Module 8 – Exit Strategies

If you come into a situation where the property is simply not selling, you'll want to consider a number of exit strategies that we discuss here.

Lowering the Price

Exit strategy number one is simply lowering your price. But the idea is to understand where your bottom line number is at all times because that's really going to determine your strategy and how you lower your price, and time is very relevant to that.

This is also why it's so important to understand what the maturity date is on your promissory note. It's very relevant, because if you have a six-month promissory note, that could be a serious problem. I would never recommend to anybody to get involved in a six-month promissory note. You always want it for at least 12 months. The idea is to buy it, rehab it, and sell it in under six months. But you don't want your note ever called because you couldn't sell it in 30 days or something like that.

Of course, every day that goes by costs you money because you're borrowing money to do your deal. So you've got to keep that in mind what your cost of money is as you're lowering your price. The idea is to really understand how lowering your price weighs against your bottom line. If you're selling a property at $300,000 and your projected profit on that might be $60,000, you have some room there. And you might say to your real estate agent, *"Hey let's put it out there for $300,000, but let's have a strategy to lower that price if, in fact, we get no offers in, let's say three weeks."* You may sell it on day one. But in three weeks if you get very little activity, and there could be several reasons why that is the case, you need a strategy. And that's where a good relationship with your real estate agent will help you to determine that, but talking these things out with your real estate agent ahead of time will help you to come up with a price-lowering structure so that everybody knows what's going on.

The idea is you never want to price it too high, and we talked about that in the ARV session. But you need to have an idea when you go into it, if there's no activity or if there's lots of activity, to help determine when or if you lower the price. Your agent may be saying, *"Hey I recommend a price change or lowering it. It's been three weeks and we had no activity at all."* And maybe are there other factors that are causing that. But if it's just purely on price, then you might put in place to lower it ten grand. And then you're already thinking about the next price lowering amount and even if it's three weeks out, but as you think about that you really need to start to make sure you understand where you are with the property, what your expenses are and what the results of your net profit is going to be.

The whole point of this is to understand what is your bottom line and how long will it take you to sell it, especially on a time-sensitive situation. Let's just say your project took you way too long. You were in it for six months with your contractor. By the time you got it listed you were in it for seven or eight months. You've got to keep in mind that you might have a note that's due in 12 months, so your urgency to lower the price may be stronger in that situation. It doesn't mean you need to give the house away, but you want to also recognize that you might have to sell it more quickly to make sure that you don't get in the situation where the note gets called.

Now I don't want to scare you with this note being called or this foreclosure and things like that, but you need to understand that this could happen if you don't pay off your note in the time that it says in the promissory note. And you need to have a good relationship and a good understanding with your lender; if it's a private lender, the deal will be structured differently but if it's a hard money lender sometimes you have to go with their terms. The idea is I always ask my hard money lender, *"Hey, let's just say I got stuck on a property. It took longer than I wanted. We ran into some legal issues. Blah blah blah blah, and all of a sudden we didn't have it sold in that 12 months. Are you going to foreclose hard on me?"* The ones I do business with say, *"Mike, we're not going to foreclose on you. We'll do an extension. Maybe we'll give you another 90 days. We're going to work with you. The idea is we don't want to hurt you in this transaction."*

So it's always good to have that conversation with any hard money lender in the event you get into a contract with them; maybe even put an extension in writing as part of the note to say if it's not sold in that 12 months an extension will be granted.

So lowering the price is always the first thing I think of. The idea is to sell in the end, to make the flip. But you also want to know what your bottom line is to determine how much money you want to make when you decide to maybe go to option number two. If you say you have to make $30,000 on this deal and you don't make $30,000, then you're not going to sell it because you will wait to sell it later maybe. And that's a personal decision that you have to make. Do you need to make $30,000 or maybe only $20,000 or $10,000? This is what you really need to know before you get out of the property. Maybe on your first property you say you want to make the $60,000, but if things go wrong and you end up making $20,000 or $30,000, that's fine. Sell it and move on to the next one. If you're in a financial situation where maybe you can refinance out and keep it as a rental, that's a possibility. But you need to know where you need to be. I know I keep saying it, but that will determine how you lower your price structure and over what period of time.

