How a Real Estate Investment Achieves Results

By Scott Lukes, President

Nexus Real Estate Advisors

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Please Download
This presentation and Investment Modeling tools can be downloaded at nexusREA.com

WELCOME !!!

Inside:

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

Net Rental Income

Principal Paydown

Appreciation

Tax Deductions / Depreciation

Look at methods for funding the down payment

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The investment…

928 Scranton Street, Aurora, CO 80011 **$400,000** - Closed

Listing | Tax | History | Parcel Map | Flood Map | Photos | Foreclosure

1 / 32

Listing ID:	**5402228**	MLS Status:	**Closed**
		Close Price:	**$400,000**
County:	**Arapahoe**	List Price:	**$425,000**
Property Type:	**Residential**	Original List Price:	**$425,000**
Property Subtype:	**Single Family Residence**		
Structure Type:	**House**	Basement:	**No**
Levels:	**One**	Year Built:	**1953**
Subdivision Name:	**Hoffman Town**		
Listing Contract Date:	**12/15/2022**	Spec. Listing Cond:	**None Known**
Purchase Contract Date:	**12/30/2022**	Contingency:	**None Known**
Close Date:	**02/07/2023**		
Days in MLS:	**15**		
Association: **N** Multiple:	Cov/Rest: **N**	Assoc Fee Tot Annl:	**$0.00**
Tax Annual Amt:	**$2,123**	Tax Year:	**2021**
Special Taxing/Metro District Y/N:	**No**		
Tax Legal Desc:	**LOT 13 BLK 25 HOFFMAN TOWN 3RD FLG**		

Mortgage Info

Interior Area & SqFt

Building Area Total (SqFt Total):	**1,401**	Living Area (SqFt Finished):	**1,401**	Area Source:	
Above Grade Finished Area:	**1,401**				
PSF Total:	**$286**	PSF Above Grade:	**$286**	PSF Finished:	**$286**
Foundation:		Fireplace:			
Heating:	**Forced Air, Natural Gas**				
Cooling:	**Evaporative Cooling**	HVAC Description:			
Security Features:		Flooring:	**Carpet, Linoleum**		
Appliances:	**Dishwasher, Disposal, Dryer, Oven, Refrigerator, Washer**				
Exclusions:	**Seller's personal property**				

Bed & Bath Summary

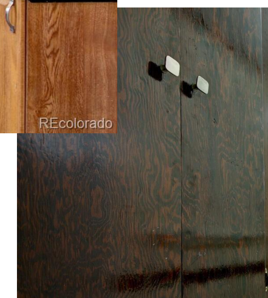
Bedrooms Total:	**3**	Bathrooms Total:	**2**	Bathrooms	
Upper Level Bedrooms:	**0**	Upper Level Bathrooms:	**0**	Full:	**1**
Main Level Bedrooms:	**3**	Main Level Bathrooms:	**2**	Three Quarter:	**1**

$400k property located in Fitzsimons (Hoffman Heights)

Listed @$425k,
Sold @$400k, 15 DOM
Closed end Dec 30, 2022

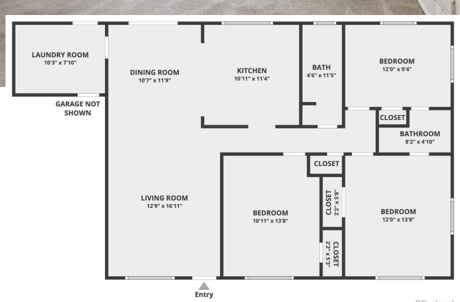
Rents for $2,500


REcolorado




REcolorado


REcolorado


LAUNDRY ROOM
10'3" x 7'10"
GARAGE NOT SHOWN
DINING ROOM
10'7" x 11'9"
KITCHEN
10'11" x 11'4"
BATH
4'6" x 11'5"
BEDROOM
12'0" x 9'4"
CLOSET
BATHROOM
8'2" x 4'10"
CLOSET
LIVING ROOM
12'9" x 16'11"
BEDROOM
10'11" x 13'8"
CLOSET
BEDROOM
12'0" x 13'8"
CLOSET
Entry
REcolorado


REcolorado

Investment structure...

