

## **Buying the “Right” Investment House (Or: “Lessons on “What Not to Buy”)**

After personally buying over 250 homes, and placing another 600 houses with investor clients over the past 28 years, I have learned some hard lessons about what houses to buy as well as what houses to avoid. Hopefully my experience can help others make fewer mistakes and avoid some of the costly learning curves I have paid for.

**Let's break these issues down by category.**

### **Rent Ceilings**

Every market area has a rent ceiling. A rent ceiling is the highest rent tenants will pay in any given area. For example, an investor might be getting a bargain on a \$350,000 house in Canton that could rent for \$2,600 a month, but the rent ceiling in Canton is only get \$1,300 a month, no matter how much house you own. Canton, like every community, has rent ceilings, regardless of what sales price is paid for a house or what a monthly mortgage turns out to be.

We have investors bring us houses they purchased at a great bargain price, in an area that just won't support the rent needed to cover the debt service. Get with a competent property manager before you buy, and buy the right price range for the area. Figure out what the area rent ceiling is before you start looking!

### **Stay in the lower price range for the area**

No matter what part of the country an investor buys property in, a \$400,000 house does not rent for twice as much as a \$200,000 house. To make the cash flow numbers work; the investor should buy at the lower end of the market area.

Now don't take this to the extreme! Buying quads or trailer parks might show a better cash flow, but you will be managing a tenant that will drive you crazy! Stay at the lower end of the “single-family market” for the area. You'll have better cash flow and tenants you will enjoy.

### **Buy single-family homes**

I have watched my friends buy duplexes in super locations for \$80,000 and sell them ten years later for \$120,000. During this time period and market area change, the single-family homes doubled in value! The cash flow may be better on a duplex or quad, but the appreciation will not be as good by a long shot! I do not believe the “American dream” has the word “plex” after it. Sixty-two percent of the American population lives in a single family residential home. Every time I talk myself into

buying a townhouse, because it's such a bargain, I end up remembering why I buy houses. Learn from my many mistakes; stick with single-family homes.

### **Geographic Area**

More than once I have bought a well built home in a great community far from employment centers, major traffic arteries and shopping centers. I missed the fact that there were no large bodies of tenants to draw from to get these great homes rented. Renting the house became a problem, not because it wasn't a good house, but because it was too far away from the people who needed to rent it. I love quiet towns outside the bustling Atlanta area. I just don't want to own rentals there.

We all want to buy new homes, at low prices! But, to find those new homes, we often have to go so far out of the metropolitan area that there aren't enough tenants to get them rented. Often times those \$140,000 new homes are so far away from the traffic areas and base of people, that although we got a bargain on the price, we're going to pay for it with a negative cash flow and a long vacancy.

**Here's the problem:** It is harder to make the numbers work (cash flow) with more expensive houses. Paying \$250,000, in highly populated areas of town, will get a tenant quicker, but the numbers won't work as good unless you put a large down payment into the equation. We all want the lower priced homes for the positive cash flow, so we hunt down the cheaper homes away from the very people we are trying to rent them to!

**The lesson:** Buy in areas that demand a surplus of tenants. Make sure your houses are near masses of people so you can get them rented. When you buy, keep one eye on rent ability. Rent ability changes with a geographic area. In Atlanta, you can buy a \$250,000 investment property along the Georgia 400 corridor because the rent ability, necessary to make the cash flow work, is positive. However, buying a \$250,000 house in an emerging area like Dallas, Newnan, Winder or Canton, will not rent for enough to make the numbers work.

Atlanta has no natural boundaries (no mountains or oceans) to limit growth and no limits on urban sprawl. The Atlanta metropolitan area is spreading like wildfire and there are an unlimited number of \$140,000 new homes to buy. Just be careful where you buy them because someday you will want to rent them, and you need a good rental pool of potential tenants to draw from. Make sure, before you buy, that the population density in an emerging market area will support the rental price you are expecting.

### **Floor plans**

Houses with dysfunctional floor plans should be bought with great caution! An example is a house with 2 bedrooms and a loft. Sellers love to call it a three-bedroom home, when it

is clear that the loft, without a closet, private entrance, and window, is just a loft, not a bedroom.

Another example is a house with the kitchen behind the garage, on the lower level of the home. This floor plan makes the kitchen stick out like a sore thumb when you think about it, but many investors don't notice that it's funky.

