BUYING LIKE A REAL ESTATE INVESTOR:

15 SECRETS FOR BUYING YOUR NEXT HOME

By Dahna M. Chandler

Your home is among your biggest lifetime purchases, so you'll want to make it right. Like most Americans, you have most of your net worth tied up in your real estate. As an appreciating asset that typically accrues significant equity in the long term, real estate can be used for multiple funding purposes, from college tuition to additional real estate investment. It can also be passed down to your children.

Whether it's a condo, single-family home or multifamily property where you'll occupy one of the units and rent out the others, your property is an investment. You should buy it like a real estate investor so it's the most lucrative asset possible. How do you buy like an investor? This guide shows you how, and why this is the best purchasing strategy for residential property.

To provide the best real property investment advice, we interviewed five experts. Find out more about our experts here.

Get Your Mindset Right

Before doing a property search, shift your mindset from an everyday residential buyer to a savvy real estate investor who's determined that their investments will be profitable. These first few secrets will help.

1. Don't Fall In Love

On real estate buying shows, the buyer tells their real estate agent they must "love the house the moment they walk in" because "it's how they'll know it's meant for them." But our experts say, "Never fall in love with a property".

This is a business transaction where a clear head makes for the best deal on each property. "They're just bricks and sticks," says Kyle Alfriend. "There are hundreds of great deals available on great homes. Always be willing to walk if the numbers don't work," he continues. Mindy Jensen agrees, adding, "Don't get emotional. That first home might seem 100% perfect, but another might fit your needs better. If you have to walk away, remember, you'll find another house."

2. You make your money when you buy, not sell

Focus on the end game—getting your selling price. That's true whether you'll stay two years or 20. Even if you're bequeathing the property to your kids, think about what they can sell it for so you buy the right house at the right price. "Selling well is the realization of having bought correctly," explains Bruce Ailion.

Adds Jenson, "Not every property is a good deal or a good investment."

3. Be future focused

Remember, for most residential buyers, real estate is a long-term investment and you should buy your house with the future in mind. Know what you will do with the property before you start looking.

“It’s critical, when you’re buying like an investor, to determine your exit strategy for the house in advance,” says Johnna Barry.

Because this will be your primary residence, you’ll probably live there while you renovate and then sell later. Both Alfriend and Jensen use this strategy. “I see every house as a flip,” Alfriend says. Every buyer should.

Jensen adds, “I live in the house for two years, long enough to reduce capital gains taxes at sale; I fix it up and get a great sales price when I sell.”

If your goal is to buy low, build equity and use that to invest in other properties or buy a bigger house, know that when you buy. Also, if you’ll be a landlord, know how long you’ll live in the property before moving out and renting your unit. If you plan to stay long-term, learn what design trends are likely to be when you sell and buy a home with the flexibility to make the changes necessary to sell.

Get the Numbers Right

Your next step is to know what your numbers will be at closing even before you secure financing. Let these next several secrets be your guide.

4. Know what you can buy before seeking financing

Real estate investors know their financial position before they secure financing. They know the following: what type of property they can buy, how much down payment they have, their maximum monthly mortgage (and what that will include), their other financial obligations, their full credit profile, and the additional costs for their desired property.

They also know whether they'll be saving for their next down payment while living in the house or using equity gained on the house to purchase their next property. They understand their buyer type—whether they're gainfully employed or successful business owners.

Additionally, they make sure nothing on their credit report will scare lenders. Ailion says, "Check your credit score before seeking financing and evaluate with a lender or credit expert how to improve it. Lowering balances, challenging inaccurate or old items, and reducing installment payments like auto loans to under six months remaining will improve your borrowing ability." In fact, do whatever's necessary to repair or rebuild your credit before pursuing financing.

Most investors also have a formal financial plan that includes real estate. That means you've sat down with your financial planner and created a plan for buying property that fits your long-range goals. Then you'll know what you should buy before obtaining funding.

