10 INTERNATIONAL CITIES TO MAKE BIG, FAST PROFITS!

CANADIAN Real Estate Wealth

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Display until March 18, 2013
MARCH 13 $7.99
canadianrealestatemagazine.ca

To be or not to be {a landlord}

You've read the stories of successful real estate investors who made millions from their investments, and you want some of it too! Before you take the leap, *Chris Seepe* offers a reality check

The opportunity to make big bucks through real estate is as attractive as ever; however, it pays to know the risks so you can minimize them. Here are a few to be aware of – not to discourage you, but to arm you with the facts so you're prepared.

You'll have vacancies. You don't always achieve full rental income from your property. Lenders average vacancy levels at 3–5%. And the less units you have, the greater the financial impact. Minimize this by buying well-located and desirable properties.

Bad legislation and inappropriate tax rules have created thin profit margins, especially for smaller operators, forcing them into nominal maintenance programs, thus eroding property quality, lowering tenant quality of life, and producing very little new rental housing stock. Ensure you do your strict due diligence to avoid this risk.

Government and mainstream lenders have made it increasingly difficult to purchase rental housing, despite shrinking rental-housing inventory and low vacancy rates. The upside is: there is less competition from other landlords, and rents are more likely to rise.

If you're not a "people person", hire an amiable but firm property manager; otherwise, you'll alienate your tenants and cause misery for yourself.

You need to be a master of cash flow. You must plan ahead for everything, from property taxes and insurance to major repairs. Maintenance costs come in big chunks. You may have nothing for a time, and then suddenly get hit with a roof, boiler, or other major repair.

Know the law or become a potential victim of it. Among other things, you need a solid rental agreement and you must understand it completely.

You may inherit the previous landlord's problems. You have legal recourse for undisclosed latent defects,

stigmatisms, etc., but you may still end up financing the remedies until you can collect. Strict due diligence is important.

Be prepared for unpleasant life experiences, such as dealing with the passing away of a tenant (by natural or unnatural causes), or dealing with tenants conducting illegal activities. Screening your tenants properly and strictly will reduce these risks.

If the police or fire department kick in a door or otherwise damage your property in the conduct of their job, you pay for the repairs. Setting up a buffer ensures you have enough funds to cover this.

Tenants may call you at all hours of the night, sometimes for repairs, at other times in emergencies, and at still other times regarding domestic disputes. A good property manager will take care of this for you.

You may have to be a mediator between neighbours who don't get along.

The government has eliminated security deposits that would otherwise discourage tenants from disrespecting or even trashing your property, and you'll have a hard time collecting the cost of damages from tenants who have moved away. Vetting your tenants properly will reduce or even eliminate this risk.

Crunch the numbers properly before buying any property, to ensure it stacks up

You must visit your rental properties often. One landlord never checked up on his renters. The property was seized by the police because it was used as a "grow op". The landlord did not regain possession because he was expected to have had knowledge of this kind of obvious use and to report it.

The Ontario government has put a 2.5% cap on annual rent increases. Landlords are already prevented from passing on many types of legitimate operational and capital costs. Crunch the numbers properly before buying any property, to ensure it stacks up.

Ontario has the longest eviction proceedings process in Canada. You can avoid this by choosing the right tenant at the outset.

Capital Gains Tax and Recoverable Capital Cost Allowance (depreciation) discourage long-time landlords from selling their properties to new investors, who statistically spend the most on building renovations.

Landlords cannot compile a list of bad tenants. In case resolutions, the Landlord and Tenant Board makes a landlord's name public, but the tenant's name is hidden – an odd interpretation of privacy legislation.

The landlord is charged for a Fire Code violation committed by a tenant.

Statistically, tenants who have their utility bill included in their rent consume substantially more energy than those tenants who pay their own utility bills. Make them pay their own bills to eliminate this.

The government requires landlords to provide new tenants with one year of utility consumption history for a rental unit. The Privacy Act prevents landlords from obtaining this information from utility companies if their previous tenants paid their own bills.

The government expects landlords to foot the bill for damage and foul odours caused by pets. While there are legal recourses, the practical application of those recourses is onerous and often fruitless. Impose a no-pet policy to avoid this problem.

You must know the Fire Code. Some updates can create unexpected capital costs, such as installing bullhorns in every unit.

