FLIP

HOW TO FIND, FIX, AND SELL HOUSES FOR PROFIT

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RICK VILLANI AND CLAY DAVIS

McGraw-Hill

New York Chicago San Francisco Lisbon London Madrid Mexico City
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1 2 3 4 5 6 7 8 9 0 DOC/DOC 0 9 8 7 6

ISBN-13: 978-0-07-148610-1
ISBN-10: 0-07-148610-0

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Foreword

What are you looking for? When you picked up this book, you were looking for something. Do you know what it is? Earning extra money? Finding a new career? Starting your own business? Or maybe you're just drawn to the idea of fixing up houses.

I got into real estate when I was twenty-one years old, and I was looking for something too. At first, I thought I just wanted to make some money right out of college. Later, I discovered I also could build a career. Then, within a few years, I realized I could start my own real estate business. And I did.

As I traveled this path, something interesting happened: I found myself making a deeper and more meaningful commitment to real estate. Why? Because I realized that above all else, real estate is a virtually limitless investment opportunity.

What surprised me was how few people actually understood this. It seemed that people gave a tip of the hat to real estate when they said, "The best investment I ever made was buying my home." However, I noticed that they didn't continue to buy and sell real estate. It would seem that the purchase of one's own home was just an accidental investment. The funny thing is that what was true then is still true today: Most people are, at best, accidental investors. That's one of the reasons I decided to write the Millionaire Real Estate Investor series. Not only did I want everyone to recognize that real estate is a wonderful opportunity, I wanted people to take advantage of it.

In the summer of 2004, I started doing the research for my second book, *The Millionaire Real Estate Investor*. As part of that research, my coauthors and I interviewed over 100 millionaire investors from all walks of life and from all over North America. The group we profiled was as diverse as it was successful. I learned a lot from those conversations—more than I could fit into one book—and many of the people I talked to made a strong and lasting impression on me.

Rick and Clay are two of those people. Not only are they investors, they run a company, HomeFixers, that helps hundreds of other investors each year. What they bring to the table is hard-won brass-tacks knowledge from over fifteen years of personal investing as well as riding shotgun on over 1,000 flips with their clients. You'd be hard pressed to find anyone with greater real-world experience in the process of flipping houses.

Rick once remarked that you didn't really get good at fixing and flipping homes until you had three going at the same time. Three, it seems, was more than even the most organized investors could handle effectively without a solid, proven system to guide their actions. When I asked how many they could handle today, Rick and Clay replied that with the system they'd honed over the years, they could handle as many as ten flips at a time. That intrigued me, and I knew I wanted to get to know them better.

We continued to meet, and I discovered that they were not only excellent doers but also dedicated teachers. These were two guys who loved what they were doing and genuinely cared about helping others succeed at fixing and flipping. After getting a good look at their business, I discovered that their knowledge was as vast as their systems were well defined. They knew what they were doing. A little while later, we hatched the idea for them to share their systems and concepts with others. That was when this book, *FLIP*, was born.

I'm excited about this book. Few people know more about fixing up single-family houses for profit than Rick and Clay do. Their insights about analyzing a potential flip property will bring clarity to your decision making. You'll know when to buy and when to walk away. Their offer formula is the most practical and accurate I've seen. Once you understand it, you won't want to buy a property without it. Their step-by-step construction process alone is worth the price of the book. It'll keep you on time and on budget.

Above and beyond Rick and Clay's proven technical expertise, here's what I've come to know about them: They approach their work with integrity and enthusiasm. Their philosophy of real estate investment is shaped by both a desire to make an honest profit and a desire to do work of real worth.

It's a great honor to have Rick and Clay write this book for the Millionaire Real Estate Investor series, a book on a very important subject: how to find, fix, and flip houses for profit. If you choose to follow the map they have laid out for you, I honestly believe you will be taking a personally fulfilling and financially rewarding trip.

Enjoy the ride!

Gary Keller
Author of *The Millionaire Real Estate Agent*
and *The Millionaire Real Estate Investor*

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Acknowledgments

First and foremost we want to express our gratitude to Gary Keller and the Keller Williams team for giving us the chance to write this book. We are honored to be a part of the Millionaire Real Estate Investor series and are fortunate to partner with such a professional organization. Thanks, Gary, for the opportunity and for your many contributions to this book.

Jay Papasan at Keller Williams provided tremendous support in orchestrating the project from its inception through to the end. His vision, insight, and expertise were invaluable. We cannot thank him enough for his dedication to *FLIP*.

We are grateful to Dave Jenks for the time he spent reading and editing the manuscript. He is a master of real estate and inspirational writing. We also would like to express our gratitude to others at Keller Williams who helped make *FLIP* a reality, including Jim Talbot, Jefre Outlaw, Olga Uchitel, Suman Jagdish, Dawn Sroka, and Maryanne Jordan.

A huge thank you goes to Chuck Faust for authoring the story line and characters of Samantha, Ed, Mitch, Amy, Bill, and Nancy. Chuck's dedication to understanding how real estate investors think is evident in the high-level of realism of our narratives. Many thanks to Meredith Davis for adding life and personality to the narrative characters. Thanks to Paige Hamilton, who tirelessly edited and reedited, making *FLIP* a better book.

The HomeFixers team was immensely supportive in helping us juggle the tasks of writing a book while running a business. We offer special thanks to Rebekah Kern for her commitment both to HomeFixers and to us. We couldn't have done it without her! We also give thanks to Chris Glass for the keen insight and creativity that helped shape many of the concepts in *FLIP*.

A special thanks to our HomeFixers affiliates Chuck Whiteside, James and Dangela Hill, Andy and Cindy Davies, and Greg and Eursula Clarkson. These guys make their livelihood in real estate investing. Their knowledge and wisdom were immensely valuable in helping us present a comprehensive view of flipping houses.

We would like to thank the craftsmen and trades who have helped build HomeFixers over the years and kept it going while we wrote this book—you are like family to us: Mike Yazalina, John Wrigley, Camille Sales, Jeff Ashmore, Ken Pacha, Matt York, and Jim Tersigni of Carpet Stop; Tobin Carpenter, Rey Cyr, Duane Moore, Marvin Vanicek, Walter Williams, Lita Gordon, Robert Andres, James Dorman, Fernando Hernandez, Brandon Jolly, Marcus Ramirez, Gary Weaver, Terry French, Mike Edwards, Jay Burleson, and the folks at BMC; Don Smith and the crew at Trim Tech; Ken and the staff at Texas Re-Key; Randy and Pete McQuiston at Fiberglass Waterproof Systems; Tiburcio Garcia, Steven Hays, Bob Knox, Jeff Tucker, Jack, and Terri at Custom Quality Marble; the team at Gold Star Cabinets; Rhonda and Kent at Parrish & Co.; and George Celtrick for his hardwood flooring expertise.

Thanks to our supportive customers Avery Carpenter, Ellis San Jose, Marcus Hsia, Kary Aycock, Phill Grove, Shenoah Peck, Rene Lafair, John Harris, Robert Grunnah, Stacy Cunningham, Michael Spickes, David Foster, Justine Smith, and Marilyn Williams. Special thanks to Jay Otto, who generously gave his time, lent his expertise, and shared stories that only a veteran real estate investor of twenty-five-plus years could amass. And thanks to HomeVestors franchise owners Rick and Suzanne Edson, Pete Pesoli, and

John Holman, who have been a huge support to HomeFixers over the years.

