How to Invest in Real Estate

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Retirement

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Investing in real estate is super popular, and—if you do it right—you can make some real money! You know why? Because property is *valuable*. As Mark Twain said, “Buy land. They’re not making it anymore.”

Surveys show that most Americans think real estate is a great long-term investment.[1] So, what holds people back?

Let’s be honest: It can be hard to get into real estate investing because it’s a big commitment. You’ll have to put in a lot of time, money and serious work!

Before we talk about *how* to invest in real estate, we’ll walk you through the different types of investment properties so you know your options. Then we’ll get to the good stuff—how to get started, how to make money in real estate and even how it affects your taxes.

Let’s dive in!

Types of Real Estate Investments

First, real estate investing comes in different shapes and sizes. So if you want to know how to invest in real estate, you have to learn your options, like these:

Homeownership

Our culture needs a mindset shift. Many people want to *buy* a home, and that’s good. But it’s time to reach higher. The goal is to *own* the place.

Homeownership is the first step in real estate investing—and a huge step toward having financial peace. In fact, paying off your home is the best way to invest in real estate. Once you do that, as long as you pay taxes and insurance, you won’t ever have to worry about losing your house. You can stay calm regardless of the ups and downs of the real estate market.

Not having a mortgage also frees up your budget to save for other investments. It won’t increase your income, but you’ll feellike you got a raise without that monthly payment!

Plus, owning your house outright is a huge boost to your net worth. Remember, your net worth is what you own minuswhat you owe. Since the point of investing is to increase your net worth, start by getting out of debt *first*. Then, any real estate you buy is gravy!

The bottom line? Pay off your house *before* investing in any other real estate.

Rental Properties

Rental properties are a great way to bring in extra cash. They can add thousands of dollars to your yearly income. And if you decide to sell, you could earn a nice profit depending on the type of property and how you managed it.

That said, rental properties come with renters. And being a landlord has challenges. You'll face seasons when someone doesn't pay rent or you're in between renters. You also have to consider the expenses of maintenance, repairs and insurance. And then there's the time cost. When the toilet busts at 2 a.m., guess who has to come to the rescue? That's *you*!

Rental properties are a great investment if you're playing the long game—you can milk that cash cow for years! But if you want quick wins, you might prefer the next option.

House Flipping

Flipping a house means you buy it, make improvements, and then sell it—all within a fairly quick amount of time. The key is to buy *low*, because in most cases, you can't expect to make a decent profit unless you're really getting a great deal on the front end.

House flipping is appealing because it's quicker than renting out a property for years. In a matter of months, you could get the house back on the market and (hopefully) turn a nice profit.

But just like other investments, there's a risk you could lose money—especially if the market changes or the house turns out to be a dud.

Another word of warning: Flipping houses isn't as glamorous as TV shows make it seem. If you love hands-on work, then have at it! If you don't, you'd better hire a contractor. And either way, budget plenty of time and money for the process. Renovations almost always cost more and take longer than you think they will.

Before you jump into house flipping, talk to a real estate agent about the potential to successfully flip houses in your area. They'll help you figure out how to get into real estate investing based on your local market.

How to Invest in Real Estate in Six Steps

All right, let's talk strategy! Remember, your first investment property should be your primary home. After that's 100% paid off, then you'll be ready to start investing in additional properties. Here are six steps on how to invest in real estate—beyond your primary home:

Step 1: Pay in cash.

Yep, you read that right! You should alwayspay in cash—in full—any time you buy or renovate investment properties. Don't even *think* about going into debt for this!

Now, our advice might be the opposite of what you'll hear from some real estate investing "gurus." But the truth is, *there's no such thing as "good debt."* Debt always equals risk—and the riskier your investment, the more likely you are to lose everything. That's no good!

A 100% down payment takes debt out of the equation and lowers your risk. Can't find a tenant for your rental property? Who cares—without a mortgage, you don't need renters right away. Housing market took a nosedive right when you wanted to sell the house you flipped? That's okay. You can afford to wait for the market to pick back up.

Paying in full also sets you up to make money sooner. Instead of repaying a lender, you get to keep all the profits. *That's* how to invest in real estate wisely!

Now, this means you won't be able to invest in real estate with just a little money. And that's okay! If all you've got is a little money, put it toward your retirement. Which brings us to . . .

Step 2: Diversify.

