THE DEFINITIVE GUIDE TO INVESTING IN CENTRAL INDIANA

T&H REALTY SERVICES, INC.

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Introduction

By now, it's no secret that Indianapolis, Indiana is a premier market for rental property investments.

That's most likely why you're reading this in the first place.

Just as with any other market, there are specific factors and nuances that are important to be aware of as you begin your Landlording ventures in the Hoosier Sate.

Whether you're just curious to learn more, or you've committed to investing in this great city, you're about to find out everything you need to know to be a successful investor in Central Indiana.

In this guide, we'll cover the most important topics from start to finish and hopefully answer most, if not all of your questions.

Indianapolis Fun Facts

- Indianapolis is the 15th largest city in the United States with a population of 869,387
- The Indianapolis Motor Speedway is the largest sports facility in the world. It can hold more than 600,000 people
- Eagle Creek Park is one of the largest municipal parks in the States
- Elvis Presley's last concert was in Indianapolis three months before his death
- Indiana is the top popcorn producing state in the country
- Indianapolis native Albert Von Tilzer penned "Take Me Out to The Ball Game"
- Wonder Bread of Indianapolis became the first major company to commercialize and distribute sliced bread
- Sitting at a whopping 33, Indianapolis is second only to Washington D.C. for its number of war memorials and monuments.

Learn more about Indianapolis

Where to Invest in Central Indiana

This answer all depends on your investment goals.

Similar to other populated areas, Central Indiana has very diverse cities.

We have very old neighborhoods and we have newer neighborhoods.

Some areas in Central Indiana will have better benefits than others such as better cash flow, better appreciation potential, and/or less risk.

In general, Central Indiana is a great location for investing in the rental market.

Finding the perfect investment property can be tricky at times. Because of this, you'll need to do your own research as well in order to find a property that aligns best with your investment goals.

1 What to Consider When Purchasing a Rental Property

1) Townships: When choosing a rental property, it's important to understand the layout of Central Indiana.

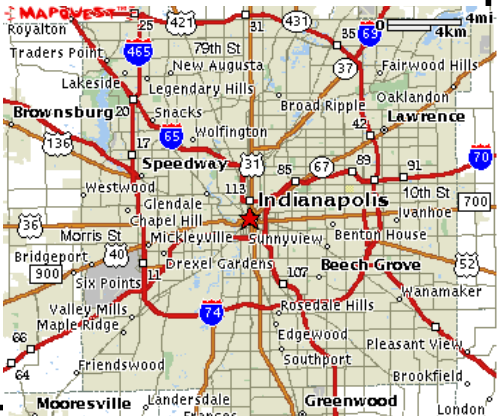
Surrounded by Interstate 465 (loop) there are a total of 9 townships. Inside the "loop" you will find most of the older homes while outside the "loop" you will find most of the newer homes.

2) Schools: A large deciding factor for most Residents are schools.

Having a property in a popular school district can help you when it comes time to finding Residents for your rental property.

3) Safety & Crime Rates: Safety is a high priority amongst many people. No one wants to live in a high crime area including future Residents.

Crime can also cost you a lot of money when it comes to stolen items and damaged property.



2 What Property Classes to Consider

Class "A"

Pros: Due to the newer property and high-quality amenities, Residents will usually take better care of the home and maintenance issues will be less excessive.

Cons: Due to the higher price, these properties don't off much when it comes to cash flow. Class "A" benefits are long-term appreciation

Class "B"

Pros: Due to the lower quality of amenities but the good condition of the property overall, "B" class properties have a more manageable price point.

Cons: Although these properties offer more growth potential, there still won't be an abundance of cash flow. The main financial benefit for these properties will be long-term appreciation.

Class "C"

Pros: With the lower price point of these properties, you are likely to see more cash flow.

Cons: The lower quality properties in class "C" are more likely to have Residents that cause problems along with having more maintenance issues. Long-term appreciation can also be affected by the location of these properties.

Class "D"

Pros: Depending on the location, these properties might be worth it for those who flip homes, but otherwise there aren't many pros.

Cons: Without experience and knowledge of how to handle these properties, there will be several headaches including excessive maintenance and difficult Residents.