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928 Scranton Street

Purchase: $400,000

Financing: 25% down ($100,000), 30 yr fixed, 6.5%

PI: $1,896 / mo

TI: $171 / mo (assume 9% of PI)

OPEX*: $338 / mo (13% of monthly rent)

Vacancy: $130 / mo (5% of rent)

Rent: $2,600 / month

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

Assumptions and variables

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Variables							
Purchase		**Financing**		**Rent**		**Tax**	
		Interest	6.5%	Rent	$2,600	Tax Bracket	22%
List Price	$400,000	Term (yrs)	30	Rent growth	4.0%	Depr. Land%	33%
Cash Discount	0%	TI% (of PI)	9.0%	OPEX	13.0%		
Purchase Price	$400,000	PI/mo	$1,896	OPEX Growth	4.0%		
Down%	25%	TI/mo	$171	Vacancy	5.0%		
Down$	$100,000	PITI/mo	$2,067				
Loan $	$300,000	TI growth	4.0%				
Appreciation	5.0%						

Front Range historical average in 7-9% range

Assume inflation rate

4 elements of return...

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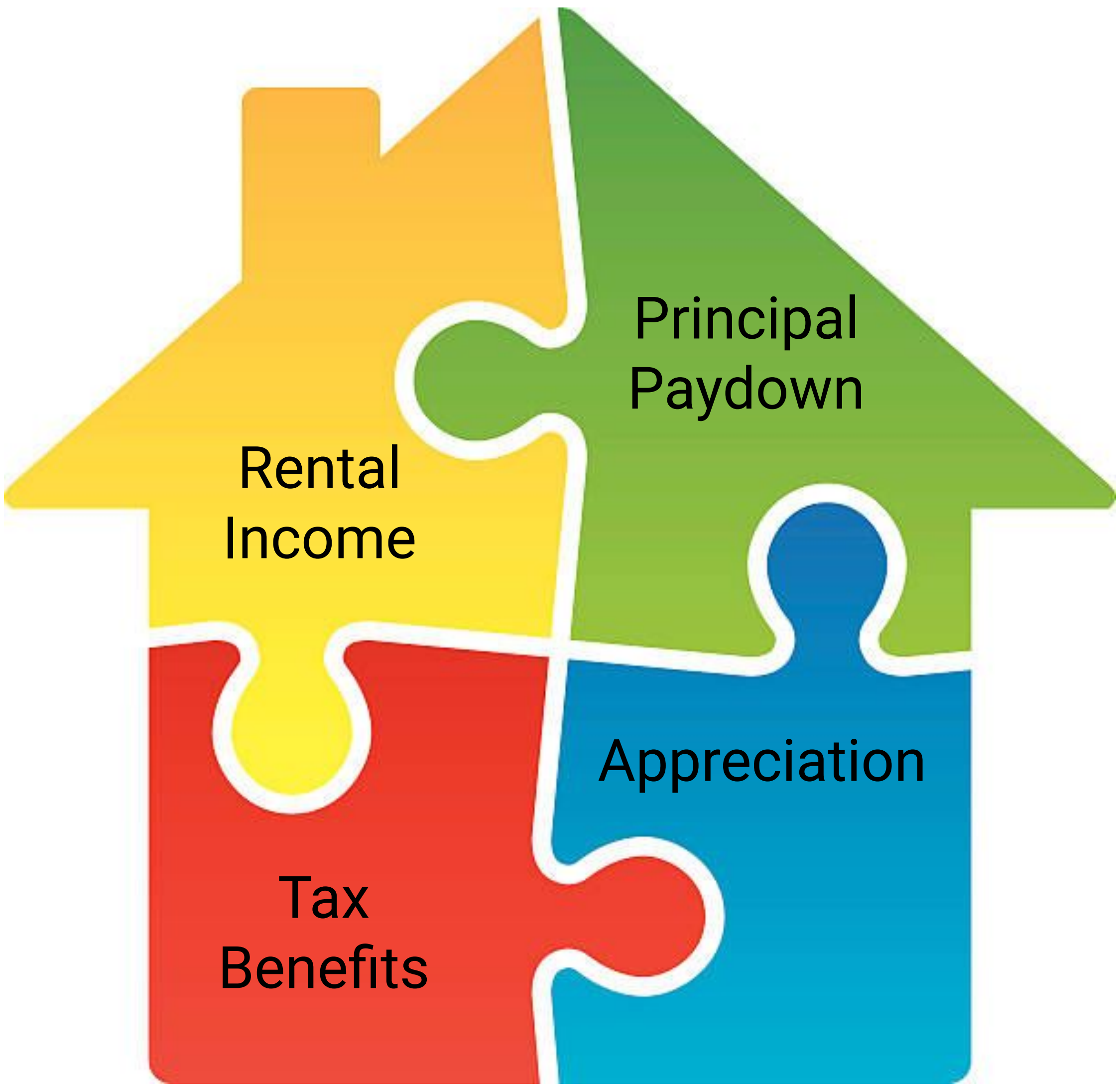

Rental Income

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Rental Income...

