

NEXT MEETING

Monday,
October 20th
7:00 p.m.
Fort Stephenson
House
600 W. State St.
Fremont

Inside Stories

*The 7 Key Contract
Clauses for Investing
in Real Estate*

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*Absorption Rate and
Months of Inventory*

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SEPTEMBER 15th MEETING:

7:00 p.m.

(meet at Fort Stephenson House)

FIELD TRIP TO SANDUSKY COUNTY COURTHOUSE

(after a short business meeting)

TO LEARN ABOUT SHERIFF SALES AND FORECLOSURE AUCTIONS

With all the foreclosed properties being auctioned off by the county, do you want to get in on some of the great deals that may be available? Have you been a little intimidated by the process due to lack of understanding? This month's program pulls the curtain back on the whole process. We will be taking a field trip over to the Sandusky County Court House after we are done with the business portion of our meeting.

Brad Lawrence, Administrator of the Sandusky County Civil Office, will be our guide through the maze of foreclosures. Some of you may know Brad, who was the long time general manager of the Robert Wolfe Company. After that career, Brad went from a communications officer with the County Sheriff to an appointment as Director of the Sandusky County Emergency Management Agency, which he held for 4 years, until his current appointment in March.

Brad will walk us through the foreclosure process from start to finish. You'll learn about the wealth of information available at their office before the sale. Find out the length of time it takes to get possession, if you are a successful bidder. Can you inspect the property in advance? How much money do you need the day of auction? We even plan to hold a mock Sheriff sale right on the courthouse steps!

Make sure you plan to attend and bring a friend that may have an interest in real estate as well. With the confidence you will gain from this inside information, you can add Sheriff Sales to your arsenal of property acquisition techniques.

NOTICE:

SCAREIA board member elections will be held during our November meeting. Anyone who would like to become a board member please be sure to put your hat in the ring by letting any current board member know of your interest, as we always look for new and better ways to get our message out there!

The 7 Key Contract Clauses for Investing in Real Estate

In real estate you need a set of "standard" contracts to use when you are buying and a second set to use when you are selling. Your contracts should be carefully prepared by your attorney to cover you as the buyer when you are buying and to cover you as the seller when you are selling.

Here are 7 key clauses you need in your purchase agreement when you are buying a property. Make sure you go over this list before you sit down and meet with a seller so that you understand what you are asking for. You can also use this list as a checklist as you are having your attorney draft your contracts so that you save lots of money and protect yourself when you are buying.

Clause One: Liquidated damages clause:

A liquidated damages clause is critical to your minimizing risk because it lets you contain the cost of walking away from a deal. When you enter into a contract with another party you both have the right to expect the other party to perform everything that was mutually agreed to in the contract. If one party doesn't do what they agreed to do, the other party may sue for "specific performance." This means that they ask a court to make the defaulting party live up to the terms in the contract.

When you are buying real estate and you sign an agreement to buy a property, you want to be able to walk away from the deal if after doing your due diligence you discover something wrong with the deal. Now the way many investors give themselves this freedom is by using all sorts of "subject to" clauses in their agreements with the seller. For example, "This agreement is subject to Buyer's inspection and approval of the property." Or, "This agreement is subject to Buyer obtaining satisfactory financing." You get the picture.

If you were a seller and your buyer showed you paperwork with all kinds of these overt escape clauses, would you feel confident that you had a real buyer? That's where a liquidated damages clause comes in to play. It accomplishes the same thing as an escape clause, provided it's used correctly, without arousing seller concerns about your commitment as a buyer.

A liquidated damages clause merely spells out the exact payment one party must make to the other party in a contract should a default occur. When you're buying a property, you use a liquidated damages clause that spells out that if you as the buyer default (i.e. don't buy the property) then the seller gets to keep all the money you've paid to the seller so far as "full and complete liquidated damages." This sounds pretty strong and sellers like that. But remember, you are only giving the seller a token up-front payment. Some investors use up to \$500. The key is to delay the payment of any serious up front money until the point that you have done your due diligence and are sure you want the deal. (Preferably you will have already found your end user for the property before you ever give the seller any serious money, whether you put a tenant buyer in the property or are selling to a retail buyer for all cash.)

Here's what the legalese version of a liquidated damages clause sounds like: *"In the event of default of Buyer, all money paid to Seller by Buyer shall be retained by the Seller as consideration for the execution of this contract and as agreed liquidated damages and in full settlement of any and all claims for damages."*

Clause Two: "... or assigns, Buyer"

Any time you sign a deal to buy a property you want to maintain maximum flexibility. You may want to buy and hold the property or you may decide to quickly resell the property for a fast-cash profit. One important component to this flexibility to sell fast is the ability to assign your interests in the deal over to another party for a quick cash payment. While any contract is always assignable unless there is a clause in the contract limiting or forbidding the assignment of the contract, it still makes sense to clearly put in your agreement the fact that you may assign the contract.