And the other thing I want you to consider too, so if you happen to get it under contract and you sell it, it still could take 30 to 60 days. Thirty days would be a very quick closing. Not too many banks can close properties in 30 days these days. Most of them are 45 and I've seen them go longer than 60. So if you're 11 months into a deal, and believe me, we don't want you in a deal that long, we're going to do everything we can to get you out of a deal quickly. But if you are and you sell it, you want to let your hard money lender know that, *"Listen, I sold this property. We're going to be closing on it. We're going to be beyond the 12 months. I just wanted to give you a heads-up. I'll send you over the P&S."* Just so that they know what's going on and everything will be good.

Lease Options

Exit strategy number two is what's known as a lease option. If you don't want to lower the price to the point where you make only a little money or maybe even lose some money, you may decide that you don't want to sell it. You may decide to do a lease option with them. A lease option is basically finding a buyer that puts down a deposit, what's known as an option payment on the property, which secures their right to buy that property at some predetermined date down the road.

This gives you some cash ahead of time, which allows you to extract some profit out of the property. And then you can also charge them a monthly rent or a monthly option fee on top of the rent, therefore increasing your cash flow at the same time. But you have to know ahead of time whether you can refinance this property with the bank. You may look at any property from the standpoint of it being financeable from a bank standpoint. And if it is, great; then you know in the back of your mind that if it came down to not selling it at a reduced price because you'd rather do the lease option and keep it as an investment property, you've already had some indication that this is a property you can refinance with the bank and then put the lease option buyer in there. And it's better than being a landlord, because they've got a vested interest in the property, and they're going to take care of it. They could put down anywhere from $10-$50,000 on it depending on the price that you agree to sell at. The option payment is non-refundable and that's what protects you from them turning into tenants and you becoming a landlord when that's not what you agree to do. The option down payment protects you and your investment so that if they change their mind, that money would not be refunded. It's really a win-win situation.

The lease option buyer might be in a situation where they might have a good job, and they have money but their credit is bad. And the reason why their credit might be bad is they could have simply just gone through a divorce; maybe bills weren't being paid and one partner didn't know about it so it drove their credit down. They could have been in a two-income family and one person lost their income and then they had to short sale their house giving them a deficiency judgment, which means they can't buy a house for a couple more years. So they might be just good hard-working individuals. They don't want to rent, they want to own, be proud homeowners again. This is a great way for them to own a house, and help solve your problem. You don't want to give the house away by reducing the price, so you go for option number two, the lease option. It's an exit strategy because it keeps you from getting into any situation where you lose the property.

Land lording

Exit strategy number three is land-lording, which would be nothing more than you buying a property and then renting it out. So if neither Option one or Option two is not what you want to do, for whatever reason, you need to have another fallback position and that could be land-lording. This would mean that you would be keeping it as a rental property.

So the idea is to think of what your third strategy is before you go into any type of default on your loan. Again the whole idea behind exit strategies is for you to avoid that. And knowing what those strategies are ahead of time puts you again in a proactive strategizing mode as opposed to a reactive mode where mistakes can be made and the worst can happen. And we don't want that to happen. I mean this is a quick way to end your real estate flipping career. So this is why it's very important and very integral in every deal you go into. And believe me I've seen people get into deals and they can't get out of them and they lose them. There are hard money lenders out there that I call predatory hard money lenders because they lend money on deals knowing some of these folks are going to fail on these deals. It ends up being a good deal for the lenders because they foreclose on them, but then the investor who put some money and sweat equity in or all their cash into maybe some of the rehab process ends up losing it because they couldn't carry it beyond the 12 months. And we want to really stay away from predatory lenders like that anyway.

