Is a rental home a good investment? In most cases, they're not for making money | Podnos

NEWS

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For FLORIDA TODAY

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Q: I’m trying to figure out if my rental house is a good investment or not — how do I do this?

A: I contacted you for the facts about the home and let’s discuss them in detail here. You told me that you own the property free and clear (no mortgage) and that it will sell easily for about $300,000 (net after expenses of sale).

Your renters are paying what you consider a fair market price of $2,600/month. Your property tax is about $4,000 a year and your insurance is currently $3,500. So, net income per year is $23,700 after these two costs.

Now let us add in probable expenses such as replacing hot water heaters, air conditioners and the roof every so many years. Let us call that at one percent of the value of the home (that's a low estimate). Now let's assume that there are also unexpected repairs such as the sprinklers breaking, plumbing issues, electrical issues etc. We'll add another one percent a year to this assumed cost. Every so often, you will most likely need to upgrade the kitchen, paint walls (especially between tenants), replace cabinets and flooring. Let's budget one half percent a year of the home value.

After we subtract these almost certain expenses, we are down to $16,200 in net income. It is reasonable to knock off some more presumed income due to no rent between tenants (and keep in mind the possible cost of tenants not maintaining the property and even needing to be evicted).

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Let's assume that nothing bad happens and you get the entire $16,000 a year income after the mentioned expenses.This works out to be a five percent return on the value of the home.

A large unknown in total return for owning this home is whether the value of the home itself increases or decreases over time. Nationally, residential real estate appreciates at less than the rate of inflation. Unless you are lucky or smart in where you buy, appreciation is unlikely to add to the value of the overall investment return.

So, you are getting a five percent return in exchange for owning an illiquid property (you cannot get your money out quickly). It is subject to expensive "surprises" of various types and will certainly take up time to deal with tenants and problems at the property.

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I’ve ignored some tax advantages such as depreciation, but you will have to pay this back eventually if you sell the property before you die. Considering that you can buy a bank CD that will pay you almost the same return, I’d say that your rental home is not a good investment. We see the same with most rental properties that families we work with and rarely think it’s a good choice.

Consider even your own primary home. I’ve lived in mine for over 35 years. It has perhaps doubled in price compared to its initial cost. That’s about a 1-2% return per year, well below inflation. So, in most cases homes are for enjoyment and security and not for making money.

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