Don DeRosa's

Real Estate Investing for The Real World

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Pricing it Right: Legwork Plus Intuition Equal Profits

Intuition will tell the thinking mind where to look next. ***Jonas Salk***

You pick up the Sunday paper and review the "For Sale by Owner" ads. One of them catches your eye: *"Moving out of town, must sell fast. Three bedrooms, two baths, lots of upgrades. Great area with excellent schools. No agents! Make an offer! 555-555-1111."*

Well, you never know. So you call the owner and ask what he wants for the house. He tells you the price is $214,900, but it's negotiable. The seller tells you that he had an offer on the house for $225,000 but it fell through. You ask a few more questions, get the address, and now it's time to get to work. You do some research and visit the house.

Your research shows that the seller's price is on the high side, but it's a great house. In fact, it's a *really* great house. You're ready to move in yourself, and you're sure everyone else will feel the same way. You know you'll make a profit, so you're willing to pay a little more rather than risk losing the house to another investor. Yeah, there are a few funky places where it may need some repairs, but wow, what a house!

Let's back up and make sure you're clear on some basic concepts, because in this business, knowledge truly is power.

First of all, remember that old real estate adage: You *make* your money when you buy, but you *realize* it when you sell. What the heck does that mean?

It means that before you ever go to the closing table – before you even make an offer – you'd better know what that house is going to cost you and what you can sell it for when you're through with it. In other words, it means doing lots of due diligence *before* you buy. If you're not going to hold the house for a while, it means you should decide what you'll sell it for before you ever put in an offer.

Now, I thought twice about doing an article on this topic, because it's pretty basic stuff. But a lot of investors are beginners. More importantly, I've found that just because someone knows what they should do doesn't mean they actually do it. Nowhere is that more true than in the real estate investment business! At every investor association meeting, you'll find people who are either too afraid to make any offers at all, or they're too eager to buy and they don't do their due diligence.

So I'll talk about determining market value momentarily, but first I want to talk about something even more important than pricing. It's that little guy (or gal) buried deep in your brain. Call it instinct, gut feeling, intuition, conscience, or a higher power. Whatever you call it, most of us have it. Maybe it's just a vague feeling you can't put your finger on. It might be a little voice inside that says, "I don't' think that's such a good idea." Or maybe it's someone in there screaming, "Are you nuts? Get out while you can!"

I've never lost money on a house, but I've done some things in real estate that weren't very smart Guess what? Every time I did something not-too-smart, I heard that voice. I just chose to ignore it.

Why am I mentioning intuition now? Because human beings are experts at ignoring our intuition. As investors, we get excited, we get greedy, and we want the house. So we ignore that voice that's saying, "Slow down, because something isn't right." We buy houses that we shouldn't, or we pay too much. I don't know about you, but if I want something badly enough, I'm really good at ignoring that voice!

Now, intuition can be wrong, but that's why you've got to do the footwork, too. You don't want to rely on intuition alone. But if you combine hard work, intuition, and due diligence, you'll make money in this business. If you ignore intuition, there's a pretty good chance you're ignoring something else, too. Namely, facts you don't want to hear.

So let's get back to our seller with the house. He wants $214,900. Is that a good price? It depends on what you're going to be able to sell it for, so let's talk about how you price a house.

There are five things that you must take into consideration when you buy a house in order to price it right and make a profit when you sell.

1. After-repair market value
2. Acquisition costs
3. Repair costs
4. Holding costs
5. Marketing costs

All of these elements are critical, and things can get complicated, so you'll need to set up a spreadsheet for doing calculations rather than trying to figure things on a napkin at your local MegaBurger joint. A good spreadsheet can be used over and over again to determine whether to buy a house and how much you're willing to pay for it. You can also use it to determine your loan-to-value ratio and return on investment.

Of course, the spreadsheet is only as good as the information you put into it. A mistake on your after-repair value can affect your profit dramatically, so you need to get that right. Your repair estimates could also be off. Maybe your holding period will be longer than you expect.

If you look at objective information, act conservatively, and build in a good margin of error, you'll probably be all right. But if you really want that house, you're likely to be a little optimistic in your calculations – and this is one place where you want to listen to your intuition very carefully. Do you have some sort of objective information to back up your figures? Are there any red flags you

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haven't fully investigated? It's just like marriage: the time to work out those red flag issues is *before* you take the plunge, not after!

Whatever else the calculation involves, though, it all starts with the after-repair value. Get that figure wrong, and you could be in big trouble!

There are several methods for determining the after-repair value of a house. The best method is through direct access to your area's multiple listing service, or MLS. The MLS, of course, is what real estate agents use. It's the best source of current sales information because it's constantly being updated.

If you don't have direct access yourself, the next best thing is to partner with someone who does have access, so they can help you pull comparable sales or "comps." If you want to work with an agent, I recommend you find one who understands what we do as investors. If you just pick an agent off the street, they may not have a tendency to think outside the box.

The next best way to get access to a house's value is through subscription-based services. There are all kinds of services out there that will give you information like tax record data. You have to pay for the services, but if you're going to spend money some place, this is the place to spend it.

Another way to value your house is by using a free Website that searches house sales. Now, there's a reason those sites give you information for free. They want to capture your email address so they can send you spam. But it is free if that's all your budget allows.

The next two are really almost a joke, but if you're in a crunch and you need to know roughly what a property will sell for, you can drive the neighborhoods and pull all the flyers. Now I caution you, just because they ask $150,000 doesn't mean the houses in that area are selling for $150,000. In fact, chances are they're not.

Last, and least reliable, is the seller himself. Ask the seller what his house is worth. And then assume that the seller is wrong.

If you have access to MLS one way or the other – and hopefully you do – then you'll be able to get comps for your area. How do you read them? The bottom line is this: look for houses that are similar to your house. Specifically, look at proximity, size, and age. Look for recent sales, too.

Determining the after-repair value of a house, and doing it accurately, is a critical key to success in this business. Don't skimp on research. Don't trust your instincts alone, but don't ignore them, either. Red flags don't go away just because we don't pay attention to them. In the long run, profits come when you combine objective facts with intuition. Dropping either of these ingredients just so you can get in the game is very risky.

In short, never forget that losing a deal is a lot less painful than losing your shirt.

Don DeRosa *was recognized as one of the nation's top 21 real estate investors in the New York Times bestseller* The Millionaire Real Estate Investor. *Don, who is a full-time investor, trainer, and mentor, offers a complete system to build and run a thriving real estate business. For more information on Building Wealth with Real Estate, visit* www.donderosa.com.

Synopsis: The key to making profits in real estate is to determine your costs and potential profits as accurately as you can before you buy the house. Sometimes, instinct can remind you that you haven't checked everything you should have. It's better to lose the deal than to lose money over a bad decision. Use objective criteria, like the MLS listings, to determine the house's after-repair value. Don't move forward with a deal until you are satisfied that you have done your homework and it looks like a good deal.

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