

GET THE SCOOP ON...

Turning negatives into positives ■ Starting your investment business ■ Understanding the good, the bad, and the ugly of owning rental property ■ Running a business ■ Meeting important people who contribute to your success ■ Financing properties and finding tenants

Rental Property Management 101

If you're reading this chapter, you're probably considering purchasing rental property or already own rental property that you want to rent — for any number of reasons. This chapter helps you make the decision to purchase property or help you cope with the decision that has been made for you (if, for example, you inherited property or are renting a house you're having trouble selling).

One thing is for sure — this is not an easy process. You need to treat owning rental property like purchasing a brand-new business that you know nothing about. When you own rental property, there are numerous things you must learn or you will end up in trouble. One idea is to look for a reputable property manager in your area and make an appointment to discuss managing property. As a property manager for others, I often get calls saying, "I don't know anything about renting property, but I'm moving out of the area and don't want to sell."

Chapter 1

**Bright Idea**

I recommend calling a local property management company and offering to pay a consultation fee. Make a list of questions in advance and spend some time talking about your rental property. By taking the time to get the basics from a professional, you may avoid several mistakes that you would otherwise make.

This is one of my favorite calls. You will likely find that property managers are willing to take the time to discuss the pros and cons with you for the specific type of property and your situation.

You need to be willing to take the time to learn the basics at the beginning and be willing to continue to learn. Know in advance that you'll make your share of mistakes. When you do, get up, dust yourself off, learn from the mistakes, and then swear you will never let those situations happen to you again. This is where joining a group of other property owners or investors — for advice and for moral support — can really pay off.

I have been managing my properties and managing for others 23 years, and I still make mistakes. So I am still learning by reading periodicals, taking courses, and networking.

Understanding the pros and cons

Here's a look at the positives and the negatives of purchasing and managing rental property. If, after perusing these two lists, you decide that property management is not for you, professionals can manage your property for you — see Chapter 17.

Pros of managing rental property

The positive aspects of renting property are as follows; a lot of these apply whether you hire a property management company or not:

- You own your own business.
- You'll never be bored.
- You save the fees charged by a property management professional.

- Technology has made self-managing your properties easier than in the past.
- It's a people business.
- It can be fun and challenging.
- You may enjoy it enough to make it your career and even manage property owned by others.
- After everything is set up properly, it's not a lot of work.
- You have a choice: You can be completely or minimally involved.
- You can see and touch your investment.
- The business provides continual income rather than the one-time income from a sale.
- With creativity, you can purchase with little cash.
- You can keep a home you may want to move back to later (for example, if you're transferred from an area you love).
- Renting properties is usually profitable.
- Renting property provides current or future lodging for your children.
- Buying your first property starts you on your way to purchasing more.
- Property values usually appreciate.
- You diversify your investments.
- There are great tax advantages.
- You can defer capital gains with a 1031 exchange (see Chapter 15).
- It can be a second income.
- It can be a part of your retirement.
- You can use your 401k or other retirement plan to buy the investment property.
- It can be a long-term business.

Cons of managing rental property

You may have days when you question why you purchased rental property and became a landlord. But then, when you arrange an appraisal and find that your property value has gone up, you're probably pleased with the gain in value. The time, money, and effort suddenly are all worthwhile, and you realize that hard work really does pay off.

Keep in mind, however, that managing rental also has a few downsides:

- It takes a lot of time in the beginning to set things up.
- There are many details you need to learn and understand.
- The initial outlay may be greater than with other investments.
- Your property may have a negative cash flow, especially at first.
- Technology is hard to keep up with and takes time.
- Reporting income and expenses on your tax return requires additional time and knowledge.
- There are many local, state, and federal laws.
- You will need to purchase more insurance.
- Like anything, there is always a risk involved.
- You can be sued.
- There are ways you can be taken advantage of.
- The hours are not 9 to 5.
- It is like having a second job, often without vacations.
- Dropping everything to respond to an emergency isn't fun.
- Finding and dealing with contractors can be tricky.
- It is a people business, which means you have to enjoy talking to people.
- You listen to many complaints.

- The market can and does change constantly.
- Things do go wrong with rental property.