We would be remiss if we didn't thank the late Ken D'Angelo, founder of HomeVestors, whose creative genius transformed and legitimized an industry literally from bandit signs to billboards. It was Ken who gave us the initial encouragement to expand our model of "predictable rehabbing" across the nation.

Thanks to Mary Glenn, our editor, and McGraw-Hill for their support. We are grateful to Daina Penikas, who skillfully shepherded *FLIP* from raw manuscript to bound book, and to Seth Morris, who ran point on the marketing.

There are many others who edited, advised, and supported us during this time, including Wendy Papasan, Cameron Tankersley, Cristina Valdes, Dianne Faust, Rudy Gutierrez, Bob Guest, Jim McClarty, Robert McKee, Rick Hair, Damon Jamieson, Karen Lear, Ted Lear, Sherri Williams, Angelique Naylor, Leslie Ray, Dave Merhar, Susan Graham, Bill Temple, Ann Temple, David Temple, Brian Russell, Ed Frank, P.E. and inspectamerica.com, Curt Bilby, Greg Herring, Tod Klubnik, John Hayes, Steve Wells, Kent Presnell, Russ Stolle, Scott Taylor, Joyce Mazero, Rob Lauer, Chris Willis, Jeff Powers, Kenneth Hausmann, Tim Clarkson, Jack and Gayle Little, and Marvin and Sharen Eggleston.

From Rick: I am deeply thankful for Carrie, my wife of twenty-one years and my best friend since high school. She continues to put up with my "great" ideas and my propensity to be consumed with giving them life. Emily, Jack, and Anne, our children, have been a huge support, giving us words of encouragement, water bottles, midnight snacks, and much-needed diversions. I am thankful for my late father Tony Villani, who dedicated his life to real estate, and my mother, Diane Spinosa, who is never far from her sketch pad and graph paper. I thank Larry Spinosa, who is a second father and mentor to me. Thanks to my brother, Tony Villani, and my sister, Susan Presnell, for their constant support. Finally, I want to give special recognition and thanks to Clay Davis, my business partner and friend. Without his determination, focus, and perseverance, this book would not have been written.

From Clay: First, I thank my wife, Meredith, the love of my life. Her unwavering dedication, love, and support for me are more than I could ever deserve. I offer special thanks to my children, Alayna, Nate, and Benji. Their encouraging words, notes, and prayers were an inspiration on many late nights. Thanks to my parents, Maurice and Peggy Davis, and my brother, Craig Davis, for their encouragement, support, and advice. I thank Rick for making this opportunity possible and putting his confidence in me. His vision and perseverance in the formative years of HomeFixers laid the foundation for *FLIP*.

Finally, we both give thanks to God, from whom all blessings flow.

Rick

Clay

—Rick Villani and Clay Davis

Introduction

Whatever Happened to the Haunted House?

Close your eyes and think back to when you were a kid. Do you remember that run-down, overgrown house at the far end of the street that you walked by fast? The one that was clearly neglected, possibly not lived in, and certainly unloved. The one that when you asked your folks about it, your dad muttered something about "bulldozing that eyesore" and your mom pointed her finger, warning you to "stay away from there." It was the house where you and your friends rode your bikes to its weedy front yard and dared each other to enter. Double-dared. Triple-dog-dared. No way. For every kid, that was the classic "haunted house."

There was a time when those houses were everywhere. Virtually every neighborhood had one—often vacant and always uncared for—the source of childhood mysteries. But think for a minute: When was the last time you actually saw one?

They're still out there, but it's a lot less common these days to find a dilapidated house in the middle of an otherwise vibrant neighborhood. Why? The "haunted" house has become the "wanted" house. In the early

1990s, real estate investing reached a whole new level. There was a burst of activity driven by independent investors, working on their own, who recognized the opportunity to buy those houses, fix them up, and sell them for a profit. They decided to build their wealth on Main Street instead of Wall Street, and their strategy worked.

Those investors learned the art of flipping a house for a profit, and that is what this book is about. Although today haunted houses—glaringly obvious candidates for flipping—are not as common, the opportunity has absolutely not gone away. There always will be houses that with the right attention, following the right strategy, can create a profitable flip.

Most people are aware of this investment opportunity, and many have even thought about doing it themselves. A lot fewer actually do. Why? It may be that they have the same feeling they had as small kids standing in front of a haunted house—*fear*. They may feel they can't do it. They've never tackled anything like this before. What if it costs more than they planned to fix it up? What if it doesn't sell? What if, in fact, they lose money?

We don't want any fears standing in the way of your taking advantage of this time-tested financial opportunity. Here's what we know. When you understand the *FLIP* process and formula for buying, rehabbing, and selling houses for a profit, the fear goes away—and excitement takes its place.

Experience Is the Best Teacher

At some point in the process of finding, fixing, and flipping houses, all investors are going to encounter at least one problem for which their personal experience hasn't prepared them. Sometimes those problems are as bad as they seem, but most of the time they're not. The key is how well you anticipate the problems, how ready you are to deal with them, and who you have to help you get through them.

That's where this book comes in. We can't find, fix, or sell houses for you, and we certainly can't predict every problem you'll encounter. What we can do is give you a proven formula, a step-by-step process, and real-world advice based on our extensive experience. To that end, we've covered both the practical and the technical aspects of flipping a house. We've also tried to convey the real-life lows and highs of flipping houses, with all the accompanying smells, sights, and sounds.

Some say that experience is the best teacher. You can learn from your own experience or from someone else's. The question is, whose comes first? This book asks you to learn from our experience first. With the experience of over a thousand flips condensed into this book, by the time you finish it, we believe you'll feel like you already have several rehabs under your belt.

Why We Flip Over the Flip

It is our heartfelt intention to provide you with the best guide to buying, fixing, and selling houses. We are passionate about this because we're convinced that flipping houses is one of the best real estate investing strategies available. Consider the six reasons why we flip over the flip.

1. *Flipping generates cash*. Buying, fixing, and selling houses is a quick way to earn money. Done once, a flip creates cash. Done a lot, it creates cash flow. Both put money in your bank account.
2. *Flipping is a short-term venture*. Flipping a house, when done properly, often is accomplished within a few months. This means that if you try it and like it, you can do it again and again. If you decide it's not for you, you're not tied to a long-term commitment. Additionally, you get immediate feedback on your performance, allowing you to learn quickly and build on your growing expertise.

3. *Flipping works in any market.* Why? Because it's about following a process, and that process isn't tied to any specific market or any particular time period. Your success in buying, fixing, and reselling houses comes primarily from finding value (buying a house below retail market value) and creating value (making improvements that increase the selling price beyond their cost). Finding and creating value always works whether your market is cold, lukewarm, or just plain hot.
4. *Flipping can be done part-time*. We know many successful investors who earn tens of thousands of dollars by flipping part-time, and we recommend that everyone start out that way. Then, as you build success and confidence, you'll always have the option of staying part-time or going full-time. Flipping works either way.
5. *Flipping doesn't require a lot of your own money.* In investing, when you find the right opportunity, the money will find you, and that's never been more true than in real estate investing. Lenders know that good real estate deals make good loan opportunities; that is why there are many institutional and private lenders willing to back rehab investors, even first-timers. If you bring them the right deal, they will finance it.
6. *Flipping is available to anyone*. It is an equal opportunity investment choice. Flipping doesn't care who you are, how much you make, where you live, or what you do. If you can find a house worth flipping, you can finance it and thus the opportunity is available to you.

