Real Estate Investing in Canada

Description

Canadian real estate investing involves purchasing investment or rental properties, rehabbing distressed homes, issuing private mortgages, or even buying shares in a real estate investment trust (REIT) or real estate ETF. Even with high interest rates making it more expensive to borrow money, investing in real estate can be a very profitable enterprise, especially if you combine it with stock investing.

The mix of steady cash flow, tax breaks, and capital appreciation can make real estate investing a solid contribution to your investment portfolio. It can be labour-intensive, sure, but with so many different ways to invest in real estate, you can surely find one that fits your lifestyle.

If you're up for the challenge, here's what you need to know about real estate investing.

What is real estate investing?

Real estate investors buy, lease, rent, and sell pieces of real estate for profit. For many investors, it's a key asset in their portfolio diversification, which involves combining numerous assets (stocks, bonds, real estate, cryptocurrencies, etc.) to achieve a balanced portfolio that minimizes risks and maximizes gains.

Real estate investors make money in numerous ways. They can buy distressed or undervalued properties, rehab them, and resell them for a higher value. Or they could buy rental and vacation properties and earn recurring revenue off rent. They could also buy commercial properties, such as warehouses and office spaces, and rent them out to businesses and corporations.

While many real estate investors are actively involved in buying and selling properties, others take a passive approach. Instead of pounding nails in walls, you could invest in REITs or real estate exchange-traded funds (ETFs). These stock-like investments allow you to capitalize on the real estate market, even if you're not actively flipping properties yourself.

How to invest in real estate in Canada

1. Buy a house
2. Flip a house
3. Buy rental property
4. Buy commercial real estate
5. Buy vacation property
6. Invest in real estate investment trusts (REITs)
7. Buy land
8. Issue a private mortgage

The great thing about Canadian real estate investing is that it has no shortage of options. Whether you want to buy property and manage it yourself, or take a hands-off approach and invest in a fund, you can surely find a method that fits your budget, time, and schedule.

Let’s look at the most common ways to invest in Canadian real estate and see which ones might be best for you.

1. Buy a house

Most Canadians are real estate investors without even realizing it. Yes, when you buy a home, not only are you buying four walls to live in, but you’re also putting your money in a long-term investment called *equity*.

Equity is the difference between what you owe on your mortgage and the value of your home. As you make more monthly mortgage payments, your equity — your investment — goes up. Likewise, as your home increases in value, whether because the overall market is gaining value or you renovated your property, your equity increases (if your home’s value goes down, the opposite happens).

If your home is the place where you live for most of the year, you’ll label it your “principal residence”, which can help you get a tax exemption for capital gains if you sell the house later.

2. Flip a house

Thanks to HGTV, house flipping is probably the most popular real estate investing strategy out there. It’s also the most misunderstood and underestimated in terms of work.

The most common way to flip a house is to buy a home in dire need of a cosmetic lift (called a “distressed property”). Additionally, you could also buy foreclosed or auctioned homes, as these properties often sell for less than market values. As you make renovations to the house, the resale value tends to increase. Once you’ve made the home safe to live in, you can list it for a higher price.

In theory, house flipping can seem like a lucrative idea. But in practice, it can be difficult to keep your rehabbing costs low. Property flippers must know which renovations and repairs will yield the highest resale value, as some will cost you more than the return on investment.

Another challenge is knowing where to *find* properties. Some house flippers do what's called "driving for dollars," in which you physically (or digitally) drive around neighborhoods looking for vacant or distressed houses. Others will scout auctions for foreclosures or pre-foreclosures. You might even want to hire a real estate agent or property wholesaler, someone who can bring deals to you.

3. Buy residential rental property

If house flipping sounds like too much work, you could buy rental property instead.

In fact, as more and more Canadians are renting for longer periods of time, becoming a landlord isn't such a bad idea. As a property investor, you could rent out single-family homes, condos, apartments, duplexes, or even townhouses. Rent from your tenants will produce extra cash flow, and you could also benefit from long-term appreciation of your property.

Keep in mind, you'll be in charge of the maintenance and upkeep on the property. The mortgage rates on residential property are typically higher than those on your primary residence. You'll also need to keep a long-term perspective with rental properties, as it could take years before you recoup your initial investment.

4. Buy commercial real estate

Commercial real estate is rental property for businesses and corporations. This includes malls, shopping centres, industrial complexes, grocery stores, and offices.