So one of the things you really want to do ahead of time is to know what the market demand is for rentals in your area. It doesn't necessarily mean that you wouldn't do a deal because the demands aren't great for rentals, but it's good to know ahead of time. Maybe it's an area where rentals are in demand and the property you're buying is a great flip, but also it would be one that would be easy to rent. It's good to know that. And the other thing that would be good to know is can you get conventional financing on that. There are some mortgage brokers that I know that work with buyers to determine if the end result would be a financing deal from a mortgage company or bank. They actually have hard money lenders as well that they work with.

So let me give you an example. They would put you into a hard money loan. You would go in and rehab the project and then refinance out into a conventional loan, which is great because you've already gone through the process for you to get you preapproved. And that might be a strategy you go into but you also may know that the underlying strategy might be that you want to flip it but you sort of protected yourself or you hedged your bet in a sense to cover your butt in case you couldn't flip it and you wanted to keep it as a rental. So that's why you always want to just do some research on that and see if that would be something that could work for you in the event you couldn't flip it.

On the other hand it may be a slam-dunk flip and you go running into it and say, *"Listen, my broker told me all day long this thing is going to sell at $300,000, no problems."* And you may be looking at worst-case scenario if you had to unload it quickly you would sell it for $290,000. And you know that and you feel pretty good about that so you might discount exit strategy number three as far as keeping it as a rental because you just don't want to do that with that property. But it's always good to know that going in.

I really feel that in the current market, May 2013, this is going to be less of a problem for you. And I think you're already experiencing a little bit of the market heating up because you're seeing deals disappear more quickly, which is a good sign when it comes to selling of properties. I believe we're on an uptick. I believe the market's heating up. It's very geographic. It could be different in different areas of the country but we certainly know from most people we talked to that things are selling more quickly. I'm certainly experiencing it.

That does not mean I want you to discount exit strategies. This is when people get themselves in trouble. Market's hot; don't worry about it everything is going to sell. This is why I want to reinforce and want you to apply these and understand how they work, so that when you go into a deal at least you know these are options that can protect you.

Wholesaling

Now for the bonus exit strategy, which I'm calling bonus exit strategy number four, wholesaling. We know that you're not in this business to wholesale right now because that's why you came to me. You want to buy a property, you want to rehab it, and you want to make some money. You might be looking at buying homes down the road for investment properties. But I want you to understand wholesaling because we talked about how wholesaling is a full-time profession, and as investors we don't typically wholesale. Although I did wholesale a property not too long ago just because I had several different deals going on. I bought this property because I was thinking about moving my office in there, and there were just too many challenges in terms of the local building inspections and the laws regarding commercial properties and setbacks and all that. It was just like, *"Yeah I got a great deal but it's not worth it to go through all those things to put my office in."* So I decided maybe I'd sell it to another investor, and I did that so it was great.

So the reason why I'm telling you this is to give you an example where I think you might consider wholesaling a property maybe to another investor. Why would you want to sell one of your great deals to another investor? Well I'll give you a perfect reason why. This happened to me when I bought a property off another investor, so basically he wholesaled it to me. It was a few years ago where he just had a deal under contract. He was getting ready to close and another one of his offers got accepted. And this can happen to you. You might have a few offers out there at one time, and that's why we set these offers up the way we do because it gives the ability to maybe get out of an offer if we need to.

But let's just say you're set to do two deals but you just couldn't get financing for both of them. You wanted to do both of them so what you end up doing is choosing maybe the better of the two, the one you thought would make you the most money, and now you have this other one that you actually have under contract. You know it's a killer deal, and you may be able to flip that contract to another investor. And you might be able to make $5,000 or $10,000 just flipping the contract. But it's definitely an exit strategy to get you out of something that you might not be able to close on; that's why I put it in there. It's not an exit strategy that you're going to be able to use at the end of a project.

