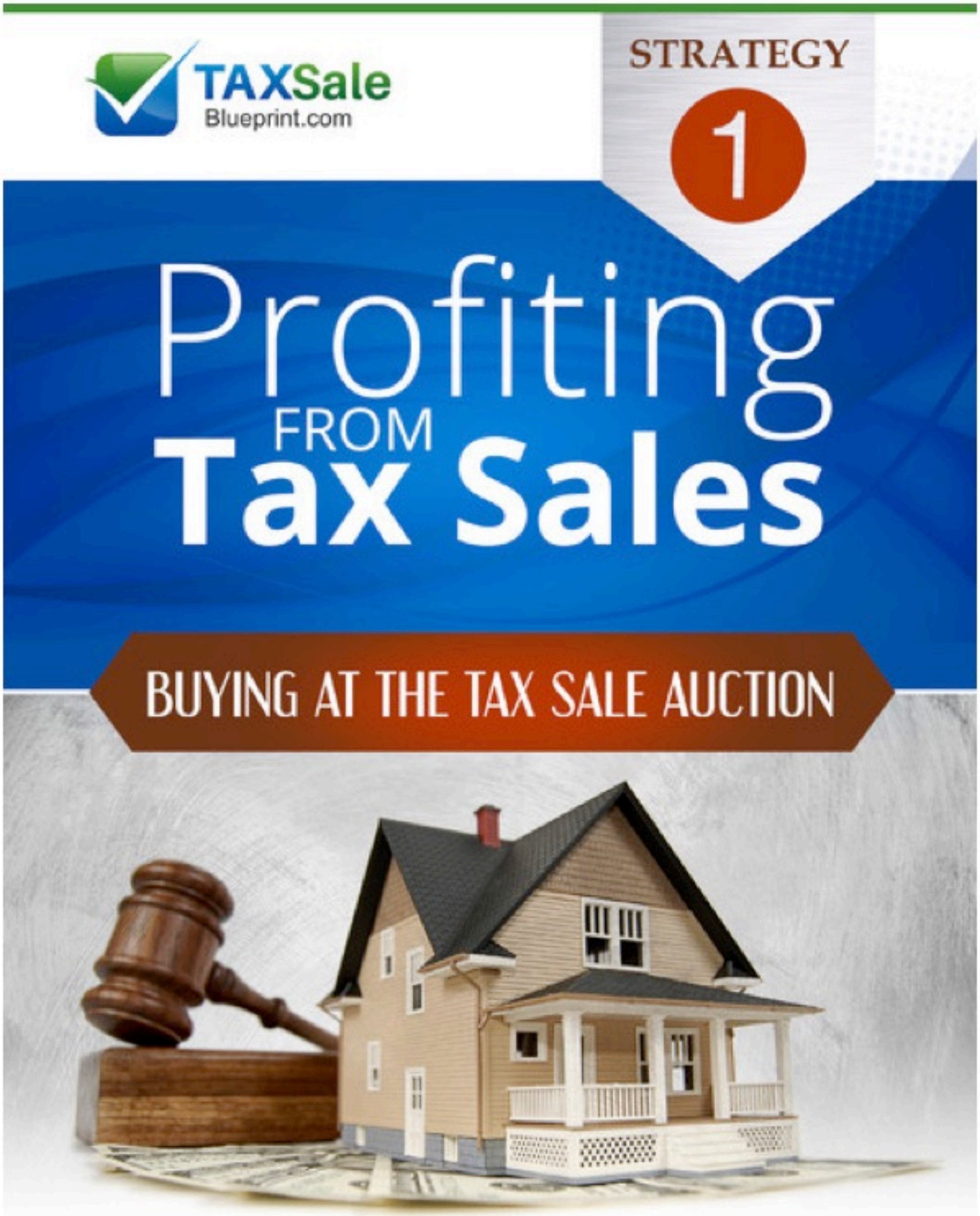

The Insider Pro's Guide to Profiting at Tax Sales Part One

- Strategy 1 -

Buying at the Tax Deed Auction a.k.a. "Tax Sale"

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Welcome to the world of Tax Sales. Opportunity for you to buy properties at bargain prices, get high rates of return on your monies and work with a behind the scenes strategy being used by a few insiders to make a killing.

