

Flitton's Rules TM

9 Proven Strategies to Guide Real Estate Investing

➔ Money Makes You Stupid

“Money is the material shape of the principle that men who wish to deal with one another must deal by trade and give value for value.”

– Ayn Rand, Author & Philosopher

On my very first day in the real estate business 30 years ago, I was eager and asked my mentor to please infuse me with advice. He immediately said to me, “Always remember this ... one thing I have consistently found throughout the years is that money makes you stupid!” I have never found this advice to be incorrect, and have observed that disobeying it has been the downfall of many.

I urge you to discover, understand and integrate into your thinking the concept of what money actually “is” – how difficult it is to make or earn, and therefore how preciously and judiciously it should be spent or invested. The best resource for this, in my opinion, is the novel **Atlas Shrugged** by Ayn Rand. Without a full understanding of the nature of money, a compelling and rational reason, and full knowledge of the consequences in advance, your money should not ever be invested.

Those who obtain money too easily often invest it with abandon. I have seen many investors or developers who had early success and then lost it all. Some had success by luck, and some earned their success through diligence – but then both types lost it all. Why? Because they either failed to recognize that their prior success was mere luck, **OR** they abandoned the principles, diligence and exhaustive investigative effort they applied when they were young and hungry.

Twenty years ago a novice client and I were analyzing a 10-acre piece of land for development and discovered that soils conditions were a potentially deadly issue – but, backhoe access to dig test holes to check the soils was impossible. So, without hesitating, we personally spent the entire day with a soils engineer hand-digging dozens of 5-foot deep holes with shovels all over the property in order to be certain first-hand as to what we were dealing with. The project was indeed bought and was a major financial success. Ten years later, that same client went broke on a much larger deal by failing to do a full and proper due-diligence study on a site he invested in.

This same man who had the personal care to hand-dig holes when he was young and hungry lost his edge after he had made a lot of money and felt that such exhaustive inquiries were beneath him and unnecessary ... and so he lost it all. Money had made him stupid.

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➔ Divide Your Einstein from Your Edison

"Science is a wonderful thing if one does not have to earn one's living at it."

– Albert Einstein, Scientist

"I am not a scientist. I measure everything I do by the size of the silver dollar. If it don't come up to that standard then I know it's no good."

– Thomas Edison, Engineer/Inventor

Einstein was a Scientist – Edison was an Engineer/Inventor. Both were brilliant, and yet they had entirely different skill-sets. A Scientist discovers facts, and an Engineer/Inventor applies those facts to create solutions to problems.

In real estate investing, these two separate skill-sets are vitally important, and must be kept divided and used in the proper order – Science must come first and Engineering/Invention must come second.

Your inner-Einstein tests theories by conducting research and makes investigative negotiation probes – the most cardinal thing is that this aspect of your process does not make decisions of any type. It may be challenging to refrain from the temptation of decision-making ... but, it will pay off over the long run.

Your inner-Edison shifts gears after the research is in and then employs the information your research has uncovered into engineering, crafting, designing and inventing the deal to solve the issues that pertain to the investment.

Visualize these two distinct skill-sets as different departments within a business and this should assist you.

Research not only pertains to hard facts about the property, but also to aspects of your negotiations for the deal itself – always walk into negotiations by denying yourself the permission to agree. Unless an outrageously great deal is proposed, tell the other party you'd like to think about it. Rarely are deals lost by thinking it over ... and if they are, always remember that "the only free cheese is in a mouse trap."

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➔ Beware the Turkey Theory

“In a strong wind, even turkeys can fly.”

– Source Unknown.

Don't be a turkey. Excellence in merchandising, quality, details, client-service, communication, principles, integrity and a whole host of other areas really, really matters ... no matter the market conditions. If the market is buoyant (i.e., “windy”) then one can become accidentally profitable, but wouldn't you rather be deliberately, strategically and reliably profitable?

