

Can't sell your home? Be a landlord

It might be a better choice to become a landlord while you ride out the housing slump.

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(MONEY Magazine) -- When Katherine and Jean-Paul Chretien bought their Wheaton, Md. townhouse for \$480,000 in late 2004, they expected to stay four or five years. But after daughter Jolie was born six months later, the home started to feel cramped. The Chretiens were ready to move out - but not quite ready to sell.

"Given realtor fees, we thought we'd only break even," says Katherine, 32, an internist.

Rent vs. Sell: Do the Math

Becoming a landlord for 2 years works out best if home prices recover soon.

Scenario 1
Scenario 2

Bought house in '04
\$300k
\$400k

What it's worth now
\$325k
\$415k

After broker commissions
\$305.5k
\$390.1k

Monthly rent

\$2,100
\$2,300

Monthly costs

\$1,990
\$2,650

Net annual rental income

\$1,320
-\$4,200

Forecast price appreciation

5% a year
1% a year

On a sale in 2 years

\$336.8k
\$397.9k

Payoff

+\$33,940
-\$600

You should

Rent
Sell

So when the couple, now expecting a second child, moved to a five-bedroom colonial less than two miles away this past winter, they didn't put a "For Sale" sign out; they found a tenant. The Chretiens are banking on a downtown redevelopment project to boost property values.

"We have a lot of faith that the area is going to grow," says Katherine. "We wanted to hold on to the home for a few years."

The Chretiens have joined what could be, along with laid-off mortgage brokers, one of the fastest-growing populations in post-bubble America: the Accidental Landlord.

Like others of their kind, they didn't set out to be property investors. But when faced with selling in a weakening market, they decided that renting was the better option. It's certainly hard to argue with the math.

The inventory of homes for sale is twice as big as it was three years ago, which could mean a longer wait to sell - and a longer time to shoulder two mortgages if you buy your next home first. And with home prices flat - or worse - in many markets, you may not clear enough to cover broker fees once you do sell.

The rental market, on the other hand, is robust. Rents were up 4.1 percent in 2006, according to the National Association of Realtors.

The problem is, that's not all there is to the math - and the math isn't the whole story. Landlording is a job every step of the way, from setting a price to finding a renter. So before you take in tenants, make sure you understand all the implications.

When Renting Beats Selling

To make the rent-vs.-sell call, you need to know what your home could fetch today. Get a ballpark figure at a home-valuation site like Domania.com or, better yet, sit down with a realtor.

Be prepared: Her appraisal may fall far short of what you dreamed - especially if you hoped to get what the Joneses did when they sold in 2005. In that case you have two choices: Take what you can get (and maybe swallow a loss) or rent and hope to do better a few years later. Take the latter course if:

- You can charge enough in rent to cover your costs

You'll need to suss out what typical rents are in your area and then compare that with your carrying costs. Those include not just mortgage payments, taxes and upkeep but also a bigger insurance tab: Your homeowners policy may go up if you don't live in the house, and you'll need additional liability insurance (for roughly \$250 a year, you can get a \$1 million umbrella policy).

Add on another 5 percent to 10 percent for unexpected maintenance or a gap between tenants. If you want to hire a property manager to handle paperwork and repairs, cut your projected rent by 10 percent.

- You have other funds for a down payment

If you have to rely on the equity you've built up in your current home to buy your next one, you're probably not a candidate to rent.

You'd have to finance your down payment with a bridge loan or a home-equity loan or line of credit, which at today's high interest rates would push up your carrying costs, making it even tougher to break even.

- You're sure prices will rise

Becoming a landlord is a bet that you can earn more renting your home and selling later than you would by moving on and putting sale proceeds to work elsewhere.

How much rent you can charge is important, but so is what's ahead for home prices (see forecasts for 100 top markets at cnnmoney.com/realestate). In fact, even if the rent doesn't cover your out-of-pocket costs, a big turnaround in your market could make the numbers work.

- You're not giving up a great tax break

If you rent for more than three years, you endanger a precious benefit of home ownership - the capital-gains tax exemption. Live in your house for two of the five years before you sell and you'll pay no taxes on the first \$250,000 in profits (\$500,000 for a married couple).

But become a landlord for three years or longer and you'll owe capital-gains taxes on all profits in your home since you bought it. That could wipe out more than a year's worth of recovery in your market.

Are You Landlord Material?

Even if the numbers add up, you can't assume you'll thrive as a landlord. Take on the job only if:

- You can handle the risk

Your local housing market could stumble, your house could sit vacant for months or you could get stuck with a renter who doesn't pay up.

If such unexpected bumps would deplete your savings, you're probably better off staying out of the rental world.

- You have the time

Since you didn't set out to be a landlord, you likely have a full-time job. If you have a responsible tenant, managing the property may not take much time. But even small tasks can crop up at inconvenient moments.

"It might only be 10 hours a month, but those 10 hours are not going to be when you want," says Robert Irwin, author of *The Landlord's Troubleshooter*.

Can't stomach the idea of leaving your warm bed at 3 a.m. to meet a plumber? Then rethink your plan - or hire a property manager.

- You can bear some wear and tear

Just as not everyone is meant to be a landlord, not every house is meant to be rented.

"If your home has French windows, chandeliers or stuff that could easily be broken, it may not be the best one to rent," says Irwin.

A house with lots of bedrooms will likely attract families with kids - and the damage they inflict. Get used to the idea that not everyone will care for your home the way you do.

Building Your Team

Once you decide to rent, you'll need backup. If the roof leaks when you're on vacation, do you want your tenant shopping for a handyman? Before anything breaks, put the numbers of a reputable and reasonable plumber, handyman, electrician, roofer and contractor on speed dial.

Find an accountant who knows real estate. Standard leases vary by state and sometimes even city, so hire an attorney to draft one, or start with a state- or city-specific document from CompleteLandlord.com (about \$15).

If all goes well, you may even become a Deliberate Landlord. After renting out her old home in Denver when she moved, Wendy Muller is contemplating that step.

"It's been a wonderful investment," she says. "We're going to sell it soon and buy two more properties."