

2-1-2012 – Insight - No Money Deal – Then Why Do I Need Money?

A student got her first deal recently. It was a probate that had no mortgage or encumbrances (free and clear) and the seller was motivated. She offered something below forty thousand dollars and after going back-and-forth with the seller, they settled on \$46,500. In addition, the student agreed to pay the seller's closing costs.

Since the property was a recent probate, the property had personal belongings in it. It had also been partially rehabbed with permits and a new roof. Essentially, it was in excellent shape except for flooring. The seller didn't want to give the student the key because of personal items in the property. However, after much discussion, he relented and the student agreed to only show the property if she was there.

I first heard about a buyer she had on a Sunday afternoon on a three-day weekend. She called and asked how to fill out her buyer's contract. Turns out, she had a neighbor who was a contractor and he had asked her to tell him when she got a property. She also had told her contractor-neighbor she would pay him \$500 for a referral to a buyer – but didn't figure on him being the buyer.

We had advertised the property and had a steady stream of investors calling to make offers and set appointments. The student showed the property to her neighbor, and returned to the property to show some of our call-ins what it looked like on the inside. The offers we got ranged around \$55,000, but the neighbor's offer was \$62,500.

We did the contract together and all sorts of complications seemed to keep cropping up – the buyer wanted four people as buyers on the contract. He wanted his \$500 for finding the buyer – as she had promised. I brought up the fact that, "If I had a partner who wasn't putting up any money and he was getting paid a fee by the seller, I would, be bent out of shape!" Wouldn't work for me! I explained that to her and she agreed and asked the buyer to take a \$500 price reduction – he agreed.

Next, the question arose of how much the buyers would have to pay in closing costs and the student told them no more than \$2,500. This was a total guess on her part and you should never guess, but a good guideline, not including hard money costs, would be 3% of the purchase price – depending on what the buyer and seller each pay. The actual cost was a little over \$1,100. The title policy got a discount as a re-issue; the closing agent was doing the "A – B" side of the transaction so there were limited attorney's fees. I guessed on the phone \$1,200 but told her to put \$1,500 that the buyer would pay and we would pay anything over that.

Seems simple, right? Actually, it was once I spoke to the moneyed partner who was raising objections to the fees – fees that he hadn't even seen. I had our closing agent issue a "draft" HUD-1 Closing Statement so he knew exactly what he was getting. All that passed and the buyer even came to our REI meeting the next day.

When we discussed the coming closing with the student we asked if she had the money to close. She said "no" so we told her about using transactional funding to keep the transaction legal. She next said that we had always talked about no money into deals except for deposits, but she couldn't understand why she needed money to close.

It is simply a legal issue with closing agents. Their title underwriters seldom like double closings that require no money from the investor, so they may not underwrite a title policy. This is always the case with end-buyers who get conventional bank financing. Banks are suspicious of investors who try to do deals with the bank's money and the banks almost never allow it – if they are told beforehand! The result is no deal.

In the past we had explained that we occasionally use a cash buyer's funds to close the B – C leg and she asked why we couldn't do this in her case. I explained that we could ask the end-buyer but he didn't know her and he might cancel the deal. Likely, if he asked his attorney, the attorney would have killed the deal as a possible fraudulent transaction. When I spoke to her buyer, he had said the neighbor-contractor of hers was the one who wanted to do the rehab but he felt it wasn't a great deal. He would go through with the purchase but wanted clarification of the exact closing costs he would be paying.

She also asked why we just didn't assign the contract. I explained that when a profit is over \$15,000 on a \$45,000 property, very often the buyer or the seller suddenly feels the investor made too much money. The homeowner signs the closing statement that shows what the investor profited and the buyer sees what the investor got at the closing table. So for the sake of saving a few hundred dollars of closing costs, the deal is irrevocably lost – which would be truly penny wise and pound foolish.

So here are two examples where no money in a deal isn't working – or is it? Looking at what the student "invested" in the deal she put up a \$100 deposit and no other money. The fact that someone else has to put up money to close still means the student didn't need any money for the deal except her \$100 deposit. So did "no money" work or not? Seems to me it did, her profit may have been slightly smaller than she expected, but it was still a good deal.

In summary, what is "no" money in a deal? In its truest form, no money would be:

1. totally owner financing including the closing costs,
2. an assignment of contract,
3. a transfer of the Beneficial Interest of a land trust,

4. an option, or another few ways where and when the situation warrants.

In the real world where you need to close transactions, no money should be defined as \$100 or less. You may have to borrow money to do a closing, but you don't need money to do the deal.

To your limitless success,
Dave Dinkel