

CHAPTER 7: THE ON-SITE EVALUATION

What You'll Learn in This Chapter

1. Why on-site evaluation seems so difficult—and is so crucial
2. How you'll get really good at on-site evaluation
3. Some basic, important stuff to make sure you look at
4. How to get “prices” on common repair items, and what to do when you can't

Are you starting to see why the ‘Education Mills’ have it all wrong?

Wholesaling isn't no work.

It's not true that you really don't have to know that much.

That's not true about ANY real estate strategy, and it's not true about any money-making venture that consistently produces a high income. Jobs that require a low level of knowledge and practically no skill pay, rather infamously, extremely low wages to the people who do them.

What IS true about wholesaling is that, unlike in more complex strategies like retailing or landlording, you have to know a moderate amount about a small number of things, including how to find potential deals, talk to sellers, find after-repaired value, and inspect a property to determine basic repair costs.

This is REALLY intimidating for a lot of new wholesalers, especially those that don't have any background in the building trades.

They act as if a house is an impossibly complex system that could be hiding major flaws that might result in the house being fatally damaged in some way. They act as if repair costs are a barely-definable expense that can vary by tens of thousands of dollars.

I totally understand where these ideas come from, and how they can take root. You hear stories about rehabs that went \$20,000 over budget, and about the house that looked fine until the kitchen was demolished, at which point the back wall of the property crumbled into dust from a heretofore undiscovered termite infestation.¹

One rehabber will brag about how he renovated an entire house from basement floor to rooftop for \$7,000, while another tells you that if you're estimating less than \$40 per square foot to rehab a house from top to bottom, you're just not allowing enough for labor and materials.

One buyer will look at your deal and tell you that you're off by 100% on your rehab costs, and

¹ That last one was me. However, it only increased the rehab budget by about \$4,000, which was easily covered by the fudge factor we'll discuss later.

another, equally experienced, one will look at it and congratulate you for being so very dead-on in your estimate.

This seeming randomness can be absolutely disheartening. And it may be why so many so-called wholesalers are so bad at this incredibly important part of the job; why bother to study something that doesn't seem to have a 'right' answer?

Let me bring you around again to why learning how to inspect and estimate costs is important and why it WORKS:

1. **While it's absolutely true that expensive problems with houses are sometimes 'hidden', it's extremely RARE.** Most expensive problems—those involving the foundation, structure, or mechanics of a property—leave observable signs even when you can't directly see the problem. A broken sewer line backs up, which leaves stains around the floor drains. A termite infestation usually has some visible traces in the form of "tunnels", and even hidden damage can usually be observed by looking for bulging walls, sloping floors, soft wood components, and so on.
2. **Even if you miss these signs, it's less likely that your typical experienced buyer will.** Because you're a wholesaler, you always have at least 2 sets of eyes—yours and at least one buyer—looking for problems. If you don't see the signs, your buyer probably will, and because you're smart enough to have an inspection contingency in your contracts, the discovery of a problem big enough to kill the deal also lets you out of the deal without risk or loss.
3. **If EVERYONE misses the signs, chances are that the problem was not discoverable, and a typical experienced buyer is unlikely to blame you for that.** I once sold a house to a buyer that had a wooden porch with no easy access to get underneath to inspect it. During the rehab process, the buyer happened to pull up a couple of the boards, only to discover that the supporting joints were largely termite-eaten. Although there were no visible signs of the problem, no problem elsewhere in the house, and none of the usual 'sponginess' one might feel when walking across a porch with a failed structure, it was a problem that cost him \$2,500 to fix. He did NOT come to me to blame me for missing a problem that no one saw; that's something civilian home buyers, not professional rehabbers, do. He didn't ask for any money. He simply fixed the problem and made a little less on that deal than he hoped.
4. **We can't, and don't try to estimate what repairs might cost for every possible buyer in every possible scenario.** The reality is, different buyers do different repairs with different materials and different labor costs. Most experienced investor/buyers will estimate their costs for a particular property within 5-10% of one another; in other words, if the average cost at which several buyers would put a particular renovation is \$50,000, the variation between the different buyers would be perhaps \$45,000-\$55,000. Any cost estimate far below or far above that average would be the result of something that made the buyer an 'outlier'; the buyer who says he can do that job for \$20,000 is either doing a lot of the work himself, or not doing all the work that a typical buyer would do. A buyer who says the job would cost \$60,000 is either not doing a good job sourcing his labor and materials, or is planning on doing more work (perhaps adding a room or creating an open floorplan) than is strictly 'necessary', but which should also increase the ARV of the property.

