

# The Good the Bad and the Ugly of being a Landlord

Becoming a landlord might seem like the wild west. But, with the right know-how, renting out property can be a good way to create your own personal gold rush.

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Iman's dad had generously bought her a home in the Annex area of Toronto for the purposes of renting it out. They both thought that being a landlord would be an easy way to make some passive income and create equity that could help with her retirement savings. And with a willing renter, who was an acquaintance of the family, the hardest part was already taken care of – so they thought.

Her renter was a prominent lawyer who, Iman believed, could easily afford the steep \$8,000 monthly rent. He was currently living at a prestigious address, and seemed affluent and responsible. So much so, that she waived any background check and told him to move right in.

Shortly thereafter, his rent cheque bounced. He promised it wouldn't happen again, and even took the family out to a ritzy dinner at one of the city's top restaurants as an apology. But the apology soon seemed meaningless as cheque after cheque kept bouncing.

"Meanwhile, I still had my mortgage, utilities, and property taxes to pay," relays Iman. "He owed me tens of thousands of dollars, and my debt was increasing."

After looking at her legal options with a lawyer, Iman realized that it wouldn't be easy or cheap to evict her tenant and collect the money owed to her. It was a difficult and expensive lesson to learn, proving that being a landlord can be lucrative, but sometimes ludicrous.

According to the Canadian Rental Housing Index, 30% of Canadian households are renters.<sup>1</sup> In this hot housing market, that number is growing. More and more people who can't afford to buy a home are choosing to rent. As the pool of qualified renters gets bigger, many believe this could be a good time to become a landlord. But, as with any investment, renting out your property comes with both risk and reward. The lure of rental income

and building equity goes along with the responsibility of owning a second property, chasing after late rent from time to time, and being saddled with less-than-desirable tenants. So, if you are thinking of an income property, here's the good, the bad and the ugly of being a landlord:

**The good: A long-term investment**

With enough cash or credit to cover a down payment, you can purchase a property and have a renter cover your carrying costs. As your home is paid off, and if your property appreciates in value, you build up equity. When you sell, that equity is yours to keep. For example, if



you had purchased a two-storey home in 2005 anywhere in Canada, the price of that home has likely increased by 115 per cent on average.<sup>2</sup>

“Buying income property will mean a significant commitment,” says Charley Tsai, Vice President of High Net Worth Planning at TD Wealth. “But, if you stick with it, over the long-term it can build future cash flow and wealth.”

Sofia was in her 20's when she bought her home that had an upstairs apartment. She rented the space, and it covered most of her mortgage. After she married Jonathan, they bought another home for themselves, and continued to rent out both the first and second floor in Sofia's first home. When they decided to sell Sofia's first home a few years ago, the 15 years of accumulated equity allowed them to pay off both homes, so they could live mortgage-free.

“It was one of the best financial decisions I've made,” says Sofia. “Living mortgage free has afforded us the opportunity to save for retirement, travel, and enjoy a few luxuries.”

And, by owning an income property or renting part of your space, you may be able to deduct certain expenses on your tax return, and your tax bill. Your mortgage and interest, property taxes, insurance, utilities, property management fees, and even maintenance and renovations may be able to reduce your taxes owed.

But if the income property value goes up – it's unlikely all of that gain will go into your pocket. "If it isn't your own primary residence that you are renting, you will have to pay capital gains tax on any appreciation when selling any property," says Tsai. "That's why it's important to talk to your tax advisor who can help you with your tax planning before selling your property."

With some good planning, that second home or rented nanny-suite can help you retire early and in better financial shape.

### **The bad: A risky housing market**

Just like any investment, your income property carries risk. Depending on when and where you purchased your property, there's no guarantee its value will go up. If you are currently thinking about buying an income property, you need to figure out whether the rental income will cover all of your costs. Otherwise, you may have to operate at a loss. It also means that, if at some point you find yourself unable to find a renter, can't financially carry the property, or face divorce or separation, you may end up selling the property at a loss. Also, if interest rates rise, you may find it difficult to afford the mortgage on your second home.