Steps To Purchasing Your Rental Property

1) Contact a Realtor or Property Manager: When finding a Realtor or PM Company to work with, here are a few things to keep in mind:

- Find a Realtor or company who works in the area your rental property will be located
- Share your goals and questions
- Ensure they work with investors and understand your goals to better help you with your investment and overall portfolio

2) Begin your research: In order to find the best rental property for you, you will have to get your boots on the ground by doing the following:

- Pick out some properties you like
- Check out various neighborhoods
- Complete in-depth research
- Reach out to professionals in your area (i.e. other landlords)

3) Make a Decision: Making a decision on the best property for you can be difficult, so here are some things to consider:

- What is your budget?
- When do you want to see a return?
- What are the expenses?
- Is this location going to work best for my goals?

Speak with a Realtor

How Much Cash Flow To Expect

Now that you know a little more about Central Indiana, where you want to invest, and what type of home you want, it's time to get into the nitty-gritty topic of how much money you can expect to pull in.

Many investors have decided to invest in Central Indiana because it's considered a "Cash Flow Market."

Note: *Indy is not a market, like in coastal cities, for example, that sees a dramatic increase in property values, but we are considered a stable market that produces 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

Learn More About Cash Flow

Factors to Consider When Assessing Cash Flow

1) Always budget for vacancy: Vacancy is a cash flow killer, so it's important to keep your Residents happy and avoid the one-year-and-out scenarios. At least 10% or more should be budgeted.

2) Cash flow will not be evenly distributed: When we say that investors here in Indianapolis expect $100-$200 per month in income, we don't mean that they will receive that amount every single month. Cash flow can vary significantly from month to month and from year to year depending on factors such as maintenance.

> *Generally speaking, you should budget 10%-15% of your income toward maintenance costs for a newer home in relatively good condition. For older homes, you should budget closer to 20% or even higher in very old homes.*

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, it's important to have a fudge factor line for your expenses. As a suggestion, any money not used should be added to your reserve for any unexpected expenses or capital improvements.

4) Cash flow is just one analysis: Clearly, cash flow is a very important model to use, but it doesn't take into account several key components out there that are very important to consider in real estate, such as loan pay down, market appreciate and tax savings.

Cash On Cash Return

As you probably know, cash-on-cash is simply the annual pre-tax cash flow of a property divided by the actual cash invested.

So, for example, let's say you buy an $80,000 rental property and your total cash out of pocket to purchase the property is $16,000.

During that first year, after receiving your rents and paying for all your operating expenses, including your debt service, your cash flow, before taxes, is $1,500.

Your cash-on-cash return, in this case, $1,500 divided by the $16,000 investment, or 9%.

Learn More About Cash on Cash Return

Variance of Cash On Cash Return

Now, keep in mind that cash-on-cash can vary significantly from year-to-year.

For example, say in that 2nd year of owning the $80,000 property, you have to replace the furnace, and say that costs $2,500. In this scenario, your cash-on-cash return in that 2nd year will likely be negative.

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.

Five Profit Centers of Rental Real Estate

Owning Rental Real Estate can provide you with more financial benefits compared to other investment strategies.

Cash Flow: Cash flow is the total amount of money left over after everything is paid.

It can be calculated by taking the total monthly income and subtracting the total expenses, fees, payments, and vacancy losses.

Tax Savings: The tax benefits you can receive as a real estate investor are incredible!

- **Annual Depreciation:** Since the IRS assumes that your property depreciates over 27.5 years, or the property's "useful life," you are able to get a deduction on the cost of your assets
  - *Example: if you spend $150,000 for a property, you'll get a depreciation write-off of $5,454 each year which is about a 3.63% deduction*
- **General Operating Expenses:** All expenses included in your investment could be tax deductible such as maintenance, mortgage, interest, etc.

Five Profit Centers of Rental Real Estate

Principal Pay Down/Equity Building: The rent your Resident(s) pay each month can go towards your mortgage, so you could have your principal paid without any money coming out of your pocket.

Having your principal paid also increases your cash flow.

Home Price Appreciation: When purchasing a home, the value should increase over a period of time depending on the condition and location of the property.

Appreciation helps an Owner to receive a larger profit the longer they keep the property and if the Owner decides to sell, they will have a greater return.

Inflation Hedging: Unlike stocks and other similar investments, real estate can be protected when inflation increases.

However, there can still be risk in having a property as an investment. The amount of risk will depend greatly on the property you choose to purchase.

Learn More About The Five Profit Centers

Cap Rate

Another important metric to consider is the cap rate. This is simply the annual net income of a property divided by the purchase price.

