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Starting a residential real estate business

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Starting a Residential Real Estate Business

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Departmental Honors Thesis

University of Tennessee at Chattanooga

University Honors

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Forward

Hello fellow entrepreneur! It seems you have set your heart on residential real estate. Great! This guide explores the steps you will need to take to turn this interest into a profitable business in real estate investing. By laying out the discoveries I made while creating my own real estate management business in downtown Chattanooga, I've created a step by step guide to help you streamline the process from evaluating the market before you buy to selling the property after renovations are complete.

Who should investigate this venture?

When I began creating my business, I would tell people that I was interested in “buying, renovating, renting, and selling homes” and they would happily tell me of the dozen other people they know trying to get rich quick with real estate.

You can make a large profit in real estate. You can also lose everything. So, before you proceed in this book, I beg that you consider a few factors that will either help make real estate and yourself a great match or will foreshadow a terrible relationship.

Have fun

I like dreaming about how I'd change the homes I drive by if I owned them. I like looking online at the homes for sale and evaluating at what price I would buy the home, if I were going to. I like figuring out which areas are increasing in value and who my clientele would be if I bought there. I like budgeting and keeping track of my expenses. I like saving up for that next house. I like being a kind landlord. I really like having a job that allows me to stay home with my family.

If you don't think you would enjoy most of those things, you should probably investigate other business ideas. If, however, you believe that you and I may be kindred souls- that real estate would be *fun* for you too- I wish you all the best as you embark on this next chapter in your life.

Finding a Home

You decide to look into buying a property. You google “homes for sale near me,” click on the first website you see, and immediately feel lost as you stare at the multitudes of homes available for sale.

And that's alright! You've started the process. Now, you simply need to watch the market in your desired area to learn how to spot a good deal.

How do I choose an area?

If you're unsure of where you want to purchase an investment property, start by searching the general area in which you live or would like to live, “general” being dictated by how far you are willing to drive from your home to the property.

Next, start thinking about what your market for this home will be. Are you interested in renting to low income families? Then you will not want to disregard low income areas. Are you interested in utilizing this investment property as your own home while you fix it up? Due to tax breaks, savings from not renting yourself, or even being able to rent out your current residence while working on the next property, this route could prove very profitable. However, this effects your home selection process;

would you be willing to live in this home for the renovation period? If you are searching for a home to resell, you will want to be looking in areas with average home selling prices comparable or higher than your resale goal.

To learn more about the market and narrow your area to search in, seek out friends and family members who are realtors or involved in real estate, make a post on Facebook asking for advice, or contact a local real estate agency to discuss the market. All of these individuals and groups, whether in hope of future business or simply because great Aunt Wendy loves to give advice, are usually very willing to share their knowledge and experience. Do remember, however, that all of these sources will have their biases so you should hear the same advice from multiple sources before you accept it.

Be prepared, too, for advice that goes against your hopes. Your local economy could be dying due to a lack of local career opportunities, resulting in few prospective buyers or renters in your area. If so, a real estate investment there would have poor returns. However, this does not mean your business idea is dead; simply explore the market in another city or town.

And at Such a Young Age!

I made my first real estate purchase at age 18, during my freshman year of college. I had realized that, if I paid \$500 a month, I would spend \$24,000 by the end of four years. That, plus the fact that I would be getting married soon and my brother-in-law wanted to rent one of our spare bedrooms from us for \$300 a month, made purchasing our \$50,000 home a 5 minute drive from campus a great investment. "But you're tied down- and at such a young age!" This was a common comment that I suspect you will hear a variant of as well. Yet, despite popular opinion, real estate does not need to shackle you to one place. For example, if I wanted to leave the Chattanooga area after four years, I would only have needed to sell my home for \$26,000 plus taxes to break even by owning the property. Since the home is worth much more than this, I know I could sell fairly quickly if I wanted to and not lose any money. Owning more homes does make the process of moving more complicated, of course, but not impossible.

When should I buy?

Perhaps, in your investigations, you find that the housing market is bubbling and is expected to crash soon. If so, Harvard's Teo Nicolais, a real estate professor and entrepreneur, offers a helpful guide to predicting market crashes. His article reflects the works of Glenn Mueller and Fred E Foldvary, two prominent real estate market theorists, with slight updates to keep their data current. In his explanation of Mueller's research, Nicolais writes that the market cycle has four sections, each marked by characteristics illustrated by the graph below (Figure 1, Nicolais cited Mueller).

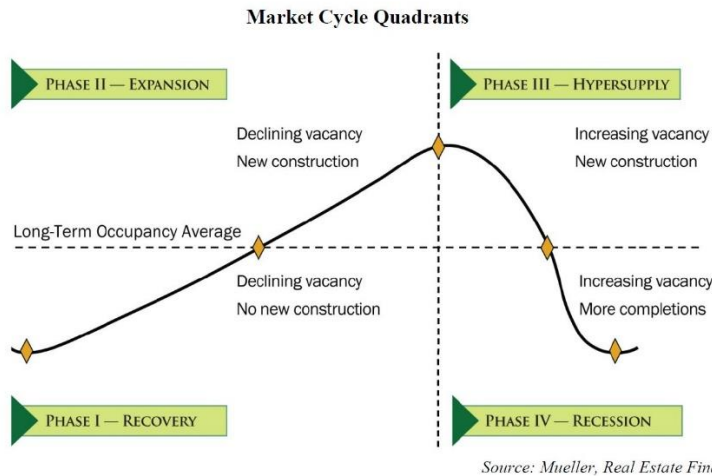


Figure 1

Foldvary adds to Mueller’s model with the discovery that the housing market has a consistent cycle duration of about 18 years- interrupted substantially only by world wars- which makes planning possible for investors who wish not only to avoid major losses but also to capitalize on the low prices found during the recession phase (Figure 2, Nicolias cited Foldvary).

Peaks in Land Value Cycle	Interval (Years)	Peaks in Construction Cycle	Interval (Years)	Peaks in Business Cycle	Interval (Years)
1818	--	--	--	1819	--
1836	18	1836	--	1837	18
1854	18	1856	20	1857	20
1872	18	1871	15	1873	16
1890	18	1892	21	1893	20
1907	17	1909	17	1918	25
1925	18	1925	16	1929	11
1973	48	1972	47	1973	44
1979	6	1978	6	1980	7
1989	10	1986	8	1990	10
2006	17	2006	20	2008	18

Source: Fred E. Foldvary, "The Depression of 2008"

Figure 2

By waiting until the market has crashed to buy homes, you will have more opportunities to purchase buildings from individuals who are motivated to sell quickly and- compounding the effect- during a time when few investors are looking to invest, increasing your chances of winning low offers and saving tens of thousands of dollars.

There are more sources online to help you determine how the housing market is acting in your area. For instance, real estate investment companies such as Norda offer websites filled with statistics related to local real estate (Norda). From these sources, you can gain data on population growth, average

property price, average time each home is listed before sale, and market projections for the next year or two (Norda). This website and more can be found in the appendix of this book.

