

# HOME

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## Cashing In on Rental Property

*Investment real estate can provide steady income and solid gains—if you're prepared to be a landlord for the next few years.*

By **JEFF WALLACH**

Photograph by **BARTHOLOMEW COOKE**

MOST OF THE NEWS LATELY about real estate has been dismal: Home prices are swooning, foreclosures ballooning. There is, however, one bright spot: the rental market, where demand is up and rents are rising. That's partly because those foreclosures have turned more than 4 million former homeowners into renters, but also because many other prospective homeowners, worried about losing their jobs or housing prices falling a lot further still, are reluctant to buy now. →

As with many investments, the best time to get in is when most others are sitting on the sidelines. To figure out whether you can benefit by investing in rental property, here's what you need to know.

### THE CASE FOR BUYING NOW

Many factors make this a great time to invest. Mortgage rates are at a 40-year low, and homes in many areas are ultra-cheap. Meanwhile, demand for rentals has risen in more than 500 cities, according to recent Census data. That, in turn, has enabled landlords to charge more. Hotpads.com, a real estate research firm, reports that rents nationwide jumped 11.6% in 2010, to \$1,320 a month.

You'll need that rental income to tide you over until home prices bounce back; in fact, the typical investor today plans to hold for 10 years, according to a survey by the National Association of Realtors. If you can hang on that long, you've got a good shot at solid gains, especially if you're financing the home purchase. "Whereas leverage is dangerous when buying stocks, it can be a good long-term strategy with real estate," notes real estate investor and Columbia University adjunct finance professor Marshall Sonenshine.

The big catch: "Can you afford to hold the property that long and not need the equity for your kid's college fund?" says Sonenshine. Or whatever other pressing need might crop up. You'll also face some tough financing rules. Most banks now require a down payment of at least 20% to 25% and evidence you have enough cash to cover six months' worth of mortgage, tax, and insurance payments.

### HOW TO FIND A GOOD DEAL

Investment real estate is like produce: It's best bought locally. "Buy

## FIVE HOT SPOTS FOR INVESTORS

Among big metro areas, these cities offer the best combo of affordable homes, healthy rental markets, and projected price gains, says the Inman Group, a leading real estate research firm.

MARKET	MEDIAN SALES PRICE	ONE-YEAR PRICE CHANGE (%)	PROJECTED 10-YEAR RETURNS (%)	AVERAGE MONTHLY RENT
INDIANAPOLIS	\$106,000	0%	301%	\$750
TUCSON	\$138,000	-15.3%	225%	\$1,050
TALLAHASSEE	\$144,000	-28.0%	183%	\$990
RICHMOND	\$180,000	-7.2%	164%	\$1,100
SALT LAKE CITY	\$203,000	-1.0%	162%	\$1,200

NOTES: Recent sales prices for single-family homes and plexes with up to three units; one-year price change through 4Q 2010; ROI factors in down payment, closing costs, projected cash flow, and price gains; rent is for three-bedroom properties. SOURCES: Inman Group, Hotpads.com

something you can get to in 10 minutes," says Seattle real estate investor Bill Snyder. Familiarity with the neighborhood also limits nasty surprises like a noisy bar or a nearby development competing for renters.

Work with a local realtor who has experience with rentals and can help you assess how attractive a given home will be to tenants. And while prices on multifamily dwellings haven't dropped as much as they have on single-family homes, don't ignore plexes: Intake from a few rents instead of just one will boost your cash flow; a single vacancy won't hurt as much; and you could benefit from economies of scale for things like appliances and painting. But stick to buildings with four units or fewer to avoid stricter financing requirements, such as a bigger down payment and higher mortgage rates.

Once you've identified candidates, crunch the numbers. The goal: to make sure your rental income will at least cover your loan payments plus a 20% cushion to handle repairs, vacancies, and property management.

To figure out what you'll garner in rent, ask sellers for recent leases, says Snyder, and double-check

their numbers by perusing sites like Rentometer and Craigslist for similar rentals in the neighborhood. Assume your mortgage rate will be at least a half-point higher than rates on owner-occupied properties. Factor in insurance and property taxes, and bank on a 5% vacancy rate. Otherwise, "one empty month can kill you," says Ellie Berlin, a broker with Houlahan Lawrence in Larchmont, N.Y.

### KNOW WHAT YOU'RE IN FOR

Brush up on your people skills: Owning rentals also means responding to tenant complaints, like the 2 a.m. phone call about a broken toilet. Want to palm off the grunt work? You can hire a handyman (around \$45 an hour) or a management company (8% to 10% of monthly income plus a half-month's rent for filling vacancies), but the luxury will eat into cash flow.

To find your own tenants, creative ads on Craigslist are your best bet. Run credit and reference checks (National Tenant Network, at ntonline.com, can help). And invest in small touches to make your place stand out, such as cool lighting fixtures or antique door hardware. Those will pay off when it's time to sell too. ■