RentersWarehouse®

Looking for ways to recession-proof your investment?

You're in luck.

GUIDE:

Recession-Proof Real Estate Investing

Introduction

Rental property investments can be a great form of investment—an excellent way to set yourself up for long-term returns both in terms of cash flow and appreciation. But what about investing prior to a recession?

During times of economic uncertainty, is it really the best time to buy? And what about now? Are we in a recession or not? Some 50% of Americans believe a recession could be on the horizon, and some experts agree. Officially though, we're not there yet. The National Bureau of Economic Research (NBER), a government agency that sets official dates for the U.S. economic cycles, hasn't officially stated that we're in one. Still, we've been hearing that a correction could be on the horizon for years now, and nothing's happened yet. Could we be facing a bull run for another few years? It's anyone's best guess right now.

The great news is that real estate and particularly single-family rentals (SFR), can be an especially sound investment—no matter what economic cycle we're in. Because of the long-term nature of this investment strategy, it's less contingent on factors like timing the market so that you can sell at the right time, as is the case for some investments—like fix-and-flip properties. Instead, with rental property, the great thing is that you have options and you have opportunities that allow you to weather out any economic cycle just fine—yes, even during a recession.

In this guide, we'll take a look at some factors that make rental property such a solid investment. And see what you can do to invest wisely, make the most of your portfolio, and to an extent, recession-proof your investment strategy.

What Is a Recession, Anyway? The Economic Market Cycle and How Does It Work?

Before we dive in, it's important that we need to familiarize ourselves with the concept of the economic cycle, and a recession. So what is a recession, anyway?

A recession is a time of reduced economic output. During recessions, the economy struggles, sales often go down, and the overall output of an economy declines. Technically speaking, a recession occurs when market indicators weaken, or contract, for two quarters.

But first up, let's take a look at the economic market cycle.

An economic market cycle, also referred to as the business market cycle, is the fluctuation between the stages of economic growth (expansion) and recession (contraction). It's the state of the economy as it goes through the period of expansion and contraction.

An economic cycle defines the state of a country's economic activities over a certain period. It has a direct impact on every economic activity and impacts stocks, bonds, real estate, employment, lending, earnings, and more.

While during the period of economic expansion, the economy will have experienced growth and there is usually an increase in corporate earnings, production, and employment; during contraction, growth slows, employment dwindles, and prices of products stagnate.

How Does the Economic Cycle Work?

The economic cycle is the trend of the upward and downward movement of the country's Gross Domestic Product (GDP). GDP is the overall monetary value of all goods and services produced in a country within a certain period. The GDP determines the worth of a country's economy and its long-term growth.

Although the economic market cycle tends to move over a trend line, it's a circular fluctuation. It starts at a point and ends at the same point to make a complete cycle. This period of natural fluctuation is characterized by four stages: expansion, contraction, peak, and trough. An economic market cycle is said to be completed when the economy has gone through the four stages.

One thing you need to understand is that each stage of the cycle doesn't have a specified interval or time frame—some stages of the cycle take longer than others. In the U.S., between 1945 and 2019, for example, expansions lasted for an average of 65 months, whereas the recession period lasted for just 11 months on average.

Moreover, the transition between one phase to another is not usually smooth or clear. But they do have distinct characteristics to define them. There are sometimes mini-fluctuations within each stage that could make it appear like the economy is transitioning from one phase to the next. As an investor, your knowledge of the economic market cycle can help you make important decisions.

While economists, analysts, and investors make speculation about the state of the economy and the stage of each market cycle based on certain factors (capital availability, supply and demand, and investor and consumer confidence), it must be understood that there is no official date or notice to mark the beginning or end of a market cycle. The NBER defines the economic phase using the quarterly GDP and some undisclosed factors.

Experts are divided on how many recessions the U.S. has experienced, but it's fair to say that there have been quite a few. According to some economists, there have been 33 recessions in the United States between 1854 and 2018, and ten recessions since 1948. The most recent recession was a major one, and as you will remember, was between 2007 and 2009.