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Rent: $2,600 / mo

(minus)

PI: $1,896 / mo

TI: $171 / mo

OPEX: $338 / mo

Vacancy: $130 / mo

Net Rental Income: Rent - PITI - OPEX - Vacancy = $65 / mo ($782 / yr)

$782 Net Rental Income / year divided by the initial $100,000 investment yields a 0.78% return

Rental Income...

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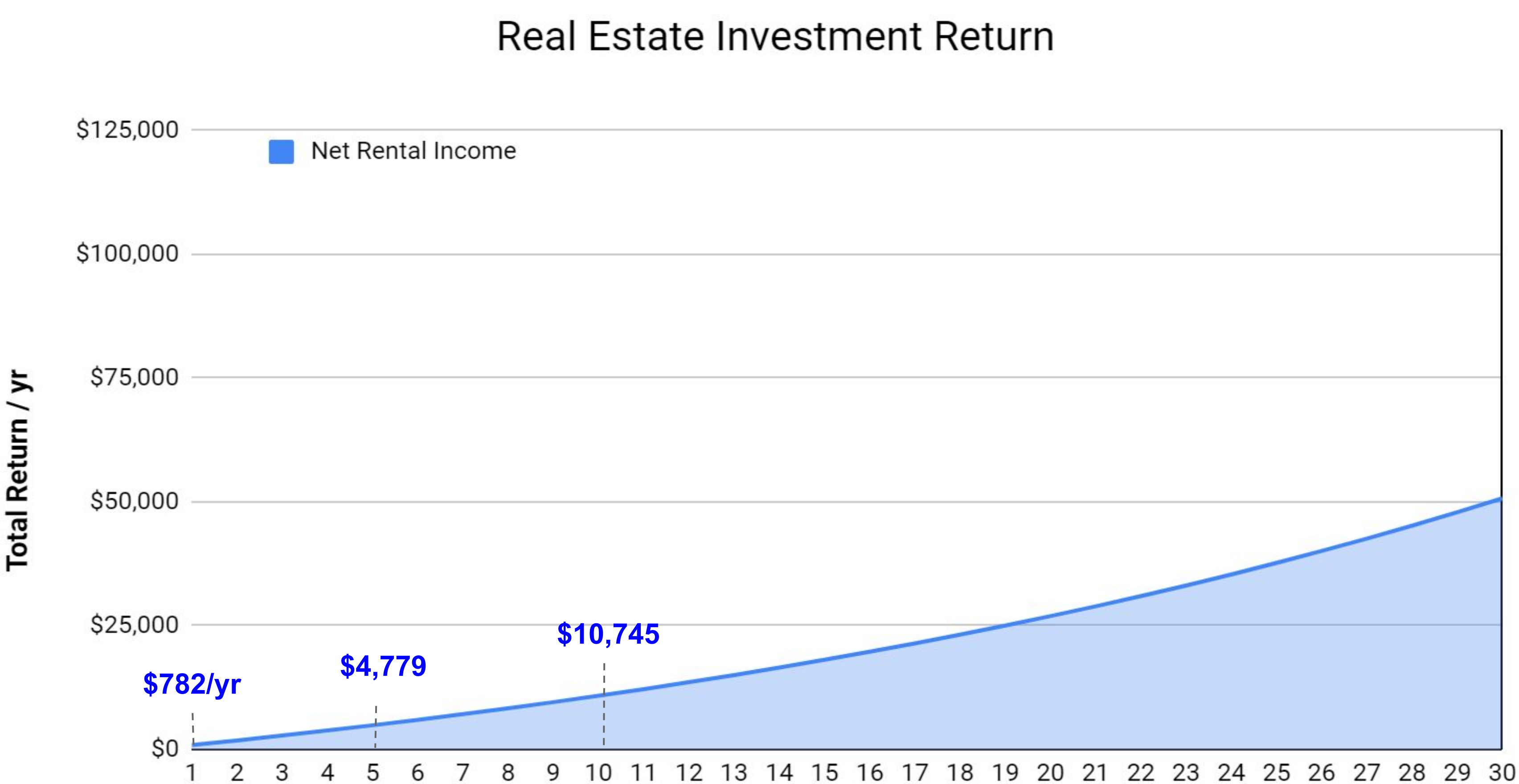

Assume: 4% rent growth, 4% TI growth, 4% OPEX growth

Principal Paydown

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Principal Paydown...

Of the $24,804 in PITI, $3,353 went to Principal

Principal is <u>not</u> an expense, it is pure equity… post-tax money that is ours, albeit tied up in the investment.

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

<u>PITI:</u>	**<u>$24,804 / yr</u>**
Principal:	**$3,353 / yr**
Interest:	**$19,401 / yr**
TI:	**$2,050 / yr**

$3,353 Principal/year divided by the initial $100,000 investment yields an additional 3.35% return

Total Return has now become 0.78 + <u>3.35</u> = 4.13%

Principal Paydown...

