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Hosted by: Doug & Andrea Van Soest

Episode 3 – Is it a Deal?

Doug: Welcome to the *Spouses Flipping Houses* podcast with Doug and Andrea Van Soest.

Andrea: A podcast about real estate investing, business, entrepreneurship, and balancing it all with someone you love.

Doug: Hello and welcome to *Spouses Flipping Houses* podcast. This is episode 3. We are super excited to have you with us today. Really excited about our topic. Good morning! Andrea, how are you doing?

Andrea: I'm good. How are you?

Doug: I'm doing really good. Almost through my second cup of coffee. By the end of that cup, I'll be doing excellent. So we've got a great topic for you today. One that I'm really excited about and is near and dear to my heart especially because I'm a former certified appraiser in the state of California and the topic is "How Do I Know if it's a Deal". Deal Analysis. What is a deal and what isn't. We're going to dive into

that in a little bit, but before we do that, what's going on in our business this week, Andrea?

Andrea: Well, we are getting ready to list two houses, probably tomorrow. We finished the rehab on them last week. The photographer just went out there over the weekend and I just got those photos back. So we're going to get those listed, hopefully tomorrow, and we are starting rehab on two new flips that we're going to be doing.

Doug: Big rehabs.

Andrea: Big rehabs, yes. So we just walked those properties with the contractor and kind of made a plan of how we're going to rearrange walls and everything structurally that needs to be done and changed and everything so that we get going on those two. Those are going to be pretty exciting before and afters, I think.

Doug: The two we're just about to list were on the other side of that. They were more carpet, paint, countertops type of rehabs which are easier, quicker, but not necessarily better or worse, just different for those houses.

Andrea: Cool. Okay, so let's get into it! Today I'm going to interview Doug and ask him a few questions. We're going to pick his brain on his appraisal knowledge. I think this gave us a lot of confidence getting started in real estate investing. Just knowing from an appraiser's perspective whether or not it was a deal. So, first question. Doug, how did you get started as an appraiser?

Doug: Well, if you'll remember when we were in San Diego, we had moved back, we had sold our kettle corn business in Colorado. We moved back and we wanted to get into real estate investing somehow.

And we read a book by a guy by the name of John T Reed about getting started in real estate investing, and one of the things he recommended doing was get yourself a career in real estate. Just to kind of learn the lingo, the business, kind of how real estate works, whether it be mortgages or as a realtor or an appraiser or other things like that. And you actually had the idea of becoming an appraiser and I sort of stole your idea.

Andrea: Well, I got pregnant, too.

Doug: Yes, there was a lot going on in life at that time. I was working two or three jobs just to get by and do what we needed to do. And Andrea came up with this idea of becoming an appraiser, started researching it, found out that I could get all the educational training I needed in about thirty days with an online course.

So I did that. Went to the coffee shop every day, studied, took my test, had my certification education done, and then literally just got on the internet and started researching appraisers in San Diego where we were living.

And started calling everybody in the book, just going down the list, calling, "Hey, I'm licensed. I had my education done. I'm ready to start learning. Do you have any room?". Nope. Nope.

Probably went through thirty or forty names calling before finally I reached somebody who said, "Yeah, I just left this one office. You might try calling this other guy. I think they're looking for somebody". She gave me his number.

Called him. Went down. Got hired as a trainee which is what you do in the appraisal world. You become a trainee first and start working as an apprentice. So that was 2003. So that's how we got started and I

was full time as an appraiser from that point until we started flipping houses.

Andrea: And I would definitely say that not everybody needs to go get a full-time job in a real estate venue to get started in real estate investing. But we were in San Diego, a market that was way too expensive for us to get involved in anyways.

The market was going up, prices were going up like crazy and everybody was already starting to speculate that, oh, this could be a bubble. So it wasn't really a time at the place in life that we were for us to jump in. So getting a job just made sense. Getting a job in this world.

Doug: In the field isn't a requirement, but not a bad way to go if that's something you want to do. It's good way to kind of learn. So, that was how I got into it.

Andrea: Okay, so then you were an appraiser for several years, became certified, that sort of thing.

Doug: I got my actual license about a year later and then I became certified maybe two years after that, and those are just different levels of the appraiser license. But literally we worked on our own as our own independent appraisal company from 2004-2010.

