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San Diego Ranked in Top 25 Markets for Home Flipping in 2012

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San Diego saw more than 2,800 house flips in 2012, but with rising prices and low inventory that number will likely fall in 2013.

San Diego ranked 11th in the top 25 markets for flipping homes by RealtyTrac, based on the percent of gross profit. There were 2,853 single-family flips, an increase of 36 percent from the previous year. The average purchase price was $299,098 and the average flipped price was $384,812. That equates to a gross profit of $85,714, or 29 percent gross profit of the original purchase price, according to RealtyTrac.

RealtyTrac defined a flip as a situation where the home sale occurred within six months of the previous sale of the same home.

“I think its ‘been there, done that,’ and flipping is really not a profitable enterprise today,” said Alan Nevin, principal at The London Group. “Most of them fall into the category of putting lipstick on a pig and the flippers typically want to be in and out within 90 days. So it’s really not a matter of a major reconstruction; It’s almost always cosmetic.”

Sean Mayer, principal at **Legacy Real Estate Ventures LLC**, said the gross profit is deceiving because the rehab of a $400,000 home could have a gross profit of $75,000 but could have cost $70,000 for the renovations. Whereas in Phoenix, he said a $155,000 property could have a $15,000 rehab and make more than a San Diego flip.

“The most important thing to realize is that single-family residential rehab has now become a household name,"

Mayer said. "Several television shows have focused on the investment side of residential real estate, which has lured a variety of household investors into the residential rehab field.

“Investment firms, such as Legacy Real Estate Ventures, have certain investment hurdles and rates of returns that we must abide by during the duration of our equity funds," Mayer said. "These parameters sometimes limit the buy side on our acquisition strategies, but likewise mitigate risks in the investment world. Investment firms take calculated risks when evaluating the projected upside on properties do to these stringent rules.”

Investors flock to the coastal markets because it’s a “flight to safety” for capital, Mayer said.

“Investors sit there and stay where it’s safe — in coastal, beach communities, where there’s a high probability of making sure the principal is protected,” Mayer said.

In areas such as Otay Ranch and Escondido, Nevin said home prices fell as much as 50 percent during the Great Recession.

“And therefore, the possibilities of them bouncing back are much greater than areas where home prices hardly went down at all,” Nevin said. “In a number of areas, predominately coastal, the prices are very much back to where they were in 2005.”

He said he expects prices to continue to increase, with one driver being the growth of the Asian market, which will drive prices up in affluent areas.

There were about 40,000 homes sold in San Diego in 2012, Nevin said.

“The only reason why we could not achieve that total again would be because there is insufficient inventory of homes for sale,” Nevin said.

He said he would expect fewer flips as prices continue to rise. Home values increased by 14 percent in 2012 from the previous year, according to RealtyTrac.

“I cannot envision a flipper going into a venture unless they made at least $75,000 to $100,000. The risk is too high to accept a lower rate of return,” Nevin said.

Some local flippers have tackled higher-priced homes and completed substantial upgrading, and are looking for profits far higher than $80,000, Nevin said. In La Jolla, Del Mar and Rancho Santa Fe, Nevin said most of the homes are “long in the tooth,” meaning they’re at least 30 and most are 40-plus years old.

“When a flipper goes in, you can’t just put in an IKEA kitchen as you can at the lower end of the scale. You really have to spend some serious money,” Nevin said.

He referenced a friend of his who bought a La Jolla home for $1 million and put more than $400,000 into renovations and is now selling it for “substantially more.”

“It’s absolutely a very, very high-risk venture because investing in that home and spending several hundred thousand dollars fixing it up puts it into a price range that is higher than homes that have sold in the neighborhood,” Nevin said. “In almost every case where high-end activity has occurred, the resulting product is much better than its neighbors.”

Mayer said that as prices rise, the household investors may take unwarranted investment risks on the assumption that the housing market will continue to appreciate. Those investors may be willing to take lower returns on their capital, but Mayer said an investment firm has strict guidelines and risk parameters regarding how they manage and place funds.

“Investment firms usually purchase the majority of truly distressed product, but now household investors are bidding up pricing for many investment firms simply because they do not have risk parameters or return thresholds. As you can see, this adds a new layer of speculative risk to the investment world,” Mayer said.

Mayer said there are probably about 12 to 18 months left in the “flip game” and there will always be opportunities for value-add strategies in markets across the country.

“We will obviously see other markets continue to see a flow of opportunities as long as we are careful and follow our investment guidelines to mitigate risk. In core markets such as San Francisco, Los Angeles and San Diego, deal volume is much less than two to three years prior,” Mayer said.

“In the past 24 months, hedge funds began to diversify away from equities and into real estate,” Mayer said. “With the current run-up in stocks and commodities since 2009, money managers had to shift portfolio allocation in order to chase yields and realized that single-family residential was still down 65 percent from the peak and was a highly undervalued asset class.

“This spurred a massive inflow of capital into the single-family rental arena, which created a floor for housing prices in those submarkets and likewise sparked an accelerated housing recovery,” he said.

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