But I also put on there, and I don't know if this is a word out there used by any other investor. I actually thought about it this morning when I had this slide and I called it wholetailing. And that's why I put I made this word up. So it's like wholesaling to a retail buyer. I actually had put in bold the T-A-I-L but for some reason it didn't show up on the slide. So whole – W-H-O-L-E and tail – T-A-I-L so therefore wholetailing. Let's say you bought this property, and for some reason you just needed to get out of it quickly. Maybe another deal came along and you wanted to close on it, but you needed the money from this one. So rather than doing a full rehab on this property, you do a quick cleanout. It could be a property where there could have been a hoarder in the house, it just could've been a mess, or there could've been dogs and cats. It could smell like garbage.

But you go in there you get a dumpster, and you hire a demo crew to go in there and clean everything out. You rip up the old carpet, maybe there's hardwood floors, maybe just do a quick sanding. So maybe you put $5,000 or $10,000 into the place, just do some light cosmetic repairs. I put cosmetic repairs because what I don't want you to ever do is sort of cover up stuff. I don't like the guys that go in there and cover up known problems or try to cover up mold. You have to be responsible as a rehabber. You never want to sell anything to someone that you might know that might have electrical hazards or mold behind the walls. But when I say a quick cleanout, I mean the house is solid, the foundation's good, and the framing's good. It's just a mess and no one wanted to buy it. So you're able to buy it. Maybe you bought it at $100,000. You go in there and you put maybe $10,000 into just a quick cleanout, maybe do some painting, maybe you don't.

But you're not necessarily wholesaling it because maybe now you can get more money and almost sell it as a retail property. Maybe you call the broker and say, *"Hey, you got any buyers? I've got a great deal."* So it's a combination of you doing some wholesaling but you're selling it to a retail buyer where maybe this property completely rehabbed it might be worth $180,000 but you're offering it at $130,000 and you're going to make a quick $20,000 to do this. But you might want to sell to someone who's a handyman who could come in and because it's in pretty decent shape maybe replace some windows or just put a new boiler in. They could do that themselves or hire a plumber to do that. The idea is that you might find yourself in this situation where you can make a quick dollar only because maybe you have a few more deals going than you want to or maybe you just don't want to do two deals at the same time.

So I just want you to think about that. That is an option and it's good to know. It might never happen to you. It's never happened to me. I've never done a wholetailing, but I did do a wholesale recently. But I just thought it was good to know this because the more information you have, the more knowledge you have, the more you can think outside the box, the more options it gives you to get in and out of deals.

So knowing the strategies is very important. I hope I was able to show you why you need to understand these. You want to think more about the entry point of the transaction. So when you're crafting your maximum allowed offer and you're going into this property, that's a good time to start thinking about it. "All right. I'm going to buy this property. I'm going to flip this property. Let me think about these other things. Will there be valid exit strategies? If I bought this property and all of a sudden

I saw that there was an opportunity to sell it really quickly, to make a quick $10,000, $15,000, or $20,000. Is that even a consideration? Do I want to do that? Or maybe after 15 days, after the cleanout, maybe I'll throw it out there to the investment world and see if someone wants to buy it because I just happened to get another deal that I'm going to make $100,000 on. I can't do them both. I'll wholetail this one or I'll wholesale this one and move onto the next one."

So always keep those creative juices going because if you had that deal going and that was maybe a projected $30-40,000 deal but you said no to this other one because you didn't want to do two deals at the same time but that other one was going to potentially make you $100,000 – well, don't leave that hundred grand deal on the table because you're finishing up another project. As a matter of fact, you may decide to finish that one up because you want to. But if you have that other one you may pick up the phone and call someone like me and say, *"Hey, I've got this other deal. I can't close on it. You want to partner with me on it? Can I wholesale it to you?"* Never, never, never let a good deal just go out the window, because someone else will end up picking it up. Always look for the opportunity to make money on it.

Promissory Notes

Very important here: it's best to have a promissory note with a maturity date as late as possible. Let me give you two examples. If I'm working with a private lender, and this is someone that I know (it could be a family member or a friend, could be a business acquaintance), I'm setting the terms. So if I write that promissory note, I'm still going to personally guarantee it because that's the way I do it on all my note holders; I personally guarantee most of them, depending on the situation. If it's equity deals it's a little different, but on a pure note I usually personally guarantee them. It's important to me to make sure my lenders are well protected.