Watching the market

Now you have a general idea of your intended clientele, when you would like to buy, and where you would like to buy. With this information, select a real estate browsing website to check daily. You will want to look at the filter options when selecting. For instance, both Zillow and Motovo allow you to filter by price, but Movoto's smallest price filter is 100,000 while Zillow's is completely customizable. Therefore, if you would like to search only for homes that are listed for \$50,000 or below, Zillow would be the better option for you. If you would like to search only for multifamily dwellings, such as duplexes and triplexes, Movoto has this filter available whereas Zillow does not. Of course, if there are features you like about multiple websites, you can always move between them while searching; simply being familiar with what each website offers will help you navigate the information more efficiently.

Once you have decided on a database, begin a routine of checking daily for a few specific kinds of homes that you are interested in. For me, my first category was homes and duplexes under \$75,000 with two bathrooms and three or more bedrooms within ten minutes of downtown; I was interested in these homes for rentals. My second category was homes within ten minutes of downtown under \$50,000 with one bathroom, three or more bedrooms, and the space to add another bathroom; these were also homes to rent. My third category was homes within 20 minutes of downtown with 2,500 sq. feet or more, 1/3 of an acre of land or more, and some character; this search was simply to gage how expensive my own dream home would be. Because I enjoyed looking at this final category of homes more, it helped me enjoy checking my real estate app every day to evaluate the available homes. Furthermore, by looking at homes I would love to live in, I was keeping a personal goal in mind. Whenever I wondered "What's the point to all this effort?" I would look up a few dream-worthy homes and happily get back to work, driven to earn the capital to buy such a home.

Of course, though you are looking for some specific kinds of homes, browsing other homes that could possibly interest you is also prudent when you have the time. For instance, you can explore other areas, properties with more land, or properties with less square feet than you want. However, be careful not to overwhelm yourself with too many options; it is far more fruitful to become familiar with the market value of one kind of home over a long time than attempt to understand the trends for all kinds of homes on the market at once.

To accelerate your learning of market values, set the search filter to "sold" (available on Movoto's app or website). At first, this filter may seem unnecessary; why search for homes you no longer have the chance to purchase? However, this setting allows you to see first not the asking price but the selling price for a plethora of homes. Listed in the home's description is the original asking price, which allows you to learn how much under the original asking price the buyer was able to purchase the property for.

← *This information is not only useful on a logical level, but also an emotional one. After making many offers and being rejected or totally ignored (which means they are even less interested in my offer), I would start to feel self-conscience for offering so low. Was I offering ridiculously little? Was I wasting my realtor's time? The seller's time? My time? Will I ever win an offer? Then, I would return to the sold section and I see homes that were sold for 20-30% under asking price. These are the deals I wanted and, by staring at the data, I would regain confidence that I could win deals of the same caliber.*

Selecting an Agent

There are two important factors to consider when selecting a real estate agent. Firstly, whether or not they will make offers significantly below asking price. Sometimes, realtors will refuse to make low offers for you, assuming that the offer will not be accepted or will somehow offend the seller. If you have a realtor like this, you will have a tremendously harder time acquiring deals on homes. The second factor to consider is response time. Good deals will often fly off the market in days or even hours. If you cannot reach your realtor in time, you will miss several good opportunities. Select a realtor who responds quickly to a mode of communication you check frequently, such as text messages or calls.

Deals Go Fast!

It was a Wednesday. I was perusing Movoto when I saw a freshly listed duplex- it had been on the market for only four hours. It had 2750 sq. ft of living space, longstanding tenants whose rent hadn't been raised in 7 years, a partial stone exterior with great curb appeal, 5 bedrooms and 3 bathrooms, and it was in a nice area. Property showings were only allowed with an accepted offer, but I knew I could withdraw my offer without penalty after the showing if the interior was too bad. I wanted a chance at this duplex, so I sent my realtor a text at 11:45am with an offer of \$99,100, \$100 above asking. Since she was busy until 4:00 that day, she immediately referred me to her associate (and son). While running errands at 2:00 we learned that the owner was calling for "highest and best" by 5:00 that day, less than 24 hours after listing. We increased our offer to \$101,100 and signed the paperwork while tossing pasta in our shopping cart. The next morning we learned that we had won the offer (barely) and that evening we viewed the property and made a spreadsheet of all the needed repairs and cost estimates, decided what we would be willing to pay, and re-offered \$92,00. The next morning, the realtor's son was the first person to know I was in labor when, at 6 am, I accidentally texted and called him instead of the midwives. At 11am, two hours after giving birth to our daughter Rose, I signed the paperwork to make the offer official and prepared to close on the house. Good deals go fast; if you and your realtor are ready, you can grab them even faster.

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Financing the Property

This chapter comes after the “Finding a Home” chapter because I suggest that you begin to learn the market as soon as possible and that you don’t buy a home until you have a great grasp on what a good and a bad deal looks like in your chosen area. Watching the market in this way is a great learning strategy, but if you employ it you will see multiple good deals come and go without a chance to purchase them. If, however, you are confident in your knowledge of the area already and want to purchase a home immediately, you could start with this chapter and merely watch the market while you work on the financial side of starting your business.

“Cash is King”

After congratulating us on winning the offer on our second property, our realtor informed us that we did not have the highest offer. However, though the highest bid did exceed ours, they promised to pay with a loan, not with cash. Loans cause a lot more hassle for both the buyer and the seller and increase the risk of the deal falling through, so oftentimes a seller will accept a lower cash offer, even if the offer is hundreds or thousands under the highest.

How will I pay for this?

The idea of saving up to buy a home in cash is often a daunting prospect. Most Americans don’t even have a \$1000 emergency fund, let alone the capital to purchase a \$30,000, \$40,000, or \$50,000 home (Nova, 2019). However, if you are reading this guide, I assume that you are looking to beat these statistics and be financially successful. So, I challenge you to invest in your business with your own cash. Saving large sums *is* possible. Just think, what if you made \$10,000 or \$20,000 less a year? What would you do? Make a budget for that income bracket. Maybe you would have to rent a smaller place. Maybe you could rent out your current home and live in a smaller rental for a while, saving the profit made by this downsize. Maybe you just would cook at home more often or adjust the thermostat. If these changes still seem workable to you, seriously consider making them. Then, speak to a financial advisor about account and fund options that could give you interest while you save up enough to buy a property.

I highly suggest this strategy if your ideal market is booming and you think you have a few years until a market crash. Not only would you avoid paying interest on a loan, eliminating the risk of losing your investment if you are unable to pay the loan, and increasing your chances of winning the offer because of sellers’ preference for cash offers, but you would also be able to get properties for discounted prices by timing your purchase for a dip in the market.

If, however, you are in a market crash right now and foresee prices only increasing in the future, there are some other options for getting capital more quickly.

Home Equity Loan:

If you already own a home, you can take out a home equity loan at a comparably low interest rate, usually 5.5-6.5% (Current Home Equity Interest Rates). If you sign for a home equity line of credit,

often referred to as a HELOC, you can use it like a credit card that has your home as collateral. Certainly, this is not a choice to be taken lightly because failure to pay could result in the loss of your home, but it is an option to help get cash fast if an amazing opportunity presents itself.

