



Pros and Cons of Flipping Houses and Investment Properties for Fast Cash Profits

A Special Report From Real Estate Expert Bob Bruss

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Report #04362

A few weeks ago I was in Washington, DC attending Yanik Silver's superb Internet Marketing Copywriting Conference. One day at lunch, when some of the Internet marketer attendees discovered (by reading [The Washington Post](#)) I write about real estate, they asked me if it was better to "flip" properties for fast profits or "hold" properties for long-term investment.

After I explained the term "flip" to those at the table who weren't familiar with it, we got into a heated discussion about the advantages and disadvantages of making quick resale profits within a short time (a few days, weeks, or months) after acquiring a property.

Frankly, there is no right or wrong answer to whether or not it's smart to take a fast resale profit soon after buying a property. Personally, although I've flipped a few properties for quick cash resale profits, I'm more of a "buy and hold" long-term real estate investor.

But I know other investors who recently bought houses at bargain prices and quickly resold them in rising local markets for thousands of fast profit dollars. "It depends" is a sound answer to whether fast flipping or long-term holding your realty investments makes the best financial sense for your personal situation.

THE PRIMARY REAL ESTATE "FLIPPER" OPPORTUNITIES. As long-time subscribers know, I've been buying fix-up single-family houses and writing about earning profits from these properties for many years (please check the list of my special reports involving fixer-upper profit opportunities which interest you).

OPPORTUNITY #1 – FAST FIX-UP FLIPPER PROPERTIES. Fixer-upper properties, whether houses, apartments, shopping centers, warehouses, or any other type of property, are available in every community and in all price ranges. Properties needing fast fix-up are the primary "flipper" profit category.

Many real estate investors make a full-time business of acquiring fix-up properties, upgrading them, and then quickly reselling for fast profits. To illustrate, have you seen those big billboards and newspaper ads in many major cities that say, "I buy ugly houses. Call Joe at 555-5555." Joe is obviously a "flipper" investor. You wouldn't

keep seeing those expensive signs and ads unless they were paying off for the advertising investors.

However, as I've emphasized many times in these reports, it only pays to acquire fixer-upper properties with "the right things wrong." That means look for properties needing inexpensive cosmetic fix-up work such as fresh paint (by far, the most profitable improvement of all), new landscaping, new light fixtures, wall-to-wall carpets, general cleaning and repairing, kitchen cabinets and appliances, and other value-adding upgrades.

A sound goal is to add at least \$2 of market value for each \$1 spent on fix-up work. But avoid acquiring unprofitable fix-up properties that need expensive major repairs, which add little or no market value exceeding their cost, such as foundation work, new roof, and room additions.

EXAMPLE: A few days ago I was driving through a middle-class neighborhood called "Shoreview" near where I live. Over the years, I probably bought and sold at least 20 houses in that area which was built in the 1950s. The houses originally sold for about \$7,500! Today, fixed-up houses in that neighborhood sell for at least \$400,000, usually more. But what shocked me was, among those mostly-fixed up houses, were many run-down "original" houses, which still haven't been upgraded to today's modern housing standards. As I drove along Norfolk Street, within about 15 blocks, I was drooling at all the fix-up profit opportunities still remaining. If I wasn't in a hurry, I would have jotted down the addresses and checked their ownership at the county tax office to inquire if their owners want to sell.

At this point, I must hasten to add it is usually most profitable to hire the improvement work done rather than doing it yourself. I learned that lesson the hard way years ago – I once painted every apartment in my nine-unit San Francisco apartment building. I still recall tiling around a bathtub (breaking many tiles before I got the hang of cutting and installing tiles perfectly!) and even tiling a kitchen counter. I also replaced many broken windows in that building, making frequent trips to the local hardware store for replacement glass.

Looking back, I wasted about six months when I could have, instead, been earning rental income from those vacant apartments. *If you are short of cash (as I was when fixing up those nine apartments), borrow the money needed on a bank improvement loan to get the renovations completed as fast as possible by hiring professional workers.*

Another advantage of hiring fix-up work done (rather than doing it yourself) is you can add the cost of the hired labor to your property basis, whereas if you do the work yourself Uncle Sam values your labor at zero so you will then come out short on the tax benefits.