As a stage of the economic cycle, some level of correction is normal and necessary. And like a piece of a jigsaw puzzle, it's necessary for a stable economy because it completes the market cycle. Therefore, no matter the length of economic growth and buoyancy, a recession is bound to happen, at least, once in a while.

The Four Stages of the Economic Market Cycle

An economic market cycle goes through four significant stages (expansion, peak, contraction, and trough) to make a complete cycle.

What are these stages? How do they affect the economy? And what are the economic indicators that define the transition from one stage to the other? Here's a quick run-through now:

The Expansion

First up, we have the expansion stage. This is the stage everyone loves. This is when the economy reaches buoyancy. Although GDP is not the only defining factor for the expansion stage, most investors and economists believe that economic growth of two or more consecutive quarters signifies expansion. Expansion is when the economy moves from the trough to the peak.

Although the stages of the market economic cycle are usually decided quarterly by the NBER, you can also determine the monthly state of the economy to make better investment decisions. Expansion is characterized by an increase in employment, upturn in production, growth of per capita income, greater customer and investor confidence and spending, low-interest rate, rise in GDP for two or more consecutive quarters, buoyant stock market, and so on.

At this stage of the market cycle, economic activities generally improve as a result of the increase in customer and investor confidence in the future. While not all households will experience an increase in income, many people will be confident about the future, and they'll be more likely to make big purchases which will increase product demand. This will trigger companies to increase supply, which will have a ripple effect on production, employment, income, and interest rates.

The Peak

The peak is the highest point of the economic cycle. It's the point where the economy reaches saturation. The peak marks the end of the expansion stage. At this stage, the economy could start to become overheated. While expansion is good, an overheated economy can lead to hyperinflation. It's also just not sustainable.

At this stage, the economic growth is at maximum, and all economic indicators slow down. Unemployment reaches its lowest point, interest rates are usually low, GDP reaches its maximum point and growth slows down, consumer and investor confidence is at a maximum, and inflation increases. The economy has reached a saturation point where growth is no longer possible.

The Contraction

According to NBER, the contraction stage is defined as a significant decline in economic activities that could last for more than a few months. It's the corrective phase that tackles the imbalance brought about by the preceding peak stage. Contractions could last for as little as a few months (like the two-month-long recession in 2020) or as long as years (like the Great Depression in 1920).

Contraction, also known as a recession, is an important piece that clears the way for normal growth to resume. As a widespread and prolonged downturn in economic activities, the contraction stage is usually characterized by a decline in domestic output, rising unemployment rate, falling per capita income, decreasing capital spending, increase in interest rate, dwindling investor and consumer confidence, and so on.

Recessions usually have a rebounding effect across the economy. It affects all investment vehicles and cuts across all industries. While GDP decline, for most investors and analysts, is the primary indicator that defines transition into contraction, the major cause of the abrupt reversal in economic growth is usually a decline in consumer and investor confidence.

The Trough

The trough is the lowest level of the economic market cycle. It's the last piece that completes the economic cycle puzzle. Like other phases of the cycle, it's also very important because it marks a positive turning point for the economy. The trough signifies the end of a recession; it precedes recovery. An example of a trough is in June 2009, which marks the official end of the Great Housing Recession. At this stage, the economy will reverse.

Unlike expansion and contraction, which could be identified while in the stage, a true trough can only be identified in hindsight. Economic indicators that mark the trough stage include stock rallying after a significant decline, rising credit availability, increasing job opportunities after a massive layoff, increasing business sales and earnings, increasing income and wages, rising consumer and investor confidence, and rising demand.

Are We In a Recession Now?

Okay, so we've arrived at the million-dollar question. Are we in a recession now (September 2022)? The answer is: it depends who you ask. Experts are divided. But what exactly does this potential recession look like? Are we facing housing price collapse and prices in freefall?

If you've been standing by waiting to invest once property prices hit rock bottom, you might be in for a disappointment. Despite the fact that some experts are stating that we may be in a housing recession, it doesn't look like prices are going to fall off a cliff. So what does this housing recession look like, exactly?

