

Think Twice About Direct Real Estate Investing

Written by Rob Copeland

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Many of my clients are interested in investing in rental real estate. They see it as a reliable source of retirement income and believe it may be a good alternative to historically low CD and annuity rates, and bond yields.

My advice to would-be real estate investors: Slow down and think carefully about what you're getting in to. If you have experience in the business of real estate, then investing in rental properties might be a good idea. But if your professional experience is in another field, I strongly advise caution.

Buying rental real estate definitely looks attractive on the face of it. Clients have told me that they've done the math and figured out that they can earn high yields by renting residential properties or vacation properties. They might be able to buy a house for \$100,000 and lease it for \$1,000 a month. On paper, it looks like they'll be earning a 12% yield.

The first thing I ask them is, are you handy? How much do you want to be working during your retirement? Because that's the reality of what's involved when you're a landlord. As the landlord you will have schedule or do everything from mowing the grass to fixing the refrigerator—which lowers your 12% yield. And don't forget, you'll be the one your tenants call every time something goes wrong.

Most of us don't want to work in retirement or to take on a second job as we're approaching retirement. We want to be winding down, not going to someone else's home to fix toilets.

And then you have to deal with people moving in and out of your properties on a regular basis. You might surprised to find that they've not taken care of your property like it was their own—and guess who will have to fix it! Plus every now and then you'll have to replace a big-ticket item; replacing an appliance or an air conditioner can be very expensive, effectively destroying your profitability for years to come.

What if your renter stops paying rent? You've got to evict them, and the process can cost you several months' rent, attorneys fees, time in court and so on. The process can be daunting and expensive for someone new to the rental business.

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Vacation rentals are even more stressful. They involve a never-ending cycle—advertise your home, negotiate pricing, vet the renters, hire the cleaning crew, make sure the old renters are out in time for the new ones to move in. Overseeing this whole circus is even harder if your property is outside the town you live in.

I can tell clients from my personal experience that the amount of work and worry involved in owning rental properties comes close to neutralizing the yield you earn. That 12% paper yield is not real and certainly isn't free, whether you handle the work yourself, hire a rental company and/or hire a handyman to do it.

Finally, rental properties are not liquid. Finding a buyer may take months or, especially in a bad market, years. And the potential sales commissions sting.

No one should "retire" into a situation full of stress and hassle. It's much better to let your money work for you. If you're already paying an advisor, let that person worry about finding you yield. Investing for yield often requires time and patience, but in the end, you'll probably do better than you would in real estate and not lose any sleep over it!

One big caveat: If you've got experience in real estate, then owning rental properties can definitely be a good idea. Patching a hole in a wall or replacing washers is a huge headache for a banker or a doctor, but if you're a contractor, it's probably a snap. Likewise, if you've been a real estate agent, handling the ins and outs of real estate will be a lot simpler, and the whole experience will likely be much more profitable for you.

But if you're new to real estate and think it's a simple way to grab yield, my message to you is, caveat emptor.