

# **Twelve Deadly Mistakes Even Experienced Investors Make and How to Avoid Them**

The real estate investment business is tough no matter how much experience or practice a real estate investor has under their belt. There really is no simple formula that will guarantee a real estate investor will make a fortune, but there are some deadly mistakes that can be avoided that will knock an investor out of the game altogether. These mistakes are made by even the most senior investors who have had years of experience and practice in the tough game of real estate. The unfortunate part is that many of these mistakes keep investors from really getting started in the business of real estate or make them walk away before they even get started. Simply by being aware of twelve mistakes past investors have made can make the difference between staying in the ball game and walking away empty handed.

## **Mistake #1: "Gotta get my first deal" syndrome**

This syndrome is especially true of new real estate investors who first get out into the world of real estate and see all the different options that are available. They just want to get their feet wet in the real estate business so they will take just about anything to get into a deal, which often times means that they are getting a bad deal. Instead of waiting for a good deal to come along, new real estate investors will instead take a bad deal just to say they have gotten their first deal as an investor.

It is absolutely essential not to make this mistake upon first entering the real estate investment business, simply because this could be a deal breaker. One bad deal could force a new potential investor to decide that the real estate business is not for them and they will end up getting out if they lose money because of a bad first deal. This is also crucial because most people who are trying to invest in real estate cannot afford to lose on their first deal.

One of the most important factors in getting the first deal is to make sure that deal is a homerun, even if it takes a little extra time to make that first deal. This means going through the financial numbers to recognize that even in a worse case scenario after purchasing price, closing costs and repairing the home, the investor is still in at 70% or less than the after repaired costs. If this is not feasible in a worst-case scenario, then walk away. This is not a homerun first deal!

This will also mean doing some homework to determine the appreciation and depreciation value of the property depending on what you plan to do with it. Take time to survey the neighborhood, nearby rental prices or resale prices and determine what you can afford to offer for the price of a property. If it isn't within your budget then don't do it.

## **Mistake #2: Trying to retail a rental**

Another major mistake investors make is to get an idea in mind that they are just interested in buying and selling as soon as they fix up a property. Although this is a great idea in theory, an investor needs to first make sure that the house is salable. There are so many neighborhoods out there that are perfect rental neighborhoods, and there are neighborhoods out there that are perfect retail neighborhoods, and

there are neighborhoods that are good lease or purchase neighborhoods where there is a good mix of rental and retail. It is essential to make sure the property an investor is considering has the right future set up for the house.

For instance, investors have to be especially careful with two bedrooms, not only do not many people want to buy them, not as many people want to rent them, unless the house is in the right location. A two-bedroom rental property will not do well in a regular suburban neighborhood while it would probably do well at the beach or in a resort area.

If an investor wants to purchase a two bedroom, one bathroom house, which is probably worth around \$60,000-\$70,000 in an average suburban area, people who would be looking to buy the house on a resale would also most likely be able to purchase a home upwards of \$100,000. Then the investor is competing with three bedroom and possibly two bathroom houses, which are a much better investment for anyone.

Although it is tough to retail a two bedroom house, that doesn't mean it isn't possible or isn't worth investing in. If a two-bedroom home has the potential for add-ons, to possibly turn the home from a two bedroom to a three bedroom, then it would definitely be worth the time and energy to invest in the home. This will substantially increase the value of the home in the long run. Of course this will mean the necessary land space, as well as the investor being able to afford these renovations.

Keep in mind that tough retail is true of high-end homes as well. It is probably even tougher to try to rent a higher end house than it is to rent a two-bedroom home. For example, the higher price houses will afford less percentage of rent to value that you are able to receive from the house.

While the best cash flow deals may be in the lower end homes, be careful not to go too low, as many mortgage companies set a minimum that they will finance for a home loan. Usually the loan cutoff is somewhere around \$40,000, so for a home that is selling at \$30,000-\$50,000, with a down payment an investor may not be able to receive a loan.

### **Mistake #3: No reserves for retails or rentals**

Unless you are an investor who is lucky enough to have a rehab lender, it is essentially to have reserves available for resale or rental properties that you have purchased. This is true whenever you are buying a property, whether you are going to buy it, fix it up and sell it or buy it, fix it up, refinance and rent it.