EXAMPLE: As many readers know, I live in an upscale neighborhood (as I hope you do, or will soon enjoy). My nice house is one of the least expensive in

the area. However, the happy result for me is when the neighbors improve and expand their nearby houses, that automatically raises the market value of my home too. But even in upscale neighborhoods, there are fixer-upper houses. The house uphill from mine has been abandoned for well over a year. A contractor bought it with the intent of fixing it up and “flipping” for a fast profit. At least that’s what he told me. He started out strong, but apparently ran into unexpected problems. Or maybe he ran out of cash! I’m not sure what is causing his delay. My points are (1) fixer-upper properties are available in virtually all neighborhoods, and (2) when acquiring a fixer-upper “flipper” property, be sure you know what you are doing and that you can borrow enough fix-up funds to complete the work, otherwise you might become involved in a costly mistake.

OPPORTUNITY #2 – 26 SOURCES OF BARGAIN PURCHASE PRICE FLIPPERS. Whether or not you want to “buy and flip” or you are a long-term investor, bargain purchase price properties are a great source of flippers. *By bargain purchase price property, I’m talking about property that can be bought at least 25% below full market value.*

If the property needs extensive fix-up work, then discount the purchase price further to compensate. Although I refer to single-family houses, please be aware there many additional types of bargain properties.

Here are the 26 key sources that work best for finding flipper properties:

- (a) Drive around neighborhoods which interest you (see my “Shoreview” example above) and check the property tax records to contact owners of dumpy houses (most of these properties won’t be listed for sale);
- (b) Contact real estate agents (they often know about unlisted open “pocket” listings of owners who will sell but who won’t list their property for sale with an agent);
- (c) Mail letters and postcards, especially to out-of-town absentee owners who might be having trouble maintaining or renting their property;
- (d) Purchase “I buy houses” signs and bus stop benches (I saw a billboard in Houston a few months ago which said “I buy houses others won’t buy”);
- (e) Buy pre-foreclosures before the foreclosure auction (please see my foreclosures report for more details);
- (f) Purchase at foreclosure auctions;
- (g) Buy REO (real estate owned) from foreclosing lenders, often with easy financing;
- (h) Divorce sales;
- (i) Bankruptcy sales;
- (j) Read the “for sale by owner” (FSBO) newspaper ads (these sellers can be very tough because many of these individuals think they can get top dollar by saving the commission and not listing with a professional realty agent);
- (k) Distribute door hangars in neighborhoods where you want to buy (also a great way to walk around a neighborhood to get the feel of the area);

- (l) Advertise in direct mail co-op mailing packs (such as Val-Pak and others) which are mailed to homes inexpensively;
- (m) Place “Property Wanted” newspaper ads, especially in the inexpensive weekly papers;
- (n) Place ads on “for sale by owner” Internet websites and in local FSBO magazines;
- (o) Attend local real estate investor club meetings;
- (p) Buy vacant properties (such as that abandoned house uphill from me);
- (q) Inspect tired listings which have been on the local MLS (multiple listing service) longer than 90 days;
- (r) Offer to buy partially-completed remodeled homes;
- (s) Purchase at probate and estate property sales;
- (t) Make offers on tired for sale listings which have become tear-down houses;
- (u) Make below-market purchase offers on over-priced MLS listings (most retail home buyers and their realty agents won’t waste time on these listings);
- (v) Offer to purchase advertised *rental* houses where the landlord might welcome your lease-option or purchase offer;
- (w) Phone month-old newspapers to ask if the property as sold yet;
- (x) Buy model homes whose builders will sell and then lease back for 30 days;
- (y) Check local tax records for properties with unpaid property taxes;
- (z) Give everyone you meet your business card and let them know you buy properties.

OPPORTUNITY 3 – ASK LOTS OF QUESTIONS TO DISCOVER MOTIVATED SELLERS AND WHY THEY WANT TO SELL. As long-time subscribers know, a question I always ask when considering a possible property purchase is “Why is the seller selling?” Only once was I ever told (by a nasty real estate listing agent) “It’s none of your business.” I later learned the retired old couple was selling their house to move to Palm Springs and I could have easily obtained low cost seller mortgage financing if I had been more persistent!

