of the tech stock bubble in which the Nasdaq Composite Index eventually shed 75 percent of its value.

I was trading actively in those days, and reading a lot about financial strategies.  I traded stocks, commodities, and currencies, and even wrote a novel about currency trading.

What I liked about Altucher's book wasn't a strategy at all. Chapter 19 was titled, "What Doesn't Work." It debunked common myths about trading.

I got into real estate in 2006.  By background, I am journalist, and over the next few years, I wrote dozens of articles about real estate for the Denver Post. All along, I pondered how to put my thoughts into a clear context such as "Trade Like a Hedge Fund."

So much of the conventional wisdom about real estate seemed off-base to me.  So many important ideas were missing from the popular discussion. So much of what can make a deal work is completely off the radar of most real estate professionals.

A great analog to Altucher, I figured, could be built on ideas about real estate.

Those ideas—along with some news articles I wrote at that time, and stories about Denver investors written for my own blog, Denver Property Investor, appear in this book.

Ordinary homeowners may not think themselves as part of the same universe as Donald Trump of New York or Sam Zell of Chicago.  Even Denver's top investors may seem to be playing in a different game, or another league.  Yes, those guys are brilliant.  And for each one of the better-known names, there are several “below the radar” players who are doing deals, making money, and getting smarter every day. If you could sit down with any of them—even if you’re just a regular residential buyer or seller—you’d gain valuable insights about finding your dream home, getting your price, or staying out of financial trouble.

My aim is to bring together the two worlds of investing and everyday “retail” real estate buying and selling, and to help ordinary homeowners think like investors.

Some of the ideas herein relate to owner financing, or “seller”-financing. Others have to do with finding good deals and maintaining the right mindset.

More so than in stocks—where professional techniques can be very arcane—the strategies of professional real estate investors are usually quite understandable and accessible. You will need professional help, no question. But with awareness of your options, you’ll be miles ahead of most of the prospective buyers and sellers you’ll encounter as counterparties.

Sadly, perhaps, you’ll also be better informed than most of the people doing business as real estate professionals. The solution to that is simple: Find the right people. Like most urban areas, metro Denver is home to many good brokers who work hard to educate themselves about real estate options. That leaves a few thousand others who generally make a living saying “no,” and who should be avoided.

This text, by the way, is scattered with web links, which is great if you’re reading the book online.  If you’re reading a print copy, at least all the links are gathered together at the end of this text, so you can click away happily in a single sitting.

# Idea 1: Selling Yourself Short

It may seem odd, in a book about acting “like a real estate heavyweight,” to lead off with a strategy designed for homeowners in distress. This idea is about short sales, which are done when the owner is underwater, owing more in mortgage debt than the property is worth. In a short sale, the lender release its lien against a property so that it can be sold unencumbered to a new buyer. In that situation, it’s hard to maintain that the original owner is in the driver’s seat in any significant way. It’s more like he is being driven—by the whims and wishes of the lender, and by a buyer's willingness (or not) to make an adequate offer for a property that in many cases isn't in prime condition.

But in one way, a lender-authorized short sale is the greatest gift you'll ever receive. Done right, it is a forgiveness of debt—sometimes hundreds of thousands of dollars of payments that might otherwise continue for the rest of your life—in exchange for a signature. Not quite the same as getting a big check in the mail, but over the course of your life, perhaps just as impactful to your personal balance sheet.

I used the term "done right" because it's important to approach the process intelligently. You should hire an experienced broker to handle the bank negotiations. The "experienced" part is crucial; short sales are tricky and time-consuming. Ask your broker how many short sales he has done. Ask who will actually be on the phone with the lender. (Many brokers have teams, which is fine. Just so the person negotiating on your behalf has been there before.)

