How a Real Estate Investment Achieves Results

Presented by Scott Lukes, President

Please Download !
This presentation and Investment Modeling tool can be downloaded at nexusREA.com/resources
(scroll to bottom of page)

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WELCOME !!!

Today...

De-construct a real estate deal to assess its true overall return

Net Rental Income

Principal Paydown

Appreciation

Tax Deductions

Depreciation

Analyze and modify return variables

Look at methods for funding the down payment

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About Nexus

The power of experience.

As both your advisor and Realtor®, Nexus takes the mystery and challenge out of real estate investing, helping build residential income real estate into your wealth and retirement strategy.

Nexus was created by the founder of Echo Summit Property Management, one of Colorado's largest and most respected management companies (acquired in 2019). After managing nearly 10,000 properties across the Front Range for over a decade, we know the winners and losers, often down to the street-level. We also have a proven personal track record of building significant wealth with residential RE investments.

We are experts in purchasing… from identification to negotiation to inspection to close. Nexus also has access to best-of-breed technologies, vendors and ecosystem partners to ensure a smooth experience every step of the way.

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The investment...

880 Quari Street, Aurora, CO 80011 (Status: Closed, Listing ID: 7742086)

		Close Price:	$353,000
County:	Arapahoe	List Price:	$330,000
Property Type:	Residential	Original List Price:	$330,000
Property Subtype:	Single Family Residence		
Levels:	One	Basement:	No
Structure Type:	House	Year Built:	1952
Subdivision Name:	Hoffman Heights		
Listing Contract Date:	11/20/2020		
Purchase Contract Date:	12/01/2020	Contingency:	None Known
Close Date (DIM):	12/29/2020		
Days In MLS:	5		
Association: N Multiple:	Cov/Rest: N	Assoc Fee Tot Annl:	$0.00
Tax Annual Amt:	$2,127	Tax Year:	2019
Tax Legal Desc:	LOT 15 BLK 30 HOFFMAN TOWN 3RD FLG		

Interior Area & SqFt

Building Area Total (SqFt Total): 1,800 | Living Area (SqFt Finished): 1,800 | Above Grade Finished Area: 1,800
PSF Total: $196 | PSF Finished: $196 | PSF Above Grade: $196
Heating: Forced Air
Cooling: Evaporative Cooling | HVAC Description:
Interior Features: Ceiling Fan(s), Eat-in Kitchen
Appliances: Dishwasher, Disposal, Gas Water Heater, Oven, Range, Refrigerator
Flooring: Carpet, Laminate
Exclusions: Seller's Personal Property and Staging Items

Bed & Bath Summary

Bedrooms Total: 4 | Bathrooms Total: 2
Baths Full: 1 | Baths Three Quarter: 1 | Baths Half: 0 | Baths One Quarter: 0

Parking

Parking Total: 2 | Garage Spaces: 2 | Offstreet Spaces: 0

Site & Location Information

Lot Size: 0.21 Acres / 9,148 SqFt | Waterfront Feat:
Elementary School: Sixth Avenue / Adams-Arapahoe 28J
Bldg/Complex Name: | Middle/Junior Sch: South / Adams-Arapahoe 28J
High School: Aurora Central / Adams-Arapahoe 28J

Building & Water Information

Direction Faces: West | View:
Construction Materials: Brick, Frame
Roof: Composition | Exterior Features: Private Yard
Water Included: Yes | Water Source: | Sewer:

Public Remarks

Beautifully updated brick ranch style home perfect for main floor living with plenty of space both indoors and outdoors, with a big fully fenced back yard and an oversized 2 car garage. This home boasts laminate wood flooring throughout main living spaces, and has 4 bedrooms and 2 bathrooms which have been recently updated with new vanities and laminate wood flooring. The newer installed furnace ...

Confidential Information

Private Remarks: Please review supplements in the MLS- Improvements to the Property including Structural and permanent stabilization work done to the property, and Transferable Warranty of Structural Work to the new homeowners. The agent is CTMe user, all information is deemed reliable, but is the Buyer's agent and Buyer's responsibility to verify everything, including square footage, schools, zoning etc. P
Buyer Agency Comp: 2.8% | Dual Variable: No | Submitted Prosp: No
Transaction Broker Comp: 2.8%

~$350k property located in Fitzsimons (Hoffman Heights)

Closed at end of 2020

Rents for $2,200

This is an example property, but I own many in same ‘hood...


REcolorado
REcolorado
REcolorado
REcolorado
REcolorado

Investment structure...

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Purchase:	**$350,000**
Financing:	**20% down ($70,000), 30 yr fixed, 5%**
PI:	**$1,503 / mo**
TI:	**$135 / mo (assume 9% of PI)**
OPEX*:	**$286 / mo (13% of monthly rent)**
Vacancy:	**$110 / mo (5% of rent)**
Rent:	**$2,200 / month**

* Operating Expenses (OPEX) includes proactive and reactive maintenance and professional management

5 elements of return...

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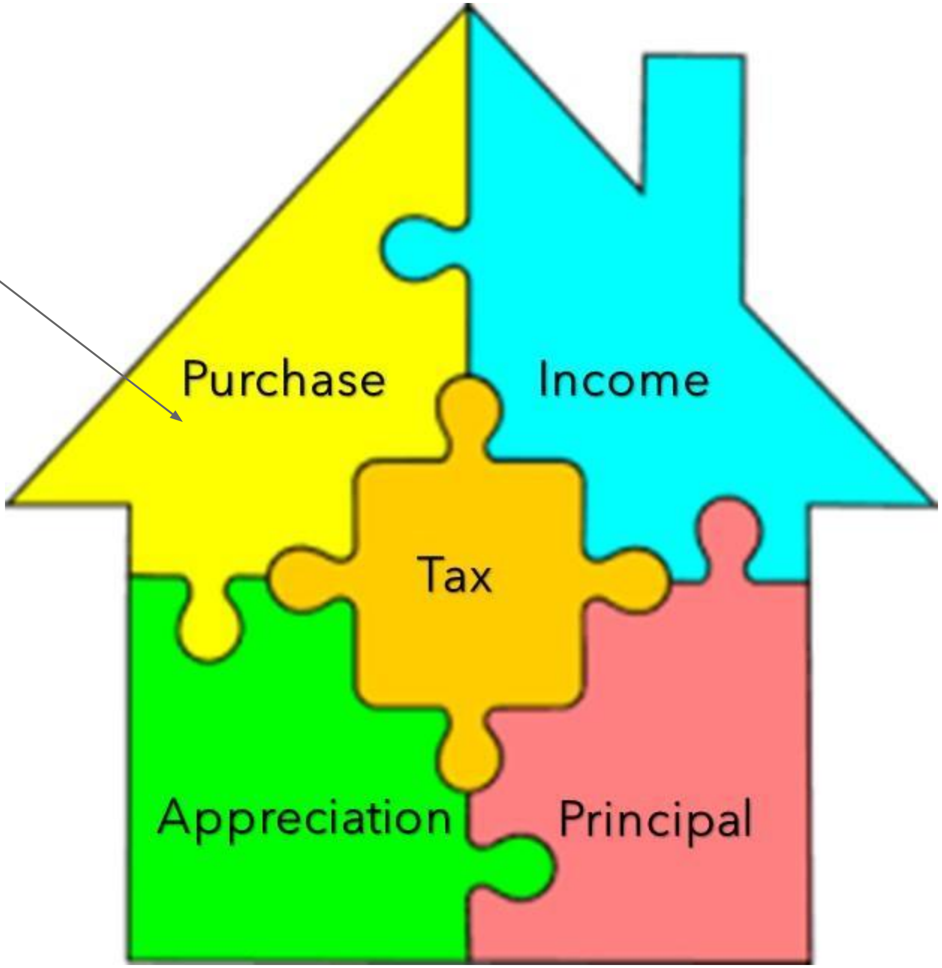
Will cover if time



Net Income

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Net Income...

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Rent: $2,200 / mo

(minus)

PI: $1,503 / mo

TI: $135 / mo

OPEX: $286 / mo

Vacancy: $110 / mo

Net Rental Income: **Rent - PITI - OPEX - Vacancy = $166 / mo ($1,992 / yr)**

$1,992 Net Rental Income / year divided by the initial $70,000 investment yields a 2.8% return

Net Income...

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Assume: 4% rental appreciation, 4% TI growth, 4% OPEX growth

Principal

Principal…

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Of the $19,656 in PITI, $4,128 went to Principal (in year 1)

Principal is not an expense, though we treated it that way when calculating Net Rental Income. This Principal is pure equity… post-tax money that is ours, albeit tied up in the investment.