Your job isn't to create a deal that every buyer, working under every scenario, will like. It's to create a deal that a TYPICAL experienced buyer will like. That means that when you inspect properties and estimate repair costs, you look at what an AVERAGE buyer will do to the property, and what he will pay for labor and materials. That's the number you use when putting together an offer.

A lot of the 'wholesalers' you see who put seemingly ridiculous numbers on their repair costs ("It needs a kitchen 2 baths, a furnace, central air, windows, paint, carpet, and landscaping, so \$10,000 in work") will explain themselves by saying that they sell to buyers who do their own work, so it's OK to be selling at a crazy high price, because, you know, their buyers don't spend as much. This is a huge mistake both because buyers like that, who can also pay cash for a house, a few and far between, AND because buyers like that quickly learn that their labor DOES have value, and that to pay more for a house because they're the ones spending 100 hours physically doing the rehab basically means they're doing \$40 an hour work for free.

Doing this right—aiming your repair estimates at the middle of the bell curve of experienced buyers' costs—means that you'll have the maximum number of potential buyers.

Inspecting the Property

The next step in your evaluation of any property is to inspect its condition. **The purpose of your inspection is:**

1. To evaluate the overall condition and desirability of the property
2. To decide whether the individual mechanical components of the property are functional
3. To determine which mechanical, structural, and cosmetic items might need to be repaired, replaced, or updated

It's not necessary to be a professional inspector, or even to understand how all the parts of a house work, in order to do an adequate inspection. As time goes by, you'll learn more and more about how to identify subtle signs of hidden problems, but with a sharp eye, the willingness to take a little time, and a few inexpensive, easy-to-get tools, you'll be able to find 99% of the major problems a property might have.

In case you're still worried about the inability on your part to do a good inspection on a property, remember that your purchase contract will have an inspection contingency for the express purpose of allowing your buyer to do his own inspection. If the buyer turns up a problem that you were unaware of, and it turns out to be a major and/or expensive repair, your inspection contingency will allow you to "get out" of the contract without even losing your earnest money. So do the best, most thorough inspection you can, but don't get paralyzed by the fact that you might have missed something.

There's a set of inspection tools that you should expect to have with you anytime you inspect a property. It's easiest just to keep them in a bag in your car that never gets removed. These tools would include:

- A powerful flashlight (the one on your phone is probably powerful, but doesn't give you the viewing radius of something like a maglight. Plus, that light drains your battery crazy fast, and you don't want to be in vacant properties without a working phone)
- An awl or penknife to check for rotten wood
- A digital camera (the one on your cell phone may be adequate, but if you're taking pictures for the purpose of advertising the property to buyers, you'll want the ability to take wide angle shots)
- A pen and clipboard
- A good inspection sheet.

A "good" inspection sheet is one that is easy to follow and reminds you to look at EVERYTHING about the property. Many a deal has been lost because the wholesaler, fascinated with the seller's antique furniture, has gotten so distracted that he forgot to pull the curtains aside to look at the condition of the windows. The buyer quickly discovers that the house needs \$3,000 in new windows that the wholesaler didn't estimate for, and POW! No more profit for the wholesaler.

The inspection itself should include all of the rooms of the property (including the basement and attic, if present), all of the major systems of the property (heating, cooling, electrical, water and drain lines, and roof), the structure of the property (foundation, exterior walls), and any outbuildings (garages, sheds).

The most expensive and complicated problems to fix will be structural, followed by mechanical, followed by cosmetic. So although the ugliness and smelliness of a property might be overwhelming, they are also the most minor problems to overcome in the overall scheme of things.

Explaining how to do an inspection in the context of a MANUAL (as opposed to actually being inside a property) is a challenge I haven't figured out how to overcome.

Nonetheless, there are some things you should make SURE you look for, and at, when you are actually inspecting a property.

