Property Investing For Real Estate Novices

By Elizabeth R. Elstien

Ever thought about dipping your toes in the real estate waters? Research separately conducted by both Fannie Mae and RealtyShares, who worked with the help of Harris Interactive, shows that 85 percent to 55 percent, respectively, of Millennials are in favor of buying into real estate as an investment. If you already have a retirement fund, savings and some extra capital, maybe it's time to look to property investment.

There are two primary ways to get your feet wet as a real estate investment novice: residential small multifamily and commercial real estate trusts. The first involves a down payment and the second the purchasing of shares, as discussed here. Once you get comfortable in one investment strategy, you may want to mix it up and learn the other for a more diversified investment portfolio.

Residential Property Investing

A multifamily property of four units or less can be a profitable investment, but you'll need a down payment and closing costs. If the property is purchased as your primary residence—meaning you live most of the year in one unit of the property—you qualify for a residential mortgage just as if you were buying a house or condo for your family, which means you may be eligible for FHA or VA loans with lower down payment amounts. You can even get down payment assistance if you qualify in your locale.

Do your research and purchase through a real estate agent who is knowledgeable in area rents. Alternately, pay a property manager to view a few potential properties with you and provide insight into ease of renting units, items to be addressed for rental safety and livability and range of unit rental price(s) to make an informed purchase. Avoid making contract or monetary commitments on the property with your real estate agent until this supplementary information is evaluated.

Realistic rental rates for the unit(s) you plan on renting to others is important in your decision. After all, you need an accurate estimate to know if the rent(s) will pay all or a portion of your mortgage after expenses—utilities, maintenance/repairs, insurance, property taxes, management, advertising, etc.—are deducted. If you choose to manage the property yourself, you will save money on management fees, which can be around 10% of rents plus any surcharges for maintenance or repair work.

Real Estate Investment Trust

Commercial real estate is hard to get into as a beginner due the tighter loan and insurance requirements, as well as the high amount of capital needed. A Real Estate Investment Trust (REIT) is a simpler way to get into commercial real estate that requires considerably less cash outlay. About half of all REITs are in pension plans, 401(k)s or IRAs, so you may already be a REIT investor through your workplace. With high taxes charged on REIT payments, investing through these delayed-tax or tax-free programs is a boon to commercial investors, but you may want to invest in REITs on your own, so prepare to pay as much as 30-40 percent in taxes and fees on earned dividends.

Described by the U.S. Securities and Exchange Commission as "a company that owns and typically operates income-producing real estate or related assets", a property (equity) REIT can hold an office building, industrial warehouse, data facilities, retail shopping mall, apartment complex, resort, hotel or self-storage facility. REITS typically have one property type in their portfolio, but some have multiple types.

Instead of buying a building outright, you buy stock in any number of REITs. Modeled after mutual funds, a REIT is a professionally managed investment property that pools money from numerous investors. National Association of Real Estate Investment Trusts (Nareit) notes that "REITs historically have provided investors of all types regular income streams, diversification and long-term capital appreciation". Of course, you must choose the right REIT to invest money in, so research your choices and work with a reputable financial planner or REIT broker. Check the Nareit website for REIT investment options, along with a wealth of information to keep you informed.

Considerations of Property Investing

Know the pros and cons of investing in one or both real estate investment options. Some items to consider as you study the market include:

The economy. As you may remember, the recession beginning in 2007 took the rental market down with high unemployment and the closing of large and small businesses. People could not afford to rent—notably high-end properties—and investments declined in value for the short term. Decide if you can afford to weather another economic downturn before investing in real estate.

Interest rates. Higher interest rates tend to decrease REIT shares and increase the initial cost of a small multifamily property. Study interest rates for your best investment value in the market when you purchase.

Property type. Hospitals and medical-industry tenants, who tend to lease for many years, keep vacancies low and are a safe choice for REIT investments, as everyone needs healthcare no matter the economy. Office, retail and residential rentals, for instance, come with more volatility in slower markets.

Do Your Research

Real estate as an investment strategy can be worthwhile, but not without research. Study the properties before you make your move to include a full analysis of income and expenses, market factors and other considerations. Get second opinions, consult with small multifamily or REIT property experts, work with a mentor and perform your due diligence to vet properties that don’t pay off or have the long-term potential to perform.

Discuss with your financial planner and accountant to determine if you are financially prepared to dabble in the real estate market. If ready, jump on in and get wet, but it’s best to use a trusted real estate agent or REIT broker to help you make informed purchases.

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