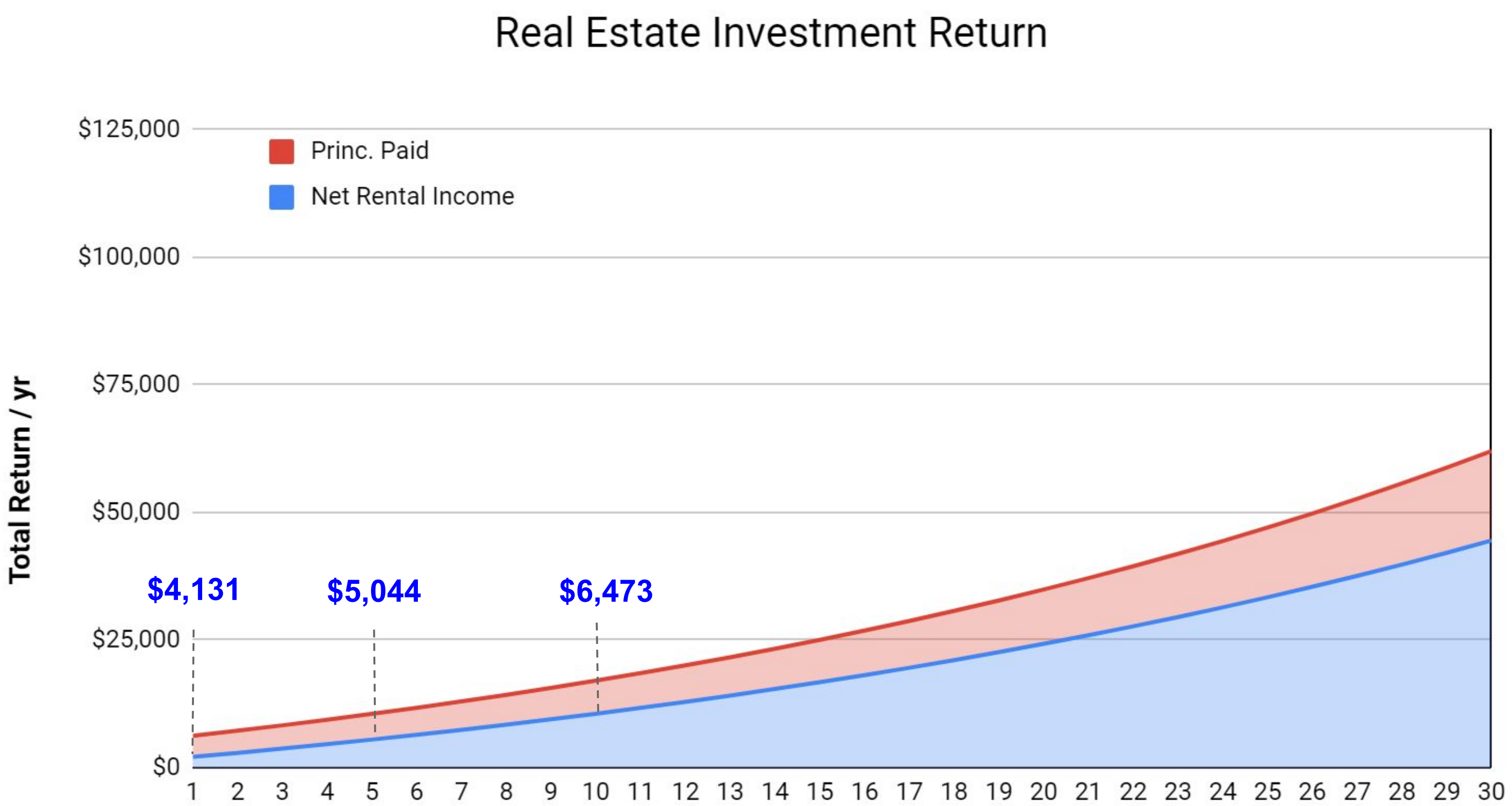
IMPORTANTLY, it is money that we can refinance out over time, and ideally use for other leveraged investments or RE purchases.

PITI:	**$19,656 / yr**
Principal:	**$4,128 / yr**
Interest:	**$13,908 / yr**
TI:	**$1,620 / yr**

$4,128 Principal/year ($344x12) divided by the initial $70,000 investment yields an additional 5.9% return

Total Return has now become 2.8 + 5.9 = 8.7%

Principal...



Real Estate Investment Return
Princ. Paid
Net Rental Income
Total Return / yr
$125,000
$100,000
$75,000
$50,000
$25,000
$0
$4,131
$5,044
$6,473
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30

Appreciation

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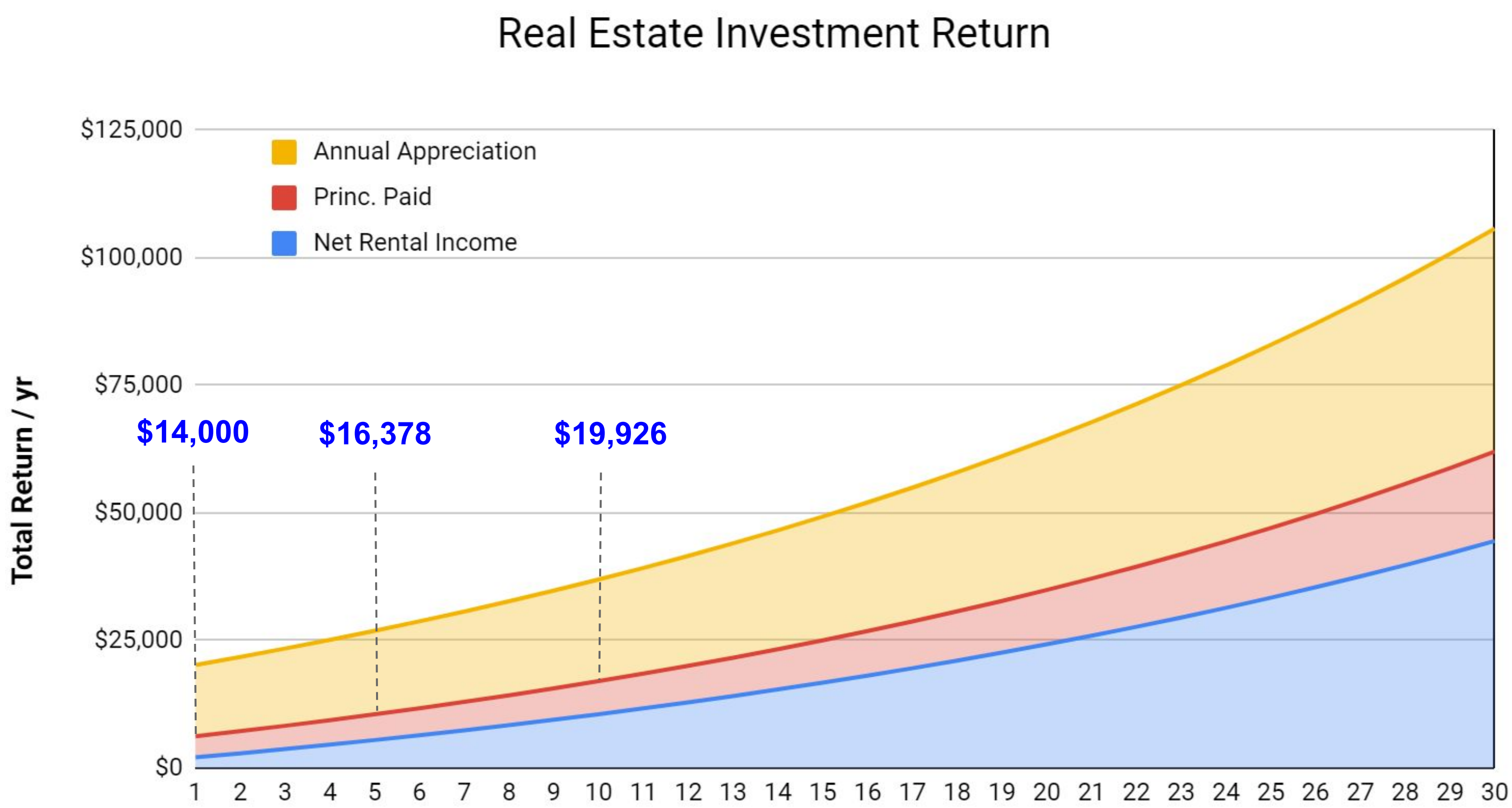
Leveraged - vs - Non-leveraged Investments

Non-Leveraged (e.g.IRA)		**Leveraged** (e.g. our house)	
Investment Balance:	**$70,000**	**Equity:**	**$70,000**
Investment Gain:	4%	Appreciable Value:	$350,000
Investment Return:	$2,800 / year	Appreciation Rate:	4%
Total Return:	4%	Appreciation Return:	$14,000 / year
		Total Return:	20%

4% of $350,000 yields $14,000 / year, a 20% return on the initial $70,000 investment

Total Return has now become 2.8 + 5.9 + 20 = 28.7%

Appreciation... the power of COMPOUNDING



Assume: 4% property appreciation

Fun Fact: Rule of 72...