What to Look for When You Inspect²

The first key to doing a good wholesaler inspection of a property is just to LOOK at everything. You'd be amazed at what a hurdle this is for some people; because there's so much to look AT, I often have to tell mentoring students that they've missed a \$5,000 issue that was glaringly obvious, because they didn't walk around the back of the house, or didn't look up, or down, or whatever.

If you can discipline yourself to a) Carry and actually look at your inspection sheet, and make sure that all of the lines are filled in (even with n/a) before you leave the property, b) do what you need to do, including pull back rugs and window shades, move things that are against foundation walls, pick up

²*An excellent book for the wholesaler who wants to learn to become really adept at inspection is The Complete Book of Home Inspection, by Norman Becker, Tab Books. \$ 19.95 in bookstores or at Amazon.com. Easy to read, complete with photos, covers every system. Includes explanations of how things work. One of the best books I've ever seen on the topic.*

random sheets of plywood you find in the yard (they're often covering something), and c) walk the property in the order below, you'll get to most of what can be gotten to in an inspection.

1. First, stand across the street from the property, looking at the roof (if visible), the overall impression the property gives, the properties around it, and whether the exterior walls look "true".
2. Second walk the ENTIRE perimeter of the property (yes, even if there are weeds and snakes and God knows what) TWICE: once looking at it from your eye level and below and the second time looking above eye level at the gutters, soffits, windows, etc.
3. Once on the inside of the property, go straight to the basement or the utility room/closet, and check on the expensive things (heating, electric, etc) before moving on to the interesting things (kitchen bath etc)
4. In each interior room, do the same check as the exterior: eye level and below to see the condition of the flooring, baseboards, outlets and so on and then above eye level to see the ceilings, wall condition, signs of water damage etc.

Specific problems that you're looking for include:

Foundation: Foundation problems are the most expensive problems to fix AND the hardest to get buyers to tackle. Examine the foundation carefully inside and out.

- What type of foundation does the property have? For instance, poured concrete, concrete block, stone
- Are there any vertical cracks (in a concrete foundation) large enough to put a dime into edgewise?
- Are there "step" cracks in a block foundation?
- Are there any inward or outward bulges in either type?
(The above can signal major movement in the foundation and a potential foundation "problem")
- Are there signs of excessive water leakage through the foundation? This would include discoloration on the walls, or tracks of water on the floor, or, in extreme cases, soil inside the basement.
- Are there any signs of settlement (slanting floors, window or door trim at an angle? Space between the floor and the baseboard trim?)
- Has part of the foundation been obviously repaired (or covered up) recently?
- Are there any parts of the foundation that you can't see from the inside due to "stuff" piled against it?
- Are there any floor jacks present in the basement? (these will look like metal posts with a screw at the top, and are used to support joists that have bowed or failed)

Structure: Another "big deal" item. Few buyers are willing to mess with properties that have structural problems. Most structural problems are the result of foundation movement, pests (termites, dry rot, etc.), flooding or excessive moisture, or, of course, fire.

- Are the exterior walls in good condition? Are they bulging inward or outward?
- Are the exposed joists in the basement solid? Is there any discoloration? When you poke it with your awl, does the awl go in no more than a fraction of an inch?
- If the exterior is brick, are there step cracks where the mortar is cracked? Is the surface of the brick still solid, or is it worn away?

- Have any of the exposed joists been cut to make way for furnace ducts? (Small holes are OK)
- Is the “main beam” (a wood or metal support present in most house over 25' wide) solid?
- Are any exposed roof joists solid? Are they true? Is there any sign of exposure to water?
- Are the window and door frames true? Do the windows and doors open and close easily?
- Examine the baseboard in every room. Are there places where the floor drops away and leaves a gap?
- Are there any signs of pest infestation in the basement joists? What about in exterior wood? (Look particularly at wood that comes in contact with the soil)

Roof & Gutters: Replacing a roof can cost a lot or a little, depending on the condition of the wood beneath it, how many layers of shingles are already on it, the number of floors the house has, the pitch of the roof, how complicated it is, and what it's made of. Gutters are a particular problem in a lot of the country; it's the gutters that are intended to carry the water away from the property, thus avoiding damage to the exterior and potential foundation problems.

