Don’t Make a Profit, Make a Fortune

Buy & Hold Real Estate, the I-D-E-A-L Investment

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I hate playing coulda, woulda, shoulda but indulge me for a moment.

Sitting in front of my laptop in the late nineties I remember looking at $23 Apple stock. If we could go back in a time machine and buy Apple right after Steve Jobs came back to the company, would we? Of course! After a 10 to 1 split that $23 dollar stock would now be worth around $1,200 today. You can do the math: 1000 shares would now equal 1.2 million, 10,000 shares, 12 million. I don’t lose sleep over this “loss” because how could I have known that Steve Jobs would so masterfully turn Apple around? I had no control of what was happening inside Apple’s offices in Cupertino, California. (And this is the biggest problem with investing in the stock market.)

But here’s a situation I did control. I purchased a home in an upscale neighborhood of Portland, Oregon in the mid 1980’s for $60,000 and rehabbed it (poorly, I might add). I was just getting into real estate and didn’t have much of a game plan. Not wanting the burden of figuring out property management or how to finance another deal, I decided to sell it. (“Flip it” might imply I made a profit, so I’ll stay with “sell it!”) A couple named Michael and Julie bought it for $70,000 and lived there for four years. They ended up selling it for a loss at $66,000 in the depths of a recession in the mid 1980’s.

I found this out because thirty years later my wife and I met Michael and Julie on a fluke and they told me the story. But when Michael asked if I wanted to hear the rest of the story, I hesitated because I kind of knew what was coming. “Okay, tell me,” I finally replied. Michael simply said, “Nine hundred and fifty thousand dollars.” Even I was stunned. That house I sold thirty years earlier for $70,000 recently sold for $880,000 more than I sold it for! Congratulations to whoever made a whole lot of money. Of course, that whoever wasn’t Michael and it wasn’t me. What if, instead of selling, I would have figured out how to do property management and real estate financing, then doubled down, tripled down or better yet, have bought another ten, twenty or thirty of those Portland homes?

Of course real estate does not always go up as recent history has reminded us. Real estate prices are a function of supply and demand and are very localized when it comes to appreciation. There are a few areas in the country that my $60,000, early-80’s house would still be worth $60,000 today. But even in those rare places, it still may have been a great investment to have bought and held.

We can’t go back in time, but we are going forward. No stopping that. Do you think ten, twenty or thirty years from now that buy and hold real estate investors will look back with coulda, woulda, shoulda regret. I seriously doubt it. Why? Because simply put, buy and hold real estate investment is the **I**-**D**-**E**-**A**-**L** wealth building investment adding up to:

I-come / **D**-epreciation / **E**-quity buildup / **A**-ppreciation / **L**-everage

Before we get into these IDEAL advantages, let’s take a look at the fix and flip model. There are benefits to fix and flip too and, if we understand them, they will shed further light on just how good the buy and hold strategy is.

The Benefits of FIX and FLIP

Cash Now: When you get good at fix and flip (and, like any endeavor, it takes work and experience to excel) you can make 10- 30% of the properties' original cost. Putting $10-30,000 or even more into your pocket two, three, or more times a year adds up to a pretty great income and all the time you get to be your own boss. If you look at this as a game of getting the best ROI (return on investment) flipping can produce a very high return.

Limited Risk: As recent historical experience has reminded us, real estate does not always go up. Over time real estate follows inflation but if you are in a down cycle, flipping properties protects you from the downside.

Less Financing Pressure: If you can find a source of cash and you are successful at flipping, that cash can be "re-circulated" time and again without the need to look for further cash sources. This allows you to focus on finding and flipping for the highest returns.

No Property Management: There are no tenants, termites or toilets and thus no need to find competent property management (no small task) or to build a competent property management company yourself (also no small task). Management, maintenance and tenant-landlord legal issues can eat up lots of time, energy and profits if not done well. Even when done well you can sometimes end up with high turnover costs and unpaid damages or rent. Again, consistent, expert property management is no small feat, but the only way to reliably extract income from your rental assets.

