

TALES FROM THE TRENCHES

BY BARRY C. MCGUIRE

March, 2011

THE BASICS

As real estate investors our perfect world would be something like this:

- ☺ Find a completely renovated property that exactly fits the system, make an offer,
- ☺ do and be satisfied with your diligence (due diligence), remove conditions,
- ☺ close on time,
- ☺ place your perfect tenant
- ☺ and enjoy your solid positive cash flow.

That would be a perfect world but real estate investing, and life, isn't really like that. There are lots of bumps and twists, questions and situations that come up every day in your normal lives and with every real estate transaction.

What I have discovered over 35 years of being a lawyer and handling approximately 25,000 transactions is that every deal has its wrinkles and crinkles, its ups and downs; situations where you say, "should I or shouldn't I?" There are many situations that keep coming up time and time again, situations that raise basic questions to which you need the answers. Having answers will help you move forward with your business of real estate. These answers will be valuable tools in your real estate toolbox, enabling you to quickly deal with those ever-present puzzles and questions that come up constantly in the world of real estate investing.

Tonight we present the 2nd chapter in our new series, 'Tales From The Trenches - The Basics'. We are going to look at those situations that keep coming up, get into the details and give you the tools to solve every day real estate problems.

HOME INSPECTIONS

"I don't need no stinkin' inspection!" Effectively, that's what a lot of buyers say when they fail to get a home inspection. It is wrong, wrong, completely wrong. Home inspections have gone from an oddity, hardly ever done, to an essential tool in every investor's toolbox. This is the first part of a two-part series on home inspections. Part one will give us graphic examples of how a home inspection can help. Part two will deal with how to pick a home inspector, home inspection contract schedules and dealing with those inspector-revealed surprises.

KNOB AND TUBE?

This Tale comes from an e-mail that was so descriptive I am reprinting it here. To help understand the e-mail, please note that 'knob and tube' is an out-dated and now forbidden way to wire a house. Wikipedia says, "It consisted of single-insulated copper conductors run within wall or ceiling cavities, passing through joist and stud drill-holes via protective porcelain insulating *tubes*, and supported along their length on nailed-down porcelain *knob* insulators". Google 'knob and tube' for more info and especially pictures of fires caused by knob and tube wiring.

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Now here's the e-mail.

"We went to Saint John New Brunswick to look at properties mainly because of the price point in the area. Put an offer in on a 3 plex that was eventually negotiated down to 185K. Rents were a little more than \$3000 a month total including heat. Cap Rate on the property was over 19%, tenants had been there on average for 2-3 years, so it looked great.

Went through our due diligence on the property. Expenses, rent rolls, etc. all came through as expected. We also had a property inspection done which was even more of a requirement than usual because of the age of the building in Saint John as opposed to Alberta. The inspection was thorough and discovered some minor problems we expected and one major one we didn't. All of the visible electrical including the service coming into the building, the breaker panels, and wiring that was visible had been replaced however, none of the wiring in the walls had been replaced and was the original knob and tube wiring that the pig tailed to the new visible wiring. They tried to pass the building off as new wiring building when it wasn't.

Getting insurance for the property and passing fire codes now became an issue if we didn't want to replace the wiring. If we did replace the wiring we would have had to kick out the tenants to complete the task which was estimated at a \$30,000 repair bill. We went back to the owner to discuss what we could do about this, negotiate a lower price or cash back for repairs or something. He told us he wouldn't negotiate further and would hope any new offers wouldn't be as diligent with their property inspection as ours was."

LESSONS LEARNED? Moral of the story. A \$500 property inspection saved us a \$30,000+ surprise somewhere down the road.

PAINTED LADIES

Painted ladies are sometimes known as show homes. Builders construct show homes in new subdivisions to let customers have a look at what their new home might look like. Those show homes often get top-of-the-line appliances, decorating and a lot of hard traffic in the 2-3 years that they are open. The show home is sold once the subdivision is completed or the builder doesn't need the show home anymore. If you are looking at a show home you're probably asking yourself, "what could go wrong? Surely the builder wants to look good. He must've done a great job".