The best way to do this is to pre print into the contract the words "or assigns" right after the blank where you fill in who is the buyer. The reason you pre print it into the contract is because if you write it in by hand into the line of who the buyer is (e.g. John Smith or assigns, buyer) it calls it to the attention of the seller. Anything that is printed directly into the agreement flows smoothly past the seller and is usually accepted without comment.

If the contract that your seller wants you to use has a "non-assignment" clause, make sure you cross out this clause and have both you and the seller initial the change.

The 7 Key Contract Clauses for Investing in Real Estate (cont.)

Clause Three: The Closing Date and Closing Agent

Controlling the closing is critical for your success when buying (or selling for that matter). You always want to be the one who gets to control who will be doing the closing so that you can make sure they do it in a way you are comfortable with. That's why I recommend you always reserve the right to be able to choose who the closing agent will be. Also, when you are buying you want to be able to have a degree of flexibility in case you need a little extra time to finish getting your financing together, find your renter for the property, or just to do other preparation for the closing. You can accomplish both these things by using the following clause:

"Closing shall be held on or about _____ unless extended by no more than 60 days by either party in writing. Closing shall be at a time and place designated by Buyer, who shall choose the escrow, title, and/or closing agent."

Clause Four: Get Access to the Property and Permission to Start Your Marketing BEFORE You Close

Why wait to get started on marketing the property to your end user? Maybe you'll want to rent out the place, or even sell it on a rent to own basis. Either way, one of the best ways to reduce your risk in any deal is to have a non-refundable earnest money or rental deposit from your end user before you ever close on the property. But to do this you need access to show the property and ideally permission to put your marketing sign in the front yard while you are waiting to close. Now I can hear some of you saying that the seller will get upset that you are selling it for more than they sold it to you for. Of course you are selling it for more! I sit down and make sure every seller understands that the reason I am willing to buy their property is because I want to make a profit. I also tell them that if they don't feel the deal we've agreed to is a real win-win for them then we shouldn't do it. By being up front with the seller they will be happy when you win too. Remember, you aren't buying from just any seller. You are buying from a *motivated* seller who has a specific need or problem you are helping them to solve.

Here's what the legalese version of this clause looks like:

Buyer shall be entitled to a key and to access the property prior to closing to show partners, lenders, inspectors, contractors, and other interested parties prior to closing. Buyer may place a sign on the property prior to closing to help Buyer find end user for the property. (Be aware, if the seller still lives in the house and it's not empty then rather than him giving you a key, you simply arrange to bring any interested parties, whether they be prospective buyers or renters or contractors, over at a time when he can leave the house for a few hours.)

Clause Five: The World's Best Inspection Clause

Check this inspection clause out. It not only clarifies that everything should be working in the property and that the seller will pay for any needed repairs prior to closing, but it also says that unless otherwise noted you get all the personal property (i.e. curtains and appliances and such things) too. It also comes with a guarantee from the seller that survives the closing that everything is in working order when you buy. One thing to be clear on is that if you are buying a fixer for a low, low cash price then you are going to have to modify this clause in most cases, since part of the reason you are getting a great cash price is the fact that you are going to be responsible to do the repairs to fix the place up.

Here's the clause: Buyer or his agent may inspect all appliances, air conditioning and heating systems, electrical systems, plumbing, machinery, sprinklers and pool system included in the sale. Seller shall pay for repairs necessary to place such items in working order at the time of closing. Within 48 hours before closing, Buyer shall be entitled, upon reasonable notice to Seller, to inspect the premises to determine that said items are in working order. Unless specifically excluded in this agreement, all other items of personal property located in or on the property shall be included in the sale and shall be transferred by Bill of Sale with warranty of title. Seller expressly warrants that property, improvements, buildings or structures, the appliances, roof, plumbing, heating and/or ventilation/air conditioning systems are in good and working order. This clause shall survive closing of title.



The 7 Key Contract Clauses for Investing in Real Estate (cont.)

Clause Six: Automatic Renewal or Extension of Note

Many times when you are structuring owner carry deals the seller won't want to have to wait for 30 years to get all of his money. In these cases using a balloon note works wonders. A balloon note is a loan that has a clause saying that the unpaid balance all becomes due at some future date. For example, I once bought a 4 bedroom house where the seller carried back the financing with a five year balloon due for the balance of the note. This meant that we paid the seller monthly interest payments and at some point within 5 years of closing we must pay of the balance of the loan. This is called a balloon payment. Typically it's paid by either reselling or refinancing the property.

Obviously as an investor the more time you have before that balloon note comes due the more flexibility you have. But there are times that the seller won't give you as much time as you would like. The best way to handle these types of sellers is *indirectly*. Don't argue with them and butt heads, instead agree to go along with them. Then later in the negotiations simply ask for either a one or two time renewal of the term of the loan, or for an extension if you need it.

