RentFax™

Rental Property Road Signs

10 Factors Veteran Investors Follow To Find Profitable & Stable Rental Properties

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Raise Your Rental IQ
by reading this report

If there is one thing almost all real estate pros can agree upon, it's that the list of factors contributing to a great financial outcome for a rental investment property is subjective and over whelming. We're in the business of helping educate investors, lenders, managers, agents and others involved in the selection and management of rental income property, so we'd like to change that. Here we share our favorites, having broken them down into two categories.

Selection vs. Management

The first category includes those circumstances, data, and decisions that occur prior to the acquisition of the property, i.e., SELECTION factors. These are the attributes of the property that are inherited; they generally cannot be changed by the owner, but can be evaluated and used to determine whether or not to proceed with the transaction.

The second category includes those circumstances, data, and decisions that take place after the acquisition of the property, i.e., MANAGEMENT factors. These latter attributes can be managed, fixed, or otherwise mitigated by the owner, provided the owner and/or its manager both: (a) recognize the issue and (b) make good management decisions based on proper collection of data.

In another report, we will look at the latter of these two categories, management factors. Here and now, however, we will adopt the perspective of a prospective purchaser, lender, or manager of investment property and focus on the criteria and methods of evaluation of rental property that pertain to selection of profitable deals.

The Top Twenty Percent

It's been estimated that 20% of rental property investors are responsible for 80% of the due diligence performed on available rental property. These "Top 20 Percent" investors have been taught, or learned through experience not only the extraordinary payoff of proper due diligence, but also the nuances, anomalies and secrets regarding which elements of due diligence are most cost effective at appropriate times during a deal and which have the greatest impact on the financial performance. Do you think this behavior pays off? You bet it does! Handsomely.

The rest of the investing population, the 'amateur' 80%, either fail to do much due diligence at all, or rely on advisors who themselves are deceptive, lazy, or simply under-educated with respect to the critical factors influencing rental property performance. Furthermore, and unfortunately, many advisors are compensated only by the closing of a transaction, thus placing their counsel and judgment at odds with the interests of the investor, lender, manager or other affected parties.

Add to this mix the growing number of investors going beyond their backyards (i.e., out of state) into locations about which they know very little, and we fear these circumstances may have cooked up the perfect storm. Without widespread education, understanding and use of available tools and data, and the adherence of the real estate professional community to a higher standard of ethics and accountability, we may soon face a wave of rental property investing catastrophes of epidemic proportions.

You don't have to become rental property road kill. Read this short report and apply the information contained in it. You will catapult yourself into the top 5% of those involved in rental property and almost certainly improve your rental investment returns!

1. A thorough professional evaluation of the property's PHYSICAL STRUCTURE

This factor probably comes as no surprise. Attributes of the physical structure drive income performance in three areas: maintenance (repairs), capital expenditures (major system replacement), and operating costs (heating and cooling efficiency, insulation efficiency, plumbing leaks, etc.) Construction material and quality, age, deferred maintenance, systems at the end of their lifespan, and general observable conditions all contribute to financial returns.

However, what else about the physicality of the property affects financial outcome?

For one, take the homogeneity of building types in the neighborhood. This has been found to correlate with rental property performance. If buildings in the area consist mostly of a single type (e.g., single family homes) that matches subject, this bodes favorably in income stability. If not, this diversity of structure types is a negative influencer on income stability of the unit. Yes, a mix of multiunit and commercial buildings in the area will drive down stability of rental income. Wide diversity can be a negative factor. What if the building is older / newer than neighborhood average age? This, too, can be indicative of rental property performance. If the structure is newer than the average, then take that as a positive. If not, again, potential performance is lower.

2. Knowing the TENANCY DURATION of the properties in the subject neighborhood.

Tenancy duration is defined as the length of time a tenant resides in one place. Does high turnover exist in this neighborhood? Demographic experts and professional property managers call this “mobility”, as it relates to the propensity for tenants in an area to move or change residences. Thus, tenancy duration is a “lifestyle behavior”. It is inherent to both the demographic and the desirability of properties in the area.