Even if an investor is going to rent the property, they should keep a little bit of money in the bank or have money in an escrow or construction account, just in case. This is extra money that should remain in an account even after a rehab on the house is done because invariably this property is going to go vacant at some point. Whether it is three, six, twelve, or eighteen months down the road and when the time comes the investor will need to almost always redo the carpet and paint in the house. There may also come a time when further repairs are needed on the home and without these reserves the money is coming out of the rent check or the investor's pocket and no profit is being made off of the property.

Keep in mind that with rental properties, as well, many investors will assume that their rental income is considered straight income and cash flow, but mortgage companies will usually only allow a renter to count 75% of that rental income towards their mortgage payment on another property. Mortgage lenders know the rental business and they know that 25% of your rental income is going to go to repairs and vacancies. This 75% does not include taxes and insurance, which always raises the mortgage payment as well.

An excellent reserve option that investors can go ahead and set up if they own their own home is a Home Equity Line on their own personal property. Don't take any money out of it, but set up a Home Equity Line to have it available to you for any type of reserve need that you may have in the future. Because when you really need it you may not qualify for it.

#### **Mistake #4: Underestimating repairs**

Without a doubt one of the biggest mistakes that real estate investors make is simply underestimating repair costs on rental and retail properties. Keep in mind that when first viewing and inspecting the home you cannot see everything, so you have to assume that whatever you are estimating you need to go with worse case numbers. Even the smartest, savviest investors will say that they have rarely, if ever, seen a real estate deal come in under budget. With this in mind, it is best to go with the worst-case scenario by adding at least a few thousand dollars to the budget estimate, making sure you have that extra cash flow in the bank if necessary.

Remember that it is difficult to be too conservative when it comes to a budget estimate in the real estate business. At the very least, anticipating the worse, you will be pleasantly surprised much more than you will be disappointed with an overflow of your budget in the end. Investors should shoot for getting in it at 70% of the after repaired value, after everything is said and done. That means if an investor is extremely conservative with the appraised value of repairs, they may end up making between 50%-65%.

When dealing with underestimating repairs, investors will also want to be concerned with dealing with contractors who are giving an estimate on repair costs. It is essential to do everything possible to get an investor to nail them down a price that they are going to stick to as far as repairs go. It is also essential to get a timeframe on the amount of time it will take to complete the repairs. Have both the timeframe and the price of the work in writing. This makes it more difficult for a contractor to move on to another project without finishing your job or to change the price of the work after the original quote.

You may also want to consider putting a clause in a work contract with your contractor or any of your subcontractors that if they say it is going to take two weeks to do the job, give them three to do it and at the end of the third week start charging them a certain rate a day. This is because at that point the house should be ready to rent out and there may even be people lined up to live in the house. If the house is not ready to be lived in, then the contractor should be liable for rent money that is being lost.

### **Mistake #5: Not doing your own due diligence.**

One of the most important things you can do as an investor is to shop around when it comes to repairs and inspections. Be sure to get several different prices and estimates if you are having a contractor do repairs on a purchased property. Don't rely on the estimates of a mortgage company's inspector or a real estate agency's contractor, go out and get your own estimates. Even if you feel pressed for time to close a deal or make a sale, not shopping around could cost valuable money in the long run.

As well, it is important to always do your own homework when it comes to a deal. No matter who you are talking to about that deal, do your own due diligence and homework and get people who are not associated with that deal to give you advice on the deal. This also means finding someone to determine what the investor can afford to buy or rent a property for and don't rely on what realtors say.

Doing homework on a deal is especially important when an individual is not going through a realtor. Unfortunately there are people out there who are trying to scam others out of money and real estate investors are on the top of their list. There are people who will attempt to sell a house when they are only renting the property or whose property has already been foreclosed on in an effort to scam a few thousand dollars from someone who would put down a down payment. If you do your own due diligence, you will uncover these potential scams, not get caught in a mess and can just move on from there.

