FIND AND FINANCE THE MOST PROFITABLE INVESTMENT PROPERTIES

REAL ESTATE INVESTOR'S CHECKLIST




- Must have-information on cash flow, tax strategies, property management, and timing a sale
- Fool-proof advice on how to find the most profitable properties for investment
- Includes single-family homes, multiplexes, apartment buildings, and commercial properties

ROBERT IRWIN
AMERICA'S #1 REAL ESTATE EXPERT

Real Estate Investor's Checklist

Everything You Need to Know to Find and Finance the Most Profitable Investment Properties

Robert Irwin

McGraw-Hill
New York Chicago San Francisco Lisbon London Madrid Mexico City
Milan New Delhi San Juan Seoul Singapore Sydney Toronto

The McGraw-Hill Companies

1 2 3 4 5 6 7 8 9 0 FGR/FGR 0 9 8 7 6 5

ISBN 0-07-145646-5

Library of Congress Cataloging-in-Publication Data

Irwin, Robert.
Real estate investors checklist : everything you need to know to find and finance the most profitable investment properties / by Robert Irwin.
p. cm.
Includes index.
ISBN 0-07-145646-5 (alk. paper)
1. Real estate investment. I. Title.
HD1382.5.I74 2006
332.63'24—dc22

2005030870

Preface

WHY AN INVESTOR'S CHECKLIST BOOK?

This book (in this series) is unique. It's aimed squarely at buyers whose primary motivation in purchasing real estate is not habitat, but profit.

There are over 65 million homeowners in this country, and every one of them probably considers himself/herself a real estate investor. After all, during the last decade, if you bought a house, lived in it for a while, and then sold it, you probably made money—sometimes a lot of money. But to be a real estate investor involves more.

It means finding properties that will turn a profit either immediately or over the long haul through serial investing. It means knowing how to get the best financing. It includes understanding market cycles and knowing the optimum times to buy . . . and sell. It includes expertise in evaluating property so that you don't overpay or get stuck with a lemon. And so much more.

In short, a successful real estate investor needs more than dumb luck. He or she needs techniques that work. In the past, these were only honed from sometimes painful experience.

That's where this checklist book comes in. It has evolved from my own experiences in real estate as well as those of many other successful investors. You don't need to reinvent the wheel by making everyone else's mistakes on your way to successful real estate investing. This book gives you a list of what you need to know and then shows you how to get started doing it. It's one-stop shopping.

Try a few pages. You'll find you quickly fall into the flow of the format. You'll be picking up knowledge even as you casually read entertaining observations and commentary.

If you've always wanted to get started investing in real estate, but didn't know where to begin, even if you're already an investor with properties, you'll find that this checklist book comprehensively shows you how to do it. Just check off the paragraphs on your way to true expertise.

Robert Irwin
www.robertirwin.com

Contents

Preface xv

1. How Will You Make Your Profit? 1

Questions to Ask Yourself

Can the property be put to a higher, better, and more profitable use? 1
Can the property be split? 2
Can the property be flipped? 2
Can the property be held? 3
Can the home be "scraped"? 3
Can rents be raised? 4
Are there any lease advantages (or restrictions)? 5
Can the security deposits be an advantage? 5
Can I get a better price because of poor condition? 6
Can I get a better price because of poor location? 6
Can I buy with little or no cash? 7

2. What Do You Need to Get Started? 8

Questions to Ask Yourself

How much cash do I need? 8
Where can I get the money? 8
What's my ability to get financing? 9
Will I have the time to devote to real estate investing? 10
Do I have a team? 10
Do I have the right mindset? 11
Do I have the right personality type? 12

3. Did You Evaluate the Market before Entering? 13

Questions to Ask Yourself

Is now a good time to invest in real estate? 13
Is it a good time to flip properties? 13
Are sellers motivated to take lowball offers? 14
Am I competing with many other investors? 14

Can I afford to get into the local market? 15
Are rents high enough to buy and hold? 15

Questions to Research

Where are we in the real estate cycle? 16
How are the state and local economies doing with jobs? 16
What is the local supply/demand for housing? 17
Are there many REOs in the market? 17
Are many sellers "upside down"? 18
Are there many FSBOs in the market? 18

