

## DEVELOPING YOUR BUYING FORMULA

One of most important things you need to know as a real estate investor is the maximum you should pay for a property so you can make your desired profit. The key to determining your maximum cash offer is knowing how to estimate the:

- ARV (“after repair value”) of the property (without relying on Realtors)
- Rehab costs
- Other costs of acquiring, holding, and selling the property

### ***Buying Formula Components***

Estimated Sales Price  
minus Estimated Rehab Costs  
minus Acquisition Related Costs  
minus Holding Costs  
minus Sales Costs  
minus Profit You Want  
Equals your Maximum Purchase Price

### ***Property Information Services***

You need to have a source for obtaining comparable sales. There are 3 data sources covering Harris, Ft. Bend, Montgomery, Brazoria, & Galveston Counties:

#### Multiple Listing Service

MLS Comps and Actives for sale

Realtors Only

#### Real-Comp (281-994-0405)

Basic Info & MLS Comps

Realtor Required

#### The Real Estate Almanac, Inc. (281-398-0880)

Basic Info w/MLS & non MLS Comps

Realtor Not Required

Realtors are very protective of their MLS arrangement because if caught letting non-Realtors use their MLS identification codes, they would no longer be able to use MLS.

Real Comp requires a Realtor be named in the application in order to obtain sales information reported by MLS. You should be able to get a Realtor to cooperate because doing so doesn't make the Realtor liable for the fees charged and it will not jeopardize the Realtor's MLS contract.

### ***Estimating ARV & Sales Price***

“After Repaired Value” (ARV) of the property is determined by an Appraiser at the current time (or time of loan).

Appraisal Guidelines are:

At least 3 comps – no trending

Use comps that sold in past 6 months if available

Use comps in subdivision if available

Square feet of comps should be within 10% to 15% + or – the square feet of the subject property

Don't cross natural boundaries to get comps

If comps not available, go to close-by competing neighborhood of similar properties

Don't use new or recently built houses as comps to a house built a long time ago.

### House Square Feet Adjustment

The square feet of living space is the #1 factor in determining the ARV of the property for a retail sale, assuming the rehab will be of such quality to bring the property to a good, marketable condition (relative to the subdivision prices and comparable furnishings for similar priced rehabbed housing). In other words, you don't fix up a \$200,000 house like a \$70,000 starter home, and you usually don't need the same quality in rental property as you do in selling retail for top prices.

Contrary to what many Realtors believe, there is not a linear relationship between the ARV and the living space of the house. You need to adjust at about  $\frac{1}{2}$  of the average square feet sales price for properties of a size similar to subject property.

Example: 3 comparable houses with 1500 square feet sold for \$74,000, \$75,000, and \$76,000 (average of \$50 a square foot). Subject property has 1700 sq. ft. What's the estimated ARV?  $\$75,000 + (200 \text{ sq. ft.} \times \$25) = \$80,000$ , not \$85,000.

You need to measure the house square feet yourself. The counties' appraisal districts frequently make mistakes on estimating square feet, particularly 2 story houses and houses with internal atriums.

### Bedroom adjustments:

Usually no adjustments are made based on the number of bedrooms, other than 2 bedroom houses are usually harder to sell.

### Seller Concessions

In evaluating comps, you should reduce the sales price by the amount of seller concessions. For example, a house that sold for \$80,000, with the seller paying \$5,000 of buyers closing costs would be the same as a house that sold for \$75,000 without any seller concessions.

### Miscellaneous Adjustments

Low end of range for \$75k house – high end for \$250k house

Full Bath:	\$1,000 to \$5,000
$\frac{1}{2}$ Bath:	\$ 500 to \$2,500
1 vs. 2 car garage:	\$2,000 to \$5,000
2 vs. 3 car garage:	\$2,000 to \$5,000
Fireplace:	\$ 500 to \$2,000
Gunite Pool:	Roughly 10% of Sales Price

### Internal Obsolescence

Value reduced if:

- No closet in bedroom
- No ½ bath downstairs on a 2 story house

### External Obsolescence

Value reduced if property:

- is next to vacant land
- is on a busy street
- backs to or next to commercial building or apartments
- backs to railroad or freeway
- close to high voltage power lines

### ***Estimating Fix-up Costs***

CRC's inspector uses the "Scope of Work Form" in determining the work needed to bring a property to a good, marketable condition and the "Cost of Work Form" to estimate the cost to do so. These forms are designed to be used regardless of the property's size and after repair value.

### ***Estimating Other Costs*** (6 Month Holding Period)

	<u>AS % of ARV</u> <u>ARV = \$100K</u>	
<u>Acquisition Related Costs</u>		
Inspection, Appraisal, Legal, Flood Cert.	.7%	
Mortgagee (lender) Title Policy	.3	
Title Company Charges	.4	
Loan Origination Fee	<u>3.5</u> .....	4.9%
<u>Holding Costs</u>		
Interest (6 months)	3.9	
Draw Inspection Fees (4)	.3	
Property Taxes	1.4	
Utilities & Yard Maintenance	.4	
Insurance Premiums	<u>.7</u> .....	6.7%
<u>Sales Related Costs</u>		
Owners Title Policy Premium	1.0	
Title Company Closing costs	.5	
Marketing/ Advertising/Commissions & Seller Concessions	<u>6.9</u> .....	<u>8.4%</u>
Total		<u>20.0%</u>

Note: These costs do not include flood or Texas windstorm insurance, survey, or seller's costs paid by buyer per agreement with seller. The mortgagee title policy premium is based on the seller paying for an owners title policy.

### ***Sales Price vs. ARV***

Sales Price should be more than ARV in a Sellers' market when there is a high demand for homes and prices are increasing.

Sales Price should be less than ARV in a Buyers' market when there is a lower demand for homes and prices are decreasing.

If your house is nicer than others in the neighborhood, you should sell it quicker and for more money than if you don't do the scope and quality of work necessary to produce this result.

### ***Your Buying Formula***

Assume your desired profit is 15% of selling price

Your Maximum Purchase Price (assuming SP = ARV) is:

Estimated Sales Price SP  
 minus Estimated Rehab Costs  
 minus 20% of SP for Other Costs  
 minus 15% of SP for Profit  
 Equals Maximum Purchase Price

#### Examples:

Est. Sales Price	\$75,000	\$100,000	\$150,000
Rehab Cost (assume)	-12,000	-16,000	-25,000
Other Costs (20%)	-15,000	-20,000	-30,000
Profit (15%)	<u>-11,250</u>	<u>-15,000</u>	<u>-22,500</u>
Maximum Purchase Price	36,750	49,000	72,500

#### Profit

Gross Gain (SP minus PP)	\$38,250	\$51,000	\$77,500
Rehab Cost	-12,000	-16,000	-25,000
Other Costs (20%)	<u>-15,000</u>	<u>-20,000</u>	<u>-30,000</u>
Profit (15%)	11,250	15,000	22,500
Profit as % of SP	15%	15%	15%

It's O.K. to pay more if:

- your financing costs, if any, are lower than estimated
- your seller concession and other sales related costs will be lower than 8.4% of the sales price
- you have minimal rehab work and an expected shorter sale time
- you will accept a smaller profit
- you are buying the property to be your own rental property.