

Buying From Wholesalers – Why Do It?

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Perils, Pitfalls, and Promises

Buying investment real estate from a wholesaler can seem, at times, like a good idea. I should know – I was a full time wholesaler for the past 3.5 years, and founded one of the top wholesale companies in the Mid South. Anyway, I know wholesaling – but the question is, do you?

Wholesaling is essentially buying a property not from a licensed broker or Realtor, but from an individual who usually controls the property through a Purchase and Sale Agreement. The difference is, essentially, that when you buy from a wholesaler you are not buying it at cost: you are buying it at their cost plus a premium markup. The advantage of buying from wholesalers becomes plainly clear when the truth is that, even if you are paying a premium, you are getting the house(should be getting, anyway) at a substantial discount under market value. So if you can buy houses so cheap through a wholesaler, why shouldn't you just buy from them immediately and just buy based on numbers? What need is there for caution?

Well, in order to look at the reason that we need caution we must first look at the reasons why you would buy from a wholesaler.

1) Convenience

This is probably the primary reason that people consider making an investment from a wholesaler instead of sourcing a property for themselves in the field. The fact that they can avoid 'driving for dollars' makes the process of real estate investing, especially for those who want to do it part time(working professionals, example) extremely accessible. No need to spend long hours in the field, walking through trashed houses, when a wholesaler can do it for you. That alone makes buying from a wholesaler a potentially enticing choice.

2) Lack of Experience

For people who are new to the world of investment real estate, wholesalers can look like saviors. Surrounded by intimidating information and a lack of experience, working with a wholesaler can seem like a godsend, especially if they are furnishing data such as After Repair Value and repair estimates. In these cases wholesalers seem to 'bridge the gap' for the new investor.

3) The Offer of Complete or 'Turnkey' Services

This can be an enticing lure for inexperienced investors. Some wholesalers will offer 'everything, including the kitchen sink.' This would include finding the property,

placing a tenant, managing the property, offering financing, insurance(vacant and dwelling), snow removal, the works. For a new investor who does not have experience with all aspects of the purchase/renovation, these services can seem from simply puzzling on the good end to exasperating(or worse) on the lesser end.

4) The Promise of a 'Good Deal'

Wholesalers make money by finding discounted deals. This means that when you buy a house from a wholesaler, you technically are supposed to be getting a really good deal. This is the premise that lots of people buy from wholesalers based upon – the idea that if someone is wholesaling a property, it must be a good deal.

These are the factors that make up the idea of wholesaling. Wholesaling is also a unique career in that it requires no licensing – unlike becoming a real estate agent, there is no law barring an individual from putting a property under contract and then reselling it. That simply is a capitalistic enterprise and anyone is entitled to do it. So, while the barrier of entry is low, the cost to purchase from a wholesaler may be steeper than you think. Let's consider the cons of purchasing from a wholesaler, and pitfalls that might take place if you end up working with the wrong individual.

1) The Wholesaler Tells You the House is in a Good Area, and You Trust Them

Then you find out that it actually ISN'T in a good area. The problem is, you already bought the house. In fact, the house is in such a bad area that you will be hard pressed to ever resell it! That, coupled with the fact that the area is so bad that it is extremely difficult to rent(assuming your strategy is to rent – if you were planning on retailing this scenario becomes WORSE) makes your house vulnerable to being stripped by thieves(ask me how I know this). So, the wholesaler is laughing all the way to the bank while you are literally stuck with an investment that you never would have made, had you known what you (paid to) know now!

2) The Wholesaler Tells You What the House Will Appraise For, and You Trust Them

This is even WORSE than number one, You have calculated your refinance costs, your repair costs, factored in your hard money costs, and even included your prorated taxes so you can refinance and have zero out of pocket costs. Then what happens? The appraisal comes in way below what you were told what it will appraise for. Now, you have two very undesirable choices. First, you can bring a lot of cash you weren't planning on bringing to the close to the close, and satisfy the balance of what is owed to the close. Or, you can order another appraisal(which costs more money you weren't planning on spending) and then get the results, which will probably be about the same. So, in the end you will end up bringing the cash to the close anyway. Sad game!

3) The Wholesaler Tells You About The House Repair Costs, and You Believe Them

This is almost as bad as number two, above. The wholesaler tells you the repairs will come in at price x, but later you find out that the house is price x plus 10k! Unfortunately, the wholesaler has disappeared and is nowhere to be found. So, surprise! You get to come out of pocket another 10k – money that you will never get back, because if you calculated the numbers correctly, you will not be able to refinance your money out of the property because your repair costs have exceeded the amount that you had planned on, and it is a good bet that the wholesaler sold the property at a price where all of your costs had been factored in with his original repair estimate – making your additional 10k expense just that, an expense – which you will have to wait 30 years to get paid back!

4) The Wholesaler Tells You They Will Manage The Property for You

Then they don't. It stays vacant and gets stripped, and you get to renovate it again, the whole time using your personal resources and unable to shake that nagging feeling of 'why did I invest in real estate?' Maybe the wholesaler who says they will rent it can try harder the second time. Second time is a charm, maybe?

You see, this really illustrates the potential pitfalls with using a wholesaler who is a 'one stop shop.' The wholesaler says they can furnish you with all of the critical services that you need to have a successful investment home, but the truth of the matter is even if someone becomes a licensed insurance agent (the wholesaler, for example) they are doing so because they want a revenue stream, not because they are passionate about the insurance business. So, when a tree falls on your neighbor's car, and you call your insurance agent who was also your wholesaler, can he really help you? Odds are, he'll give you an 800 number to call, and you'll be on hold for a while only to find out that you aren't covered. Think I'm kidding? This happens WAY more often than you think.

I don't want you to get the idea that all wholesalers are evil, because they are not. It is just that MOST wholesalers really have no idea what they are doing OR are so unscrupulous that they are not focused on your needs. In my last wholesale company, when we made a mistake, most of the time we would get out the checkbook and write checks to cover cost overruns, incorrect appraised values, and so on. It got expensive, and these lessons really taught us that we needed to tighten up our approach – so we wouldn't make mistakes with the people who trusted us. You need to be critical with your wholesalers as well, and due your due diligence – not just trust and rely on theirs, especially at first. After you have established a good relationship with them, then maybe you can loosen up. But not at first.

A final idea here for your consideration. Wholesalers are essentially real estate consultants, and are doing so and acting in that specific role which is the reasoning by which they earn their living. Your real estate consultant(wholesaler) is expected to guide you to an excellent investment, a 'piece of the puzzle' if you will for your personal portfolio which you want to become a living, breathing, and vibrant entity. Since that is the role they are paid to play, put them to the test with one simple question.

'How many rental houses do YOU own?'

Now, if their answer is 'well, um, none right now because...' or 'the owner of the company owns x properties', then chances are that you shouldn't be working with that wholesaler, simply because if they do not own any investment property then who are they to give YOU advice on what and what not to buy? I'll give you a little secret – there are some wholesalers who HATE real estate. Don't believe me? It's true. They like the money, but hate the process.

So, the next time you are thinking of using a wholesaler, ask them if they own real estate. Their answers just might surprise you.

Robert Feol is an author, speaker, teacher, investor, and radio personality who's primary focus is helping others get safely into real estate investments. Want to learn more? Listen to his radio show every Saturday at 11 AM CST on News Radio 600 WREC, Memphis. Or, catch the archived show here: <http://www.wrecradio.com/pages/expert.html>.