There's no doubt that right now, we're seeing a slight cooling in the housing market. Whether or not this means we're in a recession, however, is uncertain. Housing sales have slowed over the last few months. This means that the total number of houses sold has fallen over the last six months. Houses sold in July were down 6% from the previous month.

But this doesn't mean that it's all doom and gloom. And it's crucially important to note that while total housing sales are down, housing prices have not fallen.

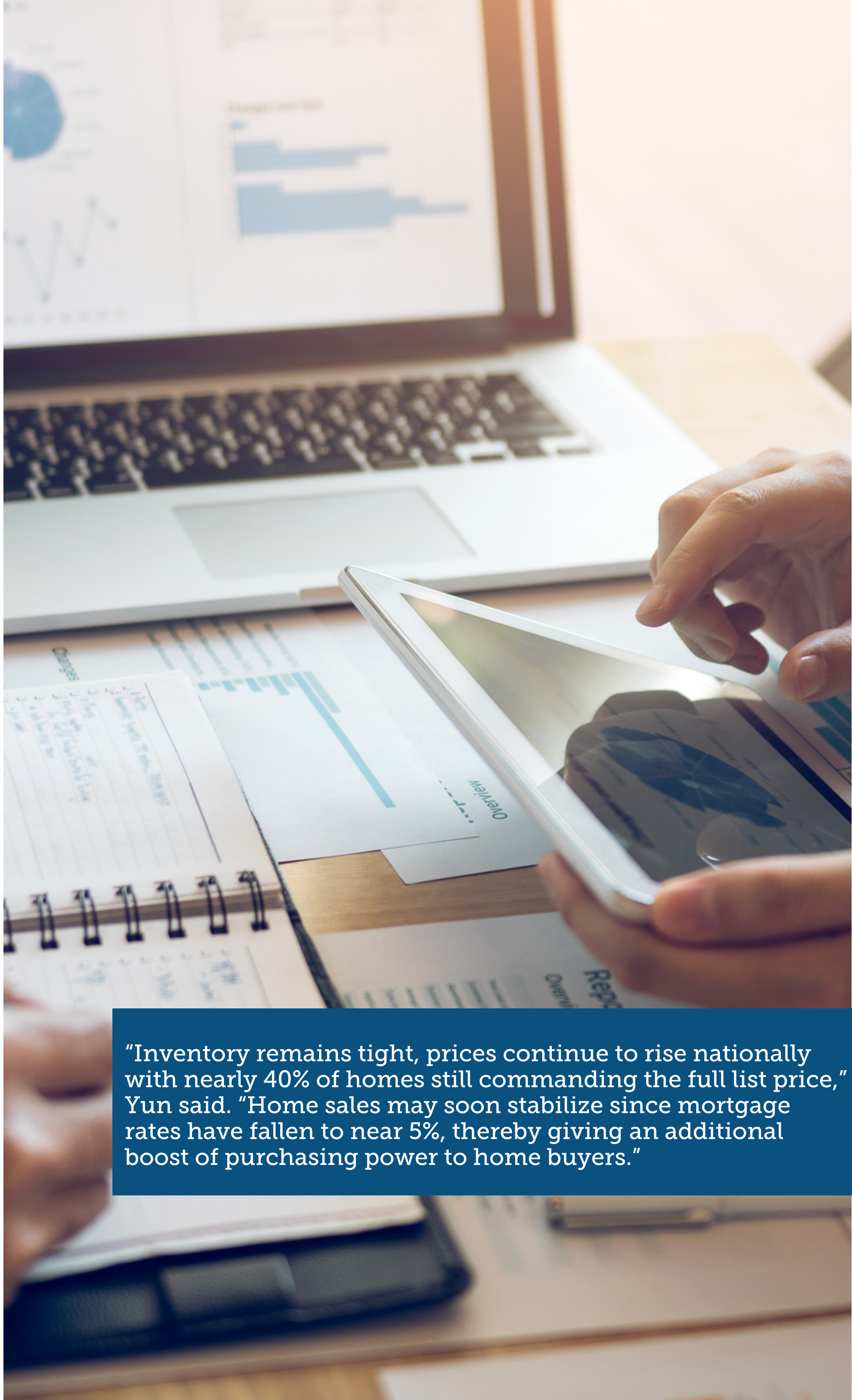
In fact, housing prices are up. The median existing-home price for all housing types in July was $403,800, up roughly 10.8% from July 2021 ($364,600). The NAR reports that home prices have increased across all four regions.