Andrea: And pretty much all over southern California, so he appraised everything from the border of Mexico all the way up through LA.

Doug: Through LA, yeah.

Andrea: And that was a great experience. So Doug, from everything that you've learned, what are some things that determine the value of a house.

Doug: Well, good question. There's a few things that are super important. Obviously location. Location would be the number one thing. You can't compare a house in one city to a house in another city. It's just a different area, so location is number one. Size. Bedroom count. Age. Condition of the home. Those are all key areas that determine the value of a house.

But really the thing that you need know as an appraiser or as an investor when you're determining a value is what are the comparable homes selling for. The "comps" as we call them. "Comps". It really determines what your home is going to sell for when you can compare all of the different features that your home has to a house maybe down the street that sold last month. What does my house have versus what that house has and you can add or subtract value from your house based on what that home sold for and compare.

Andrea: So how would somebody go about finding comps if they are not a realtor or an appraiser?

Doug: In this business, you really need to get access to the MLS. MLS for those who don't know is the Multiple Listing System, or Service depending on where you are. Most areas have their own local MLS system for your market area. The people who generally are given access to that are going to be a realtor, someone who has a real estate license, like a mortgage broker, or an appraiser. Those three licenses will give you access, legally, to the MLS.

There are other ways to legally get access to the MLS. You can be an appraiser apprentice, or you can be an assistant to a realtor and have

access to their multiple listing login. And you know, to do that, if you don't have any of those licenses, I would call up a realtor and I would say, "Hey, can I help you in any way?

I'm going to be buying homes and be an investor. Homes that I'm not able to buy, maybe I can refer them to you and you can list them. But you definitely can get a real estate license. I mean you can take the classes online and get your license within a matter of a few months. To have your own login and there's other benefits to that we can go into later. Bottom line, you really do need access to the Multiple Listing Service.

But it can be done without it and there are other ways around that and other ways to find comps. A few of the popular ones that are free services online would be redfin.com, one of my favorites. Zillow. There's ways to run comps on Zillow. Trulia plus different public record sources, like Realty Track and other titles companies have their own websites with public data information that you can look up sales and things like that. That's a whole other topic, but those are ways.

Andrea: Great! So how do I know if a house is a comp or if it is not a comp to my property?

Doug: Like I mentioned before, you want to look for similarities in features. You want to look for closeness and proximity, meaning the closer to your house the better. And you want to look for the most recently sold homes.

An ideal comparable, let's say I have a house on the block that I'm trying to appraise, ideally the house next door is the exact same model, exact same square footage, built the same year, has the same features, bedroom, bathroom count.

It just sold last week. It was listed on the market so it had a normal marketing exposure, and it sold for X amount of dollars. That's going to be the ultimate comparable because it's literally the same house as yours.

Now that almost never happens because we're talking about real estate and there's differences. There's differences in location so maybe it might have been across the street that backs up to a freeway, or maybe it had a swimming pool and other features that your house doesn't have.

So there's all these different things to consider. You're looking for similarities in those major factors. Size, age, bedroom, bathroom count, and proximity being the major ones that you want to consider.

And we talked about recent sales. An appraiser, typically you don't want to look for something within three months, no more than six months back if possible. So something that sold last year, twelve months ago, that's not really comparable.

I mean, all your neighbors will say that's a comparable and people think that but it's really not a comparable because market conditions can change so much over that given amount of time that it may not be indicative of what your house might be selling for today.

Andrea: And I think that's an important thing to know is that if an appraiser cannot use it, as a comp, it is not a comp because ultimately that house has to appraise at the price that you're hoping for in order to sell it to a person for that price.

Doug: Right, and I go into this in detail in the free gift we give out. About how to look at these homes as an appraiser would look at them

when you're trying to determine value because ultimately that's what the person buying the home is going to have to get an appraisal done.

Andrea: Right. So what if there are no comps? How do I determine value then? If I literally cannot find anything comparable to my house?

Doug: Okay, so if you put in those parameters, and you just don't find anything that looks comparable, first of all you want to expand your parameters a little bit. So let's say you looked up to a mile away and you looked for homes that were similar in square footage and there was nothing.

Well, expand your square footage a little bit. Expand to a mile and a half away. See if you can find anything there that looks comparable. Still don't find anything? Go a little bit further, maybe two miles.

