Pros and Cons of Real Estate Investing: A Comprehensive Overview

Including real estate as an asset class in your investing portfolio adds diversity to reduce your overall investment risk. There are many real estate investing strategies to achieve this. Some options, like real estate investment trusts (REITs), are as passive as holding dividend-paying stocks. Others, like buying and holding rental properties for cash flow and capital appreciation, require active involvement and a fair amount of knowledge to be successful.

I’ve personally found the results of active real estate investing far surpass more passive strategies. And let’s face it, owning and profiting from actual properties is a lot more exciting than owning shares of a stock on paper.

Like any investment, taking on real estate in your investment portfolio has its pros and cons.

The Pros of Real Estate Investment

1. **Real Estate Appreciates Over Time**

Well-chosen real estate appreciates over time, generally at a rate that far outpaces annual inflation. Yes, there are occasional market corrections, and people can buy the wrong type of property at the wrong time. But I’ve found there is always a

chance to buy a quality property at a discount, make improvements to increase equity and eventually sell for a profit. It’s the real estate equivalent of the stock market mantra to “buy low and sell high.” And real estate always has an intrinsic value. A stock can go down to zero, but a property is a tangible asset that will always have value derived from both the raw land and the “improvements” (the building structures attached to the ground).

2. **Real Estate Has Unique Tax Benefits**

Real estate’s unique tax benefits allow investors to grow their wealth over time. Rental income is not subject to self-employment tax, and the government offers tax benefits to real estate investors. These include depreciation and significantly lower tax rates on long-term profits. And depending on your income level and classification as an investor or real estate professional, there is a good chance your rental property will give you an overage of tax deductions you can use against your other income. Rental real estate is a business, which means many expenses, such as travel costs to check on your properties, are tax-deductible expenses of running your business.

3. **Real Estate Provides a Steady Cash Flow**

Rental properties can provide a steady flow of monthly income called "cash flow." This is the extra money that is left after all the bills have been paid. Once your property is set up, cash flow provides ongoing, monthly income that is mostly passive, allowing you to spend your time building a business, spending time with family, or reinvesting in more real estate.

4. **Real Estate Lets You Use Leverage**

You can use the power of leverage to quickly grow your real estate holdings and accelerate your wealth-building results. Leverage is the use of borrowed capital to purchase and/or increase the potential return on investment. Leverage, when used wisely to minimize risk, is a powerful advantage of real estate investing. Using a conventional loan, you can buy an investment property with a 20% down payment. So, for example, with an initial investment of $30,000, you get the opportunity to control — and get all the benefits of owning — an asset worth $150,000. Done with proper due diligence, you can build your wealth exponentially using leverage, especially in the low interest-rate market we're currently enjoying.

5. **Real Estate Builds Equity**

When you use leverage wisely, your tenants are essentially buying the property for you. Rental income pays down your loan each month and builds equity for you. When you buy a rental property using a mortgage, your tenant is the one paying the mortgage payment, thus increasing your net worth each month. Think of it as a savings account that grows automatically without your depositing money each month.

Today you might owe $200,000 on a rental property, but next year you might owe only $195,000 because the tenant is making the payment for you, making you $5,000 richer. Thirty years down the road (or whatever the term of your loan), it's paid down to $0. You own a significant asset that you can sell or continue renting, all thanks to your tenant paying the mortgage.

6. **Real Estate Gives You Control**

You have a lot more control over your overall investment success with real estate than with other investing classes. You can't sit in the boardroom and steer management decisions that influence the value of the stocks you own. With real estate investing, you are in the driver's seat of a lot of decision making. You can mitigate risks and grow your portfolio at a much faster pace investing in real estate. As a real estate investor, I'm in control of my success or failure. When I want to find deals, I can hustle. In a competitive rental market, I employ strategies to make sure the best tenants are attracted to my properties. I can make strategic improvements to increase rental income.

7. **Real Estate Provides a Hedge Against Inflation**

Inflation is the economic reality that prices increase over time due to the value of money decreasing. The annual inflation rate varies. For the 12 months ending June 2019, the U.S. inflation rate was 1.6%. In 2011, the inflation rate was 3.2%.