You can always hire a professional to rent and/or manage your property. This way you don't have to deal with the emergency call in the middle of the night or all the problems that arise from dealing with different types of people. You let them take on the time-consuming tasks while you receive the income.

“ Purchasing rental properties allowed me to retire a lot earlier than I expected. Over time, I have made enough money to hire a professional management company, so now I can leave town anytime I want without the worries. ”

—Chuck P., investor

Overcoming the negatives

To overcome the negative aspects of managing rental property, consider these tips:

- You already know by this point that it takes a lot of time to get started. Just know that and set aside the time. Knowing the time commitment in advance and taking things one step at a time helps you in the long run.
- Minimize or eliminate the risks by investing in setting up your business and tending to the details in the beginning. Also line up and meet with the professionals you will work with (see the “Hiring real estate professionals” section for details).
- Keep your files concise and be sure to keep all paper receipts in your property file (see Chapter 11). In addition, many software programs can assist you with your record-keeping. If you choose to set up your new business on a computer, you may save a great deal of time and effort when filing your tax returns. Invest in a scanner so that all your documents can be accessed online. Get a digital

camera so that pictures of the property can be downloaded to your computer and uploaded to your Web site.

- You're on call 24/7 and there are no vacations when you self-manage your properties. However, perhaps you can occasionally trade with friends who own property by taking turns covering for one another while taking vacations. In some states, you cannot pay your friends for their time unless they have a real estate or property management license, but you still have options. I even know people who travel in a motor home all year, managing their rental properties via e-mail and cellphone, and accessing all records and monies online.
- Ask around and do your homework before you hire contractors. Most states require a license to do a trade. If so, check government Web sites to find consumer brochures. You'll probably find some hints and tips on what to ask before you choose the right one for you. If you have friends who own property, ask them whether they will share some of the names of their contractors. And don't be afraid to ask friends or other contacts how they're handling their rental properties. Be prepared to hear their war stories, though — listen and learn from them, don't let them scare you.
- Carry plenty of insurance and be prepared to be sued. Make sure you review your insurance annually with your agent. Always look at your property from a safety and liability angle.
- Take workshops on how to deal with and listen to all types of personalities. Know that managing rental property is and always will be a people business.
- Keep up with property-management laws by joining a local income property owner's association in your area. Use the Internet by searching on "landlord association" and the name of your area. Continue to read books and take classes.

- Expect things to go wrong and learn how to be proactive and creative in handling them.
- Keep up with technology.
- Turn negatives into positives and be ready for the next challenge.

Running your business like a business

Whether you've been managing property for years, are just getting started, or are contemplating purchasing your first property, it is a good idea to treat your rental properties like a business. Start with the basics: Choose a name for your business. I suggest that you choose a name that is simple but allows your business to grow, so that you can purchase and rent out other properties under the same name.

I had a client who owned a five-unit Victorian that I managed for years. He purchased the building when his daughter, Sarah, was quite young and named his business Sarah Properties, after her. Not only did this give the business a separate name, but it made it special. The great part of the story is that his daughter is now in college, and I believe the value and equity in the property appreciated enough over the years to help pay for the daughter's college education.

You also need to decide what form you want your new business to take (for example, sole proprietorship, LLC, trust, corporation, and so on). An attorney can give you advice, as can other people who have experience owning and managing properties.

Setting your business up correctly in the beginning means you need to meet with several professional people to gain practical knowledge. Consider meeting with a real estate agent, banker or mortgage broker, accountant, insurance agent, attorney, and (if you want someone to manage your property for you) property manager. See the following section for details.

After you have your new business name, have decided what sort of form your company will take, have met with the

necessary professionals to assist you, there are a few more things to do:

- **Set up a bank account.** Order preprinted deposit forms and a deposit stamp with the new business name. This saves you a bit of time in the beginning, but as you accumulate more properties, it can save you massive amounts of time and makes your business far more efficient. Seek out a bank that has online banking to save money in stamps, and even look for one that provides a day-to-day tracking of your bank account.
- **Get a P.O. box.** If you don't want your tenants to know where you live and don't have a professional office where your tenants can mail their rent checks, get a post-office box and add a second phone line in your home (or, if you have excellent cellphone coverage in your area, get a cellphone dedicated to your business). A separate phone line can have an informational voice mail on the outgoing message. Also get an e-mail address that contains your business name instead of your personal name. Put all of this contact information on your new business cards.
- **Set up a Web site.** Keep it simple — you just want a presence on the Internet. You should be able to set up a Web site quite simply and affordably; in fact, you may be surprised just how easy it really is to have your own site, which can give potential tenants information about your property. I believe a Web site is becoming a critical part of marketing any rental property.
- **Take a class, attend a workshop, or hire a professional to teach you the basics to get you started and to keep you out of trouble.** There are many fabulous resources out there (including this book, I might add!).
- **Plan now to own property long term.** You may not own the same property forever, but you should have a plan to purchase property and build your business from there.