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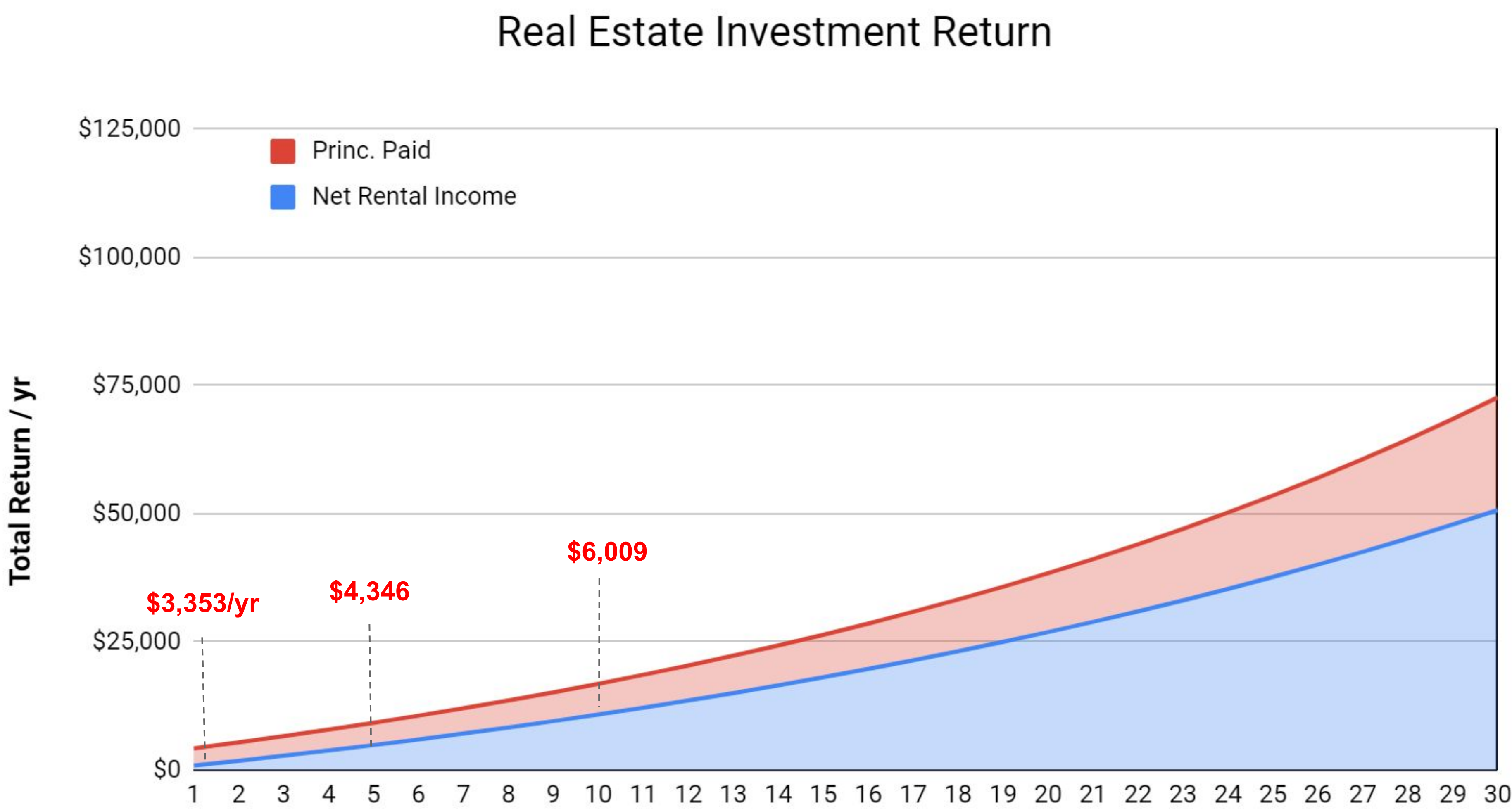

Appreciation

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Leveraged and Non-leveraged Investments

