

The Magic Touch

With a Little Paint and a Lot of Sweat, the Right Fixer-Upper Can Yield a Profit for an Investor

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Special to The Washington Post
Saturday, September 24, 2005; F01

It's little surprise that John Beal considers real estate the best investment a person can make.

During the past five years, the Leesburg resident said, he has bought about 10 homes in fixer-upper condition -- they needed new hardwood floors, fresh paint jobs, modern carpets, new windows -- spruced them up and then sold each one for a sizable profit.

Take an example from earlier this year. Beal said he bought a townhouse in Alexandria from owners who were in danger of falling into foreclosure. This meant that Beal got the home at what he considered a discount price. It also meant that the house wasn't in ideal condition and that he had work to do before he could put it on the market.

He refinished the hardwood floors, put in a new kitchen, added paint throughout the interior, put down new carpet and cleaned up the landscaping. The renovations took a little more than two months. He sold the home this spring, after a month and a half on the market, for a six-figure profit after taking renovation costs and other expenses into account.

"You can do three things with a fixer-upper: You can buy it to live in it. You can fix it and flip it. Or you can fix it and rent it out. I've done all three, and all three have worked for me," Beal said.

Last year, 15 percent of mortgages written were for non-owner-occupied property, according to the Federal Reserve. That's a big jump from 1990 through 1995, when investors accounted for about 5 percent of loans.

The reasons are obvious. The stock market continues to be volatile, scaring off some potential investors. Meanwhile, housing prices have risen steadily across the country and in the Washington region. For example, the median price of a single-family house in the District was \$485,000 in August, according to statistics from the Greater Capital Area Association of Realtors. In August 2004, the median price was \$375,000.

Investors such as Beal, though, are after something different: They are searching for bargains, those fixer-uppers that need some love and can be bought for thousands of dollars less than the cost of an average home in the same neighborhood. They hope to renovate the houses and sell them for significant profits.

It's a strategy that has worked well for Beal, who is acting president of the Capital Area Real Estate Investment Association. Beal, though, has an advantage: He's a real estate agent who knows how to price homes properly, knows how to market them and knows how complicated real estate deals can become.

Too many people looking for bargains don't understand any of that, Beal said. They make common mistakes that can torpedo their chances of making solid profits.

"A lot of people don't understand what it takes to actually do an entire deal," Beal said. "I've seen people get involved with renovation projects that cost more than they initially thought. A lot try to do their own general contracting to decrease the cost. Then they find they can't put in the new granite countertops because the cabinet guys haven't installed the cabinets yet. I've seen people underestimate what it takes to sell a property. They underestimate the holding costs, the mortgage, insurance, selling expenses, taxes. They think, 'If I sell it for \$500,000 and buy it for \$350,000, I'll make \$150,000.' It's not like that."

Real estate pros have plenty of advice for new investors. Their tips can make finding that perfect fixer-upper, and avoiding the costly mistakes that burn other new investors, a bit easier.

Lots of Competition

It's clear that investing in a fixer-upper can be frustrating if buyers don't know what they're doing. Every investor would like to find that bargain-priced house that needs just a touch-up -- some cleaning, a few coats of paint -- before it goes back on the market.

The problem is, such simple fixer-uppers may not exist.

"The only people who think there is an easy fixer-upper out there are people who haven't done it before," said Jeff Lyons, general manager of consumer Web site RealEstate.com. "Finding a house that needs only a fresh coat of paint for 50 percent below market value is unrealistic."

The first mistake people searching for fixer-uppers make is thinking that they're unique, that no one else is hunting for the same prize.

They're wrong, especially if they happen to be looking in a hot real estate market.

"The competition for these homes in this area is tough," said Susann Haskins, president of the Greater Capital Area Association of Realtors and co-manager of the Potomac office of Long & Foster Real Estate. "I don't have any reason to believe it is going to be easier in the future than it has been in the past to purchase these properties."

Those who find such houses, though, had better be prepared to act quickly.

"They are a great opportunity to some people," said Peg Scherbarth, district director of ZipRealty in Washington. "To find a house in Arlington close to the D.C. area at a great price that needs some fixing up, [is] a great value for some people. They're going to jump on houses like that when they come on the market."

Competition can turn otherwise smart people into terrible investors. Those who have successfully completed the sometimes stressful process of buying a fixer-upper, renovating it and then selling it for a healthy profit know the possible pitfalls awaiting investors, especially new ones. Most important, they know when to walk away from a fixer-upper that, for whatever reason, is not a good investment opportunity.

Walking away is a skill that new investors sometimes struggle to acquire. It's also one that investors sometimes need to exercise quickly, if the price for a fixer-upper isn't right.

Investors who pay too much for fixer-uppers will struggle to make a profit when it's time to sell. How much is too much depends on the neighborhood.

