Chapter Two

Understanding Your Product

What You'll Learn in This Chapter

1. What your "product" really is
2. How to identify deals that lots of people will want to buy
3. What to do with occupied properties
4. The importance of high equity
5. Why motivated sellers are motivated to sell

You Can't Have a Business Unless You Understand (and Deliver) What Your Buyers Want

Every wholesaler in every industry feasts or starves based on one thing, and one thing only:

Are they able to consistently deliver the product that their ready, willing, and able buyers want?

If you plan to earn all or part of your living wholesaling properties, you'd do well to take this to heart, and spend the vast majority of your time doing exactly that.

But our business is a little different than that of wholesalers in other businesses.

For one thing, what "our buyers want" isn't the same from buyer to buyer—one might only like single families on the east side of town while another only wants duplexes on the west side.

It also isn't the same from moment to moment: the same buyer might literally pay 75 cents on the dollar for properties in a hot market, then insist that he won't pay a dime more than 60 cents on the dollar for the same property post-crash.

And to make things even MORE confusing, two equally experienced buyers with the same preferences might look at the same house on the same day, and one will love it and want it immediately at your asking price, and the other will tell you it's terribly overpriced.

The whole thing—that different buyers want different properties in different areas, and have different cost structures and different formulas for what they'll pay—leads wholesalers, and some people who are "Tryin' to wholesale" to believe that there's no rhyme or reason to what buyers want.

The natural outcome of thinking, "No 2 buyers want the same thing or want to pay the same thing for it" is "So who cares what I put under contract or at what price? It's all random anyway."

The thing is, it's simply not true that what buyers want, or what they're willing to pay for it, is random,

It's more accurate to say that it's a mathematical distribution; a bell curve, if you will.

Learn to Love the Bell Curve

If you're a more traditional wholesaler who, say, wholesales underwear to Walmart, your job is to "take orders" from Walmart.

If Walmart wants 1 billion pairs of men's lime green briefs, in medium and small, you just get Walmart what they asked for. You don't decide you know better than they do, and deliver X-tra large white boxers[1] instead. If you do, you won't get paid and, one presumes, you won't ever get the chance to work with Wal-Mart again.

Here's the thing:

Real estate investors and landlords aren't Walmart.

Unless you're a buyer for a large hedge fund (in which case you'll have a single customer big enough to set all the rules starting with what you 'get to' make, and trust me, it won't be a full wholesale fee), your buyers aren't all turned on by the same deal on the same cookie-cutter property.

If your product can be said to be a single thing, <u>it's a great deal, as represented by a purchase contract, on a property that's desirable to a particular buyer</u>.

As your wholesaling career progresses, and the number of buyers who actually buy deals from you expands, you will find that your specific understanding of what any <u>individual</u> buyer prefers becomes more and more clear.

In fact, you'll get to a point where you pretty well know which buyers will be interested in which deals based on your knowledge of their specific likes and dislikes, without even asking the customer.

Let's be clear, though: if you want to have a thriving wholesale business, your best approach is NOT to look for specific deals for specific buyers, but rather <u>to find as many deals as possible that fall within the tolerances of as many buyers as possible</u>.

Unlike the underwear wholesaler, your job is not to take orders and fill them. It's to find deals and sell them. Doing it backwards—starting with what a particular buyer wants and trying to put that deal together FOR HIM—is almost always a mistake.

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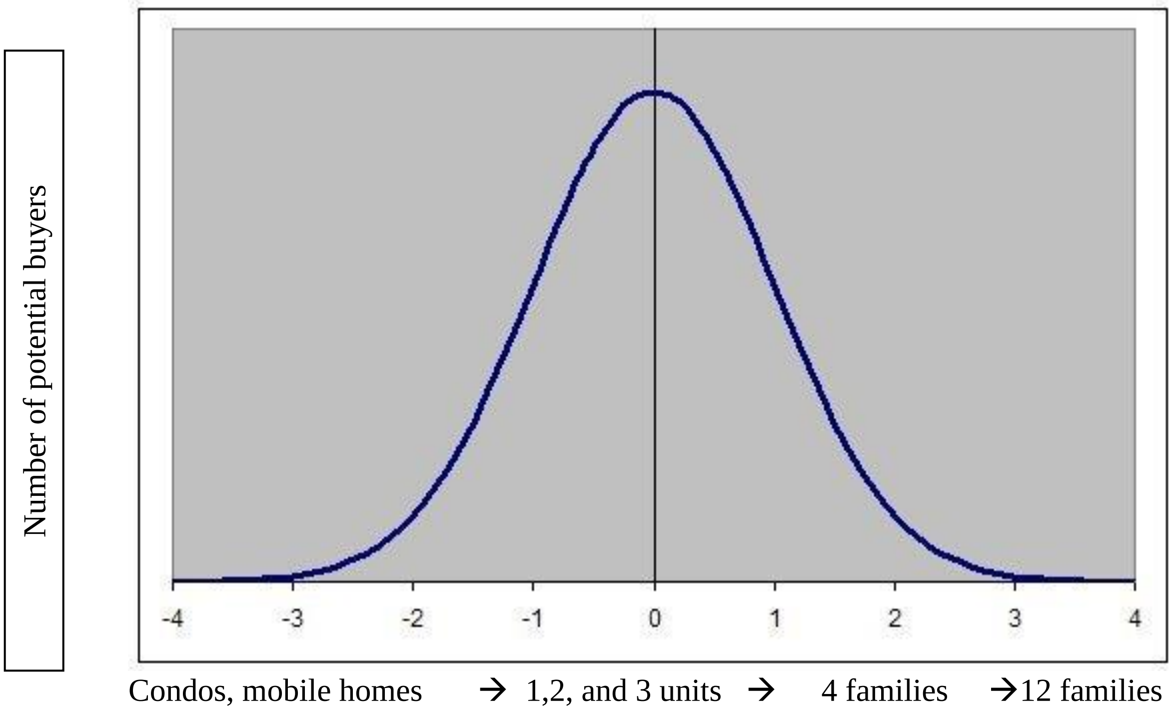
[1] *Not even if you've BEEN to Walmart, and believe in your heart that you're doing the world a favor by not clothing their typical customer in tight, loud undies.*