College Loans:

Here's an unconventional idea. If you are in college, you have more loan options available to you with lower interest rates or no interest for the time you are in school. Your school will have an estimated total cost of attendance that includes transportation, food, housing, books, school fees, and other living experiences; this number determines how much financial aid you can receive through the school. If you can live on less than your school thinks the average cost of living for a student is, then you could use the leftover funds for real estate. For instance, during my college career, I qualified for subsidized government loans. If I had needed those extra funds to be able to invest in a home, I could have taken out the loans, lived on less, and purchased the property with no interest for the rest of my college career.

Grants and Funds:

There are several grants and funds available to various groups of home buyers. For instance, the Good Neighbor Next Door Program discounts homes by 50% for police officers, firefighter, emergency medical technician, and teachers when they buy in areas deemed in need of revitalization ("HUD"). Great Choice Plus is a loan program that also includes a 5%, no-interest loan, repayable only when you leave the property or refinance ("Great Choice Plus"). Another program, the Hardest Hit Fund, loans up to \$15,000 with zero interest that is 100% forgiven after 10 years of residing on the property ("FHA"). There are options to help catapult you in your savings and investing goals; just assume you'll find something and search for it.

Advice on loans

Those who fail in real estate usually fail when they cannot pay their loan payments and have their assets taken because of that. Oftentimes, they hope rent will cover the loan payments, but do not have the reserve funds to compensate for a temporarily vacant property. Therefore, if you want to protect yourself from bankruptcy, you need to ensure that you can pay the loan payments even if the home is unrented for months. For instance, if I take out a loan for an investment, I require two safety precautions in place already. Firstly, to have other cash inflows that can cover the loan payments in the event of empty properties and secondly, to have several months of loan payments saved. This will mean taking longer to save funds before investing; however, this extra time will safeguard all that I have already invested in the project as well as in my other assets. Slow and steady wins the race, right?

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Creating the Business

The first step to making your business official is deciding which form of business license you wish to operate under.

Sole Proprietorship

The simplest, easiest form of business. In fact, if you don't register your business but still perform transactions, your business is automatically classified as a sole proprietorship. There are no legal protections with this kind of business; all the liability of debt and possible suing is personally on your shoulders. Tax wise, it's taxed like personal income.

Partnership

This is the simplest form of business if you want to create a business with one or more other people. In this form, you can structure in two ways; A) one partner has unlimited liability while the other partners have limited liability or B) all partners have limited liability. Tax wise, a partnership is just like a sole proprietorship.

LLC (Limited Liability Company)

I assume this is the structure you will first use. With this structure, your personal assets are protected from any lawsuits or debt incurred by the LLC. Therefore, if one tenant sues, they cannot take your personal home. Revenue will still be considered your personal, self-employed income and will be taxed accordingly. However, there are annual fees associated with an LLC. Each year when you file your annual report to the Secretary of State in Tennessee, you must \$300 plus extra fees if you have more than six LLC members ("Limited Liability Company").

Creating the Business works cited

"Limited Liability Company Fee Schedule." *Limited Liability Company Fee Schedule | Tennessee Secretary of State*, <https://sos.tn.gov/products/business-services/limited-liability-company-fee-schedule>.

Making an Offer

Once you have completed the above steps and have located a home you are interested in, it is time to visit the property, evaluate it, make an offer, and hopefully make a counter offer (I'll explain that hope later).

Visiting the property

After watching the market for a few months, you will have begun to develop an eye for which homes will sell quickly and which will remain on the market for a long time. Call your realtor immediately when you find a home you are interested in that you believe will sell quickly and schedule a viewing as soon as possible. Well priced, well-advertised homes can become contingent within days of listing. This is because investors and lay people alike are drawn to these homes; seeing their potential takes little to no skill. The other homes on the market, those you do not believe will sell quickly, are likely over-priced, poorly photographed, or have daunting-looking issues. Visit those likely-to-sell-fast properties first, and if you don't get those for the price you want or you decide not to offer, go ahead and set up appointments to view any other homes you are interested in.

Evaluating the property

Your evaluation of the property should begin before you have arrived. How is the drive? Are you passing by nice homes, or does the area seem to be a high crime zone? Are there any parks nearby? Restaurants? Where is the nearest grocery store? Did the GPS take you to the correct address, or was it frustrating just locating the place? These questions become increasingly important in the home's value as you near the property.

Once you have arrived, make note of your first impression; this represents the curb appeal of the home. While you must take note of the curb appeal, you must also realize why curb appeal is important; it creates a subconscious bias. If a person's first impression is positive, they are more likely to approve of the entire home. As an investor, your ideal curb appeal situation is one that appears terrible at first but can easily be improved. For instance, if your emotions react negatively when you first see a home, but you logically realize that the yard simply needs to be mowed and trimmed and the porch needs a new coat of paint, you have surpassed a hurdle that less alert property viewers will be driven away by; as a result, you are more likely to win a low offer. If you fix the curb appeal problems, you can increase the value of the home by up to 17%, according to research conducted at Texas Tech University (Elam and Stigarll).

While visiting the property, take photos of every defect you would fix if you purchased the home. Does the house have single pane windows? An old roof? Water damage? Uneven flooring? Cracked foundation? Damaged doors, walls, or flooring? Is the electrical up to code, or still "knob and tube"? Does the home need finish updates, especially in the bathroom or kitchen?

How much should I offer?

Now that you have documented the troubles of the house, create a spreadsheet of the issues and an estimation of the cost to fix it. The website "Home Advisor" stores information on the average price for home improvement projects and serves as a great resource for getting a general idea of the cost you

would incur. For instance, the average cost to build a deck in Chattanooga is \$8,041, the typical range is between \$4835-11,584, with \$35 as the average cost per sq. ft (“Learn How Much it Costs”).

Example Lane	Home's Square Footage	Last Sell Price	Gov's Assessed Value	Standard Deviation Sell Price	Standard Deviation Assessment
	1,377	\$36,000	\$46,500	11824.56248	13738.33849
Problems: Strip/Repaint and screen in front porch, new back door, fix cabinet doors, put in door strips between rooms, update kitchen appliances and minor cosmetic issues.					
Estimated Improvement Costs	Low Cost	Average Cost	High Cost	Estimate	Notes
Landscape & trim yards	\$432-506		\$1,594-1,839	469	
Update kitchen & bathrooms	\$1,546-2,120		\$3,823-4,885	1833	<i>Stove, sink, fridge, and fixtures</i>
<i>Estimated repairs costs (includes material and labor)</i>					
Gutter	3-\$5		4-\$9 per ft	468	<i>At \$3 per ft</i>
	\$250 per window		\$1000 per window	2750	<i>Approx. 22 windows replace 11</i>
Windows With Double Pane					
Exterior Door	\$250		\$2,500	250	
Replace outlets/receptacle.	\$10 each		\$50 each	20	
Light fixtures	\$10		\$300 (ceiling fan)	50	
Home Advisor Info					
Repair Floors	\$180	320	481	180	
Replace Stove Hood	285		685	300	
Microwave	98		186	98	
Replace water heater		1029	3000	1029	<i>In near future</i>
Complete driveway	2825	4329	6118	2825	
New Kitchen Cabinets	\$60 per linear ft		200 per linear ft	480	<i>St. Approx</i>
Repair Front Porch	\$450-\$600		\$650-\$800	450	<i>Bricks torn apart by vines</i>
Repaint/Strip Porch	2.13 per ft ²		4.25 per ft ²	173	
Repair Screen Windows	50		850	1100	<i>Approx. 22 windows</i>
Repair Screen Porch	150	600	8900	600	
Taxes Incurred During Renovation		582 per year		582	
			Total Cost Estimate	13657	
"Fixed-Up" Value Estimate based on comps. in area (Gov. Assessed price plus 1 standard deviation)				58324	
Current Approximate value of "Fixed-Up" Value - Cost)				13075	

I Want to Clone You!

