How to Make an Additional 10% to 50% Profit on Wholesale Real Estate Deals

Every mentoring class I get at least one or two students who start doing deals very quickly and at a high volume, often one or two deals a week. I didn't initially tell them about a strategy that makes a huge difference between average success and meteoric success because the outstanding students figure it out for themselves.

Let's start with the basics; the students are all taught how to bid on any type of deal – REOs, short sales and direct sales with homeowners. These three types of deals along with their specific contracting pretty much cover the spectrum of what clauses are needed in the students Purchase and Sale Agreements. The students then use a specific percentage of three known numbers that establish the value of any property including multifamily units.

The students' offers are designed to be too low to be accepted. If by chance, they get an acceptance from a seller, they have offered too much – even if the percentage was correct. Frankly, this danger of "over-offering" doesn't matter because we have the inspection period to cancel the contract or re-negotiate the accepted price. I just mentioned the key to what the very successful students are doing – renegotiation.

Only one of two possibilities can happen to REO properties – they can sell at the listing price or higher with someone overpaying for them or they can be tracked and purchased later at a price where an investor can resell them and make a profit.

Most listing agents will proclaim that every REO property they list sells at or above the listing price. In many cases this is correct for two reasons. First, rehabbers and wholesalers over-bid on new MLS® listings in an attempt to get these properties under contract. They literally chase their own tails to get the deals. In the case of investors, only about 35% close but for rehabbers, about 80% close.

Rehabbers tend to over pay because they can create equity by rehabbing and selling the properties retail. Investors want to wholesale the properties and know that just getting a deal under contract can mean a profit, be it small because they over-paid. Their buyers are the "bigger fools" who most often are rehabbers who don't know how to get deals.

Secondly, the REO listing price is lowered after an investor or rehabber puts the property under contract. This happens fairly frequently and our students most often cancel the contract. This makes the new listing price lower and we go back to do what we call recycling the deal. This means we start reoffering at a lower price because the listing price is now lower. The result of dropping the listing price is similar to someone shooting themselves in the foot trying to outwit the investor buyer.

The investor with the most patience is usually the winner in terms of making ongoing profits. But the super-students who get the process down also take the negotiations to another level. Remember, when a contract is approved, there is an inspection period in which the investor/buyer should be doing his title work as well as trying to sell the property. The critical time is when the inspection period lapses and the investor's deposit "goes hard". This means he risks losing his deposit of he doesn't come to closing. If the deposit is small ($100 - $500), it may be worth the risk to go to closing and try to get a buyer right up to a couple of days before closing. If the deposit is larger, say $1,000 or up to as much as 10% of the purchase price, this decision normally becomes harder to make.

The super-students bid at a higher percentage than is sensible to make a profit on wholesaling the property. This higher offer can be 10% to 25% above what is usually offered by students. Their thought process is that they will get more deals; they can get out if they can't resell them and they may take the property and rehab it themselves. Their experience has been that exactly all of the above have come true.

The critical aspect is the renegotiation of the purchase price which must come twice – before the inspection period's expiration and again just before the closing. Even if the property is destined to be closed on and rehabbed, renegotiation is critical. The worst the seller can say is “no” but over 80% of the time there is some adjustment in the price and often two adjustments.

For the zero-day inspection properties, our experience is that the listing broker or agent puts this demand in the contract he writes. It does not come from the asset manager as can be seen in the addendum that is signed by the lender’s authorized agent or asset manager. In literally hundreds of zero-day inspection requests, only one that was attorney written for a private lender was actually had a zero-day inspection.

This is not to say that it won’t happen to you so be careful if you bid on these properties.
If a Realtor® asks why you need so long an inspection period for REOs, explain that it is because of title issues. If he tries to convince you that his sales always include marketable title – he doesn’t know any better or he is lying. REOs done by courthouse foreclosure sale are transferred by certificates of deed which “disrupt” the chain of title.

Especially susceptible to renegotiation are the properties with large code liens and existing code violations. We recently had a $445,000 lien reduced to $4,100 but the student had to close and agree to have the work done in 90 days. He had it resold to a buyer who agreed to this stipulation. The result was a substantial price reduction from the seller before the closing.

In the above case, the property was finally purchased for $47,000 including the $4,100 to the city and sold off an MLS® listing for $79,000. Originally, there was a buyer who reneged on his purchase at $62,000. When he didn’t close the student decided to close and re-offer the property, essentially retail, after a minor cleanup by a handyman. Completely rehabbed the property would have sold for another $20,000 but would require $10,000 in repairs. Better to have the end-buyer put the money in the property and move on to the next deal.

This strategy can quickly backfire if the buyer doesn’t close because he isn’t willing to renegotiate or if he doesn’t get a large enough price reduction. In another case, the student worked on a REO triplex for seven months. The asset manager finally took the student’s price in the low $60,000 area. We had it sold very quickly and the best priced buyer went to inspect the property three times. On the last trip he asked where the electric meters were and I checked with the student and the pictures he had taken.

There were no electric meters to be seen. I called the student and then the power company. They researched the meter reader’s log and said the meters were located on the backside of the building. Actually, the meters were located on the backside of another building – not this building! When the original owner built the building he had four more built at the same time. Only one building contained all the meters for all five buildings.

This meant that our buyer would have to have new meters placed on the building we were selling him. Estimated cost of this “problem” was $15,000 so our buyer passed and we lost the deal. The student told the agent and the agent after seven months was disappointed. A week after canceling the contract, the agent called the student back and asked if he would reinstate the contract if the lender gave him a $4,000 credit. Ultimately the price reduction became more than twice this amount which made it a deal.

In summary, if you are having a problem even getting a deal, renegotiation is an advanced tactic. It requires the guts and fortitude to take “no” for an answer and keep going – exactly what it takes to be a successful investor in the first place. The best way to learn how to do this is to just do it and the more you try the luckier you will get!

To your limitless success,

Dave Dinkel