



The
Masters
Weekend

A Gathering of Experts

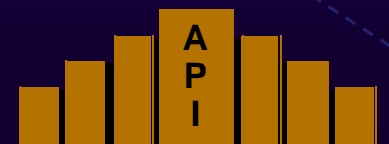
ASSET PRESERVATION, INC.

~ Presents ~

The Power of **Analysis**

INSTRUCTOR:

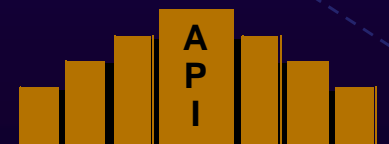
Kathy Biewenga
Division Manager



INVESTMENTS

Investing Defined

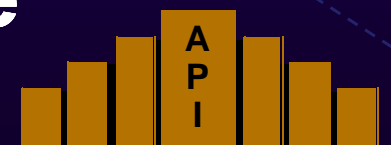
Whenever an individual places surplus funds in the bank or stock market, or purchases real estate for speculation, he or she has made an *investment decision*.



WHY PEOPLE INVEST

Why People Invest

- To generate additional income
- To acquire wealth for their retirement
- To accumulate for their children's education
- To acquire prestige in the community
- To create an estate for their heirs
- To obtain financial independence



COMMON INVESTMENT VEHICLES

- Saving accounts and certificates of deposit
- Stocks and mutual funds
- Real estate
- Partnership interests
- Bonds and bond funds
- Mortgages/trust deeds
- Collectibles/art



WHICH IS THE BETTER INVESTMENT FOR YOU?

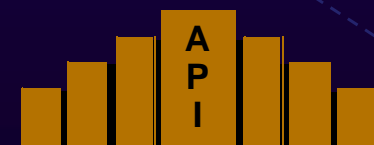
It depends on your . . .

- Need for liquidity
- Risk tolerance
- Yield requirements
- Desire for cash flow vs. equity growth
- Holding period



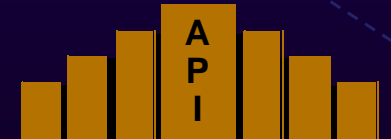
WHAT IS . . . “INVESTMENT REAL ESTATE”?

Investment real estate is any type of real estate held for investment except the investor's personal residence or second home.



FIVE MAJOR ADVANTAGES OF INVESTMENT REAL ESTATE

- 1) Income from Cash Flow
- 2) Equity from Loan Pay-Down
- 3) Equity from Appreciation
- 4) Tax Savings
- 5) Higher Leverage



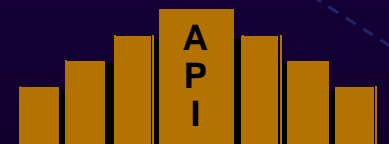
REAL ESTATE CASH FLOW CONCEPTS

Investment properties can be analyzed . . .

Before-tax

and

After-tax



Before-Tax Cash Flow *Simplified*

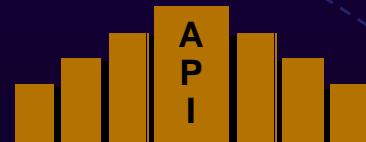
Income

- Expenses

= Net Operating Income

- Annual Debt Service

= Before-Tax Cash Flow

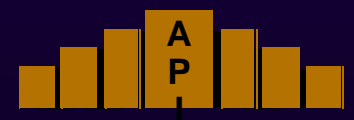


Before-Tax Cash Flow

Detailed

1.	GROSS SCHEDULED INCOME		\$
2. -	<u>Vacancy & Uncollected Rents</u>	-	\$ _____
3. =	EFFECTIVE RENTAL INCOME	=	\$
4. +	<u>Other Income</u>	+	\$ _____
5. =	GROSS OPERATING INCOME	=	\$
6. -	<u>Annual Operating Expenses</u>	-	\$ _____
7. =	NET OPERATING INCOME	=	\$
8. -	<u>Annual Debt Service</u>	-	\$ _____
9. =	BEFORE-TAX CASH FLOW	=	\$

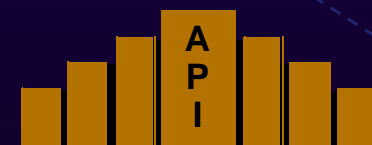
You only need to learn the items listed in blue. The rest are the results of addition and subtraction.



