White Paper

Nexus Real Estate Advisors
Boldness. Creativity. Patience.

Funding the Down Payment for a Real Estate Investment Purchase

Synopsis: There are many ways to obtain funds for a down purchase on investment real estate. For those without cash simply laying around, this paper analyzes the options of home refinancing / home equity loans, gifts, loans, and utilizing the Cash Value of a Whole Life Insurance policy. It then deeply examines one of the most important and overlooked options available… tapping into our IRA/401(k).

There are many options for funding the down payment for a real estate investment, which is typically 15-20% of the purchase price. Here are a few popular methods.

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 Principle and Interest (assuming a 30yr/5% fixed). This is not all bad... Principle 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).

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.

Tapping into Cash Value of 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).

Loans from Relatives or Friends

Private loans from relatives and friends remain one of the top ways to start new real estate ventures. As in the above example, if we do not own a Cash Value Whole Life Insurance policy ourselves, maybe we have relatives or friends that do. Offering them 8% for a loan, as an example, actually makes them more money than if they simply had the money sitting in their policy.

Save Your Tax Refund

You can increase your federal income tax withholding if you lack the discipline to save something of each paycheck. It's simply a matter of submitting a new W-4 to your employer, asking the company to withhold more. Your employer will pay more of your paycheck to the Internal Revenue Service, and this is likely to result in a larger income tax refund for you. Even a regular tax income refund might be enough to help you buy a home.

Of course, the downside to this is the IRS doesn't pay interest. It just holds onto your tax money all year, then it gives it back to you dollar for dollar if you don't end up owing as much as you had withheld. A savings account paying even minimal interest can be a better option if you're disciplined enough to save something every pay period.

Ask the Seller for the Money

You'd be surprised at what some sellers will do if you're willing to pay their asking price. Some will give you the down payment as a credit, pay your closing costs, or both. You won't know unless you ask. That's more money you can dedicate to your down payment if the seller agrees to give you a credit for closing costs, freeing up those funds for use elsewhere.

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?

This is probably the most overlooked of all real estate wealth-building strategies. Here is how is how we can tap into a portion of our IRA to diversify our wealth portfolio:

Step 1 - Understand our current IRA return

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

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

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

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 *(the C.A.R.E.S. act eliminates this penalty, and pushes taxes to equal installments over 3 years !)*
-	$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 illustrated in the Nexus White Paper "*How a Real Estate Investment Achieves Results*", **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).

Step 4 - Analyze the returns

(next page)

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

Real Estate: $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

IRA: $200,000 x 5% = **$10,000 Gain**

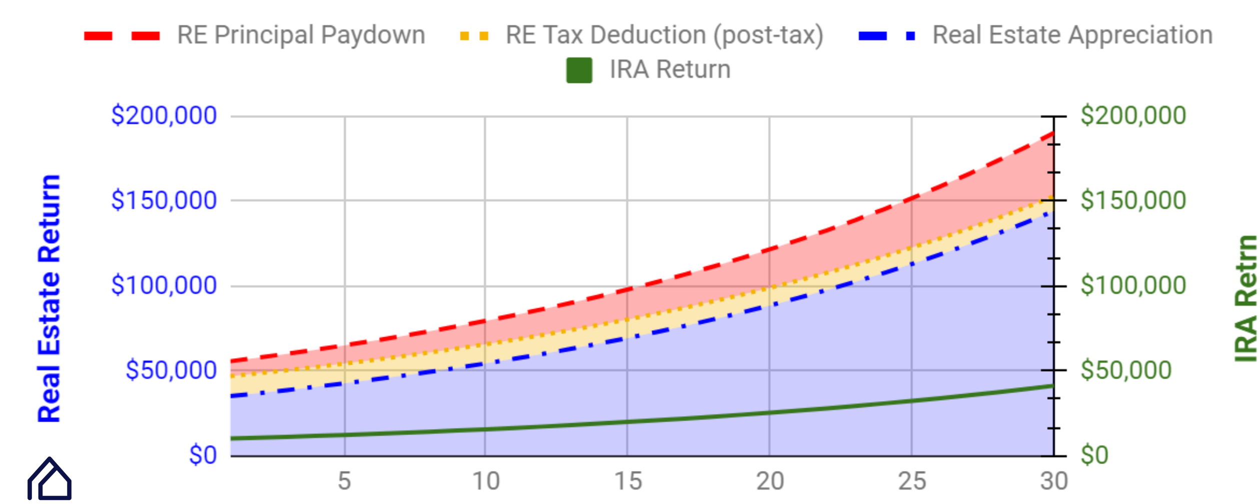
Year 2 Gain

Year 2

Real Estate: $735,000 prop value x 5% appreciation = **$36,750 Gain**

IRA: $210,000 x 5% = **$10,500 Gain**

Real Estate versus IRA Returns



Exemption for First-time Homebuyers
Digging into your IRA usually carries the same 10% penalty of breaking open your 401(k) piggy bank, with one major difference: The penalty doesn't apply to first-time home buyers. And unlike a 401(k), you don't have to repay what you take out of an IRA. The withdrawal is still taxable, however.

Summary
This White Paper has shown that are many ways to obtain funds for a down purchase on investment real estate. For those without cash simply laying around, we have the options of home refinancing, home equity loans, gifts, personal loans, and utilizing the Cash Value of a Whole Life Insurance policy. We also have the powerful option of diversifying our retirement funds by tapping into our IRA/401(k).

The power of experience.

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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 generally free of charge.