

PUTTING Stock IN Real Estate

The 1986 Tax Reform Act chased many real estate investors from the market because they believed the main rationale - tax sheltering - was eliminated; yet individual investors can still receive tax breaks. Other factors also deter some people from investing in real estate; difficult tenants, maintenance and repair time and costs, lack of liquidity, and detailed record keeping. As with any investment venture, knowledge of the industry is key. Armed with such knowledge, however, real estate investors can reap handsome rewards from their money for a number of reasons.



Diversity—Investors should never put all their eggs in one basket, and this adage includes the stock market—particularly considering its current volatility. In fact, even if returns from securities and real estate were completely even, the residential property profits would be more valuable than stock market returns because of current tax laws.



Tax Savings—Real estate offers tax advantages such as deductions for maintenance and repair costs, management expenses, and depreciation. In some cases the combination of first-year accelerated depreciation and hefty startup costs can produce tax deductions that exceed the size of an initial cash investment when 80 percent of the cost of that investment is financed with borrowed funds. This means that if investors are in the 31% tax bracket, their net initial cash outlay may be reduced to zero!

Income—Real estate investors make money several ways. While they own the property they earn money via rent income and tax benefits. Then when they sell the property they make money through equity buildup from paying down on the loan balance and through appreciation in value.



Equity Buildup and Appreciation—For many people, investing in real estate is a great opportunity to gain equity and possibly generate cash flow in a hands-on investment. As the population keeps growing in the United States, land prices will continue to rise, meaning that real estate will continue to be one of the best investment opportunities in the country. And as land is developed, existing houses will be in high demand.

Inflation Hedge—Income property investments are typically held for long-term gain as well as a hedge against inflation. Real estate investors actually profit from inflation because with a 30% equity, just a 3% inflationary increase in property values results in a 10% return on investment.



REITs—One way to own property without the hassles is to buy mutual funds that invest in real estate. Real estate investment trusts (REITs) are companies that own the properties themselves, eliminating investors' work in finding, managing, and selling a property. REITs also pay out 95% of their income in dividends and reinvest the rest. Since 1975, REITs have also outperformed stocks by 17% a year, as compared to 15%.

Real estate will always afford investors opportunities to make money. Ultimately, however, individual investors have to determine the best opportunities for their portfolio.