When we made an offer on what would become our first home, we submitted a spreadsheet (featured above) to the seller along with our offer and 34 photos in a pdf document of the damage to be repaired. This data supported our claim that the property should be sold for \$45,000, significantly less than they were asking. However, because of the home's utility to us, its future value for rent, and the fact that we did not think all the homes' issues really needed to be repaired, we were actually willing to pay \$52,000. So when they sent back a counter offer of \$50,000, we accepted it.

At closing for this property, the owners told us that they were very impressed with our research. They had children about our age and said that they wished their children had our skills. They said something about wanting to “clone us and make us their children.” It was a strange compliment that inspired some awkward laughter, but the obvious respect that the couple beamed at us was appreciated nonetheless.

Counter offers and highest offers

Typically, when I make an offer, I hope it will be countered. This may seem counterintuitive at first; however, given context, the concept makes a lot more sense.

Situation 1: The home has been on the market for a long time and you make an offer. Because of the length of time on the market, the home has a higher chance of selling for far below asking price. However, if your offer is immediately accepted, you probably offered more than you had to.

Situation 2: If, instead, you offer less than you think the property is worth, the owners make a counter offer, and you make another counter offer that you are still satisfied with, you are more likely to have found the owner's minimum sale price.

Situation 3: Of course, if you offer less than the property is worth and they accept immediately, you still won a good deal, but the question "How much less could I have paid for this property?" may bother you periodically.

However, I only "typically" want a counter offer because in some situations counter offers are not applicable.

Situation 4: A "highest and best offer" situation. These often occur in newly listed homes with under market value asking prices. The owner receives multiple offers in a short time frame and establishes a time frame in which other offers can be made before the owner will select the winning offer. In these scenarios, there is no counter offer opportunity; merely, the "highest and best offer" will win.

In these situations, you must be especially vigilant to avoid letting your offer increase to more than you actually want to pay. Whenever you make an offer remember, this is not the only home on the market; if you lose this offer, nothing is truly lost because you retain all of your assets and can simply offer again on another investment opportunity. Therefore, if you are unsure whether you should offer \$45,000 or \$50,000, offer \$45,000 and try again on another home if you don't win the current attempt.

Making an Offer works cited

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Preparing to Begin Work

At last, after many losses, you will win an offer. Congratulations! Armed with your spreadsheet of estimated repair and improvement costs, an estimate of the maximum fixed-up value of the house, and a decided use for the property (see “How Do I Choose an Area”), you can tackle the improvement stage of your real estate business.

Budgeting and Record Keeping

The first step to improving your new property is refining your repair and improvement spreadsheet so that you can use it for your own budgeting purposes. Perhaps, for instance, you want to buy cheaper fixtures and windows than the average you reported in your spreadsheet when making an offer. Adjust this on your spreadsheet. Or, perhaps, you decide that you want to add a bay window instead of a fixed window. Adjust your spreadsheet to reflect this increased cost.

There will be plenty of small repairs and improvements that will not take much planning to accomplish. Replacing an outlet cover, changing a fixture, buffering hardwood floors, painting a room, etc are examples of tasks which you could manage yourself after watching a few do-it-yourself videos or hire a local professional to take care of. However, before you embark on any larger project, you will need to find more detailed estimates and quotes than those provided by sources like Home Advisor. For instance, if you are going to renovate a kitchen, you will need a cost for the material and labor to take out and replace the flooring, the cabinets, the sink, the fixtures, the appliances, the countertop, the back splash, and/or any other finishes you desire to change. If you charge into the project without these more intimate figures, you could end up spending more than the project adds in value to the home or being unable to finish the project due to a lack of funds.

A Working Stay-at-Home Mom

My mother-in-law started her real estate business in 2005. Being a mother of six, she couldn't just leave her kids at home- so she brought the whole family into the business, including her seven-year-old son, my husband. He helped with painting, yard work, cleaning, etc, and learned how to care for a house without relying on handymen. This is part of why I chose a real estate profession: not only does it allow me to be a stay-at-home mom with something else to do, but the business offers great experience for my kids!

What should I fix?

Knowing how much a project will add in value to your home is crucial to setting a budget for the project, which in turn is crucial to the design. However, I cannot tell you “Renovating your kitchen will add \$4,500 in value to your home” because there are too many variables; how nice was the kitchen to begin with? What sort of appliances and finishes are you adding? What is the value of the neighbor's homes? Luckily, your experience from watching the housing market will help guide your own assessment of the value a project will add.

For instance, if you are planning to add a bathroom, how much more valuable were homes with the projected number of bathrooms in comparison to your property's current number of bathrooms? Does

home advisor indicate that you could accomplish this improvement for significantly less than the value added by it (remember to look at data for your home's value range- low, medium, or high)? If you plan to renovate the kitchen, how much more did the homes with updated kitchens sell for in your area? If you plan to add a porch, how much more would you or your friends value a house with that feature? If you intend to use the property as a rental, you should consider similar questions, but in the context of monthly rent rates. Additionally, tenant retention should be considered.

For instance, I used these considerations to decide that I would invest time, effort, and cash into adding a bathroom to my first property. I purchased the three bedroom, one bathroom home at \$50,000 and, based on other homes I had been watching on the market, believed that adding a full bathroom near the master bedroom of slightly nicer quality than the bathroom already present would increase the home's value by about \$20,000, if and when we chose to resell. I also knew that having people in all three bedrooms yet only one bathroom is a major annoyance that causes many renters to stay only a short time or even not consider the home at all when searching. Other improvement possibilities, such as adding a breakfast bar, a gas fireplace, a fully paved driveway, and replacing the laminate counter with stone would be nice, but not as influential to tenant attraction and retention, rent rate, and resell value.

Knowing the value added would be \$20,000, I gave myself a budget of \$10,000-\$15,000. This budget was only possible because my husband was willing to learn various trades (such as tiling) in order to decrease cost.

Because bathroom improvement projects are one of the most common types of project in real estate, I will use this example to illustrate how to craft the design and the budget while maneuvering codes, permits, and contractors.

Codes

Codes, codes, codes. I took an entire college course on codes. They can be troublesome- but they can also be helpful. Many codes are in place to make sure we don't place fixtures in inconvenient or inaccessible places. Sinks must be 30" from toilets, from center to center- which is great to know because it helps me avoid a sink placement that would only trouble for the residents. Where should that toilet go? At least 15" from the wall to the toilet's center. With these guidelines, I can focus on making choices about the appearance of the bathroom and not worry as much about whether it will be functional.

You do not need to know every code out there; that is a career in itself. However, if you intend to make major renovations to residences, you will want to have a base knowledge of the codes that apply and where to find more details.

