

# Your Guide to Passive Real Estate Investing

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Real estate, including land, homes, office and retail buildings, is a popular type of investment for people who like to put their money into assets they can physically see and feel. Many investors also choose to invest in real estate because it produces income, or because it's relatively easy to borrow money to invest in properties.

One of the drawbacks of [real estate investing](#), however, is that it can take more effort than other forms of investing. Active real estate management involves being a landlord and dealing with renters, or putting in the work to rehab and renovate homes or buildings to be put up for sale.

For passive investors, there are some investing options that offer the benefits of [real estate investment](#) without the effort and active management that many real estate investments require.

## Note

Borrowing money to invest in assets, including real estate, is also called leverage.

## What Is Passive Real Estate Investing?

[Passive real estate investing](#) involves buying into real estate without taking an active hand in managing the properties.

Someone who purchases a home and then works as a landlord, finding and vetting renters, collecting rent, and fixing up the home as needed would not be a passive real estate investor. Instead, a person who purchases shares in a real estate investment trust (REIT), which buys real estate and deals with the day-to-day management of that real estate on behalf of the REIT's owners, is a passive real estate investor.

Active investors put not only their money but their time into their investment. This can have the advantage of increasing potential investment gains but means that active investors spend much more time on these investments. Passive investors are free to focus on other things after choosing only to involve their money in the real estate investment.

There are many ways for people to invest in real estate, both actively and passively, and each has pros and cons.

## Preparing To Invest in Real Estate

Real estate investing can be difficult and stressful for beginners. There are a few steps recommended by experts that you can take to get yourself ready to start investing.

Robert Chase of Pro Deal Evaluations offered some advice in an email to The Balance. “Invest in accordance with your goals. If you want current income, the appropriate passive investments include diversified funds, projects with smaller value-adds...and debt transactions. If you’re focused on total return, you can take more value-add risk,” he said.

Chase suggested that potential buyers try to get references for good targets from people who are already invested in passive real estate, as well as finding someone whom you know to talk you through a transaction.

Rachel Hernandez, an author and real estate investor who focuses on mobile homes, said, “For anyone just starting out as a real estate investor, I always recommend doing a small deal first. With small deals, you can make mistakes and learn from them without as much risk as a larger deal. “After doing a few small deals, then you may be ready to take on a larger deal. Small deals allow you to gain experience and learn from your mistakes with less risk,” she told The Balance by email.

Hernandez continued, “It’s best to decide on a niche and specific asset class of real estate that you want to buy (i.e. single-family homes, condos, apartment buildings, etc.). From there, you’ll have to study the market and explore neighborhoods. Get to know the values of the types of properties that you intend to buy including the rents in the area.”

## Note

Some passive real estate investors choose only to look locally for deals, while others are willing to go farther from home to find opportunities. It’s possible to be a successful real estate investor from afar but can make due diligence, such as learning about the neighborhood a home is in, harder.

## Types of Passive Real Estate Investments

There are many different types of passive real estate investments.

### Real Estate Investment Trusts (REITs)

One option is the [real estate investment trust \(REIT\)](#). REITs are popular among investors who want to produce cash flow from their investments. REITs are companies that invest in real estate such as single-family homes, apartments, retail locations, hotels, offices, warehouses, or shopping malls. Generally, REITs purchase and invest in properties to add them to their long-term portfolios, producing returns from rental income and appreciation of the properties.

By law, REITs must pay out at least 90% of their taxable income to shareholders as dividends. Most pay out almost all of their income, so investors can expect to receive more cash flow from a REIT than many other investments.<sup>1</sup>

### Turnkey Rental Properties

A [turnkey rental property](#) is a home that doesn't require any renovations, repairs, or updates after you purchase it. You can simply sign the closing documents and immediately start renting it out.

Most people who are looking to make rental properties a passive investment hire a real estate management company to help them. These companies handle the day-to-day of taking care of your investments, including finding and vetting renters, collecting rent, and doing necessary maintenance.

Hiring a real estate management company comes at a cost, though. You'll likely pay fees for things like finding new tenants, evicting non-paying tenants, and new lease signings, in addition to the ongoing cost of property management. Typical fees will be up to about 10% of the total monthly rent.<sup>2</sup> However, if you hire a management company, you won't need to spend time worrying about the property and will receive the benefit of regular rent checks in the mail, usually along with property appreciation.