It's really going to depend on the area that your house is located in, and a lot of other factors on how unique it might be. But if you're not finding comps, it's probably pretty unique so bottom line is if you just have no idea, and you're not finding anything, and that house could be a one-hundred-thousand-dollar house, it could be a million-dollar house and you have no idea? I would just turn around and run! Just go to the next deal.

Unless you have a lot of experience and really know what you're doing and you're okay with taking big risks, I would run the other way. There's going to be another deal come across your desk soon enough. There’s always another opportunity, and if you have it narrowed down to a pretty good range of what you think that house is worth, just skip it.

Andrea: Okay. So, my agent swears that this house is going to sell for $555,000. They're my agent. Who am I to disagree, right? So how do I know if they're right or they're wrong?

Doug: Okay, so always respect your real estate agents, but never ever rely solely on what they're telling you. A couple of reasons here. They may be a great person, but agents get paid by commission, so they get paid to list the house or sell it, or represent you as a buyer when buying a house. That's how they get paid. They don't get paid based on the profit you're going to make on that deal, or lose. Just take that into consideration. They're salespeople. They're there for a commission. Now you're an agent, so I'm not trying to knock agents. We need to work with agents and agents are great.

We love agents, but definitely you need to know the value for yourself. You need to know beyond a shadow of a doubt, based on the data that you've collected, and the research you've done, that you're confident in what that home will sell for.

Don't rely on the opinion of the agent. You can take that opinion for what it's worth, and kind of use it, but don't let it influence you too much. That's the quickest way to get in trouble, I think in flipping homes for a new person who's inexperienced is to just rely on what a real estate agent is telling them it will sell for.

Andrea: Absolutely. I would say the two deals we made the least amount on, in fact we may have only broke even on those properties, were two homes that a realtor told us he was positive was going to sell for this price. And we went against our own appraisal knowledge!

Doug: You know, and it was very convincing. I've got buyers in this area!

Andrea: Yes, that is what he told us.

Doug: I know someone who would pay this much for it. That's very convincing.

Andrea: And guess what? That person he knew was out of the country and they had just bought something else and their money was tied up.

Doug: Yeah, yeah. That's ultimately what happened.

Andrea: And we put it out on the market and guess what? People didn't want to pay what he said that they would pay.

Doug: So we should have taken our own advice there. Just don't be totally sold on something like that. If someone tells you they have a buyer for that. It's guaranteed to sell. Know what it could sell for on the open market.

Andrea: Absolutely. Okay, so I've got some comps and I think I know what this house might sell for. So how do I know now what to offer?

Doug: Okay, so you think you know what the house will sell for. In order to know what to offer, you're going to need to back out of the equation, back out your numbers, to determine what offer you can make. This is kind of a bigger conversation than just this little answer, but there's some general formulas you can use, but first of all you need to understand your expenses, your costs.

There's buying costs. There's a cost to buy the property, the escrow fees, the things like that. There's the rehab cost. How much work am I going to have to do it if any? There's holding costs.

You're going to hold that property for three months versus twelve months? That's a huge difference in your cost there, just in utilities, and if you're borrowing money, all that interest that you're paying the whole time.

And your selling costs and those can vary a lot. If you're going to sell it "For Sale by Owner", okay. If you're going to sell it on the market, you're going to pay agent commissions. You're going to pay potentially termite things. You're going to pay for the buyer's insurance. There's a lot of expenses to consider there. The typical formula that you would hear that in most cases is a pretty safe offer to make and that's why it's widely used, a lot of people will teach to use this formula.

They take the ARV, which is what we talked about before, which is the After Repaired Value, ARV, get used to that term. That's what you think the house will sell for when it's repaired.

And then you multiply that by 70% and then you minus out the cost of repairs. That's generally a pretty safe offer to make if you're going to be flipping a home.

That 70%, taking that 30% off the top, what that does is that's accounting for all of the general expenses, the cost to sell, the cost to hold it, the cost to buy it, other contingencies in there. And hopefully it's leaving you with about 15% profit on the overall ARV.

Does it always work out? No, of course not. It's just a general safe formula to use. But I want to say this about that formula. You really need to kind of know your area. And what market you're in.

Andrea: How competitive it is.

Doug: How competitive it is. What other investors are paying for their flipped properties. And this will come with experience and the more you dive into this business and are working it every day and get used to seeing what's out there, you'll get a better feel for this. But if we were to use this formula on making our offers today?