International Residential Code

The IRC, International Residential Code, is the master set of residential codes for the US. Though the U.S. as a whole has adopted the IRC, certain regions have adopted different versions of the code. For instance, as of 2019, Chattanooga is operating under the 2012 IRC publication, though the 2018 version is the most recent publication. Because there are subtle differences between the versions, you will have to check which version applies to the homes you are working on.

What sorts of things are regulated by codes?

Codes apply to almost every aspect of design; however, you will likely only meet a few applications.

- Lighting: Some codes relate to how low light fixtures can hang and how close they can be to water.
- Electrical: Some codes regulate how many outlets there must be in a room and how far apart they must be.
- Bathroom: There are required clearances around toilets and sinks.
- Stairs: Stair riser heights and tread depths are standardized, as are stair railings.
- Ceiling Height: Ceiling height typically must be at least 7 ft, with some exceptions for sloped ceilings.
- Windows: Code requires certain rooms to have a minimum "glazing area" that lets in natural daylight and to have openable and accessible windows in case of fire- even in the basement (here, you can install what are known as "window wells").

These are just a few general examples to help you understand what sorts of things are regulated by building code. However, I suggest that you browse through the IRA book to better understand the codes applicable to residential projects. You can find the book by signing up for a free trial at www.iccsafe.org.

Design

Now that you have a general idea of what value your project will add to your property, you also have a general idea of your budget. This information, coupled with a basic understanding of code, allows you to start the design process.

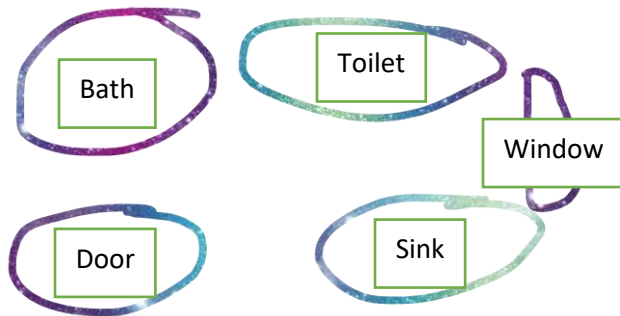
Drafting

With a vague budget in mind, your first design step should be to get your basic design out of your mind and onto paper.

There are plenty of ways to accomplish this. You can start by making notes about your design.

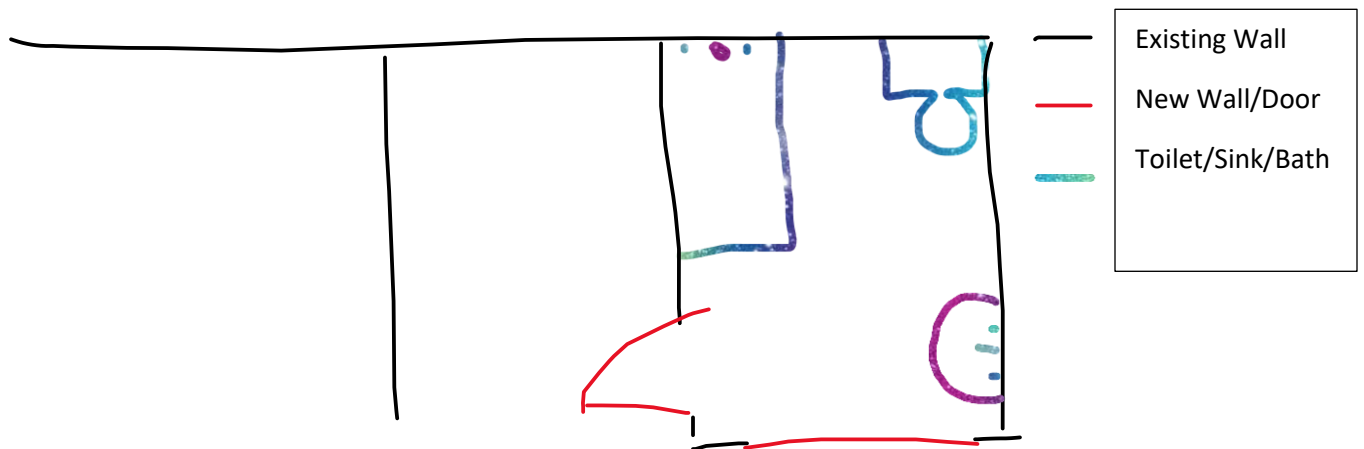
For example; *"I want a jacuzzi bath to be the highlight of this bathroom, which will be located at the back of the house in the too-small-to-be-a-dining-room-dining-room"*.

You could start by making crude bubble sketches of your ideas.



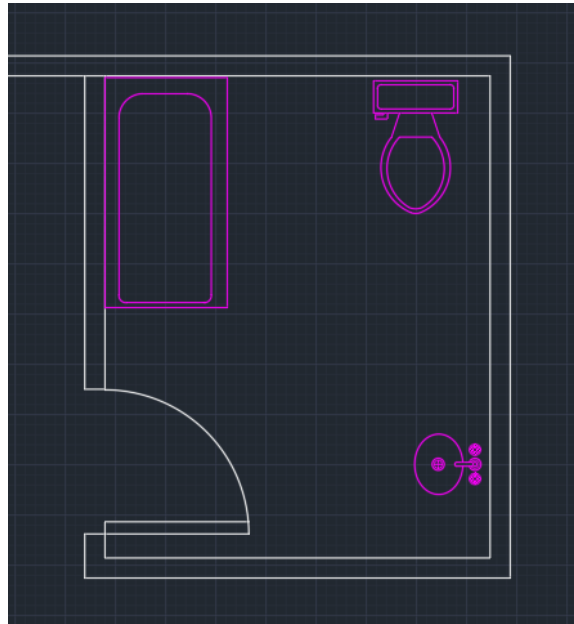
Design Figure 1

You could start by creating rough sketches of your plans.



Design Figure 2

You can go the professional route and use AUTOCAD or hand drafting.



Design Figure 3: AUTOCAD version of the bathroom sketch

Or you can start with one and move on to others. At this stage, it doesn't have to be pretty (obviously- just look at what I doodled in this publication); so long as you're beginning to form your design, you're headed in the right direction.

Hand drawing

Soon, however, you need to introduce measurements and build a more specific, concrete plan. This process of creating a 2D representation of a space or design for a space is called drafting. There are many standard symbols in drafting and codes which help professionals quickly understand the details of a draft; however, even without knowing all the short hands and symbols, a basic understanding of drafting can help the non-interior designer, non-architect home designer.

If you want to use a very basic version of hand drafting, you will need a few tools.

- Pencils of various lead weights
 - This helps differentiate outer walls from interior walls, furniture from walls, room labels from flooring patterns, etc.
- Engineer's scale
 - This allows you to scale a large plan down to paper-size by representing large measurements, such as a foot, by smaller measurements such as a $\frac{1}{4}$ of an inch.
- Adjustable triangle
 - This tool helps you to draw lines at specific angles. If, for instance, you have wall at a 30 degree angle, you can adjust a side of the triangle to 30 degrees and use it as a straight edge to guide your drawing.
- Circle template

- Using this, you can draw sinks, door swings, tables, and other round objects with a certain diameter.
- Painter's or Architect's Tape
 - Or any tape that can be stuck to and peeled off the paper without causing tears.
- 11" by 17" or 24" by 36" vellum paper
 - These larger sizes are both more professional than the 8.5" by 11" paper size and easier to draft a detailed plan on.