There are many reasons why homeowners and investors decide to sell. Some just want to take advantage of a strong local real estate market. Those sellers are obviously *not* good sources of below-market purchase price “flipper” properties. *But strong seller motivations are job transfers (relocation companies often discount prices if they have held title to a corporate transfer house for several months), unemployment, divorce, financial problems, illness, death in the family, health, etc.*

The longer the seller has owned the property, the better for bargain hunters of “quick flip” properties. In addition to asking why the seller is selling, here are three more key questions to weave into your friendly conversation with the realty agent or the seller:

- (a) How long has the seller owned this property?
- (b) How much did the seller pay for this property?
- (c) What is the current mortgage balance(s)?

This is usually public document information that your favorite title company where you do business will gladly obtain for you at no charge. But rather than checking the county records, it's often much easier to get the answers to your questions from the seller or the realty agent. Most people tell the truth! *If the seller has owned the property many years, because that seller has a large potential profit, he or she probably won't demand top dollar.* The result is "free equity" for the buyer!

After you learn how much the seller paid for their property, plus the approximate cost of any capital improvements added, then you know how much negotiation leeway you have with that seller.

If you discover the seller purchased the property within the last few years and has a large mortgage balance, there might not be much room to negotiate a favorable price and terms.

HOW TO FINANCE FLIPPER PROPERTY ACQUISITIONS. If you expect to hold title to a property acquired at a bargain price just a few days, weeks, or months before "flipping" it to another owner, the last thing you want to do is obtain an expensive bank mortgage.

Whenever possible, please don't use your own cash to acquire flipper property. *Personally, I've found I negotiate the best purchase price and terms when I don't have much ready cash available and am forced to negotiate creatively.*

The same principle applies even if you acquire a fixer-upper house or other property that you plan to immediately fix-up to increase its market value but you want to keep it rather than flip it – conserve your cash!

Here are the easiest ways to avoid the high cost of obtaining a new mortgage at the time of property acquisition:

- (a) Assign your bargain purchase contract to your buyer. *That means you won't actually be taking title.* Be sure the purchase contract form you use doesn't prohibit assignment. This method is sometimes called "double escrow." It is perfectly legal IF you disclose to your buyer that you don't yet hold title but you have the contractual right to acquire title.
- (b) Take title "subject to" the existing mortgage(s). That means you don't formally assume the current financing. Of course, you must make the payments or lose the property by foreclosure. *Yes, this violates the mortgage due-on-sale clause. But most lenders won't complain as long as the payments are made on time.* This method works especially well if the current financing is in default and you are obtaining the seller's deed before you cure the default. Most institutional mortgage lenders just want their monthly payments made on time with no hassles.

The worst that could happen (but probably won't occur), is (1) the current lender might demand a 1% loan assumption fee, or (2) you will have to refinance with another mortgage lender.

If you need cash for a down payment to pay the seller, borrow on your unsecured bank credit line, or even on your credit cards (especially when you can use those low interest rate credit card checks the credit card companies mail to their best customers almost every month). You will only need the cash for a few months until you can "flip" the property, so it won't be too expensive.

Another, but more expensive, cash source is to borrow from an equity lender. These lenders usually loan private-party money on the equity in the property rather than on your credit rating or good looks. *However, their interest rates are not cheap.* But if you will only be using the money for a few months while you fix-up your flipper property, the money won't be too costly. After these equity lenders get to know you, they will often lend on appraisals based on the fixed-up market value of the property rather than on its current market value as a run-down "el dumbo."

- (c) Option or lease-option the property you want to acquire. This is a great way to *control* the property while you fix it up. *Just be sure you will be able to get the deed from the owner when you're ready to exercise your purchase option.* Some lease-option buyers insist their sellers deposit the deed into escrow so all they have to do is walk in, pay the option purchase price money owed to the seller to exercise the option, and get the deed to the property.