Before-Tax Cash Flow vs. Real Estate Taxable Income

An investor's marginal tax rate is applied to
Real Estate Taxable Income,
NOT
Before -Tax Cash Flow.

At line 7 of the cash flow model, we take a detour to
calculate
the income that we will actually be taxed on.



Before-Tax Cash Flow VS. Real Estate Taxable Income

Line 7: Net Operating Income



Net Operating Income

- Annual Debt Service

= **Before-Tax Cash Flow**

Net Operating Income

- Cost Recovery (**D**epreciation)

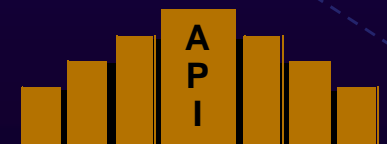
- Mortgage **I**nterest

- **P**oints Amortization

= **Real Estate Taxable**

Income

D. I. P



After-Tax Cash Flow

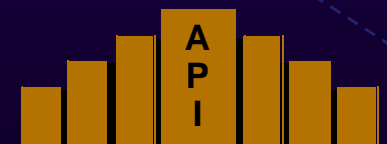
The only difference between before- and after-tax cash flow is the amount of tax liability (or tax savings).

Line 7: Net Operating Income

Net Operating Income
 - Annual Debt Service
 = **Before-Tax Cash Flow**

Net Operating Income
 - *Cost Recovery (D)epreciation*
 - *Mortgage (I)nterest*
 - *(P)oints Amortization*
 = **Real Estate Taxable Income**
 x *Marginal Tax Rate*
 = **Tax Liability (Saving)**

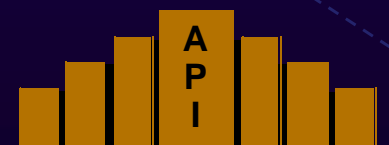
Before-Tax Cash Flow
 - Tax Liability (Savings)
 = **After Tax Cash Flow**



COMMON USES OF CASH FLOW ANALYSIS

There are many uses for the information represented in the Before-Tax Cash Flow model:

1.	GROSS SCHEDULED INCOME	\$	
2. -	Vacancy & Uncollected Rents	-\$	_____
3. =	EFFECTIVE RENTAL INCOME	=	\$
4. +	Other Income	+ \$	_____
5. =	GROSS OPERATING INCOME	= \$	
6. -	Annual Operating Expenses	-\$	_____
7. =	NET OPERATING INCOME	= \$	
8. -	Annual Debt Service	- \$	_____
9. =	BEFORE-TAX CASH FLOW	= \$	

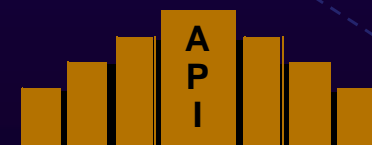


DETERMINING THE VALUE OF INVESTMENT PROPERTY

The two most commonly used methods of determining the value of an investment property are:

Gross Rent Multiplier (GRM)

Cap Rate or Income Capitalization

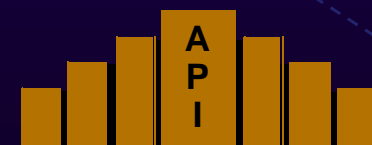


GROSS RENT MULTIPLIER (GRM)

To calculate the Gross Rent Multiplier (GRM) divide the asking price by first year Gross Scheduled Income (GSI)

$$\frac{\text{Asking Price}}{\text{GSI}} = \text{GRM}$$

The GRM used in evaluating investment property is typically derived from comparable properties in the marketplace and may be adjusted by the investor to reflect his or her specific requirements.

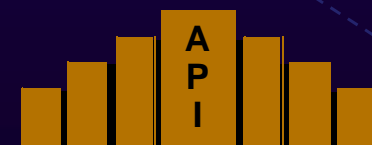


CAP RATE (CAPITALIZATION RATE)

The investment value of a property can be determined by its ability to produce cash returns. After paying all expenses, except P&I payments, the remaining cash flow is called the Net Operating Income (NOI). NOI is most commonly used in conjunction with a cap rate to determine property value.