Similar to rental properties for residential areas, commercial property requires a large upfront investment—but much *more.* You'll typically need more than a few million (possibly even billions) to even sit at the table of commercial investors.

5. Buy vacation property

Vacation properties are short-term rentals, such as Airbnbs or bed and breakfasts. It doesn't have to be separate from your principal dwelling: the intersection of technology and hospitality has made it easier for people to find accommodation (think: Airbnb), and you could easily rent out a room in your home.

More ambitious real estate investors will want to buy vacation property near key Canadian destinations, such as Blue Mountain, Jasper National Park, Niagara Falls; or in big touristy cities, such as Quebec City, Vancouver, or Montreal. If you can handle the maintenance and cleaning of your property, you could potentially make a killing off tourism. Plus — when you want a vacation for yourself, you have a vacation spot you can go to. Who knows, it could end up becoming your retirement home.

Just be aware of the investment costs: you're in charge of the maintenance, upkeep, and cleaning, not to mention the extra mortgage payments. And, if we ever experience another 2020, you'll have to figure out how to balance potential losses with your other income.

6. Invest in real estate investment trusts (REITs)

Not everyone wants to pound nails or manage property. Thankfully, for real estate investors who prefer a more hands-off approach, you can always invest in a Real Estate Investment Trust (REIT).

A REIT is basically a real estate company that owns and manages numerous properties. As a REIT investor, you and several others pool your money and allow the company to use it for their real estate endeavours. In short, they do the dirty work. You provide the money and earn profits.

As with other investments, REITs have investing risks. The biggest is losing money when the value of your REIT drops due to either the underlying property becoming less valuable or rising interest rates digging into your REIT company's profits.

But if you're okay taking on these risks, REITs can be a great investment for your portfolio. For one, REITs pay dividends. That alone can come in handy, as the extra money from dividends can give you a steady stream of income to supplement your normal paychecks.

Secondly, REITs can diversify your portfolio. Depending on your REIT, you could invest in numerous properties across Canada, not just one region. That can give you a major hedge against total loss if the real estate market performs poorly in one area.

Finally, REITS give you an easy way to invest in real estate without requiring you to actually buy property. As with buying property, you still want to be strategic about which REIT you choose. You don't want a REIT that's invested in poorly performing areas. But if you make a solid choice, you can expose yourself to real estate in a passive way.

7. Buy land

As Mark Twain once said, "Buy land. They don't make it anymore." When you own vacant land, you can rent it out for agricultural or recreational purposes. You could also sell it if it becomes more valuable, or you could build on it.

8. Issue a private mortgage

Instead of buying property or investing money in a REIT, you could take another approach to real estate investing. You could become a private mortgage lender. As a private mortgage lender, you play the role of the bank. You lend money to homebuyers, charge an interest rate on what they borrow, then slowly take back in what you lent out.

Why would homebuyers come to you for money? Well, they may have no choice. They could have poor credit, or their income threshold or job status may disqualify them from getting a traditional mortgage. Either way, a demand for private mortgages does exist. And if you have a lump sum growing by a meagre interest rate, lending it out as a private mortgage could help you earn more.

Pros of real estate investing

- **Real estate helps you diversify your investments.** Real estate has a low correlation with stocks, meaning activity in the stock market doesn't necessarily affect real estate values. Having real estate in your investment portfolio might help you balance losses during bear markets, market corrections, and other volatile times.

- **Real estate assets provide extra protection against inflation**. Inflation and real estate typically move together: as prices for certain materials go up, so do home prices and rent. This could help your overall holdings outpace the rate of inflation, which becomes more important as you approach retirement.

- **Real estate investing could lower your overall tax bill.** The government looks at your real estate ventures almost as a business. Property taxes, property depreciation, mortgage interest, and even maintenance and repairs can be written off as business expenses, helping you cut your tax bill.

- **You have an opportunity to make a major impact on a community.** Real estate investing isn't just for greedy capitalists. You could invest in affordable housing or add a much needed grocery store in a food desert. This could give new life to a dying rural town, or you could add new business space to boost the local economy.

Cons of real estate investing

- **You need more money upfront.** Even with the recent market correction in Canada, the average price of a home is still high. You'll need significant cash and access to credit in order to buy properties and fix them.

- **Real estate is less liquid than stocks or ETFs.** Buying property isn't like buying stocks; you can't just cash out whenever you want. You must list your properties, market them, sell them, wait for the mortgage process to finish, and finally collect your money. Even when you rent or lease, it could be years before you recoup your initial investment.

