

Valley landlords face new reality

21 comments by **Catherine Reagor** - Oct. 11, 2009

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Renting out homes has long been a profitable enterprise for many Valley landlords.

The business model was simple: Buy a home. Rent the home for at least the monthly mortgage payment. And when you decide to sell the home, enjoy the Valley's reliable appreciation in home prices.

That model fell apart amid the housing-market crash. Landlords, like everyone else, saw home values plunge. Rents fell. Many landlords who bought when prices were high now struggle to charge tenants enough to cover their mortgage payments. And this year, as foreclosures mounted, homes were snapped up by investors and turned into inexpensive rentals.

Suddenly, the landlord business has changed. Competition for tenants is increasing as more homes become rentals. Apartment owners are lowering rents, offering free utilities or a month's free rent, eliminating security deposits and .

This is the third in a periodic *Republic* series on how different segments of the housing industry are reinventing themselves to work toward a recovery. The new reality for Valley landlords is still taking shape. Longtime landlords slammed by the housing crash find they have to settle for less income, take more risks on tenants' reliability and try to keep their properties out of foreclosure. New landlords see opportunity in the low housing prices.

There is no way to count the number of different types of landlords in the Valley. There are people who own a number of houses as their primary source of income. Other people buy one or two rentals to supplement their income and sell later for retirement or a college fund. Some landlords are local. Others are out-of-state investors. Some landlords manage their own properties. Others pay a fee and turn them over to property management firms.

What they all share now is a rapidly shifting landscape and no clear solution yet as to how to re-establish that simple business plan. And that may not be possible until the housing market in general stabilizes and the variables in making money through rentals also settle.

Those variables include how much to charge for rent to stay competitive, the costs of maintaining properties and the challenges in dealing with problem renters.

Competition

Among many things that have changed for landlords is the level of competition for reliable tenants.

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Because of the economic downturn, more people are losing jobs and unable to always pay their rents. Record foreclosures and rising bankruptcies in the Valley also mean more renters with less-than-stellar.

More foreclosures does mean more people who have lost homes turn to renting. But supply still exceeds demand as the number of new homes for rent and vacant apartments is still larger than the pool of tenants.

So landlords are lowering rents to attract tenants. At the same time, apartment owners are lowering rents, giving away flat-screen TVs, iPods, scooters or a month of free rent.

Rent rates used to be a function of covering mortgage payments for many landlords. More downward pressure on rents comes now from people who recently paid cash for inexpensive foreclosure homes and can ask for less in rents. With Valley home prices down 50 percent from 2007, longtime landlords are feeling the pinch.

Rents on Valley homes are now down 10 to 25 percent from last year, depending on the area, landlords say. The drop in rents means many longtime landlords can't cover their mortgages anymore.

David Gudmundsen is offering new tenants \$50 off their rent for six months in his 20 Valley rentals.

"The rental market really got tough, probably because apartments are giving away the farm to get tenants," said Gudmundsen, a real-estate with S.J. Fowler/GMAC Real Estate. He purchased most of his rental properties during the past two years. Gudmundsen is a longtime Valley landlord

who owned 80 rentals in metro Phoenix during the late 1990s but sold them before the market's downturn in 2007. Homes with rents below \$1,500 a month are now the most popular in the Valley.

"Just look at Craigslist or other online sites that list rentals. There's a lot of Valley homes for rent priced below \$1,500," said Mike Sargent, a former executive with a high-tech firm who became a Valley landlord after the dot-com crash. "That's what most people can afford now."

Sargent recently dropped the rent on a Chandler home with a pool to \$1,195. In 2002, the rent was \$1,795.

"Everyone is dropping their rents now," said Dean Wegner, a Valley mortgage broker and landlord, who is president of Arizona's Independent Rental Owners Council. "It's not only about getting tenants; it's about keeping those who can pay."

To keep a tenant, Wegner recently dropped the rent \$100 on a north Phoenix home with a swimming pool to \$850.

In the Valley's , rental homes can sit empty

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for months. Cutting rents means lost income for landlords but perhaps less than losing several months of rent in a row.

"My business partner and I pay close attention to our renters, and we have been lucky," said Phoenix City Councilman Tom Simplot, who owns five central Phoenix homes. "We lowered rents 20 percent this year because we want to keep our tenants."

One place tenants can go if they choose to leave is sometimes to a nicer house down the street that was lost in foreclosure, purchased and turned into a rental for monthly payments well below recent mortgage payments. This is especially common in the newer neighborhoods that have been hard hit by foreclosures.

There's no exact figure on how many Valley homes have been turned into rentals, because some buyers don't disclose their intentions on property records.

As many as half of the 50,000 foreclosure homes to be sold by lenders in 2009 have been purchased by investors, according to property records and market watchers. Many investors are renting out the houses until home prices climb again and they can sell for a profit.

It's a renters market now, and most landlords must drop prices to fill their homes, even if they lose money on the deals.

Maintenance

Another variable in the cost of doing business for a landlord is property maintenance and fixing damages caused by tenants.

Before the housing and economic crash, rental rates were rising with home prices. As rents drop, longtime landlords lose money on rents and lose the extra cash to maintain homes.

