

# Real estate profits abound in fixer-uppers

## How can I turn a run-down home into a gem?

Ask any experienced real estate agent, "What is the most difficult type of house to sell?" The answer will probably be "a fixer-upper house."

The reason is most home buyers want to purchase a residence in near "model home" condition. Just turn the key in the front door and move in. That's the goal of most home buyers.

However, savvy buyers who want (1) a nice home to live in and/or (2) a profitable home purchase consider buying fixer-upper homes. Of course, these unique home buyers are usually bargain hunters who expect to pay considerably less than fair market value if the home were in near-perfect condition.

WHAT IS A FIXER-UPPER HOUSE? Fixer-upper house profit opportunities come in all shapes and sizes. If I had to define a fix-up house, it is one which has been allowed to deteriorate in physical condition below neighborhood standards.

As a long-time investor in this type of property, I've bought sound, well-located fixer-uppers, which only needed a coat of paint (the most profitable improvement of all) and a few other cosmetic repairs to make them into model-home condition. I've also seen, but never bought, million-dollar "fixer" houses, which can best be described as "wrecking ball material."

One of the most profitable fix-ups I purchased was a run-down house in the center of a middle-class neighborhood of well-maintained houses. I had driven by it many times, wondering if anyone lived in it. Several times I stopped to knock on the door and leave my business card with my name and phone number for the owner to call me about a sale. No reply.

But one day, a neighborhood Realtor phoned me, knowing I buy fixer-upper houses. He told me the owners needed a quick cash sale because the city condemned their house as uninhabitable. Within 24 hours, they accepted my purchase offer.

After ignoring the city's big red "do not enter" sign on the front door, when inspecting the interior I discovered the living room and front bedroom had "open air skylights" where rain and tree leaves drifted in.

That extreme fix-up house required about \$50,000 of renovations, but it was well-worth the extensive fix-up work to bring it up to neighborhood standards. Ironically, the fireplace in that 50-year-old house had never been used and the fireplace brick was pristine clean.

**WHY SOME HOMEOWNERS REFUSE TO FIX UP THEIR HOMES.** There are five key reasons why fixer-upper houses become available:

1—The owner is financially or physically unable to get the home into tip-top condition before selling it. These are often called "as is" home sales because the seller refuses to pay for any repairs.

2—The seller inherited the run-down property and just wants a quick cash sale. So-called "probates" are often great sources of bargain fixer-upper houses with superb profit opportunities.

3—Distress or foreclosure properties are another source of fixer-upper houses. Some borrowers just walk away from their homes, often due to unemployment, divorce, drugs or alcohol, and other personal problems.

4—Using a Realtor term to describe a home, it's "tired." That means it is a basically sound home, which has not been periodically updated to current standards.

A personal example is one of the bathrooms in my home, which has ugly blue tile that was fashionable around 1965. Knowing the mess and cost of replacing bathroom tile, I've elected to live with my "tired" bathroom rather than go through the inconvenience of updating it. I keep hoping blue tile becomes fashionable again.

5—The home has a serious structural problem. Fixing a structural problem often costs more than will be added to the home's market value. This type of fix-up home should be avoided, such as when a house needs major foundation repairs, which will add zero value.

**PROFIT IS THE PRIME REASON FOR BUYING A FIXER-UPPER HOUSE.** The major reason I (and millions of other home buyers) buy fixer-upper houses is profit. But I've met several "do good" investors who buy run-down houses to help improve entire neighborhoods, and make a profit at the same time. City-sponsored fix-up renovation finance programs often encourage upgrades of older historic areas by offering tax abatements.

Another important motivation is to live in the home while fixing it up. Many marriages can survive home remodeling, but some cannot. However, as explained below, this motive has important income tax benefits because the inconvenience can result in major tax benefits.

**TAX-FREE PROFITS FOR FIXING UP YOUR HOME.** Thanks to Internal Revenue Code 121, if you own and occupy your principal residence an "aggregate" two of the five years before its profitable sale, up to \$250,000 of your

profit is tax-free. A married couple filing jointly can claim up to \$500,000 tax-free profits.

This tax benefit is available to any home seller, not just those who buy, renovate and sell fixer-upper houses. But it is an extra benefit for smart home buyers who purchase a fixer-upper house at a bargain price, move in, and fix it up before selling after at least 24 months of occupancy.

Last year, I actually met a couple who have done this twice since IRC 121 became effective in 1997. I call them "serial home sellers." Actually, they have a very profitable tax-free business buying, renovating, and selling their fix-up houses every two years.

Another alternative, for investors, is to make tax-deferred Internal Revenue Code 1031 exchanges of fix-up houses purchased as investments. After fixing up, the upgraded house can qualify for a tax-deferred trade for another fixer-upper property of equal or greater cost. There is no minimum holding period for such investment properties.

**THE MOST PROFITABLE RENOVATIONS.** As explained earlier, some fixer-upper houses should be avoided if they need major structural work, which won't add much market value. But the most profitable improvements add at least \$2 of market value for every \$1 spent.

The best example is paint. Often, painting the exterior and interior of a house will add thousands of dollars to its market value, usually at minimal cost.

Other profitable improvements that often add more value than they cost include new carpets, fresh landscaping, new light fixtures, refinished or new kitchen cabinets, cleaning and repairing. My personal value-added favorite is to add a white picket fence around the front yard.

**CONTRACTORS AND HANDYPERSONS ARE IDEAL FOR FIXER-UPPER HOUSES.** If you have construction experience, or are handy with tools, buying a sound, well-located fix-up house can be a profit opportunity without much competition from other buyers.

Better yet, hire experienced workers (as I do) so the work will progress quickly and usually with excellent quality.