Andrea: We'd never get a property.

Doug: We would rarely get a property, yeah. I don't know about never. You might get a property here and there depending on how hard you work.

Andrea: It's just very competitive right now.

Doug: It's very competitive. Most of the time you're not even going to get close to buying a house with that formula.

Andrea: But in the past, years past, easy. That was our formula.

Doug: That was our formula. Even maybe even 65% minus repairs was our formula in 2008 when we first started. 2009. It was different. Same area, the market was different.

The market was crashing, foreclosures, short sales through the roof, nobody was buying. Very different. It was definitely a buyer's market at that point and it's a seller's market currently here today at this recording, October 2015.

That may change next year if you're listening to this. You just don't know so you really need to get a feel for the market and what's a competitive number and know your expenses. Your own expenses. I'm not going to be able to save on that or that or that depending on how you go about the flip process.

Andrea: And what return do you want to make? So this is based on the return that we feel like our time is worth and what is it worth for us to go through this whole process. What do we need to make? Some people are okay with making less. Some people use their own money, they don't use hard money, so you need to figure out what return you need to have and back that up.

Doug: Right. You're going to have a certain amount of capital invested, whether it's your capital or a partner's capital or some kind of...you're going to have capital and time and energy invested into this project. You were expecting to get a certain amount back at the end of the day. Is that return...are you happy with that? Are you not? Is it good enough for the risks you're taking or not? Yeah. Stuff you have to determine.

Andrea: Right. Okay. What if I'm going to keep this house as a rental and not flip it? What would you suggest that I offer then?

Doug: Okay. Good question. Totally different in a sense but very similar. You still need to know your After Repaired Value, in my opinion. You still need to know what that asset is worth on the open market. Now, there's another term that I'm going to make up called the ARR, After Repair Rent. I just made that one up.

Not only do you need to know your ARV, After Repaired Value, you need to know your ARR. What will that house rent for when it's repaired to the rental standard for that area? And that's important because if you're going to keep it as a rental, you need to know what kind of income you can expect to get as market rent for that house.

You also need to know, again you mentioned what return are you looking for? So in a rental property you're investing a certain amount of money into that home and expecting it to return a certain amount of money every month in a form of cash flow.

But if you figure that out over an annual basis, it becomes a certain percentage that you're hoping to get. So you need to kind of know that number.

What kind of expenses can you expect? There's a whole other podcast episode we'll probably do on analyzing rental properties, but there's a lot of expenses in there: vacancies, maintenance, management. Are you going to manage it yourself or are you going to hire somebody to do that for you?

Andrea: Water. Do you have to pay the water? Do you have to pay the trash? Some cities require that.

Doug: Yeah utilities can vary. Taxes that you have. Insurance. So there's a lot of costs in there. And what type of financing? Do you have financing on the house or is it just going to be your own cash, your own capital?

Because if you have financing, then there's a cost to that. You know you have to figure in all those things. So, how long do you want to hold the house is another factor you'll want to consider. Are you buying that as a rental hoping that will appreciate in value? That's kind of a speculation.

But, if you're a market expert, or you have a pretty good sense that you feel the market is going to appreciate, it might be a strategy you want to do. Have a sort of an exit plan in mind before you analyze that deal.

But the reason I say you need to know the ARV is because even though a house might make sense on paper, as a return in terms of cash flow, you still don't want to overpay for that house for what it's worth as an asset. Does that make sense?

Andrea: Absolutely.

Doug: So you don't necessarily have to buy it at seventy percent minus repairs to make it a good rental property, but I wouldn't be paying 110% of its value just because it looks like it's going to be a good cash flow property. Obviously that would be foolish. So, you've got to know those numbers again and just look at it from a little different perspective.

Andrea: Okay, so analyzing comps. What about active listings and pending sales? Should I consider those?

Doug: Okay, so people who are selling their homes and even agents will use these to justify their number a lot more than they should be. An active listing is just a home that's for sale, It means really nothing as far as the number that they're asking.

Andrea: In terms of an appraisal essentially.

Doug: Yeah, in terms of an appraisal or if I'm trying to determine the value of a home. If the home next door is listed for five hundred thousand, that doesn't mean that this house is going to be five hundred thousand or even in the neighborhood of five hundred thousand.

