

White Paper



Nexus Real Estate Advisors
Boldness. Creativity. Patience.

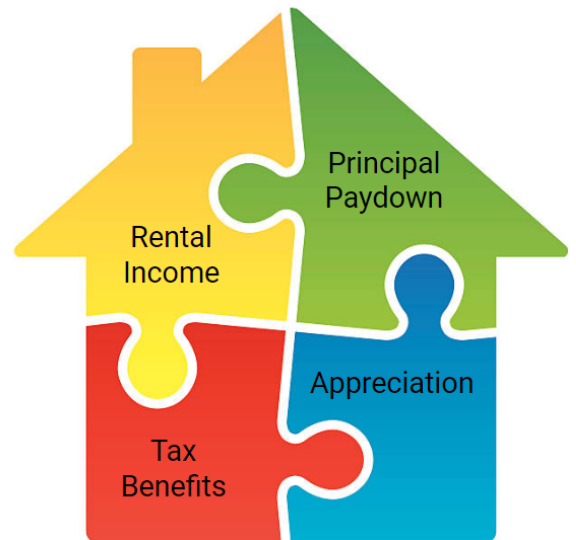
How a Real Estate Investment Achieves Results

Please Visit
www.nexusREA.com/investors for
accompanying spreadsheet tool

Synopsis: Residential real estate, when used as a buy-and-hold investment, can produce tremendous returns in terms of cash flow and asset growth. This paper illustrates how Net Income, Principal Paydown, Appreciation, Depreciation and Tax Deductions combine to generate these results.

Using the following 'non-special' turn-key scenario that is typical for rentals in several Denver, Aurora and Northern Colorado Front Range neighborhoods:

- \$400,000 single-family property
- 25% down (\$100,000)
- 30-year fixed loan at 6.5% (\$300,000)
 - Principal and Interest: \$1,896/mo
 - Tax and Insurance (9%): \$171/mo
- Rent \$2,600/mo
- 13% of Rent goes to operating expenses (OPEX - which includes Property Management and Maintenance) = \$338/mo
- 5% of Rent goes to Vacancy = \$130/mo



1 - Net Rental Income

Rent: **\$2,600 / mo**

(minus)

PI: **\$1,896 / mo**

TI: **\$171 / mo**

OPEX: **\$338 / mo**

Vacancy: **\$130 / mo**

Net Rental Income = \$2,600 Rent - \$2,067 PITI - \$338 OPEX - \$130 Vacancy =

\$65/mo, or a 0.78% return

Not a great return, so why would an investor do this deal?

Read on...



2 - Principal Paydown

Of the \$1,896 in PI, \$279 went to Principal paydown. That is pure equity... post-tax money that belongs to the investor, albeit tied up in the investment.

It is money that they can refinance out over time, and ideally use for other investment purchases.

PITI: **\$24,804 / yr**

Principal: **\$3,348 / yr**

Interest: **\$19,401 / yr**

TI: **\$2,050 / yr**

\$3,348 Principal paid/year (\$279x12) divided by the initial \$100,000 investment yields an additional 3.35% return

Total Return has now become $0.78 + \underline{3.35} = 4.13\%$

This is just the beginning, however.

3 - Appreciation

Many say that appreciation is a 'form of speculation.' It is. If, however, the horizon is mid-term, and ideally at least an economic cycle (10-12 years), the investor can fairly well count on at least historical appreciation numbers... especially in the Colorado Front Range. Although the numbers have been much higher recently, they can easily assume a 3-7% range over time. In this analysis, we use 5%.

Witness the power of leverage. If we put the initial \$100,000 into a non-leveraged investment like a stock or mutual fund, a 5% gain would result in \$5,000. Not bad. If the same \$100,000 was used to control a \$400,000 investment however, gain (at the same 5%) jumps to 20%.

Non-Leveraged (e.g. IRA)		Leveraged (e.g. Rental Investment)	
Investment Balance:	\$100,000	Equity:	\$100,000
Investment Value:	\$100,000	Appreciable Value:	\$400,000
Investment Gain:	5%	Appreciation Rate:	5%
Investment Return:	\$5,000 / year	Appreciation Return:	\$20,000 / year
Total Return:	5%	Total Return:	20%

A 5% gain on \$400,000 yields \$20,000/year, a 20% return on the initial \$100,000 investment

Total Return has now become $0.78 + 3.35 + \underline{20} = 24.13\%$

These are not 'funny' numbers... this is how money is made in real estate.

It gets better...