Landlords used to be able to charge tenants deposits equaling one or two months of rent, as well as non-returnable cleaning and maintenance deposits. But since the crash, many renters don't have the extra cash for big deposits. And landlords have less leverage to ask.

The competition for tenants forces some landlords to drop required security deposits, which, combined with declining rents, makes it harder to cover regular wear and tear on a home or those unexpected expensive repairs. In some cases, landlords are even skipping credit and criminal background checks, which can lead to problem tenants.

"Landlords are lowering the bar on screening tenants and taking deposits," said Margie O'Campo De Castillo, a Valley real-estate agent and landlord with two rental homes. "Homes are being wrecked, and landlords stuck with big cleanup fees. It's

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hard to make money on rentals now."

A friend of De Castillo has a Phoenix rental home that was recently vandalized by tenants. The friend will lose several months rent and spend thousands of dollars on repairs.

Michael Rhone lives in California and is a partner in seven Valley rental homes. He received a call from a Valley police department a few months ago about a possible meth lab in one of his rentals. "I had to fly in and deal with that. There wasn't a meth lab, but tenants were involved in other illegal activities"

Rhone said the house is "trashed" and he's thinking about letting it go into foreclosure instead of spending the money to fix it up because he's already losing so much money and can't sell for a profit now.

Just as some homeowners caught in foreclosure strip or vandalize their homes, the same thing can happen with tenants. According to Valley landlords, more renters are wrecking or stealing appliances and fixtures because they're being evicted for not paying rent or because the home fell into foreclosure and they have to leave.

Sargent, who is co-owner of the property-management firm HomeLovers, said in today's rental market, a landlord should have enough money to cover half a year of mortgage payments in case they can't collect rents, have to fix homes or pay legal fees for evictions.

Despite the competitive pressures upon landlords, Sargent warns landlords to still be prudent. "Don't forgo deposits just to attract a renter," he said. "Renters must have some skin in the game now."

Collecting rents

Before the economic downturn, fewer Valley residents were struggling to pay their bills. Now more renters, like homeowners, are falling behind on their bills each month.

So landlords sometimes have to find ways to keep a steady flow of payments coming in.

"I know not everyone has and everyone makes mistakes, so I won't do background checks," said Elaine Balderas, who owns four south Phoenix rental homes. She drives by her properties every Sunday to check on them and usually collects rent on one of those trips.

"I can't charge ridiculous deposits," Balderas said. "But I want to see a recent pay stub, and I want them to look me in the eye and tell me they will pay."

Julie Bieganski has had rental homes in the Valley for the past decade. She recently rented out a former foreclosure home in north Phoenix for \$850 a month.

"You could get \$900 a month in that area,"

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she said. "But the tenants are great, and their employer cuts me a direct check for the rent and it goes in my account as a direct deposit. This way I don't have to chase around for the rent."

When tenants stop paying rent, landlords have to decide whether to evict them and potentially go months without income or try to work out a deal hoping they'll catch up on their monthly payments.

One of O'Campo de Castillo's longtime renters recently lost his job and was going to move out.

"I told him, 'Wait, we all are struggling now. Stay put. You need a home. Let's give this a month or two,' " she said. "He is now paying his full rent again. It's much better to lose some money for a few months than have the home empty or look for another good tenant in this market."

More landlords are now faced with evicting tenants for not paying. It can be a costly legal process involving hiring a lawyer, filing court documents and paying to store anything they leave behind.

Rhone said three of his renters are behind on their payments. He is in the process of evicting one and is considering going through the legal process to have that tenant's wages garnished to pay back rent.

When Gudmundsen had to evict a woman from one of his rental homes, she left almost all of her belongings. Under Arizona law, Gudmundsen had to give her more than a month's notice to collect her belongings.

He had to pay to have them stored and pay for a public notice announcing they would be sold if she didn't collect them.

To , Balderas skips formal eviction processes with her tenants, because she doesn't have them sign leases.

Instead, Balderas has tenants sign an agreement stating when rent is due, and if they don't pay, they have a month to vacate. To evict, she pays \$37 to take them to small-claims court.

Earlier this year, she had to evict a tenant who hadn't paid rent for a few months because she lost her job. "It wasn't fun, and she (the tenant) tried to beat me up," Balderas said. "But she's out, and I found a better renter."

Opportunities

Despite the downward pressure on Valley rents, the housing market's downturn is enticing more people to become landlords or to expand their portfolio of rentals.

Landlords who can afford to buy Valley homes now, maintain them and hold on to them for several years are setting themselves up for the market's recovery.

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"Investors need to have a strategy if they want to buy rental homes now," said Beth Jo Zeitzer, president of R.O.I. Properties. Balderas is looking for more rentals to buy but only in south Phoenix. She looks only at brick- or block-built homes that her husband can fix up.

Landlords are also seeking out people for whom renting is a good option.

"When I talk to renters who have recently lost a home to foreclosure, I usually find their mortgage was twice what I am asking in rent," Gudmundsen said. "Unfortunately, a lot of folks are losing their homes to foreclosure. Those people need places to rent."

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