

The Pitfalls of Investing in Real Estate

So, you want to invest in real estate. . .

For a number of years, individuals have been looking for investments that would pay higher returns than bank deposits, stocks or mutual funds. All of those investments were paying small returns due to the Federal Reserve Bank having lowered the interest rates to spur the economy over the last several years.

Many people invested in real estate on the expectation of significant appreciation by "flipping" the property. The investor buys a house for a price, does little or no work done on it, and then sells it for a higher price, obtaining a profit on the transaction.

Another method used by real estate investors over the last several years is to invest in a house or six flat and rent it out to various tenants. The investor expects to earn rents over the term of the lease and then at an appropriate time, sell the property at a profit.

Investing in real estate is not without pitfalls. When you sell the property, there are higher transaction costs, i.e. broker's commissions, title charges, survey fees, than what you would see in other types of investments. There is a smaller pool of other investors who might purchase the property from you when you are ready to sell than what you would find in owning a stock or mutual fund. Moreover, your investment is not readily available when you need it without selling the property or refinancing it.

Another pitfall of the real estate investor who owns a house or six flat for rent is that you are a landlord with all that goes with it. That means when the furnace goes down at 3 a.m. on Sunday morning, the tenant calls you. If there is a new roof needed on the property, you have to find a contractor and pay for it. If the tenant is not a good tenant and causes the property to be damaged, you have to fix the property for the next potential tenant. If the tenant fails to pay the rent when it is due, you are the one who has to begin eviction proceedings with a five day notice and to bring them to court to obtain eviction, which might take several months. These problems with bad tenants were fairly common over the last several years as most of the good tenants purchased their own property taking advantage of the low interest rates.

In the last several weeks, many newspapers have indicated that there is a softening in the real estate market due to rising mortgage rates, causing properties to remain unsold on the market for longer periods of time. Even in once hot real estate markets like Phoenix, Las Vegas, San Diego and Washington, D.C., there is evidence of a cooling off in those markets. As the mortgage rates continue to increase due to the Federal Reserve increasing the Fed Funds Rate, the price that investors might pay goes down, resulting in a lower or marginal profit.

Investing in real estate is fine as long as you don't mind the real estate cycles and are mindful of the pitfalls.

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