That marks over ten years of year-over-year increases, which is the longest-running streak on record, according to the NAR.

NAR top researcher Yun said that while the U.S. is "witnessing a housing recession in terms of declining home sales and home building," it is just not seeing a recession in terms of home prices.

It's also important to remember that housing has been accelerating at a steady, white-hot pace for some time now. The S&P CoreLogic Case-Shiller Index reported an 18.8% Annual Home Price Gain for Calendar 2021. It's safe to say that increases like that are just not sustainable. You can't have properties appreciating at 15-20% year-over-year, and expect that trajectory to continue. At some point, the market's going to start to cool. It's healthy, and no, it doesn't mean that housing prices are going to freefall.

So while housing sales are cooling, housing prices are still continuing their steady march upwards. This means that investors who own rental housing, are in a good position. They have options and even opportunities in store.



"Inventory remains tight, prices continue to rise nationally with nearly 40% of homes still commanding the full list price," Yun said. "Home sales may soon stabilize since mortgage rates have fallen to near 5%, thereby giving an additional boost of purchasing power to home buyers."

Why Rental Property Is an Ideal Asset to Own During a Recession

It's no longer news that a rental property investment strategy is a tried and true wealth creation vehicle. Even during economic downturns, rental property is a solid investment. Why? For one thing, while housing prices often dip during a recession, they always recover and then go on to exceed their previous values. During the recession, demand for rental housing is usually strong in most markets. While luxury property or commercial might take a hit in some markets, your standard SFR residence is likely to remain unaffected from an occupancy point of view. For investors, this means that holding onto that real estate, and continuing to rent it out during the recession is usually the plan. If you'd like to sell, you can always do so when housing prices return to normal.

In this section, we will lay out some primary reasons why you may want to consider investing in long-term rental property—even during a recession.

- **It generates income and offers steady cash flow.**

During an economic downturn, consumer spending reduces. People only spend on essential goods and services, and this affects all sectors of the economy. But if you own a rental property in a good location, you may not feel the effect at all. Why? Shelter is essential. In most markets, there will always be a demand for rental housing.

Therefore, no matter the state of the economy, your rental property will always generate income, and you don't even have to work at it every day. And apart from your income being steady, your cash flow increases over time as you continue to pay down your mortgage and as you (ideally) experience appreciation, increasing your equity in the property.

- **It allows you to use leverage.**

Although real estate does involve an outlay of capital, the great thing about it is that it allows you to use leverage to grow your portfolio. This, of course, is something that most other investments just don't offer. For instance, you couldn't walk into a bank and ask for $200,000 to buy Apple stock. But you could walk in and ask for $200,000 for a rental. Why does leverage matter so much? Simple: it allows you to grow your own money faster than you'd be able to if you were simply using your own capital. Leverage gives you access to bigger assets that, in turn, offer higher returns, and you benefit from the returns on the entire value of the asset, not just the portion that you put in (down payment). This is an excellent opportunity, and if you structure it properly, can offer solid returns.

- **It benefits from appreciation.**

Real estate investments also benefit from appreciation. According to the Federal Reserve bank of St. Louis, the median sales price of homes sold in the U.S. at the turn of the century (Jan, 2000) was $165,300. Today, the median sales price is $440,300. As you know, the Great Recession took place during that time. Still, despite it all, real estate has shown its resiliency.

Real estate properties generally appreciate between 3% to 5% annually, but of course, this varies a great deal depending on the local housing market. When investing, it's important to look at local housing market conditions to assess the long-term growth potential of a property.

You can also increase the value of your property through repair, improvements, and maintenance, which is called forced appreciation. Making selective renovations and repairs can also increase the value of the property when you want to sell it.