Focus on Good Deals: Flippers know that margins can be thin and that any number of "soft costs" can eat into their profits. This often forces them to get the best deals possible. So they are always looking for motivated sellers, negotiating the best possible deal, keeping their hold times to a minimum in order to maximize their profits and move on to the next flip. The pressure is on from start to finish… and that's a good thing.

Breadth of Market: There are higher-end homes and expensive locations (e.g. San Francisco or Honolulu) that will never cash flow for a buy and hold strategy but conceivably you can flip any property in any location for a profit. Buy and hold investors who purchase such lower ROI properties may do so because they have plans for a large value add or because they believe the property/location has a significant upside with appreciation in the future. Normally however, higher end markets are not as conducive to a buy and hold strategy as they are to fix and flip.

The IDEAL Benefits of BUY and HOLD

We're inundated with "Flip This House" type TV shows which interject just enough drama to keep our interest. "Hold This House" just doesn't cut it for spell-binding television. So fix and flip has its advantages, (especially when it comes to reality TV) but does it hold the advantage when it comes to reality itself?

I'll admit bias. After my dismal real estate experience in Portland, I started up again buying real estate in Eugene, Oregon in the late 80's with a buy and hold focus. With the winds of appreciation filling my sails I was able to build a fortune relatively quickly from buy and hold which would have never happened with a fix and flip strategy. For me, as it has been for so many others, buy and hold proved to be the **I**-**D**-**E**-**A**-**L** real estate investment.

I - Income: Residual income amounts to positive cash flow on autopilot, whether you put time into hustling for the next deal or lying somewhere on a beach. This is the goal of the buy and hold strategy, to provide you with a reliable stream of income that is not contingent on working. The challenge is to keep financing properties at 100% (or nearly 100%) and manage them so that the rental income exceeds the expenses. Obviously the more properties producing positive cash flow in your portfolio, the greater your monthly income becomes. There are many real estate buy/hold investors who would never have to work another day in their lives if they chose not to.

D – Depreciation: One of the cons of flipping is that it produces taxable income at ordinary rates whereas holding real estate can allow you to have an income and yet show a loss on your taxes from depreciation. The IRS allows active real estate investors to depreciate the value of a property over 27 and a half years, and those "losses" can count against both rental income and other earned income as well.

Thus, real estate can provide a reduced or nonexistent tax burden. When a property is sold, its depreciation is "recaptured," but even still, this is taxed at the capital gains rate (if the property has been held for at least a year) which is substantially less than the regular income tax rate. And it gets better still because such taxes can be deferred with a 1031 exchange. A 1031 exchange allows an investor to sell one property and roll the taxable gain into the new property.

Or instead, you can just hold the property for a lifetime and pass it on to your heirs or a charitable cause. If properties are passed on to heirs they receive them as if they have not been depreciated at all (at zero tax basis). Federal inheritance tax law currently allows 5.4 million dollars (or 5.4 million from each spouse via a trust) to freely pass on to heirs. (State laws vary.)