You have to take the whole market and all the sales into consideration, not just that home. Because that's just what somebody is asking for the home. It really doesn't mean anything.

Now pending, you can put a little more consideration to, because that house is typically in escrow. There's an offer. It's been accepted. They're just going through the process of maybe qualifying the buyer and going through all that to get the house closed.

Andrea: But as an agent I will tell you that they do not tell you what the house is pending for. So you might see that it was listed at 550, and it went pending. That doesn't mean that's it's pending at 550, and you won't actually know what it's selling for until it's a closed sale and they list the price that it sold for.

If you even call the agent and ask them, they might be cool and tell you, but most of the times they're not going to tell you in case it falls out of escrow and they have to relist it.

They don't want you to know if they came down on their price. So it's kind of a hidden number. You don't really know what it's pending for. Maybe they came down by $50,000 and it's actually pending for 500 now.

Doug: Yeah, excellent point. So you don't want to give too much away to either the active or the pending sales. The one thing that they are, not the one thing, but something that they are valuable for is just helping to know your overall market conditions that you're in.

For example, if there is a ton of active listings in a particular neighborhood, you've got to take that into consideration because all of those active listings are potentially your competition if you were to

have this home listed on the market and try to resell it yourself. Your competition is all of those other active listing homes.

So you need to really know what kind of market you're in now. Are the active listings lower than the average sales in the area? That could be an indicator that maybe this market's going down.

Or are the active listings way higher than all the average sales? Maybe their expectations are for it to go up. So those an appraiser would look at, and an investor should look at when they're trying to determine the market conditions.

A good thing to kind of know is with active listings and sales would be to figure out the months of inventory in your particular area. So let me explain that a little bit.

Generally, agents will tell you about six months' worth of inventory is a balanced market. And what that means is if you take the current number of active listings, in your search, let's say in a particular neighborhood. And let's say I've got thirty-six active listings. You divide that by the average number of sales per month over the last six months or so.

So let's say over the past six months there's been 36 sales. And you divide that by six, that's six per month. So if I have 36 currently active homes, and I've got an average of six sales per month, I have six-month's worth of inventory. Is that too many sixes?

I hope that math equation worked out because I just did it in my head and I hope that makes sense. That would be a balanced market.

Typically, anything below that, four months' worth of inventory, two months' worth of inventory, that's going to be a seller's market. There's less competition.

There's typically a higher demand for that property than what is available. Anything above six months, if you get into the eight, nine, ten months' worth of inventory, it's the opposite. You're in a buyer's market. The buyers have more choice of homes. So those are certainly things you want to consider with the active listings and the pendings.

Andrea: Good! Great info!

Doug: Bottom line is when determining value, you've got to know what the sales are. You've got to have access to data, MLS, public records, so you can know what homes sold and have a general idea of what those homes have in terms of their features. Pictures are great. When you look at a sale, go into the MLS and you can kind of see what kind of condition that home appeared to be in. Read the comments from the agent about that house.

So you have to know your data. Don't take people's opinions of what it would sell for. Really know the numbers yourself. You have to be confident in your own research that you know what it's going to sell for. Know your After Repaired Value. Know your numbers and just get out there and start making offers.

If you want to be conservative at first, great. That way you won't get in trouble. But start making offers and practice at it. You'll get feedback. Take it with a grain of salt, but the bottom line is kind of get started. Start making offers, and you'll learn a little bit more about your market as you go.

Andrea: Cool. So we want to invite you to go over to our website and check that out, spousesflippinghouses.com and we have two free gifts for you over there. The first one is a three-part video series that Doug has created on deal analyzation, and he goes much more into depth on all of this information on a video that you can see.

You can see his screen as he's going through comps and showing you how he finds comps and how he analyzes them, and what's good and what's not. It's valuable, valuable information.

So we're giving you that for free as well as a little e-book on working with your spouse and having fun doing that. So, check out our website.

Doug: And please give us a rating and review on iTunes if you would. Take the time to do that. We really appreciate it. We love your feedback and it would just help us to get the word out to other people who might want to learn more about this topic as well.

If you have questions, get on our website and let us know what your questions are. We'd love to answer those for you as well. So, that wraps up today! Anything else?

Andrea: I don't think so. Have a great week everybody!

Doug: Have a great week and we'll talk to you next week!