Most importantly, ask about the chances of a full release from your debt. Ideally, the lender will promise not to pursue a deficiency judgment, representing a debt that's collectible in the future. Some lenders, alternatively, may expect you to sign a promissory note payable at some future date. This too is a non-optimal solution from your perspective. Understand that your broker may not be able to promise a full debt release of at the start of the process. The answer to your question may depend on recent trends, which are constantly changing. But it's important to hear what the broker has to say on this, and to know he'll be fighting hard for you. You can always stipulate a full release or no deal. But a good broker can always decline to deal with you, and move on to clients more likely to yield a commission.

The real point here is this: In an economic climate where good news is hard to come by, relief from a large debt may be the greatest gift you'll ever receive. My advice in most situations is, grab it if it's available. That's what a heavyweight likeTrump would do. It may not feel good, but it is Step 1 in what may be a long (or quick) return to financial health and strength.

# Idea 2: Taking a Credit Hit for the Team

To be considered a short sale candidate, you must "qualify." Just as the original loan process included a lengthy application, the short sale process will involve a lot of documentation of your financial situation. But rather than prove you can repay the loan, in a short sale you need to prove that you can't. You'll do so with bank statements and W-2 forms and tax returns. An inability to pay—not just an unwillingness—is a prerequisite.

I've already made clear my belief that a short sale, if it's available, makes a lot of sense as a financial move. But what if you're able to repay a loan and simply not sure you want to? Maybe the home is so far underwater that it will take years, or decades, for it to have any equity. Much debate has centered on the subject of "strategic default," which is the decision to walk away from a debt even though you're able to continue making the payments.

The central question is this: Is it "wrong" to violate your promise to repay a debt—any debt—when you're fully able to do so? Or is it a morally neutral business decision, no worse than a business conglomerate defaulting on a business loan when its declining buggy whip business subsumes the ability to service the debt?

What would Jesus do? Surprise surprise, this book will not delve deeply into moralistic matters of right and wrong. My perspective comes from an easier question. What would a Real Estate Heavyweight do? (Again, think Trump.) I think the answer to that question is easy as well:

He would default.

Let's briefly consider the credit consequences of a short sale and a full-blown foreclosure. Why do sellers agree to short sales? Often it's because they expect a kinder, gentler handling of their credit rating. The thinking goes that if a lender sees a willingness to work with them in securing a sale, they'll be more sympathetic.

You'll often hear figures like this: In a short sale, the FICO score of a borrower with decent credit will endure a hit of around 100 points. In a full foreclosure, the hit is more like 200 points. "Decent credit" connotes a better-than-average beginning FICO score of around 680. Note however that most people facing foreclosure has have already endured a credit-score firestorm due to late payments. Not only on the mortgage, but on the Visa account, car loan, and J.C. Penney account. So much of the damage has already been done.

 

When choosing between a short sale and a full foreclosure, I recommend checking your credit at the outset. If your FICO is 600 or better, a short sale may be the better alternative. If it's already been decimated (down to say 500 or less), there is little to salvage. Choose the road less stressful, and get comfortable with the consequences. Remember, you'll be back.

# Idea 3: Peace Out, Lease Out

Another idea with which to make peace is the idea of "being a landlord." The prospect of it frightens people, who think they'll be answering midnight phone calls about clogged toilets. One way to mitigate the threat is to hire a property management company. Another is to attract a "better class" of lessee by attaching to the lease an option to purchase the property within a specified time period at a certain price.

This idea can have great benefits to tenant/buyers as well as landlord/sellers; and to individuals who are distressed, debt-free, or anywhere in between. A lease with an option to purchase may represent the best financial move you'll ever make, irrespective of which side of the buy-sell fence you're on. Let's consider a few situations.

Consider an unfortunate homeowner with a $250,000 home and a $300,000 mortgage. The home may have been worth $500,000 when the debt was incurred, but it was shrunken in a broad real estate devaluation that followed. The owner may feel he's trapped, unable to sell except in a short sale. And with that may prospect come a serious blow to his credit rating. Good credit is important to him, because he hopes to eventually downsize and perhaps buy a home again.