## Real Estate Crowdfunding

Crowdfunding is a method of investing in which a management company pools investments from a group of individual investors. Together, the pooled funds of the individual investors can purchase larger investments than any of them could buy individually.

There are many [real estate crowdfunding](#) companies out there, each offering different investment opportunities. Some popular options include [farmland](#), large apartment buildings, office complexes, retail locations, storage facilities, and hotels.

Typically, investors pay a management fee to the company organizing the crowdfunding deal. Each investment has a stated strategy, target return, and investing timeline. Often, investors can't get their money back until the company managing the investment chooses to end the investment. That means that investors will need to plan for long-term commitments that could lock up their money for a long time.

## Hard Money Lending

If you have a lot of cash but don't have the time or skills required to purchase, renovate, or manage real estate investments, you can get involved in real estate investing by borrowing from [hard money lenders](#).

Hard money lenders offer loans to people who want to purchase homes, typically so they can renovate and flip those homes or otherwise turn a profit on their real estate investment. Unlike banks, hard money lenders usually offer quick financing and charge higher interest rates.<sup>3</sup>

Hard money lenders rely on finding good borrowers who succeed with their real estate investments. If the real estate investment succeeds, the hard money lender usually does well. If the investment goes poorly, the hard money lender might have to deal with a borrower that defaults.

## Pros and Cons of Passive Real Estate Investing

Pros

- Many deals don't require a lot of capital
- Less time-consuming than active real estate investment
- Produces income
- Backed by a physical asset, unlike some securities

## Cons

- Can require long holding periods
- Some investments can incur high tax burdens

## Pros Explained

- **Many deals don't require a lot of capital.** "Investors can access residential and [commercial real estate](#) investing through REITs. Investors can own a piece of an office complex, a mall, or an apartment building without having to afford the full price of the real estate," Ricardo Pina, entrepreneur and founder of the Modest Wallet, said in an email to The Balance.
- **Less time-consuming than active investment.** Passive investors are free to focus on other things after making this kind of real estate purchase.
- **Produces income.** Whether you purchase a REIT or a home that you have managed by a third party, you'll receive regular checks from your investment.
- **Backed by a physical asset, unlike some securities.** Investments like [stocks](#) and bonds aren't backed by a physical asset. Some investors like that they can see and feel their investment, which makes things like real estate seem more secure.

## Cons Explained

- **Can require long holding periods.** Real estate prices can sometimes experience drops or long periods of flat valuations. For investors to profit, they may need to hold their investments [for the long term](#).
- **Some investments can incur high tax burdens.** Investors who receive income from real estate investments like REITs pay higher taxes on that income compared with other investment returns, like long-term capital gains or qualified dividends, which can be a concern for income investors.<sup>4</sup>

## Frequently Asked Questions (FAQs)

## **Which is riskier, investing in stocks or being a passive investor in real estate deals?**

It can be hard to predict whether stocks or real estate will be riskier. Both have pros and cons. Stocks tend to be more volatile, but are often more liquid and easier to build diversified portfolios with, which can reduce risk.

With real estate, unless you buy REITs or other diversified investment vehicles, it can be harder or more expensive to diversify your investment with multiple properties. However, real estate tends to be less volatile than stocks.

## **What is passive LLC real estate investing?**

Limited liability companies, or LLCs, let business owners limit their personal liability in the event that their business fares poorly, accrues debt, or gets sued by a customer. Some investors in real estate choose to form LLCs to buy real estate investments, limiting the potential for one property's catastrophe to hurt their personal finances or other investments.

## **How much money do you need to start investing in real estate?**

The amount of money you need to start real estate investing varies with the type of investing you want to get involved in. Buying a share in an REIT can be very affordable and is achievable for most investors. If you want to purchase an entire home to renovate and sell or rent out, you may need hundreds of thousands of dollars to finalize the deal.

## **What is the meaning of the 'cap rate' in real estate investing?**

"Cap rate" is short for capitalization rate, which is the rate of return that real estate investors expect from a property. It is commonly used to analyze different real estate investment opportunities, with investors typically aiming for higher cap-rate opportunities.