WHAT PERCENTAGE OF YOUR NET WORTH SHOULD BE IN REAL ESTATE?

Wealth creation demands proper and remunerative investments. In search of a comfortable retirement life, having a good and balanced net worth allocation strategy is key. Investing in real estate is probably the safest and most recommended way to grow and solidify your financial stability in the long run.

It generally brings positive returns in the shape of passive income, tax breaks, stable flow of cash, rental income etc. However, on average people suffer from mismatched net worth allocation and find themselves asking, **"What percentage of my net worth should be in real estate?"**

Either they invest too much in real estate risking the chance of possible liquidity problems or too little to achieve positive equity and income. Other factors such as age or work experience, risk tolerance and desired financial objectives come into play when it comes to allocating a portion of your net worth in real estate.

In this article, you will find the right insights, reasons and benefits that will meet your expectations and hopefully give you a better understanding on how to invest in real estate, how much percentage you should allocate of your net worth to real estate in an elaborate manner and help you make your investment decisions smartly.

THE IDEAL PERCENTAGE OF NETWORTH TO ALLOCATE IN REAL ESTATE

The decision of allocating how much of your total net worth in real estate has to be taken objectively. The amount of percentage one should allocate into investing in real estate will differ from person to person. Taking financial situation, age, risk tolerance, financial objectives and other factors into account, ideally it should range between 20 to 40 percent of your total net worth.

As a result, this will provide the investor the flexibility to venture into other plausible businesses and investment opportunities while not having to get completely entangled into a single one. This is great because it offers you the luxury to not only take the advantages of your investments in real estate but also minimizes risk factors and liquidity problems.

By allocating the right percent of his or her (his) net worth into real estate an investor would be able to capitalize the benefits and positive returns of his ownership and while allocating his remaining assets in other business ventures will amplify the possibility of wealth creation to a greater extent.

KNOW YOUR NET WORTH BEFORE INVESTING

While calculating your net worth, there are two pieces of information you need to acquire. Your total liabilities that is, the total amount you owe and your total assets, that is everything that you have ownership of. After you have done that, the formula to calculate your net worth is easy enough to understand.

Net Worth = Total Assets - Total Liabilities

ASSETS

Your total assets can be categorized based on certain and each have their own set of monetary value. They are current assets, fixed assets, tangible assets and intangible assets and based on your usage, operating and non-operating assets.

- Current Assets — these assets have a higher degree of liquidity meaning they are easily convertible into cash or cash equivalents within a short period of time.
- Fixed Assets — are long term investments that return a steady income but have lower liquidity such as your investment in real estate.
- Tangible Assets — are those having physical existence.
- Intangible Assets — are such which have no physical existence such as business ownerships, partnerships, your stocks etc.
- Operating Assets — readily used typically in a business to generate revenue.
- Non-operating Assets — not required in daily use but still have use in revenue generation.

LIABILITIES

Debts you owe can be of different types.

- Current Liabilities — short lived debts that are payable within one year.
- Long-term Liabilities — debts that are due for a longer period of time.

From the above classifications, it gives a clear picture to a possible investor about his assets and liabilities thus, his current net worth. This information is vital in the sense that it provides the investor his capability and sustainability before a decision is made.

BENEFITS OF INVESTING IN REAL ESTATE

For its wide range of benefits investing in real estate attracts countless investors. A smart real estate investor can boost his wealth creation in many ways such as predictable steady cash flow, tax advantages, rental income, business profits that leverages your property and diversification. With good business decisions and well organized assets in hand, it is fairly possible to build wealth by investing in real estate.

There are a number of notable benefits that make investors add to their portfolio.

- Cash flow — investing in real estate allows the opportunity to generate a steady source of income strengthening over time. It helps to pay off your mortgage quickly and pave the way to your equity.

- Tax advantages — real estate investors can enjoy countless tax breaks and deductions. It opens the door to reduce tax and save money from operating and maintenance costs. Real estate depreciation not just allows the investor to fully cover up the costs and improvements over the years but also reduces tax income heavily.
- Real estate appreciation — rents and the value of the property tends to rise over the years, leading to an increasing cash flow. Business profits that are dependent on the property is also a great way to make money.
- Ensures equity and wealth creation — when the amount you owe of buying a property is less than the actual value of the property is equity. With the added profits, it is quite easy to pay off your mortgage loans and sustain equity and build your wealth even more.
- Inflation hedge — investing in real estate is a good way to hedge against inflation. Over time the worth of a property rises even above the inflation rates within the economy which is why investments in real estate is said to be an effective hedge against inflation.
- Leverage — properties can also serve as leverages that can improve one's wealth creation or may serve as collateral.

RISK FACTORS IN REAL ESTATE INVESTMENTS

To be considered a smart investor, one ought to be wise enough to evaluate and understand the possible risk factors involved in real estate investments. Important risk factors to be commonly looked out for are - bad locations, unpredictable real estate market, troublesome tenants, decline in cash flow, liquidity problems.

Until 2008, many investors had the idea that the real estate market only goes up and never goes down. However, the great recession proved that was not the case. In this unpredictable market, anything could go wrong in your favour leading to a bad investment. In real estate investments, choosing the right location is absolutely paramount. An undesirable location will lead to decline in profit, negative cash flow and negative equity and many more.

Thus, it is worth considering the possible risk factors that come with real estate investments before making the decision. Good understanding of risk factors always helps an investor to determine the way of venturing into a business decision.

FINAL THOUGHTS

Real estate investment is an amazing choice of strategy when it comes to the decision of net worth allocation. However, when it comes to the question of how much net worth allocation into real estate, an investor should be smart and decisive with regard to its percentage of allocation.
A little too much would lead to the risks of liquidity and less opportunities to other investments, and little too less would also hinder the possibility of wealth creation. The goal is to find the right path which will open the door of endless benefits and wealth creation that comes with investing in real estate without getting tied up.

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About the Author

	Ismael "Rey" Reyes has been investing in residential real estate since 2005 and multifamily since 2016. Under his leadership, MI Real Estate has invested in 13 multifamily properties total of 599 units worth over $47 million. Rey also works as an independent consultant for multifamily investors and is the author of best-selling book "BLUF: Bottom Line Up Front about Passively Investing in Multi-family Properties".