Why We Wrote This Book

What's in this book is the information we would put in the hands of all real estate investors *before* they buy a house. We've been flipping since the early 1990s, and now, in addition to our own investing, we consult with investors across the country as well as the builders who work with them. During this time, it has become clear to us that there is a need for a practical, systematic approach to flipping. There are too many investors out there at risk because they don't follow a step-by-step proven process. In fact, after poring over the available books, we found that very little has been written on how to do it in the most organized and profitable way. Therefore, we developed a finely tuned approach that has saved our clients hundreds of thousands of dollars (and made them even more). Now we want to share that approach with you.

Maybe you're looking for a satisfying activity to complement your day job. Or maybe you are contemplating a change of career and are drawn to the opportunity of real estate investing. Either way, we want you flipping over flipping houses too.

Overview

A Game of Skill

To people who have never studied the game of poker, it can seem like a terribly risky enterprise. After all, huge sums of money are won and lost depending on which cards are dealt. Surely, they think, poker is all about luck or nerve. They call it gambling, and for some people it is. But the truth is, for others it is not.

As David Sklansky writes in his classic work *A Theory of Poker*, "poker is not primarily a game of luck. It is a game of skill." There is a formula for success, and the numbers tell you what to do. All poker professionals will tell you that the vast majority of their work consists of calculating the exact mathematical likelihood that a particular hand will play out in their favor. If the numbers aren't right, they wait. Sometimes they wait for a long time, but when they play a hand, they expect to win. The numbers tell them that they should.

Successful flipping works the same way. You have a formula for success, and if a potential investment doesn't make the grade, you pass. And you keep passing until you find a property where the numbers say it will work. Following systems reduces the risk and improves your chance of success. The best flippers—those who win consistently—have and follow a proven system.

For some, poker is gambling, but for the consistent winners, it's not. For some, flipping is gambling, but for the consistent winners, it's not.

We owe our success to a system we created based on our own experiences and the best practices of successful real estate investors. It will help you recognize the best deals and have the discipline to pass on the bad ones. It will help you protect your profits through the improvement process. And it will help you sell houses for top dollar. In short, our proven model is designed to take the risk out of the game.

How to Flip a House

The core of our system is a five-stage model for how to flip a house, and it's the organizing principle around which this book is constructed. But let's stop for a moment and make sure we're all on the same page. Flipping can mean different things to different people, and so we want to be clear about what we mean.

We define flipping as buying houses under value, fixing them up, and selling them for a profit. Others think it's about buying a property and then immediately turning it for a quick profit. Both work when they are done well. But we'll really zero in on the fix and flip in these pages. We believe that if you can do that, you're better prepared to do both.

Figure 1 provides a brief summary of all five of the stages, along with an explanation of what you'll take away from the corresponding parts of the book.

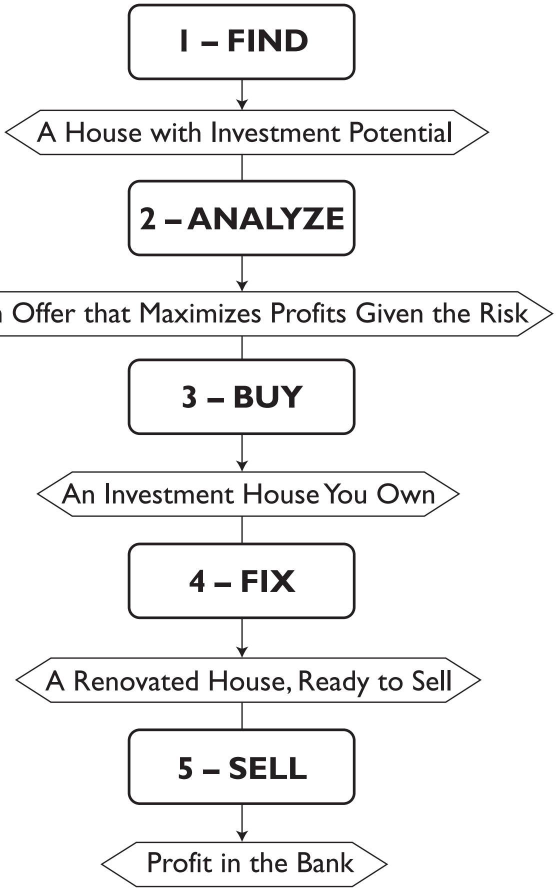


Figure 1 The Five Stages

Stage 1: FIND

At the beginning of this stage, you'll develop your specific investment criteria for selecting a house, including price range, acceptable condition, and location. At the heart of this stage, you'll create and implement a plan to uncover likely investment properties, which you'll approve or reject by applying your criteria. Most properties won't make the cut, but those which do will move forward to the Analyze stage.

Outcome: A house with investment potential

Stage 2: ANALYZE

Once you're standing in front of a house that meets your criteria, the real testing begins. You'll need to make decisions about exactly which improvements to make to maximize your profit, create a thorough and accurate improvement budget, and determine what you can sell the house for once it's been fixed up. By crunching these numbers, you'll emerge with a workable offer.

Outcome: An offer that maximizes profits given the risk

Stage 3: BUY

Beginning with your offer to the seller, this stage represents the last opportunity to abandon a flip. After negotiating an accepted offer, you'll bring in professionals to perform a final examination of the house, including a professional inspector and possibly an appraiser to verify the numbers. If everything checks out, you'll close on the house and move on to the Fix stage.

Outcome: An investment house you own

Stage 4: FIX

The improvement budget you created in the Analyze stage is the basis for the step-by-step construction plan you'll create in this stage. We can't overstate the importance of the Fix. Your profit depends directly on your ability to implement the plan quickly and thoroughly. Any serious miscalculation has the potential to make your profit diminish or even disappear, and so following a step-by-step improvement process is critical.

Outcome: A renovated house that is ready to sell

Stage 5: SELL

If you found a good buy, performed the proper analysis (one that includes a realistic selling price), and executed your construction plan successfully, you are set up for success in this final stage. By adding good marketing and some well-chosen finishing touches, you'll be able to maximize the profit from your flip.

Outcome: Profit in the bank

These five stages represent the five different hats you'll wear during a flip. Each represents a major area of focus as well as a skill set you'll learn.

How Many People Does It Take to Flip a House?

As you move through the five stages, you'll quickly discover that there are three resources that you'll need again and again. Actually, they are the timeless resources required for any endeavor: time, talent, and treasure. You may have all three, but chances are that you don't. That's okay. Flipping houses is almost by definition a team effort. If you don't have one of the three, you will always be able to team up with someone who does.

This means you'll have to take a good long look at yourself to make an honest personal assessment. How much time can you devote to flipping? What skills do you bring to the table? Finally, how much money do you have available to invest? This is not some touchy-feely attempt to get in touch with your "inner home flipper." Knowing the answers to those questions is absolutely crucial if you're going to make a profit flipping houses.