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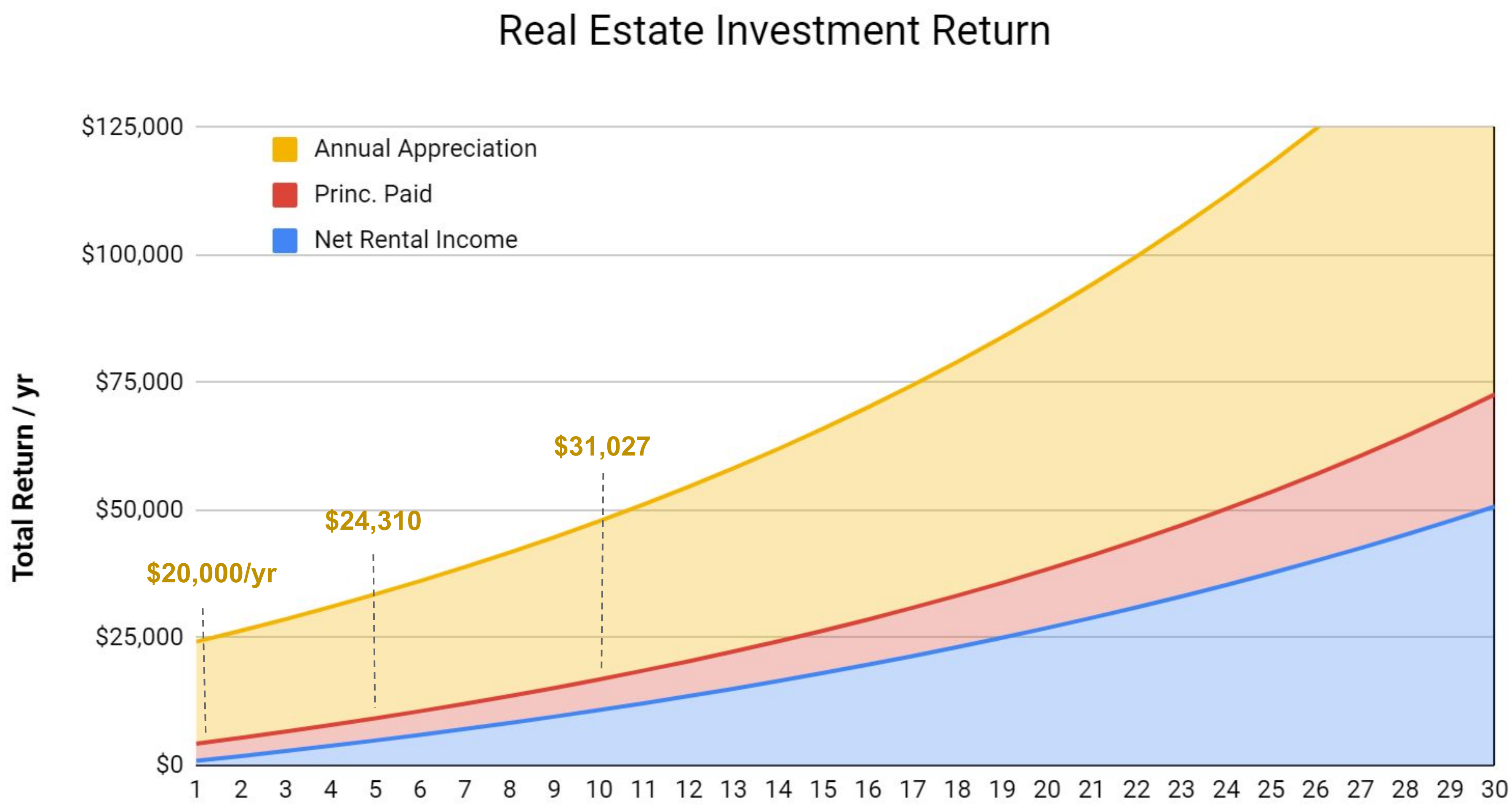
Non-Leveraged (e.g.IRA)		**Leveraged** (e.g. Rental Investment)	
Investment Balance:	**$100,000**	**Equity:**	**$100,000**
Investment Value:	$100,000	Appreciable Value:	$400,000
Investment Gain:	5%	Appreciation Rate:	5%
Investment Return:	$5,000 / year	Appreciation Return:	$20,000 / year
Total Return:	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 + 20 = 24.13%

Appreciation...



Assume: 5% appreciation

Tax Deductions

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Tax Deductions...

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For a primary residence, there are very few tax deductions.
Mortgage Interest (the 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.

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

Tax Deductions...

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

Mortgage Interest:	**$19,401**
Taxes and Insurance:	**$2,050**
OPEX:	**$4,056**
Depreciation:	**$9,745**

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

Total deductible expenses: $35,494

AND, this 7.8%
is post-tax $!!!

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 + 7.8 = 31.9%

*** Omitting state taxes for simplicity*

Tax Deductions...