If he has a good, low-interest loan the homeowner's monthly payments may be will roughly $2,000. That includes the full PITI--payment and interest on the loan, plus taxes and insurance. Suppose he "straight lease" the home for $1,800. The added feature, the option to purchase, is worth certainly worth something. Let's say it's worth $2,000. The result is a "break-even" monthly cash flow ($2,000 in income minus $2,000 in expenses).

Granted, there are a lot of "supposes" here. The point is that in this situation, as in many, both the seller and the buyer did fine. The seller "sold" an unsellable home. The buyer (who presumably couldn't qualify for a conventional loan) got a potential ownership stake in a decent home. His hope is that the home value will improve, as will his ability to qualify for a conventional loan, by the end of the option period.

Note: People tend to think of a lease-option as a single agreement. It says I'll lease your home with an option to buy it at a certain price by a certain point in time. But many lawyers, at least the ones most deeply involved in lease options, say the arrangement should be done with three separate documents: A lease agreement, an option agreement, and a conventional purchase-and-sale contract. In Colorado, there is no "standard" lease-option contract from the state Real Estate Commission. As a Realtor, I will broker lease-option deals only when the documents are drawn up by an attorney.

# Idea 4: "Subject"… to What?

Leasing property with an option to buy it might be considered a mutually protective arrangement. The tenant/buyer benefits from a path to possible home ownership. But there is no obligation to make the purchase—it is merely an option. The landlord/seller retains full ownership of the property until the option is exercised. (Most such options are never exercised.)

But in many situations, a buyer may have a stronger hand. Suppose the property is run down, situated near a dump, and highly encumbered with debt. The buyer may be willing to take it off the hands of the seller, but only with some improvement in terms. He may insist on taking ownership and require the landlord to sign over the deed. In exchange, he may promise to take over the monthly loan payments and even to bring the loan current, if necessary, by making some overdue back payments.

This is called a "subject to" deal. The buyer becomes the owner *subject to* his ongoing maintenance of the debt.

As soon as you get into subject-to dealings, you will hear one major objection. The complaint centers around the "acceleration clause" of a typical Deed of Trust. (A Deed of Trust, in turn, is the security instrument that enables a bank to foreclose on your property if you don't make payments on the underlying loan. Alternatively, many states use a security instrument called a Mortgage. It's almost the same thing.)

People will wave red flags and warn you about subject-to transactions, even saying there are "illegal." They are not, although they may bring larger risks than you'd care to carry. My advice: Be aware of the risks, but don't rule out subject-to deals. They may represent the best solution for all concerns. Another arrangement, similar but risk-reduced, arrangement, is called a “wrap.” That’s outlined in the following section of this book.

The acceleration clause says if you transfer ownership of the property, the lender has a legal right to “call the loan due.” When a new deed is issued, they can order the new owner to pay off the loan immediately (within 30 days) or face foreclosure. This is an unpleasant prospect for both parties. The seller, whose name is still on the note, may see his credit shot to hell. Or at least see his unwanted property retuned, with the note still due. The buyer may lose the property, perhaps right after painting and repairing it and signing up some new tenants.

As in much of life, however, reality is less threatening than reputation. In the real world, acceleration clauses are seldom enforced by the note-holding lender. The underlying loan, in many such cases, was delinquent. Now it’s current and being paid regularly. Long as that’s the case, the lender is likely to be happy. Be aware that if prevailing interest rates rise significantly, lenders may be more motivated to “call due” notes issues in times of lower interest.

Many lawyers warn brokers to steer clear of subject-to deals. The concern is that sellers will sue, claiming they were screwed, and not fully informed of the terms. If you’re a homeowner with an interest in selling “subject to” an underlying loan, here’s a tip to help make it happen. Write up a statement in your own words acknowledging the terms of the deal, especially the deed transfer provision. Attach this to the contract, which should be drafted by an attorney. A good broker can help you through it. A lazy, uninformed broker, probably not.