- (All roofs) Does the roof have a constant slope, or is it wavy?
- (All roofs) Are there signs of water inside the property?
- (Asphalt roofs) Are the shingles flat, or curled at the ends? How many layers of shingles are there?
- (Metal roofs) Has the roof been maintained and painted or tarred regularly? Or is it rusty?
- (Slate roofs) Are many of the slates broken or missing?
- Are the gutters intact? Are there signs of water running down the side of the house anywhere?
- Are the chimneys in good shape? Are they leaning or missing a lot of mortar?

Electrical System: Many of the older houses you'll inspect will need at least some updating of the electrical system to handle today's electrical demands. This is another common item that makes buyers nervous.

- Does the house have 220 volt service? (If the electric service wire coming into the house is overhead, check to see how many wires are connected to the weatherhead: 2 wires = 110V service, 3 wires = 220V) If not, it won't handle central air or other major appliances.
- What is the amperage available at the service box? (Most of the time, there will be a large main switch at the top of the electric box with a number on it. Any number less than 60 is definitely inadequate.)
- Does the panel box contain fuses or “Pushmatics”? Is it a Federal Pacific Stab-Loc box, which are known to cause fire? Your buyer will probably replace it.
- Is there visible knob and tube wiring? Or a grounded, insulated wire system like Romex? (Knob-and-tube consists of 2 separate wires running in parallel through ceramic “tubes” placed every few feet—insulated wire looks like one wire)
- Are there enough outlets in each room? Are they located in the walls, or on the floor?
- Do kitchens and the bathrooms have Ground Fault Circuit Interrupters? (Outlets with a “reset” switch)
- Are there overhead lights in most of the rooms?

Heating/Cooling

- What type of heating system does the house have (gas forced air, gas gravity, oil, boiler, heatpump, electric baseboard), and is it appropriate for the climate?
- How old is the boiler or furnace?
- (if a gas forced-air furnace) is the furnace high-efficiency (more than 90% efficient)?
- Are there any signs of damage—i.e. rust, dents, etc—to the boiler or furnace?
- Does the house have central air? Are there signs of damage or neglect to the outdoor compressor?
- Does the house have window A/C units? Will they stay?
- Does the house have space heaters? These no longer meet code in most of the country.
- Check every room for heating registers or radiators, especially attic rooms and rooms in converted porches or garages.

Plumbing

- Are there water pipes in the property?
- What are the water pipes made of? Are they a mix of materials?
- Are there any signs of rust, corrosion, or dampness in the water pipes? Check joints carefully.
- Are there any waterlines that are broken off, or end suddenly with no “caps”?
- What are the drainpipes made of? Is there any sign of corrosion?
- Examine the sinks, tubs, and toilets carefully. Are they leaking underneath or behind them?
- Is the water meter connected? Are there signs of leakage around it?

Kitchens: Modern, attractive kitchens and baths sell (or rent) a home. When the best use of the property is to re-sell it, most kitchens and baths that are more than 15 years old or so will be replaced by the buyer, even if they're in good working order. When the best use is to rent the property, the standard is attractive and functional, not updated.

- Are the cabinets attractive? Are all the doors, drawers, and internal shelves present and accounted for? Could they be made good looking with new doors, or hardware, or paint?
- Are the counter tops modern and unblemished?
- Is there enough storage for an average family?
- Is the floor clean (or cleanable), intact, and attractive?
- Is the lighting attractive and adequate?
- Does the sink look good? Does it drain properly? Look under the sink. Are there signs of leaking/water damage?
- Will the buyer have to replace the appliances: oven/range, refrigerator, microwave, dishwasher?

Baths

- Are the fixtures attractive and intact? Is there a shower?
- Does the medicine cabinet have storage, a mirror, and lighting?
- Is the area around the tub/shower undamaged? Is the tile or vinyl intact and clean?
- Is the vanity in good shape? What about the sink/counter top?
- Is the floor solid? Is the floor covering attractive?
- Do the drains run freely? Does the toilet flush?