Cap Rate = Annual Net Income / Purchase Price

For example, let's say you are considering a property that's listed for sale for $90,000.
You determine that the home will rent for $1,100 per month, so your gross income would be $13,200 per year.

To get your net income, you would simply account for your expenses, which could include:

- Property Management = $1,320
- Taxes = $1,800
- Insurance = $750
- Maintenance = $1,980
- Total Expense = $5,850
- Net Income = $7,350

Cap Rate:
8.2% = $7,350/$90,000

Cap Rate

Generally, anything in the 5%-7% cap range is a good cap rate for Indianapolis.

Some investors, especially those who are interested in buying in really nice areas, are settling for smaller cap rates.

As an investor, Cash flow, cash on cash return, and cap rate are some of the most important things to assess for your Indianapolis rental property.

It's impossible to know exactly how much money you'll make from year to year as there are many unexpected situations that can occur and lots of factors outside of your control.

However, if you know what to calculate and how to calculate it, you'll be better prepared for a successful investment.

What Are Possible Expenses

Expenses can be more difficult to understand because there can be all kinds of expenses to consider. Some of these expenses could include:

- Your Mortgage
- Property Taxes
- Property Insurance
- Preventative Maintenance
- Property Management fees
- Reserves for capital improvements
- Vacancy

If you choose to self-manage your home, you could run into additional expenses, including:

- Attorney fees to create a lease and consult on any numerous landlord-tenant issues
- Advertising fees
- Fuel to show the home and conduct move-ins/move-outs
- Postage

Keep in mind there will be other expenses as well once a rental property is purchased such as maintenance expenses, turnover costs, insurance, taxes, and other fees.

Rental Property Expenses

Estimating Maintenance Costs

For most homes that we manage, that are newer and considered to be in “good” to “very good” condition, we recommend budgeting 10% of gross yearly rent on maintenance. So if your property rents for $1,000 a month ($12,000 per year), you would need to plan for $1,200 in maintenance expenses annually, or $100 a month.

Of course, you probably won't see it happen at a perfect $100/month rate. Typically, you could go several months with no maintenance, then a $300 issue may happen. Seasonal changes, which we experience in Indiana, do cause more reported maintenance. After multiple years of owning and managing rental real estate, this is the method that we have come to use and feel is most accurate.

Turnover vs. Maintenance

It's also important to keep in mind that turnover costs and maintenance costs are not the same thing. Turnover expenses are incurred between Tenants (while you're getting the property rent ready) while maintenance expenses are usually incurred while there is a Tenant occupying the home.

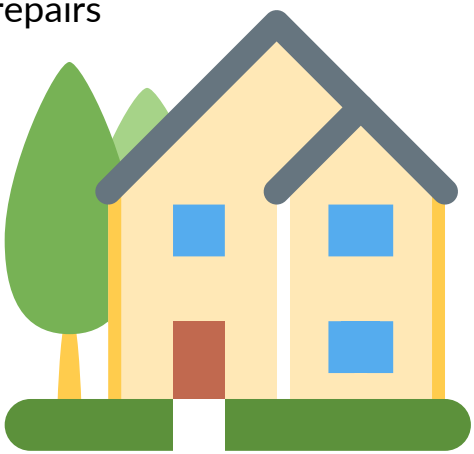
Maintenance Expense Variables

1) Age of the home - It's generally safe to say that the newer the home, the smaller the odds for things to break and go wrong. Vice versa, the older the home is, the more room there is for problems to arise.

Because of this, you'll need to budget accordingly.

Using our suggested method these percentages should be budgeted out of your gross monthly rent amount:

- Properties 10 years and younger should be within the amount of 10%
- Properties 10 - 20 years old should be within the amount of 15%
- Properties 20 years or older should be around the amount of 20% due to an increase in possible maintenance repairs



Maintenance Expense Variables

2) Quality of the Home - Not only do you need to consider the age of the home, but the quality of it as well.

There's a term in the real estate industry that you've likely heard: "Vinyl Villages".

Vinyl Villages are typically neighborhoods in suburban areas where lower-priced houses are built.

Many of these homes, particularly those built between 2000-2009, were built with low-quality materials and finishes, which has had a definite impact on maintenance costs.

We manage dozens and dozens of these types of homes and they generally have maintenance issues that an otherwise higher-quality home wouldn't have.

