SO YOU WANT TO BUY A FORECLOSED PROPERTY…

BY
Salvatore F. Spadaccino

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Chapter 1: Introduction

So, you want to buy a foreclosed property. Perhaps you heard a story from your buddy at work about how he made money buying real estate and you want to know a little more. If you are reading this to get rich quick, this may not be the book for you. If you are willing to go back to real estate school, then keep on reading.

In fact, this book is going to take you back to Real Estate 101—which is information that every person buying a home should know and practice.

I am writing this booklet to share with others the information I have learned and practiced in my real estate career, and also to reveal common mistakes and misconceptions surrounding the foreclosure and short sale arena.

In my real estate career I have bought (and now sell) bank-owned properties, short sale properties and tax auction properties, as well as my own personal homes. I specifically remember purchasing our second home.

We had three children under the age of nine, interest rates were coming *down* to 14% and we were borrowing money from our parents for the down payment. It was exciting, scary and definitely one of the most significant financial decisions we've ever made.

In my years in investing and real estate I have seen the mindset range from that kind of serious consideration to something akin to buying a pack of gum—in some quarters, there seems to be less and less emotion associated with buying a house.

However, despite what you hear in infomercials and read on the internet, purchasing investment property and making money are not as easy as one, two, three.

It seems everywhere you turn today someone is trying to tell you the next get rich quick idea. If you turn on your TV at 2AM, you will hear about how somebody bought a home for $300 that is now worth $100,000. While that can and very occasionally does happen, so does winning the lottery.

The only "secret" I will give you is that there are no secrets. The only thing that separates you from the next investor is hard work, preparation and insight. I will stress this in almost every chapter in this book.

Throughout the course of this book, I will share with you many of the successes, failures, trials and tribulations from my personal experience over the past 16 years and over 850 transactions. At the end of this book, you can decide if this is for you and you'll have some idea of how you want to proceed.

Chapter 2: Current Market Conditions

Unless you have been living under a rock, you are probably aware that we are currently in the midst of one of the worst economic periods in U.S history. How it happened and who is to blame really doesn't matter at this point. All that matters now is how we can make ends meet until the economy eventually turns around (and, yes, it will turn around). You should see the look on people's faces when I meet someone and tell them I am a real estate broker. "Tough market, huh?" That is the typical response. It is true that many Americans, especially real estate agents, are struggling. However, there may not be a better time than now to get into real estate investing and purchasing. The number of properties that flood the market is seemingly limitless. That, coupled with home values coming down to pre- 1990s levels, adds up to a situation where many properties can be obtained at affordable prices-whether this is your personal home or an investment opportunity.

While there are no short cuts, there are proven methods and practices that will make your career as an investor a long and fruitful one. If you are old enough to remember life in the late '80s, you can certainly remember how bad things seemed. I remember driving around and seeing "for sale" signs on almost every street. I certainly wish I had invested in some of those properties then.

Well, then is now. The current real estate market may last one, two…maybe five more years. There is no better time to get involved in real estate then right now. But before you become excited thinking about how you are going to spend your money please understand that investing in real estate is not easy. For every property, there may be three or four people just like you waiting to get their hands on the very same property. What separates you from the next person is knowledge.

Sometimes a war is won before the battle ever begins. In real estate, properties are often won or lost before the offer is ever made. For every ten offers you make, only one may get accepted. If reselling the property is your goal, you may end up realizing less money then you had expected.

On the other hand, you may find that buying your dream house is much easier they you ever imagined. There will be issues along the way (we will get into those). It won't be easy. Nothing worth accomplishing usually is.

Why invest now?

Whether you are debating if real estate investment is for you or you are a seasoned real estate investor, the economy is ripe with opportunities.

Many real estate investors that were investing in 3-4 family properties at 100% financing a few years back have been forced to sell at a tremendous loss. The lack of preparation and foresight drove many investors away. But this situation also created opportunity.

Like any other important endeavor, we need to go in with a plan—with numerous contingencies in most cases. No two deals are exactly alike, and no two properties are alike. An opportunity is only viable if we act upon it.

One of the reasons so much opportunity exists right now is the lack of qualified buyers. Getting a mortgage right now has become extremely difficult. Most mortgage loans now require a minimum of 5%, 10% or 20% down. Gone is the no-income, no-asset 100% loans. To get a loan now you need money…real money. If you have that kind of money to put down you can almost have your pick of the house you want to live in.

Houses listed just three short years ago can now be purchased for 40-50% less. In the current economic climate, most people are not willing to empty their savings to buy property, even with the dramatic dip in home prices. The old adage "cash is king" is back. Many properties are attainable on a cash-only basis.

But don't worry if you don't have an extra $100,000 or so laying around. The plan is to start small, or even better, start by using other people's money. With an overflow of inventory and a decrease in the buyer pool, home prices (and property values) have plummeted over the past two years. This brings out all the "value" shoppers in the market trying to steal properties for pennies on the dollar. That is where we come in. I will arm you with the information to decide what a real value is and what is fool's gold.

Chapter 3: Developing your Investing Strategy

Before you dive right into the world of real estate investing you should take a step back and see where you best fit in. Believe me…not every real estate deal will be a home run. Real estate investing is not for everyone. There will be many traps and pitfalls along the way. The most important piece of advice I would give as you get started is to develop a plan and stick to it. I firmly believe in the power of making lists and goals—not only for my personal life but especially for my real estate business. To help determine if real estate investing is right for you, answer the following questions:

- What are my real estate goals?
- How long do I want to take to achieve them?
- With how much risk am I comfortable?

What are my real estate goals?

If you answered, "to make a million dollars," you may have set the bar a little too high. Yes, there is a considerable amount of money to be made under the right circumstances, but buying a house is not the same as buying a lottery ticket.

By making an overall goal, you can refer back to that goal when pondering each individual deal:

- Do you want a portfolio of one, two or three houses in five years from which to earn rent?
- Do you want to make a minimum amount on a few homes per year?
- Is your preference to swing for the fences and only buy homes that can make you a great deal of money?
- Do you want to buy a home for your primary residence?

