REAL ESTATE

A guide for investing in rental property

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Rick Nayar bought his first rental property at the age of 27 – and had 25 by the time he was 30 years old.

The owner of Orlando, Florida-based Centurion Realty Group, Artesian Title and Full Circle insurance companies, Nayar saw investment real estate as a good opportunity to build wealth and achieve monthly cash flow.

Since 2003, Nayar has bought, rented, sold and flipped more than 1,000 homes.

Investing in rental property isn't for the faint of heart, however, but with adequate due diligence and the following tips is worth considering.

Pick a great location. For long-term equity growth, a residential rental property in a good location is key.

"Look for proximity to major roads, public transportation, and most importantly, schools," says Abhi Golhar, host of Real Estate Deal Talk in Atlanta.

Research rents in the area you want to pursue, both in as-is condition and with repairs or improvements, adds Chris Taylor, a broker with Advantage Real Estate in Boston.

"I find the biggest mistake investors make is overestimating what their property is worth, which results in vacancies and below-market rents," Taylor says.

You also want to get inside the minds of your audience: If you are in a college town, for example, it's important to know how students think, the maximum distance they're willing to be from campus and the locations they consider ideal, Taylor says, so you can buy a property that will be in high demand.

Start small. Start with an affordable initial investment like a single unit or a duplex versus a whole apartment building, says Ryan Coon, founder of Rentalutions, an online property management platform for do-it-yourself landlords.

"That way if things go south and you are unable to afford to pay for mortgage or maintenance, you are not running the risk of going bankrupt," he says.

Because you're just getting started, avoid properties needing significant repairs, since these could cause you to overextend yourself.

Consider using a property manager and ask friends for referrals for attorneys, contractors and other real estate professionals who can help you and will become valuable contacts over time, Coon says.

Run the numbers, then run them again. It's important to treat each rental property like its own business to serve as a good investment.

"The most important consideration for prospective landlords is to accurately estimate rental income and the costs associated with leasing," says Lucas Machado, president of House Heroes, a South Florida real estate investment company. "Until a landlord has a precise grip on these issues, they risk owning a property that – rather than a profitable investment – is a net loss every month."

Betting on appreciation alone is not a good idea.

"Rental purchases should have positive cash flow and good rate of return," Machado says. That could be anywhere from 8 to 15 percent in a residential market. Investment real estate is often valued by its capitalization (cap) rate, which is computed by taking the net operating income divided by the going cap rate in the neighborhood to come to an appropriate price.

Your monthly expenses will include the mortgage or debt service, taxes, insurance, lawn and pool maintenance, property management (optional) and insurance. At least 20 percent down payment will likely be required if financing the purchase.

Vacancy, turnover and eviction are realities of leasing any property, so wise landlords must assume at least a month's rent loss annually, Machado said.

Don't over-improve the property. To keep your cash flow at optimal levels, don't spend too much on upgrades for a rental property that will likely need maintenance and repairs during turnovers anyway.

"The best advice I ever got was to imagine a box of minimum standards and never go outside that," Nayar says.

This keeps your monthly rent at an appropriate ratio of about 1.2 to 1.4 times the monthly cost of the property, with plenty of cushion.

Because maintenance is also a given when owning rental property, Nayar buys a home warranty that costs $500 per year to better spread out the cost of repairs.

"I give the information to the tenant and let them know they will have to pay a $35 deductible directly to the company every time they need something done," Nayar said. "You will be shocked how much this takes off the plate in terms of maintenance. It's important you are upfront with tenants about this and set this expectation."

Consider what type of maintenance is required based on the type of property you purchase. For a single-family home, the landlord is generally responsible for things like lawn mowing and snow removal, but if you buy a condo or townhouse, that maintenance is included in the condo fee, resulting in a more hands-off process, Taylor says.

Choose tenants wisely. Dealing with tenants can be stressful, but it doesn't have to be. "A final critical evaluation is if the buyer intends to manage the rental herself or himself. Are you prepared to thoroughly screen tenant applicants, and assert yourself in difficult tenant situations?" says Elizabeth Gibson, chief content officer for ezLandlordForms.com.

"A landlord needs thick skin," she says. "If you're likely to waver with applicants who are not qualified, or with late rent payments and other lease violations, you may need to hire an agent [property manager] to protect your investment."

Tenant income should be at least three times the rent and verified by having their employer sign a form, Nayar says, which will hopefully keep vacancies and eviction losses to a minimum.