Finding, fixing, and eventually selling a rehab property can happen in just a few months from start to finish, but it will require time and attention while the flip is in progress. But it doesn't have to be *your* time. Some prefer to invest their personal time to save money and build "sweat equity" during a rehab. Others prefer to supervise while others perform the work. Clearly defining and understanding the time it will take to rehab a property is critical to your success and will allow you to plan your time accordingly. The same line of thinking applies to talent and treasure as well. If you don't have the talent to do something, you can find someone who does. If you don't have the necessary treasure, you can seek out a partner who is willing to finance your flip.

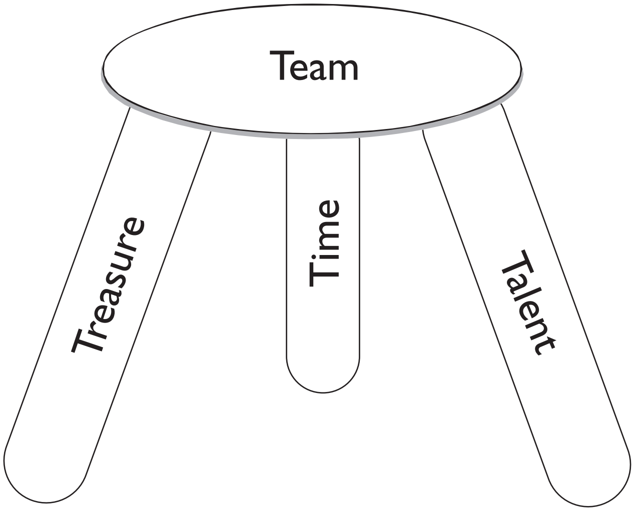


Figure 2 Your Real Estate Investment Platform

Any stable platform requires three supports (Figure 2). Think of time, talent, and treasure as the three legs on which your real estate investment platform is built. And think of the team as the opportunity to pull in additional help when you need it.

The School of Hard Knocks

Now that we've discussed what you need to do (the five-stage model) and the resources you need to get it done (time, talent, and treasure), there's one last gap we want to fill: the gap between theory and practice.

Our five-stage model didn't come from sitting around the office brainstorming. It came from years of personal investing and riding shotgun on over 1,000 flips. Some were wildly successful, and a few were anything but. We have absolute faith in our model, but there's no way a how-to description of the process can substitute for the actual experience, any more than reading a recipe can replace baking a cake.

In addition to the practical, we've gathered what we know about flipping houses into a narrative story called "The Millionaire Real Estate Investors Club" that runs throughout this book. Essentially, *FLIP* is two books in one: the practical and the experiential. You'll find a narrative chapter at the end of each stage that illustrates the emotional side of flipping and describes some real-life situations for which how-to simply doesn't cut it. Essentially everything that happens to the people in these narratives has happened either to our customers or to us.

The characters in the story line represent the types of investor customers we work with every day. First, there's Bill and Nancy, the retired couple ready to start a second career. There's also Samantha, a Fortune 500 professional who is tired of managing a boardroom and eager to try her hand at managing a worksite. Finally, you'll meet Mitch and Amy, a young couple with a knack for home improving who will do a lot of the work themselves. Your guide through the story will be Ed, a veteran flipper who seems to know our model by heart. Each character brings his or her unique mix of time, talent, and treasure (as do all our customers) and faces his or her own challenges along the way.

We believe that by taking these two approaches to teaching our model, we'll have done the best job possible to prepare you for success. Ready? Let's get started.

The Millionaire Real Estate Investors Club, Part I

"You're fired!" Mitch screamed as he slammed the phone down.

It wasn't supposed to be like this. Flipping a house seemed so much easier on those television shows. Of course, on TV they didn't have to deal with Frankie, the contractor who promised to finish the kitchen tile two days ago. Frankie, who picks up the phone only once out of every ten calls. Mitch and his wife, Amy, were running out of time and money. They had to get this house finished soon and sell it quickly.

Mitch grabbed his keys and mumbled something about having to "do it himself" as he stormed out of the house.

He was spending almost two hours a day, every day, driving to and from this place. That was time he could be spending doing something else, *anything* else. His head was throbbing, and he tried to calm down by listening to the radio as he made the long drive to the house.

Mitch reached for the radio. It was 9 p.m.; maybe listening to the Braves could take the edge off.

Tie game, two outs, bottom of the ninth, winning run on second and the cleanup batter at the plate for the Mets.

At times he rued the day they decided to form a real estate investment club with Ed, Samantha, Bill, and Nancy. That was the start of almost four months of frustration for Amy and him. A *millionaire* investment club: What were we thinking?

The Braves closer comes set and delivers strike one.

Ed. The man was a house-flipping guru. He warned against investing in a house that was too far away. Man, I should have listened.

Here's the 0–1 pitch; the batter swings and misses, strike two.

Samantha. Why did everything seem to come so easy for her?

Here comes the 0–2 pitch. It's low and away, ball one.

Bill and Nancy. They were going for a fast, lean fix-up and doing none of the work themselves. Next time, he and Amy would do it more that way, although he had to admit that Amy's and his house looked way better than Bill and Nancy's. But the nicer they made it look, the more it cost. And to keep the project on budget, Mitch found himself doing far more of the actual work than he originally had planned.

The 1–2 pitch. Fouled into the bleachers.

Between his job as a firefighter, the long drive to the property, and all the manual labor he was doing, he was physically and mentally exhausted.

Here's the 1–2 pitch. There's a drive to deep right field; it's to the warning track and gone. That's the game, folks. Mets win.

"Figures." He hit the next station. Daniel Powter's "Had a Bad Day" was playing. He pulled in the empty driveway, parked the car, but left the headlights on to illuminate the front door until he could get it open.

Frankie claimed to have finished about half of the kitchen tile, so if Mitch was lucky, he'd be finished, back home and in bed by 2 a.m. Mitch fumbled with the lock, stepped inside the door, threw the switch and gasped, "Oh no!"

Four Months Earlier

Having risen to the position of marketing director at a Fortune 500 company, Samantha was sharp, precise, and very demanding of herself and others. Despite her success, she just didn't enjoy the job anymore. It was time to try something different.

As the waiter passed out menus, Samantha studied the others at the table. Mitch and Amy were young and enthusiastic. Bill had introduced himself as a retired Marine, and his wife Nancy seemed quiet and supportive. Samantha hadn't quite figured out Ed. He hadn't said much. He looked relaxed and confident—the opposite of everyone else.

"Okay," Samantha said, pulling up her chair. "We have an interesting group here, and I guess it would be a good idea to see why we all want to get into the house-flipping business. How about you, Amy and Mitch? What's your story?"

Mitch glanced at Amy, who nodded for him to go ahead. "After we bought our first home, I found that I actually enjoyed doing a lot of the renovations myself. I'm a Saturday regular at The Home Depot, checking out the latest power tools and buying materials for our next project. Amy and I love watching those home fix-up shows where they transform a room or two, but what we've really gotten into are the ones where they show people fixing up and flipping houses.

"Amy and I figured that we could probably do as good a job as the people on those shows—and they all seem to make pretty good money. I'm a firefighter, and the rotating shifts give me nice chunks of free time. We thought buying and fixing up houses could help us earn some extra money and would be something we could work on together." He smiled at Amy.

"I'm an elementary school art teacher," Amy said, "I've done a little interior design work for friends and family during my free time in the summer. I could see myself starting my own interior design business some day. If Mitch and I can get something like this up and running, it will give me some great design experience."

