just call me Land

The rush is on to invest in rental real estate.

Why not you?

By Frank O'Brien

Photographs by Dina Goldstein

Elizabeth VanderZaag lifts a dust mask from her face as she strolls out of the half-gutted ground floor of the 90-year-old Vancouver apartment building she bought a few weeks after two jets slammed into New York City and woke everybody up. "We are doing repairs," she says quickly, "not improvements."

VanderZaag, 50, represents what real estate pros label as a 'phenom' in British Columbia: security-seeking first-time investors rushing to become landlords, buying up everything from condominiums to houses to entire apartment buildings and even offices and strip malls. An estimated 30 per cent of the condos sold in Greater Vancouver in the past year have been to investors. Says David Goodman, a Vancouver realtor specializing in apartment buildings: "We haven't seen sales like this in 20 years."

lord

CHARACTER HOME: With a little elbow grease, Elizabeth VanderZaag turns rental properties into hot commodities

The novice investors, as VanderZaag's greeting suggests, soon discover not only the potential of a lifetime investment but the byzantine world of the B.C. landlord, where bylaws, taxes, rent legislation and being handy with a hammer can be as important as gauging how much rent to charge.

"After September 11, I was struck with the idea that I had to get into something more real than mutual funds or the stock market," offers VanderZaag. She had been watching her equity investments nosedive and figured, correctly, that the terror attacks would accelerate the collapse. VanderZaag, like many self-employed boomers, had also received a shock with an estimate of her federal old-age pension. "I found I would be getting $493 a month. That might cover the wine and movies, but I also have to eat."

She first thought of buying a condominium as a retirement hedge but, with the urging of her partner, decided to look at apartment buildings instead. "The problem with a condo is that the strata bylaws can change to disallow rentals, or you can get hit with big costs for the entire building. Look at what happened with leaky condos." And buying a single house, she figured, didn't have the sufficient income punch.

Cashing out a chunk of mutual funds and some of the equity from her paid-for East Vancouver house, VanderZaag began looking at small apartment buildings in Mount Pleasant and the Main Street area. She settled on a 12-suiter on Fraser Street that was built in 1912 and has evidently not changed much since. "It does need a lot of work," VanderZaag understates, "but I have a lot of time. This is my retirement."

VanderZaag paid $520,000, with 40 per cent down, and negotiated a mortgage rate of just under five per cent. The building is fully tenanted, with rents in the $425 to $550 range per month for the fir-floored, high-ceiling apartments that are mostly one bedrooms and one bedrooms and dens. The monthly income covers the mortgage nut and, VanderZaag believes, will also help pay for an estimated $50,000 in immediate repairs and landscaping.

Vancouver buyers of old apartments quickly understand that 'improvements' are never done, only 'repairs'. That's because the aging buildings are often non-conforming. For example, the density may be higher than currently allowed or the building may not be up to modern earthquake regulations. Once a landlord applies for permits for major 'improvements', he or she could be forced to upgrade the structure to current building code standards. Basically, if the costs of improvements reach 200 per cent of the assessed value, the whole building must be brought up to code, explains John Robertson, Vancouver's chief building official.

"These old apartments are built from old-growth forests where the fir is like rock," VanderZaag argues. "With proper maintenance they will outlast any new building." But after her latest visit to the City's permits department, that thought has been modified. "In Vancouver it would probably be easier to run a grow operation than to put in a bike rack."

Despite the frustration with red tape, VanderZaag is doing the smart thing by investing in residential rentals, says Goodman. Now with Macdonald Commercial, Goodman has been selling apartment buildings in Vancouver for a quarter-century. Vancouver's current vacancy rate of 1.4 per cent is among the lowest in Canada, and rents, at an average of $954 for a two-bedroom, are the highest in the country.

"Right now is an historic point for investors," Goodman explains. "There is a convergence of tax changes that have convinced owners to sell and low mortgage rates and low vacancies that make it great for buyers. And the province is bringing in new regulations that should make it easier to be a landlord."

One of the most important changes is how the federal government now treats capital-gains taxation, a move that has boosted the number of rental properties on the market. Says Goodman: "People who have been holding buildings for 30 years are selling this year."

