RENTAL INCOME PROPERTIES

Satisfactory Investment Results Begins With Understanding

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RENTAL PROPERTIES ARE THE IDEAL INVESTMENTS

Rental homes are the IDEAL investment because they offer a higher rate of return than other investments without the volatility of the stock market. With certificates of deposit and bonds, people need an alternative investment that they understand and have a reasonable amount of control over.

In this case, IDEAL is an acronym identifying the advantages of rental properties.

- Income from the monthly rent contributes to paying the expenses and a return on the investment.
- Depreciation is a non-cash deduction that shelters income for some investors.
- Equity buildup occurs with amortized mortgages because each payment is composed of interest owed and principal reduction to retire the loan by the end of the term.
- Appreciation is achieved as the value of the property goes up.
- Leverage can increase the return on investment by using borrowed funds to control a larger asset.

These individual benefits working together make rental real estate a good investment for today's economy. Increased rents, high rental demand, good values and low non-owner occupied mortgage rates contribute to positive cash flows and very favorable rates of return.

SINGLE FAMILY HOMES ADVANTAGES OVER OTHER INVESTMENTS

Rental homes can be a natural alternative investment choice for homeowners because they are already familiar with houses. Maintenance on a rental is not that much different than on your personal home. The same plumbers, painters and other workmen can be used to make repairs.

Single family homes offer an investor high loan-to-value mortgages at fixed interest rates for long terms on appreciating assets with defined tax advantages and more control than other investments.

1. High loan-to-value mortgages – most investments require that you pay cash but rental properties can be purchased with 20% down payment.
2. Fixed interest rates – most commercial loans are based on a floating rate such as prime interest plus one or two percent compared to real estate loans as fixed rates for the term.
3. Long terms – commercial loans are generally short-term such as six months or a year with the possibility of being renewed for another six months or a year unlike real estate where a 30-year mortgage is commonplace.
4. Appreciating assets – real estate has a long-term history of going up in value.
5. Defined tax advantages – many investments are taxed as ordinary income but rental real estate enjoys a non-cash deduction called cost recovery, the profits from sale are taxed at lower long-term capital gains rates or may be eligible for a tax-deferred exchange.
6. Control – rental homes don't require partners and afford the investor more options than investing in mutual funds and other traditional investments.

There are people who choose not to buy or cannot buy a home who would prefer to live in a single family home rather than an apartment. The demand for good rentals is strong and the rents continue to go up in most markets.

IMPORTANT QUESTION: WHY ARE YOU INVESTING?

Single Family Homes Provide:

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

Popular Investment Alternatives

- Savings Accounts
- Individual Retirement Accounts (IRA)
- Stocks and Bonds
- Mutual Funds
- Business Ventures
- Commodities
- Collectibles (art, antiques)
- Direct Real Estate Ownership

SINGLE-FAMILY HOMES OFFER THE ABILITY TO:

- Obtain large mortgages (usually 80% loan to value)
- At fixed rates
- For long periods of time (up to 30 years)
- On appreciating assets
- With definite tax advantages and reasonable control

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
- Property hazards
- Management requirements
- Legislation changes
- Unexpected expenses
- Loss of value due to market

SOURCE OF REAL ESTATE RETURNS

- Income
- Appreciation
- Gain in value due to owner expertise
- Loan amortization (principal reduction)
- Tax savings

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 for retirement

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 mortgage will increase your equity

WHEN CONSIDERING A RENTAL INCOME PROPERTY...

- 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

- How many dollars must be put into the investment?
- When must they be put in?
- Will there be periodic negative cash flows?
- How many dollars will come out of the investment?
- When will they come out?

INVESTMENT CHARACTERISTICS

Risks:
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 include available financing, the economy and supply and demand.

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 can provide cash flows from operation, disposition and refinancing.

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

Return:
A measurement of the yield of an investment. It is commonly made up of return on and return of investment.

Investments can be compared by the characteristics that apply to all investments. The investor's goals and objectives of deriving a return can make a particular investment more acceptable than another.

LEVERAGE: THE USE OF BORROWED FUNDS TO CONTROL A LARGER ASSET CAN INCREASE INVESTMENT RESULTS

Positive Leverage

Borrowed funds increase the yield

As the mortgage increases, the yield increases

Negative Leverage

Borrowed funds decrease the yield

As the mortgage increases, the yield decreases

Loan-to-Value	80%	⟷	90%
After Tax Rate of Return	11.79%	⟷	16.20%
Before Tax Rate of Return	16.37%	⟷	22.50%

In the example above, the rate of return increased when the leverage was increased from 80% to 90% loan-to-value. While increasing positive leverage can boost the rate of return, it lowers the cash flow due to a higher mortgage payment. It also adds more risk to the investment because it lowers the equity and a lower market valuation could put the investor in a position of owing more than the property is worth.

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 24% investor has an equivalent after-tax yield of 3.04%. A real estate investment with a 9% return for a 24% investor has an equivalent before tax yield of 11.84%.