I, for instance, have a very well-qualified buyer who is very anxious to buy some 4-plexes in a rural-ish county on the far east side Cincinnati. When I say well-qualified, I mean that this guy recently sold a business and has over $1 million in cash, plus he already owns about 25 units.

So why am I not running all over the east side of town looking for a deal to sell him? There are several reasons (not the least of which is that I live on the far WEST side of town, and am too lazy to drive 40 minutes one way to find this guy a deal), but the main one is this: he's the only buyer on my list who's especially interested in these properties.

Both the part of town he wants and the specific property type—4 families—are outside of the bell curve of what most investors in my area are looking for. Thus, if I spend a bunch of time trying to find what he says he wants, and then for whatever reason he decides he DOESN'T want it, I've got a property under contract that I won't buy for myself and that I'll have a hard time finding another buyer for.

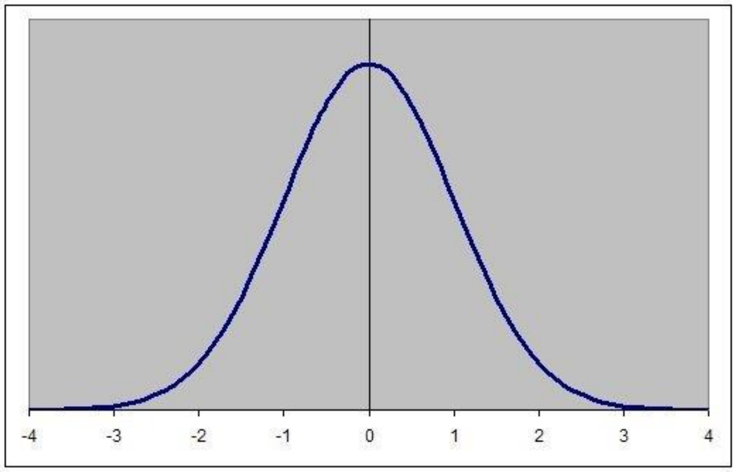
See, what this particular buyer wants, both in terms of property type and of location, is not in the center of the bell curve of what most buyers want.



If you remember the intricacies of the bell curve from calculate class, you'll remember that 68% of the volume under this curve—representing 68% of buyers, in this case—fall between the -1 and 1, known as standard deviations from the mean. Only 27% of the volume falls between 1 and 2, or -1 and -2. Between the 2s and 3s? a total of 4.2% of the total.

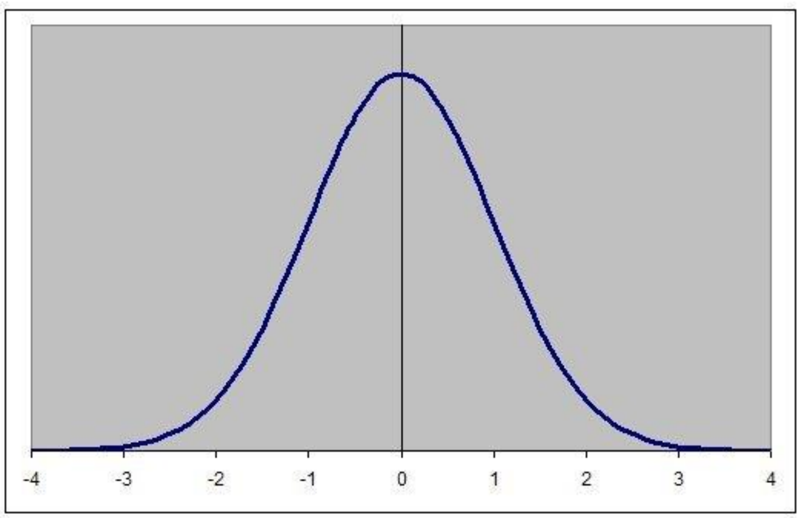
Your goal in finding the right PROPERTY on which to put a contract so that you can easily sell it is all about keeping your product in the 68%[2]

A similar graph can be drawn about most of the characteristics of a particular deal, ranging from neighborhood:



Very bad Rental Bread & Butter Move-up Luxury

To the price buyers are willing to pay:



10% of value 70% of value 100% of value

Don't get me wrong: somewhere in the world, there's a buyer for just about any property you can lay your hands on. Got a truck stop under contract? People buy truck stops. A 1972 singlewide? At the right price, somebody wants it. A fire-damaged warehouse in a rough area? There's probably a meth lab or a

[2] Which may not be exactly 68% for every characteristic of a real estate deal. The point isn't the exact percentage of buyers who want a particular thing, it's that you spend most of your time looking for things that a LOT of buyers want.

toxic waste storage company that would love to have it.