Talk to five investors and you will probably get five different strategies. The answer, as with most of the questions in this chapter, comes down to your individual personality. The hardest part with anything is starting. You never know when opportunity will present itself so you should be flexible but you should also establish a real estate personality and stick to it. Consider it your own personal formula. See what works for you. Once you establish that formula, you will be more comfortable to act upon it.

How long do I want to take to achieve my real estate goals?

If you are presented with an opportunity to buy a property for $50,000 with the possibility of making say, $20,000 but it may take you nine months to do it, would you still proceed?

Some people would instantly say "of course". Others would not want their money tied up for nine months, inhibiting their ability to buy anything else for the better part of a year.

Many of your decisions will be based on your resources but all decisions are YOURS. By making a 3, 6, 12 and 36 month plan most of your difficult decisions will be based on these goals.

I can't stress enough the importance of determining a timeframe in which to achieve these goals. This will have an enormous impact on which kinds of houses to buy, which price points to buy them at, and what repair costs are associated with them.

Also, by determining your goals and timeframes, you will be assured you are making the right decision. For example, let's say you buy a home, perform some repairs and decide to put it on the market. After a month or so you realize that there is not as much interest in the property at your desired price point as you thought. Because you have a 36-month plan you realize that you can still net money every month by renting the house out rather than selling it at close to break even.

This is a situation you knew could happen and because you are comfortable with your long term plan you take the rent and can sell later when the time is right. Many unprepared investors would settle for the last offer received, even if they are not comfortable with it.

How much risk am I comfortable assuming?

Investing is not gambling, but there are gambles associated with it. Back in 2007, I had a feeling that something bad was going on in the market. I will never forget that. It was January 2007 and a received a call from a mortgage broker at a closing. He informed me that a deal might not go through because the buyer could not come up with an extra $200 at the closing.

I was first upset, and then astonished. I asked him how this could happen. He told me that the buyers had a 100% mortgage (they borrowed the full 100% of what the purchase price was) and used up their $500 savings on other closing costs and could not bring any more money. My first thought was that if they couldn't spare an extra $200 then maybe they shouldn't be buying a house. Well, in the weeks and months to come I think we all know what happened with home foreclosures and home values.   Banks closed, homes were foreclosed at historic levels, thousands of dollars in equity was lost and global markets were on the brink of collapse.

Investors that gambled on home prices appreciating 10% annually soon realized that home values can and do go down. Did they need that appreciation to make the house profitable? What would happen if their rental income took a $300 dip every month?

Ask yourself similar questions. Can you cover the costs if the furnace stops working? Would you be comfortable buying a house for $50,000 and only selling it for $57,000? This is where your personal risk tolerance comes in.

Like the disclaimer on those stock market infomercials say: "investors can and do lose money".   I hope that after reading this book you will be armed with enough information and guidance that this never happens to you. However, don't fear or deny the possibility of the "worst case scenario." Acknowledge that something *may* happen so you can do everything in your power to prevent it.

Chapter 4: Assembling Your Team and Getting Started!

So, you have written down your goals, your acceptable time frame and your risk plan. Now it is time to start putting you plan into action. As with most worthwhile endeavors, you are only as good as the people with whom you surround yourself. Assembling a good team will give you the best chance of sticking around in the investing world for as long as you wish.

Start by interviewing every member of your prospective team until you feel that they are all working towards the same goal—your goal. Whether it is ensuring that your dream house is really the house for you, or you're investing and making money, you and your team all need to be on the same page.

Your team will indirectly benefit from your success. Take the time to make sure you are 100% comfortable working with them. Here is the team you will need.

Mortgage Broker

The starting point on your journey towards investing starts with obtaining financing. The truth is many real estate agents will not show you properties unless they know you are qualified.

Many of the practices of mortgage brokers and lenders have changed over the past five years. 100 and even 95 percent financing is a thing of the past. Anywhere from 5-20% down is now the norm with most conventional mortgages.

The mortgage broker is the person best qualified to tell you about conventional financing, which may require 20-25% of the purchase price as a down payment, 203 rehab loan financing, or, if you do not own a home and are purchasing this property to live in, all of the first time buyer, FHA, CHFA and VA type programs.

This has been a crucial mistake of some investors. They go on a hunt to locate a property, find the perfect one that fits their needs, only to discover that they are either not qualified or the numbers don't work. Their total debt to income ratio may be too high with the higher purchase price, they do not have enough money to cover the down payment and closing costs or their income took a slip dip from time of application.   A quality mortgage broker will tell you what you can afford on a monthly payment and what kind of price range you should be looking at.

Mortgage approval is based on five facets: credit score, down payment, income, employment history and assets. After providing your required documents, your mortgage broker will evaluate all of the data and let you know exactly how much you are approved for. Finding that number will help you determine which properties to pursue.

Real Estate Agent

Many novice investors make the mistake of not employing the services of a realtor. Often, they are trying to save on the real estate agent's commission. Ever hear the old saying, "walking over a dollar to grab a penny?"

Aligning yourself with a quality realtor will arm you with the most knowledge in the particular market area you are looking. They will have all the facts on upcoming commercial projects, schools, changes in taxes, and many other topics that will help you to make an educated decision—they are the market expert. They will help you determine if your goals are realistic.
A good realtor will help you pinpoint what locations and price ranges are the best fit with what you are looking for. In addition, many realtors have established relationships with banks that supply the realtors with property listings.

Private Money Financing

Private money is a loan acquired from an individual or institution that is not a conventional lender. Over the years, the term "private money" conjured up scenes of walking into the back room of a smoky bar and asking for a loan. In some instances that may still be the case but there are now typically a few other options when it comes to private financing.

Your mortgage broker or realtor may maintain a small network of private money financiers. Keep in mind that while private financiers tend to be more flexible regarding their lending guidelines, the cost of that money will be much, much higher.

Private money rates typically start range from 12-15% and usually require significant collateral.   These are very risky loans and should only be looked at as a last resort option. Your relationship with your mortgage broker will provide options and give you the best plan of attack given your strategy and resources.

Attorney

Considering all the fine print associated with real estate, it makes sense to enlist the assistance of a competent attorney. The main reason is for YOUR PROTECTION.

