

Turning Around Houses Is Risky

By Dan Rafter

Anh-Minh Tran has invested in residential real estate for more than a year, buying houses across Northern Virginia at low prices, fixing them up and reselling them.

Tran, a real estate agent who works in the Burke office of Jobin Realty, bought and sold about 10 houses in that time. But never before did he experience the kind of profit he earned in October.

Tran bought a home in Annandale that month, and spent about \$45,000 to install new hardwood floors, ceramic tile and kitchen appliances. Tran then sold the property for about \$400,000, taking in more than \$40,000 in profit.

The best part? The whole process, from purchase to sale, took only a month.

"That was amazing. You couldn't get another job that paid off like this," Tran said.

Investors across the country are sinking money into residential real estate. Like Tran, they are buying properties that need work, renovating them and either reselling the houses or renting them.

Real estate experts expect even more people to follow the lead of successful investors such as Tran. Those same experts, though, caution that investing in residential real estate is not foolproof. People who do not properly research neighborhoods, spend too much money on an investment property or fail to treat real estate investing as a business, will probably fail, they say, and lose a lot of money in the process.

"The problem with real estate investing is that everyone is getting into it late, just like what happened with the stock market," said William Bronchick, author of "Flipping Properties: Generate Instant Cash Profits in Real Estate" (Dearborn Trade Publishing, 2001), one of many books on the market with tips for investors. "Someone who is a real estate investor has to treat it like a business. They have to be persistent, and they have to want to work hard. Sometimes people make it sound very easy to make money at this. But it's not easy. It takes a lot of hard work. You're not going to get rich overnight."

The Right Neighborhood

Everyone knows the old saw: The keys to real estate are location, location, location. That is one cliché that happens to be true, especially when an investor hopes to turn a good profit. The right neighborhood can make all the difference in whether a home's value increases significantly, slowly or not at all.

The problem, of course, is finding that right neighborhood. A neighborhood that already is popular and trendy will be filled with homes that cost too much to be investment properties. One that is plagued with crime, unemployment and vacant lots will have plenty of inexpensive real estate. But investors who purchase one of those homes may have to wait several years before the neighborhood improves enough to fetch high resale prices.

That is why Gary W. Eldred, author of the book "Make Money with Fixer-Uppers and Renovations" (John Wiley & Sons, 2003), recommends that investors look for neighborhoods that are in the middle. They may not be the hottest spots in the region, but they are on the upswing. And because housing is still affordable, they are attracting residents. That means that investors can purchase a property now for a good price, renovate it and resell it when prices go up. In the meantime, they can rent out the property.

"Where are the buyers who can't afford the higher-cost neighborhoods now looking?" Eldred said. "That's

the key. Who is moving in? Who is moving out? A good sign that a neighborhood is entering a period of turnaround is when the newcomers are higher-educated and have higher incomes than the current residents."

Investors should look for several things when judging whether a neighborhood is on the way up, Eldred said. First, investors should look for active civic and neighborhood associations. Such groups, if committed, can help neighborhoods reduce crime, vandalism and other problems. They can also push residents to clean up their properties. Second, Eldred said, investors should look for neighborhoods that are either close to or have easy access to important job locations, such as factories, office parks, central business districts and universities.

Tim Bird, a Washington area agent for zipRealty Inc., said there are plenty of communities in the region that meet those criteria. He recommends that investors look for investment property in the District, perhaps in the Branch Avenue area. But he added that investors can find suitable homes and neighborhoods all the way out to Columbia, Greenbelt and Laurel.

It is important for investors to be patient, he said.

"It's important to wait for a certain period of time before reselling the property," Bird said. "Let time work for you. Let time help the property increase in value. The notion should be there that you don't have to resell the property immediately after you renovate it. Let it sit for a while as the neighborhood's property values appreciate. You can rent it out while you wait. Let time and the market work for you. I've seen that work successfully for clients quite often."

Investors should consider one more factor when looking at location: Even if a home sits in the middle of an appreciating neighborhood and can be had for a bargain price, it is best to pass if getting to it requires a three-hour car trip.

"Keep in mind, when getting an investment property, how important it is to be able to easily manage it," said Arlene Koby, an agent with the Bethesda office of Weichert Realtors. "It should be close enough to where you live that you can get to it quickly when you have to."