5. Understand the various loan types available

The kind of mortgage financing you'll be eligible for depends on the property. Several types of financing are available, like conventional, FHA, USDA, VA, and local lending programs with down payment assistance and buying incentives for certain communities.

"If you're going occupy the property right away, you can use any available program, since yours will be a standard owner-occupied purchase," explains Don Frutchey. "If you're buying a multi-unit with a lower down payment, FHA is best." That's because FHA loans only require 3.5% down and are often available at lower credit scores.

"FHA allows purchase of up to four units, but if the property is two to four units, one must be owner-occupied," adds Frutchey. "The minimum down payment would still be 3.5% but would include additional requirements, like higher reserves," he continues. Higher cash reserves are necessary for maintaining rental units.

Guidelines for jumbo loans are more restrictive because they exceed the loan limits for FannieMae or Freddie Mac backing.

It's important to know all the rules of the mortgage types you're considering to meet your real estate-related financial objectives. Frutchey says that with an FHA loan, "If the borrower doesn't intend to occupy the property, they'll need a minimum down payment of 15%. For other properties that won't be owner-occupied, conventional/conforming loans will be required." VA, USDA or local programs have other restrictions.

6. Get the right financing in place before shopping

Investors understand financing can make or break a deal. As a residential buyer, your mortgage will have more favorable terms. But you should also obtain financing with selling in mind. Once you know the differences among the various types of financing available, this aspect is easier.

Jensen says, “Just because a mortgage at a 4.00% interest rate is available, that doesn’t mean you should accept that rate. Calculate the closing and other costs and you might find that mortgage costs more long-term than one that’s 4.25%.” Use a good mortgage loan calculator to see what actual borrowing costs will be.

To get the right mortgage, find a lender who’ll work with you based on your buying goals. “Talk to at least three lenders,” says Ailion. He points to new rules under Know Before You Owe that help buyers make better choices. Familiarize yourself with the new regulations before securing financing. Also keep in mind that if you’re a business owner, there will be different requirements for obtaining a mortgage.

7. Know what kind of insurance you’ll need

There are certain types of insurance you’ll need as a property owner, and investors should think about those costs before purchasing property. Jensen reviews several.

“If you don’t put 20% down, you’ll have to purchase private mortgage insurance (PMI) to cover a loan default,” she explains. Once you’ve paid enough principal to meet the 20% requirement or the property reaches 20% equity, you can request that PMI be canceled, she says. “But if you have an FHA loan and put down 3.5%, you’ll pay PMI for the life of that loan even after you’ve reached 20% in equity or by paying on the loan, which gets expensive” she states. You can avoid paying this extra $100-$200 monthly by refinancing your FHA loan after reaching that 20% in equity or principal payments.

You'll also need homeowners insurance, and what you buy depends on property type, location, purposes for the property and other factors. Find an agent who will work with you based on your real estate investing goals. Shop around for the best rates and know which carriers are best rated for homeowners insurance as well as for your needs. Then make sure you buy enough to cover all your risks. This is no place to cut costs.

Just as important, Jensen insists that investment-minded buyers be prepared to purchase title insurance. One out of three title searches at closing reveals defects that must be fixed prior to closing. "Title insurance protects you from title misdeeds during a previous sale that weren't your fault, like forgery," she says.