Here's the way to ask the seller for this, "Mr. Seller, I'm OK with a balloon note of 4 years. That should be enough time for me to still conservatively make a profit here. But I would like to have as a worst case scenario the ability to renew the loan one time. Obviously I'd have to have paid you on time every month and all that. Does this seem fair with you?" If the seller won't give you a renewal, ask for the right to extend for 24 to 36 months. (Use months here not years, it seems much shorter to most sellers.) Even if you only get the seller to agree to a one time extension of 12 months, that is still one year more on the note than you had before! If worst comes to worst offer to pay the seller a payment of a few thousand dollars to extend the note. If you do use this idea make sure you spell out that this payment is of principal (i.e. it counts towards the money you would have had to pay the seller anyways!) The time to ask and to get it in writing is up front, NOT at the end of the loan.

Here's an example of what the legalese version could look like: *"Borrower may renew this note for ___ additional terms by paying to Note Holder \$X of principal on or before 30 days prior to the expiration of this promissory note."*

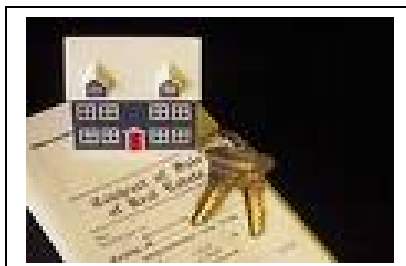
Clause Seven: Substitution of Collateral

The final clause you should always ask for if you negotiate a seller carry deal is called "substitution of collateral." This means the seller gives you the right to free up the property you are buying of any lien and move that lien over to another property you have. Imagine you are buying a \$200,000 house and the seller carries a second mortgage of \$50,000 at 7.5% interest. You want to sell that house but don't want to want to lose out on the low interest use of the \$50,000. If you have a substitution of collateral clause in your loan agreement with the seller you can move that low interest second mortgage of \$50,000 over and secure it against another property you have that has enough equity in it to be fair to the seller. Again, you don't have to use this clause, but it does give you maximum flexibility.

Here's the legalese version: *"Note Holder agrees to allow Borrower to substitute any property(ies) in which the Borrower has a total amount of equity equal to or greater than the amount of equity as existed to secure this note at the time this note was created, as collateral for this promissory note and accompanying Deed of Trust. Furthermore, Note Holder agrees to execute in a timely manner any documents necessary for the implementation of this substitution of collateral."*

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Absorption Rate and Months of Inventory

As a real estate investor, you can help maximize your profits by knowing the liquidity of a given real estate market. By knowing the liquidity of a market, you will better understand that market and therefore be able to take advantage of the various buying strategies afforded by it.

One of the measurements frequently used to gauge the liquidity of a given market is the absorption rate. This is basically the rate in which a specific segment of a real estate market sells in a given time frame. These segments are usually categorized by price range but may also be categorized by property type.

The easiest way to understand absorption is to put it in more tangible terms and measure it in "Months of Inventory". In other words, we take the number of active listings and divide it by the total number of sold transactions within the same month to give us the months of inventory.

To calculate the months of inventory for any given market:

- Find the total number of active listings on the market last month.
- Find the total number of sold transactions for last month.
- Divide the number of active listings by the number of sales to determine the number of months of inventory remaining.

As a general rule, 5 to 6 months of inventory is considered to be a normal or balanced market. Over 6 months of inventory and we have buyer's market. Less than 5 months and we have a seller's market. The smaller the available inventory, the tighter the market is. Keep in mind that these are simply guidelines and will differ from market to market.

For example, let's say there were 8,000 active listings last month and 1,000 closed transactions. That leaves us 8 months of inventory remaining on the market and also tells us that we are in a buyer's market.

If you are in the market looking to buy, calculating the months of inventory can give you an indication of how negotiable sellers might be. A large number, say 12 months or more, would mean that sellers have a high level of competition and will probably be more flexible on their sales price and terms.

On the other hand, if you are a seller trying to sell your property, the months of inventory will give you an indication of the level of competition you will face. Selling in a buyer's market will require you to put some serious thought into your pricing strategy and any incentives you may want to offer.



Thanks again to J. Murphy of Paul Davis Restoration of Western Lake Erie (based out of Holland, OH), our guest speaker for the August meeting.

J. reminded us that mold and mildew are naturally occurring and are everywhere in our environment. When the amount of mold in our homes exceeds what is normal, we tend to take notice. And none of us want excessive mold in our homes. Mold needs moisture to grow, and if you've discovered a mold problem, the first step is to find the moisture source. Routine homeowner maintenance is crucial to avoiding the buildup of moisture in your home. Proper ventilation and insulation are key components of preventing moisture buildup and mold growth.

They have the expertise and experience to contain and remove mold from your home, and restore it back to its original condition.

You may reach them toll-free at 800-886-9844 if you have any further questions.

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**For further information,
you may contact
any of the
Board Members
at any time**

About Our Organization...

SCAREIA was organized in October 2005. Our primary focus is to share information, to help educate and to motivate our members in their successful real estate endeavors.

Anyone interested in Real Estate Investing, whether you are just beginning or a seasoned investor, are welcome to join.

SCAREIA meets the 3rd Monday of every month at 7pm. Meetings are located in the basement of the Fort Stephenson House, 600 W. State St., Fremont, Ohio.

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THE MONTHLY EVICTION AND FORECLOSURE REPORTS**



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