To find the number of years required to double your money at a given interest rate, you just divide the interest rate into 72.

For example, if you want to know how long it will take to double your money at 5 percent interest: divide 5 into 72 and get 14.4 years.

$$\frac{72}{\text{Rate of Return}} = \text{Time for Investment to Double}$$

Annual Interest Rate	The Rule of 72	Actual Number of Years
1%	72.00	69.66
2%	36.00	35.00
3%	24.00	23.45
4%	18.00	17.67
5%	14.40	14.21
10%	7.20	7.27
20%	3.60	3.80
30%	2.40	2.64
50%	1.44	1.71
75%	0.96	1.24
100%	0.72	1.00

Tax Deductions

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Tax Deductions...

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

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

Federal Income Tax Bracket for 2020 (filing deadline: April 15, 2021)

	Single	Married Filing Jointly	Married Filing Separately	Head of Household
10%	$0 – $9,875	$0 – $19,750	$0 – $9,875	$0 – $14,100
12%	$9,876 – $40,125	$19,751 – $80,250	$9,876 – $40,125	$14,101 – $53,700
22%	$40,126 – $85,525	$80,251 – $171,050	$40,126 – $85,525	$53,701 – $85,500
24%	$85,526 – $163,300	$171,051 – $326,600	$85,526 – $163,300	$85,501 – $163,300
32%	$163,301 – $207,350	$326,601 – $414,700	$163,301 – $207,350	$163,301 – $207,350
35%	$207,351 – $518,400	$414,701 – $622,050	$207,351 – $518,400	$207,351 – $518,400
37%	$518,401+	$622,051+	$518,401+	$518,401+

Please note that there are SOME improvements that are capitalized and depreciated… and not treated like an ordinary deductible expense.

Can you think of a few?

Tax Deductions...

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Based on the assumptions in this case study, for year-end taxes, we can lower our taxable income as follows:

Mortgage Interest:	**$13,906**
Taxes and Insurance:	**$1,623**
OPEX:	**$3,432**
Depreciation:	**$8,527**

(assume 67% of value is the building, and we depreciate over 27.5 years)

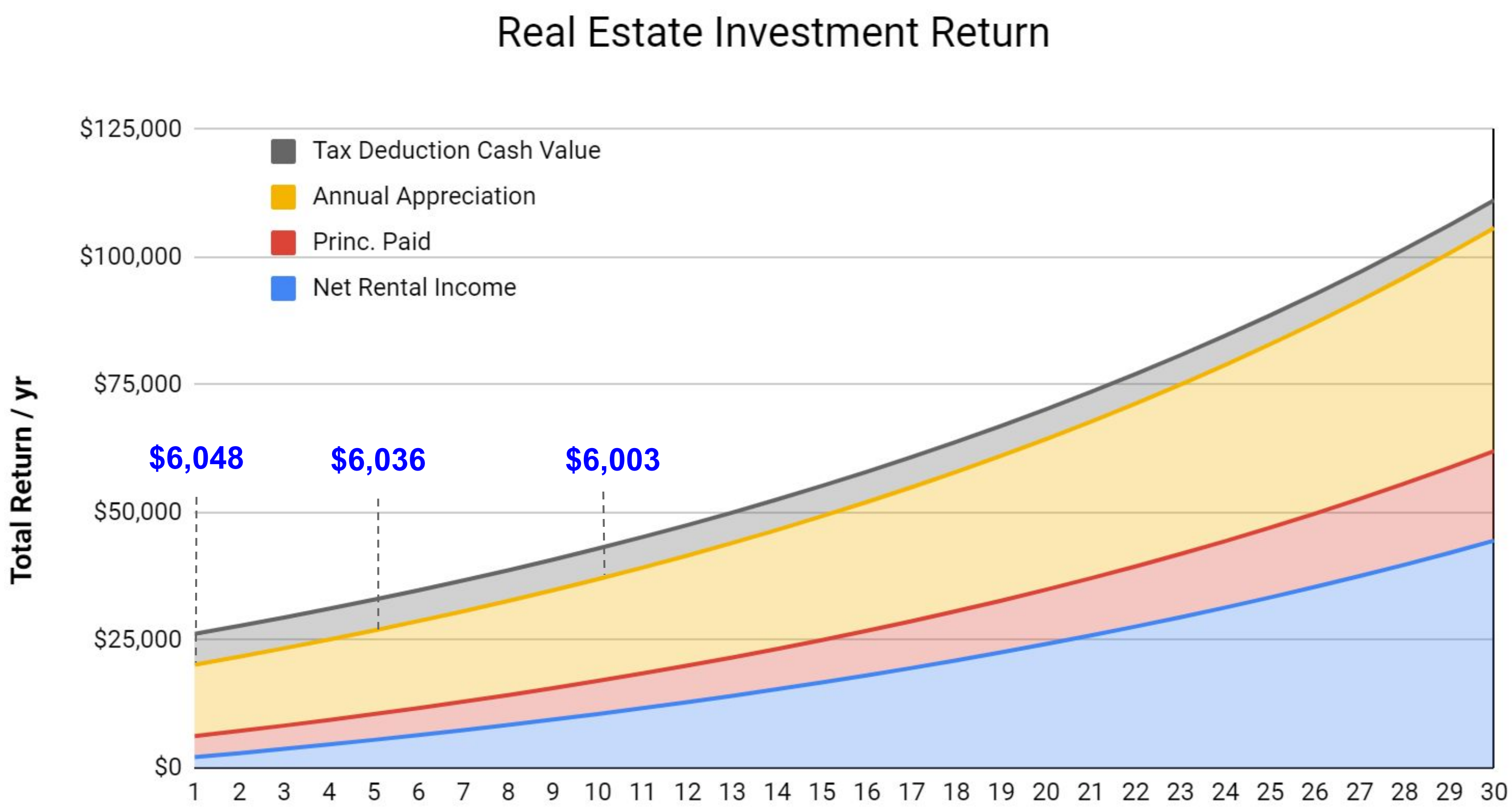
Total deductible expenses: $27,488

BUT, this 8.6% is post-tax $!!!

Assuming a marginal tax bracket** of 22%, total in-pocket cash from tax deduction is $6,047 ($27,488 * 22%), another 8.6% return on the original $70,000

Total Return has now become 2.8 + 5.9 + 20 + 8.6 = 37.3%

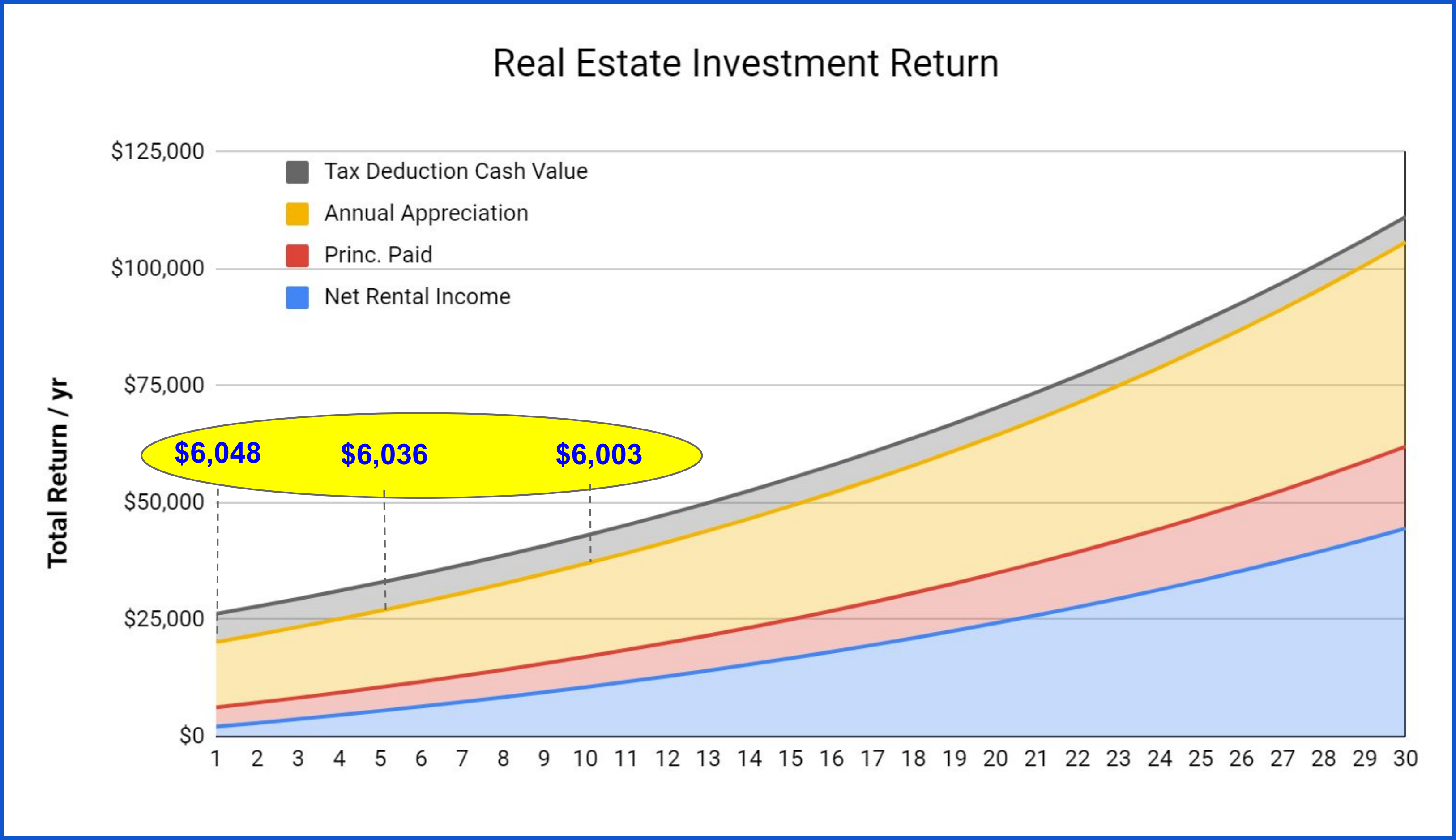
Tax Deductions...



