

Being a novice at purchasing a package of real estate with low money down provided an intense learning curve. There is a saying “that buyers are liars” but vendors can be also I found out to my sorrow. Lots of unhappy ‘ah hahs” were gained along the way. Amusingly, however, it also won my lady friend and me trophies from Raymond Aaron for being the “Players of the Year.” He told envious meeting attendees that we had bought a million dollars worth of property for \$70,000 down. None of them knew that the deal had already collapsed.

HOW *NOT* TO BUY REAL ESTATE

In 1999 my lady friend, I’ll call Ann to protect her privacy, and I signed up for Raymond Aaron’s Monthly Mentor course. When we enrolled we thought it was going to teach us how to buy real estate, but it was a goal setting course. However, encouraged by networking with others members we connected with Peter a member of the Real Estate Investment Network (REIN). Paul (not his real name) told us he had a lead on 7 pieces of property worth at least a million dollars that could be purchased with only \$70,000.00 down. He was looking for partners with money.

Meeting Paul and a friend of his in a coffee shop we decided to form a joint venture to purchase these properties. Paul would be the real estate finding partner, his friend the carpenter to make repairs and Ann and I to provide funds. We would all be equal partners. Tailoring a REIN joint venture agreement to suit our circumstances Paul took it to a REIN lawyer who recommended that we instead incorporate a company to hold the properties.

The vendor provided addresses and we drove around to see the properties from the outside. They were a 10 suite apartment building; two side by side duplexes, a condominium apartment, a half duplex and two houses, one with a basement suite.

The vendor showed us through the vacant main floor suite of a nice looking up down house telling us it had already been rented for \$850 a month plus utilities. The basement suite was rented for \$450.00 to a lady with several cats, who the vendor said had been given a rent increase to \$500.00.

A conditional purchase agreement was signed in December, 1999, for \$993,000.00 including vendor take back mortgages on most houses totaling \$189,920.00. Our lawyer advised in writing that legal fees for this deal would be \$5,000.00 plus \$2,200.00 of disbursements.

Setting possession for February 1, 2000, we began inspecting interiors. We received some information about mortgage balances and payments on the properties and we were told all mortgages were assumable. Taking on the financial partner role I made spread sheets, constantly updating estimates of our likely return and anticipated repair expense.

The property information provided in December on the ten suite building indicated a 9.9% cap rate if rents were increased by \$25.00 per unit. At first numbers looked like we

would have good positive cash flow of about \$14,000.00 a year after allowing for normal repairs, a 5% vacancy and several small rent increases. We were excited!

Pretty soon it became apparent that Paul's friend was not contributing and we dropped him out leaving three of us to complete incorporation. For our protection Ann and I held 51% of the voting shares between us since we were the only ones with anything to lose. We each placed \$40,000.00 in the corporate bank account for the \$70,000.00 down payment, plus legal and other expenses. Neither of us had additional funds that we could easily contribute.

Then problems reined down on us. Initial inspections of the older building disclosed needed repairs; carpets to replace; painting to do; and suspect boiler leaks. Regardless of attempts to persuade him otherwise the second mortgage lender on the building would not let us assume his mortgage. He would have to be paid out. That meant refinancing. We made application to People's Trust, the current lender, requesting a new mortgage to include \$30,000.00 or more for required repairs. Following their visual inspection they required us to obtain a value appraisal, engineer's reports on roof and boiler systems, an insurance appraisal plus pay to People's a ½ % fee based on mortgage value for their review. These were all required just so they could make their decision. We accepted, ordering the reports, but expenses were badly eroding our \$10,000.00 reserve fund.

The appraisal came back at only \$285,000.00. Our purchase price for that building was \$300,000.00. We negotiated an amendment to reduce our contract price by \$15,000.00.

When I inspected several problem tenants were living in the two run down side by side duplexes. Renovations were needed to replace rotted fences; damaged flooring; and several appliances and new roofs were also likely soon to be needed. The vendor said that he had already given rent increases to \$750.00 a month each from \$650.00 the tenants told me they were presently paying. Then we discovered that the vendor did not have title to the duplexes! He was not even the owner! His father was. The vendor assured us that his father had agreed to sell.

When People's Trust's mortgage approval was finally received on the 10 suiter we negotiated and obtained a \$5,000.00 discount for cash payout of second mortgage. That would provide us extra funds to offset our costs. However People's mortgage approval letter added further inspection requirements from Emergency Response Department, Building Inspection, EPCOR utilities and Environmental Law Centre searches. It appeared our small payout gain would also be eaten up. We discovered we would have to update the fire system and install wired in heat detectors in every suite. We made a deal with the vendor to cover this expense.