- **You have tax advantages.**

Rental properties offer a world of tax advantages as well. When you invest in real estate, you become eligible for many opportunities for tax deductions. Standard operating expenses can be deducted, including utilities (if you pay them), insurance premiums, property management fees, and repairs and maintenance costs. Mortgage interest and even marketing costs are tax deductible. Property tax is also tax deductible. And even though properties are expected to appreciate between 3% to 5% annually, the IRS also has another sizable deduction that it allows you to take: depreciation, reducing the amount of tax that you owe. And finally, if you decide to sell your rental investment property, there are additional opportunities to defer the amount of tax that you would owe. Learn about the 1031 exchange.

Tip: Visit the Renters Warehouse Market Research Center to get FREE up-to-date data that you need to make sound investing decisions. See housing data on any county across the U.S., and look at employment numbers, population changes, and of course, housing appreciation too.

During a Recession, What Should You Do With Your Investment Property?

Is now a good time to sell? Buy? Or should investors simply hold tight?

The answer is: it depends.

Often, rental investments can be held to continue to generate cash flow throughout any economic uncertainty. But in some cases, it might make sense to sell. Let's take a look at two things you can do with your current investments if a recession is in sight.

Sell Your Investments

Your first option is to sell high and buy when the market is down. Of course, this strategy isn't always as straightforward as it might seem. There's a risk that when you do sell, even if prices are high, that prices will only continue their steady march upwards. This means that you could be priced out of the market, or will have to put your funds into a market that's less hot, where properties are cheaper.

Still, there are some properties that might make sense to liquidate prior to a recession. Some real estate investments, such as luxury and seasonal (e.g., vacation properties), could be the most at risk during a recession. If you invest in this property type, you may want to consider selling before a recession, but then again, it depends a great deal on whether you'll be able to keep that property rented during the recession or not. For vacation rentals, depending on your market, you could experience higher vacancy rates as fewer people may be traveling during this time. However, this will depend a great deal on your property's location and price point.

If you're nearing retirement age or are looking to cash out some of your investments, you may want to consider selling pre-recession. This option does allow you to sidestep any potential stress of managing an investment during this cycle. However, if you have a good property manager, you will have less stress when managing a rental, no matter where things are in the economic cycle.

The disadvantage of this option is that you may not be able to time the market right. If you needed to cash out your property and sell right away, you might be forced to take a lower price for the property, depending on market conditions.

Hold Your Investments Until the Market Stabilizes

The second option requires you to hold the property, keeping it rented during a potential economic downturn. The great thing about owning rental property as an investment is that it gives you flexibility and options. You can hold onto the property and rent it out even during times of economic uncertainty and sell it when the market recovers.

In addition, you must be investing in properties that are historically known to do well during a recession. Properties like single-family and even, in some cases, multi-family buildings, often do well even during a recession. It depends on the health of your local market, and how the property is financed as well. Also, your properties must be in a good location where demand is high, and you must have the liquidity necessary to manage the property through the season.

Holding your investment property through a downturn means you'd continue to enjoy the ROI on the investment. The problem with this approach is you could miss out on cashing in the accumulated appreciation.

At the end of the day, you'll want to consider your situation, your finances, and your long-term goals carefully when determining whether cash flow or cashing in on appreciation is the best option for you.

Real Estate Investment Tips: Improve Your Returns and Minimize Risk During a Recession

As you plan to do a walkthrough, it is important to have a checklist of things you want to check out. Having a list will help you remember everything as well as give you a place to make notes to remember key items later.

Here are some of the areas you should consider checking out or inquiring about while you do your walkthrough:

- **Turn Light Fixtures On and Off**

Turning lights on and off will help you determine if the electricity is in working order. While it might not tell you everything about the electrical system in the house, it's a good place to start. Be sure to check all light switches, including indoor and outdoor and ceiling lights. While it's possible that they won't work if the bulbs are burnt out, you should be able to get a pretty good idea of what works and what doesn't. If possible, you should also check the outlets, doorbell, and security system. Be sure to check the breaker box to confirm it is functional and not outdated.

