Portfolio Implications of Renting vs. Owning

If you rent versus own a home, your investment profile is likely different from that of a homeowner. Consider these renter-friendly strategies to complement your lifestyle choice and financial objectives.

If you are one of the 35% of Americans who currently rents versus owns a home, your investment profile is likely different from that of a homeowner. Instead of being tied to one very large, long-term asset, renters have the freedom and, one could reasonably assume, more liquidity to pick and choose a broadly diversified portfolio of investments that complement their lifestyle choice and financial objectives.

Weigh some of these renter-friendly investing strategies as you pursue your own version of the American Dream.

THINK PAST STOCKS AND BONDS. While traditional investments shape the foundation of most long-term investment portfolios, individuals at higher income levels or with more investable assets may turn to alternative investments.

Alternative investments include hedge funds, private equity partnerships, commodities, and derivatives, among other vehicles.

Although these investments may differ in their individual risk/return features, they share some common characteristics—namely a historically low correlation to publicly traded stocks and bonds, a high risk-high return profile and a potential lack of liquidity, the chance that an investor may be unable to sell or forced to sell a security at a discount in the secondary market, due to a lack of buyers.

FOR REAL ESTATE EXPOSURE, CONSIDER REAL ESTATE INVESTMENT TRUSTS (REITS) OR RENTAL PROPERTIES. REITs feature investment in different types of commercial real estate, yet have the liquidity of stocks. A rental property also offers exposure to real estate, with the potential to build long-term equity and take advantage of tax deductions.

Turn to Municipal Bonds to Lighten Your Tax Burden. Without access to the attractive tax benefits available to home owners, renters may find municipal bonds, or “munis,” to be a wise investment choice. In general, the interest paid on municipal bonds is exempt from federal taxes and may also be exempt from state and local taxation if they are purchased by residents of the issuing state/municipality. This tax-advantage makes munis particularly attractive for investors in higher tax brackets. Although interest on munis may be tax exempt, any capital gains generated from the sale of a muni bond or bond fund are taxable at the applicable capital gains rate, currently a maximum of 20% for gains from most types of investment assets held over one year.

MAXIMIZE TAX-ADVANTAGED RETIREMENT ACCOUNTS. Without the significant expenses associated with home ownership, renters may be in a better position than homeowners to fully utilize the savings and tax benefits of employer-sponsored retirement plans and IRAs. In 2014, individuals can make pretax contributions of up to $17,500 to a 401(k)—$23,000 if they are age 50 or older, while the contribution limit for IRAs is $5,500, or $6,500 if they are age 50 or older.

Like investing in a home, all of these investing strategies carry their own risks. If you are a renter and looking to diversify your holdings please contact me to discuss the risks and strategies outlined here and how they might work for your situation.

Sources:

Alternative investments are complex, high-risk instruments with limited liquidity compared with stocks, bonds or mutual funds. In addition most require individuals to have investable assets of $1 million and some require assets of up to $5 million or more. You should consult your financial advisor before investing in any of these products.

Investors whose taxable income exceeds the thresholds set for the 39.6% ordinary income tax rate will be subject to the 20% long term capital gains rate (for 2014, the threshold is $406,750 for single filers, $457,600 for married filing jointly or qualifying widow(er), $432,200 for heads of household, and $228,800 for married filing separately).”

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