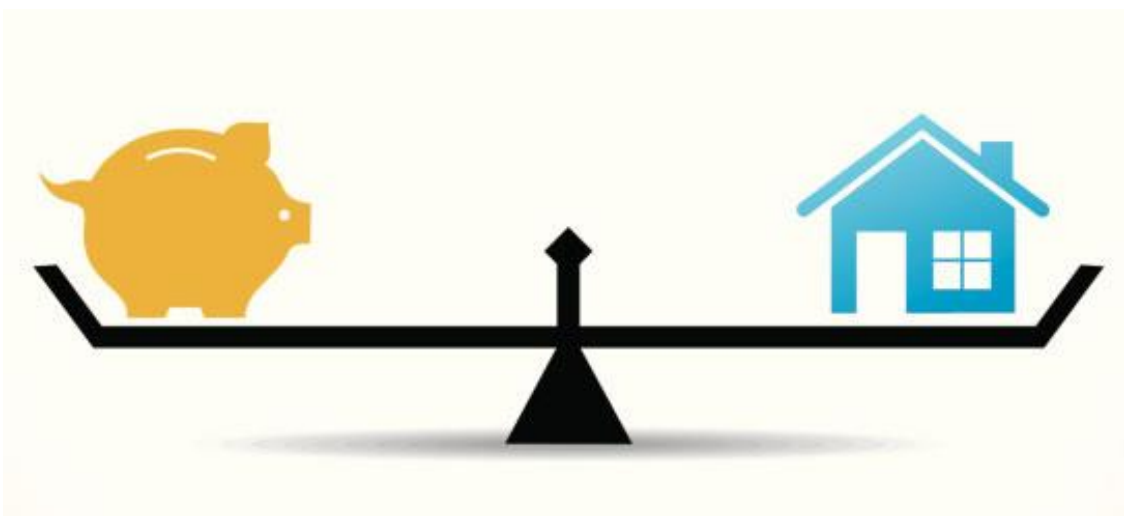
You can sue a title company if they miss issues that should have prevented you from buying the property. Owner's title insurance also protects you from defects or 'clouds on title' that may cause problems at resale, like fraud, forgery, a missed heir or a former owner's dispute. "You want to pass on a clean title at sale. If you don't know the whole chain of property ownership, buy title insurance," Jensen adds.

Depending on where you live, you may also need to buy both lender's title insurance (which covers the lender in case of a suit) and owner's title insurance. Shop around for those policies as you would for any other insurance. Don't just buy from the first company that offers.

If you're thinking about buying property that you'll renovate while living there, you'll need insurance specifically for that purpose. It's more challenging to get than conventional homeowners insurance but is obtainable. Know what renovations can affect your homeowners insurance and make sure you can afford and purchase the proper coverage before you start looking at real estate.

Finally, lenders may require additional types of insurance for owner-occupied investment properties. Check with them about what other insurance may be needed.

8. Consider other real estate investing costs



It's not just down payments, typical closing costs (some of which you should shop for and reduce) and insurance that you must calculate. You'll also need to consider real estate commissions, property taxes beyond closing, additional legal fees (for assistance becoming a landlord, for example) and the costs if you're considering renovations.

Buy the Right Property

Investor-minded residential buyers need to know what type of property to buy. Start by choosing the right real estate agent and let them help you with the process. Since you're serious about buying like an investor, work with an agent who has completed specific training for working with investors. But choose wisely, because as Ailion says, "It is hard to recover when you don't buy right." Here are additional steps to help you.

9. Buy for location

Add Many things can be compensated for or overcome, but location isn't one of them. "Investors focus on location over all else when buying," says Ailion. "Issues like bad schools, a bad commute, bad neighbors, bad demographics, retention ponds, busy streets, a shopping center dumpster, airport, cemetery or landfill will kill value," he explains. "Buy the best location you can; pay a premium to be in the best lot in the community."

If you plan to rent your property, Barry says to make sure you invest where your next buyer will. "Buy for convenience," she says, "because renters want that." They want good public transit nearby or to be within commuting distance of jobs, entertainment and other amenities. "Consider that convenience factor for rentals," she says.

Alfriend insists that you look for the pockets between hot areas because they'll be the next popular places. "They become the second-best places to buy without the risk of buying in completely undeveloped areas." Jensen says you can find these pockets by "using a map to identify the hot areas and buy either between them or on their immediate periphery." She's seen buyers get great deals and gain equity quickly using this strategy.

10. Consider distressed and multifamily properties

Both these types of real estate can be scary to average buyers, but not investors. Distressed properties need major repairs, or, according to Ailion, are "damaged or quirky in a way that limits the number of buyers, but they are fixable with money." You'll need to get a discount deep enough to make the repairs, fix the damage or quirks and then sell at a profit.

