So, You Want to be a Landlord?

The comprehensive guide to owning rental real estate in Indianapolis.

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Introduction

So, you want to be a Landlord?

Owning rental real estate is one of the most exciting and successful ventures you can participate in.

But, it can also be stressful and frustrating if you aren't equipped with the right tools and knowledge.

If you're jumping into this thinking you're about to get rich overnight, you need to take a step back.

As we'll discuss further in this eBook, real estate is a long-term investment and you need to have that mindset from the get go.

After you're through reading this content, our hope is that you will walk away with a greater understanding of what it means to own rental property in Indianapolis!

This eBook is interactive. Click on any of the symbols and you'll be directed to related resources.

Should I get a home inspection?

A question that we hear all the time from new Landlords is, "Should I have a home inspection?" We **always** advise clients to have a home inspection. Without it, you would have no clear way of knowing if everything is working properly and is up to code.

There are two main benefits to having a home inspection done.

1) Peace of Mind: The first main benefit to a home inspection is to help give you a peace of mind. During your initial walk through, you probably only looked at the house, room sizes, appliances and other cosmetic things. But you didn't climb on the roof, go in the attic or go in the crawl space. These are all things the home inspector will do for you. When the inspection is complete, you will get a full copy of the inspection report.

2) Inspection Response: The second main benefit to having a home inspection done is that it will work in your advantage during the inspection response process. Once you get the inspection report in your hand, you can sit down with your agent and look at each item to determine which items you feel are in need of repair before the closing.

Landlord Insurance

As an Indianapolis real estate investor, insurance is VERY important. You hope you never need it, but you absolutely must ensure that you have the proper insurance in place.

Quite often, we get questions from some of our new investors that surround insurance. Generally, they ask:

“What type of insurance do I need as a Landlord?”

At the end of the day, there’s not a big difference in the policy you have on your personal home and the policy you’ll need for your rental property. And in many cases, you can use the same insurance carrier you currently use for your personal residence. This is especially helpful if you are converting your personal residence into a rental home.

Landlord Insurance

Rental Dwelling Policy
The policy you receive for your rental home is called a "Rental Dwelling Policy." These types of policies usually cost a little more than a standard Homeowners policy and they contain three basic coverages:

1. Structural – Like the traditional homeowners policy, your rental dwelling policy will protect your home against damage caused by fire, lightening, wind, hail and other covered perils. There's nothing different about this coverage at all.

2. Liability – All rental policies also come with liability coverage. A standard homeowners policy provides personal liability, but that liability would not cover Landlord associated risks that a Rental Dwelling Policy does.

Now, in terms of liability, you need to seriously consider the proper coverage limits. A standard policy will generally come with around $300,000 of liability coverage. We suggest you increase the coverage to at least $500,000 or even more.

Landlord Insurance

If you are a high net worth individual, you might want to increase this coverage to match your net worth. In addition, if you hold the property under an LLC, the liability coverage should match the assets of the LLC.

Unfortunately, we live in a litigious society. Let's say the Tenant falls down the stairs and is severely injured, or a furnace explodes and your Tenants are injured or even killed. Your liability coverage is there to protect you against severe financial loss.

3. Lost Rents – Finally, a coverage unique to a rental policy is lost rents. If your home suffers a fire, for example, and the Tenants have to relocate, your insurance company will pay you for your lost rents during the vacancy. Generally, this coverage lasts for no more than one year.

Deductible -- Consult your insurance agent or even a financial advisor, about the proper deductible for you. The amount of deductible you choose will greatly impact your annual premium. As you probably know, the higher the deductible, the lower the premium. Whether you choose a high or low deductible completely depends on your individual needs and wants.

Understanding Property Taxes

Property taxes are important, and if you’re investing in Indianapolis or you plan to invest here, you need to understand our property tax rules.

I can't tell you the number of phone calls we've taken over the past several years from our customers regarding property taxes. And, trust me, they are not fun phone calls.

Me: "Hi Joe Investor. Good to hear from you. How can I help?"

Joe Investor: (very panicked voice) "Jeremy, I just received my tax bill and my property taxes doubled!! What's going on??"

That's followed by a few minutes of Joe discussing how his cash flow is killed, we have to raise rents immediately, being a Landlord is the worst idea ever, etc.

The bottom line is that Joe didn't understand how property taxes work BEFORE buying his investment property. And Joe clearly didn't use us to help buy his home, or Joe would have known exactly what to expect.

So, don't be Joe.

Take a few minutes to understand how our taxes work here in Indiana. They are a little different, and depending on how and what you buy, you may have to adjust your budget and your cash flow expectations to account for taxes.