Misc. Interior

- How much patching, painting, and decorating does each room need?
- What is the flooring—hardwood? Softwood? Laminate? Tile? Carpet? Linoleum? Is it attractive and is it fit to current tastes? What will it take to put it in good condition?
- Are the windows tight-fitting? Do they have storm windows? Screens? Are they insulated? What is the construction—wood? Metal? Vinyl? Do they go up and down? Is there condensation, or signs of condensation, between the panes?
- Is there going to be extensive cleaning and/or removal of personal property necessary?

Misc. Exterior

- Would the property benefit from vinyl or aluminum siding?
- Does the trim need to be painted? What about the porch? Are any decks and balconies in good shape?
- How much landscaping needs to be done?
- Are the sidewalks, driveways, steps, retaining walls, and patios in good shape?
- Are any outbuildings in good shape, or at least salvageable?

Estimating Repair Costs

“How do I estimate repair costs” is one of the most common, and difficult-to-answer, questions that wholesalers (and new investors of all descriptions, for that matter) ask.

It's difficult to answer, because I can tell you from long experience that repair costs vary widely in different parts of the U.S.

Sometimes, it's due to differences in climate and codes relating to climate (a roof in Florida costs roughly 3x what a roof in Cincinnati does, because it requires tie-downs to make it more hurricane-proof. On the other hand, single pane windows are rarely replaced in Florida, if they're intact, and would ALWAYS be replaced in Cincinnati, because it gets really cold here).

Sometimes, it's due to differences in cost of living and prevailing wages (it's more to replace a roof in New Jersey than Cincinnati because roofers make more); sometime it's differences in local law (if your city requires you to use more-expensive low-flow water devices, your bathroom will cost more than mine); sometimes it's differences in regional construction (Phoenix is home to thousands of stucco houses, Cleveland very few).

So, while I've included a 'starter' list of repair costs that might be dead-on for your city if it's in the Midwest, the reality is that you need to use this list as a jumping off point to create your own, local list of costs.

Let me add something important enough to put in its own text box: while one of the skills you need to develop is a good grasp on basic repair costs, the fact that you're pretty sure, but not 100% sure, you have it right on a particular property shouldn't keep you from going forward with an offer.

Remember that, if you're using the right contract, you always have an "out" in the form of your inspection clause. If every cross check you do on your repair estimates (meaning several potential buyers confirm that they're 'off') tells you that you underestimated the cost (overestimating is NOT a problem, since it means you offered 'too little', and you'll sell the deal for sure), you'll simply let the seller know that the property failed inspection and that you need to talk about a new price, or void the contract.

Eventually, much of your knowledge about the costs to make repairs will come from experience³. But this doesn't help much when you're trying to estimate the cost of a whole-house rehab for the first time. So here are a few resources you can use to get the facts and figures you need to complete this part of your mission.

1. **Use colleagues.** Far and away the best way to find out what people in your market are DOING to properties, and what they're PAYING for it, is to ASK them. This practice does a lot of things for you: it forces you to actually talk to other investors (and gives you a really good excuse for doing so); it gets you a clear idea of LOCAL rehab practices and costs; and it keeps you abreast of changes in costs as inflation, shortages, weather disasters, trade wars, and other uncontrollable, but inevitable, stuff happens.

It works like this: you pick out one (or more) of the items listed in the attached "Basic repair costs" guide and approach a few members of your local real estate association. Ask them if they think \$x or \$x per linear foot or \$x per square sounds about right for your area. Be aware that you'll hear a range of prices, because different rehabbers have different connections, but you'll soon see that there's a range that you can simply average to get to roughly the right number.

2. **Use contractors.** This is one of the most common thoughts that new investors have about getting a grip on costs; after all, contractors do the very work we're trying to estimate every day, right?

First and very importantly, let me say that this strategy and the next are things you should do only AFTER you've made your best guess, made an offer, and have the property under contract. Walking contractors and colleagues through every property that's a POTENTIAL deal is time consuming for both you and them, and will slow down your deal flow significantly.