EXAMPLE: I recently read in Ron LeGrand's superb new book ***How to be a Quick Turn Real Estate Millionaire*** (which earned an off-the-chart 12 on my real estate book review column scale of 1-to-10!) about Marco Kozlowski. Just in his mid-30s, he paid \$100 for an option from a wealthy seller to acquire at \$4,000,000 an Orlando house, which had been listed for sale with a Realtor for four years at \$8,600,000. Marco then hired a professional auction company that, 43 days later, auctioned the house for \$5,600,000 cash. For you math flunkies, that's a "quick flip" \$1,600,000 gross profit Gosh, I wonder what the annual yield on Marco's \$100 option money was? As my good friend Jimmy Napier would say, "It's good enough!" Marco also auctioned the seller's yacht for \$4,300,000 and various furnishings for almost \$1,000,000. According to LeGrand, in his first year of flipping houses, Marco acquired 119 deeds on flipper houses in the Orlando area.

- (d) Seller financing. Although this special report is not about creative finance methods (please see the list of my other report titles which explain how to creatively acquire property with little or no cash), the property seller is often the best source of acquisition financing for flipper properties. This can often be the situation where you give the seller a short-term second mortgage for at least two or three years (always try to negotiate the longest possible term for seller financing).

EXAMPLE: I recall once giving the seller of a bargain fix-up house I bought a 12-month promissory note and deed for trust (mortgage) for my down payment. *That year was the fastest year of my life!* Fortunately, I got that house fixed-up and resold in the 11th month. However, if I had not either sold or refinanced it, I could have lost that house when my balloon payment came due to the seller. That's why I suggest you insist the seller financing term be for at least two or three years, but without a prepayment penalty for early loan payoff.

POSSIBLE DISADVANTAGES OF ACQUIRING FLIPPER PROPERTIES. As promised earlier, now it's time to shift focus from all the advantages and the ease of finding and buying flipper properties to the possible disadvantages and how to overcome them.

- (a) Financing your flipper acquisitions might be a problem unless you plan ahead. But large amounts of cash and good credit are *not* needed to acquire and flip real estate for fast cash profits. The reason is you won't be applying for new mortgage financing at a bank. *If you need cash, such as for the down payment or improvements, borrow on your bank credit line, credit cards, and/or from an equity credit lender, as discussed earlier.*

Yes, the interest rate will be higher than the prime rate, but you will only need the borrowed cash for less than a year until you fix-up, flip, or refinance the property. If you are going to be living in the house, a bank home equity line of credit (HELOC) can be especially easy to obtain and economical (usually at the prime rate or even lower).

- (b) Your quick resale flipper profit will be taxable at ordinary income tax rates. When you resell your flipper property after less than 12 months of ownership, Uncle Sam will be waiting to tax your profit at ordinary income tax rates. However, if you can wait to sell your flipper property until after you have held title more than 12 months, then you qualify for the new low federal long-term capital gains tax rates.

If paying profit taxes, especially at ordinary income tax rates rather than the lower capital gains tax rate, bothers you, why not completely eliminate income tax on your real estate profits? You can do that by limiting your property purchases to single-family houses (or condos, although I don't recommend condos for flipper profits because they usually don't appreciate in market value as fast as houses, primarily due to lower buyer demand), live in the house at least 24 months as your principal residence, and then resell for up to \$250,000 completely tax-free profits (up to \$500,000 for a qualified married couple filing jointly), thanks to Internal Revenue Code 121.

The only eligibility test is the house or condo must have been your principal residence an "aggregate" two of the five years before its sale. In other words, you can be a "slow flipper" every 24 months. Your tax adviser has full details.

- (c) Most bargain-priced properties need at least minimal fix-up work. My experience has been there is a very good reason a property can be bought below the market value of comparable nearby properties. *At the very least, virtually every such property needs a coat of paint. But paint is the most profitable improvement you can make.*

For this reason, you will need to anticipate how to pay for the fix-up work – create your credit lines and other money sources in advance so you’ll be ready to roll as soon as you gain title or control of the property. As suggested earlier, buy only properties which have “the right things wrong” so you won’t get into major renovation work or room additions which usually do not meet the criteria of adding at least \$2 in market value for each \$1 spent on improvements.