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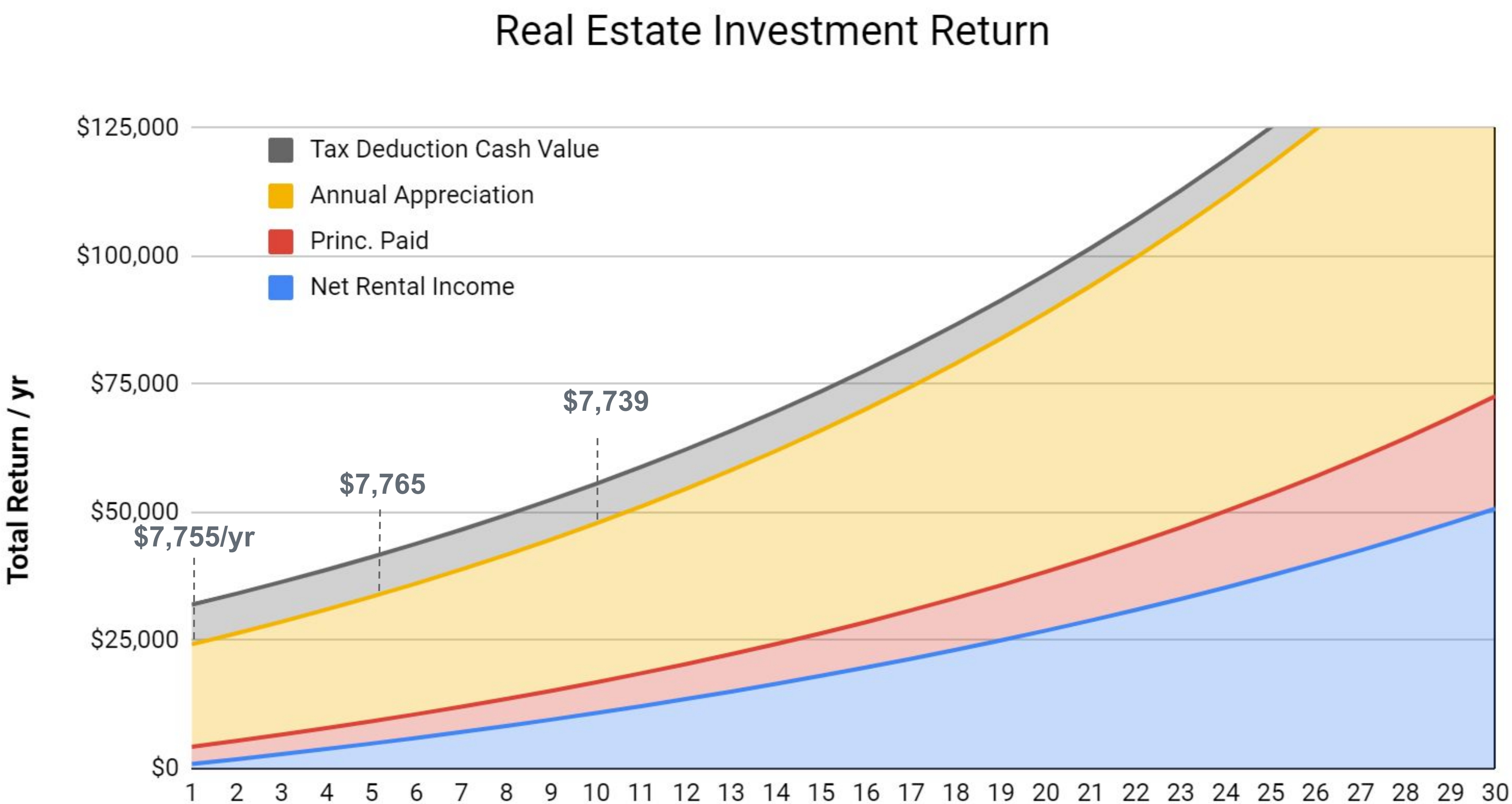
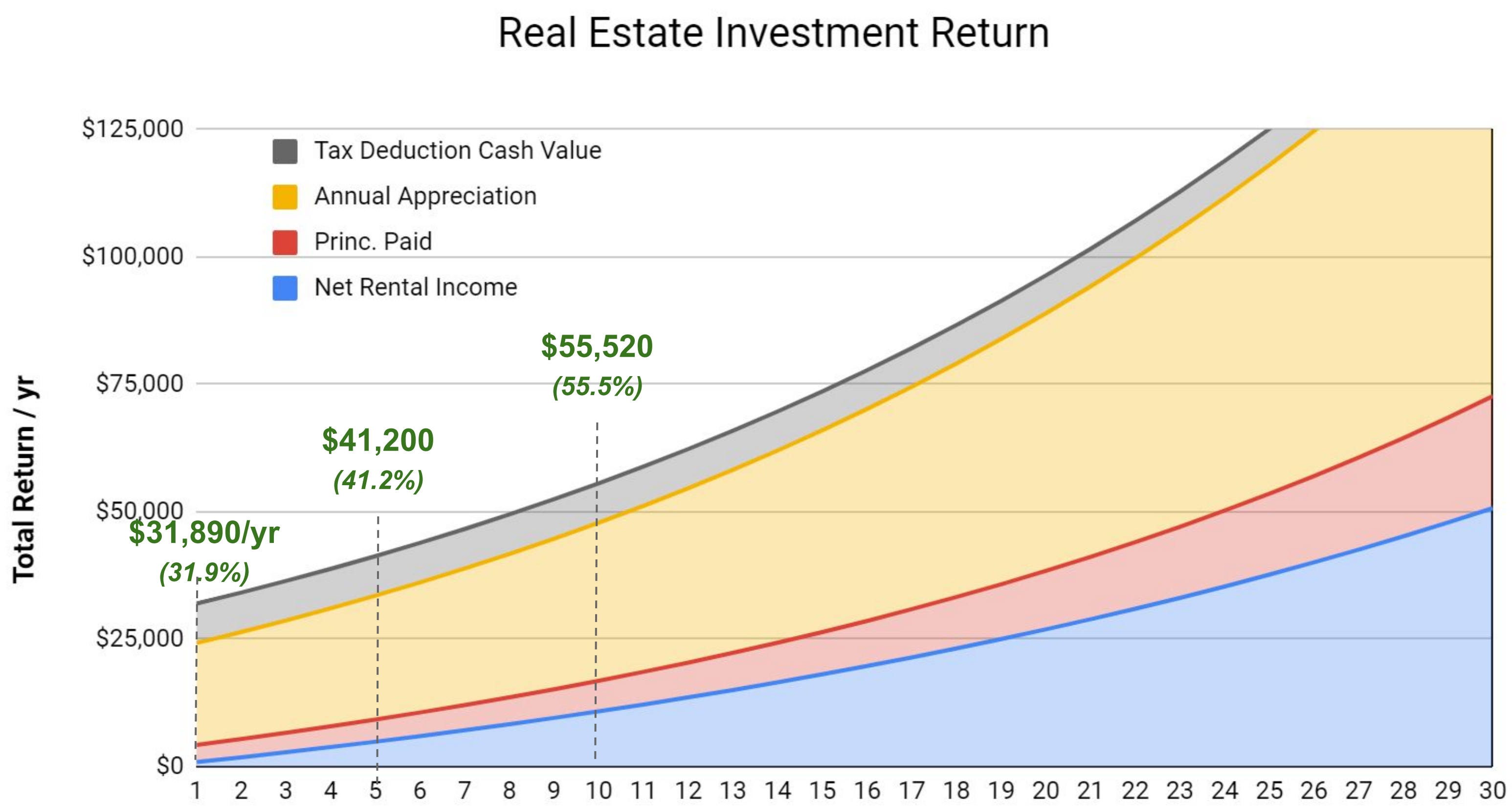