³ *When you're ready to really, really learn how to think like your rehabber/buyers, I strongly suggest Jerry Fink's "Rehabbing Right for Rental or Resale" home study course. It's cheap, it's complete, and it's awesome. Find out more at www.regoddess.com*

While a contractor estimate can be another clue to rehab costs, don't depend on it 100%. There are several reasons for this: first, contractors are actually notoriously bad at estimating costs. Rehabbers will tell you that THEY, the rehabbers, have to become experts so that they can TELL their contractors what they're willing to pay. Otherwise, the contractors bid \$x for the job, get halfway through it, and then tell their client that they can't do it for less than \$x+\$y because they mis-estimated the time and people involved. Second, some contractors have a strategy of bidding jobs low to get the job, then adding change orders to bring the price up to what they really need, and some have a strategy of bidding really high and doing it often enough that some clients will take that price. Add to that the fact that most contractors are specialized and only know what it should cost to do the roof and gutters OR the kitchen and bath OR the furnace and air, and are only guessing at everything else and the fact that in a hot market, contractors can take weeks to even get to a bid, and you see the full scope of the limitations.

This is a good option really only if you have a relationship with one or more contractors who do the sort of work you're trying to estimate. If they're a friend or relative, or you're a big customer of theirs, pay them to come and give you a quickie bid on the job. I say pay them because chances are they won't GET the job—your buyer will probably have his own contractors—and it's not really fair to waste the contractor's time without paying them.

3. **Pay fellow investors to walk through deals under contract with you.** As with the appraisal, this is something you'd do only as a re-check when you already have a property under contract, and need a 2nd set of eyes to confirm what you already think you know. If there's an experienced investor/renovator you respect, offer to pay him some reasonable fee—maybe \$50-\$100—to walk through a property or 2 with you and help you with repair costs.

However you come up with your final figure, there's one more step to take—and that's adding a “fudge factor” to take into account: 1) all the little things you didn't bother to estimate (like new switch plate covers, light bulbs, and all the other miscellany that adds up over an entire rehab job) and, 2) the fact that, in most really ugly houses, there will be additional problems that only come to light when the construction starts. All smart rehabbers—and remember, these are your buyers—insert a fudge factor, so you should, too. I find that most of my buyers use fudge factor of 3% to 10% of the ARV. The rule of thumb is:

- If the property is occupied (so that there's someone who can tell you about things you won't be able to see, like non-working outlets and slow drains), AND you can see all the systems, 3-5% is enough
- If the property has been recently occupied (so that you can be pretty sure that it's at least livable) and you can see all the systems, 5-7%
- If the property has been vacant for a long period of time, or is a “hoarder house” (you'll be surprised at how many of these you see) and you therefore can't see everything, or it's just a property that looks like everything needs to be touched (and therefore you're pretty sure that there will be issues like bad plumbing that you can't really see), 10%

Once you've come up with a repair estimate, you'll be able to move on to the next step of calculating an offer. But before we get completely away from the topic of estimating repairs, let me warn you about a phenomenon that you will run across when offering your property to buyers.

Even when you become an experienced estimator, you will find that your evaluations of which repairs should be made and how much they'll cost will be different from those of your buyer in almost every case. That's because different buyers have different sources and resources, and do different things to any given property.

Having any given buyer disagree with what **SHOULD** be done or how much it will cost isn't disastrous—you won't lose his respect because you'd paint the kitchen cabinets in a rental and he always replaces them. In fact, when you get good at estimating repairs, you'll generally find that the costs your buyer estimated and the costs you estimated are within 10% of each other, even if you got to them in different ways.

For example, I have a buyer who **ALWAYS** figures on replacing the windows in a rental property, even if they're awesome, unpainted, wood windows with storms and screens in good shape. But he **NEVER** replaces a working furnace, even when the existing one is an 85 year old coal conversion unit. He and I **ALWAYS** disagree about this, but he still buys my properties because they're really great deals.

What **IS** disastrous, is when you flat-out miss or clearly have no idea what the cost is on an important repair. Tell the buyer that the foundation "is fine" when in fact it's bulging inward by 2', and you're probably done with that buyer forever. Tell him that it's going to cost \$1,000 to fix it, and you're just as dead in the water.

The moral is, if one buyer disagrees with your repair estimates, it could be that you were wrong, or it could be that he's paying too much for repairs, or that he's just trying to negotiate with you. When 3 buyers disagree, it's time to rethink your offer.

And speaking of offers, let's discuss how to make yours.