One-Two-Three Tax Cap Rule

$200,000 assessed property value

1%

Owner Occupied
Amount of taxes owed yearly:
$200,000 X .01 = $2,000

2%

Non-Owner Occupied
Amount of Taxes owed yearly:
$200,000 X .02 = $4,000

3%

Commercial
Amount of Taxes owed yearly:
$200,000 X .03 = $6,000

Understanding Property Taxes

It’s important to understand the impact this has on your tax liability.

Most of the time, investors will buy a rental home with an existing homestead exemption on file. For example, most foreclosures that occur in our city are owner-occupied properties. So, if you buy that foreclosure, or buy it within a year the foreclosure, the homestead exemption will likely still be in place, and your estimated taxes will be around 1% of the assessed value.

Sounds great, right?

What happens, however, is when you buy the home, you are required to fill out the Indiana SalesDisclosure Form (Form 46021). This form specifically asks if the property you are buying will be your primary residence. When you choose "No" this will start the process of removing the homestead exemption and, yes, you'll now begin paying 2% of the assessed value in property taxes.

Return Expectations

Cap Rate - The cap rate simply measures the annual net income of a property divided by the purchase price. Indianapolis investors can expect anything in the 8%-10% range.

Cash-on-Cash Return - Cash-on-cash is simply the annual pre-tax cash flow of a property divided by the actual cash invested. Again, you should expect anywhere between 8%-10%. However, cash-on-cash can vary significantly from year-to-year.

It's a big mistake to draw conclusions about the success or failure of a real estate investment over a 1, 2 or 3 year period. Real estate is a long-term play and should be assessed that way.

Cash Flow - Calculating cash flow is one of the most important and basic calculations you can use to evaluate rental real estate. It's basically just understanding two big buckets: Income and Expenses.

Cash Flow = Total Income - Total Expenses

Return Expectations

Clearly, there are some factors you need to consider when assessing your return models.

1) Always budget for vacancy. Most people feel that 5% is a good number to use for single family homes. We think 10% is more accurate.

2) Cash flow will not be evenly distributed. Cash flow can vary significantly from month to month and from year to year. For example, there are some months that you may have no maintenance at all, and then you might have a month where you have a $700 furnace repair.

3) Err on the side of caution. Once you've set-up your budget and have a good idea of the cash flow you should expect, I suggest adding a fudge factor line to your expenses – maybe as high as 10% of your income – to help account for unexpected expenses. If you don't end up using this money, I suggest adding this extra money to your reserve account to help pay for unexpected expenses down the road or capital improvements.

Why it's OK to Break-Even

Consider the following scenario:

You decide to buy a rental home and officially enter the Wonderful World of Landlording.

Five years later, after reviewing all of your financial information, you realize that you essentially broke even – from a cashflow standpoint – on the investment.

Meaning, while the investment didn't put any additional cash into your pocket at the end of five years, you weren't required to put any additional cash into the investment either. So, basically, your rents covered your expenses.

Is this a bad thing?

Not necessarily.

Why it's OK to Break-Even

Ideally, single family homes WILL produce cashflow. But a consistent theme we discuss in our blog, and one we stress with our customers, is that single family investments can be a grind. Some years are better than others.

In fact, some years can be downright disastrous, particularly if you own just one rental property and that one rental property needs a new roof, or a new HVAC system, or suffers an eviction.

We've always been of the opinion that real estate is a long-term proposition and should be evaluated as such.

So, assuming you do break even after 5 years, you might wonder… "How can this be a good thing? I got into this investment to make money, not to break even."

Well, even though you broke even, you will have reduced your taxable income and, likely, added some wealth to your personal financial statement during that 5-year period. So, hardly a waste of time.

Preparing Your property for Leasing - The First Time

Our job, which is sometimes tricky and oftentimes awkward, is to provide an honest assessment of the home in terms of rentability. Is the home clean? Does it need painted? Does the carpet need replaced? In many cases, work needs to be done and you have to be willing to put money in to get money out.

Here are some things that will most likely need to be done before your property will be ready to market:

1) A professional cleaning. Yes, professional. We want to set a great tone for the Tenant. The home should shine as much as possible. Baseboards, appliances, you name it.

2) Carpet cleaning. Like the house cleaning, all carpets should be professionally steam cleaned. Rug Doctors, in our experience, are not adequate.

Preparing Your property for Leasing - The First Time

3) Eliminate all safety concerns. Are smoke detectors installed and in working order? Is the HVAC clean and functioning? Any tripping hazards? Are handrails installed? Obviously, safety risks are not tolerated and addressing them is in the interest of everyone involved.

4) Make repairs. We realize that those vice grips to turn the dishwasher off & on might work perfectly fine for you, but most Tenants won't tolerate that. Get it fixed.

6) Painting. The paint job doesn't have to be perfect, but the walls should be clean and presentable. Any touch-up paint that's available for the home should also be left behind.

For the most part, Owners understand what it takes to get the home in rent-ready shape. Our experience shows that a home prepped in a high-level way will often times be returned to us in a similar state.

