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CONSUMER FINANCE: Why Investing In Rentals Could Be Good Move

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--Foreclosures can be had for bargain prices but be ready to make required repairs

--Areas near colleges and military installations can be good places to invest

--Investors should have multiyear plans for properties, planning financials at least five years out

By Amy Hoak
A DOW JONES COLUMN

As home prices fall and rents rise, some investors are plunking their money into real estate, chasing the cash flow that comes along with becoming a landlord.

"For the first time in a long time, you can buy that home and can get a cash-on-cash return immediately," said William King, director of valuation services for Veros Real Estate Solutions, a supplier of housing data to the country's largest banks, as well as government organizations. "There are a lot of places in the country where an investor can buy a single-family home, rent it, and get a positive cash flow."

In fact, investors bought 20% of all the homes sold in April, according to the National Association of Realtors. Some of them are buying with cash.

But even if they do finance part of the purchase, they're able to turn around a profit much quicker than they would have been able to in the past, King said. And the return on rentals can be much better than returns on other investments these days, he added.

In the past, investors would subsidize their monthly payments on a property with the rent they were able to collect, and the big payoff was the price appreciation they would accumulate, he said. Now, investors can come in with a 25% or 30% down payment, finance the rest, and the rent they collect often can cover the mortgage payment, taxes and insurance--with additional cash left over, he said.

"Investors are looking at these properties on a monthly income generating basis," said Alex Villacorta, director of research and analytics at Clear Capital, a firm that provides data for real-estate asset valuation and risk assessment to financial services companies. "They can start to realize instant profit margins, even as the market goes down more."

"There's a turning point where the cost of owning a home is less than the cost of renting," he said. "When that disparity grows...we will see a push from investors to pick up investment properties."

In general, that investors are beginning to snap up rental properties is a good thing for the stabilization of housing markets, King said. It's also one of the ways that a floor on real-estate prices can be established; as more investors spot opportunities in residential markets, prices could bottom.

"Once investors come into a community, you're seeing the beginning of the end of the decline," King said.

What To Look For
Before investing in a rental, make sure you've considered the harsh realities of becoming a landlord, said Mike Litzner, broker and owner of Century 21 American Homes, which has locations in Long Island, Queens, Nassau and Suffolk Counties. He's also a landlord.

"There are some people who think it's glamorous, but when you get the wrong tenants, it can be a nightmare," he said. That said, when you get the right tenants and the properties perform as expected, it can be a "tremendous" way to make a buck--and he believes the "smart money" is now working its way into the marketplace.

Before considering any purchase, decide if you have it in you to be a landlord. You have to be willing to set expectations and consequences to ensure rents are paid on time, and you have to be ready for the possibility of evicting non-paying tenants, he said. Plus, you're responsible for the upkeep of the property, no matter how your tenants treat it.

From there, it's a numbers game. Get a sense of what rents are in the area you're considering, the vacancy rate, and consider your costs of financing, Villacorta said. Don't forget the other costs of owning a property, including taxes and upkeep. Some investors may want to enlist the help of a real-estate agent to assist with analyzing the market.

Remember, often the best investment is a home you wouldn't necessarily buy to live in yourself, Litzner said. These days, foreclosures can be snapped up at bargain prices, and as long as you have the means to make required repairs, they can represent good opportunities.

"Don't buy the most expensive house in the neighborhood," King said, "and look at the broader community. Where are the renters going to come from, and what do they do?" Areas near colleges and military installations can be good places to invest; and think about what renters typically look for, including access to public transportation, he said.

Some of the houses bought in the worst conditions ended up being the best investments for Litzner, who was able to put some sweat equity into the homes before renting them out. It's also important that investors have multiyear plans for the properties they buy, planning the financials at least five years into the future, he said.

Best Markets
Many investors sink their money into properties not far from where they live. Those are likely the communities they're most familiar with, and from a management perspective, you're never far from the tenants you're dealing with.

But some markets are better than others to invest in right now.

A recent report from Inman News, an online real-estate industry publication, named the 10 best markets for home investors. These are markets with traits including high affordability, low prices, high share of foreclosure sales, high population growth, improving unemployment rate, and high return on investment in the next 10 years.

The following are their top 10 markets:

- Indianapolis-Carmel, Ind.
- Winchester, Va.
- Gainesville, Fla.
- Tucson, Ariz.
- Tallahassee, Fla.
- Hagerstown, Md.-Martinsburg, W.Va.
- Salt Lake City
- Richmond, Va.
- Gainesville, Ga.
- Winston-Salem, N.C.

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