With the help of your realtor, a good attorney will give you the comfort of knowing you are not going to lose any money because you missed a disclaimer in the middle of your contract. Attorneys are the ones that have access to the seller's attorney if something should pop up at the 11th hour before closing. Your attorney will talk to you about the best way to take title in the property, either as an individual or as an LLC.

Home Contractor

Aligning yourself with a quality home contractor can save you thousands of dollars per deal. Most people can spot a leaky faucet or a door that needs to be replaced. A quality contractor can spot mold in a basement corner and termites in the garage. Having an extra set of reliable eyes on the property is critical.

In addition to the obvious benefits of being able to give a dependable estimate for work and repairs to be done on a property, a contractor can also spot flaws in a house that a layman would not. Being able to spot potentially serious issues will give you the option to walk away from a property if the work to be done exceeds your budget.

In some cases, this can truly save you thousands of dollars. Imagine buying a house and then finding out that you'll need an extra $10,000 to complete unforeseen repairs. At that point, you'll probably wish you could have a do-over on the house! Your realtor, mortgage broker and attorney may be more important in scouting and securing the property, but your contractor will have the most impact on your bottom line.

Home Inspector

If your offer has an inspection contingency, you will need to align yourself with a home inspector. Typically, a home inspector can spot items that are difficult to detect with the naked eye. Your inspector's primary function is to inform you of any and all defects in the property- Material, Environmental, Structural and Functional.

Because of their lack of emotional attachment to the purchase, they are better equipped to give you an honest assessment of what is wrong with the property. Sometimes the truth is difficult to hear but hearing it before you purchase can save you a great deal of money in the long run.

One of the biggest differences between the home inspector and the contractor is that the home inspector should NOT give you any prices—their job is simply to inform. You can and should take this information and review it with your contractor, who can price these items and provide insight on how to proceed.

Short Sale Agent

A short sale is simply a purchase where the seller's lender agrees to take less than what is owed on the property. Because the lender is taking a loss, they need to see paperwork from the seller showing that they truly can no longer afford the payment on the property.

Short sales have gotten a bad rap in the industry over the past few years, and deservedly so. There have been cases when it has taken over a year just to get an answer and, even after that length of time, the lender may still delay. However, the process has become much more streamlined, taking anywhere from 90-180 days to complete. There are some good deals to be had from short sales if you can afford the wait.

Therefore, ideally, the real estate agent you choose should also be proficient in handling short sale offers. During your interview process, be sure to ask if they close on a lot of short sale transactions.

In many real estate market areas, short sales make up almost 50% of all transactions so it is very likely that your agent has handled his/her fair share. ***Note for cash buyers:*** If you can pay cash for your property, great! However, if you are going to be paying cash for the property with NO financing contingency, you need to have that money in place.

Regardless of whether you are using cash, bank account, a home equity line or some other means, you will need to show that the money is in an existing account and that it is a liquid state for at least 30 days.

Don't make the mistake of thinking that you can pull your money out of a retirement account the day before closing and everything will be all right. Your proof of funds will be needed with every offer you make. If the funds are not currently in an account, today would be a good day to deposit those funds.
As you can see, preparation is a key element. Many times a home is placed back on the market because a potential buyer was not prepared. When your real estate professional tells you that the property you looked at last month has come back on

the market, you are ready. This is an example of an opportunity born from your teamwork and preparation.

It all comes back to Real Estate 101…the ready, willing and able buyer will usually get the property.

Chapter 5: What is an REO Property?

The term REO, or real estate owned, is used to indicate a property owned by a lender. This may occur after an unsuccessful sale at a foreclosure auction, or a strict foreclosure or deed in lieu of foreclosure depending on your state/county.

Once a homeowner is late with their payment, the lender (and sometimes the homeowners themselves) will start to look for a remedy to the situation. In some cases, this remedy might be a short sale (see chapter 6).

Once entering foreclosure, the homeowner has a few options that they can take to try to keep their home.

One, they can pay off the entire amount owed. This is typically an unrealistic option. Common sense tells us that if the homeowner had the money to pay, he or she probably would have paid many months ago. However, there are some cases where the homeowner can reach out to a family member or draw from a retirement fund to pay off all past due amounts on the property.

Another option is to try to sell the property through means of a short sale. The final option for homeowners is to declare bankruptcy. A bankruptcy will remain on a credit report for 7 years.

After exhausting all of their options, the lender will foreclose on the property and become its owner. Lenders are in the business of lending money are do not want the property. Before they even take ownership, the cost of foreclosure is thousands of dollars for the bank. In addition, every month they have to pay insurance and taxes on the property.

Depending on what part of the country the property is in, they may also have to winterize it in addition to performing standard maintenance.

Therefore, banks want foreclosed properties off their books as much as people may want to buy them. However, banks usually hope to sell at fair market value. We'll talk more about that a bit later.

A Crucial Mistake

Despite what I said above, it is a common misconception that the bank wants to rid itself of this money costing, non-performing asset *at any price*. Banks do want to sell foreclosed properties, but that does NOT mean they are going to give away the property.

On the contrary, in this situation, they are a seller, and in this regard, they are really not that different from you and me. Banks still want to obtain fair market value for the property they own.

This value is obtained by receiving market value opinions from a licensed appraiser and at least one (and sometimes several) local real estate agents who create a BPO (Brokers Price Opinion).

Using that information, the bank will market the property at that price point and determine what percentage of that price they will accept. Sometimes they will take less if other factors are involved, like a cash offer, length of time on the market, property condition and whether the property is in financeable condition. This is where profits can really be made in this market—getting the properties at *your* price!

Chapter 6: Short Sales/Tax Auction Sales

A short sale is a property transaction where the lender will agree to take less than what is owed on the property. For the lender to agree to take less, the homeowner must supply the bank with many documents supporting loss of income and insufficient assets to pay the mortgage.

As I mentioned earlier, this process used to take an average of nine months to complete. However, with the advent of new technology the turnaround time has been shrunk in some cases to as quickly as three months!

The longer timeframe was turning away many qualified buyers who were not willing to wait to hear if their offer was accepted. Again, this may provide you with another opportunity if you *are* willing to wait and if you accept the possibility that even after waiting you might not get the property.