But the question you have to ask yourself as a wholesaler is, "Do I want to provide great deals that a large number of buyers will find attractive, or that a small number of buyers will find attractive?"

If you answered "A large number", then you've come part of the way around to understanding why wholesalers don't spend a lot of time looking for great deals on office buildings, or farmland, or parking garages. It's not that buyers don't exist for those properties, it's that the largest number of real estate buyers in the market—by a LONG shot—are looking for small residential rental properties and single family homes to renovate and resell.

If you want to sell every one of your deals, every one of them needs to be on the kind of property that lots of investor buyers want. And that means the right type of property, in the right type of neighborhood, in the right condition.

The Property Bell Curve

Even when you've narrowed down your ideal deal to a 1-3 family property, there are certain characteristics that make properties more or less desirable to the end users—home buyers and renters—and therefore easier or more difficult to wholesale. For example:

1. In the realm of single family homes, properties smaller than 2 bedrooms or larger than 5 lie at the ends of the curve. Most buyers who want properties that they can retail, prefer 3-4 bedrooms; landlords will consider 2-5.

2. When considering the layout of any given property, the rule is, "Weird is bad." **Properties with incurable layout problems are difficult for your buyers to rent or sell**, and therefore difficult for you to wholesale. These problems, known in the industry as "functional obsolescence", are most commonly found in older properties. Examples include "walkthrough bedrooms", where the occupant of one bedroom has to walk through another to get there; bathrooms that are immediately off kitchens or where the only access to the only bath in the house is through someone's bedroom; houses with very small bedrooms; houses with bedrooms in converted attics, where the ceiling height is 6' in the center of the room but quickly slopes down with the roof line to 2', and the like.

3. Among all properties, **those that are missing amenities common to the rest of the neighborhood are difficult to sell**, unless the deficiency can be easily corrected. For example, if every house in the neighborhood has a garage, but your subject property is on an 'infill' lot and doesn't even have a driveway, that's a problem. It doesn't just reduce the value of the property in a way that's hard to define (since there will be few if any comparable sales also lacking a garage), but it also makes the property straight-up less desirable. If there's room on the lot to add a driveway and garage, and this can be done at some reasonable expense and hassle, it's still a viable deal at some price. But when you think from the buyer's perspective about whether it's worth it to go through all that when there are 1,000 other houses in the area that already have this amenity, you'll see why buying that deal from you will be a difficult decision.

4. Among all properties, those with **environmental deficiencies are harder to sell.** For instance, homes that are adjacent to industrial properties, on busy streets, or near railroad tracks or a highway are often completely undesirable to homeowners (and thus to retailers) and command a lower rent among tenants, necessitating a lower sale price to your landlord customers.

5. **General rule of thumb: Weird is Bad, and Bad is Hard to Sell**. Unfortunately, a lot of the leads that we get in our business are on properties that, in one way or another, are weird for the neighborhood. The reason, of course, is that the owners of these properties have a hard time selling them, and thus become motivated, and thus turn to us. Even when the weirdness seems to be something that could be turned into a benefit, many of your potential buyers will be turned off by the very fact that the property is unusual and that they're not sure what to do with the unusualness. It's difficult for even professional buyers to account for strange features in a property, and thus to decide what to pay for that property, if they want it at all.

   "Weird" can mean anything from unusual construction (I once made on offer on a poured concrete house—the only one I've ever seen in Cincinnati) to unusual mechanics (I had a heck of a time selling a single family home that had once been to 2-family, and still had 2 gas meters, furnaces, and electric panels, despite trying to argue that "zoned heating" was all the rage) to unusual architecture (as curious as I was about the octagonal house, I had to pass on it since it was impossible to 'comp").

Don't get me wrong: at some price, most deals will sell.

There's a price at which the underground house with 1 bedroom next to the garbage dumps with no off-street parking will attract a buyer.

The problem is, that no-brainer price is usually less than you think, and a LOT less than the seller is prepared to sell for.

The Neighborhood Bell Curve

You've heard the old real estate agent mantra about the 3 characteristics that affect price: "Location, location, and location."

That's true of marketability of wholesale deals, too: the demand for any given deal is going to depend, in part, not on WHAT it is or HOW MUCH it is, but WHERE it is.

For the sake of "speaking the same language" about neighborhoods, let's go ahead and break down neighborhoods on a scale of 1 to 5, where:

Type 1 is a war zone. You'll know it by its reputation as a high drug and crime activity area, and by the large number of abandoned and boarded-up properties.

Here's an interesting factoid: most cities don't have true warzones. When I speak to real estate associations, the members, whether it's in Greenville SC (where there is no warzone) or Chicago (where there most distinctly is), try to argue that I don't know THEIR city, because if I did, I'd know about their warzone.

A warone isn't just a place you wouldn't want to live. It isn't just place where you can get drugs, or where you'd be nervous about collecting your rent in person. Those definitions are all too subjective to be useful.