The purpose of this series is to introduce you to the opportunities for you at tax sales, the plusses and minuses of each, and to show you a hidden business opportunity within tax sales that most people do not know about.

This document is part one of a three-part series and in this document I will go over buying at the auction where properties are sold due to past due taxes. "Tax sale" is the way the pros refer to buying at auctions where properties are sold due to past-due taxes. So we will refer to this strategy as "buying at tax sale."

Buying at tax sale **can be the source of some good buys if you are looking to buy real estate – especially to "fix and flip."**[1] My maximum price for properties I am buying to flip is 70% of retail value (after repairs) minus repair costs. That can be a hard price to achieve through real estate agents, but is done routinely at tax sales. So tax sales can be a great source for you to buy properties at bargain properties.

What Exactly are Tax Sales?
At tax sale the county real estate taxing authority sells the deed (ownership) to the property to the highest bidder. The taxing authority uses the proceeds of the tax sale to pay past-due taxes, interest and penalties.

Usually by the time a property is sold at tax sale the taxes are three or four years behind and you can be assured the owner has had ample opportunity to catch up on the taxes.

Tax sales hold great opportunity – you can get properties at great prices. But tax sales are not for the uneducated buyer. Buying at tax sale is not the same as buying through a real estate agent or even buying at a mortgage foreclosure sale. There are risks that are unique to tax sales. In this document I will go over the risks inherent to tax sales and how you can successful manage those risks.

***Note that there are also auctions called "tax lien auctions" that are not the same as tax sales.* A tax lien is a financial instrument that pays interest, and sometimes penalties and fees, to the holder of the tax lien.**

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[1] If you want more commentary on why I don't use tax sales for rentals look at the bottom of this document for "Bonus Materials"

Investors in tax liens are generally looking for a return on cash invested. They are not looking for a property to “fix and flip”, live in or use as a rental. Tax Lien Auctions are not generally a strategy used to acquire real estate because they do not sell the real estate at the tax lien auction – they sell a lien against the real estate.

Tax lien auctions can be great ways to get high rates of return on cash invested, If you want to know more about tax liens I have prepared a supplemental tax lien report. Email us at taxlienspecialreport@taxsaleblueprint.com and you will automatically get a free copy of that report.

Tax Sales Give You Three Opportunities to Make Money

Tax sales create **three opportunities** for you as an investor. Buying at the auction, buying before the auction, and a hidden, third opportunity we call Strategy 3. We will cover all three of those opportunities in this three part series. In this part of the series we are covering buying at the tax sale.

How the Tax Sale Process Works

Let’s take a detailed look at each step in the process of buying at the tax sale and let me show you where you need to be careful and where you need specialized knowledge. There are great deals to be had at tax sale but you need to know what you are doing.

The following info-graphic shows a pictorial overview of the process.

TAX SALE BLUEPRINT

STRATEGY 1

GOAL: Buy a Property at Tax Deed Auction

STEP 1
Get the List.

STEP 2
Due Diligence.
Drive by the properties.

STEP 3
Evaluate Property Condition,
repairs needed, value and neighborhood.
Avoid Useless Properties!

STEP 4
Get your Cash
Together for Auction

STEP 5
Win Property
at Auction

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Step One: Get the List of Properties to be Auctioned
Typically, lists of properties to be sold at tax sale are available anywhere from 30 to 45 days in advance of the actual tax sale. The agency that is forcing the sale of the property due to non-payment of taxes is usually the one that is advertising the property for sale and has lists available to you.

The easiest way to get this list is to simply to call the county tax collector and ask who conducts the tax sales. Then call the department that conducts the tax sale for the list.

Tax Sales may be held annually, monthly, or weekly. Counties with higher populations tend to hold the auctions more frequently because they have more properties to sell every year. **Sales lists for tax sales tend to be large, which creates problems in getting your due diligence done.** The lists are only given out thirty to forty-five days prior to the tax sale.

In my local counties the sales are held once a year. The sale lists are often three thousand properties or more. Since we only had thirty to forty-five days to prepare for auction we could not evaluate all of the properties. So we picked out a few zip codes and covered all the properties in those zip codes. That helped make our time spent efficient. Today we use a computerized system to help us perform much of our due diligence electronically. We do offer subscriptions to our electronic due diligence system. If you want to learn more about that reach out to us at support@taxsaleblueprint.com and we can discuss that with you.