The biggest difference between short sales and REO properties is that with a short sale the existing homeowner still owns the property while an REO property is owned by the lender.

If you make an offer on a REO listing, you could expect to hear an answer within 48-72 hours and close in 30 days. The short sale buying process is still severely lagging in terms of timeframes.

Like REO properties, lenders still have the say on how much they value the property. Yes, the owner is still the owner on the title, but because they are taking less to sell their asset, lenders have the right to refuse any offers.

Don’t be turned off by a property just because it is a short sale. Yes, waiting to hear if your offer is accepted will inhibit you from making other offers but you could also find that “diamond in the rough.” Don’t let other people’s horror stories change what you think about short sales. Many of those stories are outdated.

Tax Auction Sales

When property taxes are owed and uncollected, the town has the right to try to obtain payment through means of a tax sale. Tax auctions are periodically held throughout the year. When these auctions are held depends upon the state and/or county.

The town needs to try to recoup the money from lost taxes. The tax lien is therefore sold to the highest bidder. That buyer has a predetermined amount of time to pay cash for the lien (typically no more than 5 days) or it goes back to the town or to the second highest bidder, with a penalty to the defaulting bidder.

Again, depending on the town or county, the homeowner and /or any other lien holder, has anywhere from 6 months to 2 years to redeem the property by paying the taxes plus interest to the new lien holder. If the homeowner/lien holder cannot pay the back taxes, the new lienholder becomes the owner of the property and can take over possession of the property, including starting eviction on the former homeowner, if necessary.

Many good publications explain this method of investing. The opportunity to make money certainly exists with tax auctions but can also come with some risk. For off all of the properties are sold as-is. Because you are bidding without seeing the interior, the first risk is the physical condition of the property. You offset this risk by bidding low enough where you can endure any costs associated to repairs to the property. Also, there could be issues with the existing title or deed. Finally, by the time it takes for you to acquire the deed (6 months) and complete the eviction if needed (1-3 months) the market could have undergone a dip in home sales. Tax auctions can be a real moneymaker but they could also leave you with a property you do not want. Make sure you do your homework with these and get everyone on your team involved before you bid.

Chapter 7: Finding the Right Property for You

You might have heard the age-old real estate saying about the three most important criteria for finding a property…location, location, location. While that saying is widely overused, it still contains much truth.

Like any other asset, a piece of real estate is only worth how much someone will pay for it. That price is usually determined by how much a future owner can make when reselling it… and the biggest factor determining resale value is still location.

Assuming home A and home B are identical, the home located in the market area where buyers are more apt to buy will usually sell quicker and for a higher price than the other home. Homeowners want to feel comfortable in their homes and are willing to pay a price for that comfort.

As an investor, you have to be comfortable with the area where your home is located. You will be spending plenty of time in the house for as long as you own it. If you intend to rent the property, your tenants want to have that same comfortable feeling. In addition to being comfortable with the location, you should also have a good feel for the area around the house.

Where is the closest school? The closest hospital? Are there any new projects slated to enter the neighborhood? What are the taxes, and have they gone up or down over the past five years? What is the crime rate? If I am renting what are average rents going for?

Searching a property by location is a great starting point but realize that inside town's demographics and settings can change dramatically within just a few miles. Never make assumptions about a property without actually seeing it.

That does not mean we should completely ignore homes that are located away from our comfort zone. In fact, some of the biggest moneymakers are the houses that appear to be in the worst shape. It is difficult to do, but as an investor, you sometimes need to ignore the poor condition of a house and instead, picture it in its updated state.

Even the dirtiest house can be cleaned out, painted and restored. Finding value where others don't is one of the keys to making money in real estate. I can't tell you how many houses I have walked into and wanted to run right back out the door! The house smelled, the debris was ankle high, the furnishings were outdated. It took all of my will to continue to view the house.

However, upon closer examination the house was actually in pretty good shape. The structure was fine. The mechanicals were in working order.   In reality, the appearance was the only aspect of the house that needed an update. And as you will learn, updating the appearance of a house is the easiest part.

The third key property search should really have been first...price. Assuming you found a house in the right location you still have to pay for it. Price is only third because, as I mentioned earlier, a property is only worth what someone will pay for it.

Let's say you get a call from a buddy of yours who has a friend who wants to sell his house cheap. "Great," you say. The only problem is that the house is cheap because nobody would buy it — it sits behind a train track!

Be careful of price points. If something appears to be too good to be true, it usually is. I would estimate that only 1 out of 20 of these kinds of "deals" are actually good deals. The other 19 may provide good experience, but are usually a waste of time.

When evaluating price, you must weigh these factors:

- How much do I need to pay for it?
- How many resources do I need to put into it?
- How high a price can I get for it?

This is where you start to make excellent use of your team. Your real estate agent will be able to find sales of comparable houses over the past 60-90 days. This will give you a ballpark figure of what you should pay for a given property and for how much you may be able to resell it (and in what kind of timeframe).

Real estate is an inexact science. Putting approximately $15,000 worth of work into a house does not automatically mean the value will increase by $15,000. Buyers ascribe more weight to certain house features then others.

Also, buyers ascribe more weight to on certain geographical areas, style of homes and of course location. The current market is changing more quickly than I have ever seen. The influx of short sale and bank owned properties are literally changing property values every day.

An agent can show you which properties have sold, but by the time you have your house ready, the market may have gone down. Of course, the market could just as easily go up.

I always allow myself a healthy cushion. That amount is safe, and anything higher is a bonus. You want to avoid buying a property and then being forced to hold it because you can't sell it for what you expected. Do your homework first.

The last piece of the pricing puzzle is estimating the repairs. I cannot stress how important this is. Having a reliable contracting team member who can provide a realistic quote and deliver on that quote is worth their weight in gold. This is where the profit margin is—knowing where you can cut corners, where you need to put extra money, how long something will take. If you can get the contractor's estimates within 5-10% of actual expenses you are doing really well.

Once you have calculated the cost of the purchase plus the cost of repairs minus the estimated resale, you should have your estimated profit. Here is where your personal preference comes into play. We would all like to make as much money as possible on every deal, or make that one home run every time out. I don't want to burst your bubble, but it doesn't work that way.