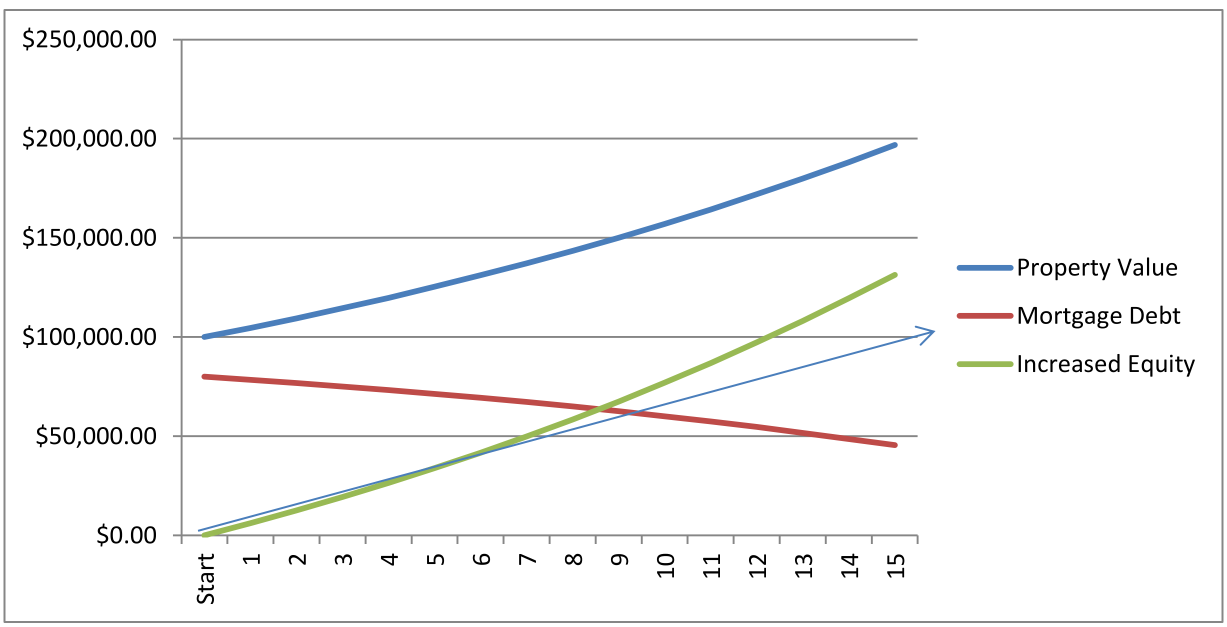
When you refinance a property, because the capital you pull out of the property is a loan, it falls under the mortgage interest deduction and is also not taxable. Refinancing can provide a very high ROI or even an infinite ROI when all the down payment and rehab funds are received back in the refinance. Refinance can, in effect, leverage the leverage!

E: Equity Build Up: Like an annuity, real estate provides a monthly cash flow, but unlike an annuity, your equity in the property goes up over time, not down. Unless the mortgage is interest only, each payment made on the loan cuts down the principal. Effectively you are using rent to pay off the mortgage. Amortization tables are a thing of beauty to a buy and hold investor because each and every month they get closer to owning the property debt-free. And then the cash flow increases drastically. Or, along the way, the investor can refinance and pull out a large chunk of that equity in cash. So, if you have a $120,000 property fully financed at 5.5% interested over 30 years you would have paid off $9,047 in 5 years and $20,951 in 10 years.

A – Appreciation: Between 1975 and 2014, real estate went up an average of 4.62% per year (significantly more than inflation) in the United States according to the Federal Housing Financing Agency. And while the financial crisis of 2007 has made it all too clear that prices can also go down, the long term trend is up. Furthermore, real estate's prices are not generally as erratic as the stock market.

Even if real estate only went up with inflation, the power of leverage (to be discussed shortly) makes it all worthwhile. For example, if you have a $100,000 house and both inflation and appreciation are 2%, it will be worth $102,000 the next year. But if you only put $20,000 down, that amounts to a 10% return, which is five times higher than inflation!

L – Leverage: The reason that real estate is the only likely investment option that can make a person of average means wealthy is because of the last word in I-D-E-A-L: leverage. When you use only a small portion of your own funds: 25%, 15%, 5% or even less and you finance (use other people's money) the remainder of your purchase and upgrade, you have put in a relatively small percentage of your own capital and yet realized 100% of the upside. So for example, if you buy a property with 20% down and the property goes up 5%, you make 25% because the property is worth five times more than what you personally put into it. Of course, leverage can come with risks, but real estate comes with the advantage of being a tangible asset. People will always need housing, which helps mitigate the risk. Furthermore, if properties are bought correctly, the risks are mitigated all the more.