Inflation erodes the value of many investments. If your annual gain last year from your stock portfolio was 5.5%, your actual profit was only 3.9%, with the purchasing power of your money decreasing by the rate of inflation.

Real estate investments keep pace with inflation. As the price of a loaf of bread goes up, so do rents and property values. The one thing that doesn't increase is the monthly cost of a fixed-rate mortgage payment.

So as your annual rental income increases, your cost of ownership doesn't. As inflation pushes the cost of living

higher, your cash flow increases. And inflation drives up the value of the property itself. In 10 years, when I want to sell, my properties will be worth a lot more than they are now.

The Cons of Real Estate Investment

Real estate Investing also has some disadvantages to consider carefully before jumping in.

1. **Real Estate Requires Money**

You need money to make money. Forget the gurus who promise, "You can get rich buying real estate with OPM (Other People's Money)." While you can buy shares of stock with a minimal cash outlay, real estate investing requires money. To get started, you'll need a down payment plus closing costs and money to repair and update the property to maximize rental income. And once you own the property, there will be ongoing expenses like property taxes, insurance, mortgage payments, and property maintenance.

2. **Real Estate Takes a Lot of Time**

You need to spend time learning and managing your real estate investments. There's a learning curve, and you can lose a lot of money in real estate if you don't know what you're doing. On top of that, actively managing your rental properties can be time-consuming.

However, some services can do the "heavy lifting" when it comes to managing your rental property. Roofstock is an online investment platform that lets you purchase turnkey rental properties. That means, if you choose, you don't have to lift a finger. The service's certified property managers can do all of the work for you. Plus, properties listed on Roofstock are pre-vetted and already cash-flow positive.

3. **Real Estate Is a Long-term Investment**

Real estate should always be bought with a longer-term strategy. You're buying a tangible asset that you can't quickly liquidate for cash if you need emergency funds. It takes time to sell a property, and the transaction costs are higher than selling stock shares.

4. **Real Estate Can Be Problematic**

Tenants can cause problems and cost you money and valuable time wasted in court. If you own rental properties, your cash flow can take a significant hit if you end up renting to a tenant who doesn't pay, leaves the property in very poor condition when they move out, or both.

In Maryland, where I invest, the law is very "tenant-friendly," and you must take a non-paying tenant to court three times before you can seek possession of your property from them. And when you do evict, you'll likely have to shell out money to repair the damage your unhappy tenant did to your property.

5. **Real Estate Benefits Don't Always Apply**

At certain income levels, some of the tax benefits no longer apply. Before you assume you qualify for any breaks, you should consult a tax professional with experience in real estate.

6. **Real Estate Investing Has Unique Risks**

Risks need to be understood and mitigated as much as possible. Following are a few of the significant risks of investing in real estate:

. Buying the wrong property at the wrong time

· Increased liability for accidents that may occur on your property

· Getting stuck with a “professional renter” who knows how to work the legal system at your expense

· Getting overleveraged. This is a pitfall that brings down many real estate investors. You need to be able to make monthly payments on your debt despite market dips, tenant problems, property vacancies, unexpected repairs, maintenance costs, and other expenses that are part of doing business when investing in real estate. Real Estate crowdfunding services such as Fundrise and RealtyMogul can answer many of the issues raised above. We recommend that you check them out first.

Summary

The main reasons people invest in real estate are to:

1. diversify their investment portfolio with an asset class that’s not directly correlated to the stock market,

2. generate monthly income from rental cash flow, and

3. benefit from long-term capital appreciation.

Active real estate investing isn’t for everyone because there are unique hurdles and risks.

Purchasing and owning rental properties isn’t going to begin building wealth instantly. Real estate can be an incredibly powerful wealth creation strategy, but only if you work it right. You must learn to find, evaluate, and purchase good real estate deals. You need to build a team of go-to contractors, lenders, property managers, and other professionals who provide competent services at reasonable prices.

As you build your rental portfolio, you can put systems in place that limit the need for your active involvement. Then your wealth steadily grows through passive income, increased equity through debt paydown by your tenants, and long-term capital appreciation. It works for me!

– Ruth Lyons