# Idea 5: That’s a Wrap

Both of the two previous ideas (lease options and subject-to deals) are forms of “owner financing.” Also called seller-financing, this type of transaction entails some form of ongoing participation by the homeowner/ seller after the property changes hands. Owner-financing takes many forms, and it enables many deals that otherwise couldn’t happen. For example, sometimes the buyer can’t buy in the conventional way because he can’t qualify for a loan. Owner financing can make it happen. In some cases the seller can’t sell, perhaps because the property is underwater. Owner financing may be the answer.

That’s why you should get comfortable with the concepts. They are sometimes believed (wrongly) to benefit only one party, most often the buyer. It’s true that a buyer who can’t qualify for conventional financing will benefit greatly from the opening of new avenues. But the sellers often come out ahead in various ways as well. They can command a higher sale price, higher interest, or some custom combination of the two. Think of a car dealer offering zero percent interest and low monthly payments. To some buyers, the purchase price is almost irrelevant.

Another misconception is that owner financing can only take place when the property is owned free and clear. That's not necessarily true. When a seller has an outstanding loan, one solution is called a Wraparound AITD (it stands for "all-inclusive trust deed"). The seller deeds the property to the buyer, subject to the existing loan. The buyer agrees to make the payments on that underlying loan, and may agree to an additional amount of indebtedness to the seller.

(If there's no such additional obligation, as in the case where the buyer is essential taking over the seller's payments, the new note is called a "mirror wrap" of the underlying note).

Either way, in the event of default, the seller has a recorded trust deed against the property and can foreclose to get the property back. In the meantime, unfortunately, the seller will have to carry the monthly payments on his own underlying loan.

For example, suppose the sale price is $100,000 and the seller owes $80,000. The buyer may put $10,000 down and sign a note for $90,000. The seller collects on the $90,000 note (with principle and interest) and continues to pay his underlying loan, pocketing the monthly spread. The new deed (the AITD) is subordinate and secondary to the older lien.

Realtors are often reluctant to broker owner-finance deals. Why? There is often no clear way for them to be paid. In the creative world of owner financing, either the buyer or the seller can contribute to broker commissions. Homeowners who stand to benefit from an owner-finance arrangement should go out of their way to make sure their brokers will benefit as well.

There is no rule of thumb for a standard down-payment percentage. Many sellers want at least enough "skin in the game" from the buyer to protect their equity. Down payments can range from very little to 30 percent or more. The settlement statement must properly report real estate broker commissions. An experienced broker, working with the title company, can smooth the way in accounting for unconventional deals.

# Idea 6: Carry Me Home

The purest form of owner financing is a promissory note "carried back" by the seller. It's more common in commercial deals. But there is no reason, in residential real estate, that a seller can't finance the purchase of his own property. I have referred to "standard" Colorado contracts for buying and selling real estate. There is no standard contract for a lease option or subject-to purchase. But there is a section in the standard purchase-and-sale contract (Form CBS1-8-10) that allows for entry of information about an owner-carried loan. This amounts to a "blessing" that's absent in regard to other, more exotic ideas.

Another point about the owner-financed purchase is that there is indeed a present-day purchase (not a lease with an option, or a promise, to purchase at some point in the future). This distinction helps clarify an important question: How will the brokers get paid? In conventional transactions, the seller pays the commissions or brokers on both sides. In an owner-financed deal, it can be the same. No further clarification is necessary. The percent can six percent, or 5.6, or whatever is negotiated.

As a current or aspiring property owner, you could find yourself on either side of owner-carry fence. Sellers may not like the idea of accepting a note rather than a lump sum of cash. But ask yourself a few questions. Suppose you took the cash instead. What would you do with it? Compared to your other alternatives, a 12 percent return secured by a low-leveraged asset can look pretty nice. That's what you might get from when to agree to "be the bank" in an owner-carry arrangement. You may also avoid an income-tax hit that would result from a cash sale.