Watch Out!

Don't give out your home address and private telephone number. In fact, at some point you may want to consider not being listed in the local phone book. In order to maintain some privacy, keep a separate phone number for your business.

Hiring real estate professionals

One of your most important duties when you're considering purchasing property or have just started managing property is to put together the best team to help you along the way. There are many professionals you need to hire and get to know within your new adventure who can help make you and your new business a success. Take the time to interview and hire people who can help you succeed as a new rental-property owner. Continue to improve and keep up with the details of managing investment properties.

Realtor/broker

Just because you have a real estate sales license or a real estate broker's license doesn't mean you are automatically a Realtor. Realtor is a registered trademark of the National Association of Realtors and it refers to people who are licensed by their states to sell real estate — buildings or land — and who are members of the association.

When hiring someone to represent you in the purchase of your property, it is important to hire a Realtor, preferably one who specializes in the type of property you want to buy. You can dive into more of that in Chapter 3. If you're not sure which Realtor to work with, ask anyone you know who manages rental property.

Establish a relationship with one Realtor when going out to look to purchase any property, including your first investment property. Yet, even with a Realtor on your team, it's up to you to



Bright Idea

Call a friend or acquaintance and ask for recommendations for the professionals they've used in managing their rental property or business. Getting referrals is the best source you can ask for. If you don't know anyone who owns rental property, ask among friends, co-workers, and so on.

know what you're looking for when you go out to view rental properties. Do your homework on your own, look for properties in the newspaper and on the Web, and have some ideas of the area and type of property you're interested in.

Banker/mortgage broker

A banker (or mortgage broker) assists you in getting the proper financing in order to purchase rental property. A banker gets you the loan from the bank for which he or she works, whereas a mortgage broker is an independent agent who works with several different financial institutions to find you the best loan possible with terms to meet your needs. Mortgage brokers generally charge a bit more, through what's referred to as points, which is usually a fee based on the percentage of the loan.

If you choose to work with a mortgage broker, meet with that broker prior to making any offers, so that you know where you stand financially and how you look on paper to a lender, a process known as pre-qualifying. **Remember:** Many financial institutions have large lending departments, which means you may never meet the person making a decision to give you a loan.

Insurance agent

The most efficient way to purchase insurance is to have one contact for all your insurance needs. I suggest establishing a relationship with an insurance agent who will not only handle the insurance on your investment property but also ensure that everything you own (your primary residence, your automobile, and so on) has the right amount of coverage.



Bright Idea

Get to know your insurance agent and plan to have all your insurance reviewed each and every year. You need to have more than enough insurance, so look into an umbrella policy, which covers you for an extra one or two million dollars. Make sure your insurance agent knows about all the properties you own.

Accountant/financial advisor

It is very important to meet on a regular basis with your accountant and/or financial advisor throughout the year to discuss your investment and to be prepared in your tax planning throughout the year. In this way, you can discuss your properties in advance instead of getting surprised when you visit your tax accountant during tax season. Some accountants even have a checklist to help you organize your files and your bookkeeping system.

Sure, you need to have a basic understanding about your investment, but you're not expected to know all the tax laws. That's why you hire a good, reliable accountant to take care of your tax needs.

Remember that owning rental property has its tax advantages. You can deduct your purchase costs, your operating expenses, and annual depreciation. (And these tax advantages don't change when you hire a professional property manager.)

Attorney

If you own rental property, I guarantee you'll need the services of an attorney at some point. Typically, you want to meet with an attorney in the beginning to be certain your company is set up properly, and then have him or her on call to assist in legal matters. You may even want to look for a real estate attorney who specializes in evictions.