Step Two: Prepare for The Auction
Once you get the list of properties to be auctioned, you need to perform "due diligence", which is the process of evaluating the properties so you can decide which properties you are interested in and how much you will bid for each property. As per the above be sure to see every property you want to bid on. If the list is too large simply do a few zip codes.

Step Three: Bid at the Auction
Once you identify the properties you are interested in, you go and bid at the auction. Be sure to check with the agency conducting the auction whether you need to register in advance for the auction and what forms of payment they accept. Often you need to register in advance. Sometimes you need to put down a deposit and often you need to pay via certified check.

If you don't register in advance you cannot bid. At most auctions they require immediate payment via cashier's check and you cannot use a mortgage (for reasons discussed below). Bottom line - check everything about the auction in advance, there are a lot of local rules to comply with. The department that conducts the sale will have a written set of rules and instructions for you to see. Read them carefully and be sure to do that far in advance of the sale so you have time to register to bid etc.

As you can see buying at the tax sale has only three steps. Get lists, evaluate the properties and go bid. But there are at least a dozen distinct problems bidders must deal with in buying at the tax sale.

Unique Aspects to Buying at Tax Sale – Challenges and Solutions

Challenge #1 – Lack of Information to do Effective Due Diligence

Due diligence is a fancy word for determining what the property to be sold at the tax sale actually is, if you want the property, what it is worth and how much to bid for it.

The first step in carrying out due diligence is driving by the properties to evaluate their condition and neighborhood. **You are not allowed to go into the property, there are no "open houses" or inspection periods, there are no condition reports nor do they have photos or any other materials to help you. All you can do is view the property from the street and make some guesses.**

Keep in mind, even a standing property that looks fine from the outside can be: water damaged; fire damaged; an EPA hazardous waste site; have nuisance liens; title problems; be unbuildable land; or have any number of other issues.

Owners do not put money into repairs in properties they are not paying taxes on, so these properties are often in very poor condition.

People new to bidding for a property at tax sale are always surprised they are only allowed to drive by the property and are not allowed to go inside to inspect it. But that is the law. Set foot on the property and you are a trespasser. Walk inside and you are breaking and entering. There is no interior access provided whatsoever. No one gives you a key, no one gives you interior photos, and no one gives you any information, guarantees or warranties of any kind. It is truly "buyer beware."

The lack of interior inspections, lack of time, lack of information, together with large numbers of properties to evaluate make buying at the tax sale much different than buying through a real estate agent.

Solution. Here is how I dealt with this –

I calculated how many properties I could see in a day and limited my due diligence to a subset of the total tax sale list. I picked out a few zip codes and drove by all of those properties. I ran comps in those neighborhoods and learned values. I called real estate agents with listings in those neighborhoods and got to know values. That made my use of time much more efficient.

Challenge #2 – A List Spiked with The Useless Properties

You also need to be very careful that you do not find yourself buying useless parcels of land at tax sale auction, such as unbuildable lots, slivers of land, and drainage ditches.

Taxing authorities routinely auction off this kind of land. The taxing authorities simply auction every property with delinquent taxes. Taxing authorities do not do any review of what they are selling, and, they do not offer any warranties, guarantees, or refunds.

Owners of useless land will stop paying the taxes and let them go at tax auction. There are almost always useless parcels of land in tax sale lists. So, do your homework before you buy any property at the tax sale and never assume that a parcel of property to be sold at tax sale is buildable, usable under the zoning laws, in good condition or anything else. Instead, assume the worst and check everything!

Solution. The practical solution to this problem for me was that I bought existing houses (no worries for me that the land was not buildable) and never commercial properties (risk of environmental issues is too high on commercial properties), and I did not buy anything I had not driven by.

Challenge #3 - Lists are Large and Due Diligence Time is Short

Most tax sale lists have a lot of properties on them. There is not enough time to drive by all of the properties. My suburban Philadelphia sales are representative of this problem. Those auctions have three to four thousand properties offered for sale and there are anywhere from thirty to forty-five days from the day the list comes out to the date of the auction. Unless I put together a large and expensive due diligence team, there is no way to even do a drive-by of all those properties to make a guess at the condition, evaluate the neighborhood, and decide if the property is desirable.