4 - Tax

For aprimary residence, there are very few tax deductions. Mortgage Interest (via the year-end IRS Form 1098) is the most significant.

For an income property, there are many more deductions, including Depreciation, Taxes, Insurance, HOA Dues, Maintenance, Property Management and others.

Based on the assumptions above, for year-end taxes, we can lower our taxable income as follows:

- Mortgage Interest: \$19,401
 - Taxes and Insurance: \$2,050
 - OPEX (minus Vacancy): \$4,056
 - Depreciation: \$9,745
- (assume 67% of value is the building*, and we depreciate over 27.5 years)*
- Total deductible expenses: \$35,494

Assuming a marginal tax bracket of 22%, total in-pocket cash from tax deduction is \$7,809 ($\$35,494 * 22\%$), another 7.8% return on the original \$100,000**

Total Return has now become $0.78 + 3.35 + 20 + \underline{7.8} = 31.9\%$

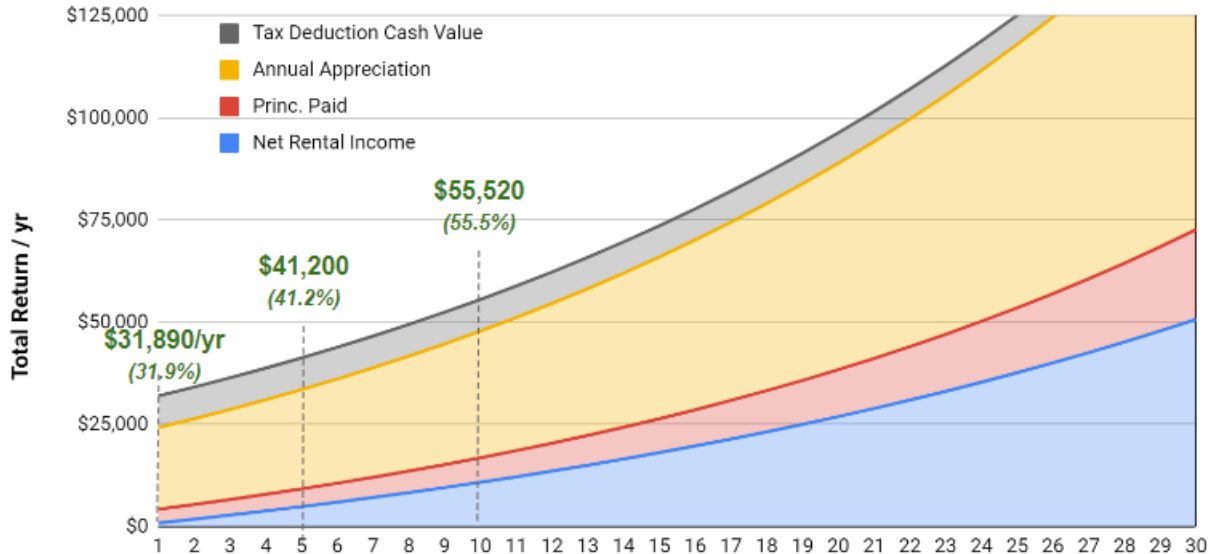


Analysis

Using the **Nexus Real Estate Investment Modeler** associated with this paper (download at www.nexusREA.com/resources), the chart below shows how this investment grows over time (using the variables below -- e.g. expense growth, rent growth, etc). All of these variables, and many more, can be modeled with this tool.

As the chart shows, Net Rental Income does not become an important factor until a few years in... this is what many get wrong about rental real estate; rent is only part of it. Sometimes we might even have to feed an investment in the early years... this is OK. The important thing to note is that the investment IS providing a positive cash-on-cash return, is not requiring additional \$ out of pocket, is professionally managed, and most importantly has become an important -and growing- annuity in ones financial portfolio.

Real Estate Investment Return



Variables							
Purchase		Financing		Rent		Tax	
List Price	\$400,000	Interest	6.5%	Rent	\$2,600	Tax Bracket	22%
Cash Discount	0%	Term (yrs)	30	Rent growth	4.0%	Depr. Land%	33%
Purchase Price	\$400,000	TI% (of PI)	9.0%	OPEX	13.0%		
Down%	25%	PI/mo	\$1,896	OPEX Growth	4.0%		
Down\$	\$100,000	TI/mo	\$171	Vacancy	5.0%		
Loan \$	\$300,000	PITI/mo	\$2,067				
Appreciation	5.0%	TI growth	4.0%				
Results (year 1)							
Net Rent	\$782	Principal	\$3,353	Appreciation	\$20,000	Tax Benefit	\$7,755
Cap Rate	6.3%	DCR	1.36			Agg. Return	31.9%

Summary

In Year 1, this 'non-special' investment yields over 30% return.

