Rental properties spark investor interest

By Jane Adler

Disappointed with sagging stock market returns, some investors have turned to rental real estate as a way to prop up their net worth. After all, an investment you can actually see and touch seems a lot more solid than elusive paper profits.

Two-flats, small apartment buildings, condominiums and single-family houses are popular choices with investors who hope to generate monthly rental income. It certainly doesn't hurt either that rental properties, just like most houses, have appreciated as much as 15% annually over the last several years. But choosing the right rental property to buy can be tricky, experts say. And part-time investors should be prepared to become full-fledged property managers, whether that means finding tenants or fixing a leaky faucet.

"Owning a building is not a passive investment," says Henry Shulruff, vice president at the Chicago office of Attorneys' Title Guaranty Fund Inc. "Being a landlord is work."

Finding a good rental property requires persistence and patience. Flight attendant Monique Jauw, for example, owns a handful of two- and three-flat buildings in Chicago's Lakeview neighborhood. It took years for her to assemble a portfolio of properties. She doesn't buy just anything.

"I look for big houses," says Ms. Jauw, a fanatic about checking the structural integrity of the building. "You can charge more rent for big apartments." She also prefers to buy only buildings in good neighborhoods, figuring she can charge more rent and the property will appreciate more quickly. But, she cautions, "You have to make sure the property is not overpriced for the street."


Photo by: Brett Kramer

Real estate investor, Monique Jauw, Chicago

A good floor plan is essential, according to Candance Kuczmarksi, a real estate agent who buys and then rents single-family homes. She likes houses with big rooms because they are easy to rent.

Ms. Kuczmarksi, owner of eight single-family houses, also prefers places that need new kitchens and bathrooms. She can buy those kind of houses for less than ones that don't need work. "In the long run it pays to fix the house and rent it," she says.

Ms. Kuczmarski, for example, might buy a house for $300,000. It might then cost $30,000 to fix the kitchen and bathrooms. On that kind of deal, she expects to charge $3,000 a month in rent, generating a 12-16% annual return on her investment. "That's a great return," says Ms. Kuczmarksi, who works at the Evanston office of Coldwell Banker Residential Brokerage.

Chaz Walters, who sells investment properties at Coldwell Banker's Lakeview office, figures rents in the city top out at about $2,500. "It is hard to make money on high-end properties," he says. Also, people who can afford a high monthly rent are more likely to buy their own place, thereby reducing the pool of available renters.

Mr. Walters thinks it's increasingly difficult to find viable rental properties because so many of the good neighborhoods, like Lakeview and Bucktown, have been "picked over." Instead, he prefers Chicago's Andersonville neighborhood and other far north areas close to Lake Michigan where investors have been less active.

Amid a flood of new construction in the city, condominiums have become a hot investment property too. Investors buy new condominiums at relatively low pre-construction prices. Investors then flip the property at a higher price to another buyer, or rent the unit to a tenant.

Some investors are becoming wary of the condo market, though. They fear a glut of new condominium buildings will increase the number of units on the market for rent. And a careless investor could get caught with a property that's difficult to lease.

Before buying a property, experts say, investors should figure their total costs. Calculate the property's income and expenses. Expenses include principal and interest on the mortgage loan, taxes, insurance and maintenance costs.

Generally, investors can expect to pay more for loans than homeowners. Interest rates on investment properties are higher than rates for owner-occupied houses. Investors also usually pay points to lenders, who typically require a 20% down payment. "Most lenders have stiff rules about investment rental properties," notes Dean D. Lawrence, senior vice president in Chicago at ABN AMRO Apartment Lending, a division of ABN AMRO Mortgage Group, Inc.

But maintenance costs can kill returns. "Maintenance is the hardest cost to quantify," says Mr. Shulruff at Attorneys' Title Guaranty Fund. Investors may be forced to use their profits to replace a furnace, or fix damages made by a reckless tenant. "Investors need to set up a reserve fund for maintenance," advises Mr. Shulruff. When leases roll over, investors should increase the rent by the amount needed to pay for anticipated repairs.

Besides cost, maintenance is time consuming—probably the number one complaint of investors who have become part-time landlords. "I am out of the rental business," says Mary Summerville, broker/owner at Prairie Shore Properties Inc., Evanston. Ms. Summerville was a landlord, but eventually found it way too labor intensive. "People think they just have to pay the mortgage. But someone has to vacuum the hallway. And when you can't find the snow removal guy, then you have to get over there and shovel the snow."

Investors who won't tackle the chores themselves can expect to pay a property management company about 10% of the rental income for maintenance. That kind of fee usually eliminates most profit, making the investment hardly worthwhile.

Ms. Kuczmarski, who owns single-family houses, admits it's a headache when leases roll over and she has to find new tenants, especially when two houses are for rent at the same time. And she adds: "The amount of money I make doesn't take into account my time spent running ads, answering calls and screening tenants."

Finding the right tenants is key, investors say. But even thorough investigations don't always preclude problems.

"What if you get a real schnook for a tenant?" asks John G. O'Brien, an attorney in Arlington Heights and president of the Illinois Real Estate Lawyers Association. Mr. O'Brien says it can take 90 days in Cook County to evict a tenant who hasn't paid rent. "You have to consider whether you have the finances to withstand having the place not generate income for a few months." •