A warzone is defined by 2 things: who really 'runs' them (the criminals, not the cops), and more importantly for our purposes whether there's a desire by private individuals to invest in the housing there.

If these areas were desirable to investors, they'd look different than they do, by which I mean that there wouldn't be such a large number of vacant, abandoned properties.

No buyers equals no deals for you, at any price.

Type 2 is a border zone. In most smaller cities, what locals call a warzone is actually a border zone, or low-income rental area.

The defining characteristic of a border zone is that the residents are primarily renters, with a handful of hold-out homeowners scattered around.

No, these are not neighborhoods in which you'd aspire to live. Yes, you can buy drugs here, but you won't get stopped at every traffic light and offered a rock. Yes, there's crime, but you're unlikely to be the victim of a drive-by in broad daylight. Yes, there are boarded and vacant properties—these neighborhoods are always harder-hit by foreclosures than other neighborhoods.

Because of the high renter population, you'll see that even the well cared-for properties don't show a lot of "pride of ownership"—landscaping, decoration, that sort of thing. You'll see trash in the yards, appliances and furniture on the porches, cars on four flat tires in the driveways.

So although border zones are places where many of the residents rent due to economic necessity as opposed to love of the community, they are extremely profitable places for landlords to invest, because of the high rental demand. Many profitable wholesale deals are available in border zones.

Type 3 is a bread-and-butter area. Bread-and-butter areas are your classic "starter home" neighborhood. While the rental-to-owner occupied ratio may still be 50/50 or 40/60, bread-and-butter areas are well-kept, though typically modest, older, affordable homes. Both landlords and renovators look for good deals in an area like this, because properties are relatively cheap and demand is high.

Type 4 is a "move-up" neighborhood. The majority of the residents here are homeowners, and they're largely professionals with dual-income families. The homes here sell for more than the than the median price in the city.

Some move-up neighborhoods are newer subdivisions. Others are older, established areas, and these are more likely to yield properties in the conditions that we look for as wholesalers.

Due to the price of the properties, your primary buyers here are retailers, because the price of these properties vs. the rents they generate will keep most landlords from finding them attractive.

Any deals you find in these areas will generate a lot of attention from rehabbers, because the higher price points mean higher net profits as measured in dollars.

Type 5 is the neighborhood we all aspire to live in, but only a few of us can. You'll find no modest homes here—only huge places on gated streets, or private drives winding through the 10-acre estate. If your city has a professional football or baseball team, this is where the really successful players live. And the team owner. And the CEOs of the largest corporations in town. And you, if you become a successful enough wholesaler.

Like the warzone, the type 5 luxury area is a place with few investor-buyers; the cost and risk associated with buying a junker for a million bucks, putting another half a million into repairs, then selling for 2 million[3], is just too much for most of your buyers to handle.

Determining which specific neighborhoods, subdivisions, and zip codes are which in your city is a matter of learning the city. Driving for dollars helps, as does networking with local agents and investors. Most neighborhoods actually represent a range of types, depending on the specific street; in my office, we'll often talk about a neighborhood as being a "type 2 ½ with pockets of 3."

But in any case, <u>your job as a wholesaler is to stay away from the extremes of this scale</u>.

You'll find few buyers who want type 1 areas—and if they did, they'd just go and buy some of those boarded-up properties for pennies, anyway. Most buyers can't afford, and are intimidated by, the type 5 areas—assuming you could find a bargain there anyway, which is mighty tough. Your 68% is in type 2, 3, and 4 areas.

The Property Condition Bell Curve

If you ask investor/buyers to describe the perfect deal, they'll all say that they're on the lookout for properties in type 3-4 neighborhoods with three or more bedrooms, that need no repairs and, that they can purchase at 70% of market value.

The honest ones will admit that these deals don't come along too often.

Although your wholesaling business profits by getting your buyers what they want, it's also true that

[3] *If you live in San Francisco or Seattle, just double these numbers so that they make sense to you. I'm trying to describe the best neighborhood in most cities, not the average house price.*

if you make offers primarily on properties that need very little in the way of repairs or upgrades, you'll have a short and frustrating career.

The problem is not that lovely homes that need no work don't exist: the problem is that even in an extremely slow market, the owners of these properties don't need to sell at wholesale prices.

And why should they? Even a truly desperate seller, by marketing a nice-looking home for as little as 80-90% of market value, can easily attract a qualified home buyer who will think (correctly!) that it's a great deal for them. So, on the whole, **the properties that you look for—and ultimately put under contract— must be ugly enough to scare off your most challenging competition: the qualified home buyer**.

These properties are commonly known as "junkers" in the investment community, and can have a variety of problems ranging from hideous cosmetics to mechanical problems to animal smells that leave you gasping for air. We're not talking "needs a coat of paint and new carpet" here, we're talking "needs new walls and floors", if you get my drift.

Internalizing this point—that junker properties are gold mines for both you and your buyers— is <u>really, really hard for new wholesalers to do</u>. If I had a dime for every coaching student who said "Oh, I didn't make an offer to that motivated seller, because no one would want a house that smelled that bad", well, I could stop wholesaling tomorrow and retire on my dimes.