I never bid on properties I did not drive by because I simply would be spending money on a property I know nothing about. Unless a better way to do due diligence is found, you should not bid on properties you don't drive by and evaluate.

Solution. The way I solved this problem was by working only a subset of the total list. I picked a few zip codes and worked those. I also intentionally picked neighborhoods that were "working class" because percentage-wise more of those properties ultimately went to tax sale. Properties listed for tax sale in wealthier neighborhoods tended to be pulled from the list at the last minute because those folks had more resources to catch up with their taxes and would ultimately pay before their property was sold (see next challenge below for more on this) and thus very few, if any, properties in wealthier neighborhoods (solid middle class and better) would be sold at tax sale.

Challenge #4 - Most properties advertised on the tax sale list will never be sold at Tax Sale

In my experience seventy to eighty percent of the properties you see on the list are never sold at tax sale because the taxes are paid. Most tax delinquent property owners will pay their tax bill between the day the tax sale list is published and the auction. To make matters worse for you many will pay in the week leading up to the tax sale.

When the taxes are paid before the tax sale the property will not be auctioned.

Any due diligence you did on a property where the owner pays the taxes prior to the auction was a waste of your time.

Solution. I made sure that I looked at many properties so I had enough properties to bid on. All owners do not catch up on taxes so I played the numbers – I knew most of the properties would not be sold – but some would. So I looked at a few hundred properties for each tax sale and had the opportunity to buy a few at each sale.

My strategy of limiting my activity to a few zip codes really helped here. Zip codes are small areas and it was much less driving to see all of the properties in one zip code than it would be to try to drive the entire list of properties.

I also kept checking on the list to make sure I crossed properties where the taxes were paid off from my list so I could focus on the properties that were still scheduled to be sold.

Challenge #5 – Hard to Determine the Amount You Should Bid

An old saying in real estate is “You make your money when you buy” which means the price you pay for the property determines whether you will make money or not on your deal. I agree with that – unless you buy at a price that leaves you room for a profit you will not make money on the deal. And in fact you could easily lose money.

In determining your bid, you should first determine what the property is worth in good condition (its “retail value”), and then subtract out the estimated costs of repairs, then add an allowance for profit.

For flipping properties my formula is (retail price X 70%) minus repairs. So for a $200,000 house that needed $30,000 in repairs I would pay $110,000

The Flipping Formula

$200,000 X 70% = $140,000

$140,000 - $30,000 = $110,000 maximum bid price

So for each property you need to know its retail value and the repair cost. Getting accurate estimates of retail value and repair costs under the tax sale conditions is challenging. More on that later.

Solution. By focusing on a few areas (zip codes) I got to know those areas well. I would attend open houses, call real estate agents on listed properties, and continue to work in those neighborhoods year after year. Over time I knew the values without having to do much research. I knew what styles of houses were popular, what sorts of problems houses in those neighborhoods typically experienced, and which ones sold quickly. That took care of values. For repairs see challenge #7 below.

Challenge #6 – Getting an Accurate Estimate of Retail Value

In this section I have interwoven the challenge and solution. To get an estimate of the property's retail value, you need to know if or you need to research. If you don't know the value then you need to learn the values in the neighborhoods you will be working. Call properties that are listed for sale, attend open houses, look on realtor.com for listings and ask a lot of questions from professionals who work real estate in those neighborhoods.

If you can get a friendly real estate agent to help you have them run off "sold and settled" properties report showing the asking and sale prices and days on market for sold properties, as well as a list of houses currently for sale including price, description and days they have been for sale. Those pieces of information allow you to estimate the selling time, market direction (up or down) and retail value of your property in retail condition.

You can get some information from Zillow, the web based consumer platform (www.zillow.com). Zillow can produce a "Zestimate" which is their version of an estimate of value. Be careful of relying upon those "Zestimates" though, the values are often off by significant amounts and not accurate enough to rely upon. I don't use Zillow estimates for my investing.