Assume: 22% marginal tax bracket, 4% TI growth, 4% OPEX growth

Challenge:

If TI and OPEX are both growing at 4%, why are our tax deductions not also increasing?



Assume: 22% marginal tax bracket, 4% TI growth, 4% OPEX growth

Analysis

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Overall Return...

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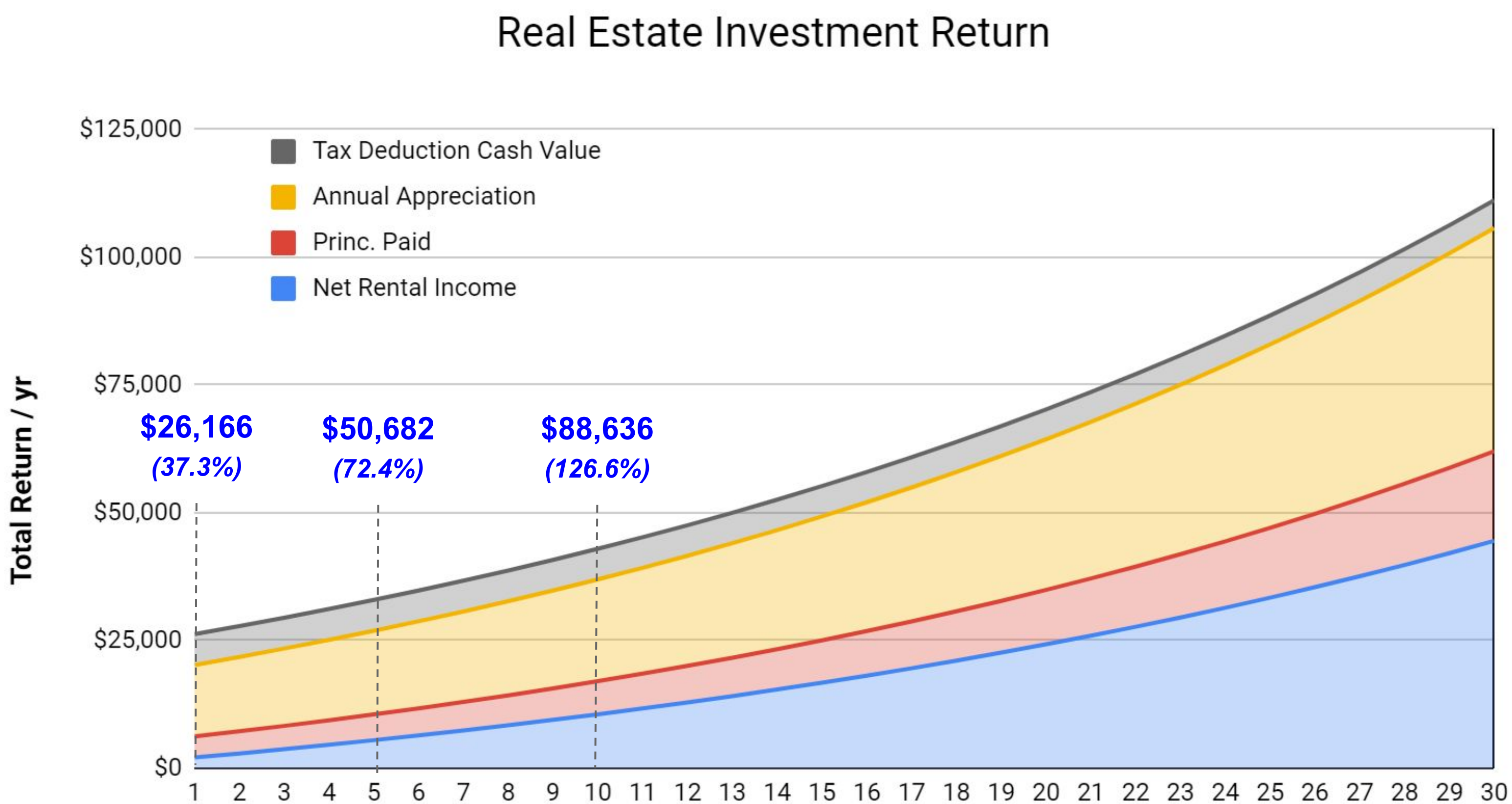

Remember: This is for a 'non-special' deal that required NO fix-up, and is now professionally managed.

