HOW TO BUY
A Wholesale Deal
WITHOUT TAKING A BATH

SPECIAL REPORT

How To Buy Wholesale Properties & Not Take A Bath

- ✓ Determine the right price to pay
- ✓ Learn the secrets to successful negotiating on wholesale deals
- ✓ Discover what the wholesaler is really thinking
- ✓ Make informed decisions to buy the right deal

Introduction

When referring to buying wholesale properties from an investor, it is often commented: “Buyer Beware!” The feeling is that many of the wholesalers in the field are unscrupulous, and will take advantage of unwary buyers. The truth is that most wholesalers are very ethical and provide a valuable service. The trick is to be able to evaluate each deal to make sure it is profitable for YOU.

Don’t allow the fear that a wholesaler may be unethical deter you from buying wholesale deals. Think about it, when you are dealing directly with a motivated home owner, do you know if he is ethical? Of course not. So to protect yourself, you must know how to fully evaluate a prospective lead, then purchase the deal that makes sense. So how do you evaluate a deal?

First of all, you have to look at a wholesaler just like any other home seller in the field. No better, no worse. You don’t try to buy a house from a homeowner, and ask the homeowner to tell you whether it’s a good deal or not. You expect them to advertise the best points, and you'll determine, based on your own criteria, if it makes sense or not. You should approach wholesale buying the same way.

When you receive a wholesaler's ad for a property, your first job is to determine whether to pursue it further or not. In other words, quickly weed out those that do not meet your investment criteria. For the purposes of this task, it is OK to assume that all of the data provided is 100% accurate. If you are not interested in the deal at this point, there is no need to validate any of the data.

On the other hand, if the property does meet your criteria, then verify all the information, apply your own formulas, and create the offer that makes financial sense. I know that this should go without saying, but always visit the property before making your offer. Believe it or not, many investors buy sight unseen, then later discover the property wasn't what they expected.

If you follow these steps you will no longer be at the mercy of the wholesaler or any other seller. You'll be able to evaluate the deal for yourself, picking and choosing the ones that make the most sense.

Determining Values

The first thing to do is verify the ARV (After Repaired Value) of the property – in other words, the market value of the property after it has been renovated. Someone told me recently that they didn't believe the ARV listed in another wholesaler's flyer because the house in the picture didn't look like it could support the value listed. Frankly, that's a ridiculous method to evaluate a deal – and I assume it comes from fear of not knowing how to determine the true value of the property. The only accurate measure is to see what other similar houses have recently sold for in the area. The "eyeball' method is dangerous and could lead to either under or over estimating values.

I have been amazed at some of the prices at which I have sold relatively small houses. It I had eyeballed the house, I would have said that it was worth half of the price. But by studying the market, I knew what the real price would be. Often, it's all about the location. The only way to determine the ARV is to look at comparable sales (commonly referred to as "comps") for the area.

Any wholesaler worth his salt will give you the comps used to determine the ARV (if they don't I would question how they determined the ARV in the first place). The first thing you want to look at is how far away they are from subject property, and how old they are. Appraisers allow properties as far away as 1 mile and sales as far back as 1 year. As much as possible, do not exceed ½ mile distance and 6 months from sale date.

Next, drive by the comps. Compare them to the subject property you're evaluating. Is the neighborhood – or even the street – the same? For instance, if the subject house is on a street with several boarded up properties, and the houses that are inhabited are all run down; but the comp is on a beautiful street full of rehabs, then it is not an accurate comp.

The same is true for evaluating the house itself against the comp. Are they basically the same house? Obviously the comp is going to look great – it has probably already been rehabbed. That's OK because you're trying to figure out what the subject house will be worth AFTER rehab as well. But is the construction essentially the same? You can not compare a small frame, plain-Jane cottage with no architectural design, to a huge brick multi-dimensional mansion – unless you've calculated enough in your rehab to get your subject house to look the same when it's done.

What you want in a comp is similar size, similar number of bedrooms and baths, similar design, same frame or brick, etc. to what your home will look like when you're done. I've bought houses for rehab that did not look like the comp when I bought it, but I knew that it would after the rehab because we would add a bath or a bedroom, and would change the façade of the house. The key was that my renovation budget reflected that as well.

Sometimes, there are no houses that are exactly like the one you're evaluating. That doesn't mean that you can't use the comps at all. It just means that you have to make a ARV price adjustment. Think of yourself as the ultimate homeowner. How much of a price drop will it take for them to buy your house over the competition if your house is different? How significant is the difference? For instance, a house on a very busy street will require a significant price decrease to sell as compared to the houses on the interior streets of a subdivision. On the other hand, a fenced yard vs. no fence will have little effect on the values.

The acid test is to stand back and think about the final owner occupant that will be looking for a home in the area. Would any price concessions be necessary to motivate them to select the subject house over the others on the market?

