

# Why Own Real Estate?

## By Mike Cheney

Sources- US Housing Price Index (KC, Mo)

departmentofnumbers.com

Zillow.com

Findings-

average monthly rent - \$834

ave price increase 20 years- 72%, 3.6% per yr, uptrend expected to continue next 3 years

ave annual rent increase 20 years 2.3%- renter fraction is 36% and has been growing past few years

For the next few minutes we'll look at owning residential real estate as a part of the family economy.

The basis of our example property is taken from current market conditions (2014-2015) in the Kansas City, Missouri area.

According to Zillow.com there are currently more than 500 homes for sale in KC at asking prices of \$80,000 or less. Using their nifty overlay feature we were able to identify properties for sale and for rent in the same neighborhoods. That's how we checked out our pricing and rental rate assumptions. We also assumed the property will be purchased with a \$20,000 down payment (25%) and a \$60,000 mortgage on a 15 year term at 5.5% interest (currently available through several national mortgage brokers). We also suggest that you have and maintain a \$5,000 cash reserve in addition to the down payment. Unlike the examples shown on "Reality TV" shows tenants sometime fail to pay the rent and the property will require repairs from time to time. Bad news for you if these happen at the same time and you have no reserves!

One more thing- you'll notice that we focus on 1, 5, 10 and 15 year time frames. That's because real estate is generally not a get rich fast deal. It's also not for everyone. Not very exciting TV but it is the truth.

Ok, enough disclaimers. Let's get to the "Nuts & Bolts".

## Why own real estate?

**Rental Income** (someone pays you to live there)

**Net Income**- the difference between rent received and the costs of operating the property.

**Appreciation** (Sometimes referred to as Inflation)- the amount the property increases in value during the time you own it

**External Appreciation-**

location, outside influences, overall market conditions

<b>Beginning Value</b>	<b>\$80,000</b>
<b>5 Year Value (3.5% average annual increase)*</b>	<b>\$92,000</b>
<b>10 Year Value</b>	<b>\$109,000</b>
<b>15 Year Value</b>	<b>\$129,000</b>

\*US Housing Index, KC SMSA- 20 year average annual price increase-3.6%

**Internal Appreciation**- negotiating/buying well, improving the property, increasing the rental rate, reposition the property to a higher tier in the market

## Do I Keep it or Do I Sell it?

Which property to buy and how to find it

**Location-**

**Value-**

**Timing-**

How to improve the value of the property and how far to go

**Cosmetic Rehab**- repair drywall, paint, replace/repair broken items, clean and shine inside, spruce up the landscaping, trim trees and bushes, etc.

**Moderate Rehab**- all of the above plus make strategic improvements/replacements- appliances, refinish cabinets, flooring/floor covering, bath vanities, mirrors and light fixtures

**Complete Rehab**- might involve new kitchen and baths- all fixtures, cabinets, interior and exterior doors and frames, windows, sprinkler system install, additional shrubberies/garden, add a deck or patio

The extent of improvements will be determined by

your strategic plan for the property (fix and flip, re-position and retain)

Your time frame to hold the property prior to reselling

**The degree of financial benefit vs. the cost of improvements**

**How to operate residential rental properties**

**Establish the rental rate- neighborhood surveys, craigslist, rent.com, etc**

**Market the property- the property itself, yard sign, brochure, nearby large employers**

**Select the tenant**

**screening potential tenants, application, background check (credit, employment, prior landlord). More important than these is personal, face to face conversation**

**The rental agreement documents- lease, condition checklist**

**Property maintenance**

**Corrective and Preventive**

**repair requests, periodic walk through, seasonal maintenance**

**Periodic re-evaluation**

**Income- Rental Income less Operating Expenses equals Net Operating Income**

**(sample income/expense statement)**

**First 10 steps to get started**

**Sources of Funding**

**Identify Your Team (broker, investors, contractors, insurance agent, etc)**

**put systems in place (what will you do and in what order?)**

**Identify property**

**Identify the Acquisition/Retention/Disposition Plan**

**Determine Level of Improvement and Estimate Costs**

**Close or Pass on Property**

**Commence Improvements**

**Market Property for lease/Sale**

**Consistently Assess/Review**