Overall Return… final thought

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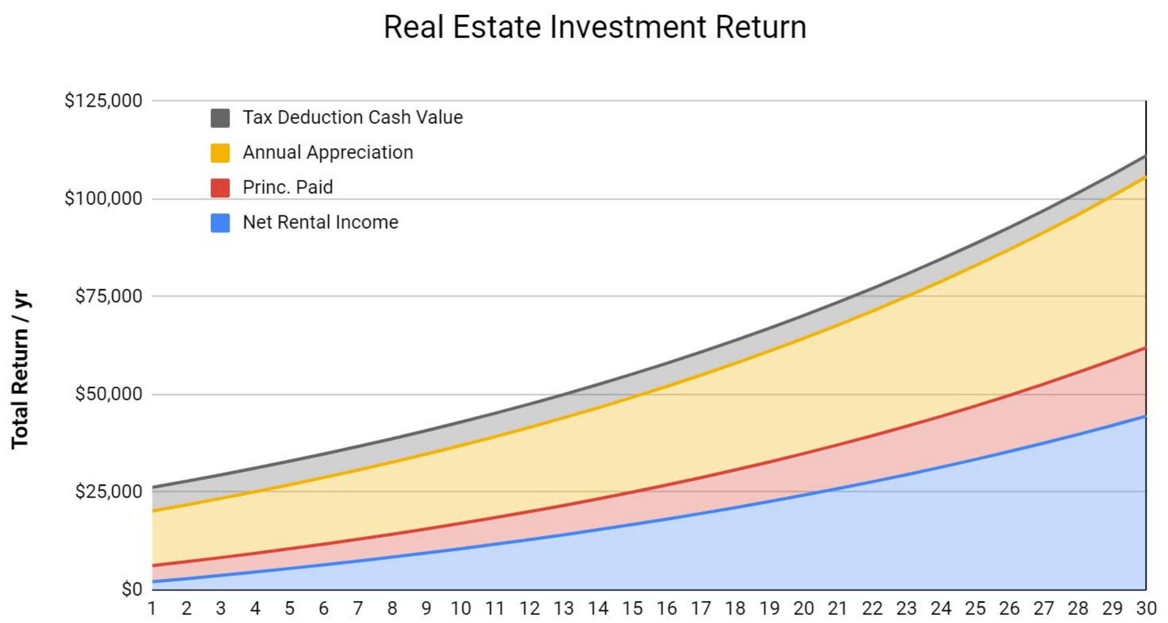
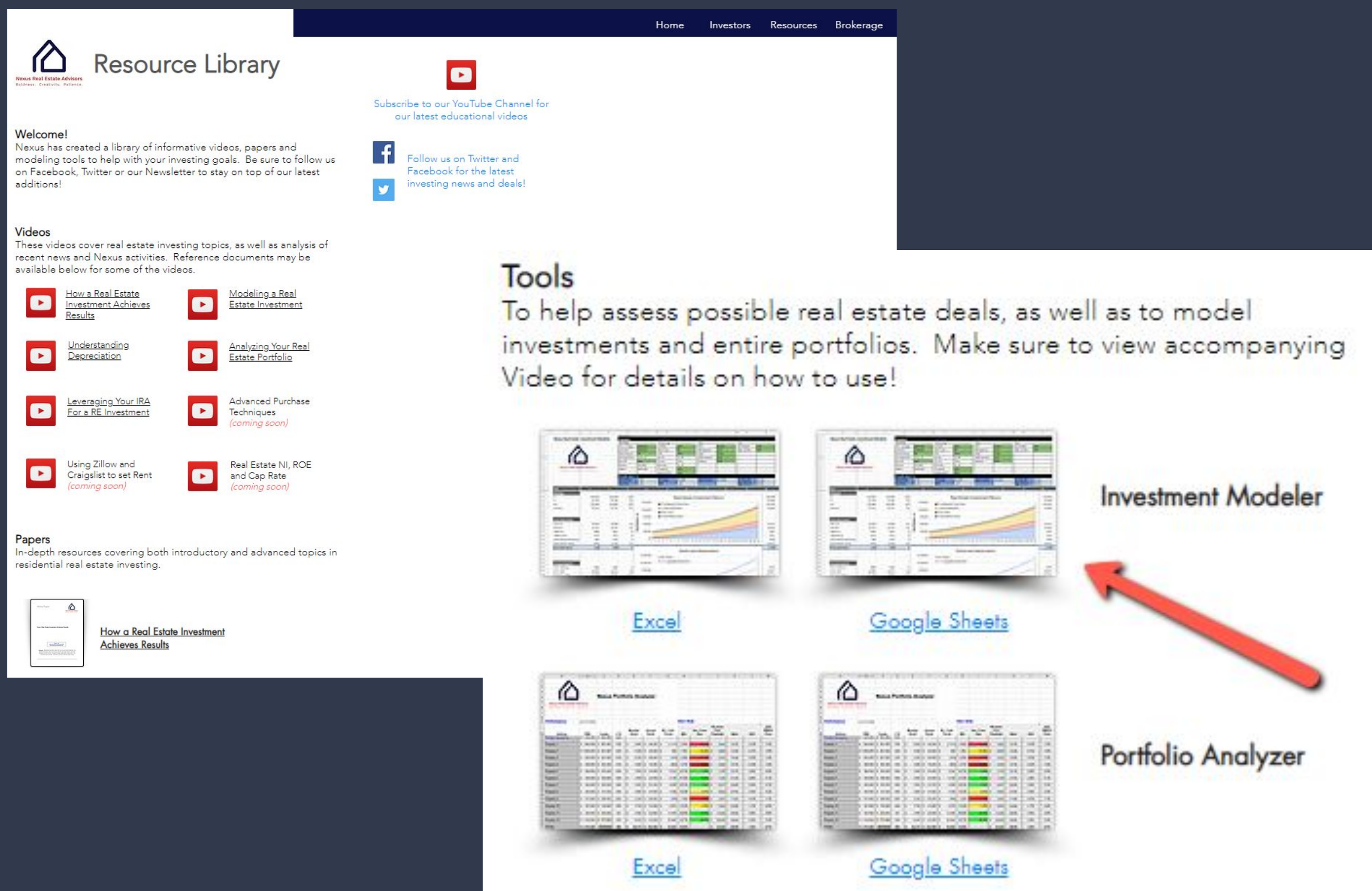


As the analysis shows, Net Rental Income does not become an important factor until a few years in… this is what most people get wrong about rental real estate; rent is only part of it. Sometimes we might even have to feed an investment in the early years… this is OK. The important thing to note is that 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 our financial portfolio.

For next section, make sure and download the Real Estate Investment Modeler at:

nexusREA.com/resources



Break

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Ya...
but what if
_______?

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What if... rent is only $2,000 / month?

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What if... rent is only $2,000 / month?

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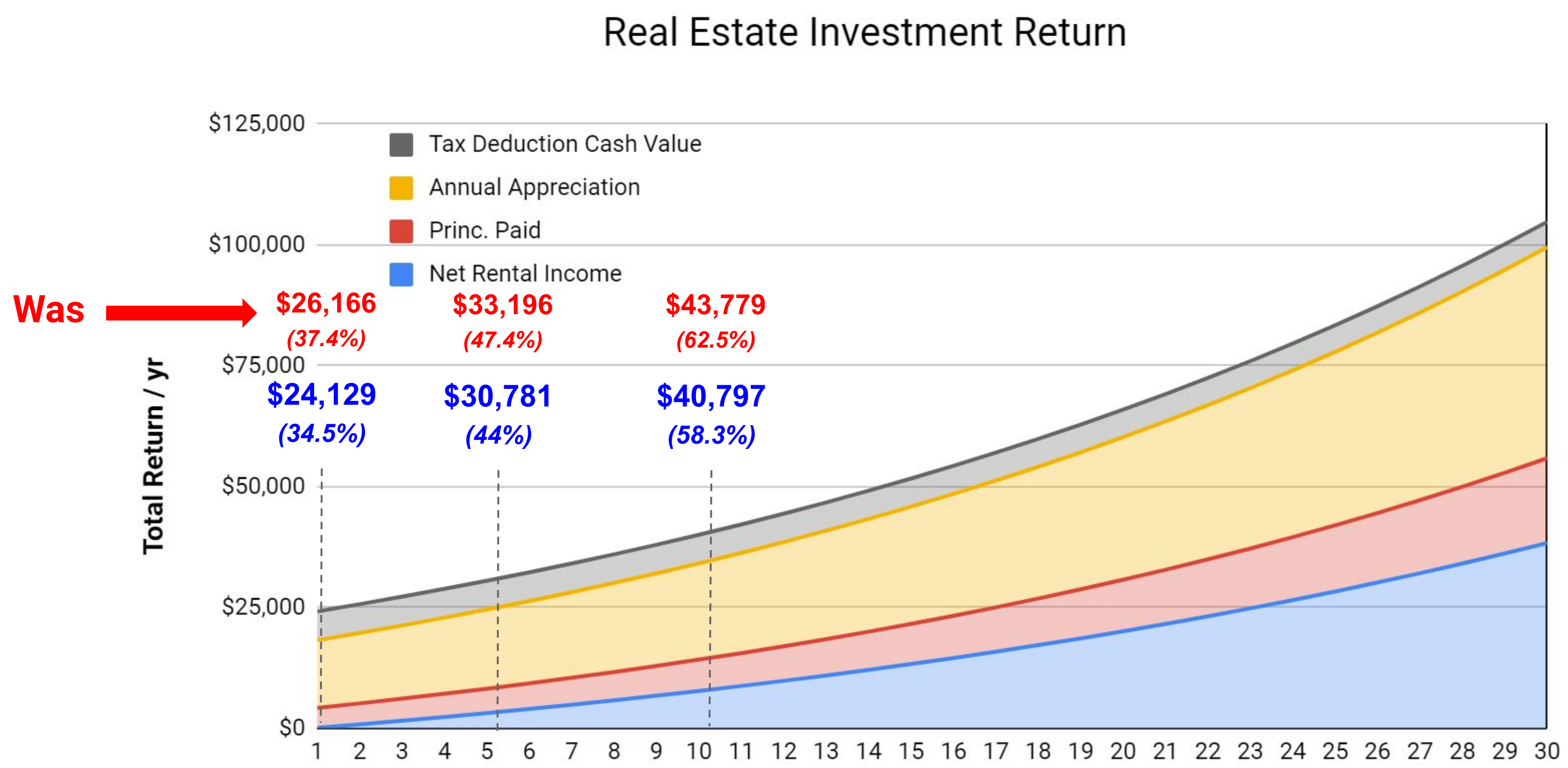

What if… I manage it myself (take out 8% OPEX)?

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What if... I manage it myself (take out 8% OPEX)?