One can control even the worst type of economic climate by constantly and consistently paying attention to the things that matter within one's own industry. If you merely rely on the strength of the wind, then in the end it is the lack of wind that will inevitably result in your doom ... if you live by the wind, you will die by the lack of wind.

Warren Buffett preaches and practices this ubiquitously throughout his empire. He only invests in businesses that have monopolistic or highly leveraged positions in the arenas in which they compete. He knows that he needs to rely on the cash-flow and profitability of his businesses through all market-cycles ... he never relies on luck.

It is not very challenging to buy a run-down home and renovate it ... the challenge is to sell such homes consistently for profit. When one pays attention ahead of the game to the possibility of having to sell it during a depressed market, one then invests only in those homes with unique or special qualities that can dominate and sell faster and more profitably in any type of market.

All players enjoy and benefit from wide-market appreciation, which we saw in the real estate market from 2000 to 2006 ... and we consequently saw that the vast majority suffered from the ensuing wide-market depreciation. The smart goal is to strategize how to profit and benefit from isolated transactions regardless of up or down markets. One weak premise that some people hold is to pay too much attention to macro- or global-economics versus the regionalized conditions that are right in front of their faces (i.e., right down to their own neighborhood).

No matter what positive or negative economic conditions are in the world, your country, your state, or your city, never forget that your ongoing and never-ending task is to constantly and consistently earn your share of the market.

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➔ The Value of Manufacturing v. Speculation

“Figure out what customers want.”

– Steve Jobs, Apple

There are only two basic way to make money – manufacturing and speculation. A Manufacturer assembles raw materials and then sells his value-added product for a profit – a Speculator merely buys a product at X price, does not alter it, and then has faith that someone will later pay him X + Y for it.

NIKE makes money buying raw materials of rubber, canvas, glue, string, etc., for a few dollars, investing in people and a manufacturing plant, and by then making highly merchandised shoes that they sell for ten-fold – never do you see NIKE simply buy a pair of shoes for X price and then speculatively try to find some other person to buy it from them for X + Y.

Manufacturing is vastly superior because it is a consistently reliable way of making money – you are producing something for someone that they cannot reasonably or easily produce on their own and so you have built-in value. Speculating can be profitable, but relies on having a volatile market and mastering and capitalizing on the ups and downs of that volatility. Whereas, when manufacturing is done properly, it can also enjoy speculative profit as a bonus. One downside to manufacturing can be the cost of carrying the inventory of the raw materials, especially in real estate.

When considering an investment it is vital to know which one you're undertaking and to strategize the risks accordingly.

In real estate, the original land developer is a manufacturer – the raw materials are the land itself, the zoning approvals he negotiates, and then the utilities and grading and site improvements he builds. The home builder that buys his building-lots is also a manufacturer – he takes a wide array of raw materials, including the lot, and builds a value-added home or condo that an end-user buys.

These two market manufacturers have been dramatically harmed over the last five years because the inventory of raw materials they loaded up on for a wide and hungry market could not be dumped and cost them a fortune – since it takes 3+ years to develop a building lot, stocking up on supply had been necessary. They bought a large inventory of expensive building lots, but then the rapidly shifting market dictated that those lots should have been bought at a fraction instead.

Five years ago, new homes were cheaper than used ones ... today the opposite is true and now a builder's finished product is necessarily far too expensive and they have been aggressively trying to dump or unload the expensive raw materials in their inventory. Observe, though, they while they are adjusting their inventory size and costs they continue to exist and compete as Manufacturers and have not succumbed to becoming mere Speculators.

A type of Manufacturer that has successfully evolved out of the last five years in response to dwindling market supply of new homes is the renovator/flipper – he buys homes in rough shape at under-market prices, adds raw materials to them, merchandises them, and sells them for profit. Even today in the worst imaginable economic conditions, Speculators cannot objectively and properly judge markets.

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➔ The World is Not Zero-Sum

“Always be financially inclined and trade value-for-value.”