Here's why. Say you realized a gain of $2 million on the sale of a Vancouver building you had owned for years. In 1998, before the tax changes kicked in, you would have paid $877,500 in capital gains tax. If sold at the same price today, the total tax bite would be only $537,500.

This is a powerful incentive for some long-time owners to cash into today's hot market – and it is also creating the first healthy selection of apartment buildings in years. In the first eight months of 2002, more than 150 apartment buildings were sold across the GVRD, up 60 per cent from a year earlier.

Conversely, for buyers the math is very simple. If you can borrow money at 5.5 per cent and purchase a building at a capitalization rate of 6.75 per cent – the average in Vancouver – you have positive leverage. (The 'cap rate' is the net rental income at full tenancy divided by the market value. The higher the cap rate the better. For example, if the income is $240,000 per annum and the market value is $3.4 million, the cap rate is around seven per cent.)

The alacrity with which small investors have grasped the concept is startling and, some say, a bit scary. Last fall a 12-suite Kerrisdale apartment building sold at a record-low 4.6 cap rate and a 16-suite, 75-year-old wood-frame building sold in the West End for an astonishing $121,800 per suite – and those suites are mostly less-desirable bachelor units.

Both buildings sold to first-time buyers. Institutional-type investors aren't interested in these kinds of returns since the low cap isn't enough to even cover the fees for real estate fund managers.

"It is mom and pop who are driving the market," Goodman explains. For someone buying at today's mortgage rates and willing to handle management and repairs themselves, he notes, "in theory, you could buy an apartment building with 100-per-cent financing and still enjoy positive cash flow."

That was the reasoning behind the blitz-like attitude of a small Victoria syndicate led by 23-year-old Adam Gant. Using some fancy financing and leveraging, the group bought a condo, a townhouse and four houses within eight months in 2002, all in or near the capital city. Gant and his partners ended up with about $1 million worth of property churning $7,600 a month in rent, enough to cover all the mortgages.

"We figure that with three universities and the provincial government here, Victoria will always have a demand for rentals," says Gant, who went from running a College Pro painting franchise to self-taught property investor with the help of a "very sharp" mortgage broker.

Gant claims he had no problem raising the financing, despite the 20 to 25per cent down payment required. "If you find a good deal, there is no problem finding the money."

[With the changes to the capital-gains rules, the number of rental properties on the market has soared. Last year, Adam Gant *(above)* amassed a condo, a townhouse and four houses. "If you find a good deal there's no problem finding the money," says the 23-year-old]

But the local market does spook big-money players. Paul Moon, a spokesman for Calgary-based Boardwalk Equities, a publicly-listed company which owns 29,000 rental apartments, says there is a good reason none of Boardwalk's holdings are anywhere near the Lower Mainland: "We find it hard to justify the low cap and high prices on the B.C. south coast."

Moon notes that in Calgary and Edmonton, where Boardwalk is a major player, returns are around seven per cent, but apartments sell in the $40,000 to $45,000 range, far less than Vancouver prices. Thomas Shwartz, president and CEO of Canadian Apartment Real Estate Investment Trust (CAP REIT), notes that in Ottawa, Halifax and even Toronto " 'door prices' (price per suite) are $60,000 to $70,000 and cap rates are eight per cent. Vancouver is just too expensive for the returns you can expect."

Meanwhile, others believe Vancouver prices are just about stretched to the limit.

"If the peak of the market is 12 noon, Vancouver is at 10 to 12," says Maurice Kagan, chief financial officer of Toronto-based Residential Equities Real Estate Investment Trust (RES REIT), one of two REITS which specialize in Canadian big-city apartments. RES REIT holds 58 concrete high-rise buildings but only one – the 470-unit International Plaza in North Vancouver – is in British Columbia. CAP REIT has no property at all in B.C., though it owns scores of apartment buildings across Canada.

"We have been trying to buy in Vancouver for five years, but you just can't make the numbers work," explains Kagan. Vancouver, he says, is dominated by "private, patient money that is willing to wait years and years for a return on investment."