Preparing Your property for Leasing - The First Time

Why Property Preparation is Important:

We realize all this work may seem like a lot. But again, it's important to remember that you are entering in a business. It’s important that your customers (the Tenants) are satisfied with the product (the home) for many reasons, including:

Supply/Demand - Renters are attentive and choosy because of the increased availability of rental homes in Central Indiana. In fact, there are more rental properties in Indianapolis than ever before. Tenants simply have a lot to pick from, so it's imperative to present an attractive product.

Higher Rents/Better Tenants - Tenants will pay more for a desirable home. Most Tenants won’t even consider a home that’s dirty or in obvious need of repair.

Simply put, good homes draw good Tenants who are willing to pay top dollar. Unattractive homes draw unattractive Tenants who probably can’t afford to live there. dollars-31085_1280.png

Preparing Your property for Leasing - The First Time

Shorter Vacancy - As we've mentioned many, many times, nothing will kill your cashflow like vacancy. Days on Market – how long it takes to rent your home – has a direct impact on your bottom line.

The better your home looks, the faster it will rent, and the more profitable your business will become.

Higher Renewal Rates - While renewals will generally be dictated on how well you actually manage the home, providing a quality rental home at the outset will go a long way making your Tenant happy.

Happy Tenants tend to renew, which is every Landlord’s goal.

Again, you are entering into a business. If you are willing to prepare your home the right way, running this business will be easier and more profitable for you.

Rental Property Expenses

This is not an exhaustive list of possible expenses, but it should give you a pretty good idea of what to expect and plan for.

Rental Property Maintenance Expenses

Maintenance is an expense that you will never be able to avoid. Some months you may get hit with large repairs, and other months you may not have to fix anything. It's incredibly variable. There's a long list of different types of maintenance that you may have to perform for your Tenants.

Typically, we recommend that you budget 10% of your gross rental income for the year for maintenance. So, if your property rents for $1,000 a month ($12,000 a year), you should expect to spend $1,200 on maintenance for the year.

However, this number will vary depending on many factors including the age of the home and other unexpected expenses.

Rental Property Expenses

Turnover Costs

Turnover costs differ slightly from maintenance costs in that these are expenses incurred in between Tenants as opposed to while the Tenant is in the property. Turnover costs could be relatively low, or extremely high depending on the level of work that needs to be done to get the home rent ready.

One rule of thumb is to allocate 10% of the total value of the lease for turnover cost at the end of the lease. So the longer the Tenant stays, the higher the typical turnover cost will be because of more “normal” wear and tear.

If a Tenant stays for 3 years, at $1000 month, then you should anticipate at least $3,600 in needed turnover work to recondition the home for re marketing.

Rental Property Expenses

Landlord Insurance

When you decide to rent out a single family home, a typical homeowner’s policy will not provide adequate coverage. A Rental Dwelling Policy not only covers damage to your investment, but also provides liability coverage in case your Tenants get hurt on the premises.

The cost of a Landlord policy varies depending on many factors such as geographic location, size of structure, amount of rental units, age and condition of the building, etc. Typically, Landlord insurance will be a little more expensive than your average homeowner's insurance policy.

Rental property taxes

As we discussed earlier, Indiana follows the 1-2-3 Tax Cap Rule. You'll be paying 2% of your property's assessed value.

Rental Property Expenses

Property Management Fees

If you decide to hire an Indianapolis Property Manager to run your investment, that will incur additional fees every month. All PMs have different pricing structures, but typically there will be a leasing fee for the first month the property is leased, and then a management fee which is a certain percentage (usually 8%-12%) of the rent each month. Some companies also charge on boarding fees, marketing fees, and even vacancy fees.

Real Estate Lawyer Fees

If you choose not to hire a PM, you will need to think about what kind of legal help you’ll need to employ. At the very least, you'll need to have a lawyer on hand that you can reach out to should you have to evict a tenant. Some lawyers charge a flat fee for Landlord services, others charge hourly, but it's going to be upwards of a few hundred dollars for that process.

Rental Property Expenses

Rental Property Vacancy

Vacancy isn't a direct expense, but it's something you need to take into consideration. For every month that your property isn't occupied, it's a month that you don't have any income. We've said it before and we'll say it again, vacancy is a cash flow killer.

This is another instance where it is critical to have a reserve fund to pull from. Paying two mortgages is enough to stress anyone out and it can be hard to stay financially afloat during this time.

Rental Property Marketing Costs

If you have a Property Management company, they will take care of this for you. If not, you need to think about how you're going to fill your vacant property. It's worth spending the money to get it visible to as many people as possible in order to reduce vacancy time. There are a lot of channels you can use to advertise like Zillow, Craigslist, flyers, newspaper ads, for rent signs, etc.