But the one thing I don't want is to be in a position of being worried about getting into a situation where I can't pay off that note only because, several reasons, maybe it went beyond the 12 months. What we typically did in the beginning was I put in our promissory note "when the property sells" in a lot of cases and that's perfectly fine. I don't do it that way much anymore as this is not a concern with my experience now. But again the idea is not to make you lazier or make you say, *"Don't worry about it. I've got plenty of time."* Because let me tell you – time is money and you never want to be in a property that long. It's just a little extra layer of protection to know that you're not going to be foreclosed on hard by your lender because of that.

But if you are dealing with a hard money lender, then the rules are different. They're creating the rules; they're professional lenders just like a bank. We talked earlier about some of them put in six months. Never, ever, ever get into a six-month note. I don't like them. I wouldn't recommend them. I just don't think that's enough time. You could buy a property, and it could take you 60 days to rehab it. That's two months into it and you list it and activity starts. Maybe it was towards the year and it took a couple months for the selling season came about. And even if you sell it right away, it still takes 30 to 60 days to close. So you can see how six months can just go by very quickly. I don't recommend it. Did I say I don't recommend it? I don't recommend it.

So always try to get at least 12 months out of your hard money lenders. But ask the question! *"Hey, believe me; I want to close this deal very quickly, Mr. Hard Money Lender. I want to buy it and rehab it, and I'd love to be out of this thing in four or five months or sooner. We project six months on everything. However, if I run into some complications or maybe some cost overruns, or complications in permitting process, what's going to happen if in 12 months if I don't sell it? I know I've got $50,000 or $60,000 worth of equity on this deal, and I want to wait maybe for the spring market to maximize my profit. You're making your percentage every month. I want to know how you would react to that."*

See what they say. They might say they're going to foreclose and then you're going to be like okay. You've got to be very cautious with this lender. They might say, *"We like you. We don't want to see you fail. We make money. We make damn good money lending you money. We will look at the deal at that point and we would talk about an extension."* But again I would want to see that in writing if you can. Quite honestly, with one of my hard money lenders, I have to go back and look at the documents but I know he's not going to foreclose on me. We have a strong relationship, and when I put that meeting together we looked each other in the eye and he gave me the answer I wanted to hear. And sometimes that's important to see the lender's reaction to know that they care about you as well.

But again, more important, maybe you can at least get that clause in there that allows the extension of that 12-month note. So it's better to be proactive than reactive. I can't say that enough. Knowing these strategies, having these conversations with your lenders, letting them understand what possibly could happen. And we talked about trying to be transparent in the sense of letting your lenders know the potentials of what could happen and more so with your private lenders. The hard money guys know the game. They know what can happen.

But, for instance, you could borrow some money from someone and say, *"We're going to write a note for 12 months, but my goal is to return this in six and get you back into another investment pretty quickly."* But the bottom line is their money is paid on an annual percentage rate (APR), so it really doesn't affect how their rate of return. You still want to let them know that their money could be tied up for 12 months or longer. You just want them to understand everything.

And then you could also say to them, *"Hey just out of curiosity, we could write it up for 12 months. Are you okay if we do need to do an extension? Just for whatever reason, if the project takes longer than we want and we want to be able to extend."* And get their reaction. *"No Mike, I absolutely don't want to be in anything longer than 12 months. That's the absolute deadline."* Well, I'm not saying you wouldn't do business with them, but it's good to know that. But he might be like, *"Not a big deal. We could extend it."* But again you might just explain to them what your model is, and you write it up so that when the property sells they get their money back and their interest and you don't even really have to put a time-sensitive date on it. Or put in 24 months. I've done that; I've put in 24 months. I know I'm going to be out of that loan way before that but again that's just an added protection. Just be transparent and communicate the terms so everyone is comfortable and there are no surprises.