- **Consider Avoiding Adjustable Rate Mortgages**

Adjustable Rate Mortgages (ARMs) are usually cheaper to get, but they come with a risk. When interest rates go up, your mortgage payment will too. To avoid being caught out with a loan that's too high during a recession, you'll want to tread carefully when it comes to variable-rate loans. While these loans may be suitable for the short-term, in the long run, they may present a risk.

- **Try to Make a Large Down Payment**

Whenever possible, making a large down payment is often the best way to go. Why? Because a large down payment can help you to save over time. By making a payment that's over 20%, you may be able to eliminate PMI (private mortgage insurance) from your mortgage payment, which can help you to save a great deal over time. A larger down payment can help you to qualify for a better interest rate as well. Finally, with a large down payment, you'll be much safer from potential fluctuations in the housing market, and won't be at risk of an underwater mortgage.

- **Ensure You're Able to Invest**

Make sure you're in a good spot financially, and able to invest. Making an investment involves many costs and expenses, and can sometimes represent a drain on finances—at first. Of course, this is temporary, and ideally, you'll soon be out of the red, but you'll want to make sure this investment won't take a huge bite out of your resources during this time.

- **Look to Manage Costs**

Recessions result in economic contraction: decline in economic output, higher interest rates, low per capita income, and higher unemployment. However, as a way to minimize its effect, consumers have learned to only spend on essential commodities during this period.

Take care when it comes to costs. During this period, review your insurance policy, read the conditions offered, ask questions, and consider dropping less important policies. Conduct routine checks to ensure your property is always in good condition. With this, you can reduce maintenance costs. For example, you might find that with a little bit of maintenance each year, you can extend the life of your roof, rather than requiring a complete replacement, postponing that costly bill.

- **Focus on Your Tenants**

It's also important to focus on your tenants. Try to improve your tenant retention rates to help keep your vacancies down. Keeping your tenants happy, focusing on performing maintenance and repairs requests in a timely manner, and making the occasional upgrade at the property can help to boost tenant satisfaction and keep your tenants around longer. Likewise, take care when screening new applicants to ensure that only qualified tenants gain access to your rental. Great tenants can help you to maximize your ROI, even during a recession.

- **Try to Increase Liquidity**

The liquidity of an asset is how easy it is to buy and sell it. Unlike real estate, stocks are highly liquid assets that can be sold online in a few clicks. This doesn't mean that you should exchange your real estate for stocks, but it does mean that it might be a good idea to ensure that you have some liquid assets on hand in case you need access to capital.

When economic indicators are showing signs of a heated real estate market, it may be advisable to cash out some gains early on before a potential price dip, and stay liquid through any economic uncertainty. It might be time to weed through your portfolio and consider offloading underperforming assets while prices are high. Invest in properties that offer solid returns from a cash-flow perspective and try to keep some cash on hand just in case.

- **Reduce High-Interest Debt**

During a recession, there is less money in circulation. Interest rates are usually higher, lenders may tighten up loan requirements, and consumer spending is usually lower. So, loan payments can be a difficult thing for investors during this time.

To prepare for this period, find a way to reduce high-interest debts. Review your mortgage and refinance terms with a high-interest rate. Negotiate better terms and rates, and convert adjustable rate mortgages to fixed mortgage rates.

If you finance projects with hard or private money lenders, you should consider paying them off if you can before a recession. Hard or private money lender rates can be very high.

- **Diversify Your Portfolio and Assets**

No doubt, real estate is a hedge against long-term inflation, but it's always advisable to diversify your investments. With diversification, you create a cushion for your investment during hard times.

For example, if you invest in different parts of the country and recession strikes, not all parts of the country will feel the severe effect of the downturn. And this means that while some of your investments may be affected short-term, others will remain stable.

- **Maximize Your Cash Flow**

The main effect of recession is that it shrinks the economy and reduces ROI and cash flow. And the only way to mitigate this effect and create a cushion for your investments is to minimize instability and find a way to increase your returns.

If you want to maximize cash flow, you need to do your research. Forget about the different conventional knowledge: look for what's currently working. Sometimes, the known rule might be outdated.