Samantha liked the couple already. Mitch's interest was genuine, and Amy's excitement about making a job switch was something with which she could identify.

"So now it's your turn, Samantha," Amy prompted. "Why are you interested in flipping houses?"

"Oh, I've spent way too much time on planes," Samantha replied. "I'm tired of traveling. This is something I can do that will let me stay close to home. Bill, Nancy—what brings you two here?"

"Not so fast." Nancy smiled. "You're not going to get off that easy. Tell us about your work. Are you married? Hobbies? C'mon, let's have some details."

Samantha shrugged, "There really isn't much to tell. I've been in the software business for almost 20 years, ever since I got out of college. I'm an avid runner, and no, I've never been married." Samantha shifted in her seat and pointedly turned to Bill and Nancy, "What about the two of you?"

Bill seemed more than ready to start. His voice was deep and low, but more than that, it had a tone that made people want to listen when he spoke. The group at the table looked up from their menus. "When I turned eighteen, I did two things right." Bill counted them off with his fingers. "First, I enlisted in the Marines. And second, before I got shipped off to my first tour in Vietnam, I married my high-school sweetheart." His blue eyes twinkled as he looked over at Nancy, "That was forty years ago last week."

There was general murmur of approval from around the table. Wow, Samantha thought, forty years.

Bill gestured toward Ed. "During my second tour, I served with Ed's father, Mark. He's a good man and a great Marine. After the war, I worked my way up through the ranks to master sergeant and have been in the corps ever since."

"Well, at least until this year," Nancy piped in. "When he retired."

Bill nodded and continued. "We always talked about fixing up houses. Now that I'm retired, we thought it might be fun—and profitable—to give this thing a try. Besides, I'm too young to sit around the house doing nothing."

Nancy looked over at Bill. "I wouldn't know what to do with him; it would drive me crazy."

Bill set his coffee cup down on its saucer. "Anyway, we decided to settle down in this area to be closer to our kids."

"And grandkids," Nancy added.

"Once we got settled in, I gave my old buddy Mark a call and told him about our plans," Bill said. "He suggested that I come to tonight's real estate investment meeting to meet Ed. Nancy and I are glad Samantha suggested that we all have dinner together. Ed, why don't you bring everyone up to speed on yourself?"

Ed set down the menu he had been holding. "Well, there isn't too much to tell," he said, glancing around the table. Everyone was interested to hear his story. "I grew up in construction working summers for my dad."

"Ed's dad is one of the big developers in town," Bill interrupted.

"That's right. After I finished school, it seemed like a good idea to go into the same sort of business—with my own twist, of course. I've been a builder for about fifteen years, and I especially enjoy finding and buying fixer-uppers and then renovating and reselling them. Bill and my dad are lifelong friends. I was glad to be able to offer advice when he told me Bill and Nancy were interested in getting into real estate investing."

Samantha looked at Ed more closely. Ed had seemed different from the others at the meeting because he *was* different: He had experience flipping houses. She couldn't stop herself from asking, "How many houses have you fixed up and sold?"

"At last count, just over a hundred," Ed replied.

"One hundred? Impressive," Samantha said.

The group's attention shifted as the waitress approached their table, "Are you ready to order, or do you need a little more time?" she asked.

"A couple more minutes" said Bill. Turning back to the group, he said, "How about a toast? To us rookies—and even Ed—may we all make a boatload of cash." Glasses clinked all around.

"Yeah," Mitch chimed in. "To the Millionaire Real Estate Investors Club."

"Hey, I like the sound of that," Amy said. There was some laughter. "No, I mean it. Let's be a club. We can get together after the monthly investor meetings like we did tonight to check in with each other and share ideas.

Maybe Ed would come to the meetings too and give us some tips,” Amy added.

“Sure, a lot of people helped me get started. It’d be happy to share what I know,” Ed said.

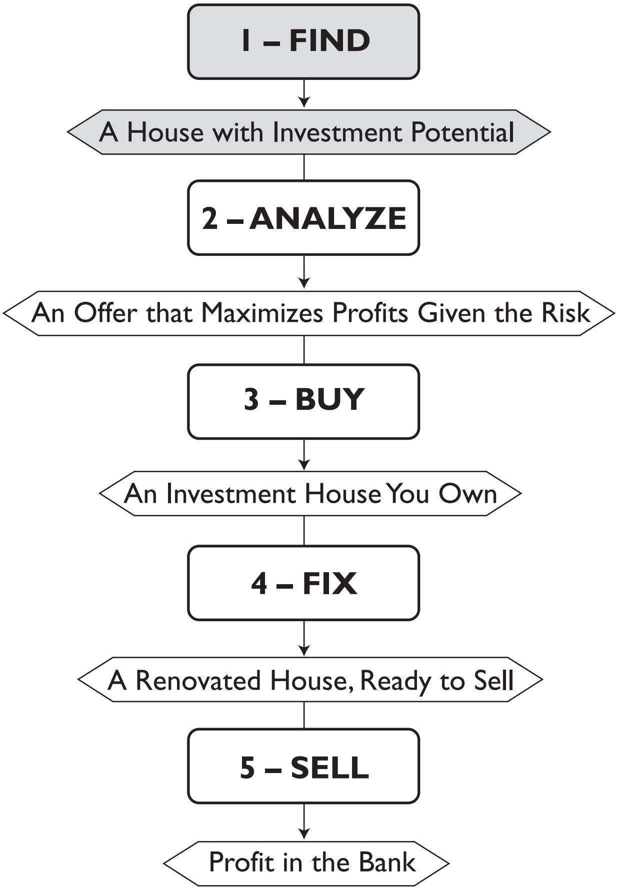
“So, it’s decided,” Bill said. “Ed, what’s the first order of business?”

“Well, the question I get asked most often is, ‘How do you find those houses?’ So that’s where we’ll start.”

Stage One

FIND

How to Find Houses with Investment Potential



FIND Introduction

That which we persist in doing becomes easier,
not that the task itself has become easier,
but that our ability to perform it has improved.

—Ralph Waldo Emerson

When we think about finding investment houses, we are reminded of a story about going after big-game fish. Howell Raines, the former executive editor of *The New York Times*, enlisted his close friend Tennant McWilliams to join him on a fishing trip to the Christmas Islands in the South Pacific. They hired a guide and headed offshore in search of big-game fish. The hours passed. As conventional tackle and methods proved fruitless, their initial excitement waned. Just before heading in, their guide suggested that they try the unique approach of trolling an inexpensive billfish fly using a 10-weight fly rod. Amazingly, before long, Raines hooked a large and powerful Pacific blue marlin.

They labored throughout the day, holding on and chasing the fish and patiently waiting for it to exhaust itself. Near the end of a seven-plus-hour struggle (and nearly sinking their wooden skiff), Raines wrote, “Tired as I was, I believed, again, that something wonderful was going to happen. We had waited for it and it was going to happen. We were going to catch this fish. . . . I was going to touch its shoulders, which would be as glossy and deeply colored as a lacquered Chinese box.”

When nothing seems to work, what is the motivation to stay out there for “just one more cast”? The joy is in the pursuit; it’s the anticipation that at any moment the strike will come. For those of us in real estate investing, the big strike usually comes after months of preparation and hard work. The phone rings. You answer. And the person on the other end of the line says, "I need to sell my house." You are ready to see exactly what kind of fish you have on the line.

