5 Things You Need To Know Before Investing In Real Estate

Understanding the basics of real estate investment before taking the leap

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With the height of the recession a full decade in the rear-view, a new generation of real estate investors are eyeing their first foray into real estate investment in 2018. So far this year, the housing market has proven strong. Though real estate is undoubtedly a sellers' market in 2018, many investors see that dynamic as an opportunity for a faster return on a larger investment than they would typically find by purchasing when prices are down and waiting for the market to flip.

Regardless of the economic climate, any potential investor new to real estate will need to do some research before they jump in. Here are the five most important things to know before deciding to invest in real estate.

Know what you are investing in.

Unlike stocks and bonds, which are easier track and value, real estate qualifies as an alternative asset, traditionally considered more difficult to assess. It is, however, one of the more conventional forms of investment, and there are a number of well-worn paths into the field.

The first step is deciding how you want to find a return on your investment. Typically, that falls into one of three categories: interest from loans, value appreciation or rent. Once you've researched and determined how you want to make your return, you'll then need to make sure you understand the basic types of real estate investments and how each generates income for its owner.

Know your options.

In its most basic forms, real estate property breaks down into five categories:

- Residential properties, like houses and apartments, can be purchased and later sold after renovations or market forces have increased their value, or they can be turned into rental properties and leased to tenants for a slower but more reliable return.
- Commercial properties, like residential, can be rented to tenants, but those tenants are typically businesses, which often require longer-term leases than residential renters.
- Retail properties include shops, malls and outlets. Retail properties have the unique advantage of offering owners a percentage of sales recorded by tenants.
- Industrial properties, including warehouses, manufacturing buildings and distribution centers, make owners money through both long- and short-term leases and can offset their high upfront investment by being relatively hands-off properties with minimal upkeep for owners.
- Mixed-use properties include any combination of retail, residential, commercial, retail and industrial uses in a single space, providing investment diversification in a single property.

Know your finances.

For most investors, real estate is not going to replace their core business or income, but it will almost assuredly have a dramatic impact on their bank account. Having the upfront capital to invest is not enough; you need to have a strong understanding of your entire financial landscape. Before even looking at properties, you should conduct a throughout analysis of your tax returns, any existing property-tax bills, net income, cash flow, credit score, existing loans and any number of other potentially impactful financial factors. Most first-time and even many experienced investors would do well to work closely with a financial advisor before looking into any particular real estate investment.

Know the risk.

As in most investment opportunities, a degree of risk is inherent to every real estate opportunity. Most real estate transactions are paid for by some combination of equity and debt. As the property's value is increased—either through renovations or a change in the market—the return on equity is increased in step, but if the property value declines, so too will both the equity and the debt. The most conservative investors, then, will typically look to increase their equity and decrease their debt. Most advisors will warn against dipping below a 50-percent equity-to-debt ratio and push for a 100-percent-equity capital structure when possible. There is a suite of additional risks associated with each type of real estate investment. Work with your financial advisor to understand and mitigate those risks.

Know your market.

Market strength is the most important factor determining the return on a real estate investment. In order to buy low and sell high, you'll need to be prepared to pull the trigger during a buyers' market and forecast the next sellers' market with some degree of reliability.

There is a bottomless pool of newspapers, blogs, television programming and other resources looking closely at market trends, but don't mistake national patterns for local ones. Pay close attention to the trends occurring in your market and use the national cycle as a larger context to help predict where your market may go next. And don't look exclusively at home prices. Interest rates, lender requirements, population and demographic data, job market and a host of other factors will impact your investment, and each has its own cycle.