Vinyl Village properties can offer good cash flow opportunities, so we understand the appeal to purchasing them, but keep in mind you will most likely have higher maintenance costs.

Maintenance Expense Variables

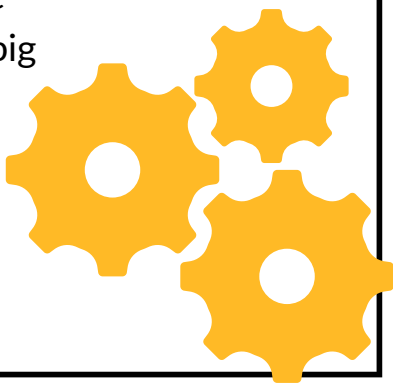
3) Size of Home - Larger homes have more square footage, more equipment, and typically more amenities that may need attention.

Therefore, your average maintenance and turnover costs will be more for a 4 bedroom 4,000 sq ft house vs. a 2 bedroom 900 square foot house.

4) Cyclical Nature of Maintenance - This is an age-old accepted concept, but you may not have thought about it in terms of budgeting for maintenance.

It's generally known that single-family homes are on 10-year cycles. Meaning, most major appliances, HVAC systems, roofs, etc., are only made to last around 10-20 years.

So, as your property ages, you'll likely conduct some replacement maintenance at these 10-year marks. These are usually big ticket items and can cost thousands of dollars. Don't get blindsided by these expenditures and keep this in mind when you're purchasing your investments.



Maintenance Costs

Importance of a Reserve Fund

If you're just starting out in the rental property business, establishing a reserve fund is mandatory.

Yes, mandatory. Many new Landlords think they'll buy a rental property and immediately start generating positive cash flow each and every month.

That is NOT the case.

Establishing a reserve fund is one of the single most effective things you can do as a new investor.

Here at T&H Realty, we preach to err on the side of caution when it comes to finances, and having a reserve fund is one way you can do that.

We suggest having at least 3 months of rental income saved up and 4-6 months is even better.

This gives you a cushion should some large, unexpected maintenance expense come up like having to replace the roof or get a new HVAC system.

Rental Property Maintenance Deductions

You can, in fact, deduct most of your maintenance expenses from your taxes each year or include them in the depreciation.

Let me explain further.

There are two classifications of deductions - business expenses and capital expenditures.

Business Expenses

These are usually smaller, less expensive repairs and maintenance such as fixing a toilet, replacing a dishwasher, or patching a hole in the roof. You can deduct business expenses from your taxes each year.

Capital Expenditures

These are larger, more expensive repairs and maintenance that overall improves the home and adds life and value to the property. This would be things like replacing the entire roof, purchasing a new HVAC system, or landscaping the entire property. Capital expenditures must be deducted proportionately over a long period of time. The IRS has specific rules and

Understanding Indiana Property Taxes

Although this might not be the most interesting topic, taxes are important to understand, and if you're investing in Indiana or you plan to invest here, you need to understand the property tax rules.

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 when it comes to taxes.

Simply put, we operate under a one-two-three tax cap rule. This means if the property is owner-occupied and there's a coveted homestead exemption on file, that person should pay no more than one percent of the assessed value in property taxes annually.

So, if that property is assessed at $200,000, the owner would pay a maximum of $2,000 under that tax cap rule.

Non-owner-occupied homes, or those that are occupied by Residents, without a homestead exemption on file, are subject to a two percent tax cap. So, that $200,000 Indianapolis rental property with a Resident in place would be subject to a $4,000 tax cap.

The third category is for commercial buildings like an office structure. Their tax cap is at three percent.

How Taxes Impact You

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

Most of the time, investors will buy a home with a homestead exemption on file.

And in many cases, the exemption will be with the home for the first year, which means the property taxes should be no more than 1% of the assessed value.

However, once the exemption falls off (and it always will) your tax bill will double.

Almost all of the investors we work with have dealt with this scenario, so it's important to know the tax situation when you buy the home and then plan accordingly.

Conclusion

In closing, Central Indiana is ripe for investing.

Equipped with the right knowledge and resources, you can be a very successful investor here. Hopefully, this guide was helpful and will aid you in your future rental property endeavors!

If you have any questions or would like to speak to a local real estate expert, please contact us.

We would love to hear from you and help out any way we can.

You can find all of our business information on the next page.

Contact T&H Realty Services