These tools will help you convey a rough draft of your plans so that you can explain small scale projects to contractors or use them as a guide when doing the work yourself.

If, however, you wish to use your draft for more official purposes (such as acquiring a permit or conveying large scale remodeling plans), you intend on making many drafts and want to save time, or you simply want a higher chance that the workers will understand and implement your design exactly as you envisioned it, you will want to have some more advanced tools.

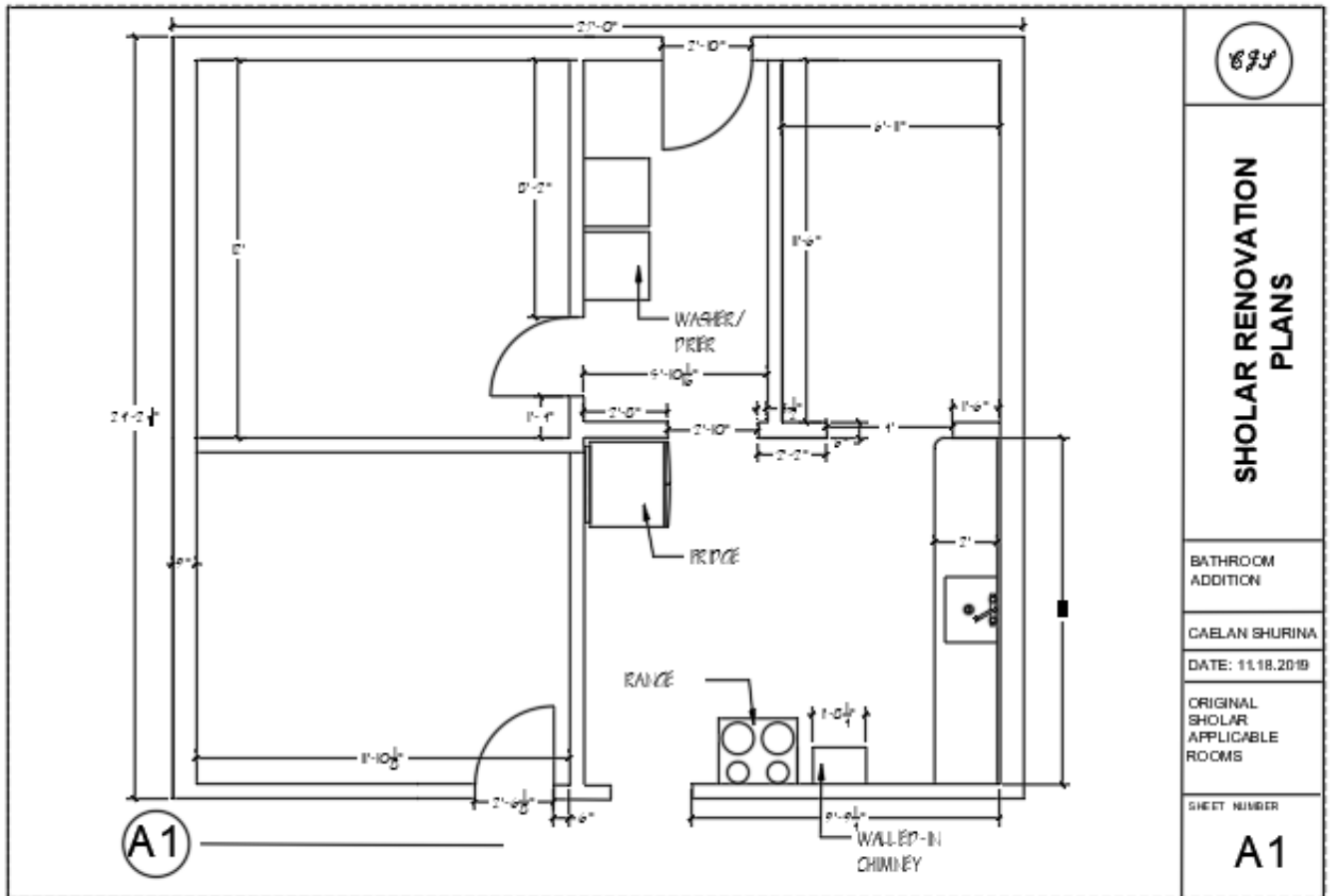
- Drafting Table or Board
 - This tool is a flat surface to draft on which can be adjusted to various work surface angles. The most important feature is the mayline, which is an adjustable, secure bar used for drawing horizontal lines.
- Tracing paper
 - When you don't want your erasure marks to show on your final copy, draft first on tracing paper and then copy it into the higher quality vellum. No one has to know how many scrapped ideas and mistakes went into the final product.

If you want to move on to creating even more professional drafts, AUTOCAD is a computer program designed for drafting. However, to purchase a copy of the full, non-student version is pricey- costing \$1,610.00 per year. This in addition to the time and money required to learn the program (classes are offered at many colleges), investing in CAD is likely not warranted, especially in the early stages of your real estate business. However, I will include some examples of AUTOCAD designs so that you know what it offers in a final product.

Do note, however, that you cannot submit your draft to obtain a permit completely on your own; a licensed designer must stamp your work. Luckily, some designers are willing to simply review, edit, and approve your work rather than doing the drafting themselves. Speak to professionals near you to learn how much you could save by drafting your own designs.