Assume: 22% marginal fed tax bracket, no state

Analysis

Overall Return...



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

Overall Return...

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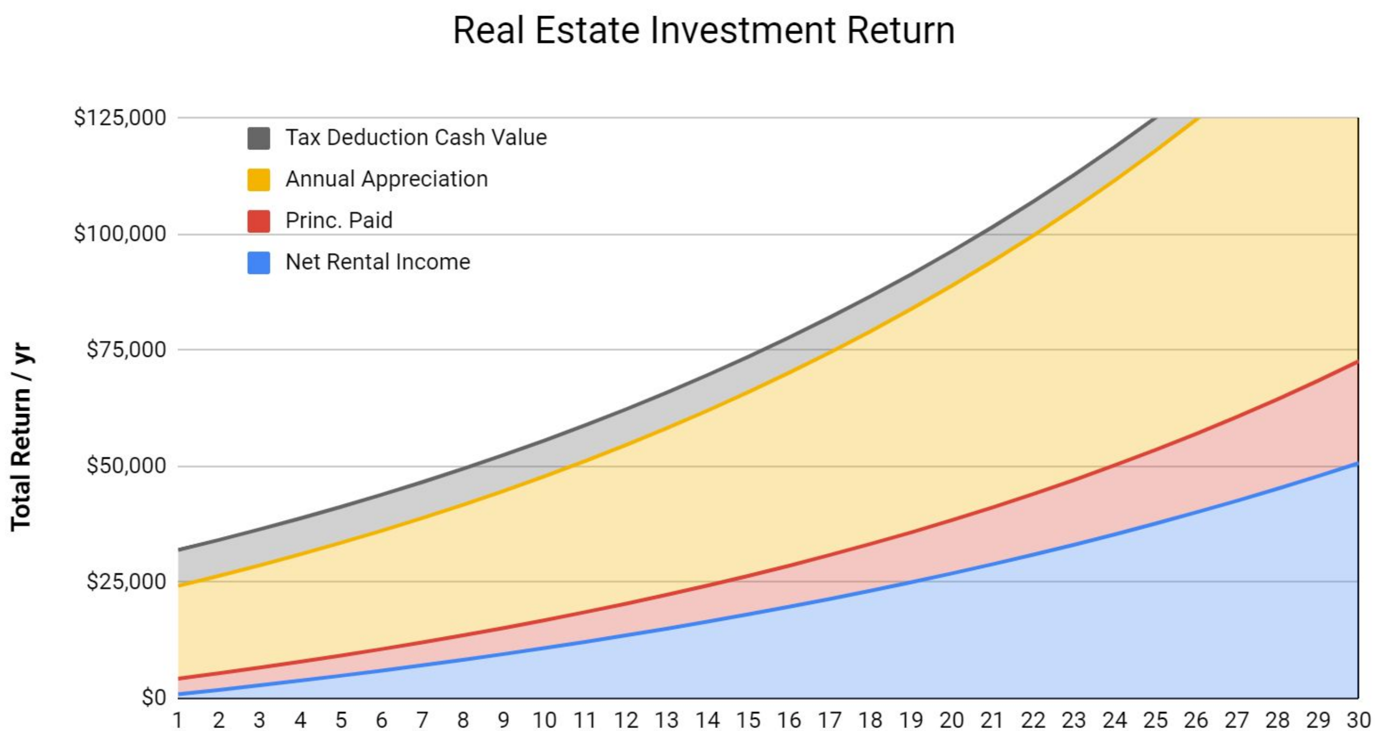