We still had not been able to inspect a number of apartment suites and one house. That older house had water stains on its soffits and stucco that looked problematic. Requests for information, rent verifications and full building proforma had still not been provided.

Since I was about to embark on a preplanned five week trip to India in early January, Ann and Paul took over. Our lawyers had not received information or adjustments from the vendor's lawyer so they advised Paul and Ann to extend possession date. They moved it

to March 1, 2000. On my return in mid February to my horror I found out that Paul had cursorily inspected the other properties, without making repair lists, and had signed off all conditions without ever having received rent verifications! Nor had the vendor's lawyer prepared any of the adjustments yet! Backing out of the deal at this point would mean deposit forfeiture but it was beginning to look like repairs could bankrupt us in the process.

Telling Raymond Aaron at a meeting in February about our purchase I asked about not been given rent verifications. He replied. "There is no reason a vendor would not provide this information unless he has something to hide." Now I was doubly concerned.

On March first we finally received a very simple building proforma. It did not include caretaking or grounds keeping at all and indicated different revenue and expense. Now with extra costs added there was no longer any cash flow left in my projections.

Our lawyer seemed to be sending out a number of uninitiated letters to us and we asked him to cease. Days passed. Still no information from the vendor's lawyer, so possession moved once again to dates first in April and then to May 1, 2000.

In desperation our lawyer's staff began to prepare the time consuming adjustments with information I submitted. Still no verifications were forthcoming. May 1, also passed by without. Finally our lawyers arranged a face to face meeting in mid May to see if the deal could be saved. Across the table from the vendor and his lawyer we discovered that there were actually a number of vacancies including unrented main floor of the first house we were shown five months before. The vendor admitted that rent increases had not been given to duplex or house tenants after all. Any last possibility to make it work disappeared at that table. The vendor's failure to provide information requested in the purchase agreement gave us the opportunity to walk away from the sale. Our lawyer suggested that a law suit for damages would be expensive so that idea was dropped.

We found out later that the vendor's lawyer was notorious for this practice of pushing preparation of adjustments onto a purchaser's lawyer to save his client money.

We were shocked to be presented with a bill for \$11,357.00 in legal fees including charges for unnecessary correspondence work we had chided our lawyer earlier about. With the senior partner we finally settled the total bill for \$8,000.00. Three months after our settlement was paid we received a letter from our lawyer that two other legal bills were still outstanding for mortgage transfer work by other lawyers. In light of our total settlement we refused and our lawyer ultimately settled with them.

After this sale collapsed Paul found another property to purchase. An old three story combined commercial and apartment building. We completed another conditional offer. My inspection of this building again yielded expensive potential problems. An unfinished part of the basement showed signs of past water problems. The suites above were in need of painting, carpets and some renovation but were livable. We discovered that the commercial area tenant was a government department whose five year lease was about to expire. Being the only commercial tenant their possible move out could leave both the main and basement levels vacant, a loss of over 60% of revenue. We didn't need any

further inspections to tell us to drop it and wisely walked away from this money pit “opportunity” also, with no loss of money.

We then asked Paul to give up his interest in our corporation to which he agreed. His ideas of good deals certainly did not mesh with ours.

Ann and I paid dearly for these “ah hah” lessons. Our out of pocket expenses were close to \$13,000.00.

EXPENSIVE LESSONS LEARNED

- When taking on a partner do thorough due diligence into the person’s background and references before agreeing to anything. Do not presume the person is an expert.
- Obtain titles to all properties as soon as you make your conditional offer.
- Verify with the lenders on title all amounts due and whether all mortgages or second mortgages may be assumable.
- Do not trust a vendor’s verbal rent statements. Get proof.
- Request copies and review actual rental lease agreements for length and terms.
- Obtain written, signed verifications of rents and utilities from each tenant. When tenant signed verification of rents are not forthcoming in a reasonable time the vendor may have something to hide.
- Conduct thorough inspections with written repair lists and obtain repair quotations to eliminate surprises before you are committed.
- Placing a new mortgage on an old building can be expensive and time consuming with all required appraisals, inspections, mortgage placement fees, legal fees, etc. plus the likely hood of having to meet current building and fire codes.
- Verify through inspections whether older properties require expensive repairs.
- Limit exposure to expensive lawyer’s fees by doing as much ground work as you can.
- Get assistance from a mentor if tackling something unfamiliar.

And lastly if a deal sounds too good to be true, it likely is!

Nana
August 2008