Sometimes you might only make $5000 on a $60,000 purchase. Do you want to do that twelve times a year for your $60,000? Is $5,000 too little profit to justify your outlay of $60,000? For some people that is too little return on their investment given the fluctuation of the housing market.

It is at these decision points that you can revert to the goals that you wrote down and use them as your guide. Like any other worthwhile endeavor, building a real estate portfolio takes time. Anyone can do it. It just depends on how fast you want to get there and how long you want to stick around.

Chapter 8: Rent vs. Re-Sell

In the previous chapters, we have discussed strategy and developing a real estate style that fits your personality. Next, we need to talk about the Rent vs. Re-Sell approach to investing.

To take a step back, when I use the term "re-sell" it simply means buying a property with the intention of reselling it in a short amount of time. This can be a property on which I perform an extensive amount of work, or it can be a property I acquire and just perform some cosmetic work (painting, trim, etc.). The amount of work typically depends on my approach to that individual property.

I evaluate this by determining what I can bring in per month in relation to what the true cost of my money is. Regardless of how you finance the house you must put a price on that. If you received mortgage financing, then your cost is your PITI—Principal, Interest, Taxes and Insurance. That is the minimum set payment on the house every month.

In addition, you will have maintenance costs that must be factored in:

- Heating the house
- Unforeseen repairs
- Water and sewer vacancy
- Emergency fund
- Vacancy Factor
- Repair Fund

As much as you'd like to think that everything will go smoothly, especially with the preparation you've done, there are always unforeseen expenses—so be prepared.

Once you know your monthly expenses on the house, it's time to evaluate your monthly collected rents.   Your realtor can help by looking at how much rental properties are going for in your particular area. However, use these figures as an indicator and not as a concrete number. Knowing how much the rents should be doesn't mean that's what they will be. You must market the house and get tenants.

There *are* places in your community (check with your real estate professional) that can give you guaranteed rents. Your state has many programs, like: not-for-profit organizations, Section 8, Veteran Organizations and HUD (Housing & Urban

Development). Once you have a reasonable idea of what the rents are, take that number and subtract it from your total housing expenses (PITI + emergency fund). If that figure is a negative number, you need to evaluate the negative cash flow to your equity position or what you feel the value will be at a later date. In simple terms, you are outlaying more than you are bringing in every month. This could still work if you don't mind dipping into your personal funds if you think you can resell the house in a few months recouping enough back so it makes sense. If that number is positive—even by a small amount—you have some options to weigh.

Every property should be viewed individually but you should make a short list of some principles to guide you. Here are some questions I ask myself:

- What would I do if the tenants stopped paying?
- What would I do if a major mechanical item broke?
- Where do I see the property value in 30-60-90-360 days?
- If someone wrote me a check tomorrow, what amount could make me sell?
- Where do I see this neighborhood in 30-360 days?
- What can I do to the property to increase its value and what would that cost?
- What would I do with the profits every month?

All of these factors must be carefully weighed before determining if the property is right for you. And if you glazed over the last bullet point, please read it again. *What would you do with any extra money every month?*

If there is an extra $400, are you going to put it in your personal account to spend as you see fit? Are you going to put it in your investing account? While $400 might not seem like much, if you own three other properties you are now looking at $1200 a month. Do that for a year and you have down payment on your next investment house and you are on your way to owning your houses free and clear.

If you have money to purchase houses without financing you are already ahead of the game. The aim for you at this point is deciding how to best allocate your funds. Do you want your money tied up in a property that might take you six months to sell? What would you do if you needed immediate access to your money?

If you want to maintain easy access to your cash, then getting in low and reselling is the way to go for you. There is nothing wrong with making $5000-$10,000 on your investment. You're probably not going to retire off that kind of deal but if done right you can establish a steady stream of money so you can acquire more properties and continue the cycle.

At the end of the day, it all comes back to how much money, time, and exposure you are comfortable with. Both approaches can lead you to your goals. It's just a matter of how you want to get there.

Chapter 9: Financing Options

In a perfect world we would all begin this process with a nest egg from which to start investing. Unfortunately, we don't live in a perfect world. One of the biggest obstacles I hear about from investors is finding financing.

If you think about it, your deal really starts and ends with the financing. You can do everything else right but if you can't secure financing all your efforts are for naught. It was only three short years ago when there were investment programs that would allow you to buy an investment property with no money down and without verifying income or assets. Those programs are now ancient history…but this is a good thing.

I can't tell you how many investors have bought houses at incredibly inflated prices only to lose the houses to foreclosure two years later. Being forced to have some of your own money in each house forces us to evaluate the property from multiple perspectives, and not just on the price for which I can sell it in 90 days. Yes, plenty of people made a lot of money but I am sure we all know someone whose life has been affected by the recent foreclosure mess.

There are currently two basic ways to obtain financing and both of them require a significant amount of your own money down. Regardless of how you want to finance your property (with your own money or a mortgage), you will either need a proof of funds letter or a mortgage prequalification letter to begin.

Conventional Mortgage Financing

As I previously mentioned, there was a push in the early part of this decade to offer mortgages with less down in attempt to make housing more affordable. That trend enabled almost anybody to make an offer and purchase a house with literally no out-of-pocket money and no assets in the bank.

This trend slowly started to trickle down to investment properties. Two and three family houses were gobbled up by a pack of novice investors enticed by the thought of purchasing for $200,000, then putting the house immediately on the market and selling it for $225,000 based on nothing more than simple demand.

This pack of investors bought with the promise that home values were certain to rise 10% annually. They were further encouraged by the potential of a positive cash flow of at least $200. Once home values started to level off and eventually drop, buyers stayed away…leaving the pack with properties on which they merely broke even.

Soon the properties required maintenance and the investors were forced to dip into their individual savings. Then, one of the tenants stopped paying rent. The investors were forced to use the rents to maintain their primary residence and they soon faced foreclosure on their investment property.

Fortunately, lending guidelines have reverted to a higher standard, requiring down payment and assets. While this certainly restricts us from purchasing every property we see, we also have less competition and are more personally vested in the property. However, obtaining financing on that property is certainly not a guarantee.

