

4 Pitfalls First-Time Real Estate Investors Can Avoid

The glut of foreclosures clogging the housing market has driven down home prices, which are now about 33 percent off their 2006 peak. Even with the recent seasonal uptick, prices are still down 4.1 percent compared to June 2010, making purchasing a home more affordable than ever. Meanwhile, rents have risen in 80 of 82 U.S. markets, according to the latest data from REIS, underscoring the demand for rental properties.

"Prices have come down, you have low borrowing costs on money, you've got good inventory, and you have high demand for the rental pool," says Charlie Young, president and CEO of ERA Real Estate. "From an investor's perspective, this is a great time to get in at a low cost and have high demand for the product."

But while housing market conditions might be ripe for real estate investors, there's a few things newbies should know before taking the plunge. *U.S. News* talked to experts about how to best navigate today's mercurial housing market.

Low-balling offers. With prices so low and many people desperate to sell, first-time investors might be tempted to throw out a low-ball offer in hopes of scooping up a bargain. But that strategy might backfire, Young says. "The average American is reading the national press and seeing all these price declines and they're thinking, 'This is a time when I can come in a really low-ball,'" Young says. "What the consumer doesn't realize is that the market has a way of correcting for itself, so the price declines they're reading about in the newspapers are already reflected in the prices."

One way consumers can gauge whether a house is overpriced is finding out how long a property has been on the market—"days on market" in real-estate speak. If a particular property has been sitting on the market for awhile, it may be a sign it's overpriced or has some other defect. "Typically when you look at properties that are for sale in a marketplace, the ones that are priced appropriately for the market move even in a down market," Young says. "Those that are overpriced for the market will sit for longer."

On the flip side, while you can purchase some homes at ridiculously low prices today, a cheap deal isn't always a good deal. Find out the potential rent you can charge and ensure that it covers the monthly carrying costs of owning the property. Websites such as [FinestExpert.com](#) provide users with a wealth of information, including a property's asking price, estimated value, and estimated rent.

Finally, check out the surrounding rental properties in the neighborhood you're looking to invest in. If competitors are offering lots of incentives for renters—such as free rent or waiving fees—it may be a sign that demand isn't strong in the area. "You need to do your due diligence and make sure you understand your investment and the market," says Jim Evans, CEO of Bruce G. Pollock & Associates, and president-elect of the Institute of Real Estate Management (IREM). "Find out what the demand for rental property is in your market."

Financing. Mortgage rates are at all-time lows, but getting a mortgage with those low rates can still be tricky. "Traditional financing is very much available," Young says. "But all the same principles that you hear about for primary residences applies."

Borrowers should have good credit—a FICO score of 740 or above to get the best mortgage rates—and be prepared to put down a sizable down payment. Investors should also be

prepared to supply information about their personal finances as well as expected cash flow and expected returns for the rental property.

Underestimating costs. Just knowing how much you can charge in rent and whether it will cover your monthly housing payment for the property isn't enough, experts caution. Prospective real estate investors need to factor in taxes, insurance, closing costs, maintenance costs, and any expenses they will incur from preparing the property for renters.

For repairs that will likely come up during a tenancy, experts suggest setting aside at least six months' worth of expenses to cover any major or minor issues. "I tell my clients to price out the cost of a new furnace, because that's probably the most expensive repair, and to make sure they have that in the bank," Evans says. "If you're a small investor, you don't want to have to dip into your personal savings."

Foreclosed or distressed properties can come with a whole other set of challenges. "With bank-owned properties, they're letting you low-ball a bit, but make sure you do your homework," Evans says. "Some of these homes have been shuttered for awhile," and could need significant investment to get the property up to snuff.

But investors shouldn't fixate only on costs. Myriad other factors contribute to the success or failure of real estate investing, such as location, proximity to public transportation and shopping, and employment availability. "When you're looking to buy for your primary residence, you're looking at things like curb appeal," Young says. "What you need to be looking at when you're buying for investment purposes when you're going to turn around and rent that property is how marketable it is as a rental property."

Underestimating the time commitment. Being a landlord isn't a hands-off activity. "I tell people to be prepared to plug your phone in next your bed," Evans says. In addition to maintaining livable conditions for tenants according to state and local ordinances, landlords should be prepared for the time it takes to find, screen, and close a rental contract with tenants.

Background and credit checks can also eat up time and money, so experts recommend setting aside a portion of monthly rent proceeds for miscellaneous management fees.

But while it might be challenging for newbie real estate investors to assume the role of landlord right away, you don't have to go it alone. Groups such as IREM and the National Association of Residential Property Managers can help you find a professional property manager to help with day-to-day management responsibilities. Many local communities also have associations to support landlords as well.

"Real estate investing can be profitable, rewarding and lead to a great career," Evans says. "But make sure you do your homework."

By Meg Handley