The Answer is Real Estate

Now let's look at the benefits that are inherent in real estate investing. Some of these simply aren't available to stock, bond and other asset investors. Others provide a better risk versus reward profile.

Cash Flow Every Month of Ownership

Every month you own it and the rental home is occupied, you're taking in that rent check and going to the bank with it. Sure, some stocks and most bonds pay a dividend, but it's usually a very low yield.

It's quite a bit different when you can own a $150,000 rental home and bank, as an example, around $350/month in cash flow after expenses. Find a stock or bond that does this and I'll buy it!

Appreciation in Value over Time

Your bond will not likely ever be worth much more before it matures, and it could be worth less. Stocks go up and down, sometimes violently, and they are open to significant manipulation as we've discussed.

It is true that home prices took a major hit starting in 2006, but at the time of this writing, values are back to pre-crash levels in much of the country. Before that, they were in a steady boom market. Now we're beginning to see price increases again, and values are expected to rise year-over-year.

Homes have increased in value historically, but there are blips for periods of time. What many failed to see in the most recent crash was the fact that most rental property investors were relatively unharmed. How could that be?

Sure, their properties dropped in value like all the others in every market. However, value is only crucial at the time of sale. They were still receiving the same rental income and going to the bank every month. As long as they didn't have to sell, they really didn't have to worry about short term values.

In fact, while the market was trying to recover from the crash, rents began to steadily rise as former homeowners became renters, and as those who would normally have been first time homebuyers chose to delay or could not afford to enter the housing market. Rental demand increased, and it's still increasing as I write this.

And, it's insured!

You can take some protective action if you use options to protect your stocks, but it's complicated and can be expensive. When it comes to owning a rental property, you have an insurance policy that will pay replacement value if it is destroyed or repair it if it is damaged. Even if it's destroyed, you'll get paid the structure's value and you can sell the land.

Less Inflation Risk

To see why this is true, let's look at the definition of inflation. It's the rise in costs of labor and materials. Now, what do we need to create a home? We need labor and materials. It's logical to assume that when inflation is significant, it's going to cost more to build a new home.

Builders must make a profit. When their costs rise, the price of a new home rises as well. When new homes increase in price, existing home prices will almost always rise as well.

Instead of damaging your investment, as is often the case with stocks and bonds, inflation can actually grow the value of your rental property. Even more interesting, when home prices rise, mortgage payments rise, and rents often rise as well. Renting is the trade-off if you don't want to buy, so when fewer people are buying because prices are rising with inflation, they choose to rent … there's that old supply and demand thing again.

Tax Breaks on Profits at Sale JUST for Real Estate Investors

Let's say that we actually have a great year in stocks, with some nice gains. To protect our gains, we sell some of our holdings at a profit, or we sell to reposition our portfolio into other industries. In either case, you are selling a winning investment just when it is doing well for you.

So, we sell some of our winners. Now we're staring at the tax man and the capital gains tax structure. Those stocks we owned for less than a year would place these profits in the ordinary income tax status, and our rate could be anywhere between 15% and almost 40% depending on your income.

If you owned the asset for more than a year, you get off a bit better. Your long-term capital gains rate at this time is between 15% and 20% depending on your income.

With certain municipal and government bonds you don't have to pay income taxes, but the trade-off is tiny returns on your invested money.

Now, real estate gets some really preferential treatment from the tax man when it comes to your profits at sale. You can't get these deals with stocks or bonds.

When you sell a real estate asset at a profit, if you choose to take advantage of the 1031 Tax Deferred Exchange from the IRS, you don't have an immediate capital gains tax liability. The rules are complex and strict, so you'll need professional advice. However, if you follow the rules you can avoid capital gains taxes the year of the sale.

In the most general terms, the guidelines state:

- You must buy another investment with the proceeds of sale.
- To avoid capital gains completely, you must roll all of your investment into the new investment.
- You won't pay capital gains doing this over and over until the final sale when you don't reinvest again.

Let's repeat that last point just in case you missed it. You can use this 1031 Exchange strategy over and over throughout your life and retirement and not ever have to pay capital gains taxes. In the meantime, the perceived value of your real estate holdings can be used to create cash flow as needed when you leverage the equity.

When you leave this planet, your heirs will inherit your real estate holdings at their "stepped up value." This means that the properties will be valued at their current market value with all previous cost history ignored. You didn't get to really take it with you, but your heirs will certainly make better use of those profits than the tax man.

Tax Breaks While You Own It Too

Anything I tell you about here should be considered interesting, but verify it with an accountant before using it in your investment calculations.

When you own a rental property, you spend money on certain ownership and management related expenses:

- Maintenance
- Mortgage interest
- Real estate taxes
- Insurance

- Repairs
- Management expenses
- Advertising and marketing
- Legal and accounting

Those are all things you'll spend money on during ownership. You can deduct those expenses against the income from rents.

But wait, there's more! One expense you get to deduct is for money you don't actually spend. Depreciation of your rental property is expensed over a 27.5-year period of ownership. You're not spending any money, but you're saving cash on taxes. By the way, this is only on the structure, as the land doesn't lose value over time.

Let's do a quick accounting review of the benefits of real estate investment:

- Monthly cash flow.
- Inflation doesn't hurt a real estate investment as much as stocks and bonds, and can even help.
- Historically, real estate appreciates in value over time.
- Your real estate investment is fully insured against catastrophic loss, unlike a stock investment or corporate bonds in the case of a company's bankruptcy.

- Super tax breaks only available to real estate investors, including the ability to avoid capital gains taxes for a lifetime.

Why, after understanding these advantages, would anyone not consider real estate investment and take one step toward their first purchase?

Life Lesson

During the summer of my sophomore year, I started studying for the ACTs. I was not a great standardized test-taker and I really didn't have the study skills--or the attention span--to be successful spending hour after hour, day after day of my summer studying. My head just wasn't in the books.

My parents were concerned that I was not ready, so they had me wait before taking the test to give me some extra time. At that point, my mom decided to become my "study buddy." She sat with me every day from sunup to sundown.

It was torture. But it was also awesome.

Because my mom put in the time, effort, and dedication to help me, I did, too. She taught me the mechanics of reading the question thoroughly, understanding what the question was asking for, and finding the right answer.

We constantly practiced over and over, taking mock exams, being grilled by my parents, exploring the topics beyond what was contained in the study guide--just immersing myself in the process of studying.

When I tried to study by myself, I didn't really know what I was doing. When my mom sat down with me, I got it done. I scored incredibly well on the test--far higher than on any of the standardized tests I had taken before.

The Takeaway

There's a lot to learn when you're first starting out in real estate investment, but the rewards are so worth it. Find a strategy that works for you. Is there a certain time or study space that helps you to be more productive? Do you have a study buddy who you can work with to reinforce and understand the concepts? Would you benefit from adding additional platforms, like online resources, podcasts (like the Real Estate Deal Talk podcast on iTunes), or national radio shows (like mine)?

Put in the time and put in the effort. Do it every day. If you're doing real estate investment on the side right now, you should still approach it like a job. Do something, learn something, try something every day. You'll be glad you did.