 

# Idea 7: Embrace the Escape

It is sometimes said there are “seven ways out”—or some similar number—in a contractual commitment to buy in Colorado. The number refers to opportunities for typical buyer to walk away from an agreement to purchase property, without serious consequences. (That is, generally, without relinquishing his earnest money.)

In signing a standard contract, the buyer is saying, sure, I will buy the home. Unless …

The inspection turns up something I don’t like. Or…

I don’t like the seller’s plan to remedy my inspection complaints. Or…

It turns out the home can’t be insured. Or…

It can be insured, all right. But I don’t like the premium I was quoted. Or…

I can’t get a mortgage. Or…

I can get a mortgage, all right. But I’m not crazy about the interest rate. Or…

You get the idea. Each of these provisions amounts to an exploitable escape route. Each one is assigned a deadline date, entered by your broker in the standard Colorado contract. If you miss your inspection deadline, you have given up one of the permissible escape routes. But there are several more. I’m not sure of the exact number “outs” in a Colorado contract. The real number, of course, is “enough.”

The bigger point is this: When you sign a contract to buy, realistically, you are not really “on the hook” to consummate the deal. When you realize that simple fact, you’ll graduate to a better mindset---one that screams, “Make offers!” rather than, “Be careful!” It is an investor’s approach to real estate, and one that will help you find and recognize the right deal when it comes along. When your hesitancy disappears, you’ll be able to take advantage of the vast array of opportunities awaiting owner-occupant buyers.

 

# Idea 8: Appreciate Investors

Not too many years ago, real estate investors were widely vilified, especially in the mainstream media. In 2003 and 2004, for example, the Denver Post ran an award-winning, multi-part series called "Foreclosing on the American Dream." It portrayed investors largely as scammers and greedy opportunists. (This preceded my own involvement as a journalist with the Post, which began in late 2006.) More negativity oozed from the world of real estate brokers, who sometimes regarded investors as their commission-dodging competition.

The negative notions began to fade during the depths of the real estate recession around 2008. I think people realized that investors were holding up the market almost single-handedly. The lion's share of home purchases were being made by investors, risking their own capital and restoring trashed-out houses to the stock of livable, affordable housing. Without their involvement, the market may have fallen into a hole from which it could never climb out.

In very rare cases, real estate investors are untrustworthy. In my experience, more than 99 percent are honest and ethical, driven by a desire for true "win-win" results. I offer this perspective to make a further point. Homeowners should get to know local investors, appreciate them, and learn to work with them. Real estate investors can help you as much as you can help them.

Indirectly, I've already outlined a few of those ways. When you're willing to extend owner-financing, the offer may be extremely attractive. Unfortunately, most homeowners won't understand that. A greater percentage of investors will.

Suppose your home is worth $150,000 and it's encumbered by $150,000 of debt. In effect, it's underwater. Why? Typically the "cost" of selling a home after commission, title insurance, closing fees, etc.—is around 10 percent of its sale price. So a normal sale of this home would yield $135,000 in proceeds. It's not enough to pay off the debt.

You can consider a short sale. But here's another idea. Sell it to a fix-and-flip investor with owner financing. The terms: He'll make your mortgage payments while he renovates the home, and sell it quickly thereafter.

 

Suppose he incurs $30,000 in repair costs, and then sells the home for $220,000. He nets $206,000 from the sale (his selling costs are somewhat lower than yours ). With the proceeds, he pays off your $150,000 mortgage and covers the selling costs.

The result: You're rid of the home free and clear. The investor's profit is perhaps $25,000, earned by mainly renovating the home and increasing its value. To him, the profit is thin but sufficient. Because he didn't have to write a big check to purchase the home, his out of pocket costs were very low. So he'll settle for less profit.

The lesson: You should learn to work with investors rather than regard them with suspicion. In this case, it might have been wise to advertise the availability of owner financing for the underwater home. It starts with finding a broker who understands investors and the costs associated with renovating homes.

Another way to work with investors is to buy from them. Unlike ordinary homeowners, they are usually unemotional about houses. Their objective is to sell quickly at some price. So make an offer.