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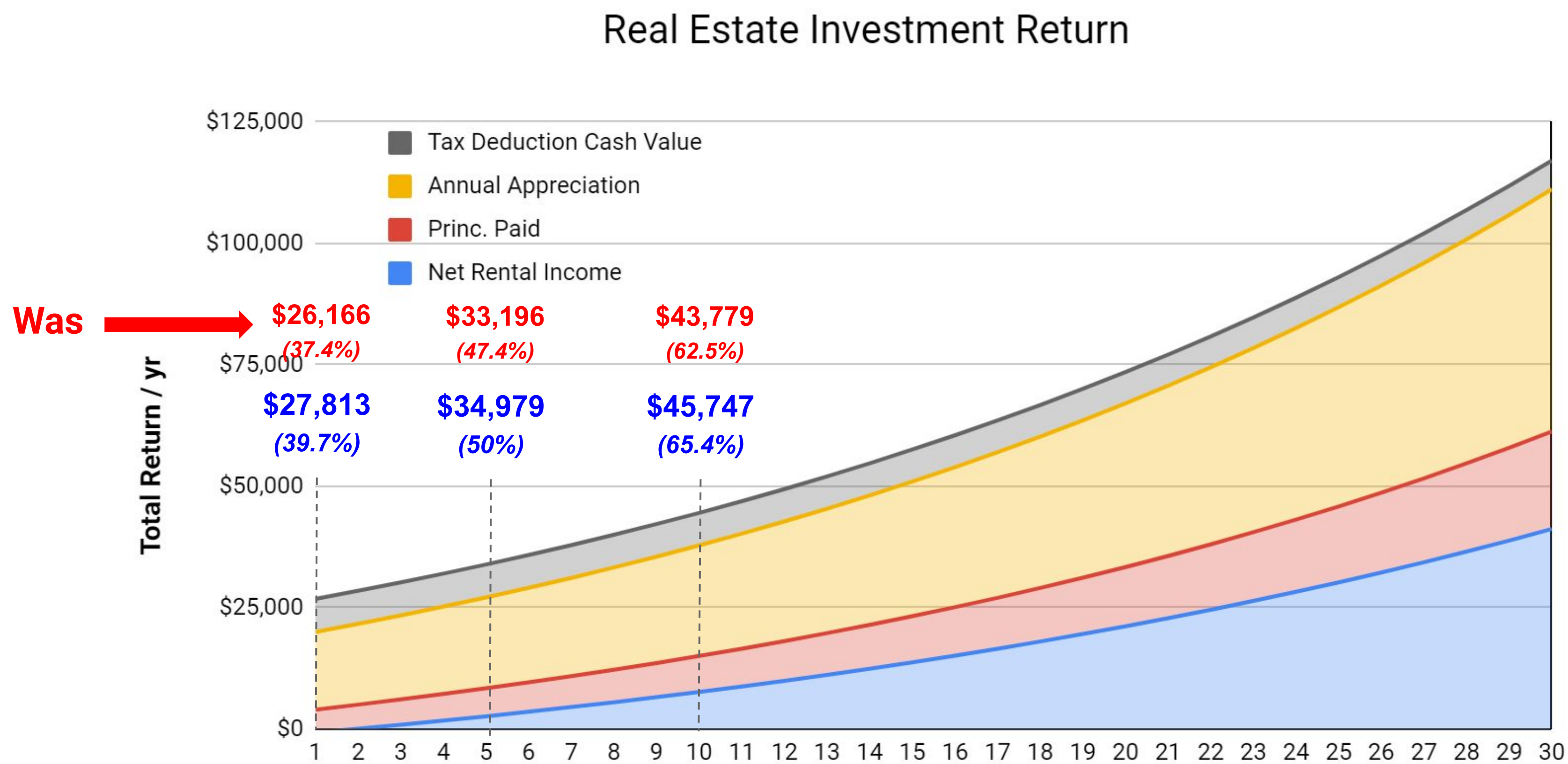

What if... appreciation is only 2%

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What if... appreciation is only 2%

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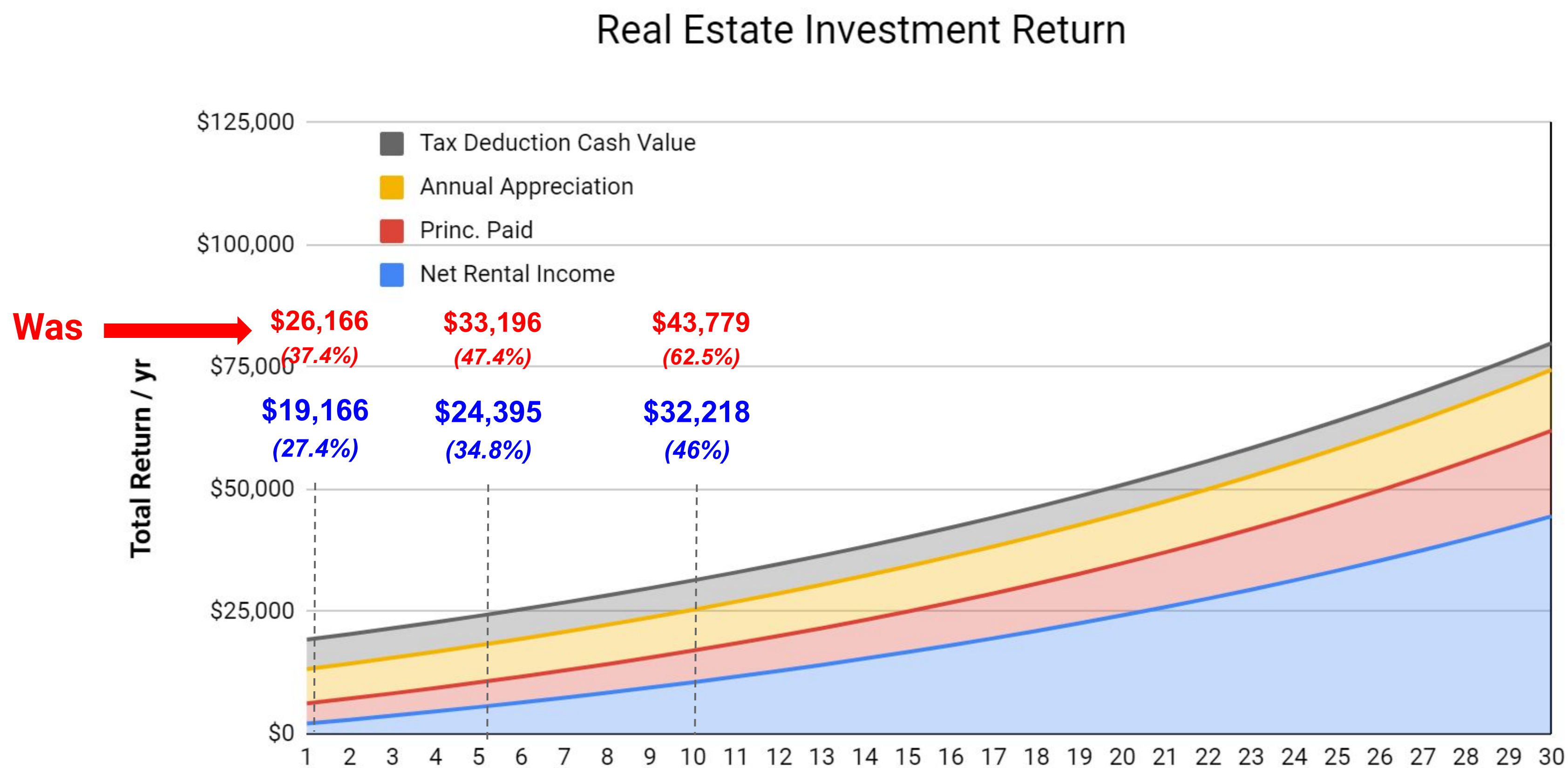

Funding the Down

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BUSINESS

REAL ESTATE

Home equity bonanza in 2020

The average in Colorado was an increase of $32,000.

By Aldo Svaldi
The Denver Post

For homeowners in Colorado and across the country, 2020 was a year of enrichment unrivaled since 2013, when the nation was bouncing back from the housing crash.

U.S. homeowners gained $1.5 trillion in home equity last year, which works out to an average of $26,300 per household, according to a report from real estate analytics firm CoreLogic. Colorado homeowners, reflecting the above-average home prices in the state, did even better, with home equity gains averaging $32,000 last year.

Among the Colorado metro areas that CoreLogic tracks, Boulder residents enjoyed the biggest home equity gains at $46,673, followed by Colorado Springs residents at $33,284, metro Denver residents at $31,895, Fort Collins residents at $23,934 and Greeley residents at $20,118.

CoreLogic estimates the average home equity amounts homeowners were sitting on at the end of last year were as follows: Boulder, $400,038; Colorado Springs, $188,312; Denver, $258,894; Fort Collins, $230,998; and Greeley, $177,428.

Sharp gains in home prices boosted home equity, and the pandemic was a big driver. Early last spring, the Federal Reserve intervened to stabilize mortgage markets and push down interest rates to historic lows, which boosted affordability and increased demand.

Fearful of catching the virus in a cramped living environment, more multifamily tenants sought out a place of their own. The shift to remote work and school arrangements also fostered a desire for more living space to stretch out, among existing owners and renters alike. And the loss of amenities like concerts and shows also made urban apartment living less attractive.