As the analysis shows, Net Rental Income does not become an important factor until a few years in… this is what most people get wrong about rental real estate; rent is only part of it. Sometimes we might even have to feed an investment in the early years… this is OK. The important thing to note is that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

About Nexus

The power of experience.

As both your advisor and real estate agent, 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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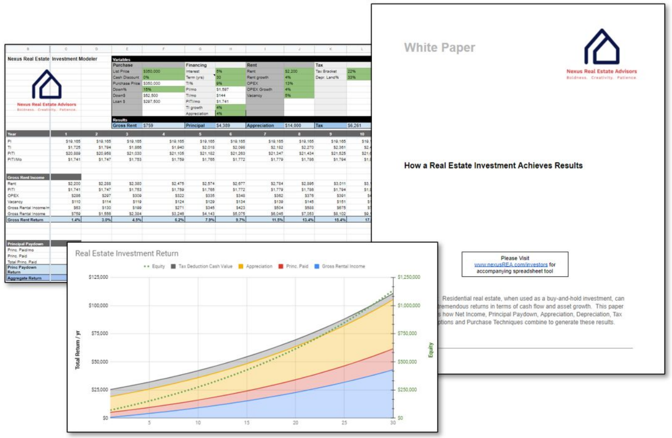

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Appendix: Funding the Down

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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 80% loan to value (LTV). For instance, if our home is worth $600,000, and we owe $250,000 on the home, we have:

80% of $600,000 = $480,000 loan max
Minus current loan = $250,000
Equals max HELOC/refi loan amount = $230,000

Assume we only take out $100k for the subject rental purchase, the additional PI for loan amount (6.5% 30 yr fixed) = $632/mo

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 2023 is $17,000 for individuals and $34,000 for married couples filing jointly. The annual exclusion is per recipient; it isn't the sum total of all gifts. That means, for example, that they can give $17,000 to a cousin, another $17,000 to a friend, another $17,000 to a neighbor, and so on without having to file a gift tax return in 2024.

Let's say our dad gives us $40,000 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.

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?

Funding the Down Payment...

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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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Real Estate | **IRA**

$200,000

$200,000
(taxes eventually)

$200,000

- 20,000 Early Withdrawal Penalty
- 30,000 Taxes (est. 30%)

$150,000 to deploy to Real Estate

- $5,000 Reserves
- $5,000 Closing Costs
- **Prop 1** – $70,000 Down ($350,000 Purch)
- **Prop 2** – $70,000 Down ($350,000 Purch)

Year 1 Gain

Year 1

$700,000 prop value x
5% appreciation =
$35,000 Gain

In Year 1, we have equaled our IRA gain of $10,000, paid back the IRS penalty of $20,000 and added $5,000 to Reserves

We have also contributed $4,131 in Principal, and realized an in-pocket tax benefit of over $6,000

$200,000 x 5% =
$10,000 Gain

Year 2 Gain

Year 2

$735,000 prop value x
5% appreciation =
$36,750 Gain

$210,000 x 5% =
$10,500 Gain

Appendix: Purchase Techniques

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.

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