Here are the keys for current mortgage approval:

Credit Score

This is the starting point in the approval process. Your credit is scored by the three major credit companies: Equifax, Transunion, and Experian. Your score is based on a scale from 350-850 with 850 being the highest. Those numbers are determined by timeliness of payment, amount of revolving debt and number of accounts.

If you are maxed out on your debt but pay everything on time, your credit score may not be as high as you think. I strongly urge you to go to one of the many free credit-reporting sites and get a copy of your credit report. You may notice an outdated or incorrect entry that could have a damaging impact on your score.

A good credit score is anywhere from 680-720, with 720 being the "magic number" for many current mortgage products. A score over 620 is really the *minimum* score that you should have to obtain a conventional mortgage.

Income

The second factor in obtaining a mortgage is your ability to repay your loan. If you are a W2 wage earner, calculating your income is fairly simple. Take your gross income and divide it by 52. Then, multiply that number by 4 and you have your gross monthly income.
If you are self-employed, the calculations become much more difficult. Lenders

will generally take your adjusted gross income and use that number as your income. This is an area where being "creative" with your taxes may inhibit you from getting a mortgage. Lenders look to see that the total monthly payments on your mortgage, plus other revolving debts (auto payments, credit cards, etc.), is less than approximately 32% of your gross income. (This number was in the 50% range just a few years ago.) This 32% is probably the biggest factor in buyers getting approved at a significantly lower rate than just a few years ago.

Assets

How much you have in asset reserves is the third factor lenders will look at when deciding whether to approve your mortgage application. You need to have an amount equal to at least six months of your mortgage payments in the bank. Any money in checking, savings, stocks, bonds, 401k can be uses as assets. However, some lenders will go so far as to require proof that the asset can be liquidated on a month's notice.

Down Payment

We already know that lenders have done away with the 100% financing programs. Currently 5-20% of the purchase price is required as a down payment. This money has to be documented and verified when you present your offer. In addition, the money must usually be liquid and in some cases in must have been in an existing account for six months prior to the mortgage closing.

Lending options have been severely limited over the past five years. Contacting your lender or mortgage broker are your only ways of obtaining a mortgage. I would advise calling at least three different people to gauge their mortgage approval requirements. They will all ask for the same set of items: a paystub, W2 or 1040, asset documentation, and bank statements. They will also need to check your credit rating.

The old myth about your credit rating going down when someone checks your credit is just that…a myth. You would have to check your credit every day for a month to see any dip in the score. Having three companies check your credit will not do any harm.

Even so, don't rate shop just yet. Your only goal at this point is to see if one (or all) of the lenders you contact are willing to loan you the money for your property. One lender may have a program asking for only 10% down, while another is asking for 15% down. Getting approved is the starting point once you are serious about buying a house.

Private Money Lending

Considering the strict set of guidelines currently in place, there is a realistic possibility that you may not get approved as easily as you may have thought. Showing income if you are self-employed restricts many investors, and the amount of money needed to start investing is viewed as an obstacle.

Your mortgage broker should be able to refer you to private money lending options. Private moneylenders are individuals or groups that lend money, but are not a bank. Keep in mind that you will pay a premium for their service.

If you are self-employed and have cash to invest but you can’t qualify for a mortgage because you can’t show enough income, private moneylenders may be an option for you.

Private money groups typically look for 40-50% of the purchase price in assets. You may or may not have to liquidate it but you’ll need to have it available. Also, interest rates are two to three percentage points higher than your local bank.

Paying a premium for this kind of loan brings us back to having a battle plan for every property. Is it worth it to make less on a deal that we are not financing? Every investor has to start somewhere. If you see this as something you would like to do, even once or twice a year, making less on a deal still makes sense. Hitting “singles” in investing still means you are getting on base and staying in the game.

You need to determine if the rate of return on your property is greater than it would be with other financing opportunities (bank rates, CDs, bonds). If that is the case then it makes sense to go for it. If not, it’s okay to walk away and wait for the next opportunity.

Chapter 10: Determining the Offer Price

We are at the point in the process where you now have a prequalification in hand and have scouted out properties that fit your price point and goals. After careful examination of the property, you are comfortable enough to make an offer. Some lenders may ask you for a specific prequalification from their bank. You don't have to use their lenders but this offers another layer of protection on their end.

At minimum, you will need your prequalification letter, proof of deposit for the down payment and a minimum of 1% of the purchase price for your broker to hold in escrow. (Some lenders have specific percentages or required amounts.) Once these items are in place, you can begin the evaluation process for how much to offer. Here are three things to consider:

Where is the lender getting their listing price?

This may seem like an odd question. However, lenders have their own somewhat complicated, method for ascribing value to their properties.

One of the common myths is that the lender needs to list the house for a percentage of what is owed. The reality is that they are attempting to get fair market value on their non-performing asset. What is owed really has no bearing in determining the listing price. Regardless of the location or condition of the property, the lender relies on third-party appraisers to determine fair market value.

Unfortunately, this appraisal amount is hidden behind a cloak of secrecy and it forms an obstacle for many interested buyers. Some of these appraisals are relying on outdated information and are therefore not a true snapshot of current market conditions.

I have personally experienced appraisals that were $50-$75,000 higher than any sales in the area. Despite providing multiple supporting documents, I could not convince the lender to see reason.

As you will see, in many cases you may have to wait 60-180 days until the lender comes down to your offer price. Based on the due diligence of your realtor you should feel confident in your own personal price analysis. Let someone else buy that property 10% higher than your number.

One of the biggest mistakes investors make is buying above their target price. Using your discipline and instincts will save your much time and money in the end.

Finding the magic number

Obviously, the goal is to get the property at its lowest price point. That does not mean merely submitting low-ball offers on every property you encounter. Depending on the kind of loan that was on the property, lenders may take less than their appraisal value. However, the lender will not disclose their appraisal amount.

One of the simplest and most accurate indicators that I look at is the number of days the house has been on the market. The market will dictate how much an item is worth.

Start by determining what value *you* give to the property. Let's say you find a property and deem it to be worth $100,000. All agents try to play the game and get their property either at its highest or lowest point, depending on whose side they are on. This is where you have to put a price on that asset.

