

# Should You Turn Your Starter-Home into a Rental?

*[Editor's Note: A webinar that Matt Wiggins and I put together earlier this year all about disability insurance will be run again tomorrow (Thursday) evening at 7 pm Mountain. [Sign-up here!](#)*

*The following guest post was submitted by Dr. Altelisha Taylor, a resident physician in Atlanta, GA who writes on personal finance and real estate on her blog [Career Money Moves](#). We have no financial relationship.]*



Contrary to popular belief, not all homes make good investments. An ideal real estate property will provide you with extra cash in your pocket each month or allow you to increase your net worth in a tax-efficient manner. Some homes have both of these benefits, but many homes have neither. You can evaluate where your starter home falls on this spectrum by asking yourself these 6 questions:

## 6 Questions for Evaluating Your

# Home as a Rental Property

## 1. Do the numbers make sense?

### Cash on Cash Return

Before you list your home as a rental property you must “run the numbers.” The [first calculation you should make is the “cash-on-cash return.”](#) The cash-on-cash return helps you determine how much money you’ll *make* on the investment based on how much money you *spent* to buy the investment. In other words, it will help you see whether investing money into this starter-home-turned-investment-property is more lucrative or less lucrative than putting your money into something else like index mutual funds.

### Monthly Cash Flow

The second thing you need to calculate is your monthly cash flow. Computing the monthly cash flow will help you see how much money this rental property will put in your pocket each month after you pay the mortgage and account for repairs and other taxes and fees. Some properties have a high cash-on-cash return and positive cash flow. Others do not. Run the numbers for yourself to see if your home provides an ideal cash on cash return (at least 10%) or enough monthly cash flow to make it worth your while.

## 2. Are you planning to make expensive aesthetic changes or upgrades?



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If you purchase a home and pay the mortgage each month, you will build “equity” or value in that home. However, the more money you spend on [upgrades and costly aesthetics](#), the less equity you may keep. Don’t get me wrong, there are certain upgrades that may add value to a house, but oftentimes when we purchase things that are more aesthetically appealing, we do so for our own self-gratification.

As a result, many of the upgrades people make to their homes (modern cabinets, renovations to a basement, the addition of a pool, etc.) cost more money than they add in value to the home. Increasing expenses (through costly upgrades) without an identical increase in home value, decreases the overall profit you could gain from using the home as an investment property.

### **3. What is the housing market like in your area?**

Before you purchase a starter home with the intention of using it as an investment property, look at local housing market trends. Have houses been going up in value or down in value?

Is it a sellers’ market, in which houses are being sold for more than they are worth? Or, is it a buyers’ market in which

the supply of homes exceeds demand, so houses are being sold for less than they are worth?

Purchasing a home in a sellers' market makes the home more likely to be a *cash-flow negative* investment property. Purchasing a home in a buyers' market makes the home more likely to be a *cash-flow positive* investment property.

## 4. Will you be able to secure (and afford) two mortgages?

In an ideal world, you'd rent out your starter home to a reliable tenant and [use that rent money to pay down the mortgage](#). You may even ask the bank for a second mortgage to purchase a larger home for yourself in the meantime.



Unfortunately, life doesn't always go as planned. Asking the bank to loan you money for a second home when you haven't paid off the first home and may also have a significant amount of [student loan debt](#) may be more challenging than you realize.

Plus, it may take a few months to find a reliable tenant and there's a good chance this starter home will have an occasional vacancy between renters. Do you have enough money to cover costs during these transition periods? Can you afford

to pay the mortgage on the starter home while you find a tenant AND pay the mortgage on the other home you live in? If the answer is no, then planning to maintain two houses may not be financially feasible.

## **5. Can you or someone you trust effectively manage the property?**

Managing a rental property as someone's landlord is no small feat. You have to be diligent about collecting the full rent on the due date. You also have to be available to receive and coordinate maintenance requests at inopportune times. Do you think you have the time, experience, or energy to do this yourself? If not, you may want to consider [hiring a company to do it for you](#). Keep in mind that paying for a management company may significantly decrease your monthly cash flow.

## **6. Have you already maxed out less-cumbersome investments?**

If you've never owned a rental property, let me be the first to let you know, it's a lot of work. Securing responsible tenants who will make on-time payments requires more background work than you may realize. Spending hours negotiating the buying price and loan terms with real estate agents and loan officers can last a lot longer than you may have anticipated. Unless your return from this investment is significantly better than what you could get elsewhere, it may make more sense to max out other investments (like your [employer retirement accounts](#) and [Roth accounts](#)) first.

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The decision to turn your starter home into a rental property should not be taken lightly. For some people, renting out their home may be a lucrative investment strategy. For other people, renting out their home may require more time and money than they can provide. Thoroughly evaluate whether turning your starter home into an investment property is the right decision for you.

*What do you think? Did you turn the first home you owned into a rental? What did you learn? What advice do you have for doctors considering to do it? Comment below!*