

11-30-2011

The Bubble Head Syndrome in Real Estate Investing

Today the "Bubble Head" reared its ugly head again. Bubble Head – a person who becomes foolish or empty-headed because of an inflated ego. In real estate investing, the Bubble Head is a vendor whose ego gets so inflated, because of the business you sent him that he gets so busy he actually gets arrogant with your referred clients. He can also be a vendor who just thinks he had it all together and acts like a jerk from the start.

I am always asked for referrals to closing agents, Realtors®, mortgage brokers, hard money lenders and contractors or handymen. I almost cringe at giving referrals because it is only a matter of time until my referred vendor gets so much business that he turns into an "emotionally" fat, bloated and arrogant Bubble Head.

While they may vary for you, here is what to look for:

Closing Agents – Closing agents can be attorneys or not. Often there is a significant difference between what an attorney will do and a non-attorney owned firm will do for a closing. I am not talking about doing illegal activities - but just being an attorney, or not being an attorney, doesn't mean everything they do is legal. I am talking about accommodating you on doing "complicated" closings – such as ones with too large a profit or double closings using the end-buyer's funds to close. Yes, it is legal to use an end-buyer's funds in a cash transaction if it is fully disclosed to the end-buyer.

The problem we see most often is the closing agent gets so busy he actually misses certain things that are critical to the closing. In a couple of recent incidents, there was a missed water bill and what should have been a forfeited deposit that was actually never made by a buyer. The lost deposit was a \$5,000 mistake and the largest missed water bill that we caught before a closing was \$4,300.

Closing agents sometimes do not check for unpaid utility bills because their limit of liability for the title insurance is for liens in the public record. However, it doesn't take much to call the city or county and find out if the seller has an outstanding bill. This problem is prevalent in closing agents for REOs who just want to get the deal closed because there is no repeat business in the future from a buyer and many times the agent is out of the city or state.

Once your deposit goes "hard" (non-refundable), the REO closing agents know their rights for their client to keep your deposit and seem to be even less productive until closing. Here is the leverage – at closing, no one gets paid unless you close, so this is the time to negotiate hard to get the HUD-1 Closing Statement to reflect all the issues you can find.

Many times, we have had the closing agents reduce their fees or move them to the opposing party's side to satisfy an issue we had. If you don't try it, you should – it will be worth a few hundred dollars at any closing. The worst that can happen is the agent says "no" and you either bluff more or give in for a smaller reduction.

Realtors® - Every Realtor®, with any common sense, wants to be in the loop of activity with investors because of our high volume. Frankly, I'm always initially distrustful of agents who tell me they can get me deals and they will even sell them for me – for a double commission. Everyone is entitled to make a living but I am often hard pressed to see value in what the average agent can do for me that I can't do myself. But in the spirit of cooperation, I use a few agents for specific purposes.

Most common things we need agents for are:

1. Simply putting in a contract for me as a cooperating broker or agent and they get 50% of the seller's agent's commission – at no cost to us and free to the agent. Certain banks have gone to requiring contracts be submitted by a buyer's agent.
2. Flat-fee listing properties we have for sale. We list them at prices above our wholesale prices that we advertise to our list to "create" value for prospective buyers who check the MLS® to see what they are listed for.
3. Doing short sale negotiations and getting only the seller approved commission. If we are unable to wholesale the property, the agent can sell it to a higher offer that came in through the MLS®. This requires a great deal of trust because the agent may keep the deals for himself as he will make a higher commission on a retail sale.
4. Looking at the MLS® for tidbits like how many price reductions a property has had and by what amounts each time. This helps us formulate a perspective of how negotiable the bank is for REO properties. Often times, you can get this information online at Trulia.com
5. Bring us cash buyers for wholesale properties and net the fee into the sale price so the agent gets a 10% to 20% fee instead of a commission.

It seems that critical mass is when we start adding about \$150,000 to \$200,000 a year to his income and he gets really busy - so busy that he starts to decide what is an important task for him or not. This usually means we start to slowly get slightly less service until we stop sending referrals altogether.

Then we immediately get emails and phone calls about what's happening. The next solution is the truth and we tell him the problems we have had. He offers solutions and apologizes profusely, but too little avail on our side. The problem is we can't tell how much business we have lost because of his Bubble Head attitude. Stopping referrals is an instant wake-up call.

Mortgage brokers – This is probably the biggest problem I have had in my investing career. They can be geniuses in getting mortgages for buyers that need conventional loans. For rehabbers selling finished homes, they are a lifesaver. My experience has been that I refer other rehabbers to them and single family home (SFH) buyers and they get so busy that files start being grossly delayed and even falling through the cracks.

The next bigger problem is they start jacking up fees as if they were the last mortgage broker on earth and a direct lender of the last dollar in the world! Clients have called me after a closing to complain that the estimated closing costs that should have been within 10% of the original estimate are 25% more. What happened? The mortgage broker used my credibility to bring in the customer and then killed them on the closing. They are probably thinking the buyers won't say anything to me, but that isn't the case. I get blamed for the broker's ridiculous fees. Done with that broker, on to the next!

Hard Money Lenders – They are referred to as Predatory Lenders in the business and it's true. Even the nice guys get greedy as they get more business. Their interest rates and closing points go higher and their lending criteria get stricter as we send them more business. You should have a couple of these guys in your vendor file and be careful of referring them. In some ways I can't blame them as their loan process includes trusting borrowers and that is always subjective and dependent on the ability of the borrower to be able to rehab, flip or retail the property as he planned.

Ask the hard money lenders what their referral fees are before you refer someone. In many cases they will tell you to mark-up the interest rate and the closing points. If the cost of the money wasn't too high to start, you should be able to make 2% and one to two additional points for closing costs. Your best bet is to find and use private money as your hard money source – I call this "soft money" because the cost to borrow it is relatively cheap – no points and 6% - 10%. Where do you think the hard money lenders get their money?

Contractors and Handymen – I vividly remember a local contractor coming into the office and saying he was going to get his truck driver's license to do long-haul trucking. He got caught in the market decline and no new jobs were available. We started referring him to students and people who asked for a referral. Within a couple of months he stopped by the office again to thank us for the business. This was about the same time that we started getting calls that his work was satisfactory but his prices were astronomical! Seems he got so busy he upped his prices to take advantage of the new rehabbers we referred.

We always say if you are rehabbing, get multiple contractor or handyman bids for your job. This won't help a lot if the contractor or handyman you are interviewing is more focused on selling you on using him than doing a real estimate of repairs. These guys usually come back before the job is complete and want more money to finish the work. This can be very hard to refuse if the permits have to be closed by this contractor or he threatens to put a mechanic's lien on your property.

In summary, what does all this mean to you? Well, if you are using one of those referrals and having any problems with the vendor go back and tell the referring party so their credibility isn't ruined. A telltale sign of the Bubble Head is he loves to brag about all his achievements and if you are working with him, he continually misses deadlines and doesn't return calls or emails timely. These vendors could be the top of their profession but I wonder what they would say if they were treated the same way by another Bubble Head?

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