“You may have to put down a significant chunk of the purchase price as a down payment to secure financing,” Tsai says. “As a real estate investor, it might be trickier to get qualified for financing; there is no mortgage insurance for investment properties, so you’ll need to have a high down payment, and good credit. You may not get the lowest mortgage rates that are reserved for homebuyers.”

Talking to a mortgage professional will help to assess your options, and can help you determine whether an investment property may be a good option for you in this housing market.

### **The ugly: Work, work and more work**

As a landlord, you are responsible for maintaining the property in a good state of repair. You also need to ensure that the property complies with all health and safety and housing standards. Even if your tenant knew about any problems before they agreed to rent the space, you still need to make sure the property is in good condition. That means you will need to make any necessary repairs promptly. So unless you are willing to take on the efforts and expenses for maintaining a rental space, you may want to think twice before you go down the road to becoming a landlord.



And it’s not just the inside of the home you are responsible for. As a landlord, you are responsible for maintaining all common areas. That means shoveling the driveway in the winter, mowing the lawn in the summer, removing leaves from gutters in the fall, and cleaning the chimneys in the spring.

You also hope that your tenant will let you know, in a timely fashion, when repairs need to be done, so there’s no unnecessary damage to the property.

Dianne, a make-up artist from Toronto, recalls her basement apartment tenant who didn't notice a leak coming from the upstairs kitchen.

"When I noticed the leak, there was mold growing everywhere," she says. "It cost me thousands of dollars to repair and it wasn't covered by insurance."

Sofia says that the wear and tear on a rental property is much higher than a primary residence. "My tenants tended to not call me, so there was definitely some long-term damage," she says. "My husband had to take care of most of the handyman stuff. There were weekends that I wouldn't see him, because he was repairing the rental."

And of course there is all the work involved in being a business owner, keeping track of receipts, budgets, accounting and taxes, legal fees, and the work involved in finding good tenants.

There are property management and maintenance services that will take care of your property, renting it out, and keeping track of all the accounting. The fees can be a flat rate, but usually fall somewhere around 10 per cent of the rental price depending on the size and condition of the property. However, when real estate prices are high, and rent may barely cover your mortgage and expenses, hiring a service could eat into your profits.

### **The really ugly: Problem tenants**

Iman's story continues. She took her renter to the landlord-tenant tribunal, and although they said he needed to pay-up his late rent, getting him to comply was another issue. He was a self-employed lawyer, making it impossible for his wages to be garnished by an employer.



“I was soon schooled in how difficult it is to remove a problem tenant and get the money that was owed to me,” sighs Iman. “Lawyers warned me that tenant rights in Canada are heavily protected.”

In most Canadian cities, you can't just tape an eviction notice to the door, and expect your tenant to just pack their boxes and get out. Before you can legally evict your tenant, you will likely go through a hearing with a landlord-tenant tribunal, and landlords need to have some compelling proof and reasons for the eviction. This takes time, money, and is often wrought with delays – not to mention stress.

Should an income property be a part of your wealth-building portfolio? That should only be decided after considering all the risks and benefits, and whether other investments would be a better fit for you, especially if you don't know how to use a screwdriver, or have any interest in using a plunger. Buying an income property is about more than just making money, and it's a longer-term investment; you can't just buy one day and sell the next.

“The far majority of us will never get rich overnight” says Tsai. “It takes long-term investing and a diverse portfolio to build true wealth. Don't forget that real estate can be a part of the equation.”

So what happened to Iman's nightmare tenant? It was costing Iman more money, time and mental anguish as she continued to try to evict her tenant. Eventually, her renter agreed to leave if the debt was forgiven, and Iman felt that she had no choice to accept. But, even after all that, Iman still rents out the house, as she believes it is a good path to building wealth. She has found a new renter, who is much more prompt with payment, but “he's still a pain,” she laughs.

— *Denise O'Connell, MoneyTalk Life*

<sup>1</sup>Canadian Rental Housing Index. Community Profile. Rentalhousingindex.ca. Accessed July 27, 2016

<sup>2</sup>Canadian Real Estate Association. MLS Home Price Index. crea.ca/housing-market-stats/mls-home-price-index/hpi-tool. Accessed July 27, 2016

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