Cash On Cash

Cash flow before taxes divided by initial investment

Equity Build-up

Annual amortization divided by initial investment

Before Tax Return On Investment

The equivalent rate of return needed to achieve the same after-tax rate of return

After Tax Return On Investment

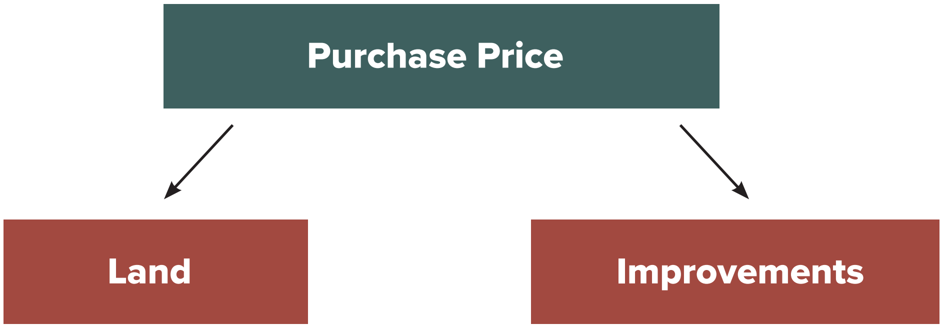
A rate of return that considers the initial investment, After-tax proceeds and cash flows after tax

Cash on Cash (Cash flow Before Tax/Initial Investment)	9.68%
Equity Build-up (Amortization 1st Year/Initial Investment)	5.87%
After Tax Return on Investment	11.79%
Before Tax Rate of Return	16.37%

COST RECOVERY

Cost recovery or depreciation is a non-cash deduction from taxable income due to wear & tear that provides a tax shelter.

Land is not depreciable, but the improvements are. The value of the land can be determined by appraisal or by using the tax assessor's ratios and applying it to the purchased price paid.



LONG TERM CAPITAL GAINS

Real estate held for more than 12 months benefits from long-term capital gains taxed at 15% to a maximum of 20% for investor's in the highest tax bracket. 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

- Do you own rentals now? If yes, how many?
- What is your federal income tax rate?
- How much cash do you want to invest?
- Where is it currently invested?
- Is it available?
- How much is it earning?
- Are you aware that earnest money will be required to make an offer?
- 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?
- Is there anyone else involved in making this decision?
- When are you ready to invest?
- Describe your investment experience:
- Do you have an accountant (name)?
- Do you have an attorney (name)?
- Price range of investments:
- Summary:

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.

Savings 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.

INVESTMENT ANALYSIS ASSUMPTIONS

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

There will be a constant appreciation rate during the holding period.

Rental income and expenses will remain constant during holding period.

Investor wants to maximize wealth and will reinvest positive cash flows.

If negative cash flows result, an interest charge will be made at the same savings rate to offset the opportunity cost of being able to use that money elsewhere.

The marginal tax rate of the investor will remain constant during the holding period.

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 the year of sale.

The investor can apply the annual tax savings generated against that year's tax liability.

The investor will pay federal taxes for long-term capital gains and recapture of cost recovery in the year of sale.

EXAMPLE OF INVESTMENT ANALYSIS

Investment Analysis - Input Data

Property	
1234 Sample Street	
Purchase Price	$175,000
Value at time of Purchase	$185,000
Improvement Allocation	80%
Improvements at time of Purchase	$0
Type of Depreciation	Residential
Acquisition Costs	$3,500
Mortgage @ 5.00% for 30 years	$140,000
Mortgage @ 0.00% for 0 years	$0
Income & Expenses	
Monthly Rent	$1,600
Annual Vacancy	5.00%
Annual Taxes	$3,000
Annual Insurance	$1,200
Monthly Utilities	$0
Annual Maintenance	$1,200
Management	0.00%
Other Annual Expenses	$0
Investor	
Holding Period	10
Annual Appreciation	3.00%
Projected Cost of Sale	7.00%
Investor's Combined Tax Bracket	32.00%
Savings Rate	2.00%

EXAMPLE OF INVESTMENT ANALYSIS

Investment Analysis - Annual Property Operating Data

Purchase Price/Value					$175,000
Acquistion Costs					$3,500
Mortgage #1 - loan-to-value				80%	$140,000
	Rate	5.00%	Term	30	
	Monthly Payment			$751.55	
Mortgage #2 - loan-to-value				0%	$0
Gross Scheduled Income			Monthly:	$1,600 Annual:	$19,200
Less Vacancy Allowance				5%	$960
Gross Operating Income					$18,240
Less Operating Expenses:					
	Property Taxes			$3,000	
	Insurance			$1,200	
	Utilities			$0	
	Repairs/Maintenance			$1,200	
	HOA			$300	
	Advertising			$0	
	Management			$0	
	Other Expenses			$0	
	Total Operating Expenses				$5,700
Net Operating Income					**$12,540**
Less Annual Debt Service					$9,019
Cash Flow Before Tax					**$3,521**
Cash on Cash Rate of Return					**9.15%**
Equity Build-up (year 1)				**$2,066**	**5.36%**