Although you may trust the advice of your mortgage lender, your real estate agent or your appraiser, it is still important to do your own homework and understand exactly where you stand as far as numbers go in the real estate game. This holds true for researching the value of properties in the area, the current rental prices for properties in the area, as well as the repair costs of a property you want to purchase. It is all right to go to several different contractors or appraisers to get different numbers and figure out what works for your investment. Without doing this, you may not be getting the best deal for your money.

### **Mistake # 6: Treating real estate as a passive investment**

Investing in real estate passively is simply loaning somebody money, as long as you can you trust them and not worrying about collecting payments, repairs on a house or any of the details. Even for those investors who are just making payments, you are still actively involved because it is essential to know the place of your real estate security and the position of your equity before making a real estate deal.

Although finding someone experienced that will do the hunting down of real estate properties, getting the deals, making sure that the rehabs are taken care of and then splitting the profit with them is a great way to do business, an investor still needs to be actively involved by making sure the person you are working with knows what they are doing and is trustworthy. That person's position is very important in what they do and they can truly make or break an investor's real estate deal. Even for those who are a silent partner, you will want to know where your money is going as far as properties, closing costs and fixing up a house, so there really is not passive investing without potentially being left out in the cold.

### **Mistake #7: Trying to go solo**

There is definitely safety in numbers. By networking and going to your local Real Estate Association group meetings and getting involved and learning who the players are, you can be successful. As an investor, you have to associate with successful people. For investors who are interested in really being successful in the real estate industry, hang around people that are successful and people that are buying a bunch of deals and know what they are doing and either have a lot of rentals or buying and selling a lot and know how the game is played and that are doing not only a lot business, but good clean business.

Beyond the Real Estate Association meetings are smaller sub-groups and focus groups that meet outside the REA Meetings and are even better for networking, because they are a better opportunity to get to know people on a much more personal level. The valuable information regarding real estate and what is going on in your investment community that can be learned from other experienced investors is absolutely tremendous. Without a doubt this is a new trend in real estate investment, an opportunity that was not available ten to fifteen years ago. Taking advantage of free education and meeting other investors is essential to success in the real estate business.

### **Mistake # 8: Not verifying information given**

Be sure to always check any information given to you by someone who is interested in selling you a home. Do your own legwork. Although it is all right to trust what others say in the real estate market to an extent, when it comes time to make a deal, you don't want to be left out in the cold. So, even if a seller is offering their appraiser to do the appraisal on a home, tell them that is fine but that you would also like your appraiser to view the home. If someone suggests that homes in the area rent out for \$500.00 a month, assume that they might be close to the ballpark figures, but check the rental values in the neighborhood yourself.

Not verifying information that is given to you by others is simply setting yourself up to fail in the real estate business. Remember that others are trying to make money as well and that not everyone is completely honest in the real estate game. This means simply trusting your own instincts and rechecking everything before you close on a deal.

### **Mistake #9: Overestimating rent**

Overestimating rent can definitely be a major problem for real estate investors who assume they will be making a certain percentage of the mortgage every month. The difficult part about overestimating rent is that many investors will examine homes in the area for rent and assume that their house will make the same amount. While this may be true for the time being, the value of rental properties may change, and a home that used to get \$700.00 a month might not get that any longer.

The rental market fluctuates with the market value of homes, interest rates and even the current job market, so the rental market can change at any given time. If an investor got into the rental game while the market was looking good in that department, they may be surprised to find they cannot make that much on a rental home a few years down the road. With this in mind, it is important to never overestimate how much will be made off of a rental home in years to come or to

assume that the mortgage will always be covered. It is essential for an investor to give themselves leeway between the mortgage and insurance payments and the rental payment per month.

### **Mistake #10: Relying on bad appraisals**

Appraising is definitely an opinion, but it is an extremely educated opinion and in order to know whether or not that appraisal is a good one, an investor needs to be an educated consumer in knowing what it is that a lender is looking for. There are some key things that any investor really needs to be aware of when it comes to appraisals.

The first is how many days a property has been on the market and what the average days that similar houses in the neighborhood stay on the market. An investor should look for a house that has been on the market between 30 to 90 days or less.