In addition to underlying demographics, tenancy duration is driven by 3 factors: desirability of both the product (quality of units) and location, (ii) quality of management services provided (customer service), and competitive pricing of units in the area (thereby creating a disincentive to move). Mobility or migratory behavior patters in neighborhoods can be measured and should be part of the property selection process. It is is a real value that can be measured, indexed and used decisions.

3. Knowing the VACANCY DURATION of the area and surrounding units.

Vacancy duration examines how long the average stays vacant before a replacement tenant moves in. It is the corollary of, and exists independent of tenancy duration. Traditional measures of vacancy reflect the classic supply/demand model of rental analysis: how many units exist and what percentage of them is vacant at a given time. Most rental analysis includes a vacancy factor as a percentage of rents. Vacancy duration, however, reflects the reality of how this bears on the subject property: how competitive is the market as reflected by time to fill a vacancy? High vacancy duration means severe competition exists to get unit filled.

When looking at vacancies, there is often some correlation with tenancy duration, but it can vary widely. High absolute vacancy could occur for reasons unrelated to tenancy duration, such as a recent increase in supply. Examining how many similar properties have been on the market for the past 90 days will give you a measure of absolute vacancy and the competitiveness of the market, but only vacancy duration will allow you to accurately model financial performance of your rental unit.

4. Evaluating the NET MIGRATION into or out of an area during a specific period.

Net migration is the different between the number of immigrants and emigrants to an area over a period of time. It is the net result of people moving into an area less the number of people moving out of the area. This is measured at the MSA level; it doesn't apply at the neighborhood level. (Mobility is the neighborhood level migratory metric previously discussed). Net migration is tied to jobs, amenities, and other factors – generally the overall desirability of the MSA. Thus net migration will NOT be a selection factor between 2 homes in same MSA, but should be a serious consideration when evaluating properties in different MSAs.

5. Understanding the area's RENT AFFORDABILITY and where the subject unit ranks.

Rent affordability is a measure of the ability of area residents (with a measurable average income) to afford the average rent. It is based on demographics – in particular, income – and average rents in the area. Understanding area income and its relationship to rents in the area is of critical importance in both investment selection and management. Your decisions should consider the median per capita income of people attracted to live in the area. This measure also ties into the rent objective of investor – as well as how does the property rate in the range of rents. Is a high rent needed to achieve the financial goals in your proforma? What if this high rent objective is not supported by where this property sits on the rent curve for the area?

6. Determining PROPERTY MANAGEMENT MATCH: Quality, Availability, and Pricing.

OK, so you know what property management is, but haven't examined putting those other words behind it. Quality and Availability go hand in hand. Does quality property management exist – in sufficient quantity (availability) - in the area you're considering for investment? Management matching on acquisition addresses the question: will you be landlording, hiring a professional manager, or hiring a direct employee to manage the property? This criterion involves assessing a good match for the property, area, as well as owner attributes and attitudes. For example, an out of area buyer in urban core of another city needs a different type and quality of property manager than a local investor who might manage the property himself.

7. Understanding and evaluating **TOTAL COST OF TENANCY** for your residents.

Total cost of tenancy is a concept that landlords must look at all costs of a tenant's choice of residence, including utilities, distance to and quality of shopping amenities, length (time) and cost of commute and commutes, distance to city center, drive times to areas of economic influence. Rents exhibit a tendency to drop with distance to all of these amenities.

For example, poor windows or insulation are not only physical structure concerns, they drives up utility costs resulting in higher income volatility and eviction probability. Section 8 looks at this, why not you? Newer homes are often built on the fringe suburbs of established MSAs: maintenance will be lower but the additional drive time and cost is weighed by prospective tenants and factored into total cost of tenancy. Lastly, it is a little known fact that when gas prices rise, vacancy durations go up and rents drop on properties more distant from amenities.

8. Assessing the CRIME RATING

Types, incidences, and density.

