

## Should I invest in residential or commercial real estate? (Part 1: Residential)

Many “experts” provide dangerously incomplete information. Part one discusses residential real estate

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Before making your first investment, **you have to choose** whether it will be residential or commercial real estate. There's no shortage of so-called “experts” who will tell you that one or the other is vastly superior and that their choice is the one you should always choose. And people like that are almost always very experienced in one, but not the other. In other words, **they don't know what they don't know.**

Choosing the best answer for you requires understanding both, so you know what best matches your risk tolerance and timing. So **first**, let's look at the type of real estate most people are familiar with: **residential real estate.**

### What is it?

Residential real estate involves **structures that individuals live in (and/or the land under them)**. This includes single-family homes, vacation homes, condominiums and townhomes. It also includes small one to four family rental units.

Like all real estate investments, you can choose between equity and debt. (See the tutorial on What's the Difference between Equity and Debt Investments?)

Some investors will make **equity investments** to purchase residential properties and make money from the income and/or price appreciation.

### About Ian Ippolito



Ian Ippolito is an investor and serial entrepreneur. He has been interviewed by the Wall Street Journal, Business Week, Forbes, TIME, Fast Company, TechCrunch, CBS News, FOX News and more.

Ian was impressed by the potential of real estate crowdfunding, but frustrated by the lack of quality site reviews and investment analysis. He created The Real Estate Crowdfunding Review to fill that gap.

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For example, you might purchase a property from foreclosure, fix it up, and rent it.

Other investors will make **debt investments** that fund other people or investors, and make money from the interest. For example, you can invest in mortgages which individual people use to purchase homes. Or you can invest in hard money loans which are loans to investors who are fixing up properties and flipping them.

## How residential is “presidential”

Residential real estate is **generally much cheaper** than commercial real estate. As a result of this lower cost and also lower startup expenses, there have historically been **many more small investors** in this class, than commercial. (However, with the invention of real estate crowdfunding, this is starting to change.)

## Cycle friendly

Both residential and commercial properties are highly affected by local conditions. At the same time, they both are affected by national cycles as well.

Residential real estate also has a national **cycle that's distinct and different from commercial real estate**. For example, **for almost 100 years** (from the Great Depression until the Great Recession), there had **never been a nationwide drop** in residential real estate prices.

In contrast, **commercial** real estate is very **cyclical** (especially the most fragile sub classes) and tends to have **downturns every eight years on average**. So often, timing is much less important in residential real estate, then it is in commercial.

## To market, to market

Also, the residential market functions very differently than commercial real estate. This is because many **“investors”** in residential real estate are actually **homeowners**, instead of dispassionate investors.

**Commercial** properties are valued based on the **income and appreciation** they can generate for an investor. **Residential** properties are valued on numerous **things that have nothing to do with the value** of the property as an investment (including the emotional connection that the owner has with the property).

So this can be both a **hassle and an opportunity**. On one hand, many properties are priced too high to be very profitable. On the other hand, since the market is very inefficient, an **investor with local knowledge** can usually **find superior deals** that outperform.

On the downside, residential properties usually **don't throw off as much cash flow per square foot** as commercial properties. So residential investing is usually **not as profitable** as commercial.

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## Next: commercial

Now that we've looked at residential properties, let's look at [commercial next, in part two of this article](#).

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