Questions to Ask an Agent

How big an inventory of unsold homes is there? 19
What's the time needed to sell the average home? 20
Are there many repos in the market? 20
Are there multiple offers on homes? 21
Are sellers cutting their prices? 22
In which direction are interest rates going? 22

4. Did You Check the Neighborhood before Making an Offer? 23

Questions to Ask Yourself

Is it a good location? 23
Is it close to home? 23
Am I comfortable going there to collect rent? 24
What is the "graffiti index"? 24
What is the mix of tenants to owners? 25
Are all the homes and landscaping kept up? 26
Would I be willing to live in it? 26

Questions to Ask Authorities

Is there strong local job growth? 27
What is the crime rate on the street? 28
What are the test scores in local schools? 28
Is this a redevelopment area? 29
What new developments are in the planning stages? 29

Questions to Ask an Agent

What is the mix of tenants to owners? 30
Is it considered a "desirable community"? 31
Is it part of your "farm"? 31
Is there a homeowners' association? 32
What is the income level of most tenants? 32

5. Will the Property Make a Suitable Rental? 34

Questions to Ask Yourself

Are you ready to start in residential real estate? 34
Is the home too big/too small for tenants? 34
Is the home too old to be a rental? 35
Does the rental fit the job base? 36

Is the lot too large? 36
Does it have a pool or spa? 37
Is it close to my home? 38

6. What's the Condition of the Property? 39

Questions to Ask Yourself

Do I understand how condition affects value? 39
Can I inspect the property myself? 40
Should I have a professional inspection? 40
Is there any plumbing distress? 41
Is the electrical system in good shape? 41
Does the roof leak? 43
Are any appliances worn out? 43
Do I need to remodel kitchen or bath? 44
Are there any cracks in the foundation? 45
Is there any water damage? 46
Is there insulation? 47
Is there lead paint? 48
Are there asbestos hazards? 48
Is there any black mold? 49
Does the furnace work? 50
Is there hot water? 50
Does the air conditioning work? 51
Is there a temperature/relief valve on the water heater? 51
Is the water heater strapped? 52
Are there any nonpermitted additions? 52
Are there any odors? 53
Are there any "bad" neighbors? 53
Do I have all previous and current reports? 54

Questions to Ask a Professional Inspector

Can I accompany you on the inspection? 54
Is the roof in good shape? 55
How's the foundation? 56
How's the structure? 56
What's the condition of the soil/water? 57
Are there any problems with the home's systems? 57
Are there any mold problems? 58
How's the well? 58
Are there any environmental hazards? 59
Are there other problems I should know about? 59

7. Do You Know the Property's True Value? 60

Questions to Ask Yourself

Are there comps? 60
Are the comps recent? 61
Have I forward priced the comps? 61
Are the comps truly similar? 62
Can I rely on the comp price? 62

What is the GIM (gross income multiplier)? 63
What is the capitalization of the net income? 64
What is the square foot price? 64
What is the front foot price? 65
What is the replacement value? 65
What is the unit price? 66
What is the "fixer-upper" price? 66
What price do the leases warrant? 67
Should I get a professional appraisal? 69

Questions to Ask an Appraiser

What is the best method to evaluate this property? 69
What is the quality of the comps? 70
Will you physically examine the property yourself? 71

8. Have You Calculated Transaction Costs? 72

Questions to Ask Yourself

Do I understand transaction costs? 72
What are the transaction costs when purchasing? 72
What are the transaction costs when selling? 74
Can I get the sellers to pay some of my costs? 75
Will the buyer pay some of my costs? 75
Will the agent cut the commission? 76
Can I insist that the agent cut the commission? 76
Will the lender reduce its costs? 77
Will the lender finance some costs? 78
Can I save on costs by getting a real estate license? 78
Will the title company cut its costs? 79
Will the escrow company cut its costs? 80

Questions to Ask Others

Is the commission rate negotiable? 80
How much are the closing costs? 80
How much will title insurance cost? 81
How much will the escrow fee be? 81
Can I reduce the points for a higher interest rate? 82
Can I roll the closing costs into the financing? 82
Can I get a reappraisal? 83
Can we renegotiate the price? 83

9. Where Do You Find Good Investment Homes and Properties? 84

Questions to Ask Yourself

Have I checked the Internet? 84
Have I contacted an agent about local listings? 84
Have I worked the "stale" listings? 85
Have I looked for price reductions? 86
Have I done "drive throughs"? 86