In Year 10, equity has grown from \$100,000 to \$331,000, and the investment has yielded a 60% annual return.

Forwarding to Year 31, the property is worth \$1,650,000, is 100% owned, is appreciating at over \$80,000/year, and is throwing almost \$80,000 cash/year.

Multiply this by 5 or 6 houses, and an investors future is set.

This White Paper has shown how residential real estate, when used as a buy-and-hold investment, can produce tremendous returns in terms of cash flow, equity and asset growth. By combining the power of Net Income, Principal Paydown, Appreciation, Depreciation and Tax Deductions, rental real estate remains one of the top wealth-building vehicles available.

Notes

Certain things had to be simplified for this paper, but other factors to consider:

- *The analysis largely covers Year 1 (for instance with Principal, Interest, Appreciation \$), so this is a worst-case scenario. Over time, all of these numbers improve, as can be shown on our Real Estate Investment Modeler (found at www.nexusrea.com/resources).*
- *In the analysis, there are a mix of post and pre-tax elements. For instance, Cash in pocket from tax deductions is post-tax gain, while Appreciation and Gross Rent Income are pre-tax gains.*
- *When selling the property, accrued depreciation expense will have to be recaptured (unless doing a 1031 exchange).*
- *The initial down payment \$ had to have come from somewhere, thus it has its own cost.*
- *The OPEX and Vacancy numbers can change depending on the location of the property and availability of property management. This is a good number to play with in the model when considering Aggressive / Probable / Worst-case scenarios.*



Resources

Full Owner List:	Spl Capital Llc		
Ownership Type:	Sole Ownership		
Owner Address:	Po Box 4941		
City/State/Zip:	Greenwood Village, CO 80155-4941		
Neighborhood:	Cherry Creek Vista Amended		
Neighborhood Code:	467.00		
Acres:	0.2870		
Land Use:	Single Family		
Legal Desc:	Lot 5 Blk 4 Cherry Creek Vista 11Th Flg		
2019 Appraised Value	Total	Building	Land
2019 Assessed Value	773,300	503,300	270,000
	55,291	35,986	19,305
		2019 Mill Levy:	94.610

* Depreciation is based on ratio of Building Assessed Value to the Total Assessed value

2022 Tax Brackets

Tax rate	Single	Head of household	Married filing jointly or qualifying widow	Married filing separately
10%	\$0 to \$10,275	\$0 to \$14,650	\$0 to \$20,550	\$0 to \$10,275
12%	\$10,276 to \$41,775	\$14,651 to \$55,900	\$20,551 to \$83,550	\$10,276 to \$41,775
22%	\$41,776 to \$89,075	\$55,901 to \$89,050	\$83,551 to \$178,150	\$41,776 to \$89,075
24%	\$89,076 to \$170,050	\$89,051 to \$170,050	\$178,151 to \$340,100	\$89,076 to \$170,050
32%	\$170,051 to \$215,950	\$170,051 to \$215,950	\$340,101 to \$431,900	\$170,051 to \$215,950
35%	\$215,951 to \$539,900	\$215,951 to \$539,900	\$431,901 to \$647,850	\$215,951 to \$323,925
37%	\$539,901 or more	\$539,901 or more	\$647,851 or more	\$323,926 or more

** Current Marginal Tax Brackets

About Nexus



Nexus Real Estate Advisors
Boldness. Creativity. Patience.

The power of experience.

Anybody can read a book on real estate investing. But until one actually begins the process, and repeats it year after year, do they become a profitable real estate investor.

Nexus has the experience to get our clients to the next level step... no matter how high.

- Nexus was created by the founder of Echo Summit Property Management, acquired by GK Homes in 2019. Echo Summit was awarded the #1 position as “Fastest Growing Private Company” by the Denver Business Journal in both 2010 and 2011. Nexus understands the rental business, and what makes a successful income property.
- Proven experience and track record of building personal wealth with residential RE investments.
- After managing nearly 10,000 properties across the Front Range over a decade... we know the winners and losers, often down to street-level.
- We are experts in RE purchasing... from identification to negotiation to inspection to close.
- Experience in real estate and business management, taxes, Fed/State requirements.
- Access to best-of-breed vendors, and playbook for how to identify and vet new vendors.

Our buyer services are free of charge.