The Right Property

While location is key, investors should also consider carefully the condition and amenities of a potential investment property.

The common advice is to find a house that needs new paint, carpeting or other cosmetic improvements. These houses will cost less, take a minimum of effort to renovate and can be resold quickly.

That is good advice. The problem is, in high-cost areas such as the Washington region, houses that need just a little bit of improvement come with big price tags, big enough to make it tough to collect a solid profit at resale.

That is why Bronchick recommends that investors instead find homes that need a lot of work. Those are the ones that pay off in the long run, he said.

"I find that the more rehab a home needs, the better deal you are going to get," Bronchick said. "If the home just needs to have its carpets cleaned, you are not going to get a good deal. If a home needs at least \$15,000 to \$20,000 worth of work, that makes the property and the owner in more distress. There will be fewer competitors for that property."

The only way to make money in real estate investing is to get a good deal when buying the property, Bronchick said. Investors who pay near market value for a home and then wait for the home to appreciate are those who most often get burned, he said.

"You have to make the deal when you first buy the property," Bronchick said. "That's the only way to do it."

One of the best ways for an investor to find a good deal is through the Housing and Urban Development Department. HUD homes are often sold far below market rate, although it is a myth that investors can buy some for \$1. Still, bargains can be found.

All HUD homes must be bought through a real estate agent registered with the federal agency. That means investors cannot simply buy a HUD home on their own, unless, of course, they are a HUD-registered real estate agent.

Investors looking for HUD homes can visit www.hud.org for a list of available properties.

"HUD prices their houses so that they sell extremely quickly," said Ronald Rudolph, a real estate agent with Century 21 Advantage Gold in Philadelphia who, while buying and selling primarily HUD homes, has become the top solo real estate agent in the country, according to Realtor Magazine. "HUD is not really in the real estate business. They want to sell their houses and sell them quickly. It's possible to get some great deals by working with HUD homes."

Common Mistakes

Even when investors find the right neighborhoods and the right properties, there is still no guarantee that they will make loads of money.

People new to investing in residential realty sometimes start out too big. Instead of finding a small townhouse or single-family house, they choose a huge, dilapidated spread, one that needs tens of thousands of dollars worth of repairs. Such a property could be ideal for an experienced investor, who has a network of talented electricians, plumbers and carpenters. But it is a potential disaster for novices.

Reggie Marston, president of Springfield-based Residential Equity Management Home Inspections, often inspects prospective purchases. Occasionally, he advises a client to pass on a property.

"A lot of people have watched the late-night shows on TV that promise you can make quick millions by investing in real estate," Marston said. "They figure they only have to buy something cheap, put some paint on the wall and make millions of dollars. Unfortunately, a lot of the people who try to get into this have no knowledge of construction. They don't realize that there's a huge crack in the foundation. They don't realize that the whole property may be sliding downhill. There goes all the profit."

Four years ago, Marston inspected a house in the Prince George's County town of Cheverly. As soon as Marston walked in, though, he knew the house had serious problems. For one thing, it needed a completely new electrical system. It also needed a new roof. But worst of all, the entire back of the house had collapsed. Marston advised the prospective investor to start with a different house. She took Marston's advice.

"I recommend that people start with something small," Marston said. "Maybe they can start with a little condo that's in bad shape, or something that needs a small kitchen rehab. Then they can move to the next level. Maybe they can find something that's been sitting around empty for a few years and has suffered termite damage or has some rotted flooring. They can step up a bit and cut their teeth on that. . . . After they've done three or four properties, they can then go for that big one."

Another mistake investors make is buying in a market they do not understand. That can lead to some obvious, and costly, mistakes.

Some investors forget to check zoning requirements. That can prove costly, especially if an investor buys a property with plans to convert space above the garage into an apartment, only to find out too late that such use is prohibited.

Many investors underestimate how much money it takes to be successful. Rehabbing is not cheap. Investors have to spend money on contractors, may have to pay permit fees and will almost certainly have to spend money to advertise the property after the rehab is complete.

"You have to build up a cost assessment of the project," Bird said. "Without that, you really don't have any idea of how much something is going to truly cost. You won't have any idea of whether the property you are considering is even going to work."

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