It's so crucial when you have this reaction to remember that your buyer isn't looking for a place for his family to live. He's not a home buyer. He's not a renter. He's not going to live in that property, ever.

Case Study: The Ugliest House I Ever Sold

This fine specimen had been the scene of a fire about 6 months earlier; prior to that, it was a rather adorable owner-occupied property. Believe it or not, it was in a nice type "3" area. The ARV was $79,000, the repair costs around $35,000 (yep, it looked a lot worse than it was). Our purchase price: $2,500. Our sale price: $9,000. Our wholesale profit: $6,500. The BUYER'S profit, $35,000.

He's a renovator who looks at ALL repairs in terms of dollars and hassle vs. profit potential. Does he think cat pee and raccoon poop[4] is gross? Sure. Does he WANT to have to bug bomb a house wearing a hazmat suit three times before his contractors will even go in to start cleaning it out? Not in an ideal world. But for a big enough discount, he'll do all that and more.

Your buyer doesn't need to be in love with the property in order to want it; he only needs to crunch

[4] *If you think I'm just being figurative here, you haven't seen enough houses that have been vacant for 2 years.*

the numbers and see that he can make a bunch of money fixing it up and renting or selling it. To him, orange shag carpet and a leaky roof look like opportunity; the smell of animal urine is the smell of profit.

If the price is right, you can successfully market properties in any condition up to, and including,,"shells" with no furnace, plumbing, electrical system, walls, etc. **This is not to say that some properties are not UNmarketable**—if you live in an older, moderately-priced city, you'll run across properties where the repair costs exceed the after-repaired value of the property, meaning that there's no price at which you could sell it that would be a good deal for the buyer.

But assuming that this is NOT the case, and that the total purchase price plus repair costs leaves a significant amount of profit or equity for the future buyer, you'd be amazed at how bad a property can be and still be a money-maker for you (see case study).

Yes, properties that need less work sell faster, and for a higher percentage of value, and have more potential "takers" than properties that need more work. And there are certain TYPES of work that most rehabbers don't know how to do, or choose not to do because of the cost or complication of doing them.

Deals that are EASIEST to sell need cosmetic work that can be done without opening or moving walls, or tampering with any of the "systems." Few of your deals will need ONLY these things, but all of them will need some of them.

<u>Cosmetic work includes</u>:

- Paint, wall paper, minor wall repair
- Carpet, tile, linoleum, refinish existing wood floors
- New kitchens and baths and kitchen and bath updates
- Landscaping
- Deodorizing, unless the source of the odor has so permeated the porous surfaces that the subfloors, drywall etc will need to be replaced in order to eliminate the odor.
- Extermination

Most of the deals you sell will also need some level of mechanical work, which any serious rehabber has done before. This is work on the "systems" of the property.

<u>Mechanical work includes</u>:

- Replacing plumbing and drain lines
- Reconnecting, upgrading, or replacing wiring or service panels
- Replacing furnaces or boilers and central air systems
- Replacing windows
- Repairing or replacing roofs and gutters
- Replacing water heaters
- Adding or replacing siding

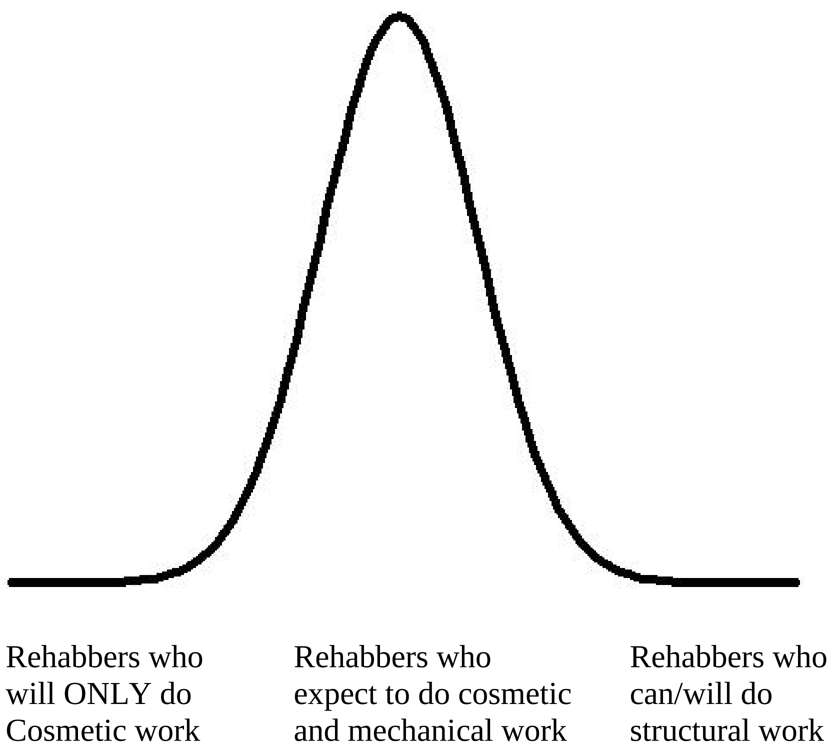
- Etc.

STRUCTURAL work is the most expensive, risky, and specialized, and, even when completed, is often still obvious and decreases the value of the finished property. While there are always a handful of buyers who will tackle it, it should be avoided unless the deal is stupid-cheap, the market is pretty hot, and you know a lot of potential buyers.

