

How To Invest In Today's Real Estate Market

Investing in real estate is not for everyone. Purchasing a rental property may be for you - especially in today's real estate market - if you're looking for a way to increase your personal wealth.

Of course we can't expect the sky-high appreciation rates of the late 1970s or mid-1980s. At that time a solid return was virtually guaranteed to real estate investors regardless of what they purchased. Today we are looking at a residential market in which a well-chosen, well-managed rental property of 1 to 4 units can be the "shining star" in an investor's portfolio.

What's happened? Today, investment sales are boosted by the availability of fairly priced - and even some under-valued homes, outstanding low-payment interest rates, and a solid rental market. Once again, opportunistic investors are finding it much easier to get a great value, finance the purchase, and keep the property rented. Keep in mind that any opportunity has a downside risk. Real estate is complex, and each property is different. At the present time, experience shows rental property investors can benefit from an informed real estate professional who can find the right property - in the right location - with the right financing. The key to success today is doing your homework and making sure the numbers work in your favor.

If you've bought your own home, you have already realized the financial advantages of real estate ownership. The following gives a brief overview of the many ways you can profit from owning rental real estate today.

Four ways residential real estate investors build wealth:

1 - Lower your taxes Investor tax incentives can be substantial.

Some investors can use deductions from rental property to offset some of their wage income. Other investors, while not eligible for the offset, can avoid owing taxes on their rental income by showing adequate expenses and deductions. Even if rental payments do not cover the investor's expenses, tax breaks may actually make up the difference - or more.

As an investor, you can claim deductions for actual costs you incur for financing, managing, and operating the rental property. That means mortgage interest payments, real estate taxes, insurance, maintenance, repairs, property management fees (if any), travel, advertising, and utilities (if the tenant doesn't pay them). All of these expenses may be subtracted from your adjusted gross income when figuring your personal income taxes up to the amount of real estate income you receive.

Also, don't forget deductions for depreciation. The tax code assumes buildings and improvements "wear out" over time. These "losses" are deductible from income, regardless of the property's actual market value. Depreciation is a "non-cash" expense; that is, no actual payment needs to be made out of pocket. Although the government collects deferred taxes on the income sheltered by depreciation when you eventually sell, you've received "free" use of the money in the meantime. And if you do a tax-deferred exchange by purchasing a replacement property, you can defer taxes on the depreciation and on any profit. (Ask your tax advisor about Section 1031 of the U.S. Tax Code.)

2 - Have a positive cash flow.

A positive cash flow results when the rent you receive exceeds the total you pay for the mortgage, taxes, insurance, maintenance, and other carrying costs.

That's not as hard as it sounds. First, decide whether you need a positive cash flow before or

after taxes. A pre-tax positive cash flow translates into current income, a goal of many retired investors and others with current expenses.

If this is your goal, you need to buy wisely. Not all properties will yield rental income which is high enough to cover expenses. Make sure you know how much rent to expect by researching rents for similar units nearby, the property's current rental fee, and date of the last rent increase. Keep in mind you may need to purchase with a large down payment to keep your mortgage payments smaller.

A positive after-tax cash flow can come from a negative pre-tax cash flow. Generally, the depreciation deduction makes the difference. If you meet the eligibility test, you'll be able to use the depreciation to shelter some of your taxable income and reduce your tax bill.

Second, you'll want to ensure your tenants make timely rental payments and take care of the property. Of course, a positive cash flow is impossible without rental income. A thorough credit, employment, and landlord check on applicants will help you find good renters. A strong lease, combined with a required security deposit, will help put you ahead.

3 - Use leverage

As an investor, you magnify the return on your investment by borrowing a large part of the purchase price. That is, by limiting the amount of cash you invest, you make your cash go farther. Leverage means using borrowed money to increase equity. And equity - the difference between what the property is worth and the balance owed on the mortgage - is what's important when figuring whether your dollars are invested wisely.

Assume you bought a \$100,000 rental property with a 30 percent down payment, and after several years the home is worth \$135,000. The \$35,000 return on your \$30,000 investment is more than 10 percent. (Several factors will actually lower your profit, but to illustrate the principle of leverage we're keeping the numbers simple.) If you bought that same \$100,000 property with all cash, the return on your investment would be 35 percent. Leverage puts other people's money to work for you.

4 - Benefit from growing equity.

Even at a modest rate of appreciation, real estate may well yield a higher return on the cash investment than some other financial investments, such as bonds or long-term CDs. Each mortgage principal payment you make is a payment to yourself. You build equity as your mortgage principal shrinks, even if your investment property doesn't change in value.

Although homes in different parts of town may appreciate at entirely different rates, the key is to have a knowledgeable professional to carefully guide you in your search. Review your expectations and think about how long you plan to hold your investment. When you reach your predetermined "equity target," it's time to sell or refinance - and perhaps use the cash you receive for other investment properties.

CONSULT A PROFESSIONAL

Your best asset in choosing investment property - whether a rental property or a vacation home - is your real estate professional. A knowledgeable realty agent can locate prospective properties, provide information and perform a market analysis, investigate local ordinances and regulations, and present your offer to the seller. The agent can also assist in finding the best available financing. Remember, you'll also need the professional assistance of a real estate

attorney, a tax advisor, and possibly a property manager.