Investments!

Investment: an outlay of dollars in anticipation of future profit.

Important Rule: Know Your Investment Objective Before Choosing Your Investment Vehicle.

Important Question: What is the reason for your investing?

Popular Investment Alternatives

- Savings accounts
- Individual Retirement Accounts (IRA)
- Marketable securities (stocks and bonds)
- Mutual funds
- Business ventures
- Commodities
- Collectibles (art, antiques)
- Direct real estate ownership

Single Family Homes Provide

- Retirement Plan
- Tax Shelter
- Leveraged Growth
- Tax Breaks
- Compound Growth - Inflation
- Forced Savings
- Source of Non-taxable funds
- Security
- Controlled Investment
- Means to Build an Estate

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Single-family homes offer the ability to borrow large sums of money:

- At fixed rates
- For long periods of time
- On appreciating assets
- With definite tax advantages and reasonable control

Single-family homes provide opportunities for personal involvement to use individual talents:

- Decorating
- Carpentry
- Marketing
- Financing

Residential Investment Advantages

- Financing
- Leverage
- Appreciation potential
- Equity build-up
- Ease of obtaining information
- Tax shelter
- Pride of ownership

Residential Investment Disadvantages

- Lack of liquidity
- Loss of value due to market
- Property hazards
- Management requirements
- Legislation
- Unexpected expenses
- Number and size of units

Types of Real Estate Returns

- Income
- Appreciation
- Gain in value due to owner expertise
- Loan amortization

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Prepare for the Future

- Buy your retirement home now
- Buy a vacation home and enjoy it two weeks a year
- Obtain one new rental property per year
- Have all rentals mortgage free retirement
- Have a self-directed IRA or SEPP in real estate

Strategies

- Average homes priced, in plain condition, in owner-occupied neighborhoods - Before selling, make them look like model homes
- Investment must be economically sound
- Owner managed to reduce expenses and maintain control
- Holding period 7-10 years
- Additional principal payments will accelerate amortization
- Shorter term will increase your equity

When Considering an Investment...

- What rents & sells best
- Reliable appreciation rate
- Realistic vacancy factor
- Reasonable fair market rent
- Reasonable operating expenses
- Realistic projected sales costs

The 5 Basic Questions

1. How many dollars must be put into the investment?
2. When must they be put in?
3. Will there be periodic negative cash flows?
4. How many dollars will come out of the investment?
5. When will they come out?

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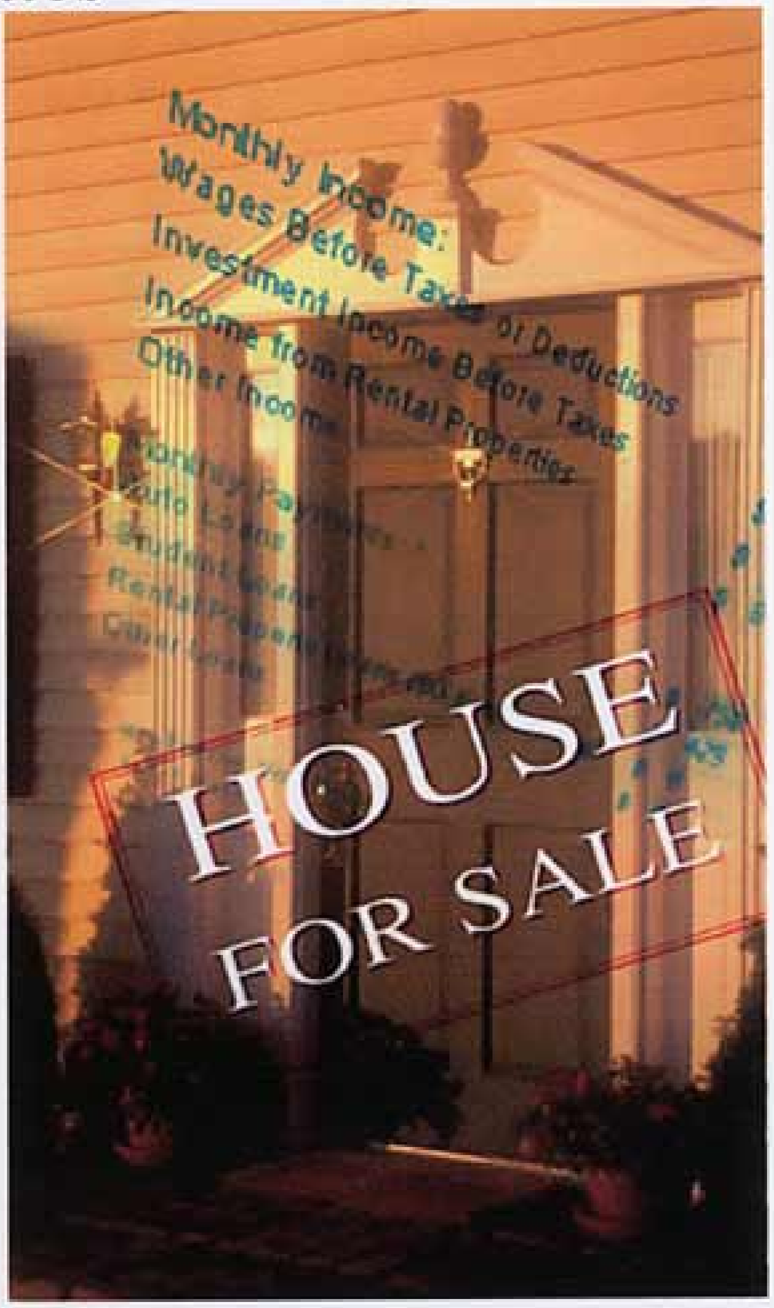
Investment Characteristics



Risk:
The uncertainty associated with the performance of an investment.