Structural work includes:

- Serious foundation problems, settlement, step cracks in brick houses
- Serious termite damage
- Rotted structural members, including sill plates, corner studs, roof trusses
- Structural damage caused by fires and floods

The bell curve for condition looks a little different than some of the others:



There's an important point that you need to absorb in regard to property condition, before we leave this topic: properties that need cosmetic and mechanical work are your bread and butter. Your customers aren't home owners or even renters; they're professional buyers and rehabbers of properties who translate those deficiencies into dollar figures and decide whether the profit at the end of the deal is worth the work they'll have to do to get there.

Wholesalers sometimes pass on good deals because they can't imagine that anyone would want them because they're filthy, or smell bad, or have mold, and as a result the WHOLESALER wouldn't want them.

But you must stop thinking about repairs in terms of "Will anyone want this property?", and start thinking in the terms your buyers do: "At what price would I need to get this property in order to entice someone to buy it and do these repairs?"

A Note About
The Occupancy Status of the Property

In a perfect world, all of your wholesale deals would be:

- 1-3 family homes with no functional obsolescence or "weirdness"
- In border zones, bread and butter neighborhoods, or move-up areas
- Cosmetically distressed with minor mechanical upgrades needed

And they'd have one other characteristic: they'd be vacant.

Vacant properties have several practical advantages over occupied ones: first, the seller is much more likely to be comfortable with giving you a key so that you, your inspectors, and your buyers can enter and leave at your convenience.

Second, it allows you show to property to as many buyers as it take, without having to bother the occupant, or having to explain to the seller who these people are.

And third, rehabber buyers generally prefer vacant properties because they can get to work on them right after the closing, and not worry about having to evict the occupants or wait months for them to move.

Most of the time, one of the reasons the seller is motivated to sell his property at a low price is that it's of no use to him, and part of the reason for that is that the property is vacant. However, a very small number will still be owner-occupied, and a still-small but significant percentage will be tenant-occupied.

In either of these cases, you might change your strategy to make buyers drive by the property and make sure that they're happy with the area and exterior condition before they see it; you might also want to take the step of pre-qualifying the buyer to make sure he can actually pay for the house if he likes the inside before you disturb the occupants. Needless to say, you need to tell your buyers NOT to get out of their car and walk around, NOT to knock on the door and ask to see the property, and so on.

Tenant-occupied properties can be a blessing or a curse, depending on the tenant. If he's paying and planning on staying, having a tenant already in the property can make it more valuable and desirable to a landlord buyer, and, with your assurance that he's unlikely to need to move when the property sells, can be very good about letting you and your buyers in to see the house. However, if the tenant is not paying, and is under eviction, or knows he will be as soon as the property sells, he's likely to be uncooperative in allowing the seller—or you—to show it.

I've even had tenants who flat out refused to let anyone into "their" house, and sellers who believed that the tenant had the right to do so. This isn't true—owners have the right to go into, and bring other people into, their properties for legitimate business reasons, including negotiating the sale of the property.

However, tenants must be given notice by the owner before anyone comes into their home—and this must be done 24-48 hours in advance, depending on State law. Even with such notice, tenants have been known to do everything from pretending not to be home to changing the locks to avoid these visits. And although the owner has the legal right to enter the premises with or without the tenant's cooperation once they've given legal notice, there's not much that they can do for you if the tenant has changed the lock, installed a deadbolt inside the door, and so on.

If your contract says that you MUST get access in order to fulfill the inspection agreement, and the owner can't provide that access, you can void the contract under the inspection agreement—but since the goal is to actually get to the closing and get paid, here's the strategy we use:

We have found that by going directly to the tenant (with the owner's permission, of course), we can usually secure their cooperation. In general, this takes a combination of: 1) small bribes ("I know it's a pain in the rear that we will have to come in here 2 or 3 times, so let us pay you $10 every time we need to get in"), 2) sweet-talking the tenant ("We appreciate your cooperation so much, you're so kind to do this for us..."), and 3) empathizing with the tenant in regards to the condition of his property (remember, he lives in a junker—probably because of damage HE'S done—but you'll still find yourself saying, "Yeah, you're right, all these roaches on the food you've left out for a week really ARE awful.")

You shouldn't refuse to pursue a deal if the property is occupied, but you should be aware that the situation becomes more complicated when it is.

- Never let a buyer inspect the interior of an occupied property without being present yourself
- Never show an occupied property to a buyer who hasn't already agreed to buy (and shown the ability to buy) if the interior condition is as you've reported it
- Make sure that your contract is clear as to what the occupancy status will be at closing, whether it's:
    - Subject to tenant's rights (i.e. the tenant will still be there, the new buyer can keep or evict him as he sees fit)
    - To be turned empty at the time of closing (which may require a landlord to evict his tenant before closing)
    - The owner has the right to stay in the property for xx days after closing. In this case, I often add a clause that if the seller "holds over"—i.e. isn't gone by the time xx days are over—he agrees to pay rent starting day xx+1, and that rent is always more than high enough to both encourage the former owner to move, and compensate the buyer if he doesn't

The One Thing That EVERY Deal Has in Common…

The focus of this chapter so far has been to help you understand the characteristics that make a property desirable to the largest number of potential buyers.