"A distressed seller may be a bank, divorcing seller, estate, or business owner selling to save their business or other investments," explains Ailion." The best deals combine both.

This isn't a beginner strategy, so when considering this, "Find a broker who specializes in working with distressed properties and sellers and who is willing to work with buyers," Ailion says.

Multifamily properties of between two and four units are also good investments for residential buyers and "a great way to build equity," says Barry. They're best for buyers willing to be landlords. It's crucial to be ready to take on all the responsibilities involved.

Barry says, "You can expect tenants to knock on your door at all hours with repairs and other requests." She says, "Carefully vet your tenants to make sure they can and do pay rent on time." You'll also need cash reserves to cover everything from repairs to nonpayment of rent. "You're responsible for your entire mortgage no matter what happens, so make sure your cash reserves support being a landlord," reminds Barry. She suggests an equity line of credit to cover contingencies like repairs, rent nonpayment, preparing a unit for re-rental, and vacancies if you can't re-rent quickly.

Here's a caveat about buying condos you intend to rent later: Make sure the condo building is rental-friendly. Its bylaws should allow owners to rent out units and, if only a limited percentage can be rented, make sure you buy when that percentage is well below the maximum. Also, says Barry, "Know how long your leases can be and if there'll be challenges to your financing in a building with owner occupancy rates that are too low."

11. Don’t overlook ugly properties

In fact, most investors target these properties in the best neighborhoods and renovate. Jenson says to make sure the house is strong structurally. “Don’t overlook obvious problems like black mold, a meth house or a cracked foundation,” she warns.

To be an investor, you must have vision, so overlook cosmetic issues like paint, carpets and outdated but changeable features, especially if you buy at a discount deep enough for renovations.

12. Buy for bedrooms, layout and expected features

Investors buy homes that residential buyers will purchase. “Always buy for bedrooms rather than just living space,” stresses Barry, especially condos or homes you’ll rent to students or 20-somethings. They’ll want space for roommates, but not necessarily great living rooms or big kitchens.

Alfriend agrees. “People want bedrooms because they can convert them for other uses like a den or an office.” But he says to consider future trends because, for example, formal offices and dining rooms are less popular than they once were.

Also, avoid strange layouts; those homes stay on the market longer. Sidestep homes that lack key features, too. “Homes must have the features that buyers expect in a neighborhood. Otherwise your prospective buyer won’t consider your home or may force you to discount at sale,” says Alfriend. “Average and boring wins,” he continues, “so copy the market; have all the features at the location that buyers want but nothing more.

13. Buy the right kind of property for your resale goals

Don’t buy too much house for the neighborhood, even if you can. “If you’re going to sell the property in a few years, buy one you can sell to the widest variety of buyers,” says Jensen. Property buyers looking in most neighborhoods aren’t seeking the most expensive house there. If yours is that property, it won’t sell quickly, even in a hot market.

In fact, Alfriend says, “Buy at average price or lower for the neighborhood because home appreciation follows that average price.” He explains, “If a $500,000 neighborhood is appreciating at 10%, every home will appreciate about $50,000. That means the $800,000 and $300,000 homes there will see $50,000 in appreciation. The lower your price, the higher your return on investment.”

14. Act fast when you find a house: Make an offer

Investors do all their research in advance, know exactly what they're seeking, and are ready to buy when they find the right property. They understand this is a business decision that they should make quickly or risk losing a great deal. Being a serious buyer means behaving like one, explains Barry. "Make your offer based on the area's comps and make sure it's for what the house appraised for. Your offer should be as attractive as possible without contingencies like selling your current home or securing a mortgage before buying. Also, consider putting down more earnest money with the offer to show you're serious."

15. Get an inspection and know how appraisals work

Jenson says investors always get an inspection; it's a cost of doing business. Unless you're an expert, an inspection is critical to getting a good deal; it will identify potential problems and their costs.