Investors who can't afford to buy their own apartments could do worse than check out rental-linked REITS. RES REIT, for instance, has shown a 22-per-cent gain in income annually over the past two years and, after paying dividends, posted returns of 7.5 per cent, similar to CAP REIT's performance, in both 2001 and 2002. "Right now you could buy 1,000 units for around $14,000 and make seven per cent to eight per cent on your money," Kagan explains.

How about the outback?

If Vancouver or Victoria is out of your league, then look farther afield, but do so carefully. Prices are lower and cap rates are much higher in outlying B.C. towns but this notes that 19,000 people receiving disability benefits could be cut off by this June under the Liberals' Employment and Assistance for Persons with Disabilities Act introduced in September 2002.

Reforms to B.C.'s welfare system will also reduce the number of tenants who have the government paying the rent, Ingram adds. Where will these tenants go? "Your guess is as good as mine," he says, "but the government seems determined to change things."

That brings us to new residential tenancy legislation tabled late in 2002, which probably will be implemented this spring. The new legislation, which landlords eagerly – and rightly – anticipated would tilt the process more in their favor, allows for higher annual rent increases and also gives landlords more flexibility in the timing and ability to carry forward rent increases. But leaving the damage deposit at a maximum half-a-month's rent has irked some property owners.

"I have $600,000 invested in this place; a half-a-month deposit just doesn't cut it," says Dyona Dallas, who rents out half her Point Grey duplex for $2,700 a month. Al Kemp, executive officer of the Rental Owners and Managers Association of B.C., agrees: "The deposits should be a full month's rent at least."

Still, Kemp says most of his members are pleased that the revised Residential Tenancy Act will give landlords greater power to evict persons running marijuana-grow operations, which he says are a serious problem in this province; the heat and humidity generated by a grow-op – not to mention the illegality and unsavory elements involved – can quickly destroy a house. Under current legislation, says Kemp, it can take six months to kick out a ganga grower.

Many investors see single condominiums as an easier rental route, but here too there are tricks of the trade. Real estate consultant Ozzie Jurock, author of *Forget Location, Location, Location*, notes that a Canada Mortgage and Housing Corporation survey last fall found that 47 per cent of downtown Vancouver condos were bought by investors. An estimated one in three condos bought in Greater Vancouver last year ended up on the rental market, he says.

Jurock believes the best buys are used condos. "You get the same rent for an older apartment as a new one and they cost a lot less." He also advises to buy into older buildings that have a high portion of offshore owners. The reasoning here, Jurock says, is that the strata council is more likely to continue to allow rentals.

The taxman cometh, to a point

Many would-be landlords believe there are huge tax advantages that can help overcome the inherent hassles that come with the calling. And while it is mostly true, there are some confusing caveats, Ingram notes: "Almost anything expended to earn the rental income is deductible if it is not considered a capital item."

The list includes the cost of the property, furniture, appliances and any fixtures worth more than $200, the legal fees and commissions involved in the purchase. You can also deduct the cost of any advertising, plus some automobile expenses used to collect rent if you own two or more properties.

The big savings, though, are in the deduction of the interest on the mortgage and the interest on a loan used as a down payment, says Ingram, "even if money was borrowed on your Visa [card] or by putting a lien on your mother's house."

The confusion comes when you buy something you intend to fix up before renting. You cannot deduct any 'fix up' expenses that you had already planned to do when you bought the place. For example, if you buy an old property for $150,000 and spend $4,000 on carpets, $2,500 for appliances, $6,000 for a new roof and $6,000 for painting the place, the carpets and appliances would go into Class 8 (the CCA [capital cost allowance] deduction classification on personal income tax forms) and you would depreciate them at "up to" 20 per cent (10 per cent the first year). However, the painting and roof costs would be added to the value of the building and are not deductible from income.

If you bought a house in November, spent a month fixing it up and did not rent it until January of the next year, you would not get any deduction for your improvements in 2002. However, you could deduct the mortgage interest, taxes, heat, light, advertising expenses and so forth as a loss against other income. On the other hand, if you buy a house, get a clean building inspection, rent it for a year and then the roof starts leaking, spending $7,000 for a new roof would be a legitimate repair expense.