But if we focus all of our time looking for 3 bedroom distressed properties in bread and butter areas—the ideal property—we're missing the point, which is we also have to negotiate prices on these properties that leave lots of profit on the table for the buyer, and a smaller profit for us, so that we can put them under contract.

Because, as I may have mentioned before, we don't sell properties. We sell great deals on properties.

Your ability to do this has nothing to do with the property itself: it has to do with the seller's situation.

There are plenty of owners of junker houses out there who can't, or won't, sell them at wholesale or even investor-friendly prices—and trust me, you'll talk to more of those during your wholesaling career than you will the super-motivated ones.

Case Study: You Have to Ask…

The seller of this property was a homeowner who has already purchased a MUCH nicer home in the suburbs. Since the ARV was only about $65,000 and the home needed $20,000 in repairs, our target SALE price was $22,000. Unfortunately, he had paid $34,000 for the property 7 years earlier, and still owed $24,000. However, the property had been on the market with an agent for more than a year, and the only offers he'd had were in the $20,000 range, which would leave him with about $17,000 to pay off his loan after commissions, and the various loan costs, the buyers were demanding he pay. So when I told him that the best we could do was $18,000 but that we could close in 10 days with NO commissions or loan fees, he agreed to bring the additional $6,000 to the closing just to be rid of the problem.

So there are two OTHER key factors in acquiring your "product:"

CAN the seller sell at a wholesale price, and WILL he?

Your Sellers Must Have Equity— or Cash to Bring to the Table

All other things being equal, the thing that determines whether you'll sell any given wholesale deal is the price.

Deals that are priced right (that is to say, at a price that allows the buyer to make an appropriate profit for the time, energy, and money he has to put into it) sell.

Those that aren't, don't, and if they do, they shouldn't.

One of the challenges you'll find, as you immerse yourself in the business, is that you'll run into plenty of sellers who really ARE motivated enough to sign a sales agreement at just about any price you'd like to offer.

The problem is, they can't, because they owe significantly more than you want to pay.

One of the first steps in evaluating any potential deal is **to determine, very quickly, whether or not the seller has enough equity to make the deal "doable."** It's not uncommon to talk to sellers who are very motivated, but owe 90%, 100%, or even 120% of what a property is worth in its current condition. If you can determine this up front, you'll save yourself many, many hours of chasing deals that can't be done.

And how do you do this? By ASKING. Before you even consider leaving your warm comfy couch[5], you should know what the seller owes against his property, whether that's in the form of a mortgage (or multiple mortgages), unpaid real estate taxes, or other liens or debts that may have attached to the property.

If a deal is marginal—that is, the seller has some equity, but not enough for you to make a profit wholesaling the property—you have three options:

1. You can ask the seller to bring cash to the closing to make up the difference (and yes, this does happen, albeit rarely);
2. You can negotiate with the seller's creditors to try to get a lower payoff (this only works if the payments are in arrears or if there is a less-secured lien like a judgment lien)[6]; or
3. You can exercise some strategy other than a typical all-cash flip[7].

[5] *Everyone works on their couch, right? Or is that just me?*

[6] *This is called a "short sale", and it's a strategy that I can't, in good conscience, recommend to beginners or part-time investors. They're much more complex than they were in, say, 2004; they require months of effort and are accepted at the price YOU want to pay only maybe 10% of the time, and you must be available to make and take calls with the creditors during business hours. On the whole, they're extremely discouraging to new investors, and you should consider staying away from them for now.*

[7] *Hopefully, you have the Real Estate Goddess's Guide to Building a Wholesaling Business, where this is covered.*

Your Seller Must NEED to Sell,
Not Just WANT to Sell.

When I describe the wholesaling process to civilians and newbies, one of the first questions I get is, "Why would the owner of a property agree to sell it to you for less than you can sell it to someone else?" The reason is simple:

A truly motivated seller is a LOT more interested in the speed and ease of the sale than in maximizing the amount of money he takes home from the closing.

Yes, in perfect-world, every seller would love to get the maximum possible price for his property—and ALSO get it quickly, and without having to do much to get it, and without any complications or costs to sell.

And when a seller is not under any time pressure to sell, or has a desirable property in a desirable area, and has the money to continue to pay the holding costs that come part and parcel with owning a property, you are probably NOT his best solution. And you shouldn't hesitate to tell sellers, who aren't motivated and have no reason to be motivated, that they won't be happy with your offer, because it will be well below what they "could" get by waiting for the right buyer with the right financing, or that they'd be better off continuing to rent it than taking your offer, or that they should seek out a good agent who can market it to the maximum number of potential buyers for as long as it takes to get a price that's really going to make him happy.

Your typical seller isn't that guy.

He's a guy who has a problem that speed and ease will solve better than money will. He'll often tell you flat out that he knows he could get more than you're offering (and, sometimes, that he turned down higher offers than yours in the past, but that things have changed now), but that he just wants to stop worrying about it.

See, all real estate transactions—not just wholesale deals—are about PEOPLE, not PROPERTIES. Every deal you do will have a story behind it. Often, it's a sad story about death, or divorce, or financial ruin. Sometimes it's a happy story about a better job out of state, or a move up the economic ladder. Or it could be a comedy of errors involving a partnership that didn't work out, or a novice rehabber who bit off more than he could chew, or a California buyer who purchased a wreck of a property sight unseen on the west coast theory of "At $25,000, how could I lose?"