Liquidity:
The ability to convert an investment to cash with little or no loss to value.

Marketability:
The ability to dispose an investment at a reasonable price and in a reasonable period of time in an established procedure.

Factors that affect marketability:
Available financing
Economy
Supply & demand
Easily accessible marketplace

Manageability:
The ease to which an investment is managed during operation as well as acquisition and disposition.

Taxability:
The extent to which an investment is taxed. Taxability falls into different categories tax deferred, ordinary taxation, and long term capital gains.

Cash Flow:
The actual cash thrown off by the investment during the holding period.

Activities that provide cash flows come from three basic activities:
Operation
Disposition
Refinancing

Leverage:
The use of borrowed funds to finance an investment.

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Positive Leverage:

Funds borrowed at a rate lower than property's rate of return will increase overall yield.

Positive Leverage:		
100,000	9%	9,600
80,000	7%	5,600
20,000	17%	3,400

Neutral Leverage:

Funds borrowed at the same rate as the property's rate of return will not affect overall yield.

Neutral Leverage:		
100,000	9%	9,600
80,000	9%	7,200
20,000	9%	1,800

Negative Leverage:

Funds borrowed at a rate higher than property's rate of return will lower overall yield.

Negative Leverage:		
100,000	9%	9,600
80,000	10%	8,000
20,000	5%	1,000

Comparing Rates of Return

To compare tax advantaged investments to non-tax advantaged investments, it is important to convert both yields to either before-tax or after-tax rates of return.

A Certificate of Deposit has no tax advantages and is quoted before tax. Real estate does have tax advantages and yield is quoted after tax.

Example:

A 4% CD for a 28% investor has an equivalent after tax yield of 2.92%.

A real estate investment with a 9% return for a 27% investor has an equivalent before tax yield of 12.33%.

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Calculating S/L Depreciation

Depreciation is a non-cash deduction from taxable income due to wear & tear that provides a tax shelter.

Purchase Price

↙ ↘

Land | Improvements

Land is not depreciable but the Improvements are.

Purchase Price

x

Allocation to Improvement

____

Depreciable Basis

÷

Cost Recovery Life

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Annual S/L Depreciation

Long Term Capital Gains

Real estate held for more than 12 months benefits from long-term capital gains taxed at a maximum rate of 20%. Profit from the gain on the sale of real estate is taxed at a more favorable rate than ordinary income and most other investments.

Investor Profile

What is your federal income tax rate?____________________

How much cash do you want to invest? $ ____________________

Where is it currently invested?____________________

Is it available? yes ☐ no ☐

How much is it earning?____________________

Are you aware that earnest money will be required to make an offer? yes ☐ no ☐

How much negative cash flow can you afford?____________________

What is your reason for investing? ____________________

What amount of return do you expect? ____________________

What appreciation do you expect? ____________________

Type and location of property?____________________

Who will manage this investment? ____________________

What interest rate on a mortgage are you willing to pay? ____________________

What holding period do you intend?____________________

Employed ☐ Self-employed ☐

How long have you been employed with this employer?____________________

Where?____________________

Is there anyone else involved in making this decision? ____________________

When are you ready to invest? ____________________

Describe your investment experience: ____________________

Do you have an accountant (lawyer)? ____________________

Price range of investments: ____________________

Summary: ____________________

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Investment Terms

Accumulated Value of Cash Flows- the total value of the cash flows compounded at a selected reinvestment rate for the projected holding period.

Capital Gain- the gain or profit made on the disposition of a capital asset including real estate.

Cash Flow Before Tax- the cash generated by an investment after all operating expenses have been paid but before any tax considerations are taken into effect.

Cash Flow After Tax- the cash generated by an investment after all operating expenses have been paid and after tax considerations are made. Many times a negative cash flow before tax can turn positive after tax advantages have been applied.

Gross Scheduled Income- all the income that a property is expected to generate prior to vacancy allowance.

Operating Expenses- the expenses necessary to operate a property including things such as maintenance, taxes, insurance, advertising, accounting, legal, and management. Interest on a mortgage is not an operating expense.

Marginal Tax Rate- the rate that any additional income or loss would cause tax liability or savings.

Proceeds From Sale- the estimated amount the investor will receive after paying all selling expenses including mortgages and the projected tax liability for the sale.

Reinvestment Rate- a rate at which the investor can safely reinvest the cash flows from the property. A typical rate would be whatever savings accounts are paying.

Vacancy and Credit Allowance- an estimation for revenue that will be lost because the property is not rented or because the tenant doesn't pay as expected.

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Investment Analysis Assumptions

The following is a list of assumptions used to make the investment analysis that accompanies this presentation:

- Investor wants to maximize wealth and will reinvest positive cash flows.
- The investor's tax bracket will remain stable throughout the holding period.
- There will be a constant appreciation rate during the holding period.
- Current federal tax laws are considered and only applicable straight-line depreciation will be used.
- The mortgage on the property is considered to be an interest-only loan with no principal reduction.
- Rent and operating expenses will remain stable throughout holding period.
- If negative cash flows result, an interest charge will be made at the same reinvestment rate to offset the opportunity cost of being able to use that money elsewhere.
- The marginal tax rate of the investor is used to determine the impact of this investment regardless of what else the investor may do in this tax year.