I found the attorney I use by going to the local county sheriff's office and asking, "Who puts through the most evictions in Marin County?" The first response I received was that they were

not allowed to recommend any attorney. I reminded them I was not looking for a recommendation. I was simply asking who

“Going through an eviction can be quite costly and time-consuming. Hire and get a rapport going with an attorney before you run into any problems. ”

—Lisa G., investor

puts through the most evictions in our county. They gave me the name, and he has been my real estate attorney for over 20 years. I decided I wanted to hire the attorney who had handled many cases, had a great deal of experience, and had seen it all. And he

certainly had a great deal of experience in evictions and in dealing with tenants. He even helped me understand what causes most of the evictions he handles and how to prevent that on my property.

You want to establish a relationship with a real estate attorney in advance of running into problems. Oftentimes, you will find you can pay an attorney for an hour or two of consultation time. If you ask, you may find out that, for example, a group of attorneys is holding workshops nearby or speaking to a group of investors. I know that the local attorneys in my area speak at many different meetings that I attend. If you find and join a local property-owner's group, I can almost guarantee that the group will have an attorney speak at least once during the year.

Property manager

A property manager is a professional who manages investment properties for others; often he or she only manages property and handles rentals. Just because someone is a Realtor does not mean he or she has the expertise and knowledge to manage your property. Go to the National Association of Residential Property Managers (www.NARPM.org) or to the Institute of Real

Estate Managers (www.IREM.org) to find a list of specialized property managers who subscribe to an ethics code. Look for ones who have spent their time and effort in obtaining a certification for themselves and/or for their companies.

Even if you decide to manage your rental property yourself, you should still get to know a local property manager in the area. You find out more about hiring a property-management company in Chapter 17.

Financing properties: Stretching yourself to take that step

The financial part of your new purchase can be a confusing tangle of jargon and paperwork. There is so much to know, so don't try to totally understand it on your own. Your banker or mortgage broker can assist you. Just remember that there are a lot of options out there, so do your homework! Also find out whether the local city, county, or state has any housing programs that can assist you in financing either the purchase or renovation of your property.

Most successful investors have a story of how they had to stretch themselves to get into their first property. Most real estate tycoons can also tell you the story of purchasing their first property and how they personally got started. At any rate, getting started — taking that first step — is the hardest and scariest part, by far. Here's my story:

I remember purchasing my very first home. I had to scrape together every dollar I had. The day of the closing, I was still short by \$500 and had to borrow from the Realtor who was representing me! It was a struggle. But then I fixed it up just a small amount, making a few changes to brighten up the inside — getting rid of the pea green and keeping it neutral. Just a few short years later, the property sold for double what I originally paid for it. I moved to a larger home in a nicer area. This was my start in purchasing real estate, and I was only 22 years old!

Years passed, and I was in a comfort zone, living in my larger home and renting office space for my business. I had purchased the property management company where I worked and taken over the lease. Twelve years flew by, and then, all of a sudden, I received a letter from my landlord letting me know that my lease had expired. In addition, my rent went from \$1,800 per month to \$2,500 in one day. I knew it was time to explore my options. I began to drive around and talk to others to see where I could move and rent more reasonably. I went to see Katherine, a Realtor friend of mine, to show her a flyer I had seen and ask whether purchasing a small office building on the flyer was an option. She immediately showed me a different flyer with information about a property she had for sale that was a much better value but, of course, more money. I looked at the better property with a lot of fear. She encouraged me and worked the numbers, suggesting that I needed to speak to her mortgage broker to make the transaction happen. Reluctantly and fearfully, I met with her mortgage broker, Suzanne, who made it look easy. She asked me lots of financial questions and worked out the numbers, and then told me that it should work out just fine and that I should make an offer on the building. I remember she telephoned Katherine from her office while I was sitting there and

told her I was on my way to meet with her to make an offer to purchase the office building.

I met with the Realtor, made an offer, and had it accepted; of course, then I was completely terrified if for no other reason than I had to use my entire sav-

“ Take a rubber band out of your drawer. Okay, now I want you to stretch it, a little more, but don't let it snap. This should be the way you live your life. ”

—Ralf C., mentor and friend

ings. During this stressful period, however, I remember a conversation I had with a real estate friend of mine who told me to stretch myself.