– Source Unknown

Many people in business mistakenly think that business transactions are zero-sum – i.e., that one’s gains or losses are exactly offset by the gains or losses of the other party, and that when the losses or gains are added up on both sides the sum will ledger out to zero like a static pie.

Such an attitude compels some people to ruthlessly and unnecessarily compete against the needs and desires of the other side – a gain by the other side is literally seen to be a threat or an exact deduction from their own side of the ledger. This is a debilitating condition or frame of mind because it leaves one impotent to engineering/inventing creative and profitable deals. There is no zero-sum or static economic pie in business. If you unshackle yourself from this type of thinking, you can grow enormously wealthy.

The correct frame of mind instead is that of the trader-of-value-for-value – the person who recognizes that a gain by the other side is not a threat to his own sum of wealth or potentiality. This does not mean you shouldn’t negotiate aggressively and strategically in your own rational self-interest – it means that the purpose of business is not winning, but rather it is to grow wealth and sometimes you grow more wealth when you help the other side grow more wealth.

There is no industry in the world with more manipulative players than the real estate industry. The industry is rife with covertly and overtly aggressive players who are constantly working on innovations for breaking agreements, structuring financial gimmicks and misleading others. I gave up trying to understand their motivations – either they are just plain mean or they mistakenly believe the zero-sum fallacy. In either case, they are nakedly aggressive in acquiring assets without earning them (sometimes on the mistaken premise that if they don’t control and steal, others will control and steal from them).

I am all about “the earned”, and work to discover right up front whether a person I am doing business with is about the earned. If they’re not, I close down discussions immediately – I have learned this the hard way many times.

A phrase I have successfully used many times to develop great ideas from negotiations when they seem doomed to turn to a zero-sum attitude is: “What if we were to ... ?”

➔ **Timing, Timing, Timing**

“Success in real estate all begins in the buying – and buying is timing.”

– Source Unknown

You have undoubtedly heard the saying “location, location, location”, which is important ... but an even more important axiom is **“timing, timing, timing.”**

Time is the most important factor in real estate. Buying at the right time, selling at the right time, the length of time you hold it, and the time you personally expend on a project – for all of these reasons, smart investors observe that “time is money.” Time can cost or save you money – depending on how you apply it. Developing good timing is a fundamental and necessary skill in real estate.

Timing is about the entrance and exit from a real estate deal – we want to buy when it is distressed, and then problem-solve or value-add, and exit for maximum value. A home in Malibu may have a way better location than some standard suburban 4-bedroom home, but good timing may make the suburban home a much better investment.

Manhattan has some of the most precious and expensive real estate in the world, but at one time it was considered worthless. Even today, though, one cannot merely consider Manhattan’s location alone. Some of the most talented developers in the world focus on Manhattan because they know that when they do pull the trigger on a deal, with the right timing they can make a major fortune.

The location of the Las Vegas Strip is considered world-class because casinos generate massive fortunes in cash. In 2007, a shrewd Kansas businessman named Phil Ruffin, renowned for his excellent timing, sold a 36-acre raw land site on The Strip to a Middle East investment group for \$1.2 billion – the highest price ever paid in Las Vegas – and they have subsequently lost more than half of this value. Ruffin exited the property because he reasonably recognized that it was at the highest probable value.

A very short time later, Ruffin quietly bought the famous Treasure Island Casino a short distance away – an entire intact and fully built and operating resort casino – for a mere \$775 million based on the timing of knowing that the seller needed the money and that his entrance into ownership of the property was when its price was as low as it likely ever would be.

Both sites had virtually identical locations, but Ruffin’s timing has produced a legendary fortune. I cannot imagine how the Middle Eastern investment group feels owning a raw development site at almost twice the price of a fully finished casino next door. The difference lies in the timing, and it does almost every time.

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➔ Think Independently and Say No When Needed

“Any Proposed Deal Can Be Demystified.”

– Rob Flitton

Independence is the recognition that you cannot escape the burden and prerogative of judgment – and nor should you want to.