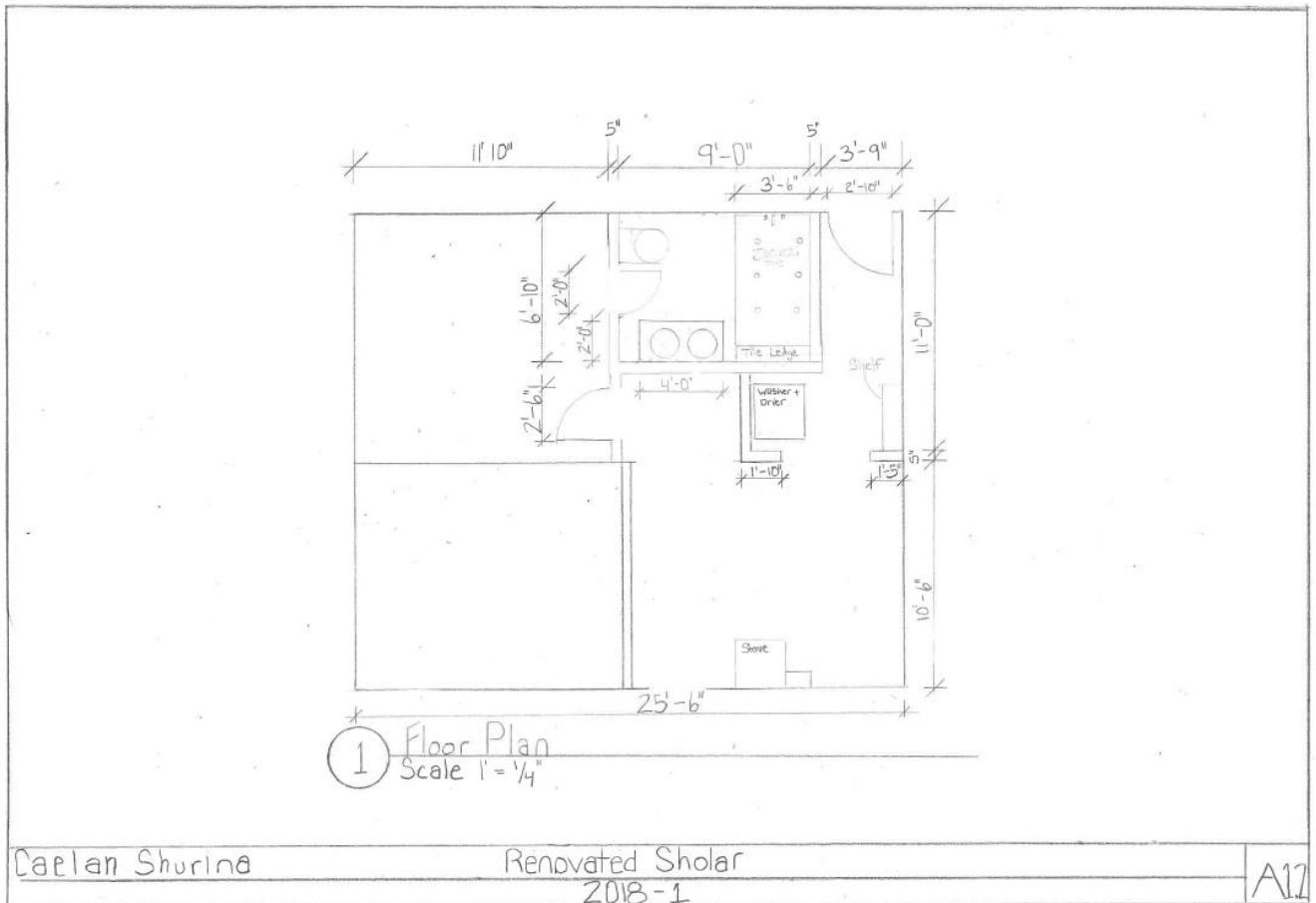
When drafting, you probably won't get your design right on the first try. When designing my bathroom addition, I edited and scrapped several designs before finally finding the one that worked best for my space. Below is a sample of that process to give you an example of what you should consider when drafting.

Examples



Drafting Figure 1

Above is the original plan of the relevant portion of the house. I measured the home and drew it using the program AUTOCAD. This process was fairly strait forward; however, I will note that I miss-measured and remeasured many times, so don't worry if it takes you a while to get the measurements just right.



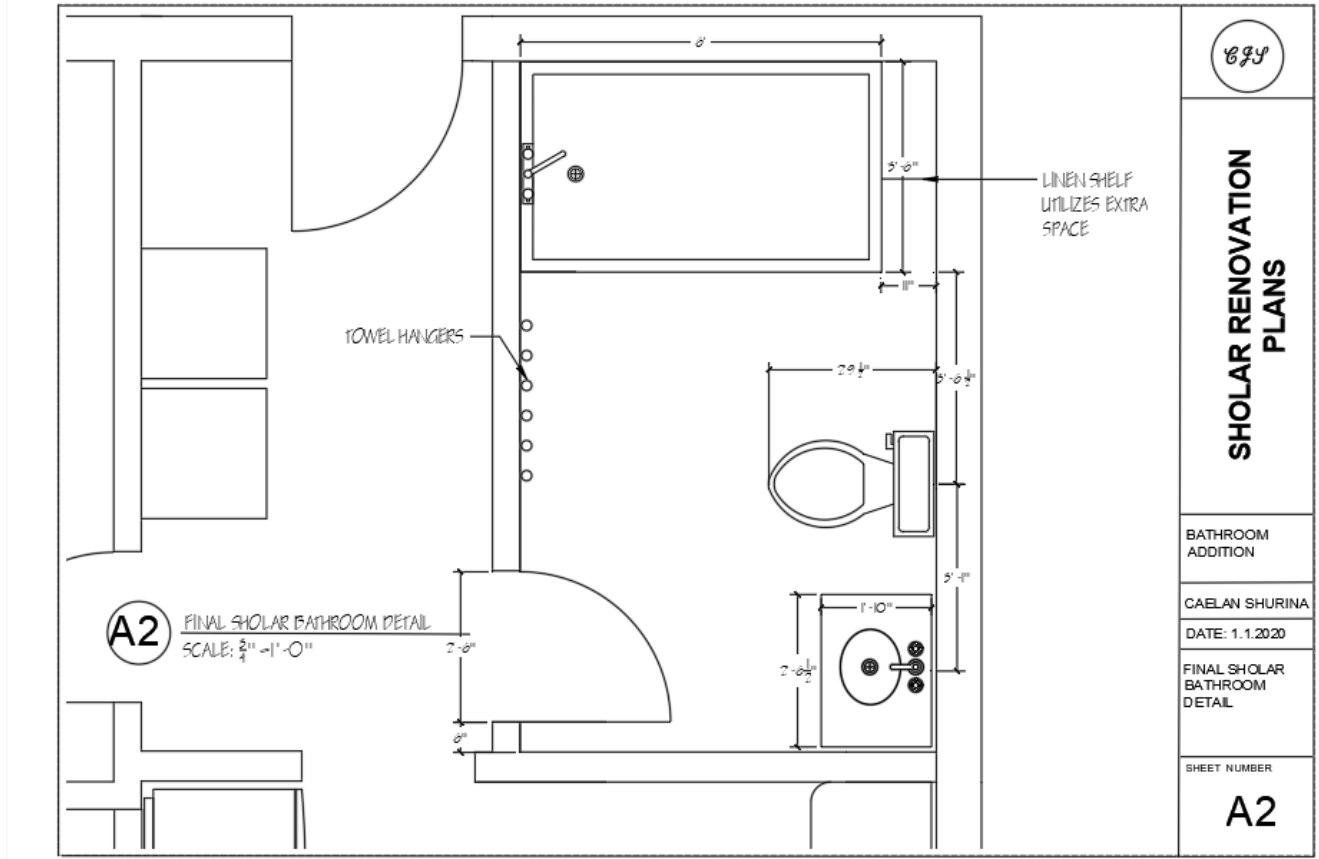
Design Figure 2

This renovation plan is an example of hand drafting, which is what you will most likely be using. Note that, in this pamphlet, the drawing is not “to scale,” but in its original form you could take an architect’s scale and use the 1’=1/4” side to find the dimensions of any item drawn. This information is noted under the title of the drawing, “Floor Plan”. Also note the “1” in a circle; if I had had more than one drawing on this plan, I would number them accordingly. This way, I am able to clearly reference the particular drawing later. Also note the “A 1.2” in the bottom right corner of this drawing and the “A 1” in the last drawing; you have some liberty with this corner, but it should indicate the order of your drawings.

There were many erased ideas in the making of this draft. After drafting one idea, I realized that the toilet would be the first item seen when the door opens, which I thought would decrease the overall aesthetic of the bathroom. With another idea, I put the sink against the windowed wall... only to realize that then I would be placing a mirror over the window. I settled on the design above because it afforded enough room for a large sink, puts the jacuzzi tub as the focus of the room, does not highlight the toilet, and allows room for a window and a mirror.