	Start	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Property Value	$100,000.00	$104,620.00	$109,453.44	$114,510.19	$119,800.56	$125,335.35	$131,125.84	$137,183.86	$143,521.75	$150,152.46	$157,089.50	$164,347.03	$171,939.87	$179,883.49	$188,194.11	$196,888.67
Mortgage Debt	$80,000.00	$78,466.49	$76,846.47	$75,135.07	$73,327.14	$71,417.22	$69,399.57	$67,268.11	$65,016.41	$62,637.71	$60,124.82	$57,470.19	$54,665.82	$51,703.26	$48,573.59	$45,549.00
Increased Equity	$0.00	$6,153.51	$12,606.97	$19,375.12	$26,473.42	$33,918.13	$41,726.27	$49,915.75	$58,505.34	$67,514.75	$76,964.68	$86,876.84	$97,274.05	$108,180.23	$119,620.52	$131,339.67
Percent Return	0.00%	30.77%	31.52%	32.29%	33.09%	33.92%	34.77%	35.65%	36.57%	37.51%	38.48%	39.49%	40.53%	41.61%	42.72%	43.78%

As an example of how this process can work, say you buy a property for $100,000 with an 80% LTV (loan to value) loan at 5.5% interest to be paid back over 25 years. So you put in $20,000 as a down payment. And let's assume that the market appreciates at its 30 average of 4.62%. This is what that will look like:

As you can see, the equity you have in the property (over your initial $20,000 investment) goes up exponentially. By year 5 you've made $34,000. By year 10 you've made $77,000. And by year 15 you've made $131,000. The annualized return on your investment starts at 30.77% (not bad by itself), but by year 15, it has gone up to almost 45%!

And that doesn't even include positive cash flow!

And it assumes the property was only bought for market value!

Okay, What's the Downside of Buy & Hold?

Buy and hold is no get rich quick scheme. In fact, I would refer to it as the ultimate get rich slow scheme. And like all good things, there is always another side of the coin. Buy and hold has its disadvantages as well, which include:

1) **Cash Intensive:** Buy and hold usually requires money and this can be difficult for a beginner or even a seasoned veteran sometimes (more on this to come).
2) **Risk**: Even though real estate is a tangible asset that humanity will always need, being leveraged means that if prices go down, you can lose your equity very quickly. The financial crisis of 2007 made this all too clear.

3) **Property Management:** Dealing with tenants can be a hassle and finding the right property management company is not an easy task. And regrettably, rental properties do not cash flow particularly well without tenants.

Fortunately, these issues can be overcome, or at least mitigated, by only investing in good deals and making property management a priority.

Buy and Hold Fundamentals

Unless one starts off rich, there really isn't any way around it; to become a buy and hold investor is to master deferred gratification. I've known a good number of buy and hold investors and every single one of them started off (and remained for some time) quite cash poor. In the end, this strategy creates incredible wealth, but that process takes time. If you want to focus on flipping and hold a property here and there, yes, it is possible to make a lot of cash quickly. However, if buy and hold is to be the cornerstone of your business, most of your excess money will almost certainly be tied up in the equity of your investments and a reserve for capital expenditures (i.e. a roof needing replaced). Disposable income is not a luxury many buy and hold investors have early on.

It is vital to play the long game. With buy and hold, time works in your favor in an unmistakable way. Patience may be a virtue, but with buy and hold, it's THE virtue.

In addition, it is absolutely vital to see real estate as a business and not as a hobby. This goes for flipping too, but it is especially true for buy and hold. I used to meet tenants at the Wendy's next to my home as my de facto office. This is because it is vitally important to keep the personal and business separated. Tenants who become friends have a habit of not paying their rent. Furthermore, a business requires polices that you can fall back on. With every part of buy and hold—acquisition, finance, rehab and management—policies and procedures will save time and energy (making decisions has been proven to drain your willpower) and will allow you to not be the bad guy by pointing to said policy.

Successful investors must fully commit to being investors, even if it’s part time. Buy and hold may be extremely lucrative, but it certainly is not easy.

The Difference between Acquiring to Flip and Acquiring to Hold

Whenever one is buying real estate as an investment, the goal is always to get a good deal. In Gary Keller’s great book *The Millionaire Real Estate Investor*, he recommends getting properties at 70% market value for flips and 80% for holds. I would hesitate to even make that distinction. Every deal you buy should be a good one, whether you hold it or not. Deals with lots of equity make exit plans and contingencies a simple matter. It allows you to get out of any deal without losing your shirt if for whatever reason you need to.

