Should You Invest In Real Estate in a Market Downturn?

A market downturn can be a scary time for investors. As people spend less and the economy slows down, many of your investments will likely produce less-than-stellar returns and you may encounter some losses. However, some investments can help you emerge even stronger on the other side of the downturn. Real estate can be one of those assets.

With 58% of economic experts expecting a recession later this year, it’s time to start planning for resiliency. Since stocks will likely take a hit as the market drops, real estate can look like a promising option. But is a market downturn really a good time to invest in real estate? Here’s a closer look at when it may be the right choice and why.

Pros of Investing in Real Estate in a Down Market

Investing in anything amid a recession can seem intimidating, but real estate has several advantages. Here are some of the most important.

Housing Is Always in Demand

Real estate’s biggest strength is that people will always need places to live. While spending tends to drop in a recession, housing isn’t something you can cut out of your monthly budget. Consequently, rental income won’t decline the same way stock prices do.

Housing bubbles in the past prove that real estate isn’t

totally immune to economic uncertainty, but it's generally more resilient than other assets. Stocks heavily depend on the overall economy, Bitcoin prices dropped with the stock market in 2021 and interest rates significantly affect bonds. While some of these issues also impact real estate, they don't alter the fact that people still need houses at the end of the day.

Since housing is always in demand, you always have an opportunity to profit from it, even in a recession. That reliability can help offset losses elsewhere.

Real Estate Can Create Cash Flow

Another reason you may want to invest in real estate in a recession is to generate cash flow. Many assets don't pay out until you retire or sell them, but property allows you to collect rental income. This regular cash flow can give you some needed liquidity in a down market.

History shows that rents rarely decrease in a recession — in many cases, they go up. People are also less likely to make a big purchase like buying a home in this environment, so many residents will keep renting. In light of these trends, leasing a property could give you a nice bit of extra cash.

Liquidity is important amid a market downturn because you'll likely have to adjust elsewhere. As your other investments falter or you need to pay more for some services, having extra income from rent provides a helpful safety cushion.

Recessions Could Create Opportunities

An economic downturn may be the ideal real estate buying environment in the big picture, too. If you've wanted to get into real estate anyway, a recession can be a strategic time to do it as it can improve your returns down the road.

Home prices fell by an average of 5% year-over-year in four out of the five recessions since 1980. In some quarters, those

drops were as large as 43%. If the upcoming downturn follows this historical pattern, you could buy a house relatively cheaply, making it easier to sell at a considerable profit when the market recovers.

Market research shows that the highest real estate returns tend to follow recessionary periods. That doesn’t mean a market downturn guarantees high returns later on, but it does make those profits far more likely with the right approach.

Cons of Investing in Real Estate in a Down Market

The benefits of investing in real estate in a recession are impressive, but there are some downsides to consider as well. Making the best decision means weighing both sides carefully, so here are some potential disadvantages to keep in mind.

More Stringent Lending Practices

One of the biggest challenges of buying real estate in a recession is stricter lending requirements. While mortgage rates and home prices typically drop in a downturn to attract more customers, lenders will often implement tighter restrictions on who qualifies for these loans.

Unemployment often rises in a recession and earnings fall, meaning lenders take on more risk by offering loans. Consequently, many of them will raise their qualification standards to decrease their chances of loaning to someone who can’t pay it off. These more stringent requirements can make it harder to secure a deal.

There may also be fewer properties on the market, as some owners may wait to sell until they can get more. Lenders’ higher requirements further limit some buyers’ options, so the property market could be challenging to get into.

Uncertain Return Timelines

It’s also important to remember that while bigger returns are more likely if you buy in a recession, they still carry some uncertainty. You can’t know for sure how long the downturn will last or when the best time to sell will be, making it difficult to determine when you can get the highest returns.

How much money you can expect from rental income is also uncertain. Economic pressures from the recession could make tenants more likely to miss payments. High rents at the end of 2022 saw roughly 15% of American renters fall behind on their rent.

This issue also affects commercial properties. Small business rent delinquency hit an all-time high in 2022. If similar trends persist in the upcoming market downturn, it could take a while for your real estate investments to pay off.

When Is It Right to Invest in Real Estate in a Recession?

Given these pros and cons, whether you should invest in real estate in a recession comes down to your specific situation. It can be a profitable investment that helps you withstand the down market, but only if you can manage the challenges that come with it.

Consider your current financial position before looking at the real estate market. Do you have a big enough nest egg to carry you through tough times? Keep in mind that after buying a property, you may have to pay for some maintenance and repairs, too. The average recession lasts 17 months, so expect to wait at least that long, if not longer, before you start seeing significant returns.

Similarly, you should review how confident you are in your

employment. If you think you could lose your job in a recession, real estate may be too significant an investment to be worth it right now.

If you have a stable job with long-term prospects, sizable cash reserves and don’t mind some risk, a downturn could be the ideal time to invest in real estate. If not, it’s best to wait for another opportunity.

Best Practices for Investing in a Recession

Real estate investments in a recession require careful planning if you want to make the most of them. Here are some best practices to consider when investing in these assets in a market downturn.

Prefer Residential Over Commercial Real Estate

It can be tempting to invest in commercial real estate when the economy’s down, but residential properties are often safer. While it may seem like a company is more resilient than a person, businesses don’t depend on buildings the same way people do.

Over half of all Americans can now work from home at least one day a week, and 35% can work remotely full-time. That trend highlights the issue with commercial real estate in a recession. When businesses start losing money, they may shift toward remote work and downsize their brick-and-mortar presence, leaving the property owners with lower or no rental income. In contrast, people need housing, so demand for residential property is more consistent.

Evaluate Properties Carefully

When you're looking for properties to invest in, make sure your excitement over their potential doesn't rush the process. Inspect everything carefully to ensure it's a sound investment.

Some properties may need extensive renovations, delaying your returns. You should also consider the location. Recessions could mean job scarcity, leading to fewer paying tenants, so look for an area with a promising employment outlook.

Compare Multiple Funding Options

Similarly, you should look at a few ways to invest in property. Renting a house is a good way to generate income, but a real estate investment trust (REIT) may be more accessible. Consider your skills, experience and cash reserves, then weigh your options to find the best way forward.

Deciding between sole ownership and a partnership is another choice to make. A joint venture limits transactions on both sides but could make it easier to buy a more expensive property for a higher return.

Prioritize Cash Flow But Keep Reserves

Next, consider how you can generate cash flow from your property. Renting is the most straightforward way, but you could also renovate and flip houses. Whatever you choose, you should approach each investment thinking of it in terms of potential income.

While generating cash flow means some spending, be careful to keep some reserves. On average, buyers of existing houses spend over $5,700 on renovations, so these investments can be considerably more than they appear at first. It'll take time

to make a profit with those costs, so make sure you can afford the wait.

Keep Your Portfolio Diverse

Finally, remember that real estate shouldn’t be the only asset class in your portfolio. Property can be some of the best investments for withstanding a recession, but diversity is key to long-term resiliency. Don’t sell all of your other assets to put more money into real estate, and keep an eye open for other investment opportunities.

Make the Most of a Market Downturn With Smart Investing

Market downturns are imposing, but the right investment can help you emerge on the other side in better standing. If you have the right resources going into it, real estate can be one of your best options for withstanding a recession.

Real estate investments aren’t a guaranteed success in a down market, but they’re more reliable than many other asset classes. As recession threats loom, review your financial standing, consider your options and refer to this guide to make the most of the situation.

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