People sell cheap (or hold out for more money than they're ever going to get) for their own reasons. Until you've actually dealt with some motivated sellers, you might imagine that you get deals because the sellers don't know what their properties are worth, or because they aren't aware that they could get a lot more if they'd fix the house up, or clean out the last tenant's junk, or replace the roof, or mow the lawn. Or you might think that you get deals because you convince sellers of something that's not true, like that their $100,000 property is only a $70,000 property. Or that the way other people get great deals is that they've got Svengali-like skills, and sellers just do whatever they say.

None of this is true, as you'll see once you've bothered to talk to enough sellers. They ALL know that they could get more money by doing any number of things, ranging from making repairs to offering it to more potential buyers to holding off on selling it for a few more months.

Heck, I often TELL sellers they'd be financially better off by holding onto the property for a few more years, or by doing the work, or by listing it with an agent.

But a truly motivated seller doesn't care about the extra money. He cares about putting an end to the problem. If he cares more about the money than he does about the problem, he's not going to be happy with what you can do for him, and that's ok.

A big chunk of the work of wholesaling is sorting through all the deals that people want to sell to find the ones where there's a real "story" behind that desire. You'll talk to 5 'suspects' for every one who tells you a story that makes you believe he'll sell at a price you want to pay.

Motivated sellers are obvious once you've talked to a few. Here are what some of mine have told me about why they wanted to sell fast and cheap:

1. The seller lived in California, and owned a number of Cincinnati-area rental properties that he was quite happy with. However, he needed to sell one to take advantage of an opportunity in California, so he chose the one where the tenant was under eviction. Because he bought cheaply and did the rehab work himself, plus collected rents for 5 years on a free and clear house, he's one of the few sellers I've dealt with this year who actually made a small profit selling to me.

2. The seller bought a rental property from a bank 6 years ago for $35,000. He completely rehabbed it, put tenants in, then got distracted for 8 months or so by the fact that his personal residence burned down and he had to move. During this time, his tenant stopped paying rent and moved out. The house was then vandalized. Thanks to the fire, he's reevaluated his life and decided that he's not cut out to be a landlord and doesn't want the hassle of re-rehabbing it. He told me repeatedly that he understood that it wasn't a good FINANCIAL decision to sell it for $16,500, but that it was the best LIFESTYLE decision.

3. The seller recently went through a nasty divorce that left him in custody of 2 young children. He has several successful rentals on the east side of town, and one performing-but-pain in the butt rental on the west side. He sold it for perhaps 75% of what he could have gotten by listing it, because he didn't want the hassle of getting the tenants in line every time there was a showing, and didn't have time to continue to manage it and his new familial responsibilities. He bought the house in 2010 for $8500 as a shell and replaced all the mechanical systems, so I'm thinking he took an overall loss by selling it at $15,000; though again, he did pull $1,000 a month in gross rent out for a year first.

4. The seller was a caregiver for an elderly woman who died, leaving her the house they'd shared in her will. However, the house was in a neighborhood that the seller didn't actually care to live in. After trying to sell it unsuccessfully with an agent for 8 months, she decided it was time to just cut it loose for cash.

5. and 6. We were the successful bidder at a bank-owned property auction. Both houses had been listed for months and withdrawn from MLS prior to the auction.

7. The sellers bought the property from a hedge fund, apparently not realizing, or not thinking through, the fact that the quit claim deed they received gave them possession of the property subject to about $6,000 in back taxes. In the 9 months they owned it, they did no work to it (but did move in), and the taxes and penalties had increased to $8,000. They took $8500 rather than lose it—and their entire investment—to tax sale.

8-10 The seller was an older, experienced landlord who'd owned these 3 properties for over 30 years. She'd decided to cash out and pursue her retirement dream of being an artist. It took her over 4 months of trying to sell them piecemeal to other buyers who never performed (and experiencing all 3 of her tenants moving out during the same period) to decide to take our lower, but sure-thing, offer. Her original asking price was $65,000 for all 3; I paid $45,000.

11. The seller had moved from his home in Northern Kentucky to a rental in Columbus to be near family. His original intention was to rehab the Northern Ky. House and get top dollar, but an opportunity had come up in Columbus to buy a house, if he could just raise the down payment. Instead of fixing his house and selling it for market price of around $60,000, he sold it for $12,000 as-is.

12. The elderly father who'd owned the house for decades and decades wanted to move to Tennessee to be with his daughter and grandchildren, because his health was so poor that he literally hadn't been to the 2nd or 3rd floor of his own house for years. He tasked his son with getting rid of the property, which was the only thing that was, in his words, "Tying him" to Cincinnati. His son advised him to sell cheaply so that he didn't have to do any of the $25,000 in work the house needed to be truly occupiable.

I hope this helps you understand that your sellers aren't stupid, or ignorant, or suggestible. They just have life situations that mean that the property you're contracting for is a problem for them. There are hundreds of stories like these—one for every motivated seller. And you won't know what "The story" is until you ask. And you won't be able to ask until you start generating contacts from potential sellers.

So let's talk about how to do that.