- **Managing and maintaining property is time-consuming**. Flipping homes and managing rental property is often a real estate investor's primary job. Though you could hire a property manager to take care of your properties, that's one more extra cost you'd have to pay. On top of that, maintenance and upkeep can get expensive. Between lawn service, seasonal maintenance, and necessary repairs, you'll need to have extra cash lying around to cover all the costs.

- **The real estate market is unpredictable**. While real estate prices have historically risen over time, the market could drastically change. Supply and demand, interest rates, and changing demographics all play a role in which way the market will swing. Even if you buy property in a hot market today, nothing guarantees it will remain hot tomorrow.

How does real estate investing affect your taxes in Canada?

In Canada, you pay a *capital gains tax* when you sell property for a value higher than the amount you paid for it. The keyword here is "sell." Only when you sell your property do you lock in your capital gains. If you don't sell, you won't pay taxes.

Contrary to what some people think, your full capital gains aren't taxed at your marginal tax rate. Only *half* of the capital gains are subject to your marginal rate. So, if you flipped a house and made a profit of $100,000, only $50,000 would be subject to the capital gains tax.

Finally, keep in mind, capital gains apply to properties and houses that *aren't* your principal dwelling. If you profit from the sale of your main home, you'll qualify for a tax exemption.

How does real estate investing compare to stock investing?

Stocks and real estate aren't worlds apart. In fact, they share several similarities. Both can provide you with cash flow, passive income, and investment gains in the form of increased share prices or higher property value. Taken together, they can help you hedge market risks, as stocks may still perform well during a real estate crisis and real estate property could perform well during a stock market crash.

But beyond that, stocks and real estate have several key differences that might make one more suited towards your investing style. Here's how they compare.

Stocks have a lower barrier to entry

With online brokerages and robo-advisors, you could start investing in stocks with as little as $1. The fees on online brokerages are typically extremely low (or non-existent), and though you'll still want to pay attention to trading commissions, you could become a stock investor with little extra costs.

Real estate investing is a different story. Unless you invest in a REIT, you'll likely need to have a large sum of cash to get started. That alone could stop many Canadians, especially given the state of the real estate market right now.

Real estate property can be hard to sell

When compared with stocks, real estate is far more difficult to liquidize. Unlike the stock market, which uses brokers and market makers to ensure there's always a buyer for every seller, real estate investors have to find buyers, negotiate prices, and collect money on the sale.

Stock investing requires technical knowledge

Short squeezes, hedge funds, ETFs, mutual funds, short selling. Yes, stock investing may require you to learn a lot of investing strategies and concepts. And if you want to be a DIY stock investor, you'll also have to learn the ins and outs of different stock companies, analyze balance sheets, and make informed decisions.

Real estate investing requires you to learn some key strategies, too, but the knowledge you need to succeed is usually far less technical. For some real estate investments, such as your principal home or vacation property, you just need to choose the best location, one that helps increase your equity.

Real estate investing can be taxing

You may not have to analyze a company's finances or spend your weekend reading financial news to be a successful real estate investor. But don't think it's a walk in the park. If you own property, you're in charge of maintaining and repairing it, not to mention paying property taxes, insurance, and the mortgage. And things could get rough if you rent property to troublesome tenants.

Who should invest in real estate?

- **Investors with deep reserves and liquid cash.** If you plan on investing actively in real estate, you'll need lots of cash upfront. You'll also need a good credit score, as you'll likely need access to credit and loans.
- **Business-minded folks who can manage various properties.** Property management requires time — lots of time. This isn't a part-time gig: for many real estate investors, it's a full-time job.
- **Investors who want to diversify their investments.** If you're already invested in stocks and funds, real estate could offer you another way to grow your money. You could invest in REITs or real estate ETFs if you don't want to be an active real estate investor.

Is real estate a good investment in Canada?

Adding real estate to your portfolio could be a smart choice. You can diversify your investments, take advantage of certain tax breaks, and create a solid stream of income that could carry over into retirement.

But, as with any investment, you want to know what you're doing. The gains on real estate investing can be immense. But so can the losses. And while you may feel motivated in the beginning to flip homes and manage rental property, the maintenance and upkeep, especially in storm-prone areas, can get old fast.

If you're new to investing, you could learn the ropes with a more passive approach, such as a real estate ETF or a REIT. Both of these can expose you to the real estate market without requiring you to buy property. That might be more suitable for Canadian investors, especially as buying residential and commercial property has never felt more out of reach.

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