Getting a great deal up front mitigates much of the risk that comes from leverage. As stated above, if you buy a property with only 20% down it goes up 5%, you’ve made a 25% return. However, as you probably figured out, if it goes down 5%, you’ve lost 25% of your down payment. But let’s say you bought the property for only 70% of its market value and the value goes down 5%. Well you still have a 25% equity cushion, so what does it matter?

In fact, one of the biggest risks to the buy and hold investor is that there is no feedback mechanism. A flipper will know exactly how well she did based on how much of a profit she made when everything is said and done. The best lessons are always experience, so if that profit is low (or negative) steps can be taken to adjust the purchasing strategy and criteria.

With buy and hold, there is no sale. There may be an appraisal, but it's not the same thing (appraisals also have the uncanny habit of coming in very close to the purchase price most of the time for reasons I will leave to the reader to come up with). This can lull buy and hold investors into a false sense of security. They may think that as long as a property cash flows, it works. That may be true in the long run, but it leaves the investor open to short term fluctuations and radically increases the risk of the investment. Buy and hold investors who bought at 70% market value in 2006 could weather the storm of 2007 and 2008. Buyers who bought at market value generally could not.

Do not fall prey to this trap. Make sure to value each property as you would if you were doing a flip and use the same general principles when purchasing (with a few exceptions to be discussed below). One very good method is the 70% rule which states:

Purchase Price = 70% After Repair Value – Cost of Rehab

For the flipper, this leaves plenty of room for the real estate commission, holding costs, closing costs and of course a nice healthy profit. For the buy and hold investor, it leaves a safety-insuring equity cushion to help you sleep at night knowing your investment is secure.

However, there are some things that are different about buy and hold and flipping when it comes to analyzing a deal.

1) **Locations and Price Points**

There is no fixed rule here, but usually a flipper will look to buy and sell properties over $150,000. This is because the margins can get too tight in the lower range. However, it's usually best to take a step down when buying to hold. This is because rents do not go up as fast as prices do as you move into a higher end market. After all, houses worth $100,000 are sought after by more renters and less owners than houses worth $500,000.

The highest cash flow areas are usually working class and lower middle class, which is the best place to target. But while you don't want to be in too nice a market, you certainly don't want to be in a war zone either. Properties in bad neighborhoods can have extremely appealing prices (often less than $30,000 in certain parts of the country), but while the numbers look great on paper, that's often the only place they'll look great on. Unless you specialize in low income housing, it's best to stay a step or two above that. To find good demographic information, check out the following free websites:

- www.CityData.com
- www.CLRSearch.com

2) **Analysis**

While I said above that one should value a property similarly when acquiring to hold as when acquiring to flip, there are some additional factors to consider. Yes, we want to have a lot of equity in the property. But as a hold, it needs to cash flow well too. So there are three important yet simple calculations to analyze that:

i. **Rent/Cost:** Monthly Rent / Total Price of Property

   According to Gary Keller in *The Millionaire Real Estate Investor*, the national average is 0.7%. What you will look for depends on the area, but a good rule of thumb is 1.5%.

ii. **Cap Rate:** (Net Operating Income – Operating Expenses not including Debt Service) / Total Price of Property

   This is usually used for larger apartments. With houses, it has the disadvantage of being fairly ambiguous because there is rarely a trailing history for operating expenses and thus it is little more than an educated guess. Annual expenses usually run between $3000 and $4500 a year, but that depends very much on the quality of the management. Still, a 10 cap rate is generally a good number to shoot for.

iii. **Month Cash Flow:** Net Operating Income – Operating Expenses – Debt Service

   This one is simple, but probably the most important. Properties need to cash flow or you are going backwards each month. The goal should be to make at least $100 a month on each house or $75 a month for each apartment unit.

For a buy and hold property to make sense it needs to pass muster for both the equity position (at least 20% and preferably 30%) and the cash flow (at least $100/month).