Jenner explains, "A good inspection will show you the basic mechanicals and structural condition of the property, but not what's behind the walls." It will tell you whether wall and foundation cracks are minor cosmetic issues or major, expensive structural problems. These things are important when negotiating a price that takes such issues into consideration.

An appraisal is an expert determination of the home's value based on guidelines established by the industry and state regulation. It is based neither on inspections nor on the price negotiated between buyer and seller. Lenders use the appraisal to determine how much mortgage they'll provide.

There are fundamental differences between FHA and conventional mortgage appraisals. “An FHA appraisal stays with the home six months before a new appraisal is possible,” says Jenner. If you buy the property, do renovations that raise its value, and want to sell within six months, you’ll be limited to FHA’s appraised value. “That’s not true with a conventional mortgage,” says Jenner.

Final Thoughts

If you’re serious about buying like an investor, get educated. First, understand the basics about buying any residential property. The Consumer Financial Protection Bureau has excellent homebuyer education resources. Know regulations specific to your state or locale for buying residential property. Understand financing thoroughly.

Also consider using sites like Bigger Pockets to learn about investor buying strategies, but use discernment when applying what you learn. Your local library also offers books and other resources about real estate investing. Again, apply the advice you get from them carefully and, when in doubt, check with your real estate agent, attorney or lender about anything you don’t understand or that seems suspicious.

Use the same caveats when attending seminars or buying courses, Ailion warns. He says, “You can buy many of the $2,000 real estate guru CD and DVD courses on eBay or Craigslist for $100-$150.” He says that while most cover the basics well, many have numerous aggressive strategies that rarely work, are nonsense, and are often unethical. Similarly, he says, “Every city has a meeting group for investors but beware of sharks there.”

It’s probably best to stick with reputable sources of information and use licensed professionals to help you.

Moreover, Alfriend says, “Always have a Plan B, because while real estate is an incredible investment, it is not liquid.” The market changes quickly and you may be unable to sell when you’re ready. You also don’t want to be forced to sell too soon. Remain in a firm financial position to carry the home longer than expected if necessary and ride out storms in the market. “Be prepared to stay in the home or rent it if selling season closes,” adds Alfriend.

Meet the Experts

Bruce Ailion

A broker, investor, and attorney and principal of The Ailion Team, he's been working for 37 years in metro Atlanta real estate and holds an MS in real estate and urban affairs. He's purchased six residences, five as an investor, and purchased and renovated about 150 properties altogether. He's taught three of his children, now 21, 26 and 29, the business and they've purchased properties, his oldest about ten. For half his career, he's represented REO sellers and holds multiple certifications in real estate.

Mindy Jensen

A licensed real estate agent, Jensen is passionate about real estate. An investor/agent who uses investor strategies to purchase properties, she has been investing since 1998. Her primary investment strategy is "live and flip," which she's done with eight properties. Jensen is also the community manager for Bigger Pockets, a social media platform for real estate investors.

Kyle Alfriend

Lead agent of Alfriend Group in Dublin, OH, Alfriend is a realtor and real estate investor. He bought, moved into, renovated, and flipped his first home when he was 18. He's bought and sold 126 homes, living in 18 of them. He's also represented buyers and investors in more than 1,500 home-buying transactions in the past 26 years.

Johnna Barry

Licensed real estate agent and owner of Bridge Property Services in Boston, MA, she has more than 16 years of industry experience, having worked in residential and commercial real estate since graduating from college in 1999. Her experience includes both residential and commercial building management, purchasing, leasing, renovation and value management.

Don Frutchey

A mortgage loan officer since 2001, Frutchey, senior loan officer for Atlantic Coast Mortgage in McLean, VA, brings a wealth of knowledge and a broad perspective when working with clients. Specializing in jumbo, conforming, FHA and VA Loans, he tailors financing to meet unique situations. He's a bona fide expert in all aspects of mortgage lending.