Finding reliable and honest tradespeople who perform acceptable quality work at a fair price *and* have people skills that respect your good tenant relations can be a real challenge.

Municipal property taxes can take 15–20% of your rental income. Some municipalities have cut back on the services they provide, such as garbage removal, but your property taxes continue to rise.

The government limits landlords from passing on certain costs, and those permitted cannot be more than 3% of the rental income above the rent increase guideline per year for a maximum of three years. This limits what a landlord can spend on improvements.

Mainstream lenders will not finance rooming-house-like properties, regardless of function, client base or proven income stream.

Being a residential landlord is definitely not a passive income investment.

NOW THE GREAT NEWS

Despite the long list of potential hazards, the possible rewards often outweigh the downsides. Here are the top 10 reasons why you should become a landlord.

1 **You use tenants' money to pay your mortgage and build your equity.** You can raise the rent each year (with restrictions) and adjust for current market rent rates when a property becomes vacant. Long-term investors buy real estate that generates positive cash flow, and either hold it until the tenants have paid off the mortgage or until there's a compelling reason to dispose of the income stream in return for a lump sum; for example, to buy something bigger/better or to create a retirement annuity income stream.

2 **Real estate assets can be leveraged to bargain for additional real estate investments.** Unlike stocks, mutual funds, term deposits, etc., you do not have to pay for the whole real estate investment yourself. Lenders will give you the extra money you need (mortgage) in exchange for receiving interest and the property as collateral if you default on the scheduled payments. When the property's value has increased enough, some lenders will let you borrow against that value (your equity), which you can use as a downpayment to buy another property.

3 **Real estate is tangible and more easily collateralized than most other types of investments.** Ask ex-shareholders of Northern Telecom, Enron, Bre-X, and other "blue chip" failures. Lenders generally offer a higher ratio of loan amount versus the value of a real estate property than they would offer on a portfolio of stocks, for example. The building and/or land will still exist if the worst should happen. Mainstream lenders also love the low-risk appeal of rental housing properties insured by the Canada Mortgage and Housing Corporation, and offer very attractive interest rates.

> Treat your investment like a business, and your tenants like valued customers

4 **A modest increase in rental income and/or decrease in operational costs can have a significant positive impact on property value.** For example, increasing net operating income (by reducing costs and/or increasing rent) by $1,000 per year and applying a 6% capitalization rate (better-than-average in today's southern Ontario market) can add about $16,650 to the value of a property, using the Income Approach. This does not include appreciation for other reasons such as high demand for, and low supply of, rental space, improvement in the neighbourhood, etc.

5 **Several current tax policies (RCCA, capital gain, etc.)** discourage long-term owners from selling their rental housing properties because the proceeds of a sale may only equal the cash flow they would receive from keeping the property for a few years.

Combine this with the discouraging rent control policies which make investors/developers unwilling to tie up their money in building a rental property. They may have to wait a decade or more for a return on their investment, when they can build a condominium and get their money back—often with a huge profit—in just a few years. So what's good about that? Rental housing inventory is shrinking, resulting in high investor demand and high sale prices for existing inventory (seller's market), and increases in average rent rates (low vacancy).

6 **A well-maintained and fully occupied rental property rarely depreciates.** Unless they have been damaged by stigmatism or an eroding neighbourhood (eg increase in crime), values have traditionally increased over the long term.

7 **If the very worst should happen,** you still have a low (or no)-cost place to live.

8 **Legitimate and reasonable expenses reduce your taxable income.** Tax deductions include mortgage and credit card interest, depreciation, a reasonable salary with employment deductions, a percentage of your local travel expenses, relevant long-distance travel (eg trade show), portion of home office and workshop costs, etc.

9 **Despite the perceived stereotype, many landlords** enjoy the satisfaction of helping to provide good-quality housing to self-sufficient people in need.

10 **Multi-residential investments are arguably the most stable,** depression/recession-resistant, and relatively secure type of real estate investment you can make. Everyone needs a place to live; not everyone needs a place to work. Buying a place to live is not possible for many young people and remains elusive for many adults too. Some adults choose the apartment-living lifestyle for its freedom from housing-related issues.

Treat your investment like a business, and your tenants like valued customers; know your rights and those of your tenants; maintain tight control on your cash flow; act promptly in everything you do; surround yourself with high-quality industry professionals, and you'll experience the success you've dreamed was possible, especially if you can expand your holdings.■

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