3) **The Rehab**

There are two major rookie mistakes investors make when rehabbing homes; doing too little and doing too much. Buy and hold investors must find the 'Goldilocks Zone' and do rehabs "just right."

When I first started overseeing rehabs, I looked for the cheapest contractors to use the cheapest materials all while doing the bare minimum. We used builder's grade carpet, cheap vinyl, single tone, flat paint and the like. And it turned out about like you'd expect; houses were hard to rent, things kept breaking, only bad tenants wanted to move in, etc.

Then we learned our lesson just a bit too well and started putting in tile bath surrounds, granite tile countertops, stainless steel appliances, etc. The tenants loved it, but as one might expect, the rehabs started ballooning and budget after budget was ruthlessly destroyed.

Flippers need to make their houses shine; holders need to make them look nice. This is a key distinction. The aim should be for durability and function first, style second. Don't use builders grade carpet, because it will only last one turnover. At the same time, granite countertops will not increase the rent. Instead, Formica countertops, fiberglass tub surrounds and standard black or white appliances will all look just fine to most tenants outside of the highest end rentals.

Financing Buy and Hold Properties

Probably the hardest thing to do when it comes to buy and hold investment is financing. The best strategy of course is to start out rich. Unfortunately, that isn't an option for most of us. Furthermore, hard money loans are too expensive for buy and hold properties. No deal can possibly cash flow with interest rates of 15% or more. Luckily there are plenty of good ways to go about raising the necessary capital.

1. **FHA Loans**

There may be no better way to get started in real estate investment than through an FHA loan. You have to have a job, but the FHA will finance 96.5% of your purchase at a rock bottom interest rate. The only catch is it's only allowed for homeowners. Luckily, there's a caveat, namely an FHA loan can be used to buy anything up to four units.

So why not purchase a fourplex with an FHA loan, live in one unit and rent out the other three? What better way could there be to get started in buy and hold for almost no money down!

2. Save and Hold

Buy and hold real estate investors do not need to be full time investors (although they do need to be completely committed). One conservative approach is to use the disposable income from one's job to invest in real estate.

Let's say you have a job that makes $60,000 a year. At risk of stating the ridiculously obvious, some people make only $40,000 a year but somehow still survive. So why not live as if you make $40,000 a year and take the remaining $20,000 to invest in real estate. If your target market is properties that you can purchase and rehab for $100,000, that would generate enough for a down payment each year to buy a new property.

3. Flip and Hold

There is no law saying that flipping and holding are mutually exclusive. Indeed, this is probably the safest and most effective way to get into holding real estate as a full time investor. So for investors who are flipping, why not hold every 2nd or 3rd purchase. For example, you can use the profits from flip 1 to live off of and the profits from flip 2 to finance the acquisition of a property to hold. Rinse and repeat.

4. Creative Financing

There are a myriad of creative ways to finance real estate. There is no reason not to have these as part of your arsenal when looking for buy and hold rentals.

> **i. Seller Financing:** Sometimes, especially if a seller is properly motivated, he will lend you every cent to purchase the property, or at least a large portion of it. This may not cover repairs, but it will still drastically reduce the cost to get into a property. You can often negotiate good terms; say 6% interest only, which will allow the property to cash flow. And many times sellers won't even mind holding the note for a long time as they like the cash flow it provides.
>
> **ii**. **Subject To:** One creative way to purchase a property is to buy it "subject to the existing financing". This transfers the deed into your name, but leaves the loan on the

property. The seller is thereby still on the hook for the mortgage, so to convince a seller to do this you must build a lot of rapport. They are trusting you to pay their mortgage, so it is critical to come off (and be) trustworthy.

Technically, this violates the 'due on sale' clause in virtually every mortgage. So a bank can call the note due, although very few do because banks are interested in getting paid more than anything else. But you should disclose this risk to the seller and have enough equity to be able to sell if need be. In addition, the laws vary by state, so check with an attorney before doing one of these.

iii. Lease Option and Land Sales Contracts: Both of these give you control of the property (and an equitable interest in the case of land sales contracts). These tools can allow you to lease out a property you technically don't own. They still cash flow all the same.

