How to Make Money From Real Estate Investing

Description

Investing in real estate is one of the most expensive financial decisions. Buying a property takes up your life's savings or binds you to a 15- to 20-year mortgage. Unless you understand the legal, administrative, and tax impact of buying a property, you are better off using the services of real estate experts. If you are looking to buy real estate as an investment, here is a guide on how to make money from it.

Three ways to make money from real estate

Land is the oldest form of investment, and there are three ways to make money from it:

- Appreciation: The property value appreciates when there is development or discovery of oil or when the property is around a civil infrastructure like a road or airport.
- Rent or royalty: You get paid so others can use your land.
- Alternative: Real estate investment trusts (REITs), mortgage-backed securities (MBSs), mortgage investment corporations (MICs), and real estate investment groups (REIGs).

Among the alternatives, REITs are closer to real estate investment. The other three are debt instruments, as they hold mortgages and earn from interest.

Should you buy physical real estate or a REIT?

There are two popular ways of investing in real estate. You can either buy a property or a REIT. Let's weigh both options.

Physical real estate

Buying a property involves significant capital and expenses like maintenance, property tax, and mortgage interest. The property price and expenses depend on the property type, location, and many other factors. Hence, specialists came up with the 5% rule. It gives you a rough estimate of the cost of owning a property. The rule states that maintenance, property tax, and debt and equity costs should add up to 5% of your property value annually.

So, if you buy a property for $450,000, your overall expense should come to $22,500 a year, or $1,875 a month. If that property earns you higher rent, then you are better off owning a property.

Real estate investment trust

REITs make real estate investments accessible even to those who don’t have much knowledge of real estate. It has a team of real estate specialists that buy land, develop it, and sell or lease the developed property. Even REITs earn money from capital appreciation and rental income, which they give to shareholders through regular distributions.

If you look at the dividend page of a REIT, you will see tax information that gives a breakdown; other income (income from rent or mortgage interest), capital gains from a property sale, and return on capital. Some REITs that invest abroad give a breakdown of foreign non-business income. This breakdown appears on your T3 form for REIT distributions, as they are taxed differently. But you can save on this tax by investing in REITs through the Tax-Free Savings Account (TFSA).

So, instead of investing $450,000 on physical real estate, you can distribute this money across different REITs like industrial, residential, office, retail, healthcare, hotel, or diversified. Retail and commercial properties, especially metros like Toronto, attract a higher rental income. So, you can stay in Alberta and still get exposure to higher rents in Toronto.

SmartCentres REIT

SmartCentres REIT (TSX:SRU.UN) provides an annual distribution yield of 5.82% before taxes. SmartCentres has retail properties in the Greater Toronto Area, and it earns 25% of its rental income from **Walmart**. Plus, it is developing mixed-use properties that will appreciate the value of the retail stores. You can get one unit of this REIT for less than $50.

Final takeaway

REITs can’t replace physical real estate investing, but they can make real estate accessible to beginners. They are a good way to hedge inflation and get regular passive income.

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