The process of determining retail values is time consuming. That is why you need to work in a few zip codes. That way you can get to know those areas and why you can usually not work an entire tax sale list. This is one reason tax sales are often dominated by local players who know their local markets. **If you are going to be a bidder at tax sale, it is probably best for you to focus on one local market where you can build your local market knowledge so you can better estimate retail market value and how long it will take to sell a property.**

Challenge #7 – Getting an Accurate Estimate of Repairs

You need to take repairs into account to bid - yet you have no interior access to the property unless an owner or tenant lets you in.

Keep in mind that you are planning to bid on a property where the taxes were not paid for years. The owner was broke. So needed repairs were mostly likely never done.

Solution. What I do with tax sales is knock on the doors to see if I could get permission to go inside. From the street I look carefully for any signs of foundation issues (look for windows and doors that are out of square, crooked roof lines), look for roof issues, evidence of fires, and whether the house was occupied or vacant. If you drive by in the evening, after it is dark, you can see if a property is occupied or not because occupied properties have lights on.

Vacant house deteriorate quickly so assume vacant houses have broken water pipes (from freezing), damage from water leaking (could be as simple as clogged gutters or as bad as a hole in the roof), and are generally in need of a full gut rehab. Unless you have gained inside access and have personally seen the inside.

I always assumed the houses would be in poor condition. I would rather lose an auction to a bidder who will pay more than win a property that I pay too much for.

Challenge #8 - No Mortgages – You Must Pay Cash

The property you are buying at tax sale does not qualify for a mortgage. No matter your credit. In order to get a mortgage on a property you need three things: a deed, marketable title, and title insurance.

In the case of a tax sale property you will not get a deed to the property on the day you win it at auction and have to pay for it. This deed will be produced and recorded sometime after the completion of the tax sale by the taxing authorities. That delay can be days, weeks or even months. Since you need the money the day of the sale and the mortgage company will not lend until there is a deed you are not able to mortgage to pay for your bid.

There is also a second problem that prevents getting a mortgage to finance your bid. Mortgage companies require you to have title insurance when they are lending via a mortgage loan. Usually title companies will not offer title insurance on a property bought at tax sale until and unless you file a lawsuit called a “Quiet Title Action” which typically costs between $3,500 and $6,000 and takes several months. There are a few specialized title companies that are offering title insurance without Quiet Title Actions but their underwriting takes time and cannot be done in a day, so you cannot get title insurance on the day of the auction. So you cannot get title insurance right away. No deed and no title insurance prevent a mortgage company from lending on that property – so you cannot get a mortgage to pay for the property you must use cash.

Solution. I used partners, private capital, credit lines and cards (at the beginning) and home equity lines of credit to buy at tax sale. Partners had the job of bringing the money, I did the work, and we split the profits. Private capital was loans from private lenders who lent on an unsecured basis (no mortgage). These were generally friends and family. Credit lines and cards were either unsecured small cash lines of credit from local banks that allowed cash advances or where credit cards where I took out cash advances. And home equity lines of credit were secured against properties I owned. This business is one where you will need to have your own cash or cultivate these “non traditional” financing sources to enable your purchases.

Challenge #9 - You have to Deal with Occupants
At most tax sales the bidder has to deal with any occupants – which can be former owners, renters or squatters. You often have to evict the occupants, which can be expensive and time consuming.

Do not expect that the property you win at auction is delivered without occupants. Often you are responsible to evict the occupants which costs time and money. Check on this before you bid.

Solution. I assumed I would need to deal with the occupants. Most do not put up too much of a fight because they know that ultimately they do not own the house and cannot stay. I would offer them some money to move and a short term leases if they needed to stay for a month or two. I preferred to be in a lease with them because it is easier to evict someone when you have a lease then it is when you have no agreement (at least in Pennsylvania, consult your own attorney in your state for legal advice for yourself). "Cash for keys" is a common strategy and I suggest you use it. $2,500 is a common fee. Don't rent to them long term. If they did not pay the taxes they will not pay you either.

Challenge #10 - Litigation to Overturn Tax Sales
Owners of valuable properties will often come back after the tax sale to try to undo the Auction and be reinstated as owners.

Sales of properties at tax sale tend to be fairly easy to overturn, so the owners will often succeed.