(For more on this subject, see *The Book on Investing in Real Estate with No (and Low) Money Down* by Brandon Turner.)

5. Private Loans

This is the method we use at Stewardship Properties. We fully finance our acquisitions (purchase, closing and rehab) with 9% interest only loans to various ma' and pa' investors. These people could be doctors or lawyers who are sick of making 0.2% in a CD. Or they could be retired school teachers, insurance agents or the like. Never assume someone doesn't have money they are looking to invest.

Properties in many markets simply won't cash flow at 9% interest, but in working class and lower middle class areas in many Midwestern, Southern or small towns, they can. For example, we're all into a house in Kansas City, Missouri for $50,000 that rents for $825/month that we fully financed at 9%. The numbers work out like this:

Income: $9900 ($825 X 12)

Vacancy: $990 (10%)

Expenses: $3000 (approximate)

Debt Service: $4500 (9% interest only is $375/month)

Net Cash Flow: $1410

Or in other words, the house makes over $100 a month even with a 9% loan. But it gets even better. After the property had "seasoned" we were able to refinance it with a local bank at appraised value. For usually about a year, banks will only finance the property based on the cost you have into it. Afterwards (when it has seasoned), they will go off appraised value. This property appraised for $70,000, so we were able to finance out the entire private loan with a 5.5% interest, 20 year bank loan. Now the debt service has been reduced to $344 a month or $4116 a year. We save an additional $384, making our net cash flow go up to $1794 a year or almost $150 a month. And right off the bat we're also paying $115 in principle each month. By the end of the first year we will have paid off over $1400 in principle. Putting that together with the cash flow and we have made just shy of $3000 a year on one property without factoring in appreciation and without putting a single penny of our money into it.

Unfortunately, people don’t just hand you their hard-earned money to do this. Private lenders, just like sellers, must trust you first before being willing to do business with you. Put together a business plan and if possible, several case studies of previous projects you’ve completed. Then prepare an “elevator speech” that is about one paragraph explaining what you do and what you offer. You can use this with anyone you introduce yourself too without coming off like a sleazy salesmen. For example,

> “Hi, my name is John Doe and I’m a real estate investor who focuses on single family homes and small apartments. My aim is to buy undervalued properties, fix them up and rent them out to quality tenants. We offer 9% interest loans for a period of one to two years for anyone who would be interested in lending to us.”

If they show any interest, invite them out for lunch or to your office if you have one. Show them your business plan and case studies. Drive them by any properties you already own. Answer all their questions and make sure to come off like you’re a professional who has done this before. Don’t be pushy, but do follow up. You will get plenty of no’s, but all it takes is a few yes’s.

6. Partners

Instead of finding many private lenders, it may be possible to find one person with a lot of money to partner with. You can also do this on a one by one basis, but that can create a lot of turmoil and can be very cumbersome. After all, partners often want to do different things, and unlike with lenders, a partner is someone who has a controlling stake in the property.

But if you can come across the Mr. or Mrs. Money Bags who wants to get into real estate but has neither the time nor inclination, a partnership may be the perfect solution. In this case, you would split the equity, perhaps 50/50 or perhaps 75/25 or something to that effect. You do the work, they provide the capital and thus it goes. Notably, to convince such a person to partner with you on a consistent basis will probably require a decent track record in either buy and hold or flipping. This is rarely a possibility for beginners.

A Note on Banks

One final note is that Fannie Mae will finance up to 10 investment houses for investors at solid rates. But after that, they won't touch you. This is a great way to start with the Save and Hold and Flip and Hold method, but after that, you will probably need to focus on local banks. They will be the best bet to secure additional financing after you've bought 10. However, their rates are usually a little higher and their amortizations are usually shorter.

In addition, an area that is often neglected by investors, but is critical for financing is accounting. Many years back our books were in poor shape and it made traditional financing almost impossible. After all, who is going to lend to you if they can't make out a good financial picture of you? Do not neglect book keeping. If you get big enough, you very well may need to hire someone to do this. And when you do, make sure that person is keeping everything in good order.