It seems silly, but you would be surprised how many people would buy a house for $99,000 but wouldn't buy it for $100,000. Many deals are lost over these kinds of psychological barriers. In reality, the difference between the two offers is only $1,000.

When considering an offer, ask yourself this: would you feel remorse if you learned that a given property sold for $1,000 more than what you offered? It is a fine line. I always advise buyers I am representing to make an offer that gets the seller's attention. Your goal should be to have your first offer accepted.

Banks are not in the business of being landlords. They want to get rid of the property as much as you may want to buy it. Loans are backed by a pool of investors that ultimately decide what the lender will accept. The longer a house is on the market, the less it'll be in demand, and the lower its asking price will dip. That sounds good in theory, but unless the offer hits the investor's magic number the lender may decide to hang on to the property and hope a better offer comes along.

Keep in mind that lenders are national. Oftentimes the only visual they have on the property is from their appraisal and maybe from local realtors. They don't know the neighborhood or surrounding areas. Unlike traditional sellers, where we interact face to face and verbally, most of the process on the lenders side is done via the internet and e-mail.

That's why when a property first comes on the market there are multiple bids. Even though one may be 10%, 20% and even 30% higher, each bidder gets an opportunity to submit his or her best offer. I strongly suggest staying with your plan. Your offer may be the higher one; however, it doesn't matter. Don't get caught up in a bidding war. Stick with your plan.

Staying on top of your offers and monitoring the property

Unlike an offer on a short sale property, a REO property offer should receive an answer within 48 hours. Even if your offer is rejected this is a good thing. Your realtor has now established contact with the lender. The lender will place that offer on file and depending on the number of other offers, they may reach out to your realtor in the future.

Even though your offer was rejected, you shouldn't give up on the property. In fact, now is the time to separate you from other investors.

Drive by the property once a week to see if there are any changes in its condition. Always make a notation of when your initial offer was submitted. Have your realtor notify you of any reductions in price. You may even consider slightly increasing your offer.

Your realtor should be able to find out if any other offers have come in. You won't know the amount of those offers but one can assume they are not near enough to the asking price if the house is still on the market. If you and your team really see value in the property, feel free to offer more.

After you make an offer, stay up to date on all your exit strategies (area rents, comparable sales, etc.). In the current financial climate, the real estate market can change quite a bit in as little as ninety days. Always update your property strategy and the associated worst-case scenario.

There is nothing wrong with passing on a property. Don't ever buy just because there is perceived value in the property. If someone offered you a product at a discount, but you didn't want or need the product, would that really be a good deal? No. Value is only value if the item is valuable to *you*. If you are not willing to increase your offer by even a few thousand, walk away and don't look back.

Some may say that is foolish…after all, in the grand scheme, what is a few thousand dollars on a purchase that size? They may be right; there is a very fine line in determining your magic number.

However, in my experience, every time I have bought a property even slightly higher than my target, it started the process on a bad note. It also sets a bad precedent for future deals. My advice is for you to stick to your guns and rely on your evaluation. If you do that, you will have no regrets. You may not get every property but doing this will greatly decrease your chances of making a bad investment.

Chapter 11: Offer Accepted! Now What?

Don't make the mistake of thinking that the process is over just because your offer was accepted. Now is when the real work begins. This is when you have to depend on your team and use every resource at your disposal.

After your realtor notifies you of the acceptance, you may have as little as 14 days or as long as 45 days to close, depending on the type of financing you secured (cash or mortgage). Time is really of the essence. Here is a brief outline of what your team should be doing.

Attorney

Start with your attorney because their job tends to be the most time sensitive. Most banks will put a "time is of the essence" clause in the contract. Your attorney will be your starting point for explaining exactly what needs to be done, and when. Lenders aren't as lenient as individuals are when it comes to contract dates. You must close on the due date or run the risk of enduring financial penalties (loss of down payment and a per diem penalty), and you may also lose the property.

In addition to any pertinent due dates your attorney (and your realtor) can detect and address other red flag items on the contract such as inspection dates and other fine print.

Their next job is to review the title. There may be an unforeseen lien, which could delay or possibly derail the closing altogether. Most title issues are minor, but you may experience more serious issues that will require your attorney's full attention.

Inspector

It is a standard practice for the lender to ask for inspections to be completed within five days after the offer is accepted. You and your realtor should have discussed the home inspections and contractors prior to this point.

The inspection is an out of pocket expense that the lender needs and you want. Don't balk at paying for this. This may be the best money you have ever spent. You would be shocked at how many inspections come back with unforeseen items on it. From mold to termites to lead paint to roof damage, your inspection will give you a more in-depth analysis of what is wrong with the property.

Most REO properties will be bought as-is, meaning the lender will not offer or accept credits for any of the work to be done on the property. This does not mean that the lender is aware of all of the issues.

Once the inspection is completed, your realtor will review the report and inform you of any issues. At that point, your realtor can notify the lender and determine, in light of this new information, if the lender will allow a credit for repairs. Many will stand firm by their as-is stance.

You can now decide if you want to move forward with your offer in light of all the work that needs to be done. If you feel that the work and the risk are within your comfort zone, then proceed as planned. This will be your last chance to walk away from the deal if you do not have a financing contingency.

Financing

Your lender or mortgage broker has been waiting for your call since they issued their pre-approval. Now is the time to contact them. It is critical that they know of any closing dates.

Some lenders may not be ready to close within 30 days. Some can close in two weeks. Find this out before you move forward. Missing a closing date because you are not approved may cause you to lose the deal.

The first thing your lender will need to do is order an appraisal. The appraisal is different from the inspection. The appraisal is for your lender, not for you. They are simply justifying that the purchase price is at least equivalent to the property value.

Your appraisal should never be lower than your offer price. If it is, you either completely missed something on your analysis or the appraisal isn't taking into account the same set of variables you are using. You can still move forward with your deal but you would need to bring the difference between the purchase price and the appraisal to the closing.

You will also be asked to provide your lender with all recent income and asset documents. Have all of your items ready so you don't delay anything on the financing side.