Another major concern with appraisals is to consider the adjustments appraisers make when they are comparing a property to another. Be careful of a great deal of adjustments to the negative or to the positive on a property being looked at for appraisal. If one house has a bathroom and the other house does not have a bathroom. For instance, the house that does not have a bathroom will get a negative added into the column. Be sure a home being looked at does not require a great deal of adjustments either way.

One more factor to consider when looking at an appraisal is to make sure that it is bracketed. A bracketed appraisal means that the subject person or the subject property also has a house that is either larger than it and one that is smaller than it is being compared. With this in mind it is important to make sure that the mileage between homes is three miles or less, preferably in the same neighborhood. Just be certain that the only home being compared to the property isn't the worst home in the neighborhood, as this would drastically change the value of the home an investor is interested in purchasing and could make or break a deal.

Without a doubt, it is essential to really go over an appraisal with a fine toothcomb once it is received from an appraiser before it is sent to the mortgage lender. Make sure that it explains anything that is unusual. It is really important to just make sure that there is no question in the mortgage lender's mind. They are going to take this appraisal and run through it, looking at all the other properties that could have been used as comparables and were not and questioning why they were not used. With this in mind, when talking to appraiser that is getting ready to do an appraisal on a property, explain to them that if there are other similar properties in the neighborhood they need to be used, or an explanation of why they aren't used should be given to get rid of any potential red flags.

As far as appraisals go, even if an appraisal was done on a property a year ago, it is still essential to have a new appraisal done on the home. The market value of real estate changes constantly and a home that was appraised last year at \$200,000 could be worth only \$180,000 this year. The value of a home all depends on the value of what the other houses in the area are doing. If a new neighborhood was built down the street and the houses in this old neighborhood just are not selling as well anymore that is going to hurt the value of a property you might be looking at. Knowing for certain what the current value on a home is can be essential to making or breaking a real estate deal.

### **Mistake #11: Quitting your job too soon**

Quitting your job too soon is a common theme among new real estate investors. Since they have been successful at the business of real estate for six months to a year, they have the idea it is okay to quit their regular job and go at investing full-time. This can be a deadly mistake in the world of real estate.

One of the major problems with quitting another form of employment is that it is awfully hard to prove that you can pay a loan back. If you quit your job to go into investing full time and you have not been investing for at least two years, an investor cannot get a CPA letter saying they have indeed been self employed for two years. Any loans an investor could get would be classified as no income no asset and the loan to values ratio would be a lot lower while interest rates are a lot higher, meaning good deals would be out because financing would kill the deal.

Even for seasoned investors, it is tough to buy enough deals to support your family. No matter how long an investor has been in the business, sometimes it can be tough to get enough deals to keep things going, to pay all the bills, and to create wealth. Real estate comes in spurts, where an investor may buy quite a few houses one month and then the next month not so many.

For an investor who is considering quitting their job to take on full-time real estate investment, do not quit your job until your investing income exceeds your day job on a regular, consistent basis for at least a year. Remember that this does not have to mean taking on 100 to 200 houses because often this comes with the burden of overhead, finding full time agents and managers to take care of the homes for you. This simply means with the homes that you have purchased, finding a way to consistently make more than your current employment and know that there are reserve funds available for these properties if they are needed in the future.

### **Mistake #12: "Don't let the analysis of paralysis bug bite you**

As funny as this term sounds, it is true of many potential real estate investors and is the exact opposite of mistake #1. Instead of jumping on a deal, a new investor will sit and analyze deals to death before actually jumping in and getting their feet wet. Of course new real estate investing is nerve racking, especially because your own money is involved. But if you do your homework, you go over the twelve deadly mistakes of investors, get other people's advice, do your own due diligence, overestimate your repairs, underestimate your value and underestimate your rent, you are going to be okay to just jump in.

Remember that taking all of the real estate classes in the world and going to all of the REA group meetings out there will not help a potential investor if they don't jump in at some point. Of course this does not mean going back to "gotta get my first deal" because the deal still needs to be a good deal. But if you want to hit a homerun in real estate, you have got to step up to the plate.

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