

Buying Bank Owned REO Properties Using Private Investors' Money

There are fantastic bargains available in the real estate market.

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Many real estate buyers are aware that there are fantastic bargains available in the real estate market. The huge amount of bank foreclosures has led to a tidal wave of bank owned REO properties which has flooded the market with low priced properties. Astute investors are taking advantage of this situation to scoop up houses at bargain basement prices.

If you are considering investing in bank owned properties then you will need to be a cash buyer. This means that you are required to show “proof of funds” which is usually a bank statement which shows that you have the cash available to purchase the house.

If you don't have the cash available then you will need to borrow the money from someone that does. If you have a relative or friend with access to cash they might be willing to lend you money to purchase a property in exchange for you giving them a first mortgage on the property. They will effectively become the bank and you will be required to make a monthly payment to them.

There are professionals in the real estate business that make these kinds of loans to people that are not relatives. They are called hard money lenders.

The only difference between a hard money lender and a private investor is the interest rate.

Borrowing from Aunt Sallie might cost you 8% per year in interest. A typical hard money mortgage in today's market would be 15% plus 3 points up front.

Why would anyone borrow money at such a high interest rate? Let's look at an example. Assume that you could purchase a bank owned REO property for \$40,000 when the house has a true market value to a non cash buyer of \$80,000. Paying 15% interest on a \$40,000 loan amounts to a monthly payment of only \$500.

Assume that you waited 90 days for seasoning of title and then sold the property to an FHA first time homebuyer for \$79,900. Assume that you paid a commission of 6% to the realtor and another 6% to pay for the buyers closing costs. You would still net \$70,000 from this transaction. After paying off the hard money lender the \$40,000 that you borrowed, you would still be left with a profit of \$30,000. Even if you held the house for six months before finding a buyer you would only have spent \$500 per month in interest for 6 months. Your total interest cost would only have been \$3,000. This would leave you with a net profit of \$27,000. Or expressed another way, using no money down (borrowing all of the money) you could potentially make a profit of \$27,000.

How easy would it be to sell a house like this to a first time home buyer? The answer is it would be extremely easy. The buyers are putting down only \$3,000 (3 ½%) to buy a house with a monthly mortgage payment which is about the same as their monthly rent. You are paying all of their closing costs. And the government will give them an \$8,000 tax credit if they purchase before the end of 2009. It is a win/win for everyone. The bank gets to sell their property quickly to a cash buyer. The cash buyer gets to flip the property and make a quick profit and the end FHA buyer gets to own a home for the same monthly payment as rent.

The trick to the above transaction is to find an \$80,000 property that you can buy for \$40,000. This is the part that requires training, knowledge and experience.

Finding deals like this is an art form and the people that find these deals are known as "bird dogs" or "property scouts".

Many bird dogs sell their deals to cash investors for a small profit. **This is known as wholesaling.** For example a wholesaler might contract to purchase the above house for \$40,000 and then sell it for \$45,000 to

another cash investor. This way, the wholesaler does not need to borrow money from a hard money lender. The wholesaler simply finds a deal, signs a contract to buy it and then flips the contract to a cash investor for a profit. This is known as “**assigning a contract**” and the profit that is paid to the wholesaler is known as an “**assignment fee**”.

Banks do not want wholesalers flipping contracts on bank owned properties. For this reason, banks do not allow assignable contracts. This means that a wholesaler cannot assign a bank owned property to another cash investor. The reality is that there are still ways that a property can be assigned. One way is to purchase the property in a Land Trust and then assign the beneficial interest in the land trust. Another way is to purchase the property in an LLC and then assign the membership interest in the LLC. However the problem with these methods is that the end buyer might not want to have a land trust or an LLC.

For this reason, the best way to sell a bank owned property to another cash investor is to have what is known as a double closing.

This means that the wholesaler essentially buys the house from the bank and then simultaneously on the same day sells it to another cash investor. The disadvantage is that the wholesaler will be paying double closing costs.

If a wholesaler has a signed contract and is wholesaling the deal to an end buyer, then if the wholesaler is short on cash they might need what is known as “**transactional funding**”. Transactional funding is perfect for bank owned properties and short sales that a wholesaler is flipping to an end buyer. Since banks do not allow assignable contracts the wholesaler is going to need to schedule a double closing with the end buyer. Double closings also known as simultaneous closings allow a wholesaler to schedule two back to back closings for the same property on the same day. The wholesaler will need to have a source of funds to pay for the first transaction. This is where transactional funding (also known as same day funds) is needed.

Our company offers transactional funding to all of our Private Mentoring Students. However our students need to schedule both closing with our title company in order for us to offer the transactional funding. We will only offer transactional funding if both closings are with our title company (Independence Title & Escrow).

If you are looking to flip a bank owned property then you will have two contracts and two closings. The first contract is between the bank (seller) and you (buyer). The second contract is between you (seller) and your end buyer (buyer). The end buyer is the person that will ultimately be the long term owner of the property.

Example:

A – Bank

B – You

C – End Buyer

Assume that you have a contract with the bank to purchase a bank owned property at \$40,000 (first contract). This is known as the A-B transaction.

You market this property to your cash buyers and you find a buyer at \$45,000. You sign a contract with this buyer with you being the seller and them being the buyer (second contract). This is known as the B-C transaction.

The difference between the two contracts (after deducting closing costs) is your profit which you will walk away with at the closing. Since there are two contracts there are two closings. This means you will pay double closing costs.

The transactional funding fee that we charge is 2% +\$495 with a minimum fee of \$1,250. For example if you were to request \$40,000 your fee would be $\$800 + \$495 = \$1,295$. We will only provide transactional funding if you use our title company (Independence Title) for both closings.

To learn more about transactional funding please visit http://lexlevinrad.com/transaction_funding.html

Lex Levinrad has been a full time distressed real estate investor since 2003. He has been involved in buying, rehabbing, wholesaling, renting, and selling hundreds of houses in South Florida. Lex is the founder and CEO of the Distressed Real Estate Institute, which trains beginning distressed real estate investors about how to find wholesale real estate deals. For more information about the Distressed Real Estate Institute please visit www.lexlevinrad.com