Contractor

Depending on what you intend to do with the property it is never too early to inform your contractor of your plans. Getting a contractor's schedule to fit your schedule is a minor miracle, but it is important if you plan to do any work on the property. You don't want your property to sit idle, waiting for repairs because while it sits there, it's not making you any money. You can avoid this by giving your contractor plenty of notice that you'll need his services soon after the closing; thirty days is usually a good cushion.

Realtor

It may appear that the realtor's job is done after the offer is accepted, but believe me, it is not. As with your attorney, the realtor's first job is to review your contract and make sure that everything your best interests are reflected in the contract.

After this contract review, your realtor will help coordinate the appraisal and the inspection. The realtor is the glue in the transaction that holds your lender, attorney and selling lender in place.

The final hurdle is coordinating all the parties involved towards the closing date and making you aware of any last minute changes to the deal.

Your realtor is also your starting point after the closing. If you intend to rent the property, your realtor can help you place an online or print advertisement looking for renters. If you are looking to re-sell, you can think about placing the property on social networking sites (Facebook, Twitter, etc.) and start creating a buzz there. In addition, it is fairly easy and inexpensive to start your own website dedicated to the property you are selling (for example, www.101mainst.com).

If you are not the technical type, you can hire someone to set up a site for you. The combination of social media, newspaper ads, and a website will give you a 30-day head start on making money from your property.

Chapter 12: Executing Post Closing Strategy

Congratulations! You are now a real estate owner. Depending on what you intend to do with the property, you should start phase two as soon as you have those keys in your hand. I hope that you have made the appropriate preparations before you closed, but if not lets go through what needs to be done.

Re-Sell

You and your realtor have discussed the area where your property is located and you both think there is a chance to fix up and sell your property within a short timeframe.

Under this scenario, you need to revisit your initial contractor estimates and get to work. The first thing I do is make sure the furnace, hot water heater, and roof is either updated or serviced.

After determining that structural or mechanical work is needed, it is wise to work with your real estate professional on determining an after-rehab price. Every market area has a price point ceiling no matter how much work is done. The goal is to obtain the buyer that will pay the highest amount in the shortest time.

As far as aesthetics, you should customize your work to the type of buyer you are targeting. If you expect your property will appeal to first time homebuyers, you can make your upgrades accordingly.

Again, repairs and upgrades are not dollar for dollar in relation to increase in purchase price. You can make an 800 square-foot home look like Trump Plaza but it’s still only 800 square feet.

Once your repairs or upgrades are completed, you and your realtor have to agree on a listing price. Don’t let the amount of work on the property affect your listing price. It’s likely that any potential buyers have never seen the inside of the property before you bought it and therefore won’t be “wowed” by the improvements.

If you list the property too high, you run the risk of scaring both realtors and buyers away. While you obviously want to profit as much as you can, inflating the listing price won’t help you get there—in fact, the opposite may be true.
By listing the property at a fair market value price, you may attract interest from

multiple buyers. Demand for your property will attract competition and can create a bidding war. If you had "over listed" the property, this interest may not have occurred.

Rent

While the repair or upgrade work is being done on the property, you and your realtor should be lining up renters and/or buyers. Utilizing the internet—particularly social media—is critical. You can find many with a quick ad on craigslist.org or other similar internet sites.
You now own the property so you can show it to any prospective renters at your leisure. I would recommend waiting until some of the work has been completed. You wouldn't want to show a house with the bathroom half finished! Wait an extra week or so and show the house in its best possible state.

Primary Residence

There is nothing stopping you from using the home as your primary residence. The process is the same and in most cases a lot easier. As long as the mechanicals and structure are sound, you can do the work as you occupy the property.

Many new homeowners have a vision for what they want to do but as time goes on never get around to doing the work. Make a list of one project you want to do every month. By giving yourself a month, you can accomplish a little bit every week. Some of the work you can contract out; some you can take on yourself. For example, painting your first home can become a cherished memory. It can also be a fairly inexpensive way to discover your limitations and explore your tolerance for manual labor.

Having your action plan in place from the beginning will save you time, effort and money. Be true to your plan but also accept that circumstances may change along the way. Remaining in contact with your team and frequently reviewing your goals will help you to stay on track.

Chapter 13: On to the Next Deal!

So, you are now ready to search for your next property. Before you do, speak with your accountant/financial advisor on how best to reinvest any profits. Your accountant can inform you of any tax ramifications.

You now have a track record and some experience to draw from. Keep looking for creative ways to find new properties; take time out every day to try and do so. Keep a notepad in your car so if you see any "for sale by owner" signs, you can jot the information down (after pulling the car to the side of the road, of course!). Drive by any new listings on your way home from work. Remember your team and stay in contact with them. This is *your* plan and these are the individuals that will help you get there.

I am glad to help you with any part of this process. My door (or e-mail address) is always open to you. If you should have a question, a suggestion or a general comment, please feel free to contact me!

Salvatore Spadaccino
spazllc@snet.net

About the Author

A Bridgeport native, Sal Spadaccino has resided in Shelton for the last 30 years with his wife Michelle. Sal has raised three children: Michael, Salvatore and Danielle.

Michael and Salvatore have followed in their father's footsteps and currently work as part of the Spadaccino Realty Team.

Sal is also the proud grandfather of three children; his youngest grandchild was born in the spring of 2011.

In his personal time, Sal enjoys spending time with his grandchildren, working out at the gym, golfing and volunteering with his church and several local civic organizations.

Educated at Sacred Heart University, Sal completed the requirements for his real estate license in 1994. In 2000, he obtained his broker's license after attending Naugatuck Valley Community College.

Sal's dedication, passion for real estate and real estate investing, and extensive knowledge of the intricacies of real estate allows him to better serve his clients. He has been serving the real estate needs of his community for more than fifteen years with Re/Max, ERA and currently, with the Independent Brokers Network. During that time, he has won a number of awards and professional distinctions.

Sal Spadaccino, together with his sons, Salvatore and Michael, ranked **#6 of 8,029 active agents** on the Fairfield County Consolidated Multiple Listing Service as Listing Brokers, and **#2 for Buyer Sales.**

The goal of the Spadaccino Realty Team is to obtain the highest price in the shortest amount of time for listed properties. **For listings sold,** the Spadaccino Realty Team **currently ranks #3 in Bridgeport** and **#6 throughout the state of Connecticut.**