
Six Mistakes Housing Investors Make

Traditional investments are delivering low returns, and home prices are at bargain levels. Is it time to consider buying some rental housing?



Illustration by Scott Pollack

Investing in real estate right now can be surprisingly profitable, if everything goes well. Rents are climbing in many areas, and more properties may be coming on the market. Last month, the Obama administration asked for proposals on how to convert at least some of Fannie Mae's and Freddie Mac's bulging inventories of foreclosed homes into affordable rentals.

Investors used to aim for rents that were 1% of the purchase price, or \$1,000 a month for a \$100,000 home—an annual gross return of 12%—says Michael McCreary. His firm, McCreary Realty, manages about 300 properties in the Atlanta area. Today, he says, some of his investors are getting as much as 2% of the purchase price.

In general, though, average returns after expenses are far less, more like 5% to 6% of the property value, says Ingo Winzer, president of Local Market Monitor, a real-estate forecasting firm. But that still is well above what many other investments yield.

Before you start scouring for deals, keep in mind that owning rental properties is time-consuming, expensive and fraught with challenges, and many investors lose money. You will want to avoid falling into one of these common traps.

• ***Mistake 1: Confusing a cheap deal for a good deal.***

It is true that you can buy some homes for ridiculously low prices—but that doesn't mean you can rent them out. Homes in deserted subdivisions aren't any more appealing to renters than they are to buyers. The same is true for less-attractive properties or those in less-desirable school districts.

Investors from the San Francisco area often look at the Sacramento market assuming they can get Bay Area-like rents, and end up overpaying, says Robert A. Machado of HomePointe Property Management. He uses several resources, including the website FinestExpert.com, to estimate rents. Other experts suggest canvassing apartments nearby to see not just their rates, but whether they are offering special deals, like a couple of months of free rent.

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• ***Mistake 2: Overlooking key costs.***

Knowing the potential rent isn't enough. Before you buy a property, you should also factor in closing costs of 3% to 6%, the costs to fix up the place and maintain it, and your holding costs. Then add the

profit you expect to make (and more closing costs, if you intend to turn around and sell it). Only then can you figure out what you can afford to pay.

• ***Mistake 3: Forgetting that time is money.***

In real estate, "time is your biggest enemy," says David Hicks, co-president of HomeVestors of America, a franchiser whose motto is "We Buy Ugly Houses." You lose money when your property is empty, whether you are painting it or between tenants. You also lose if you buy in the fall and can't replace the roof until spring. You may be better off accepting a lower rent than waiting for a higher-paying tenant.

• ***Mistake 4: Assuming you will sit back and watch the rent roll in.***

"When you become a landlord, you become a rent collector," says Mark Kreditor of Get There First Realty, which manages 1,600 rentals in the Dallas-Fort Worth area.

Just like homeowners who can't pay the mortgage, tenants lose their jobs and stop paying the rent. Evicting them can take several weeks, and some steal appliances or other property. Mr. Kreditor says that once or twice a month, a tenant removes a home's copper tubing on the way out the door to sell the copper for its meltdown value.

You will need to screen prospective tenants carefully—or pay someone to do it for you.

• ***Mistake 5: Underestimating repair costs.***

As with all homes, you will be making lots of repairs. You may find wood rot or mold when you remove that cracked bathtub. Carpet in rental homes typically must be replaced every five years, and you may have to repaint after every tenant. Tony A. Drost, president of the National Association of Residential Property Managers, or Narpm, suggests setting aside six months of expenses so that you will have funds if a major repair is needed.

• ***Mistake 6: Assuming that owning a rental is the same as owning a home.***

You might put up with flaws in a home that a renter wouldn't tolerate. In addition, many states and communities have strict (and complex) laws for landlords, even if you own only one property. A property manager can handle most of the headaches, but you should expect to pay one up to a month of rent for finding and screening tenants—and up to 10% of the monthly rent for management fees.

You can find property managers through the websites of trade groups Narpm and the Institute of Real Estate Management. In addition, many communities have local Real Estate Investor Associations, which can provide support.

Write to Karen Blumenthal at karen.blumenthal@wsj.com