- (d) If in doubt about property condition, include a professional inspection escape clause. Unless you have extensive construction experience, be sure to negotiate a professional inspection contingency clause in the purchase contract. It’s also known as a “weasel clause” which allows escape from the purchase if your professional inspector and/or termite inspection report reveals surprise structural problems.

- (e) Plan your exit strategy. *The smartest real estate investors plan their exit strategy before they acquire a property.* To illustrate, if you are a long-term “buy and hold” investor, your exit strategy might be to hold the property for many years, perhaps refinancing every five years to take out tax-free cash, before selling and carrying back mortgage financing for your retirement income. However, if you want to flip properties for almost immediate cash flow, you’ll need a quicker exit strategy.

In many parts of the nation, as I write this, the local home sales situation is a “buyer’s market.” That means there are far more homes for sale than there are qualified home buyers. *This is good for you when you are a buyer, but not so good when you are ready to sell.*

EXAMPLE: Suppose you buy a bargain-priced house for \$200,000, spend \$20,000 fixing it up and it should be worth \$275,000 after fix-up (based on comparable recent sales prices of similar homes in the neighborhood). But there is a glut of similar nearby homes for sale. What will be your exit strategy? Please don’t panic! You have several excellent choices. One is to hold the house as a long term rental investment. However, suppose the local rental market is weak because there are too many similar rentals and houses for sale. Your next exit strategy might be to offer the house on a lease with option to purchase. Even in the softest buyer’s markets, there are usually many lease-option buyers. Good times or bad, I’ve never had problems finding lease-option home buyers. But it might take two or three years for your lease-option buyer to exercise their purchase option so be sure you don’t have any balloon mortgage payments coming due shortly (for more details, please study my special report on lease-

options). Another, less desirable exit strategy is to offer your fixed-up house at a below market price, perhaps \$250,000 in this example, if you must sell now for cash. But that method leaves part of your potential profit on the table.

(f) Avoid low-income, high crime neighborhoods. Until now, I haven't mentioned the topic of location when acquiring flipper properties. Although I've made handsome profits in low-income neighborhoods, I've tried to avoid high crime neighborhoods. Long time subscribers will recall my "drug house" REO (real estate owned) foreclosure property acquisition where, shortly after my tenant moved in, there was a murder on the street in front of the house. But she and her children remained tenants in that house for almost 14 years, and the neighborhood crime rate declined (primarily thanks to California's tough "three strikes and you're out" criminal sentencing law), so it turned out to be a great long-term investment. However, it wouldn't have been a good *immediate* flipper profit property!

However, when I eventually sold that rental house at a handsome profit, it was bought by two brothers who spent about \$50,000 fixing it up (far nicer than I would have done!). Their father later told me they netted about \$75,000 "flipper profit" within six months.

But I recommend avoiding "management intense" locations. I must hasten to add some of the biggest real estate profits are made in low income neighborhoods that are on the upswing. To illustrate, a few days ago I got lost in Oakland, CA (that sounds like the title of a great movie!). As I was driving around trying to find my way to the freeway, I observed the many fixer-upper property opportunities. I also noticed all the new construction, another positive sign. However, the risk is high in such areas so be sure you can handle the uncertainty of low-income neighborhood realty investments.

Flipper property investors usually must hold for at least a year before earning profits in rapidly improving neighborhoods. Often, many years of holding are required to realize resale profits, if any.

If you can time your acquisition to buy from a highly-motivated "don't want" property owner who wants to sell out of a low-income and/or high crime area, and who will sell to you at a bargain-basement price and terms, it's possible to earn quick flip profits. But please be aware of the potential risks.

For more information. There have been at least three excellent new books published in 2004 about flipping properties. They are ***Fix It and Flip It*** by Katie and Gene Hamilton (McGraw-Hill), ***The Complete Guide to Flipping Properties***, by Steve Berges (John Wiley and Sons), and ***How to Be a Quick Turn Real Estate Millionaire*** by Ron LeGrand. Each book takes a different approach to real estate flipper profits. All are very worthwhile reading. They are available in stock or by special order at local bookstores, public libraries, and www.amazon.com.

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