For example, conventional knowledge states that primary markets (popular urban areas) are the best places to invest in. But according to a report by Pew Charitable Trusts, that has not been the case for the past two years. The events of the last two years, lockdowns and the rise of remote working have changed consumer behavior. People have been moving away from urban locations (like New York, Los Angeles, and San Francisco, for example) into suburbs and temperate regions.

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- **Consider Investing In Some REITs**

If you don't want to get your hands dirty during a recession, you can also invest indirectly through Real Estate Investment Trusts (REITs). REITs are a liquid investment, so they can be a good opportunity to balance out your portfolio. REITs are companies that own and operate income-producing real estate companies. These companies invest in different income-producing real estate assets like self-storage, multi-family buildings, student housing, self-storage facility, and so on. They manage the properties and pay you a dividend from the ROI generated.

REITs offer a liquid way to invest in real estate. It provides a steady and high-income stream. It easily diversifies your portfolio. All you need to do to invest is buy a share of the trust and you'd have a steady income stream.

Before you decide to invest in REITs, however, you should know that investing in REITs is like buying a company's stock. It's liquid, but it can be highly volatile. You won't necessarily have access to tax breaks like you enjoy in private real estate investment. And since you're not directly investing in real estate, you can't make direct decisions on what to invest in and what not to invest in.

Planning for a Potential Recession

The prospect of a recession can be tremendously stressful for investors, but it's important to remember that recessions vary considerably in terms of length and severity. Keep in mind, too, that as a real estate investor, in many ways, you're already at an economic advantage. With rental property, you have an excellent level of insulation against any short-term fluctuations in the market and should be able to ride out the different economic cycles without too much trouble.

Of course, this doesn't mean that you can become complacent, and yes, there will be times when some properties and certain markets may take a hit. But rental properties are an incredibly resilient asset class. The risk of devastation that you'll see while owning rental properties in healthy markets is much, much lower compared to other assets, such as stocks. Rental properties are solid assets that have performed consistently well long-term, even if you factor in the temporary dips and downturns. Over time, they tend to hold their value well, even during a recession. If they do experience a dip as they did during the Great Recession years, they recover relatively quickly and go on to appreciate further.

To prepare for a recession, take a step back and strategically look at your existing strategy and portfolio. Look around for ways to improve your resilience in case of a recession, while also keeping in mind that recessions are always temporary, and you'll want to have your eyes on the future as well. Long-term, rental property can be a great investment strategy. But it's important to ensure that you've taken some precautions so that you can weather any potential dips in the market and come out the other side in better shape than you were in before.

Work on your investment tactics. Learn more about the industry, your investment location, and properties that have historically done well during economic turmoil. If you're just starting out, dig deep to learn about real estate metrics and market indicators. With this, you can make better investment decisions.

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In Conclusion

In many ways, a recession is a necessary evil that cannot be avoided but can be anticipated. Once you know that, it becomes easier to prepare for it. And yes, far less daunting, too.

To help recession-proof your investment, understand different stages of the market cycle, be on the lookout for market indicators, reduce high-interest debt, diversify your portfolio, and increase your liquidity.

When it comes to deciding whether to sell, hold, or buy, that will depend on your personal financial situation and investment goals. Now is a good time to consider your financial situation and reassess your goals. Is cash flow important to you? Or would you like to cash out some of the appreciation that your rentals may have yielded at this point? Make sure your portfolio to make sure it's balanced and contains a good mix of assets that can weather a recession well and come out the other side just fine.

Recession-proofing your investment is as important as analyzing your property before buying, so make sure you take the time to evaluate your situation and investments before commencing your next step.

Note: *The information contained in this guide is intended to inform and guide. It is not meant to substitute for due diligence. As always, it's important to carefully research the national housing market and local market conditions before you buy or sell real estate.*

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Ready to get started with rental investments? See: How to Choose the Right Market to Invest In. Ensure that the property you choose will generate the returns that you're looking for. Thinking about investing in rental property now? There are still deals to be found. Take a look our available inventory to find cash-flowing rental properties, ready to go. Many of them complete with tenants.