# Idea 9: Find Fannie and Freddie

Every listing in Metrolist, the multiple-listing service for metro Denver, includes a designation for "seller type." Some of the choices are Individual, Estate, Builder, and Bank/GSE. Your broker should pay close attention to the last one. GSE stands for "government-sponsored enterprise." It's the collective term for Fannie Mae, Freddie Mac, and the U.S. departments of Veteran Affairs and Housing and Urban Development. More than 10 percent of the listings in Metrolist carry the Bank/GSE designation.

Many of the properties are good, decent homes. Some are immaculate and some are trashed. Some and overpriced and many are priced very competitively. Investors, who know bargains when they see 'em, often drool over early listings of HUD and Fannie Mae homes.

Drool they must, because each of these programs includes a "first look" period for owner-occupants only. Investors may not bid for the first 15 days of Fannie Mae listings. For HUD homes, the exclusive period varies from 7 to 30 days.

In tracking GSE homes, alert homebuyers should take the reins and by-pass their brokers. It's important to do so because GSE listings appear first at their own "official" web sites. (HUD's is HUDhomestore.com. Fannie Mae's is HomePath.com.) When a new GSE property appears, the listing agent should enter the data immediately on Metrolist. Usually they do, but not always. Check the GSE sites daily, and you'll occasionally get the jump on buyers and buyers' brokers who rely the MLS. Just at importantly, you'll get a feel for prices and values. You can also program the sites to email new listings to you, filtered according to your chosen criteria.

Owner-occupant buyers of GSE properties have another advantage over investors. They are permitted an inspection period in which the offer can cancelled without losing their earnest money. (it's 15 days for HUD homes, similar for other GSE's.) Savvy buyers should make the most of this privilege, and remember the point made in Section 7. Embrace the escape options given to you. If the home you've secured isn't a good fit, walk away. Some HUD homes pass through the hands of six or more prospective buyers, each one backing out of the offer, before a deal is consummated. HUD officials may secretly pray for properties to move to the investor stage, where offers usually close. But it's their problem, not yours.

A final point is standard fare as home-buying advice. It is extremely important in regard to fast-moving deals such a newly available HUD. Don't let a good prospect slip away for lack of a pre-qual letter. Mortgage brokers will be delighted to draft one for you, after grilling you a bit and taking your financial pulse An added benefit is that you'll know how much you can borrow, and waste less time exploring in the wrong price range.

# Idea 10: Reward Your Realtor

You knew this was coming.

Not all real estate brokers work hard.  But in the small universe of Realtors who understand and execute unconventional, owner-financed deals, the work ethic is off the charts. The transactions are complex. Matching up appropriate counterparties can be like finding a needle in a haystack. Worse, for the broker, is that when there is no conventional sale, sometimes there is no conventional way to get paid.  The compensation can come from the buyer or seller, or some combination of the two.  It come now or later, perhaps at the point when a purchase option is exercised, perhaps two years after the initial lease agreement.

 

Everything is negotiable in an orthodox deal. Your goal in the process should be to help make it work for everyone, including the broker. The lead role, in that regard, perhaps belongs to the broker. But if you really want the deal to happen, and to see future deals, you should assume the role of co-pilot.

At Denver House Pros, our mission is to make real estate deals work for all parties concerned. Buyers, sellers, borrowers, lenders, investors, and brokers should all benefit from the transactions we engineer, irrespective of the complexity. We approach real estate with a requirement for “win-win” results. We are honored by the opportunity to serve, and we welcome everyone to our doors for honest, frank discussion.

**About Tom LaRocque**

With 30 years of experience as a journalist, writer for hire, and marketing communications professional, I turned my attention to real estate investing. I am a Colorado-licensed Associate Broker with expertise in single-family homes as investment properties. I live with my family and pets in the Highlands community of West Denver. I enjoy skiing, golf, reading and writing fiction, and bluegrass banjo picking.

 