Recently one of our members decided to be cautious and get a home inspection. Here's what she found:

1. There was a beautiful stainless steel fridge with the requisite high-end icemaker. There was no plumbing to the icemaker so, of course, it didn't work.
2. The high-end dishwasher had no plumbing either. BUT, the electrical was connected. Someone had turned on the dishwasher and it shorted out. How did the inspector know this? He looked at the

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electrical panel and saw one of the breakers was off. He then established that breaker was for the dishwasher, checked the dishwasher and found the problem.

3. A furnace exhaust seal was not seated properly causing condensation inside the furnace compartment. The furnace had rust everywhere!
4. The furnace had a gas leak.
5. Basement development did not adequately avoid the fresh air intake. That piping was crushed and flattened in numerous places thus greatly reducing fresh air volume which impacts furnace combustion and air quality.
6. There were two show homes side-by-side with front drive garages. The builder had constructed a sales area attached to the two garages. When the show homes were being sold, the builder removed the temporary sales area. This left a big hole in the ground which needed to be filled. Many municipalities require new homes to have grading certificates prepared by an Alberta Land Surveyor. Grading certificates show that final landscaping meets municipal grading requirements which ensure adequate drainage. Even if this builder had obtained a grading certificate when the show homes were built, removal of the temporary sales area and the big hole in the ground would void that grading certificate. You need to ask for a new grading certificate.
7. Lastly, my client attended the inspection with her inspector. All decent inspectors encourage you to attend. While the inspector was doing his thing my client went around the house looking at and trying other things. She discovered that the controllers were not working on the expensive built-in sound system.

LESSONS LEARNED

- Show homes can be a beautiful trap
- Don't accept "as is, where is", get it inspected
- Don't rely on any New Home Warranty program to save you after closing. Identify issues before buying.

MORE INSPECTION NIGHTMARES

Building inspectors must have a lot of fun when they get together at their annual convention. There is just no end to the wacky and dangerous situations that they come across on a daily basis. Here's another batch of inspection issues, all true stories.

1. Our inspector found seven items plugged into one outlet in a bathroom. It wasn't a ground fault circuit interrupter (GFCI) outlet, so it wasn't any wonder that the homeowner said the breaker never blew.
2. Our next scenario has a wood fireplace chimney within 2 feet of a bedroom air-conditioner. Can you say carbon monoxide poisoning?

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3. One homeowner decided to install a light in an unprotected fixture right inside the shower stall. Of course, if you have a light, you need a switch and that was in the shower too.
4. A new home with a city final inspection tag is no guarantee that the drain in the bathtub is hooked up.
5. The prongs on the plug of an extension cord each have a hole in them. Some homeowners think those holes are designed for something and it's a shame to waste them. In one case our inspector found a homeowner making up for a shortage of wire by stripping the ends of his short piece and hooking them into the holes on the extension cord plug.
6. Houses need hot-air vents and cold air returns. They just don't need them right next to each other so the hot air from the furnace can immediately be fed, you guessed it, right back into the furnace.
7. If you're short of cable wire, one bad idea is to punch a hole in your exhaust flue from your furnace and run the cable right through the flue.
8. Times must be tough when 2 feet of the exhaust gas flue on a hot water tank have to be made out of aluminum tinfoil.
9. Imagine our inspector's surprise when he checked the humidifier on the furnace only to find the drum had been removed and replaced with a Cool Whip container. Not very cool.

All these scenarios were revealed by a building inspection. They are all kind of funny to talk about but none of those homeowners would be laughing if they got carbon monoxide poisoning, had an electrical fire, had giant heating bills and a cold house, electrocuted themselves, had erratic humidity or flooded their homes.

LESSONS LEARNED

- Get a building inspection, every time!

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RMLO Law Office
101, 10301-109 Street
Edmonton, Alberta, T5J 1N4

Phone: 780.431.1444
Toll-Free: 1.888.333.8818
Fax: 780.431.1499

Barry C. McGuire
b.mcguire@rmlo.com

Richard M. Bell
r.bell@rmlo.com