



Investing In Real Estate

by **Andrew Beattie** ([Contact Author](#) | [Biography](#))

Buying [real estate](#) is about more than just finding a place to call home. Investing in real estate has become increasingly popular over the last fifty years and has become a common investment vehicle. Although the real estate market has plenty of opportunities for making big gains, buying and owning real estate is a lot more complicated than investing in stocks and bonds. In this article, we'll go beyond buying a home and introduce you to real estate as an investment.

Basic Rental Properties

This is an investment as old as the practice of landownership. A person will buy a property and rent it out to a tenant. The owner, the landlord, is responsible for paying the [mortgage](#), taxes and costs of maintaining the property. Ideally, the landlord charges enough rent to cover all of the aforementioned costs. A landlord may also charge more in order to produce a monthly profit, but the most common strategy is to be patient and only charge enough rent to cover expenses until the mortgage has been paid, at which time the majority of the rent becomes profit. Furthermore, the property may also have appreciated in value over the course of the mortgage (according to the U.S. Census Bureau, real estate has consistently increased in value since 1940), leaving the landlord with a more valuable asset. (To learn more, read [Paying Off Your Mortgage](#) and [Understanding Your Mortgage](#).)

There are, of course, blemishes on the face of what seems like an ideal investment. You can end up with a bad tenant who damages the property or, worse still, end up having no tenant at all. This leaves you with a negative monthly [cash flow](#), meaning that you might have to scramble to cover your mortgage payments. There is also the matter of finding the right property - you will want to pick an area where vacancy rates are low (due to demand) and choose a place that people will want to rent.

Perhaps the biggest difference between a rental property and other investments is the amount time and work you have to devote to maintaining your investment. When you buy a stock, it simply sits in your brokerage account and (hopefully) increases in value. If you invest in a rental property, there are many responsibilities that come along with being a landlord. When the furnace stops working in the middle of the night, it's you who gets the phone call. If you don't mind handyman work, this may not bother you; otherwise, a professional property manager would be glad to take the problem off your hands - for a price, of course. (For further reading, see [Tips For The Prospective Landlord](#).)

Real Estate Investment Groups

[Real estate investment groups](#) are sort of like small [mutual funds](#) for rental properties. If you want to own a rental property, but don't want the hassle of being a landlord, a real estate investment group may be the solution for you. A company will buy or build a set of apartment blocks or condos and then allow investors to buy them through the company (thus joining the group). A single investor can own one or multiple units (self-contained living space), but the company operating the investment group collectively manages all the units - taking care of maintenance, advertising vacant units and

interviewing tenants. In exchange for this management, the company takes a percentage of the monthly rent.

There are several versions of investment groups, but in the standard version, the [lease](#) is in the investor's name and all of the units pool a portion of the rent to guard against occasional vacancies, meaning that you will receive enough to pay the mortgage even if your unit is empty. The quality of an investment group depends entirely on the company offering it. In theory, it is a safe way to get into real estate investment, but groups are vulnerable to the same fees that haunt the mutual fund industry. Once again, research is the key.

Real Estate Trading

This is the wild side of real estate investment. Like the [day traders](#) who are leagues away from a [buy-and-hold](#) investor, the real estate traders are an entirely different breed from the buy-and-rent landlords. Real estate traders buy properties with the intention of holding them for a short period of time (often no more than three to four months), whereupon they hope to sell them for a profit. This technique is also called [flipping](#) properties and is based on buying properties that are either significantly undervalued or are in a very hot market.

Pure property flippers will not put any money into a house for improvements - the investment has to have the intrinsic value to turn a profit without alteration or they won't consider it. Flipping in this manner is a short-term cash investment. If a property flipper gets caught in a situation where he or she can't unload a property, it can be devastating because these investors generally don't keep enough ready cash to pay the mortgage on a property for the long term. This can lead to continued losses for a real estate trader who is unable to offload the property in a bad market.

A second class of property flipper also exists. These investors make their money by buying reasonably priced properties and adding value by renovating them. This can be a longer-term investment depending on the extent of the improvements. The limiting feature of this investment is that it is time intensive and often only allows investors to take on one property at a time.

REITs

Real estate has been around since our cave-dwelling ancestors started chasing strangers out of their space, so it's not surprising that Wall Street has found a way to turn real estate into a publicly-traded instrument. A [real estate investment trust](#) (REIT) is created when a corporation (or trust) uses investors' money to purchase and operate income properties. REITs are bought and sold on the major exchanges just like any other stock. A corporation must pay out 90% of its taxable profits in the form of [dividends](#) to keep its status as an REIT. By doing this, REITs avoid paying corporate income tax, whereas a regular company would be taxed its profits and then have to decide whether or not to distribute its after-tax profits as dividends.

Much like regular dividend-paying stocks, REITs are a solid investment for stock market investors that want regular income. In comparison to the aforementioned types of real estate investment, REITs allow investors into non-residential investments (malls, office buildings, etc.) and are highly liquid - in other words, you won't need a realtor to help you cash out your investment. (For further reading, check out [What Are REITs?](#), [Basic Valuation Of A Real Estate Investment Trust \(REIT\)](#) and [The REIT](#)

[Way.](#))

Leverage

With the exception of REITs, investing in real estate gives an investor one tool that is not available to stock market investors: [leverage](#). If you want to buy a stock, you have to pay the full value of the stock at the time you place the buy order. Even if you are buying on [margin](#), the amount you can borrow is still much less than with real estate. Most "conventional" mortgages require 25% down. However, depending on where you live, there are many types of mortgages that require as little as 5%. This means that you can control the whole property and the equity it holds by only paying a fraction of the total value. Of course, your mortgage will eventually pay the total value of the house at the time you purchased it, but you control it the minute the papers are signed.

This is what emboldens real estate flippers and landlords alike. They can take out a [second mortgage](#) on their homes and put down payments on two or three other properties. Whether they rent these out so that tenants pay the mortgage or they wait for an opportunity to sell for a profit, they control these assets despite having only paid for a small part of the total value. (For more on taking out a second mortgage, read [The Home-Equity Loan: What It Is And How It Works](#) and [Home-Equity Loans: The Costs.](#))

Conclusion

We have looked at several types of real estate investment. However, as you might have guessed, we have only scratched the surface. Within these examples there are countless variations of real estate investments. As with any investment, there is much potential with real estate, but this does not mean that it is an assured gain. As with any investment, make careful choices and weigh out the costs and benefits of your actions before diving in.

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