EXAMPLE OF INVESTMENT ANALYSIS

Gross Scheduled Income	$19,200
Less Vacancy Allowance	$960
Gross Operating Income	$18,240
Less Operating Expenses	$5,700
Net Operating Income	**$12,540**
Less Annual Debt Service on Mortgage #1	$9,019
First Year's Interest Mortgage #1	$6,953
Less Annual Debt Service on Mortgage #2	$0
Net Operating Income	$12,540
Less First Year's Interest on Both Mortgages	$6,953
Less Cost Recovery	$5,091
Taxable Income (or Loss)	$496
Tax Liability (Savings)	$159
Cash Flow Before-Taxes	$3,521
Cash Flow After-Taxes	**$3,363**
	$0
Value at Time of Purchase	$185,000
Projected Sales Price	$248,625
Less Projected Cost of Sale	$17,404
Less Adjusted Basis	$127,591
Total Taxable Gain on Sale	**$103,630**
Total Cost Recovery Taken	$50,909
Tax Due from Recapture	$12,727
Balance of Capital Gain	$52,721
Tax Due on Balance at Capital Gains Rate	$7,908
Total Tax Due	$20,635
Projected Sales Price	$248,625
Less Projected Cost of Sale	$17,404
Less Mortgage #1 Balance	$113,879
Less Mortgage #2 Balance	$0
Less Total Tax Due	$20,635
After-Tax Proceeds from Sale	$96,707
Cash Flows Accumulated End of Holding Period	$35,761
Total Future Wealth	**$132,468**
After-Tax Rate of Return	**13.15%**
Before-Tax Rate of Return	**19.34%**

LET YOUR TENANTS SEND YOUR KIDS TO COLLEGE

Parents with children getting closer and closer to entering college may also be feeling stress because they haven't saved enough for their tuition and other expenses. It's estimated that the average cost of tuition and fees for the 2017-18 school year was $46,950 for private colleges, $20,770 for state residents of public colleges and $40,940 for out-of-state residents.

If you started saving the year your child was born, you'd have to save $6,676 per year for 18 years at 5% to accumulate $187,800. If you waited until they were 10 years old, you'd have to save $19,667 per year to have the right amount. Saving enough can be difficult when you have a lot of time but if you only have a short time to meet your goals, it can seem impossible.

	Private Colleges	Public College	Out-of-State Public
One-Year	*$46,950*	*$20,770*	*$40,940*
Four Years	*$187,800*	*$83,080*	*$163,760*
Five Years	*$234,750*	*$103,850*	*$204,700*

Student debt is one way to handle the tuition but many parents are reluctant to saddle their children with the obligation. Currently, there is more than $1.5 trillion in outstanding student loan debt to 44 million borrowers with an average balance of $35,359.

Making an investment in rental property is another way to pay for the education. Rents are continuing to rise, homes in owner-occupied neighborhoods are appreciating and the leverage due to borrowed funds can be a huge help in building the equity to pay the tuition.

Rent the home and maintain its condition over the years. As the loan amortizes and the value increases, the equity will grow. When your student is ready to start college, you'll have several options.

You can sell the property; pay the tax on the gain at the reduced capital gains rate and fund the education. Another option would be to refinance and take the proceeds to pay for the tuition. This would allow you to continue to own the asset but would free your equity and under current tax laws is a non-taxable event.

In effect, your tenants are paying to send your kids to college.

INVESTING ON YOUR SIDE OF THE FENCE

The grass tends to look greener on the other side of the fence. Maybe that's why some people invest in things they don't understand. It has been said that the grass is just as hard to mow on the other side of the fence so stay with what your're most familiar.

Single-family homes used for rental property give a person a chance to invest in something they understand: a home. They also have distinct advantages over other types of investments.

An investor can borrow up to 80% of the value at fixed interest rates 30 years. The financing creates leverage so that the investor can benefit from the increase in value of the home not just the down payment.

It is reasonable to expect that the home will appreciate while providing tax advantages and practical control that are not available with many other investments. Low housing inventory in many markets has caused rents to increase and slow new home growth will make it difficult to keep up with demand.

Consider a $150,000 home purchased for cash that would rent for $1,500 per month. With $18,000 income and allowing for property taxes, insurance and maintenance, it is still reasonable to expect $10,000 net income. There would be an 8% return on investment without considering tax savings or future appreciation compared with 5-year CDs paying less than 2.35%, or a 10-year Treasury yield at 2.03%.

Amortization is a bonus that occurs on the loan as the principal is reduced with each payment. It becomes a forced savings account that increases the equity and isn't taxable until the property is sold.

The reasonable control has a lot of appeal to many investors who find the volatility of the stock market unacceptable and don't want the risk associated with alternative investments. Please contact me if you'd like to know more about available opportunities.