Have I considered buying a foreclosure? 87
Have I looked at REOs? 87
How do I find REOs? 88
Have I looked at HUD repos? 88
How do I make HUD an offer? 88
Can I invest/buy from HUD? 89
Have I looked at VA repos? 90
How do I, as an investor, purchase a VA repo? 90
Am I ready to fix up a VA repo? 90
Have I checked out Fannie Mae properties? 91
How do I handle a Fannie Mae purchase? 91
Have I checked out Freddie Mac properties? 92
Have I checked out other government programs? 92

10. Do You Have a Good Agent? 94

Questions to Ask Yourself

How do I find an "investor's agent"? 94
Is my agent experienced? 94
How do I avoid the wrong agent? 95
What does the "right" agent's profile look like? 95
Where should I look for the "right" agent? 97
How do I interview the agent? 97
Should I work with one agent or several? 98
Can I ask an agent to cut the commission? 99
Should I work with a "buyer's agent"? 99
Do I have to pay the buyer's agent? 100
Do I want to work with discount agents? 100

Questions to Ask Your Agent

What is your specialty? 101
How long have you worked in real estate as an agent? 101
How do you feel about other agents in your field? 102
How many properties do you own? 102
How often do you come across good deals? 103
Do you have an investment group? 103
Is it your policy to buy first for yourself? 104

11. Is It a True Fixer-Upper? 105

Questions to Ask Yourself

Is it really a fixer-upper? 105
Why do I want a fixer-upper? 105
Will I need to live in the fixer-upper? 106
Can I do the work myself? 106
Do I know the three rules for success with fixer-uppers? 107
Do I understand how to buy property low? 108
Have I compensated for a future price? 109
Can I cut fixing costs? 109
Do I have a realistic timeline? 110

Questions to Ask the Seller
Will you accept a realistic offer? 110
Will you co-fix-up with me? 111
Have you disclosed all the problems with the property? 111

12. Do You Know What's Involved in Being a Landlord? 113
Questions to Ask Yourself
What is a good tenant? 113
Should I use a rental application? 113
Should I actually call previous landlords? 114
Should I actually call the tenant's current employer? 114
Can I handle rentals by myself? 114
Do I understand fair housing laws? 115
Do I have to give the tenant disclosures? 116
Do I need to provide smoke detectors in rentals? 116
Where can I get a rental agreement? 116
How much rent can I charge? 117
When can I raise rents? 117
Should I raise an existing tenant's rent? 118
How big a deposit should I demand? 118
What should I do to prepare a property for tenants? 119
Should I pay for utilities? 119
Should I restrict pets? 120
Can I restrict pets? 121
Should I get a lease? 121
Should I use a month-to-month tenancy arrangement? 122
How do I keep my good tenants? 122
What should I do when there's a repair problem? 122
What should I do about late rent? 123
What if a tenant refuses to pay me a late penalty? 123
How do I evict a tenant? 124
What should I do about a tenant who destroys or changes things? 124
How often should I check up on my property? 124
Should I hire a property management firm? 125
Questions to Ask Tenants
Can I contact your previous landlord and do a credit check? 125
How many pets do you have? 125
Do you have a waterbed? 126
How soon will you be able to move in? 126
How many people will occupy the property? 126
How many cars do you own? 127
Can you pay in cash all the money owed before you move in? 127

13. Have You Lined Up Your Financing? 128
Questions to Ask Yourself
Are investor mortgages available? 128

Do I understand why lenders don't favor investors? 128
What if I'm an investor with lots of property? 129
Where do I get investor financing? 129
Can I get an occupant's mortgage? 129
Do I really have to move in? 129
Will the seller finance my purchase? 130
How do I arrange seller financing? 130
How do I get cash out? 131
Can I get a second mortgage? 131
Can I get financing based on my other assets? 131
Can I get relatives to help out? 132

Credit Card Financing

Questions to Ask a Lender

Can you get me investor financing? 133
Can you tell me how big a mortgage I can get? 133

Questions to Ask a Seller

Will you carry back paper? 133
How much equity do you have in the property? 134
What terms will you accept? 134

