

## Subject Line - Buying "Net to Seller" is a Profit Magnet

One of the most effective ways to buy properties is what I call "Net to Seller". The actual method goes like this – a property is purchased from a homeowner on a "net" basis. This means that all or almost all of the closing costs are paid by the buyer. In the presentation to the seller, the investor-buyer says he will pay all the closing costs and the seller will net a certain amount, i.e. \$15,000 (actual example as shown below).

This method (Net to Seller) is very successful in closing deals because the seller usually remembers his purchase/closing when he financed it with a mortgage and his having to sign three (3) inches of documents and pay his mortgage broker thousands of dollars. Sellers' perceptions of their potential closing costs are generally off by thousands and thousands of dollars and are definitely a mystery to the sellers in most cases.

So using this Net to Seller buying technique, the investor-buyer only has the seller paying nominal expenses, if any, and these can be determined by the investor-buyer. One big issue can be property taxes which can run 2% – 3%+ of the property's assessed value – not the sales price. Under normal circumstances these taxes will be prorated at the closing. Prorated means the seller will pay the property taxes only for the time he lived in the property from January 1<sup>st</sup> of that year to the closing date. This is fair because the investor-buyer hasn't lived in the property for the first part of the year and will have to pay the full year's taxes as the owner of record of the property at year's end.

So at the closing these prorated taxes are credited to every buyer from the seller's proceeds on the HUD-1 closing statement. If the buyer holds the property until the taxes are due and payable, he then pays for the full year but because of the credit he received from the seller his actual amount of taxes are only for the time from the closing to year's end. This method of tax proration is simple, effective and it works if the seller understands that he has to pay this expense at the closing.

So if the seller is surprised at the closing that the buyer is not paying his property taxes in addition to his other closing costs, or you find out that five years of taxes were due, the closing may not take place. Yes, we just closed a property where there were four years of property taxes due (\$25,548) and no tax deed was ever applied for. Ironically, the property was a lake-front 4/2 worth \$235,000 that could have been taken by tax deed for the \$25,548 if the holders of the tax certificates had done their homework.

So do your homework before you put a contract on a property to know what to expect or have your weasel clauses in place to get out of the contract and not lose your deposit. We typically quote a net figure to a homeowner (i.e. \$15,000) and work our math backwards to show them what the equivalent offer would be if we didn't make it a net deal. Are you asking yourself why we do it backwards instead of from the gross price down? The reason is simple – most sellers have already calculated the net they expect

(almost always inaccurately) and they know how much they need for their move. So they have done the work and we get right to the point about “How much money do you need to move immediately?”

Just recently we closed a deal where the amount we had agreed to net to the seller on closing was \$12,000 after paying off all liens and the expenses of closing. Two days before closing, a water lien in the amount of \$3,000 was found by the closing agent and a pit bull citation (\$1,030) for a former renter in the property. Originally, the seller needed a certain amount of money and said he wouldn't take less than the \$12,000 net we promised. Now it appeared that we would have to pay \$3,000 more for the property or get the seller to take \$9,000 net because of the surprise water lien.

I told the student who had the deal about the liens and he panicked. I told him just to come to closing and we would work it out. He gave me reasons the seller wouldn't close and just kept going on and on about his not closing, without his even having recently spoken to the seller. Sometimes you just have to stop thinking about “what ifs” and get on with your life.

The seller came to the closing at the appointed time, as did the student (our partner in the deal). We explained the closing statement to the seller and he never said a word about where is the rest of my money? After all, the water was a past issue of someone using the water; we did pay a capped amount for back taxes as we had agreed (\$10,500) and the pit bull citation got withdrawn just before the closing so the seller received \$9,000 at the closing. We closed the sale in a land trust and resold the land trust to a cash buyer the same day.

Here is an important point about the title insurance and the above example. The original purchase and sale agreement was written for a purchase price of \$12,000 and the clauses in the contract stated that we would pay the items discussed above (the property was free and clear so no mortgage). When the smoke cleared on the HUD-1 Statement we actually wound up paying \$21,729.97 for the property. But in the public records the deed was recorded for \$12,000, which was obviously not our actual cost.

One could argue that we saved some doc stamps but at \$0.70/\$100 this is very nominal. The real repercussion could come when the end-buyer looks in the public record and sees he just paid \$60,000 for something we apparently paid \$12,000 the same day he bought it! There are two ways to overcome this issue – the first is to buy a title policy for \$60,000 and not \$12,000 as the closing agent would normally issue. How do you do this? Just ask the closing agent to insure for \$60,000 instead of \$12,000. The title work is the same but the closing agent will make much more money on the \$60,000 title policy.

If you find you are doing a net deal, write the full purchase price in the contract and subtract out the liens, and other costs you will have to net the amount you agreed to for the seller. The clauses of your contract must be specific about how much you will be paying and for what specific items. In the above example, the contract's purchase

price should have been \$22,000 which would have shown in the public record as the sales price – better than \$12,000 if the end- buyer sees it. The difference in costs is  $\$48,000 \times 0.70 / 100 = \$336$  and the title policy difference is  $\$48,000 \times 0.0055 = \$264$ . So is it really worth an extra \$600 for the sake of your reputation? That is your choice, but the following is what can happen when you least expect it.

What if there was a title dispute and the investor-buyer and end-buyer were sued by another investor who has a signed contract by the homeowner that was valid and you didn't know about it? This actually happened on another property and the settlement amount agreed upon was for the purchase price of \$60,000 to the investor with the valid, but previously unknown contract. Now the buyer goes to his title insurer and makes a claim on the title policy for the face amount of \$12,000. What about the other \$48,000 that wasn't covered because you wanted to save money? And what if you have partners who don't want to pay their share back? The final settlement costs and legal fees could be a lot more than \$48,000

Being penny wise and pound foolish has sunk many an investor – remember that if you want to stay in the business. Remember that simply buying and selling a property isn't like playing monopoly with you children – everything you do has ramifications.

To your limitless success,

Dave Dinkel