"What this means is that if someone has a leaky condo and moves out and rents it out so that he or she can write off the repairs, they have made a mistake," Ingram says. "They knew about the necessary repairs *before* the rental and the expenses are just not deductible, although they can be depreciated over time."

Anyone planning to be a new landlord is strongly advised to get expert tax advice. "Taxes are more important than anything else when it comes to rentals," Ingram warns.

Now for the commercial

If residential rentals are starting to sound too complicated, how about buying a commercial building?

Sorry, it's a bad idea, according to a number of commercial realtors and investors contacted by *BCBusiness*, unless you really know what you are doing.

"If a tenant moves out of your basement suite, that is one thing," says Gary Web, a veteran commercial realtor in Vancouver. "If a business leaves your office building or strip mall, that is something else entirely. It can take months to find a new commercial tenant."

Web notes that there is currently a glut of office space across Greater Vancouver (largely due to the dot-com crash), and many feckless investors who bought 'strata' office space two years ago with plans to lease it out are eating it now. "Some commercial stratas that sold for $350 a square foot are now back on the market at $190," according to Web. As for retail, choosing the right location and knowledge of lease structures is so important that, "it is not an investment for the novice."

David Eger of The Altus Group, a Vancouver-based commercial real estate specialist and investor, says first-time commercial buyers must be able to ascertain true market values. They must get detailed building inspections done and should have a solid understanding of how all tenant leases are set up, plus be aware of the legal issues. This can involve a small army of professional – read expensive – help, he cautions.

The upside, Web notes, is that if you buy retail or office space in the right spot – say, South Granville or Robson Street – you could have tenants in place paying rent for 10, 15 or even 20 years steady and without a problem. Even so, his core advice remains: "First-time investors should stick to residential. It is easier to get financing and harder to get burnt."

You won't get any argument from Elizabeth VanderZaag, who sees her old apartment building as the start of a whole new retirement strategy. "The income should be steady because there will always be demand for low rents and, who knows, maybe 20 years from now I'll end up living here myself, rent-free."

VanderZaag, an artist who once marched on City Hall to save the old Manhattan Building on Robson Street, has clearly discovered her landlord within: "We would like to buy another apartment building in Vancouver, but we got in just under the wire. At today's cap rate and prices, I don't know how it would work." □

Tips for low-rent landlords

For landlords handling low-cost rentals, there are some, shall we say, innovative ways to increase income, says Jerry Raczkowski, author of the wryly-titled book *The Landlord's Bible*, a bestseller in some real estate circles. Yes, his concepts smack of gouging, but Raczkowski says they will help wring profit from even a risky rental investment.

Raczkowski, an apartment building owner himself, says landlords have to think beyond the concept of simply collecting a rent cheque. For example, some tenants have problems meeting a monthly payment. As a landlord, you can turn this to your advantage. If the regular monthly rent is $500, for example, munificent you gives your tenants the option of paying bi-weekly. For this convenience, you add $25, to make for a bi-weekly payment of $275. Rather than 12 monthly payments, the landlord receives 26 bi-weekly payments during the 52-week year – the equivalent of 13 months of rent plus the 'convenience' stipend. In all, the landlord pockets an extra $550 by year end, plus $600 in incidental monthly rent, increasing the total cash flow per apartment by $1,150 with only a modest increase in bookkeeping. These numbers work out great for an apartment building owner if a lot of tenants fall for it.

Landlords can also boost income by charging for extra services. This can include renting TVs and VCRs for $10 to $25 per month. (You can buy used units for $75 to $150 and you should be generating profits within the first six months, Raczkowski explains.) Or what about a vacuum cleaner at $5 a week? Charging for parking can bring an extra $10 to $25 per month per vehicle and converting crawl spaces or common closets into storage can also raise the cash flow.

You can also find extra money by renting out furnished apartments. The furniture can be purchased through thrift outlets or from tenants moving out, Raczkowski says. And there would apparently be plenty of those. ■