14. Flip versus Serial Investing? 135

Questions to Ask Yourself

Am I in for the long haul? 135
Do I really understand flipping? 135
Do I understand the dangers of flipping? 136
What are my transaction costs? 136
Can I avoid transaction costs when flipping? 136
Should I do an "option flip"? 137
Do I have to pay taxes on the option profit? 137
Do I understand the time problem with options? 138
Do I need a "rebuyer"? 138
Should I do an "assignment flip"? 138
How quickly can I do an assignment? 139
Do I actually have to buy the property in an assignment? 139
Can I protect myself? 139
Should I disclose my profits? 139
Am I aware of the publicity regarding bad flips? 140
Can I flip brand new properties? 140
Do I really understand serial investing? 141
Do I know the drawbacks of serial real estate investing? 141
Can I take advantage of the financing benefits? 142
How long must I live in the property before converting? 142
Can I convert back? 143
Can I do a tax-deferred exchange? 143

15. Where Are the Profits in Foreclosures? 144

Questions to Ask Yourself

Do I understand foreclosures? 144
Do I know the three times during the foreclosure process that I can buy a foreclosure? 144
Am I aware of the dangers of buying a foreclosure? 145
Do I know the special perils of buying "default" foreclosures? 146
Do I understand "buyer's redemption" rights? 146
Where can I learn about properties in foreclosure? 146
Do I understand the advantages of REOs? 147
Why don't lenders promote sales of REOs? 147
Do I understand the opportunities in REOs? 148
Do I know the problems with REOs? 148
How do I get lenders to offer me "raw" REOs? 149
Do I have to pay cash for a REO? 149
Should I try tax sales? 150
Should I bid on probate properties? 150

16. Ready to Try Office and Commercial Buildings? 152

Questions to Ask Yourself

Am I ready to move into commercial real estate? 152
Do I understand the new dynamics? 152
Do I understand the relationship between rents and price? 153
Do I understand leases? 153
Should I start with a small apartment building? 154
Do I know how I will get financing? 154
Can I buy for nothing down? 154
Have I verified the tenants? 155
Should I get into small commercial buildings? 155
Should I work with agents? 156
Should I consider office buildings? 156

17. Should You Get Started in Bare Land? 158

Questions to Ask Yourself

Do I understand what bare land investing involves? 158
Is it hard to buy? 158
Where do I find bare land? 159
Do I know the pros and cons of bare land investing? 159
Should I look for "leftover" lots? 159
Are there special costs in developing "leftover" lots? 160
Is the lot "developable"? 160
Should I consider a "scraper"? 160
Can I do a land split? 161
Should I try an agricultural land split? 161
Can I change the use? 162
What about rural/recreational lots? 162

Do I understand rural sewerage systems? 163
Am I aware of the potential problems with septic systems? 163
Have I checked the property lines? 164
Will building costs be higher in rural areas? 164

18. Do You Understand the Investor's Tax Angles? 165

Questions to Ask Yourself

Do I understand the nature of tax advice? 165
Do I understand profit and loss from a tax perspective? 165
When do I owe taxes? 165
Can I avoid taxes by trading my investment property? 166
Is a Section 1031(a)(3) tax-deferred exchange complicated? 166
What is the tax exclusion I've heard so much about? 167
Can I convert an investment property to a residence and then take the exclusion? 167
What is the problem with a conversion and a tax-deferred exchange? 167
How do I calculate my capital gain when I sell? 168
Can I depreciate my investment property? 168
Do I write off depreciation? 169
Do I write depreciation off against my other income? 169
If my rental property shows a loss, can I deduct that loss from my personal income? 169
Why must I participate in management? 170
What if I hire a property management firm? 171
What is the tax basis of my property? 171
How does depreciation reduce the tax basis of my property? 171
How important is record keeping to me? 172
What if I refinance? 172
Should I become a "dealer in real estate"? 173
Where should I go to get more information? 173

19. Investor's Q&A Checklist 174

Questions to Ask Yourself

Do I understand the principle of leverage? 174
Can I distinguish an "alligator" from a "cash cow"? 175
Are condo conversions a good opportunity? 176
Can I escape in a down market? 176
Should I use lease options? 177
What about using a land contract of sale? 178
Should I form an LLC when I invest? 179
Do I fully know my sources of investment cash? 180
Do I have the right temperament to be a real estate investor? 182

Index 183

1

How Will You Make Your Profit?

