

addition to this, sellers often assume financial responsibility for many of the buyer's fees, contributing yet more to the ever-growing drains on your investment.

To illustrate transactional costs and the difficulty of retaining earnings in tangible investment properties, the above graphic is a representation of the cost in taxes on capital gains, by state, if any are made from the sale of an investment property. These do not include federal gains taxes, which can cost between 10-37% of the gains from your sale depending on your tax bracket.

To view the reality of where additional revenue from renting a second property will go, the graphic below illustrates a breakdown of your monthly earnings and costs based on average rental income and costs for a three bedroom house. These calculations show that investing in real estate will not give you the grand payout you are hoping for as passive income. We have assumed a generous rent amount to be charged but in reality, a \$3000 rent for a three bedroom can be very difficult to achieve. In addition to a generous rent, we have assumed a fairly low mortgage rate from a range of averages.

Average Cost of a Home in the US: \$500,000	\$500,000
Average 30-year Fixed-Mortgage rate: 2.8%	
Average Property Tax: 1.1% of avg home value	
Monthly mortgage payment: \$2,062.00	(\$2,062.00)
Monthly Property Tax payment: $(\$500,000 * 1.1\%) = \$5,500 / 12 \text{ months} =$ \$458.33	(\$458.33)
Assumed Rent for this house: \$3000/month (aggressive)	\$3,000
Presumed monthly maintenance costs using 1.5X rule= $1.5 * \$3,000 = \$4,500 / 12 \text{ months} =$ \$375.00	(\$375.00)
TOTAL Monthly Expense= \$2,895.33	
NET profit / month= \$104.67	\$104.67
Annualized Return= 7.2% Annualized Profit= 0.25%	
Average Return of REITs in 2020= 10.5%	

Lastly, one must consider the value of time spent in managing an investment property. This may become quite costly for those who are liable for managing repairs, maintenance, inspections, rental contracts, and renters, in addition to their normal working lives. Homeowners spend an average of 40-50 hours per year maintaining and managing each additional property, which can be a heavy and costly burden as time goes on, especially given travel and time away from one's present commitments. Legal litigation, risk managers, and property managers required to keep renters in check and protection can reduce the amount received from an additional property by significantly more than one may expect, meaning that any landlord should run a budget plan before setting their rent rate, and can only hope that the needed amount remains competitive throughout fluctuations in their local market.

To summarize, real estate mandates the investment of a large portion of resources towards an illiquid, unstable, and costly asset. Given the price of maintenance, transaction fees in selling, opportunity costs in holding, along with the cost of uncertainty in an unstable market, an

investor can never guarantee financial gain from holding real estate-- however, a dedicated investor can manage their risk and increase the chance of strong returns with the management and expertise of the following strategies.

STRATEGIES:

REITs

As an alternative to investing in real estate directly, one can invest in bonds correlated to the real estate market. For an individual that is adamant about participating in the housing market, Real Estate Investment Trusts (REITs) may be a more profitable investment opportunity. REITs put the responsibility of real estate success into a professional's hands as you reap the benefits. There are several different types of REITs that one may invest in based on the type of property that the agency owns. Private real estate REITs can be volatile and change in earnings and sensitivities based on what it is linked to. One can also invest in hotel real estate, however these types of investments are vulnerable to shifts in the economy, as vacations and hotel use are one of the first industries to be impacted during a recession. Commercial real estate REITs are relatively stable, predictable investments and have little variation in rent rates, therefore little variation in revenue and dividends. If an individual is looking to stay in the real estate market with a more liquid and diverse portfolio while mitigating personal risk, speak with a financial professional about catering a real-estate backed investment portfolio with REITs, mortgage-backed securities, or other investment opportunities tied to the real estate market.

Trusts

When preparing your family to take over an estate, placing real estate into a trust can give you control over how you would like assets to be appropriately managed, and can lend your family a clear sense of direction. There are two types of trusts, revocable and irrevocable. In a revocable trust, ownership of real estate is retained by the grantor, allowing for receivable income and control over the property. In an irrevocable trust, the grantor is no longer the owner of the property, though potentially still allowed to use the property as determined in the rights of the trust. The property is then placed into a non-taxable estate and managed by a named trustee. Trusts should be discussed with a tax professional and legal representation before moving forward.

1031 Exchange Investments

To minimize the loss in purchasing and selling properties, there are several tax and interest strategies that are available. Tax advantages may help to retain the capital genuinely earned by officially recognizing what has been spent, and this is maximized when reviewed or completed by a tax professional.