Always read and understand contracts, commitments, documents and other important facts first-hand and continue to drill down and ask questions of yourself and others until you fully understand the subject matter. If you hire an Attorney, you don't suddenly pass all responsibility to the Attorney – he is only there for expert advice, not final decision-making. The same applies to contractors, engineers, sub-trades, consultants, brokers or anyone else you work with.

It is a myth that some subject-matter is too tricky or specialized ... anything can be demystified and reduced down to understandable components, at least general-speaking. Having developed some **10,000** housing units as a developer, I have acquired immense specialized knowledge over the years by demystifying all of the components of a deal and its development. I always took pride in, and benefitted from, having comparable knowledge to the consultants we hired in their fields of expertise – the soils and structural walls, sewer systems, water systems, building codes and methods, architecture, tax-issues, legal, brokerage, etc. I would attend meeting and listen attentively and then speak and make decisions decisively knowing confidently what I was doing. Such wide expertise granted me tremendous respect, but far more importantly it protected our profitability.

I also believe that responsibility must always be commensurate with authority – yet, we commonly see companies and organizations fail to properly sort this out. How on earth can a manager be expected to have responsibility and accountability over a certain area of the business without the commensurate authority to perform? A manager with accountability needs to be able to take action and to reasonably exercise his independent judgment, or he is doomed to fail. Always hire, retain and associate with those that are independent and reliably very good at what they do ... while still not losing communication with, and overall oversight of they are doing.

Also ... saying “NO” is very important in the real estate business. I have spent countless hours in boardrooms debating the merits of various major real estate deals – deals that might on the surface seem very lucrative and doable to many observers – only to decline them and send them back to the negotiation table. Smart decision-makers start with a “no-attitude” and need to be talked into a deal. I can testify that such debates and having often said “no” – despite overwhelming temptation to say yes – have been critical in avoiding financial disasters several times.

When you do a pro-forma or financial projection for a project, don't set it up to validate your own feelings – don't drive an agenda. Give it to someone you trust or respect and have them tear the hell out of it. Don't be afraid to hear disagreement and always be prepared to demystify and validate any position you have to questions posed.

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➔ **When Everyone's Growing Wheat, Plant Corn**

"The past does not equal the future."

– Tony Robbins

If you plant a wheat field in a world full of wheat fields, you probably have a very thin market. Markets are all about supply and demand, and success within markets is about anticipating and strategizing for supply and demand. But even if you cannot diversify out of wheat, there are ways for the thought-driven entrepreneur to diversify within the wheat market – Triscuits, beer, pancakes, root beer ... you get the idea.

In real estate, the vast majority of investors and speculators are led by their perception of what the group around them is doing, and then mimicking what they observe. This strategy is problematic on several levels: one – it relies on non-objective criteria (i.e., the choices of others) for determining one's own actions; two – it fails to regard the ever-evolving future; three – it places you in the thick of bringing more supply to an already over-saturated supply marketplace.

Steve Jobs of Apple very properly discusses the importance of figuring out what customers want – even when customers don't yet know what they want; that's the job he has tasked his company with. After he chooses his product, he then adopts what he calls a "ubiquitous evangelism" towards that product and demands the same from everyone in his company.

As one of my mentors once told me, no economic forecaster in the world can see more than two to three months into the future even using the best and most reliable economic indicators from the past. This means that you must constantly have an assessment of the size or populations of your market, the demand that such a market size will need to use, and the supply being brought into that market – as an entrepreneur, you can serve the predicted needs of that market OR work to direct the market OR both.

➔ **Always Have an Exit Strategy**

"Sometimes when caught in a cave-in with no way to dig out, you have to go deeper into the cave."

– Source Unknown

What-if" questions are very important in considering a real estate investment – what if X, Y or Z happens? And it isn't enough to just ask the question – one must have an exact and defined way out. If, after heavy scrutiny, you cannot exactly define the exit-strategy in advance for each and every what-if, then enter the deal at your own peril ... hardly any real estate deal goes the way you expect it to.