

Surviving the Peaks and Valleys of Real Estate Investing - Reinvest **By Melissa Prandi, MPM**

Look around your community, are there poorly cared for areas? Do you see run-down houses, duplexes, or apartment buildings? Ever wonder how that happens? Is it just that properties are old?

It is likely that you are seeing rental properties owned by investors that are either in trouble or owned by someone with a philosophy to bleed a property by not doing maintenance or doing maintenance or doing only the minimum maintenance required to keep the property producing income. These investors are also known as slumlords, and they make a lot of money on their investment until the property is sold or bulldozed.

If you reinvest in your property by keeping it aesthetically pleasing outside and inside, you will be better prepared to survive and thrive in a down market.

Research in inner cities has shown that if there is graffiti on a building or a broken window that is not repaired immediately, it quickly attracts more abuse. If it is repaired immediately, it is less likely to get vandalized again in the same immediate time period. Whether or not you care about your buildings will be readily apparent, and you will attract the positive or negative by your choice in maintenance philosophy.

Protect your investment by monitoring it frequently. Enforce the lease and if there is damage, mandate that the tenant repair it, or repair it yourself and back charge the tenant immediately. Get rid of tenants who display a chronic tendency to disrespect your property and their neighbors or cause negligent damage. Don't allow your property to attract only the poorest quality tenants.

Quality properties attract quality tenants. If you reinvest in your property by keeping it aesthetically pleasing outside and inside, you will be better prepared to survive and thrive in a down market. As you reinvest, focus first on the curb appeal and second on interior aesthetics. It will not matter how beautiful your property is on the inside if a prospective tenant drives by and curls their lip at the outward appearance. Cultivate and maintain a clean, manicured, and colorful exterior and you will out-compete other landlords for the best tenants even in slow times.

Build a Reserve

Plan for upgrades and hidden bummers by building a reserve. Just when you think everything is going along nicely either some major expense comes up or a couple of your long term tenants give you notice to move. You need to plan and be prepared. If you have long-term tenants it usually means when they move you will endure a great deal more of expenses, as you will need to upgrade the unit at the time of their move-out. There are several methods for calculating an appropriate reserve to be used for capital improvements and economic changes.

These are the simplest analytical methods to use to determine the level of reserves you should have on hand. Of course, you could just set a policy of x number months operating and debt service costs. Whichever method you choose is up to you as long as you understand the importance of maintaining your properties so that you attract the best tenants even in a down economy.

Pay Down Your Highest Rate Loans First

Some investors strive to pay down mortgages more quickly than the original terms of the notes. If you choose to do this, target your highest interest rate notes first to save money in the long run. In times of economic weakness, it may also behoove you to refinance the term to lower your monthly payment. You can always pay more principal and shorten the term of the note when the market recovers.

Watch For the Signs of Change

The recent recession is frequently attributed to September 11, 2001; however, the economic changes began long before that date. Early warning signs include falling interest rates, irregular stock market changes, job layoffs, overbuilding, fewer inquiries from people moving in from another state or location, tenants moving because they need to save money, etc. You can keep your finger on the pulse of economic changes by watching the newspaper ads for an increasing number of ads for similar rentals, price changes on similar units, headlines in the news about changes in jobs and the economy, and the length of time it takes to get your vacant units rented.

Most small investors and management companies are very slow to change. You can beat the competition by watching for trends and being creative in attracting the best tenants.

Most small investors and management companies are very slow to change. You can beat the competition by watching for trends and being creative in attracting the best tenants. In a slow economy, investors lament that they cannot afford to take less for a rental unit; however, choosing the wrong tenant or holding out at a high price only increases the problem. The faster you turn your vacancy, the more stable your cash flow will be.

This is where being in a group of other investors can really help because you are not on your own to do all the research. And you get input from others on what trends they are experiencing.

Use Consistent Policies and Procedures

Tenants with poor credit, job instability, questionable landlord references, or criminal histories are turned away from most savvy investors and managers.

When interest rates recently dropped to the lowest rate in 40 years, tenants evolved into homebuyers at record numbers. In fact, the only tenants that were left in the market were the ones who could not qualify for a mortgage, and we even saw some tenants qualify for loans that we refused to rent to! Even as we saw this mass exodus of tenants, we set firm policies and adhered to them faithfully. If you allow yourself to get desperate in taking any tenant standing upright with green money, your risk multiples.

Re-Evaluate Strategies

As markets change, you need to be flexible to change with them. In the case cited in the paragraph above, the change in the market necessitated a change in our policy. We decided to accept tenants that showed some risk and then set a policy that we would conduct an interior inspection 30-45 days after the tenant moved in to see if the tenant was a good caregiver. Even when a tenant knows you are coming and clean up for you, a smart landlord can still see if there is a problem just by looking in corners and under the sofa. Any tenant we identified as having poor property care habits was immediately flagged for quarterly inspections, and any damage found during inspections was addressed then and there by giving the tenant 7 days to correct the problem or get back charged for the repair if we had to do it.

Always assess what is working and what is not, think through the ways to manage the risk, and set written policies to address the risk. Being consistent is absolutely key; however, ignoring trends is certain failure. Set yourself up on an annual schedule of reviewing policies, preferably in mid to late May, before the busy summer moving season.

Constantly evaluate property performance and get rid of the duds.

When you sit down in May to evaluate policies, also evaluate the performance of each of your properties using the same analyses as when you decided to purchase the building. Compare returns on investment, vacancy rates, etc. Get information from your Realtor® about comparative properties for sale and with your CPA on your tax status and how your investments can improve your position. Is your property producing as it should or would it be wise to sell or exchange it? Always treat your rentals as a business and make good business decisions. Some landlords get personally attached to their properties and lose sight of the bigger picture of the investment.

Opportunities are everywhere. If you miss out on what might have been a great deal, don't give up. The right real estate agent will keep contacting you with everything that comes on the market until the right property comes in for YOU. Don't buy if the property does not feel right. Take your time when you are in escrow to be certain this is the right investment for you and that it all makes sense. Better to change your mind before you purchase the property rather than after when you are knee deep in large expenses.

In summary, there are cycles in real estate investing ... times of feast and times of famine. Nothing is insurmountable, but there will be times when the going gets tough, and you will need to be tough enough to get going. Savvy investors do their homework before they buy and then manage risk throughout their ownership by staying current with economic cycles and trends. They respond to change quickly, clearly, and consistently, and they prepare ahead of time for the worst. By doing so, everything else in landlording is a nice surprise!

By Melissa Prandi, MPM President of PRANDI Property Management has been managing rental property for over 23 years. She is the author of the newly released book entitled "The Unofficial Guide to Managing Rental Property" This article is a sample of what you will find in her book. Melissa is also the Past National President of the National Association of Residential Property Management (NARPM) serving on the national board for over 8 years. Melissa teaches workshops all around the US and has been the keynote speaker and workshop instructor for the NW Regional Conference for NARPM. Melissa will also be teaching two workshops at the TRENDS conference on December 13. Reprinted with permission from On-Site Northwest.