Under Section 1031 of the United States Internal Revenue Code, investors can defer taxes on financial gains if the proceeds from the sale of one investment or business property are used to buy another like-kind investment, meaning that the gains from the sale of an investment property are used to buy another investment property, or the gains from a commercial property are used to buy another commercial property. 1031 Exchanges are subject to specific rules and regulations, such as that they require an intermediary to place the gains from the sale of the home

into an escrow throughout the exchange. To ensure that conditions for this tax advantage are met, maximized, and recorded accurately, individuals should consult a tax professional.

This exchange offers a competitive advantage in tax rates by retaining the gains made from the sale of one investment. Without this, an individual could lose between 10-35% reduction of capital from their investment simply in moving from one location to another. While you will still be taxed on income kept from the original sale, the tax deferral 1031 allows a seller to transition seamlessly from one investment property to another. This is not a fast or uninvolved process, as the buyer will require expert advice and time to find the right investment, however, as of 2020 the tax deferral is allowed on non-simultaneous investments and can be deferred for a period of time pending the qualification of a specific set of zones and opportunities.

Leaving Real Estate with Minimal Penalties

One must also keep in mind the difficulty of leaving an investment property without financial loss. There are few effective workarounds in existence that can save you money when selling a house, and each involve a series of steps which are best known by a tax or investing expert. Trusts are a valuable resource for managing physical assets such as investment homes, and can be controlled and customized to an individual's specific circumstances in many regards. If it is desired to leave an actively managed, illiquid real estate investment, hiring a professional and inquiring about how to allocate your assets to a trust could save you over 30% of your investment and potentially even reinvest your assets to foster recurring, passive income for many years to come.

HELOCs

For those who want to expand or diversify their properties, whether it be a rental home or a vacation home, there are ways to finance it while leveraging your existing property through a Home Equity Line of Credit (HELOC). Instead of taking out another mortgage at a fixed rate, you have the power to leverage your house against the loan it will provide you for your second property. HELOCs offer greater flexibility with “borrowing” than a traditional mortgage would. With a HELOC, you borrow only as much as you need up to a maximum amount that is predetermined. HELOCs do not have to be a way to finance monthly payments on your second home, but could also be used for renovations and other unexpected maintenance costs. Creating an ideal borrowing strategy allows for smarter financing without negatively impacting your personal financial situation.

CONCLUSION:

Buying a home is much like buying a new dog. It can be fun, but it is a lot of work and it will cost you money. Financial drawbacks such as illiquidity, high maintenance fees, property taxes, low rates of return and realized gains, opportunity costs, and a lack of control over your investments make investing in property an unstable and impractical reality. Normally, an individual looks to enter a market where their money can do the work for them. Even with hired help, entering the real estate market is not a passive investment and will require as much time and energy in maintaining the property as would a second job. Investors should do their due diligence to investigate these underlying consequences before entering the market of uncertainty

and be prepared to hire professional help regarding taxes, retaining earnings, diversifying investments, heirs and estates, and legally protecting their investments. The strategies to exit out of property investments are best left to the professional, as tax laws and work around investments may save you tens of thousands in loss when trying to free yourself from this market, but are difficult to know and impossible to execute without professional help. When searching for the right type of investment, it is important to foster a situation where your money grows as freely from expense and additional required labor as possible.