Cap Rate

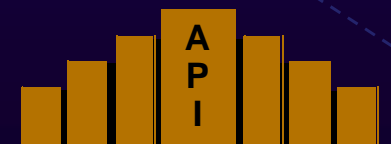
The cap rate is the ratio (expressed as a %) between purchase price and the first-year net operating income (NOI) of the property.



CASH ON CASH

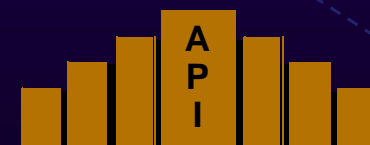
Another measurement of investment performance is called Cash on Cash (C/C). This involves comparing an investor's initial investment to the potential before-tax cash flow an investment property is likely to produce.

$$\frac{\text{Before-tax cash flow}}{\text{Total initial investment}} = \% \text{ Return}$$



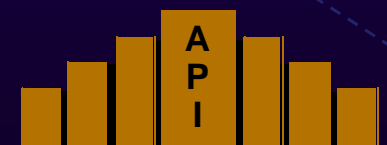
BEFORE-TAX CASH FLOW

1.	GROSS SCHEDULED INCOME	\$ 66,000.00
2.	- Vacancy & Uncollected Rents	<u>-\$ 3,300.00</u>
3.	= EFFECTIVE RENTAL INCOME	= \$ 62,700.00
4.	+ Other Income	<u>+ \$ 1,100.00</u>
5.	= GROSS OPERATING INCOME	= \$ 63,800.00
6.	- Annual Operating Expenses	<u>-\$ 21,946.00</u>
7.	= NET OPERATING INCOME	= \$ 41,854.00
8.	- Annual Debt Service	<u>-\$ 31,212.94</u>
9.	= BEFORE-TAX CASH FLOW	= \$ 10,641.06



TAX ASPECTS (“D.I.P.”) CASH FLOW

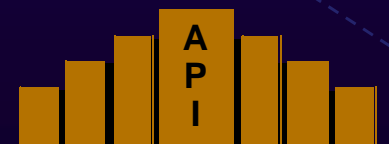
10. NET OPERATING INCOME	\$ 41,854.00
11. - Interest (Mortgage 1)	- \$ 27,783.71
12. - Interest (Mortgage 2)	- \$
13. - Points Amortization	- \$ 124.00
14. - Cost Recovery (Depreciation)	- <u>\$ 13,158.09</u>
15. = TAXABLE INCOME	= \$ 788.20
16. x Investor’s Tax Bracket	x <u>%</u>
<u>.28</u>	
17. = TAX LIABILITY (OR SAVINGS)	= \$ 220.70



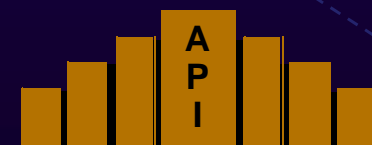
AFTER-TAX CASH FLOW

18.	BEFORE-TAX CASH FLOW	\$ 10,641.00
19.	- Tax Liability or (Savings)	- \$ 220.70
20.	= AFTER-TAX CASH FLOW	= \$ 10,420.30

Is this a good investment?



1) What is the total initial investment?	\$103,695.00
2) What is the before-tax cash flow?	\$ 10,641.00
3) What is the gross rent multiplier?	7.05
4) What is the cap rate?	9.00%
5) What is the cash on cash return?	10.26%
6) What is the debt coverage ratio?	1.34
7) What is the after-tax cash flow?	\$ 10,420.30





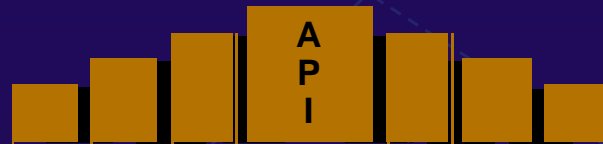
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Thank You!

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