A landlord's dos and don'ts

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Several years ago, Bennie Waller gave a renter a discount on an apartment because he agreed to sign a two-year lease.

"Thirty days after he moved in, he got transferred, and he said, 'Well, I'm going to move out'," said Waller, 50, a real-estate professor who owns several rental properties with his wife in Virginia. He learned the hard way to add a cancelation clause. "If you walk away early, you can buy your lease out for three months' rent."

For Waller – and others who have taken the rental-property plunge – being a landlord comes with a sometimes steep learning curve. Sure, it can be profitable or it can be a way to keep a home or flat you don't want to sell just yet. But there's more involved than just purchasing a rental property and collecting a monthly payment, including finding and screening potential tenants, caring for the property itself, and handling maintenance and legal issues as they arise.

"People don't realize how much work it is," said Julia Chung, a financial and estate planner with Facet Advisors in Langley, British Columbia, in Canada. "I think a lot of people do it because they feel they understand real estate better than they understand the stock market, and I wouldn't say that's necessarily true."

It can seem like an easy game to play. In the US, a third of households are renter-occupied, according to the National Multifamily Housing Council. A quarter of households in the UK are renter-occupied, and about 30% of Australians rent. The numbers are even higher in Western Europe, where more than half of Germans and more than 60% of the Swiss are renters.

In other words: There's plenty of opportunity out there for the savvy consumer. The key word is "savvy." Do you know what you're getting yourself into? Here's the scoop:

What it will take: If you plan on managing the property yourself, you'll need to be comfortable with receiving calls at 2:00 in the morning when a pipe bursts, or tracking down a tenant when the rent is late. You must find and screen tenants, manage contacts and deposits, and maintain the property both when it's occupied and between tenants.

How long you need to prepare: If you have a financial planner, you will need enough time to consult with her, and you will need time to purchase a property for rental. Depending on your real-estate market, you may be able to do both in six months to a year.

Do it now: Run the numbers. Create a model of your finances with a rental property, including mortgage payments, insurance, property taxes and maintenance. Experts recommend setting aside 2% annually for maintenance alone. On a $300,000 house, that means saving $6,000 every year, just in case. "You never know if your renters are going to run out on you or if the roof will fall in," Chung said.

Also include occasional vacancies, and the costs of finding and screening applicants every time you must re-let the place. Decide whether you will manage the property yourself or hire a property manager, who will take 10% of your rental income. "How easily will you be able to pay your mortgage if the tenant stops paying their rent or you have an unexpectedly large repair bill?" asked Chris Norris, head of policy at the UK's National Landlords Association. At the end of your calculation, are you cash flow positive?

Do background checks. For every potential tenant, you should be checking credit, employment and referrals from previous landlords. "You need to hit all three checks for someone to come into a property that you own and live there," Chung said. "You can't have two that look great and one that's terrible." In many places, you can only access your property under certain conditions once someone is living there, so it pays to put the right people in place.

Treat it like a business. Some people get into the real-estate game thinking that they can purchase a property, rent it out, then sit back and relax. Not so, experts say. "Prospective landlords need to remember they are effectively starting a small business," Norris said. "The key to survival is maintaining a healthy cash flow."

Get the right insurance. In some places, such as the UK and US, landlords are encouraged to take out landlord insurance, which provides different protections than regular homeowner's coverage. In Israel, a standard insurance policy commits you to using the insurance company's maintenance contractors to fix any problems — but for a low fee, you can bypass that requirement.

“You can free yourself to use recommended local companies who will carry out emergency repairs more swiftly and professionally,” said Shaun Isaacson, CEO of Creative Estates Israel. Talk to an insurance broker about the right way to protect your property.

Hire a lawyer. For the first iteration of your leasing contract, have a real-estate lawyer help you draft it. “Don’t just print a contract off the Internet,” Chung said. “It might not be valid in your jurisdiction.”

Do it later: Stick to the contract. Does your paperwork state that there’s a late fee for payments that are more than five days late? Charge it every time. “Everybody’s got an excuse,” Waller said. “Everybody thinks you should make the exception for them, but you need to just live and die by the lease.” If you go to court, Waller said, the judge is going to ask whether you apply your policy equally to all tenants. If you do, you should have no trouble.

Go through your terms with each tenant in detail, and don’t be subtle about extra fees and late charges. “I’ve got it bolded, highlighted in yellow, and I make them initial the cancelation clause,” Waller said.

Don’t get emotionally attached. Being a landlord is not about making friends. Get chummy with your tenants and you may find that they think you’ll overlook late payments and minor damage to the property. “You have to go into it with the mentality that you’re not going to waiver under any circumstances,” Waller said. The more straightforward and business-like you can be, the more your tenants will respect your position and play it straight.

Seek professional tax help. There are things you can deduct and things you can’t, and you may pay taxes on rental income or capital appreciation, depending on where you live. “There are also tax implications around holding a property and exiting the property,” said Jarrod McCabe, associate director of Wakelin Property Advisory in Melbourne, Australia. It’s worth the money to hire an accountant or tax pro to guide you.

Have an exit strategy. Like any investment, you should have an idea of how long you want to own it and under what circumstances you want to sell it. And don’t forget, when you estimate your exit point, to factor in what you will pay a real-estate agent to sell the property—generally 6% of the sale price.

Do it smarter: Keep the good tenants. Turnover eats into your profits, and bad tenants are plentiful. If you find a good one, hold onto him. "The best way to keep good renters long-term is to allow them to treat the property more like their home," said Jim McClelland, chief operating officer at MACK Investments, which owns and manages more than 1,200 homes in the Chicago area in the US.

"Simple modifications, like allowing renters to plant a garden, put up holiday decorations, or paint the walls, go a long way toward making them feel at home," he said. You can always repaint when they move out, and the cost of that job is far less than having the property sit vacant.

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