In the final draft, I changed the bathroom location from the laundry room/hall way to the small bonus room adjacent to it. Though this means that the master bath will not be directly connected to the master bedroom, the design is much easier to implement. We no longer have to move an exterior door,

exterior steps, an interior wall, or the washer and drier hookups. The sink is the first thing seen when a person enters the door, and the extra-large bath tub is profiled against the back wall. There will be some awkwardly unused space between the bath and the wall, but I hope to make this into a cubby-like shelf for towels and soaps. Toilet and sink placement meet code. This design also shows you another option for identifying your drawings; rather than using a number, I simply used the sheet number inside the circle. Had there been two drawings, I would have written A2.1 or A2/1.



Designing works cited

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www.autodesk.com/products/autocad/overview.

Contractor

Tips on hiring

A good contractor is a huge component of a successful real estate business; if a contractor overcharges, the extra fees will come out of your profit margin; if a contractor takes too long, you will lose precious months of rental income while still paying taxes and other expenses on the house; if the contractor does poor work, you risk harming the value of your property.

Therefore, tip 1 is to spend time searching for a contractor. Read reviews. Ask your realtor. Ask your realtor's associates. Ask anyone you know who has recently renovated. Seek out a recommendation for a contractor that combines a great price with the level of skill your project requires (the higher income level you are marketing the home to, the higher skill level you will want). If the project is important and costly, make sure you have a long list of possibilities, then call each one to select a smaller list. After calling, you will want to meet them in person before making the final selection. This may seem excessive, but there are plenty of horror stories of terrible contractors ruining a project. You want someone who will be upfront with you about timeline and cost specifics, who will provide you with a detailed contract, who is known for working in a timely manner, and who has worked on projects similar to yours.

Technically, the term "contractor" applies to many professions; designers, architects, cabinet installers, tile-layers, etc. The kind of contractor you need varies according to what job you are undertaking. With small, specific jobs, selecting the kind of contractor you need is simple; if you're installing carpet, you just need someone who specializes in carpet installation. If your task is larger scale and involves multiple specialties- such as electrical, plumbing, and painting- you will probably need a general contractor in addition to the other professionals.

What does a general contractor do?

General contractors are in charge of making the renovation happen. They hire other professionals- such as painters, countertop installers, carpenters, tile-layers, etc- to perform most of the work (Pinnell et al). Any project that requires a permit and does not involve your own residence requires a general contractor to sign off on the permit application.

What are the price ranges for contractors?

There are two ways to pay a contractor. The first involves paying an added percentage of this total cost as their fee in addition to paying the cost of the project through them. This percentage can range from 10-20%, depending on the job and contractor (Sharon, Woodland, & Meagle 2019, "Working with Contractors", 2018). The second involves paying a set amount, determined at the beginning, that comprises a contractor's "bid" price. The first way allows more flexible plans, but also can lead to grossly more expensive projects. There is also debate over whether the extra flexibility helps the workers focus on doing the job well rather than rushing to put in as little time as possible, or if it encourages workers to take extra breaks and work unnecessarily slow in order to milk your project of more money. The second way is far more appealing when you're working within a budget but allows for a lot less flexibility.

Can I become a contractor?

Hiring a contractor and their workers to renovate your property is a major expense. Of course, there are ways to avoid this expense. If you intend to renovate many homes and your business partner or yourself are interested in performing the work, you could become a general contractor. Acquiring this license will allow you to sign off on permits to legally perform the work on your properties.

Becoming a licensed contractor is a long process, requires at minimum several hundred dollars to accomplish, and demands that you learn how to do the work yourself, so it is crucial that you weigh the pros and cons before embarking upon it. The following pros and cons relate specifically to Hamilton County, TN, but are similar in other states across the US.

Cons:

- \$250 for the first two years, \$200 biannually after that
- \$110 to take the exams
- \$\$\$ for study guides and/or classes
- Provide worker's insurance (exemptions available)
- Must perform the contracting work

Pros:

- Avoids the cost of a contractor: they usually charge 10-20% on top of the cost of the project (Sharon, Woodland, & Meagle 2019, "Working with Contractors", 2018).
- Don't have to find a good contractor
- Don't risk having a bad contractor (takes far more time and money)

Levels of contractor

Not all contractor's licenses are created equal. Some license the individual to work on projects up to \$25,000, while others have an unlimited scope. The limit is determined by your financial health. The more financially stable you are, the more costly of project the licensure committee will allow you to undertake.

How to Avoid the test:

If you want to do work yourself, but do not want to study for and take the exam, there are options for you.

- *Restricted/Limited Residential License (BC-A/r):*

This license can be obtained through taking a course at a community college. All other requirements for earning a license remain (the fee for the license and providing worker's insurance), but the course replaces the standardized exam. If you hate studying on your own or you want to make a connection with someone who can help you learn how to become skilled at contracting, this may be the option for you. However, this license is restricted not only just to residential projects but also, by its nature, to projects under \$125,000 regardless of your financial situation. For most home improvement projects, this range will work fine for you.

- *Home Improvement License*

Perhaps even the limited residential license is too involved for you. If you're willing to oversee even smaller projects, you may be interested in the Home Improvement License. This license is limited to projects valued under \$25,000 and does not allow you to do electrical, plumbing, or HVAC work (Contractor's License Application, i-9). However, it does allow you to perform the other tasks involved with small projects like adding a room or renovating a bathroom. This license is not, technically, a general contractor's license and, therefore, the limit cannot be raised with your financial stability.

- *Call it Home*

If you would like to do work on the property but you do not want to become licensed, there is one more option. If the property is your personal home, meaning you have lived there for 24 months or more in the past 5 years, then you can legally work on your home in the capacity of a contractor without having a contractor's license ("Exemptions From The License Requirement"). This exemption is limited to projects under \$25,000 in value. You will also still need to apply for permits; however, you are exempt from the required contractor's signature on this paperwork.

Taxes are a big cost of owning a business so, naturally, tax breaks are greatly appreciated. On such tax break happens when you sell a home you have lived in for 2 or more years in the past 5 years (Topic No. 701 Sale of Your Home). If you decide to structure your business around this tax break and you only want to do small improvement projects, you may be able to avoid general contractors and the licensure process too.

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Conclusion

There you have it- a basic guide to starting your business that outlines the information you need to start your own residential real estate business.

Key points:

- Not everyone is a good match for real estate. If you don't enjoy this, search for a business that you do enjoy.
- Take your time: you'll make more profit if you know the market before you invest in it.
- Don't let youth keep you from starting a business. You can even buy a home as a teenager- I did.
- Cash is king- challenge yourself to save and invest in your own business.
- When you make your move, be quick. Good deals go fast; you need to be faster.
- Don't be afraid to lose offers. You win a great deal if you win a low offer, but you don't lose anything if they don't accept your offer, so offer as low as you like.
- You have a lot of freedom when designing, but there are codes you must follow.
- If you want to do the work yourself, becoming a contractor or "calling it home" may be a great way to increase your profit margin.

Appendix

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