To Manage Yourself or Hire a Management Company, That is the Question

As stated above, one advantage to flipping is it involves a distinct lack of tenants. Buy and hold may be a great way to wealth, but it is only through tenants that you can get there. The question then becomes; should I manage myself or hire a management company to do it?

My personal sympathies lie with managing yourself and eventually setting up your own management company. This is likely a personal bias, though, as we've had some bad experiences with management companies that let properties get run into the ground. I have seen other investors be successful while using a management company, so there's no one way to do it. Here are the pros and cons to each approach:

Advantages to Managing Yourself

1. **Control**

It's a lot easier to make decisions and implement them yourself or through your employees than it is through a third party.

2. **Save Money**

Management companies generally charge 10% of collected income and the first month's rent for each new tenant. This expense obviously doesn't exist if you do it yourself.

3. **Gain Experience**

It is extremely important to know the ends and outs of property management even if you are not the one doing it. It's much easier to evaluate how well others are doing if you know how to do it yourself and have experience in that realm. Managing properties will also give you a better perspective on an area which can help fine tune your acquisition criteria.

4. Avoid Fraud

Unfortunately, not every property management company operates above board. Some receive kickbacks from contractors, pocket rent from "vacant units" or do other such unsavory activity. Managing yourself can avoid this potential pitfall.

5. You Care More Than They Do

I consider this the most important factor. Consider it a universal truism that no one will ever care as much about your properties as you do. Caring equals effort. And that effort can sometimes be the difference between a performing property and one that bleeds money every month.

Advantages to using a Management Company

1. Save Time

The more time you spend managing, the less time you have to look for other potential investments (or just enjoy life). Everything you do means you couldn't do something else during that time. This is an opportunity cost that should be evaluated carefully.

2. Infrastructure

Early on, you won't have an office or policies or a staff or anything else like that. A management company will. They will have leases, applications, notices of entry and other such documents as well as screening procedures and knowledge of the landlord/tenant laws in your state (at least they will if they are any good). If you go it yourself, you will have to put these things together yourself. Management companies will also have an extensive list of vendors and contractors to use.

3. Outsourcing the Headaches

Property management is notorious for the headaches it comes with. It will require a thick skin to deal with angry tenants and maintenance disasters (which will happen). Most tenants are great people, but those won't be the ones you hear from unfortunately. Instead, the bad apples and discontents will eat up a substantial amount of your time and energy.

If you choose to manage yourself, make sure to talk to an attorney and familiarize yourself with landlord/tenant law and fair housing as well as the general principles of property management. And never skimp on tenant screening!

If you choose hire a manager, ask for referrals from other successful investors. This is the preferred option, because if they've done well for someone else, it's much more likely they'll do well for you. You can also look for managers with the Institute of Real Estate Management (IREM).

Make sure to vet a manager thoroughly before hiring them. You should interview them, ask for references and interview those references too. Make sure this manager specializes in the types of properties you own. If you own C rentals, a management company that specializes in A rentals will almost certainly do a terrible job and vice versa.

Ask them how long they've managed for and how many properties they manage. Ask them how many evictions they have each month. Ask them how long properties usually stay vacant before being leased. Ask them how they screen and if they accept people who've had evictions (if so, it should be only after at least five years). Ask them what the minimum charge for a maintenance visit is. Don't go easy on them. Getting the wrong management company can be disastrous. And if you hire a management company that isn't working out, do not be afraid to make a switch.

Conclusion

We strongly believe that buy and hold real estate investing is the best way to build wealth that exists today. That being said, it is no easy task. There are plenty of pitfalls that can snag even the best investors. But it is those that get educated and then dive in that succeed. It will take time, but if you are patient and diligent, buy and hold can be the road to riches.

Further Reading

The Millionaire Real Estate Investor by Gary Keller

How I Turned One Thousand Dollars Into Five Million in Real Estate in My Spare Time by William Nickerson

Buy and Rent Foreclosures by Joseph Neilson

The Book On Investing In Real Estate with No (and Low) Money Down by Brandon Turner