Crime ranks high on everyone's list of critical factors when selecting where to live- or should we say where not to live. The nomenclature "War Zone" comes primarily from designation of areas where crime – including violent crimes, is significant, thus making the area undesirable and making it difficult to attract quality tenants, driving down rents. While property crime (theft, vandalism) may more directly affect a property's P&L, other crimes affect desirability, which in turn affects rents, tenancy duration, vacancy, and income as a whole.

Public availability of crime statistics has blossomed with the emergence of the world wide web, and the Internet is chock full of websites where this data is not only available, but sliced, diced and presented in more ways than you can imagine. In Florida, for example, you can pull up the names, addresses, pictures, and rap sheet of every convicted sex offender in any given zip code. That's getting a bit granular, but you get the idea. The challenge is, as with most data, finding a reasonably presented summary in a way that is immediately useful without additional analysis.

9. Evaluating the SCHOOLS
Location, Number, Size, Quality, and Budgets.

Unless you're investing in student housing or senior housing, most tenants falling somewhere in life between those two stages place great value on the number, quality, location, size, and budgets of primary schools in the area. As a result, these statistics have significant impact on the desirability, and thus rents and stability, of a property. Quantifying this measure alone is a challenge, let alone factoring it into a host of other influencing data points.

Of those school-related factors, quality and location are foremost on tenants' minds: they want good education for their children without taking on significant logistical burden. School budgets are often an indication of quality, but are often unavailable at a level of detail to the individual school level (often at the county level only). Fortunately an entire genre of school rating systems and websites has evolved to help the average person make sense of school quality.

10. Evaluating the property's

EXPOSURE TO CREDIT LOSS and/or eviction.

We saved the silver bullet for last. At the end of the day, the stability or volatility of your property's income stream is the single most important predictor of profitability or problems. In fact, ANY non-agreeable departure of tenants is the single most costly event in the ownership of rental property. Not only does it manifest in a lack of income, it likely adds significant expense (damage, legal, etc.) to your pro-forma and actual returns. Vacancy is bad enough, but when you add legal expenses and property restoration costs it can wipe out 2-4 years of rental net income.

Tenant screening (credit scores, rental history, income, etc.) has been around for decades. It has become easier and easier for smaller landlords to get access to this tool to reduce risk. Only recently have analytics and metrics emerged that create the opportunity to examine credit loss exposure on a geographic basis – that is, at the neighborhood or street level. Availability of more data, greater demand, and ever-increasing computational power have driven the availability of predictive analytics that can actually rate a property for its credit loss stability.

What is RentFax™?

Rentfax produces data and a suite of rental analysis tools that makes property evaluation and management decisions easier and more profitable for investors, lenders, agents and managers. RentFax offers 3 core reports, available individually or in bulk, depending on volume, screening processes, and budget. Here is a quick overview of the current toolset:

RISC Score™

The Rental Income Stability Composite (RISC™) index comes as close to a "one number" data solution as exists in the market today. RentFax has distilled more than a dozen individual factors into a single number that provides a measure of relative stability of the subject property's ability to generate income. ***Think of it as a FICO® score for rental property – available in seconds.***

Rent Radar™

Proper financial analysis starts with accurate rents. Not only does Rentfax give you up to the minute data on rents in the area, with high, low and median discrete rental amounts, but it goes further. Rentfax's presentation of comparable rents is completely transparent, showing you the actual units used to derive the rent figures. Rent Radar carefully adjusts each comparable for square footage and amenities (bed/baths). ***Rent Radar offers an unparalleled understanding of how a rental property's ability to generate income compares with the competition in the area.***

Real Results

In the final analysis, all the factors you can consider must find their way into a single analysis of the expected results. However, building a rental proforma is tedious enough without having to go find all the necessary data, too, so the Real Results module gets the data and builds the proforma for you. It pulls actual property taxes, insurance quote, even vacancy and property management estimates to generate a rental proforma for any subject property in seconds. The RentFax income analysis features a simulation that runs 10,000 possible outcomes using real data points across most of the variables discussed in this report.

This creates a profoundly robust and accurate model of the income potential of a rental property unavailable anywhere else!

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