

How to Get Rich *Slowly* in Real Estate

By

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I started investing in residential real estate in Champaign over thirty years ago, and I've been an owner and manager ever since. Owning and managing rental property is one of the few ways I know that ordinary people can accumulate wealth into the millions of dollars during a 15 or more year term. I call this "How to Get Rich *Slowly* in Real Estate."

The first step in this process is to select homes which are going to be to highly marketable to potential tenants, and which will appreciate at rates in excess of market averages during your holding period. These homes will be located in popular neighborhoods, and will be fundamentally sound with respect to quality of construction and floorplan configuration.

The second step in the process is to improve the homes as necessary to ensure that they will rent at the upper end of a reasonable range for that type of property. For example, if you expect a holding period of 20 years and you purchase a home with an old kitchen, now is the time to install a new kitchen. The new kitchen will help the home rent quicker and at a higher rate and it will last at least 20 years.

Next, it is critically important to maintain the home in top condition at all times. This will increase the likelihood that the home will remain attractive to good quality tenants, and that it will continue to rent for "top dollar." Moreover, diligent maintenance typically reduces the chances of more significant repairs in the future. For example, when siding needs to be stained, we want to stain it now before we start needing to replace damaged wood. Another benefit of diligent maintenance is that it is an important service we provide to our tenants, and it helps improve the quality of our relationship with our tenants.

Finally, it is important to keep the home rented to high-quality tenants, tenants who want to live in a home which is in great condition and tenants who will be motivated to work with us to keep it in that condition. We work very hard to carefully screen tenants, not only for this history in taking care of rental property, but also for their ability to make timely rent payments.

Now, let's look at how this process creates success for the homeowner. First of all, with current interest rates in the range of 4%-4.5% for rental property and with current prices still below historical levels, most rental properties will produce a moderate positive cash flow. Secondly, due to the relatively strong nature of our rental market, we are typically able to raise rents in the range of 2%-5% per year. At the same time, your fixed-rate mortgage payment is never going to increase for the life of the loan! Real estate taxes, and operating expenses will be expected to increase, but the mortgage payment is the single largest monthly expense—and it's going to stay the same.

Secondly, while median prices fell in Champaign County from 2008-2011 by 8.5%, those values have increased about 4.5% since 2011. From 2000 to 2014, including the

“Great Recession” the median sale price in Champaign County has increased 31.6%, an average of 2.48% per year.

Assume that someone owned 10 rental properties collectively worth \$1,000,000 in 2000, and that they were mortgaged at 75% of value on 15-year term mortgages. The owner’s initial equity would have been \$250,000. For the sake of simplicity, let’s assume that all the cash flow from these properties was used to make capital improvements. Still, the value of the portfolio would have increased by \$316,000 in appreciation. At the same time, the mortgages would have been paid off. At the end of the 15 years, the owner’s equity in the property would have therefore grown from \$250,000 to \$1,316,000, a net increase of \$1,066,000. Sure there are risks—but remember that this analysis included the worst financial disaster of our lifetimes! Most of the areas of risk relate to poor property selection, or poor management.

Therefore, all of this is predicated on competent, professional management of the rental property—management which is based upon the principle which I have discussed in this article. Our commitment to each of our property management clients is just this: We will manage your home with same level of competence and careful attention to detail that we employ in managing the homes we own personally.