Have you ever heard the phrase, "Don't put all your eggs in one basket"? That wisdom applies to your investments.

When you reach a specific step in your finances (more on that later), we teach that you should invest 15% of your household income into retirement accounts. And inside those accounts, you should use good ol' mutual funds as the foundation of your wealth-building strategy. After that's locked and loaded, you can start investing in real estate.

Oh, and don't cash out your retirement savings to buy property—or anything else. Your real estate investing funds should be separate from your retirement savings.

Step 3: Stay local.

Don't buy an investment property in Arizona if you live in Illinois! When you live far away from your properties, you're forced to blindly trust a management company to handle your business—and that makes it much harder to hold them accountable.

Now, it might still be a good idea to hire a management group, even if you're local, to help things run smoothly. But you—and only you—are the property owner. So stay close and keep tabs on your investments.

Step 4: Be prepared for risks.

Usually, renting out property isn't as simple as getting renters and checking in once a year. Sometimes rentals sit empty for months, which can be tough if you're not financially prepared. And even in the best situations, appliances still break and roofs still leak.

The best way to prepare for risks and cover unexpected expenses is with a fully funded emergency fund.

Step 5: Start small.

Not sure real estate investing is for you? Test it.

Maybe you can rent out a space above your garage or an extra bedroom—even for a few nights at a time. That'll give you a taste of what owning a rental is like.

It's also wise to talk to other real estate investors. Get lunch with them and ask them what they wish they'd known before getting started.

Step 6: Hire a real estate agent.

We can't stress this enough: You *need* a local real estate agent. They'll know what areas you should look into and what hurdles you might face as a real estate investor. And when it's time to buy a property, they can help you get a better deal than you'd get on your own.

How to Make Money in Real Estate Investing

You can make money from real estate properties two ways: *appreciated value* and *cash flow* from rental income.

Appreciated Value

Despite the real estate market's ups and downs, most property values increase over the long term. In fact, home values have risen almost 50% over the past decade.[2] That increase in value is called *appreciation*.

The key to buying real estate that appreciates is *location, location, location!* You can sell a mobile home with a 5-acre yard for $150,000 in Kentucky. But put it on a lot the size of a postage stamp on a beach in Malibu—and suddenly it's worth millions!

So consider location carefully. Buy in an area where values are rising. Look for property near water or with a great view. And look for good bones. If a house has a great floor plan but the carpet is ugly as sin, buy it! Flooring isn't too complicated—you can replace it and earn the money back when you sell.

But if you buy a house where you have to walk through two bedrooms to get to a toilet, you're in trouble. Bad architecture doesn't appreciate. After all, nobody wants a house that looks like a toddler drew the blueprints!

Rental Income

Owning and renting out property is a great way to make money without a lot of effort. Other than lining up renters and paying for (or doing) repairs and maintenance, your part is pretty hands off. There's even less for you to do if you hire a property management company. (That'll cut into your profits but could be worth it if you want the help.)

Keep in mind, dealing with renters can be frustrating and time-consuming. So do your homework and make sure they'll keep your property in great condition. And always make your tenants sign a written lease. Then there's no question if there's a disagreement—everything's on paper.

You should hire a contract lawyer to review your lease too. They'll help make sure you've covered all your bases. Plus, if you ever need to evict a tenant who's causing trouble or missing rent, you'll already know an attorney. Eviction expenses can pile up quickly, though, so make sure you have your emergency fund fully stocked.

How Are Real Estate Investments Taxed?

Even if you live for crunching numbers, taxes for real estate investing can get complicated. So our first piece of advice is to get a tax pro on your team. They'll help you understand how your investments are taxed and keep you up to date on tax laws.

In the meantime, here are the most common real estate investing taxes.

Capital Gains Tax

Capital gains are the profits you make when you buy an investment property and then sell it for more money. And because the government is, well, the government, they want to get their hands on some of those profits. So they charge you a capital gains tax. (We know—it sucks.)

You'll pay short-term capital gains taxes when you sell a property you've owned for less than a year (think flipping a house).[3] You'll pay long-term capital gains taxes if you sell an investment property you've owned for over a year.[4]

Fortunately, you can postpone paying capital gains taxes if you reinvest the profits in a similar property.[5] That's called a 1031 exchange, and it's a house flipper's best friend!