Rental Property Expenses

Property Management Software Fees

Another expense you may have if you don't hire a PM is for some type of software or computer program that helps keep track of tenants, collects rent, generates work orders, etc. If you only have one property, you most likely wouldn't need this service. However, if you have a few or many properties, you'll most likely want to invest in some sort of system to help maintain your business.

Screening Software Fees

Screening every prospective tenant is vital to a successful leasing process. Depending on the volume of homes in your portfolio and whether or not your PM software has screening capabilities, you may want to pay for a monthly service that can conduct these screenings or you could just pay for each one separately every time you have a new application.

Typically it costs around $20 dollars per screening. However, these expenses can be offset by an application fee.

Do I need to Hire a property Manager?

Should everyone hire a Property Management Company?

Absolutely not.

In fact, the vast majority of rental homes in the United States, as high as 70%, are self-managed.

Here are the reasons why you may NOT need to hire a PM:

1. If you have Time – If you are going to manage a property on your own, you need to treat it like a business. Running any successful business takes time. For example, when you market the home for rent, are you able to respond to people – quickly – when a prospect wants to see the home? After that, are you able to show the home to prospects? Showing properties can take a lot of time, and prospects generally want to see the home during off-hours, like evenings and weekends.

Do I need to Hire a property Manager?

2. If you are Committed – Also, running a successful rental business, even if you have just one home, takes commitment. Are you committed to finding the best possible Tenant? If so, be sure you can screen that Tenant correctly. You should never just lease a property because you had a “good feeling” about a prospect.

Are you committed to investing in an attorney to draft a very good lease that will address all key parts of a Landlord-Tenant relationship and be in compliance with all state and local ordinances?

3. If you have Knowledge – A lot of do-it-your-selfers think it can be very easy to lease and manage a home. And, honestly, if everything works really well, it can be a pretty painless process. However, when things go wrong, you’ll need to have the knowledge, or employ someone who does, to remedy the situation.

For example, you’ll want to have good contact with contractors who can address all possible repairs to your home. And you’ll definitely want to have an attorney that you can consult when legal issues arise.

Do I need to Hire a property Manager?

4. If you want Control – Finally, if you are someone who really likes to control situations, and has a hard time letting go at times, it probably doesn't make sense to hire a Property Manager. A well-organized management companies won't involve you in some decisions about the property and you may have a problem with that.

How to Find Quality Property Management:

Shopping for a Property Management company should require some work on your part. After all, you are turning over the keys - literally - to one of the biggest assets you own. If you turn those keys over to a property manager that's ill-equipped to manage your home, you could open yourself up to a lot of headache and, ultimtately, a lot of lost money.

No Property Managers are alike. We all have our differentiating factors - or at least should have differentiating factors - that, if you research long enough, will align with your own specific needs and wants.

Next are 5 tips to find your best match!

Do I need to Hire a property Manager?

1. Do the owners of the PM Company own rental real estate? This is a critical question to get answered right away. If they don't own their own rental real estate, or have never owned rental real estate, it's a huge red flag.

Would you hire a stock broker that didn't invest in the stock market? Would you hire a coach who had no experience playing the sport? Of course not.

2. Understand ALL the fees. Unfortunately, management companies generally do a very poor job of listing their fees on their website. That's why you'll not only need to get a copy of a Property Management Agreement, but also ask the specific question, "Can you tell me all the fees I will have to pay for your services?"

Price is important, but it shouldn't necessarily be the most important factor in your decision. Generally, well-run, experienced Property Management companies will charge higher than average fees. But, in return, they should provide a higher level of service, get your properties rented more quickly, and attend to maintenance more efficiently. This all translates into a higher return for you.

Do I need to Hire a property Manager?

3. Understand Communication Policies. Again, the number one complaint about Property Managers is the lack of communication. That's likely because most management companies have not created a company culture that stresses communication, or they don't have the property staffing in place to allow for prompt communication.

4. Ask about the Staff Size & Experience. If the management company doesn't have a full staff listing on its website, you'll need to uncover this information during the interview. It's critical that whatever company you choose is fully staffed to meet your needs. There are not any perfect ratios out there, but if the solution you are considering has more than a 50:1 ratio (50 properties for every employee) you should probably continue your search.

5. Understand maintenance protocols. Every management company should document how they will handle maintenance within their Property Management Agreement. If they don't, you should be concerned. You'll need to understand when the PM must get your approval for maintenance, and how you will be notified when maintenance occurs.

Conclusion

Having read through this eBook, you may be feeling a little overwhelmed and less excited about owning rental real estse.

Our goal is not to scare you or discourage you in any way, but to educate and inform you about what you're getting into.

There are a LOT of moving parts that come with being a Landlord, and we want to ensure that you're set up for success.

Whether we manage your property or not, we're here as a resource and have a lot of advice and experience to share.

Good luck on this endeavor!