Problems that can result in auctions being overturned and the property ownership being returned to the former owner include any technical problems with the sale including insufficient legal notices or any irregularity in the sale. If any "t's" aren't crossed, or "i's" aren't dotted in the tax sale paperwork, the sale will often be overturned. And since sales are done on a large volume often there are problems in the tax sale paperwork and process.

You have to pay a lawyer if you want to participate in that litigation. You will not be reimbursed regardless of whether you win or lose. If you lose that litigation, typically your bid will be refunded, but that is it. You will not recover any of your attorney's fees or costs, or receive anything for your time, effort, and aggravation. Even worse, if you've started to repair or renovate the property, you will probably not get reimbursed for those costs.

Solution. Get title insurance for your "after repaired" value <u>before</u> you work on the property. That way the title insurance company will deal with any lawsuit to overturn the tax sale. And if you do get involved in litigation hire an experienced attorney and take his or her advice about settling or battling. Most of these sales do not result in litigation and I accepted that sporadic litigation was manageable – it hurt my profits on that deal but overall I made money on the deals without litigation and the business could handle some legal fees from time to time.

Challenge #11 -Bidding at the Auction is Often Competitive
The bidding at tax sales can be very competitive. Especially in California and other popular, wealthy areas. In competitive areas the bidding can get to 80% or more of retail value less repair costs. Sometimes bidders even pay full retail value if they get "auction fever."

Solution. Evaluate how competitive your local auction is. Go to an auction before you get into the business of buying at tax sales to see for yourself what the level of competition is at that particular sale. If your sale is competitive understand you will need to see a lot of properties to win any at the auction and plan to cover more properties in "due diligence" so you have the numbers working in your favor.

Generally more populated areas and areas around major cities are more competitive and less populated areas are less competitive. But check your auction so you will know what your auction is like.

Challenge #12 - Liens
Tax sales do not necessarily wipe out all the liens on a property. This varies by jurisdiction but in some jurisdictions grass cutting liens, fines for trash on a property and other "nuisance" liens some with the property. EPA issues such as groundwater and soil contamination are definitely not wiped out. At some sales mortgages, mechanics liens and judgments are not eliminated by tax sales. IRS liens will stay on for six months and the IRS has the right to buy the property from you for the amount you bid for that time period.

Furthermore if a lienholder is not notified in advance of the sale they will not be eliminated at all.

There is not sufficient time for you to check each file to see if noticing was done properly. When noticing is not done properly even if the tax sale could have divested the lien since there was no notice the lien will not be divested. Bottom line here is that you must check in advance of the sale what liens will legally stay with the property despite the tax sale, and additionally understand that from time to time you will still get stuck with liens because noticing was done incorrectly.

Solution. Consult with a local attorney to find out what liens survive a tax sale and which do not. Do not bid on commercial properties. EPA issues are not cleared by a tax sale and you could be stuck with a cleanup bill as the successful bidder at tax sale. Be sure you know whether mortgages and other liens will be cleared by the tax sale or not and do your due diligence on properties you want to bid on. The real work in tax sales is in the due diligence. But with that work you can be well rewarded with a bargain priced property.

Bottom line – there are good deals buying the real estate at the sales but you really need to do your homework to get those deals.

There are other opportunities generated by tax sales. In parts two and three of this series I will show you Strategies *Two* and *Three*, which eliminate many of the problems inherent to *Strategy 1*.

Bonus materials - Why I don't buy rentals at Tax Sale

I do not use this strategy to acquire rental properties because the properties you get at tax sale are fairly random – and I like to buy rentals in specific neighborhoods. I like to keep my rentals in one area because they are easier to manage.

I also have a strategic reason. I want rentals that will experience price increases over time. Price increases are driven by population increases and employment increases. When income and employment is rising housing values go up more than inflation and your rental portfolio will go up in value.

You can still make money in neighborhoods that are stable but not experiencing increases in value. You just will not see the wealth creation from price increases in your rental properties. If you are operating in an area that does not have increasing employment or population then my advice is to hold rentals only in areas that are stable. You do not want to be in a declining neighborhood. Being in a stable neighborhood is OK. You can make money and have a solid business. But being in a declining neighborhood is a losing proposition.

The problem is that tax sales often have properties in down-and-out neighborhoods that I don't generally see as desirable for long-term rentals. You can find fix and flip through tax sales.