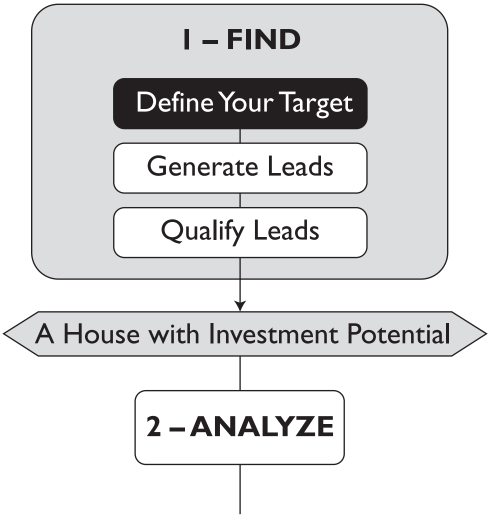
The Find stage has three distinct steps. First, you'll identify the neighborhoods that have investment houses. Second, you'll network, advertise, and prospect to generate leads from those target neighborhoods. And third, you'll qualify leads to ensure that they are worth further investigation. In short, we are going to teach you how to fish: where to cast, what bait to use, and how to hook the big one.

Now, before we get into ways to find houses, let's talk about what exactly we're looking for. A good investment house possesses these three elements:

1. The house needs updating and/or repair.
2. It is in an area of town where people want to live.
3. The owner is motivated to sell for under market value.

Chapter 1

Define Your Target



After reading this chapter you will know how to

- Target investment neighborhoods
- Determine what elements make a good target neighborhood
- Select the target neighborhoods that are right for you

Would you buy investment properties in Kathmandu? Unless you live in Nepal, you probably don't have to think too long about your answer. And if someone pressed you for an explanation, it would be easy to come up with some practical reasons why not: It's too far away. It's too difficult to travel there. And what do you know about the Nepalese real estate market, anyway?

When successful real estate investors make decisions about where to search for investment properties, they apply some of the same reasoning you just did in ruling out Kathmandu.

In this chapter you will learn how to use a set of tried and true targeting criteria to determine the target neighborhoods that will give you the best profit potential for flips. In essence, you'll learn how to create a personal house-buying bull's-eye.

Defining target neighborhoods is a two-step process. In the first step, you'll identify the various factors that go into evaluating a neighborhood. We call these factors your *targeting criteria*. Some will be proven *investment criteria*; others will be more *personal criteria*. In the second step, you'll apply the criteria to choose your target neighborhoods (Figure 1-1).

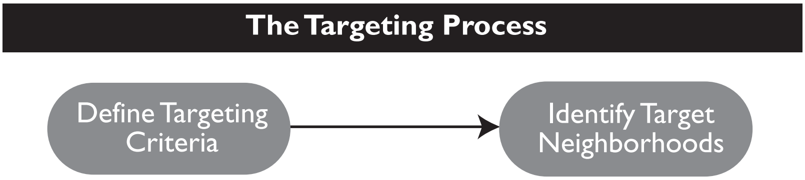


Figure 1-1 The Targeting Process

Why Target?

Targeting neighborhoods helps you focus your resources so that you can find the best possible investment property leads. Those efforts can be time-consuming and costly—all the more reason to identify and target the neighborhoods with the greatest potential for success (Figure 1-2).

The Five Benefits of Defining Target Neighborhoods		
1.	Lower Cost Per Qualified Lead	Your money is focused on maximizing high quality leads and minimizing the unwanted ones.
2.	Less Time Qualifying Leads	You spend less time filtering and rejecting unwanted leads.
3.	Find Houses Quicker	You become an expert in your target neighborhoods enabling quicker assessment of what houses sell for and what they cost to fix up.
4.	Buy More Houses	You will have more qualified leads which means more house-buying opportunities.
5.	Buy the Most Profitable Houses	You can be choosey about what deals to take because you have more leads to choose from.

Figure 1-2 The Five Benefits of Defining Target Neighborhoods

We can't emphasize enough how important it is to target neighborhoods and become an expert on the properties found in them. Your decision making will be clear, confident, and quick. Even the best investors sometimes make avoidable mistakes when they invest in areas with which they are not familiar.

We've learned this lesson firsthand. We once bought a house that was literally just a few hundred yards outside one of our hot target neighborhoods where we'd done about a dozen rehabs. We were able to get the house at such a low price that we thought we'd have no problem making a good profit. But we didn't do our homework—the house was across a major highway. The rules that governed our target neighborhood simply did not extend to this area. Selling prices were falling and nicely remodeled houses were non-existent. Eleven months later, the house finally sold resulting in a profit of less than $1,000.

What Makes a Good Target Neighborhood?

It's worth pointing out that we're not necessarily talking about "hot" neighborhoods that are increasing in value rapidly. Flipping houses is primarily about buying at a great price and adding value with well-chosen improvements. If you also benefit from the appreciation of the house's value during the time you hold it, that's an added bonus. Just remember that if you rely on appreciation to make your profit, you are acting like a speculator, not an investor. As an investor, when you look for investment potential in different areas, you'll consider a variety of factors. The six most important ones we call The Six Neighborhood Targeting Criteria (Figure 1-3).

The Six Neighborhood Targeting Criteria

1. Proximity of the neighborhood to your work and home.
2. Selling prices of the homes in the neighborhood.
3. Sales activity of the homes in the neighborhood.
4. Ages of the homes in the neighborhood.
5. Appeal and charm of the neighborhood.
6. Safety of the neighborhood.

Figure 1-3 The Six Neighborhood Targeting Criteria

1. Proximity

It is important to keep in mind that during the weeks or months that you're working on an investment house, you'll probably need to be there on a regular basis. Choosing a house in a distant neighborhood will take a toll on your ability to monitor or participate in the rehab. If you have the flexibility and free time to travel across town—or even across the country—by all means, go for it. But if you don't, you should absolutely consider keeping your projects close to home.

2. Selling Price

Flipping an expensive house certainly has the potential to be more profitable than flipping a less expensive one, but it takes more money. You need the capital not only to purchase the home but also to fund the high-end rehab improvements. And these improvements take time, during which you'll have to pay taxes, insurance, interest payments, and other holding costs. There are people who will lend you money to flip a house, but there's a limit to how much you can realistically borrow (we'll cover this in the Buy stage). You don't want to waste time focusing on neighborhoods where the average price is beyond your ability to purchase, hold, and improve a property.

In contrast, the investment challenge in low-end markets lies in being able to buy the property, do the required improvements, and still have a margin of profit that makes it worth the risk. In addition, there tends to be a much smaller pool of interested and qualified buyers for these low-end homes.

One of the biggest factors in maximizing your profits on a flip is how fast the house sells: Every day you hold a house costs you money. Ideally, you want to sell the house in three weeks or less. So everything you do and every decision you make is geared toward the outcome of a quick sale. In general, the more potential buyers there are, the faster a good house will sell. You'll have the largest number of potential buyers if your house is near or just below the median home price in the area (Figure 1-4) and that is a great price point to target.

