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'Flipping' Property Can Be Risky Business

By **PATRICK BARTA**

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Question: I am wondering about "flipping property." I've seen lots of literature on this subject saying how it is a quick process and can be lucrative if done correctly. I am wondering if there is an ethical way of flipping property, and is it even legal in all 50 states?

-- *Derrick, Washington*

Derrick: Flipping property is as legal and ethical as the person doing the flipping and potentially lucrative if you know what you're doing. But it's far from easy.

"Flipping" is the process by which an investor buys a piece of real estate and then quickly resells it at a higher price, either a few days or a few months later. It has gotten a bad name, though, for several reasons. In order to succeed, some investors have been known to commit fraud, often through the use of faulty appraisals that improperly push up the value of the property.

Also, economists are wary of too much property-flipping because such activity can push home prices higher than they might otherwise go, making it harder for consumers to afford a home and adding to the risks that a market will undergo a correction. Excessive property-flipping contributed to some of the pain during the last real-estate recession in Texas and elsewhere in the late 1980s and early 1990s.

But there also are many honest investors who make good money by flipping properties, without disrupting their local markets. In a nutshell, the strategy is to find properties that are underpriced whose values can reasonably be marked up -- perhaps after some improvements are made -- before they're resold.

Undervalued properties are particularly hard to find in today's hot market, but there are still some around. "Even in the hottest markets, you still find deals," says William Bronchick, a real-estate attorney in Denver and co-author of a book on the subject, "Flipping Properties" (Dearborn Trade Publishing, 2001). "Someone is getting a divorce, they're laid off, whatever. There's always a bargain to be found." Other "distressed" owners who might sell at a discount include people who've had a death in the household or who are headed for foreclosure.

Investors typically start by doing detailed research on prices so that they'll know an undervalued property when they see one. The National Association of Realtors, for example, publishes median prices for many local markets every quarter; the data are available on its Web site, www.realtor.org. It's also wise to contact a local realtor and scour local newspapers and Web sites to get a feel for specific neighborhoods where you might be buying.

To find the properties, buyers scan listings for key phrases, like "must sell," "needs work," "vacant" or "motivated seller." Often, they hunt for unsightly properties that need repair and are priced to sell; they also will try to develop relationships with real-estate agents who call them first whenever they see distressed properties. Serious property flippers sometimes go so far as to launch direct-mail campaigns or run advertisements in local papers or on billboards promising cash for leads on cheap homes.

Foreclosed properties are especially popular targets for property flippers, since the owners -- the banks or other investors -- often are looking to get whatever they can for the homes. The Web sites of the Department of Housing and Urban Development (www.hud.gov), Fannie Mae (www.fanniemae.com) and Freddie Mac (www.freddie.com) all have links to listings of foreclosed properties. Other useful Web sites include www.homesdirect.com, a unit of eBay. Foreclosed properties also are listed in local newspapers.

Investors should be aware of the risks, which are considerable. If you plan to flip a property, there's a good chance you'll have to pay a 6% realtor commission to sell it. That means that if you're selling a \$150,000 home, you'll need to make \$9,000 in profit just to offset your fees. You also have to factor in repair costs for the home, which can be substantial, plus all the time and labor you put into the process. In many cases, sellers have to make a lot of money just to break even. And there is a very real risk you'll lose money if you don't invest wisely -- or perform a rigorous inspection of the home and all its flaws.

To mitigate the risk, investors have to know their markets well enough to be sure they're investing in a property other local buyers will want. Don't buy a house with a one-car garage, for example, if the other houses on the block have two-car garages. And it's tough unloading a mansion to a high-end buyer if every other house in the neighborhood has deteriorated. The best property flippers, meanwhile, try to line up buyers before they even acquire the property so that they know in advance how much they can invest and still turn a profit.

-- Mr. Barta is a staff reporter for *The Wall Street Journal*. His "House Talk" column appears every other Friday exclusively on *RealEstateJournal.com*. [Click here](#) to email him your questions about the residential real-estate market. Please include your first name and city and state. If your question is answered and posted, we will show your first name and city.

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