"Find out what houses in the neighborhood are selling for. Your upside, as far as what you can sell the house for, is limited to what the best house in the neighborhood is worth," said Evan Galen, an architect who works in New York. "Don't try to break through with a new sales record in the neighborhood. You can do it, but it's extremely hard."

Unemotional Attachment

Too often, inexperienced investors will fall in love with a certain fixer-upper, Galen said. They will see a Victorian that needs new floors, has a leaking roof and a cracking foundation. They'll pay too much to get that house, underestimating what repairs will cost, because they picture what it would look like if it were in pristine condition. But getting the house to that condition would cost far too much in time and money. When it's time to put the home on the market, the investor won't be able to set a price high enough to cover the original purchase cost plus the amount of money sunk into renovation.

"If you fall in love with a house and forget it's just a commodity, you can get into real trouble," Galen said. "Don't think about how adorable a house is. That's not what's important here."

Beal, the real estate investor, said people searching for fixer-uppers first establish a fair-market value that a house can fetch after it has been renovated. Once investors arrive at that figure, it is easier to determine if the price they're being asked to pay for a fixer-upper is a good one.

Here's an example, albeit a simplistic one: An investor determines that a fixer-upper once renovated could sell for \$100,000. That investor wants to make at least \$20,000 profit on the sale. Thus, the total of the purchase price plus all repairs, insurance, closing costs and

all the other fees associated with buying, renovating and selling a home can add up to no more than \$80,000.

Real estate ads in newspapers and on the Internet will show how much other owners in a neighborhood are asking for their houses. County property records will show actual selling prices, though there can be a substantial time lag before those prices are available through government Web sites. Beal said the best way to compute a home's fair-market value is by forming relationships with the professionals who know such things: real estate agents. They watch the market closely; they also have full access to local multiple listing services, including prices on deals that have closed.

Tim Bird, broker of the Columbia office of ZipRealty, said new investors sometimes make the mistake of turning to the wrong people for information about how much they should pay for a certain home. They get advice from friends or relatives and maybe their co-workers.

That, Bird said, is a big mistake. Investors instead should turn to professionals -- real estate agents, appraisers, home inspectors and contractors -- when deciding whether a fixer-upper is a good buy or not.

Working with those professionals costs money. In the end, it will be money well spent, Bird said.

"The people investors need to focus on using for advice are the people who are qualified to present them with the real costs, the real cost estimates for these kind of projects," Bird said. "The idea is to reduce the likelihood that there will be a major surprise down the road, to find out you can't do what you wanted to do with this particular house. That first pitfall is seeking information from people whom they shouldn't be seeking information from."

When to Walk Away

There are certain structural problems that make homes bad candidates to become profitable fixer-uppers. They require repairs that would cost so much that investors would have to charge more than what is realistic when it comes time to put the house on the market. Real estate pros recommend that investors walk away from such deals.

Structural problems are usually too expensive to fix. That means ignoring houses with cracking foundations and leaky basements. Mechanical problems such as outdated electrical wiring and plumbing might also give investors pause.

"The structural issues, things like the roof and plumbing, . . . are going to be the toughest to resolve and will give you the lowest return on your dollar," Lyons said. "That's why you want to have an inspection clause in your purchase contract. You need to know what you are dealing with."

Getting a home inspection before taking on a fixer-upper is key, real estate pros say.

"People need to understand that remodeling a house is expensive," said Roger Bass, an architect and owner of Bass Architects in McLean. "There are surprises that even we run into so frequently that are hard to discover until you've started your remodeling project."

Bass once worked on an older house in Maryland that had gone through extensive renovations. He and his crew tore up the tile in a bathroom only to discover that during a previous remodeling project, a plumber had completely cut through a number of floor joists. That happened, it appeared, while the plumber had been trying to cut holes through the joists for new pipes. Unfortunately, the plumber made several holes too big.

That leads to another common problem first-time real estate investors make: They think they can handle all the repair work themselves. Too often, they can't, Bass said.

"We've been called in on a number of occasions to take care of things that people had started that didn't turn out well for a number of reasons," he said. "Either they woefully underestimated the time and cost a project required, or they thought they could do it themselves and found out they couldn't. They may have tried to do things too cheaply, cut too many corners and then wound up in trouble. It's more expensive for us to come in and do the work after someone has started it."

Such horror stories may make it seem that investing in a fixer-upper is a fool's game. But many investors, even inexperienced ones, have made solid profits. They entered the business with their eyes wide open, and walked away from properties with too many serious problems or too high a price.

Frazier O'Leary, an Alexandria resident and director of training for the Real Estate Community Networking Group, an investment club in Alexandria, said: "This is a great business to get involved in. I think the biggest mistake people make is that they think about doing it but then never do anything about it. They think they're too inexperienced, or that they don't have enough money. You want to listen to the people who are doing it, not to the people who are too fearful to give it a try."