QUESTIONS TO ASK YOURSELF

Can the property be put to a higher, better, and more profitable use? ☐

Changing the use of property is one of the oldest and smartest ways of making money in real estate. John Jacob Astor was one of the first to try it in this country in the early 1800s when he converted cow pastures in Manhattan to residential and commercial buildings, making a fortune along the way. Recently a friend I know bought an old nonproducing orange grove of 10 acres at $50,000 an acre, spending a total of half a million dollars. Then he cleared the dying trees and subdivided into lots for homes—five lots to an acre. He sold each homesite for approximately $50,000. Since he now had 50 sites, that came to $2,500,000. He made a profit of $2,000,000 before expenses (which were not insubstantial). All of this came about because he changed the usage of the property from agricultural to residential. Other changes can include small splits of a lot or home into two units instead of one (described below), or creating a big commercial usage when there was previously a multifamily residential usage. Of course, changing usage often requires approval from the local planning department, which can be anything from easy to impossible to get. However, if you do get approval for a usage change (or the property was previously zoned for a higher use), there is usually a big profit to be made. Remember, your goal as a real estate investor is to make money, and one of the fastest ways to make it is to buy a property and upgrade its use. This is an important concept that too few investors remember or fully understand. To this day, opportunities for usage change remain in most communities. For more insights into this, check out Chapter 17.

Can the property be split? ☐

This is a case of buying one and making it into two (or more). If done right, splitting can result in substantial profit for the investor. A typical split starts with buying a large lot. Once you have ownership, you split the lot into two. Now you have two lots, which, depending on the circumstances, may each be worth nearly as much as the original lot. You sell one and have the other virtually free. Or you sell both to make your profit. (Of course, each of the lots must conform to minimum zoning size.) Variations on this theme include buying a large lot with a house on it, then selling off a portion of the lot and keeping the house as a rental. In San Francisco, where many areas are zoned for duplexes or multifamily dwellings, a split can occur when a single large home is split down the center to make a duplex (or two units). Sometimes a large home of several floors is converted to a condominium with each floor being a separate unit. Each time you split the property, you multiply your profit. A savvy investor will always be looking at properties with an eye toward being able to create a split. No, this doesn't always happen in suburbia. But it is common both in rural and in urban areas. Just be careful that you comply with all building and zoning regulations. (See also Chapter 19.)

Can the property be flipped? ☐

Flipping is the fastest way to make money in real estate. It means selling the property for a profit as soon as you buy it, or, in some cases, even before title passes to you. I encourage you to flip a property whenever possible. It generates ready cash that can then be used for other real estate investments. However, it's important to know the limitations of flipping. (See Chapter 14.) One of the important steps in assessing an investment property is to determine its potential for flipping. Generally speaking, this is easy to do. If you can buy the property for well below market, you are in a good position to flip it. On the other hand, if you're buying close to market, unless you're in an area of very rapid price appreciation, flipping is usually not practical. Most flipping is done by two methods. One is buying an option, which is an agreement that gives you the right, but not the requirement, to purchase some time in the future. You then sell the option to a rebuyer and pocket the difference between your option price and your selling price. The other method is by assigning a purchase agreement to a rebuyer before escrow closes. In either case, you do not take ownership of the property, do not have to worry about financing it yourself, and can often make a hefty profit. Both techniques, however, can be tricky and you should use the services of a professional such as an attorney to be sure you handle them correctly.

Can the property be held? ☐

The most common way of making money in real estate is to buy and then hold for the long term. If you look at the value of real estate over the last 60 years, you will quickly see that overall it has always gone up. (Check out the Commerce Department statistics at www.commerce.gov.) Of course, prices have declined during certain periods and in certain areas. But the trend in almost all areas is up. Thus, what many investors do is to become serial purchasers. They buy one property, rent it out, and then hold. After a time they buy another, and then another. Over years their equity increases as the tenants pay down the mortgages and the prices go up. Many millionaires in this country got started in just this fashion. (See also Chapter 14.)

Can the home be "scraped"? ☐

Sometimes the value of a rental property is not in the building, but entirely in the land. This is often the case where prices have risen rapidly and there's an older stock of smaller homes. A good example is the San Fernando Valley near Los Angeles. Many homes were built there after the Second World War through the fifties and sixties. They tended to be smaller homes, sometimes with three bedrooms and only one bath, often under 1,500 square feet. However, because land was cheap in those days, these homes were often built on quarter acre or larger