Congress granted mortgage borrowers struggling to make the monthly payment forbearance, reducing the pressure on them to sell and keeping a source of supply off the market. When supply couldn't meet the increased demand, prices surged and the inventory of homes available for sale plunged.

"This growing bank of personal wealth that homeownership affords was noticed by many but in particular for first-time buyers who want a piece of the cake. As a result, we may see more of those currently renting start to enter the market in the near future," said Frank Martell, president and CEO of CoreLogic, in comments accompanying the report.

The equity gains of recent years combined with super-low interest rates also allowed more borrowers to refinance. Some of that money went to fuel a record year for spending on home improvements, which in turn further boosted home values.

Aldo Svaldi: 303-954-1410, asvaldi@denverpost.com

Funding the Down Payment...

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Refinance our primary residence

We can generally pull out an amount that leaves us at 85-90% loan to value (LTV). For instance, if our home is worth $500,000, and we owe $300,000 on the property, we have a 60% LTV ($300,000 / $500,000).

Borrowing against our home to achieve an LTV of 85% leaves us with a $425,000 mortgage and $125,000 in cash to invest. The negative is that we also have an additional $671 month in Principal and Interest (assuming a 30yr/5% fixed). This is not all bad... Principal goes right back to us as equity in the property, and the Interest is more than made up for in the real estate investment (or investments -plural-... $125k will be enough to fund purchase two properties and establish a reserve).

Funding the Down Payment...

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Gifts from Relatives (or very nice friends)

We can receive cash or property gifts tax-free from relatives or friends. The IRS annual gift tax exclusion for tax year 2020 is $15,000 for individuals and $30,000 for married couples filing jointly. This means each parent or a friend can give us $15,000 without triggering a tax.

Let's say our dad gives us $20,000 for a real estate down payment. At this point, he made a taxable gift. But it doesn't necessarily mean he has to write a check to the IRS that year because of his gift. However, he has to file a gift tax return and fill out IRS Form 709. The government requires this in order to keep track of your parent's lifetime gift tax exclusion. The lifetime gift tax exclusion in 2020 is $11.58 million, or $23.16 million for married couples filing jointly.

Funding the Down Payment…

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Tapping into Cash-Value Life Insurance

For those of us with "cash value" (CV) Whole Life Insurance, this can be a very powerful tool. It basically costs nothing to take a loan against the policy, as long as it is eventually returned.

As an example, the loan against the policy will cost us (the policy holder) 4.5% in interest, but at the same time, that money is still earning interest as if it were still in the account (typically 5-6%). Best of all, the loan funds are tax-free, and the repayment can happen on any schedule (possibly using free cash flow from the real estate investment itself).

Maybe you have a friend or relative with CV insurance who wants to go in on a deal with you (hint hint) ?

Funding the Down Payment...

Pull from our IRA or 401(k)

When was the last time we have heard of a person gaining substantial wealth from their IRA? How about from Real Estate?

Here is how is how we can tap into a portion of our IRA to diversify and grow our wealth portfolio...

Funding the Down Payment…

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Pull from our IRA or 401(k)

Step 1 - Understand our current IRA return

Assume a $200,000 balance that we could sell:

5% return = $10,000/yr in Interest earned

10% return = $20,000/yr in Interest earned

Step 2 - Sell a portion of our IRA

$200,000	IRA sold (assume $100k is Principal, $100k is Gain)
- $20,000	IRS 10% Early Withdrawal Penalty
- $30,000	Taxes on Gain (30% estimated… see your CPA)
$150,000	Remaining to invest (post-tax… cash in pocket)

Step 3 - Buy Real Estate and establish a reserve

Assuming the same $70,000 down payment for the $350,000 property, with the remaining $150,000 we:

1) purchase two $350,000 properties ($70,000 x2 = $140,000 down),

2) pay closing costs ($2,500 x2 = $5,000), and

3) establish a reserve fund ($5,000).

Funding the Down Payment...

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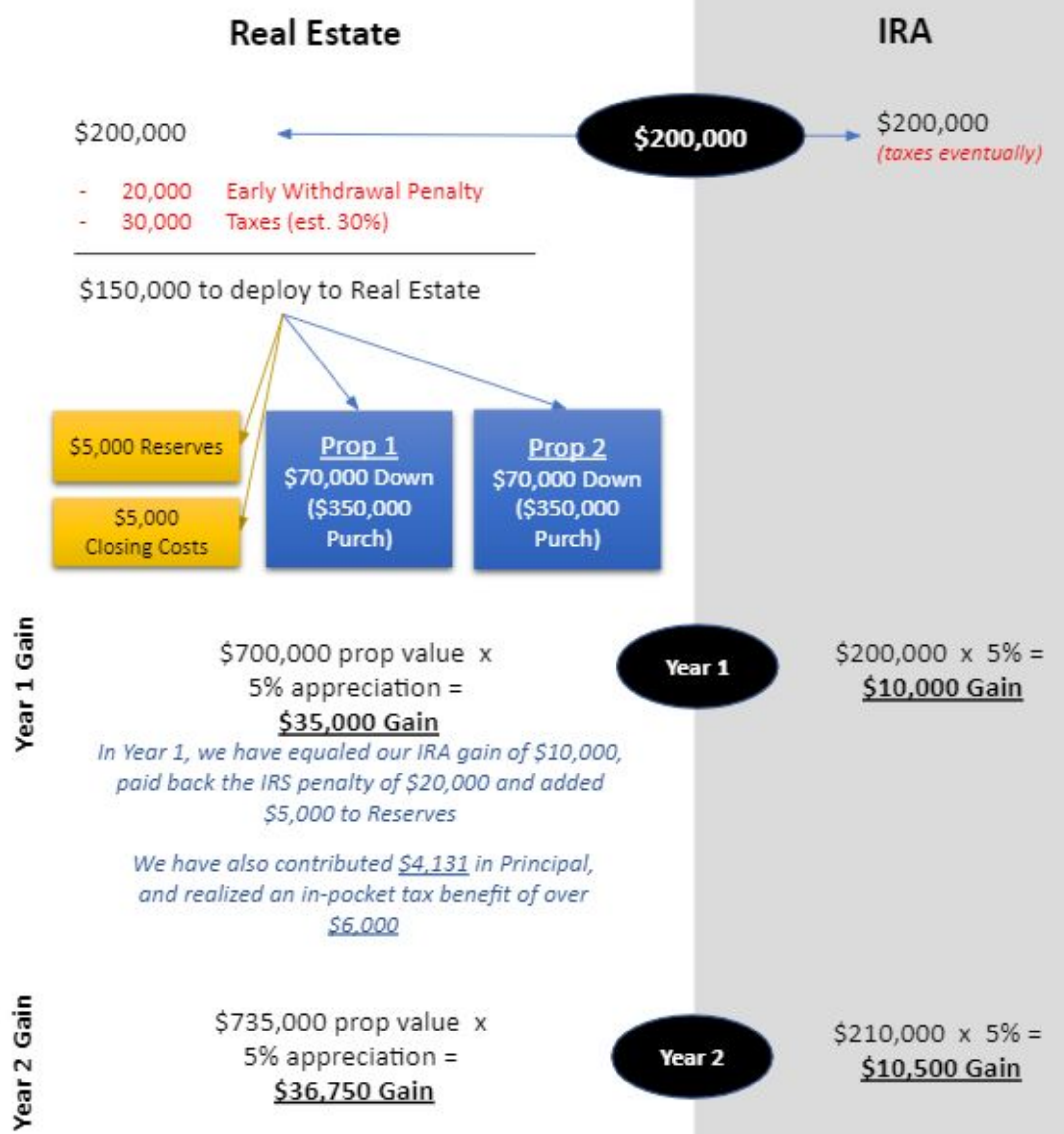

IRA Versus Real Estate...