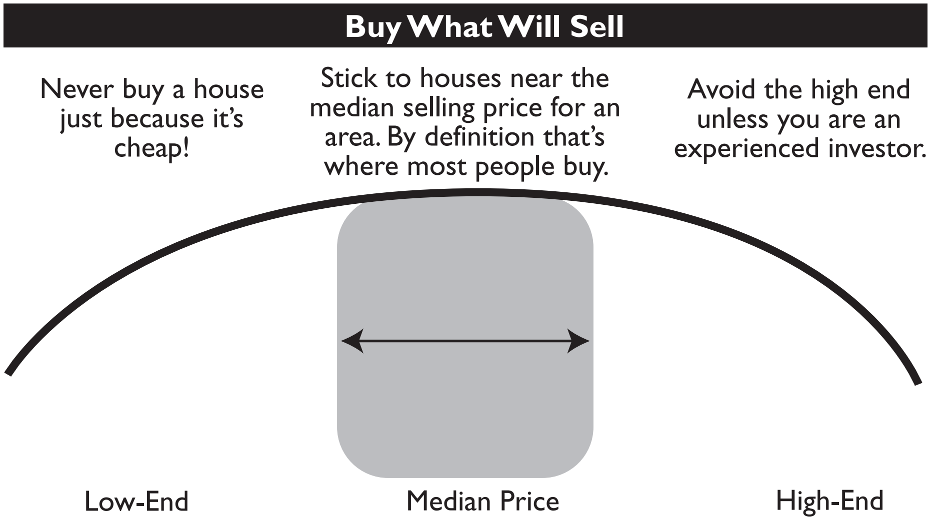


Figure 1-4 Buy What Will Sell

3. Sales Activity

The desirability of a particular area of town can be measured quantitatively by analyzing current housing sales information. Sales activity is a great indicator of a good target neighborhood. Houses just seem to sell faster in some sections of town, while for-sale signs linger in others. In this section, we'll explore the data that will help you understand what makes these neighborhoods attractive to buyers and which can help you determine whether a neighborhood is desirable for real estate investing.

To evaluate current sales activity in a neighborhood thoroughly, you probably will need a real estate agent, who has access to your city's Multiple Listing Service (MLS), to run some reports for you. The MLS is a membership database service developed by and exclusively for licensed real estate brokers and their agents. A good real estate agent will be an invaluable member of your team. In general, real estate agents like working with investors because serious investors buy and sell multiple houses in shorter time frames than most home buyers. Every business loves repeat customers.

The MLS data will provide a detailed picture of what has transpired over the last year or so in terms of market activity in your target neighborhoods. Figure 1-5 shows the nine key areas of information you can ask a real estate agent to investigate about the houses for sale or that have sold in a particular geographic location. When you see sales activity or a lack of it, you will want to understand the cause behind it. These nine areas should provide that insight.

The Nine Key Areas of MLS Information

1. Square footage
2. Price per square foot
3. Property taxes
4. Year built
5. Sales prices
6. Days on market and days to sell
7. Features (bedrooms, bathrooms, living and dining areas, etc.)
8. Amenities (garages, decks, pools, basements, etc.)
9. Neighborhood schools

Figure 1-5 The Nine Key Areas of MLS Information

You want to invest in neighborhoods where a fixed-up house won't sit on the market for months. When you target a geographic area, you'll want to have a good handle on which houses are for sale and why they haven't sold, as well as which ones have sold and why they did. The MLS can provide important underlying data about this sales activity, such as the number of houses on the market and how many are pending for sale and/or have been sold in the last year. In addition, you can see the average number of days these houses were on the market before they sold. In an active neighborhood, houses can routinely sell within a few weeks. In an inactive neighborhood, homes can stay on the market for months.

One particularly interesting bit of data you can gather from the MLS is the selling price per square foot (a 1,000-square-foot house that sold for $100,000 had a sales price of $100 per foot). Why? Selling price per square foot gives you a way to compare the relative value of houses of approximately equal size. For instance, when two houses of similar size are priced very differently, you will want to understand what is causing the difference. This may indicate an investment opportunity.

Specifically, you're looking for neighborhoods with two clusters of house values: a group of homes that sold for a relatively low price per square foot and another group that sold for a higher price per square foot. The first group represents your pool of potential investment properties; the second group indicates that there could be a market for flipping houses (see Figure 1-6).

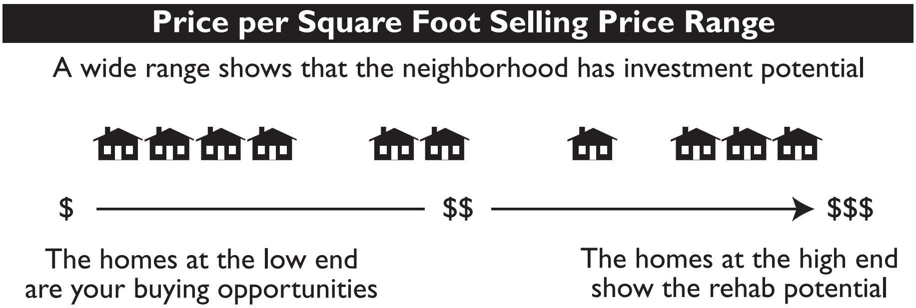


Figure 1-6 Price per Square Foot Selling Price Range

For example, a neighborhood with a group of homes that sold at $100 per square foot and another group that sold at $200 per square foot looks attractive. The range of $100 per square foot means that some 1,000-square-foot houses are selling for $100,000 whereas other houses the same size are selling for twice that price.

A quick word of caution. If there is no group at the high end, you need to consider carefully whether you want to be the first investor to push the limit on price per square foot in the neighborhood. If you find that there aren't many houses with a relatively low price per square foot, you may want to consider whether other investors have been there before you so that now the opportunities are limited.

4. Age

The age of a house can be a plus or a minus. If a house is too old, the repairs may be too expensive. On the other hand, a house in an older, established neighborhood is likely to have been owned longer, and that can translate to higher owner equity. This makes it easier for the owner to sell for less than market value because he or she has paid off a substantial portion of the mortgage. If a house is too new, there might not be enough opportunity for improvement and the owner may not have built up enough equity to accept a lower offer.

Flipping Point

There is a limit in this consideration of the age of houses. Older is not always better. One can assume that a 20-year-old home is fairly easy to update with paint, fixtures, flooring, appliances, and perhaps a new roof, while a 100-year-old home that needs updating may require that the entire plumbing and electrical systems be brought up to code. If you have ever had to replace the old wiring throughout a historical home, you know how expensive and challenging that can be.

Here are some general rules of thumb to follow when targeting neighborhoods by age for flipping potential:

- The houses should be older (twenty-plus years is best).
- Some of the houses should show signs of aging. This includes dated or distressed paint, siding, fascias, exterior trim, roof, doors, windows, garage doors, driveways, walkways, fencing, and the yard. These are your opportunities to improve.

As you evaluate a neighborhood on the basis of its age, you'll always need to balance the benefit of increased owner equity with the risk of the extensive repairs that often are needed in aging homes.

5. Appeal

One of the most important investment criteria is the general appeal of the location. In short, you must invest in neighborhoods *where people want to live*. We are talking about finding neighborhoods that are family-friendly; are close to retail, office, and recreational areas; and have schools with good reputations.

Remember, the adage "location, location, location" never loses its truth. The same type of home in a great neighborhood versus one in a less desirable neighborhood always commands a higher price.