Don't rely solely on the sales data provided by the wholesaler. Obtain your own, more comprehensive list. There are several national companies to which you can subscribe that provide local sales date (www.SiteXData.com; www.RealQuest.com). You can also ask a realtor to pull comps from the Multiple Listing Service (MLS). There may be a fairly wide range of prices. Throw out the extreme highs and the extreme lows. Focus on the price range where most houses sales are clustered.

You can take this one more step and look at trends. Look at all of the houses currently listed on the market. How long have they been on the market? Are they priced higher or lower than the ARV you've determined? If they are lower, it may mean that values are starting to drop. If they are all higher, then it means that the value is stable – maybe even increasing. But do not raise your ARV based on "listed" properties. This only provides you with trends. Better to leave your ARV alone based on sales history, and be pleasantly surprised at the end of the project when it is worth more than anticipated.

With all of this work accomplished, you will KNOW the correct ARV. You'll no longer have to wonder whether the wholesaler properly evaluated it. OK, but still, how do you know the right price to pay?

Calculating The Maximum Offer Price

Whether buying from a wholesaler or from the original owner-occupant seller, the price you can pay is the price that makes financial sense. The asking price is completely irrelevant. You must know the right price to pay before you start negotiating. The formula I use is:

ARV – Repairs – Buy/Sell/Hold (B/S/H) Costs – Profit = Maximum Profitable Offer

You already understand how the ARV is determined. Repairs are a little more difficult, because everyone has a different list in their head of what needs to be done, how elaborate the work needs to be (EX: tile vs. linoleum; carpet vs. hardwoods; Corian vs. laminate), and the cost of the contractors to do the work. Wholesalers attempt to determine a fair, middle of the road figure to advertise, but truly, it's meant to be a guide, not an absolute. You have to determine your own repair estimates after viewing the property.

B/S/H costs consist of:

- All the costs associated with the purchase of the property: title work, attorney's fees, title insurance, survey, loan origination fee, appraisal, etc.
- Costs associated with the sale of the property: closing costs paid on behalf of the purchaser; realtor commissions or marketing costs, home warranties offered
- And the costs to hold the property: debt service (mortgage payments), property taxes, hazard insurance, and utilities.

Each renovator's costs will vary from about 12% up to about 21% of the final sales price. A good average to use is about 15% of the ARV. It could be higher or lower for you based on the cost of money, and how you plan to sell your house. But as a rough gauge, the 15% rule seems to work.

Plugging in the profit is the fun part of the formula. How much do you want to make from this deal? Of course, we'd all like to make $100,000 on every deal, but we'd seldom, if ever, have an offer accepted if we always plugged in that number. I recommend that you plug in the minimum amount that you would accept and still be happy. If your offer is accepted, you'll be happy with the profit; and if the offer is not accepted you won't be upset that you missed the opportunity because you held out for too much profit. Keep in mind however, this is the maximum price that you should pay for the property. But there's still one more step…

Negotiating

Unlike dealing with the grocery store, you can negotiate on price. The wholesaler has a spread and a profit requirement that he can work with as well. The trick is to negotiate the best deal where both sides are happy. Let me tell you how it works from the wholesalers' point of view. If we have a hot property, and a lot of interest, we're not too negotiable on price. In fact, I often receive and accept offers above my asking price. If the property hasn't had too much interest, we're far more negotiable. It's the economic law of supply and demand.

If you determine that you need to buy at a price lower than the wholesaler is asking, submit an offer. If nothing else, it at least starts the negotiation process. I've had buyers offer less than I paid for the house – so obviously I pass. But I often make a counter offer with a price that I could accept. The risk of making too low of an offer on a great deal is that the wholesaler may simply accept another offer without ever offering you an opportunity to counter offer. Bottom line, be fair and up front, and it will work out for the best. But always make an offer on a house you're interested in purchasing. You never know. You offer may be accepted!

How Much Profit Should The Wholesaler Make?

Sometimes it may seem that the wholesaler makes a lot of money for taking none of the financial risk and without doing anything to the house (usually not even taking title). But you have to remember the marketing effort that goes into attracting the motivated sellers, and the time requirement to sift through all of the deals, visit all the houses, negotiate all the deals, to find the few that provide significant profit for both parties.

I’ve purchased numerous wholesale deals in my career. I’ve never cared what the wholesaler made because I negotiated a deal that worked for me. Regardless of what the wholesaler made, I was happy with my profits. I didn’t care if he made hardly any profit, or if he made a huge profit. It was irrelevant to my calculations. If you can purchase at a price that makes financial sense, the wholesaler’s profit should not matter. If it is large, that just means that he did a good job locating and negotiating a great deal which made it possible for you to have this opportunity to make money from the deal.

Remember, do your own due diligence. Review the comparable sales. Make sure they are truly comparable to the subject property. Drive by each one. Get a feel for the neighborhood, and what you plan to do. Determine your own costs. The wholesaler is providing an average. Your actual costs may be higher or lower. Determine the price that works for you, and then negotiate your best deal. When you follow this process, you’ll never worry that someone has taken advantage of you because you’ll know for sure that the deal is profitable.