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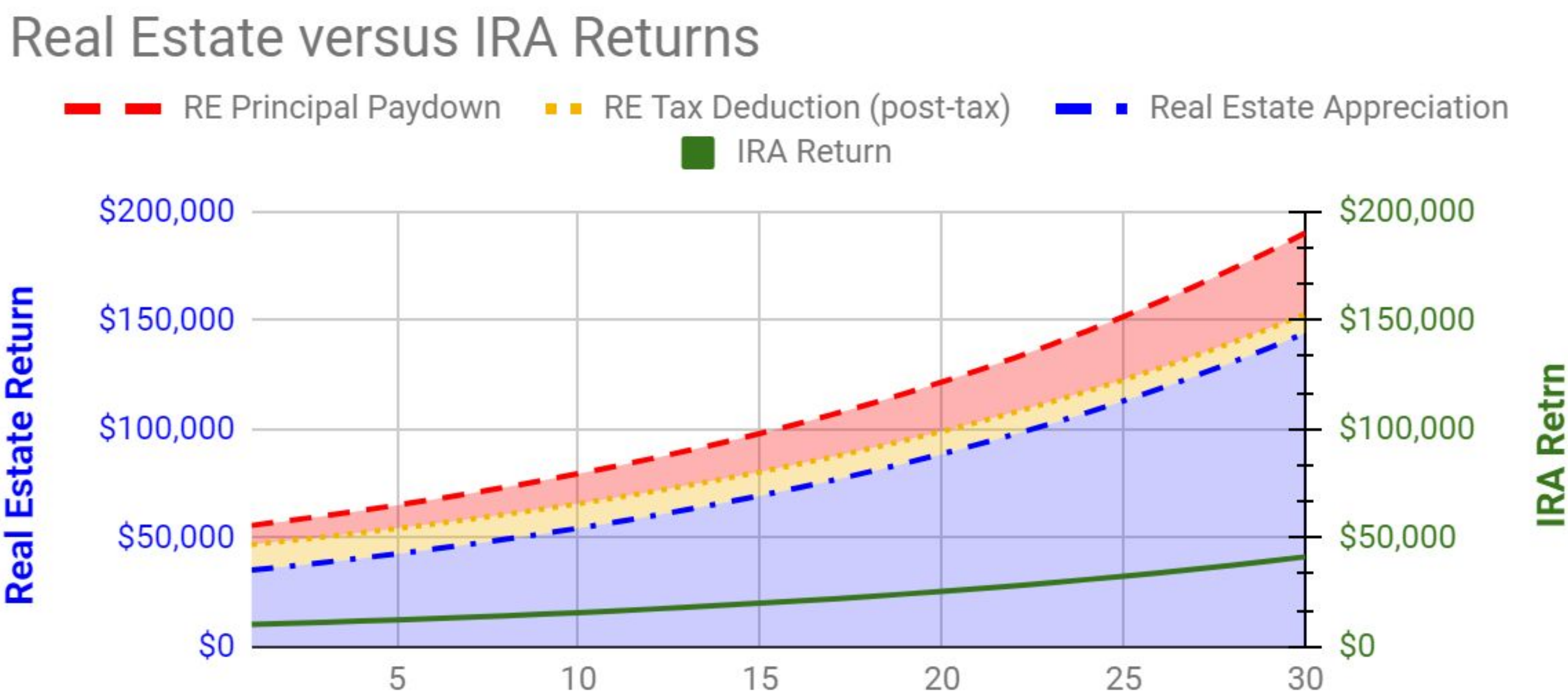

C.A.R.E.S. Act Loophole

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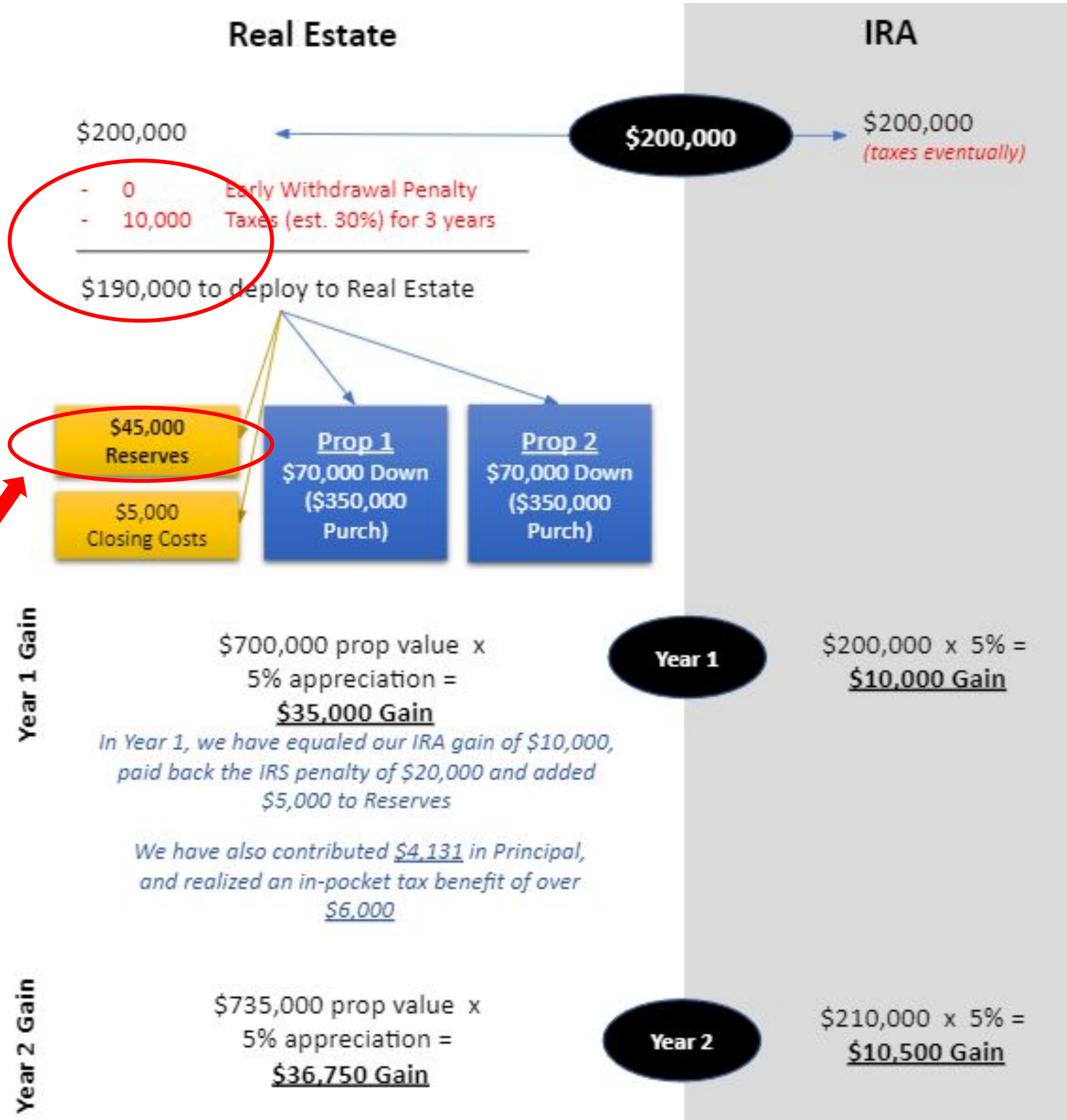
For persons 'impacted' by the pandemic, the IRS allows a $100,000 / person IRA/401(k) withdrawal with:

NO Early Withdrawal Penalty

Taxes spread over 3 years

Ability to re-contribute and claim taxes paid (w/in 3 yrs)

In this scenario, our Reserves have increased from $5,000 to $45,000!



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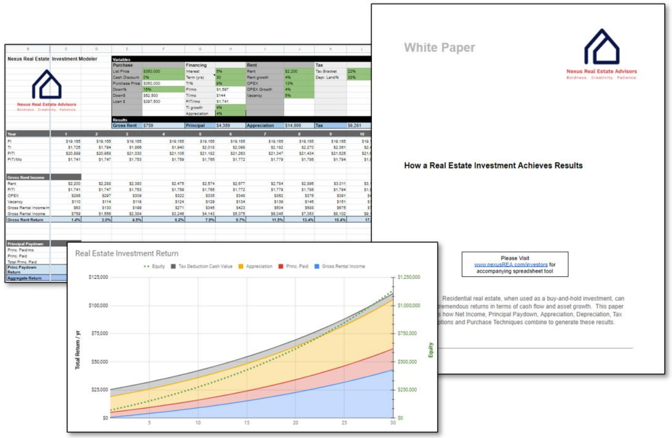

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Thank You!

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Appendix

Advanced Purchase Techniques…

Maximize Debt-to-Income with Owner Financing

Owner financing allows the investor to accumulate many properties, as the loan will not show up on credit reports or against qualification ratios (e.g. debt-to-income), but the investor can claim the income from the properties.

Interest rate will likely be higher, and loan term shorter.

Dovetail this with a staggered down payment to maximize gain, especially in a flip scenario.

Advanced Purchase Techniques...

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Purchasing with Cash

In normal real estate markets, cash purchasers typically enjoy a discounted purchase price as there is no financing contingency in the contract. A purchaser with a strong lender relationship can then either finance the property through a traditional loan, or refinance in the form of a HELOC.

What is a negative of the HELOC?

Advanced Purchase Techniques…

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Other techniques

Capitalize on Low-APR Mortgage with a Wraparound

Lease Options

Front Porch items

Negotiate Seller Buydown of Points

Purchasing ‘Subject To’ an Existing Loan

Investing Partnerships