Sources Cited

- 18, Andy Rachleff. "Why Rental Properties Are Not Good Investments." *Wealthfront Blog*, 23 Oct. 2020, blog.wealthfront.com/why-rental-properties-are-not-good-investments/.
- 24, Brandon Cornett | March. "What Will the U.S. Real Estate Market Look Like In 2022?" *HBI News*, 24 Mar. 2021, www.homebuyinginstitute.com/news/what-the-market-looks-like-in-2022/
#:~:text=What%20the%20Real%20Estate%20Market%20Could%20Be%20Like,big%20one%20for%20the%20nation%E2%80%99s%20real%20estate%20market.
- Associates, // by Nissen and, and Nissen and Associates. "IRS Extends the Opportunity to Defer Capital Gains." *Nissen and Associates*, 14 Sept. 2020, bellinghamtax.com/irs-extends-the-opportunity-to-defer-capital-gains/
#:~:text=If%20you%20invest%20that%20%24250%2C000%20gain%20in%20a,QOF%20within%20180%20days%20of%20the%20sale%20date.
- Backman, Maurie. "Property Taxes Too High? Here's How to Fight Back." *Millionacres*, Millionacres, 28 July 2020, www.millionacres.com/taxes/articles/property-taxes-too-high-heres-how-fight-back/
#:~:text=According%20to%20ATTOM%20Data%20Solutions%2C%20property%20taxes%20on,Here%20are%20a%20few%20important%20steps%20to%20take.
- Boykin, Ryan. "The Advantages of Real Estate vs. Stocks." *Investopedia*, Investopedia, 29 June 2021, www.investopedia.com/investing/reasons-invest-real-estate-vs-stock-market/.
- Chen, James. "Investment Horizon Definition." *Investopedia*, Investopedia, 19 May 2021, www.investopedia.com/terms/i/investment_horizon.asp.
- Chen, James. "What Is the Federal Housing Finance Agency (FHFA)?" *Investopedia*, Investopedia, 24 June 2021, www.investopedia.com/terms/f/fhfa.asp.
- Daly, Lyle. "2021 Capital Gains Tax Rates: Everything You Need to Know." *The Motley Fool*, The Motley Fool, 7 Apr. 2021, www.fool.com/research/capital-gains-tax-rates/#:~:text=Federal%20long-term%20capital%20gains%20tax%20rates%20%20,%20Over%20%24250%2C800%20%20%20Over%20%24473%2C750%20.
- "Existing-Home Sales." *Www.nar.realtor*, 10 June 2021, www.nar.realtor/research-and-statistics/housing-statistics/existing-home-sales.
- Fuscaldo, Donna. "How to Deal with Monthly Maintenance Fees When Buying Real Estate." *Investopedia*, Investopedia, 21 May 2021, www.investopedia.com/articles/investing/091515/real-estate-investing-monthly-maintenance-fees.asp.
- Ganti, Akhilesh. "Dow Jones Industrial Average (DJIA) Definition." *Investopedia*, Investopedia, 7 July 2021, www.investopedia.com/terms/d/djia.asp.
- Garber, Julie. "Here Are Some Helpful Tips on How to Fund Real Estate Into a Trust." *The Balance*, 13 Sept. 2020, www.thebalance.com/how-to-fund-real-estate-into-a-trust-3505275.

- Henderson, Andrew. "Why Buying a House Is a Bad Investment." *Nomad Capitalist*, 25 Jan. 2021, nomadcapitalist.com/2016/10/14/buying-a-house-bad-investment/.
- "Housing Market Indicators Monthly Update." *Huduser.gov*, U.S. Department of Housing and Urban Development, May 2021, www.huduser.gov/portal/sites/default/files/pdf/Housing-Market-Indicators-Report-May-2021.pdf.
- Merryman, US Census Bureau Ray. "US Census Bureau Construction Spending Survey." *Census.gov*, 11 Aug. 2010, www.census.gov/construction/c30/c30index.html.
- Millsap, Adam A. "Treating Housing As Investment Is A Bad Idea For Homeowners And Hurts The Economy." *Forbes*, Forbes Magazine, 8 Jan. 2021, www.forbes.com/sites/adammillsap/2020/02/28/treating-housing-as-investment-is-a-bad-idea-for-homeowners-and-hurts-the-economy/?sh=91e469759ce4.
- "MSG Management Study Guide." *7 Reasons Why Real Estate Is the Worst Investment*, www.managementstudyguide.com/7-reasons-why-real-estate-is-the-worst-investment.html.
- "MSG Management Study Guide." *The Problem with REITs*, www.managementstudyguide.com/problem-with-reits.htm.
- "Professional Resources." *S&P Dow Jones Indices*, 2021, www.spglobal.com/spdji/en/.
- "Real Estate Investing Strategies." *Connected Investors Blog*, 12 Feb. 2018, connectedinvestors.com/blog/best-real-estate-investing-strategies/?wickedsource=google&wickedid=492547685987&wv=3.1&utm_medium=ppc&utm_network=g&utm_campaign=12118200924&gclid=CjwKCAjwiLGGbhAqEiwAgq3q_mZI03lsPLzNzshLe3UCgKjpLMKly5KDJwoceoDXffJdZdzfOMcLMRoCCwkQAvD_BwE.
- Ross, Sean. "Has Real Estate or the Stock Market Performed Better Historically?" *Investopedia*, Investopedia, 19 May 2021, www.investopedia.com/ask/answers/052015/which-has-performed-better-historically-stock-market-or-real-estate.asp.
- Santarelli, Marco, and Jules Rollheiser. "Housing Market Predictions 2021 & 2022: Crash or Boom?" *Norada Real Estate Investments*, 13 July 2021, www.noradarealestate.com/blog/housing-market-predictions/.
- "USHMC - National Housing Market Indicators: HUD USER." *USHMC - National Housing Market Indicators | HUD USER*, www.huduser.gov/portal/ushmc/hmi-update.html.
- Wieland, David. "You Can 1031 Exchange Into A REIT, Here's How." *1031 Exchanges - DST, TIC, NNN*, Realized, June 2020, www.realized1031.com/blog/rolling-from-property-to-reit.