I purchased the property, moved my business there, and after four years, the property was appraised for double what I paid for it. I had taken a risk, I was scared, but it was one of the best investments I ever made. Ultimately, taking risks and stretching yourself to invest in real estate is a good thing.

You don't have to start big and buy a large building. You can start by purchasing a second home and renting out the home you're currently living in. If you haven't yet purchased real estate, look at buying a duplex or triplex and living in one of the units. This way, you have income, can manage the property, get the tax write-offs, and build equity. You can begin fixing up the property while building the equity and the value is going up.

Maintaining your property

The increase in value comes with time, increased rents, and, perhaps most importantly, the amount you maintain your investment. It is very important to care for your investment and to continue to maintain your property. Not only will that lead to the best appreciation in the value of your property, but the hands-on experience of maintaining and managing your property is a good thing, one that will help you understand property management for many years to come. What you learn will always assist you with investing, managing, and purchasing additional properties. Keep in mind that not all investors can take care of their own property maintenance. Know your limits and know when to hire professionals. (Check out Chapter 6 for more on maintenance.)



Watch Out!

Don't get too comfortable with your rental property management and let things slide. Many owners think everything is fine as long as the rent check comes in, the bills are getting paid, and they haven't heard from their tenant with maintenance complaints. Instead, be proactive, do your drive-bys, and go in your property at least once a year.

Finding and qualifying great tenants

Finding tenants and keeping them is one of the greatest challenges you face as a rental property owner. The object is to prepare your property, market your property, and attract a qualified tenant who will stay long term. You want a tenant who will move in, take reasonably good care of your property, and pay his or her rent on time. When you get great tenants, you need to keep them happy while collecting your rent (see Chapter 12). Manage your investment and increase your value through smart rental practices.

Expanding your business

After you get your foot in the door with your first investment, opportunities to increase your inventory of rental property will continue to come your way. However, many people have reasons for staying with one rental. Perhaps they don't have time for more, or maybe it is the family home that a member of the family will move into one day. But maybe, just maybe, this one experience will encourage you to invest in more properties. You may find you like being a landlord.

The goal of all investors is to watch their investments increase and to expand their portfolios. As the value of your property goes up, your equity increases and, like many investors, you can use your current real estate (even your personal home) to purchase the next property. Never stop watching the papers and the Internet for investment property that comes up for sale, and stay abreast of the market in the area you're interested in. Keep in constant contact with the Realtor who sold you your first investment property; he or she may know of something new that will be coming up for sale. In the same way, if you use a property manager, tell him or her that you want to know if another client is going to sell a property. You can also get the inside scoop on how good the tenants are and what the condition of the property is. Of course, make sure your property manager is comfortable giving out this information; don't press if he or she isn't.

The market in your area will determine how fast the value of your investment will go up. When you've paid off part of the equity in one property, you can refinance that property to purchase your next property; other times it will make more sense to sell your investment to purchase a larger building. Consider starting by purchasing a second property, either a single-family home or a small rental building. Then fix it up and move on to purchasing your next property. You can continue to do this by keeping up with the market, maintaining your property, and staying in touch with what's happening with rental property and rental prices in your area.

It is important to keep your rental rates as close to the current market as possible. This goes hand in hand with the market value of your investment: So, as the value of the property increases, the rent should increase a similar amount. (Note that most single-family homes are appraised based on comparable homes selling in the area. Multi-unit properties, on the other hand, are appraised based on the rental income and/or the CAP rate, which is the net operating income divided by the sales price.) Before purchasing a multi-unit building, it is a good idea to calculate the break-even rate so you will know what level of occupancy you need to break even with your expenses; an accountant or Realtor can help with this.

Just the facts

- There are many advantages to purchasing rental property.
- Purchasing investment property takes planning and should be a well-thought-out process.
- You're going to make your share of mistakes.
- Set up your rental property management as a business.
- Planning is your key to success.
- Build a team of advisors to help run your investments.
- Knowledge is power. When you don't know the answers, there are plenty of professionals who do.

- The long term goal is to purchase investment property, increase your cash flow, and decrease your expenses.
- Stretch to make that first investment.
- Don't get too comfortable — continue to expand your business.
- Maintain your property.
- Find great tenants.