Because a four-bedroom house rents for more than a three-bedroom, sellers love to tell us that "the room in the basement," with no access to a bathroom and no windows, is a "fourth bedroom," when in fact it is just a rec room in the basement. Unfortunately, many listing agents cooperate with this facade and market the house as a four bedroom. Unsuspecting investors fall into traps like this all the time and think they can rent a three-bedroom house at the price of a four bedroom. Tenants are going to hate it. When it has no window, no closet, and no entry off the hall, guess what, it's not a bedroom.

If you have to walk through one bedroom to get to another bedroom, it is not a bedroom. It may be a large closet. It may be a bonus room. It may be a storage room. But it's not a bedroom.

There's another issue here, "funky" floor plans. Some builders love creatively designed homes and forget to put in closets and other functional rooms. They put the washer and dryer in the garage, or the furnace in the crawl space or attic.

Don't fall for the odd floor plan with four steps (or stairs) between every room. A six-level house will only appeal to a small percentage of the market.

Look for "production built" homes (also known as "track homes"). They are generally built by builders who have spent some serious money on floor plan designs. They will flow well and "feel right."

**The Lesson:** Buy houses with standard floor plans. Stay away from oddball stuff.

### **Lot Setting**

Tenants and buyers are terrified of steep driveways. Many folks are moving from parts of the country that have a surplus of snow and ice. Leave the hilltop house for the goats, and the down-in-the-hole houses for the trowels. Buy what will appeal to the broadest market of customers. You will always be able to rent or sell a house that has a flat driveway. Stay away from steep driveways.

A home sitting on a busy street may go commercial some day, or maybe not. In the meantime, the occupants get to listen to trucks rumbling down the road at two in the

morning. Buy in the community where it is quiet and safe for the kids to ride their bicycles.

### **Niche market homes**

In the Atlanta area we have a growing number of retirement home communities. They are beautiful brick duplexes with double car garages and lots of trim molding. They are perfect for a retired couple needing a high quality home with less floor space. Be careful, this is a niche market, and although it is growing, these homes do not appeal to the broad rental market. They do appeal to a growing market that may be too narrow today to rent quickly and stay rented. In coastal areas, or in Florida, where a large part of the population is retired, this type of niche market home may be a great rental. But in Atlanta, avoid retirement communities.

**Lesson:** stay away from niche market houses.

### **Construction issues**

Most problems with houses can be fixed. The question is, do you really want to tackle lead-based paint, defective stucco, polybutylene pipes, pressed board siding, and other construction defects in class action lawsuits.

We can all find houses priced below market, with construction defects, but these types of houses may be a lot more work than you think. Be sure you know what you're getting into. You may not be getting a bargain at all.

Learn to define the difference between a “true discount” versus a “*price adjustment for an irreconcilable defect.*” Ten thousand dollars off a \$200,000 home with stucco is not a discount: *it's a price adjustment for an irreconcilable defect.* Ten thousand dollars off the price of a \$200,000 home on a busy street is not a discount. *It's a price adjustment for an irreconcilable defect.* Learn to define this difference before you get burned. It is obviously hard to rent or sell homes with irreconcilable defects.

Don't buy houses next to the community retention pond, or where the backyard has a 300-foot power line running through it, or drops off into the drainage ditch. There are just too many good houses on the market to settle for these albatrosses. Let somebody else struggle with them.

**Lesson:** Buy houses on good lots. You'll rent them quicker and sell them quicker when it's time to get out.

### **Buy the bottom half of the community**

Every subdivision sells for a range of prices. You can find streets where sold prices range from \$150,000 to \$180,000 within a four month period of time. We suggest you buy at the bottom end of that price range and let the rest of the community pull your house value up. Buying at the top-end of the community is a bad idea unless you find a substantial bargain and can't pass it up.

### **Buy from people with rental experience**

Every agent in Atlanta will say, "We work with investors." To most of them that means "they are happy to sell you a house." The problem is easy to diagnose. If they don't personally own rentals, they don't know the issues of owning rentals, and will sell you what "you want," instead of "what you should buy." If an agent's primary business is selling owner-occupied homes, then they are not tuned in to the issues of "rental houses." The decision making process for buying investment homes is very different than that of buying owner-occupied homes. Make sure your agent understands leasing and management issues. If they say, "I don't manage rentals," you should have a clue.

Crown has 28 years of experience in buying houses in the Atlanta area. We have placed over 600 houses with investor clients and have bought over 250 for our own account. We have made enough mistakes to have figured out what houses to buy and what houses to avoid. We can guide you through the process and help you avoid the costly learning curves that we have already paid for! We have leased to over 6,000 tenants and manage over 600 houses today. We know what the right house looks like and where to find it.

Contact us for more information at:

<http://www.crowngeorgia.com/contactus.htm>