Rental Income Taxes

Any money you make from rental property counts as income on your tax return. The good news is, you can also claim deductible expenses like repairs and maintenance—but not improvements.[6]

So maybe you made $20,000 from rental income this year but you also completed $2,500 worth of repairs on the property. You can deduct the $2,500, making your taxable rental income $17,500.

Real estate taxes can get tricky fast, so do yourself a favor and work with a tax professional. Meet with them regularly to discuss your investments and how they impact your taxes—you don't want to get slapped with a penalty!

When Should You Start Investing in Real Estate?

There’s a lot of hype around investing right now. With inflation rising and stocks and cryptocurrency going crazy, many people feel like real estate is a safer bet. (There’s something reassuring about the fact that you can actually *touch* a piece of property, right?)

New real estate investing companies are letting people buy partial ownership of an investment property—and then make part of the profit. That sounds great, but it’s important to keep a few things in mind.

First, always do your homework on any company before investing in it—and make sure they’re not just going to tie up your investments in debt. (Ugh, no thank you!) Besides, there’s a lot of corporate hoopla to deal with if you use a real estate investing company. But when youpay cash for your own investment property, you get to call the shots and make the money.

Also, just because the trendy economic nerds *say* it’s the right time to invest, that doesn’t mean it’s *actually* the right time to invest. You should start investing in real estate *only* when your personal finances are in order.

If you’re familiar with what we teach at Ramsey, you may be wondering where investing in real estate fits into the 7 Baby Steps or your overall wealth-building plan. We like the way you’re thinking!

You should invest in real estate only after you’ve already paid off your own home (so, after Baby Step 6). That means you’re completely debt-free with an emergency fund of three to six months of expenses saved. You should also already be investing at least 15% of your income into retirement accounts, like a workplace 401(k) or Roth IRA.

And remember: Don’t buy an investment property until you can pay 100% down.

Why Pay Off Your Own Home First?

We get it—waiting until you’ve paid off your house probably sounds like it’ll take a really long time, especially if you feel like opportunity is knocking at your door right now. But trust us on this. It’s worth it to wait until you’re *really* ready.

Let’s take Greg as an example. He owes $150,000 on his own house. Since he has a 15-year fixed-rate mortgage at 2.5% interest, that means he pays $1,360 a month on his mortgage, including taxes, homeowners insurance and such.

Greg brings home $5,500 per month—so his mortgage payment is a little less than 25% of his monthly take-home pay. Way to go, Greg!

He wants to make faster progress on his financial goals, and he thinks having rental income will help. So he decides to finance a rental property.

Greg finds a great rental house for sale for $150,000. He uses the $30,000 he has in savings for a down payment. Then he takes out a 15-year fixed-rate mortgage at 3% interest for the other $120,000 (*uh-oh*). That adds a second mortgage payment of $1,120 to his monthly budget.

But he isn't worried, because he plans to rent out the house for $1,500 per month. That'll cover the mortgage on the rental and put a little extra cash in his pocket. Greg thinks it's a great plan. (Spoiler alert: Greg is wrong.)

What Greg doesn't know is that it will take *three months* to find renters, which means he'll pay $3,360 in mortgage payments on his new rental while it sits empty. For those three months, paying the mortgage on his own place and his rental will take up 45% of his income!

And all that time, Greg's going to feel like he can barely breathe. What will he do if the air conditioning unit goes out or the dishwasher starts leaking? What if his kid gets sick? What if he loses his job?

Don't be like Greg. Don't rush it. Real estate can be a fantastic investment—*if* you do it the right way. So be smart. Pay off your own house, invest in your retirement accounts, and save, save, save so you can pay in full for your investment properties. When you've done all those things, *then* it's the right time to invest in real estate.

Is Real Estate Investing for You?

Real estate investing has its pros and cons, and it isn't for everyone. If you're wondering whether real estate investing has a place in your wealth-building plan, you need to get two key people on your team: an experienced real estate agent and a kick-butt investing pro.

The agent will help you learn about your local market and get great deals if you do decide to jump in. You can connect with a top-notch real estate agent through our Endorsed Local Providers (ELP) program. These RamseyTrusted pros are here to serve you—period.

And the investing pro? They'll help you understand investing concepts and make a plan you feel good about. Need help finding quality pros? Try SmartVestor. It's a free way to find qualified investing pros in your area.

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