Is Owning a Rental Property Actually a Good Way to Make Money?

Making money off of a rental property seems so obvious at first—if you have enough money to buy a property and rent it out, earning your money back and then some, why wouldn't you? While it's true that investment properties can be a good investment, they also carry a lot of risks, and require a level of operational and financial know-how a lot of people simply don't have. Here's a look at the pros and cons of real estate investment, and common pitfalls to avoid if you do decide to take the leap.

Pros

A steady source of income

In the last twenty years, the annual rate of return from the S&P has averaged 9.8%, and by any measurement, the real estate sector has done just as well. Unlike stocks, a piece of property is a tangible asset, one that can passively earn money through tenants' rental payments. Of course, the asset also depreciates, so upkeep will always be eating away at your earnings; it's a delicate balance. But a well-managed property can provide a steady dividend that's not directly tied to the uncertainty of the stock market, and can be a good way to diversify your overall investment portfolio. It's also worth noting that you'll be investing in an insurable asset, meaning you be somewhat protected if disaster strikes.

Inflation protection

Per Forbes, one of the best ways to fight inflation is through buy-and-hold real estate properties. As inflation rises, so does the value of your property, along with the rent of your tenants. Since inflation is almost always flat or rising, real estate can be a better option than fixed-income investments in the long run.

Tax benefits

Many Americans think of owning property as a birthright, and the tax system certainly reflects this, given the number of deductions you can take for doing so. These include ordinary, improvements, and depreciation costs, which means you can deduct mortgage interest, insurance, and repairs, boosting the return on your investment.

Easy to finance

You can buy a property with as little as a 20% downpayment, allowing you to leverage other people's money to get started. Of course, this can lead to trouble if the investment is poorly managed, but it's a good way to scale up quickly without putting in much money up front.

Cons

Depreciation

You will be in a never-ending war against repairs, big and small. While you can save some money by doing the work yourself, it's a huge, ongoing time commitment (hiring professionals is a better option, but that also comes with a cost). Plus, it's hard to plan for—even if you have the property fully inspected, there are almost always going to be unexpected costs, even in new homes. For examples, SoFi offers up a long, scary list of unexpected repairs you might have to pay for.

Lack of liquidity

Unlike stocks, real estate is not a liquid asset. This means that if you're desperate for cash, you'll have to wait months, or maybe even years to sell your property, even if the market is in your favor.

Difficult tenants

The downside of being a landlord is that you're relying on other people's income for your own cash flow, and people are unpredictable. Managing tenants is a stressful and all-consuming task, whether it means chasing down late or missing rent checks, settling disputes with other tenants, or dealing with unexpected vacancies. It will take a certain level of doggedness to protect your asset, so you'll have to be comfortable with conflict if you want to be a landlord. Of course, you can hire a property manager to take care of this stuff, but that can be costly.

Know what you're getting into

Before you buy an investment property, you'll need to formulate a plan on *how* it will make money for you. This means making an *accurate* budget that includes fixed and variable costs, an emergency reserve, taxes, and numerous legal fees (to get an idea of how many items you'll need to track, check out this list). You'll also have to be smart about real estate trends and choose a property with long-term upside, which isn't always easy to predict. For what is considered "passive income," investment properties are a lot of work, and it can take years before they start paying off, so make sure you know what you are getting into.

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Posts

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