

Pitfalls and complexities of investing in rental property

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Property can be the best investment that you make and is most certainly the best way to build wealth, but beyond your primary homestead, investing in a rental property for example can become a financial nightmare. You need to know what you are getting yourself into, especially if you are a novice investor.



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Property, and South African property in particular, has proven to be one of the best investments that you can make. Aside from investing in your own residential apartment or home, there is always the option of investing in an additional property or multiple properties as part of a portfolio of properties to rent out and earn rental returns or yields while your investment value grows year-on-year.

Many, many pitfalls

Rental property in particular seems to have grabbed attention as attractive investment options for buyers. While you cannot really go wrong with local property unless you hopelessly overpay, buy a structurally unsound property or buy in the wrong area, when it comes to property that is not your primary home, there are many, many pitfalls.

Buyers should know that while it may look as easy as buying a property and getting tenants in, there are in fact many hidden nuances, logistical, legislative and financial that you need to be aware of, especially if you are a newcomer to the market.

While it may seem like a great idea and could be very tempting to invest your cash or finance in a second property because you can off-set some of the costs against a monthly rental income, novice investors should take great care.

Unless, you are in the business of rentals, we would urge prospective buyers and investors to do their homework thoroughly, investigate the market carefully and think about the costs, not just financial, but also the time and hassles that can come with a rental property.

Poor economic outlook

While the demand for rental accommodation is likely to again tick up notably as the weak economy and rising costs drive more consumers to the rental market, the poor economic outlook can likewise dampen the performance of rental accommodation. Rental rates tend to remain flat as consumers simply cannot afford to pay more.

This is just one of the aspects to consider as the costs of a rental property almost always tends to be significantly higher than initially budgeted for. For novice investors, this can be financially crippling.

As a starting point, would-be investors should always do their homework thoroughly and investigate the market. This means making sure that you get to know the area that you want to invest in, inside and out.

Be sure to speak to a credible local rental agency with a history and successful track record in the area and find out just what type of property is in demand and at what rental rates. Often property owners think they can get more for their property versus the market reality. While some properties can achieve quite high rental rates, this may not be the case for all properties or at all times.

To furnish or not to furnish

Another consideration is whether or not to furnish. While it may be tempting to think that you can get more for a furnished property, long-term tenants tend to prefer unfurnished. For holiday and short-term rentals on the other hand, basic furniture and furnishings and extras such as satellite television and wifi have become essential. Security too is essential for any rental property. Be sure to always focus on durability and take into account the additional maintenance and insurance costs that would come into play with furnished accommodation.

Maintenance is another area that is far more costly when it comes to rental property versus your primary home. Bear mind that tenants are just using your property for a period of time. It is not their asset and they are not going to take the extra care with it that they would with their own property or assets, if at all.

You will in all likelihood therefore be responsible for not just the basic maintenance of the structure and fixtures that come with ordinary wear and tear, but need to be prepared for additional damage repairs and maintenance.

Tenant sourcing

Another problematic area, is tenant sourcing and management. Given the legislative complexities, it has become a necessity in this day and age to employ the services of a credible rental agent to assist with managing your property and its occupancy.

This includes navigating what has become a bit of a minefield of legislative issues, vetting of the tenants, collecting monthly rentals, managing the property including any maintenance issues and more. This would certainly assist in ensuring that you do not sit with unnecessary vacant periods, something that can quickly add up to a chunk out of the returns that you may have hoped to achieve.

Most importantly, there are the property costs versus the rental returns and yields. Over and above the costs of actually acquiring the property such as the purchase price and transaction and transfer costs, there are many hidden costs that come with a rental property.

The first of these include the basic holding or ownership costs such as home owners insurances, basic utilities and levies, any complex levies and costs and security costs. Further costs could relate to where the property is situated.

Near the coast for example, you would have higher repair and maintenance costs due to the coastal erosion. We have also alluded to the additional maintenance and holding costs above, including having to sit with vacant periods.

Consider also that while you may be tempted to try and recover most of this by way of the monthly rental, that is highly unlikely. The rental rate would need to be set at the correct market level to attract tenants and ensure that your property is always filled.

Building personal wealth

Having said this, investing in property is an excellent way to build personal wealth. Ordinary homebuyers could for example obtain a housing loan to finance this investment and then use the monthly rental to off-set some of the bond and other holding costs. At the same time, the natural lapse of time will see the asset grow in value and before you know, five years have passed and your asset starts accumulating real value.

High demand middle income neighbourhoods tend to be good areas to invest in, especially for novice investors, but these can come with challenges, hence our advice in taking great care.

There is generally a high demand for rental property in middle class areas, especially for security complexes and homes in areas with good schools and infrastructure including transport facilities and road access to business and commercial nodes.

Always though take great caution and consider all aspect before investing. Part of this is considering what the economy is doing and how this may affect your household finances in the short term. Interest rate hikes and rising basic living costs are all current realities for the economy and property market.

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