You'll want your target neighborhoods to have as many factors as possible shown in Figure 1-7.

6. Safety

There are two safety issues you will be concerned about: yours and your future buyer's. You should really consider your personal safety when targeting a neighborhood since you may be spending a lot of time there, often at odd hours. When you are working on a house, there may be

The Nine Neighborhood Appeal Factors

1. An established reputation
2. Clean and well-kept yards
3. A low crime rate
4. Good starter homes (smaller, relatively affordable)
5. Close to schools
6. Close to shopping
7. Close to mass transportation
8. Close to business centers
9. Close to parks and recreation

Figure 1-7 The Nine Neighborhood Appeal Factors

times when you don't have proper lighting or locks on the doors (or even windows), so choose neighborhoods where you are comfortable working after dark, especially if you are going to be an active participant in the rehab. Besides, if you don't want to be in the neighborhood after dark, your potential buyers may not either.

Identifying Target Neighborhoods

There's an old joke about how easy it is to sculpt a horse out of a block of marble: First you get a block of marble, and then you chip away everything that doesn't look like a horse. Think of targeting neighborhoods as starting with a big mass—all the available properties—and then removing all the neighborhoods that don't look like they would have investment houses.

We have created a mapping exercise that we use called the X-it strategy. It's a process of X-ing out potential areas to narrow your investing field to the neighborhoods that meet your targeting criteria.

Before we begin this exercise, you will need the following supplies:

1. A map of the city you'll be investing in
2. A pencil and a highlighter or colored pen

First, open the city map on a table. Then take the colored highlighter or pen and divide the different zip codes, subdivisions, or neighborhoods. Many times, you can find a city map divided by real estate areas in the real estate section of your local paper or on a real estate Web site that serves your area.

Now take your pencil and mark the points where you live and work (or any other place you go to on a regular basis). Then indicate the distance you are willing to travel to handle your investment properties by drawing a boundary around those points. The size of the boundary is up to you. Be sure to consider the traffic during the time you're likely to be traveling.

Next, with your pencil, X out all the neighborhoods that don't fit your proximity range.

Now take a look at each neighborhood within the boundaries and X out the ones that don't fit your other criteria. Is a neighborhood too pricey or too cheap, unsafe, too new, in a bad location? This will take some time and research because you will be applying your targeting criteria to each neighborhood.

The map in Figure 1-8 shows an investor in Austin, Texas, who works downtown and lives in North Austin. Although there are great investment neighborhoods to the east and west, she X-ed out most of them because it's too far to get there. She also marked out four areas within her proximity. Two areas were too pricey, and the other two she excluded because of low sales activity.

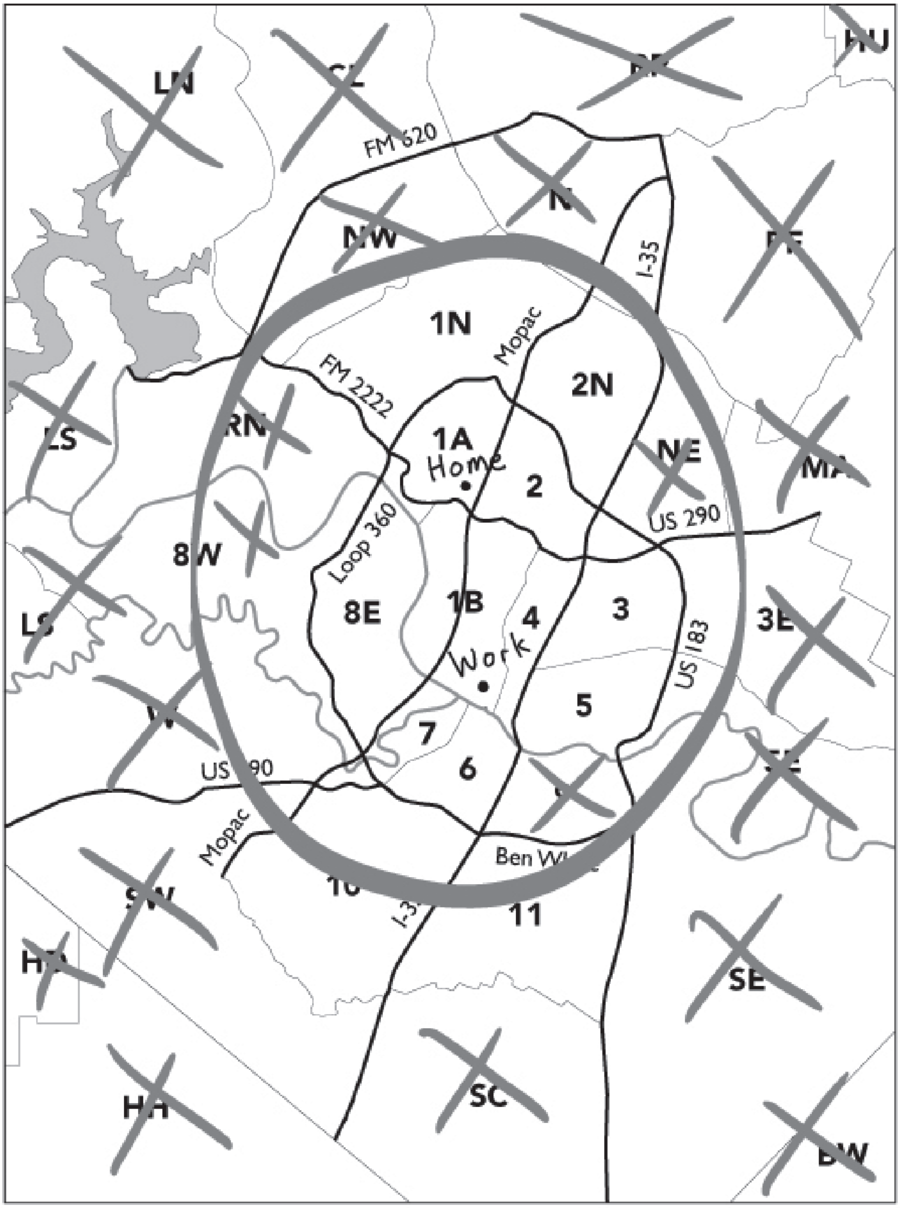


Figure 1-8 Target Neighborhoods in Austin, Texas

After completing the exercise, you should have a clear visual representation of which neighborhoods are ripe for rehabbing. These remaining neighborhoods will be the focus of your lead generating efforts, which are the topic of Chapter 2.

Points to Remember

Defining your target neighborhoods not only will save you time and money but will also help you develop expertise and familiarity with available investment properties in those neighborhoods. That expertise will allow you to act quickly and decisively when you are presented with an investment opportunity that fits your specific criteria.

Here are some things to remember:

1. Targeting neighborhoods allows you to find and buy houses you like more quickly and more efficiently. It also focuses your lead generating activities and resources.
2. You select your target neighborhoods by doing the following:
   - Analyzing the housing market in a particular area to see whether it is trending upward or downward and whether there are adequate properties for rehabbing and available buyers for resale
   - Evaluating neighborhood characteristics such as price range, market activity, and appeal
3. Avoid investor roadblocks by considering the following:
   - Proximity to work and home
   - Neighborhood safety
   - The age and condition of houses
4. Your X-it strategy map clearly and visually defines exactly where you should be concentrating your property-finding efforts.