



Investment Properties

101

The Basics for **Beginners**

Presented by **The** Rich Vaaler

Why?

INCOME-PRODUCING PROPERTY VS OTHER INVESTMENTS

- Cash Flow
- Depreciation Tax Benefits
- Appreciation (long term)
- Principal Pay Down (building equity)
- Concept of Leverage

The "Return Stack"



Cash Flow



Depreciation Tax
Benefits



Long-Term
Appreciation



Building Equity



V A A L E R
COMMERCIAL REAL ESTATE

Annual Cash flow / Investment
= Cash Flow ROI %

AKA Cash on Cash
Return

Divide the **Annual Cash Flow** (money after all expenses and debt services) by the amount **Invested** (down payment and any capital expenses) to calculate the **Cash Flow ROI** percentage.

For Example...

\$90,000 Annual Cash Flow /
\$700,000 Invested =
12.86% Cash Flow ROI

Not Bad!



V A A L E R
COMMERCIAL REAL ESTATE

$$\frac{\text{Property Value} - \text{Land Value}}{39 \text{ years}} = \text{Depreciation Tax Benefit \%}$$

Subtract the **Land Value** from the **Property Value** (land does not depreciate) and divide by **39 Years** to calculate the **Depreciation Tax Benefit** percentage.

For Example...

\$1.4M Property Value — **\$350K** Land Value* /
39 Years =
\$26,923 Tax Write Off

*Remember, your **land value is 25% of your property value!**



In the
Return Stack...

\$26,923 / \$700,000 (your
investment) = **3.85% Tax Benefit ROI**

Appreciation

Appreciation varies in every market with every type of property.

For long term projections, let's use **5%** a year.

Add that to your return stack.



V A A L E R
COMMERCIAL REAL ESTATE

Principal Pay Down

Principal pay down is the amount you **pay each year** to reduce the principal amount on your loan.

Each year, the percentage of your payment applied to your principal balance increases, while the amount paid towards interest decreases.

Let's use **1%** for the return stack.

Add 'Em Up

Add up the **Cash Flow ROI**,
Depreciation Tax Benefit,
Appreciation, and the **Principal**
Pay Down for your total return stack.



V A A L E R
COMMERCIAL REAL ESTATE

The "Return Stack"



Cash Flow



Depreciation Tax
Benefits



Long-Term
Appreciation



Building Equity

Total Return

Stack =

22.71%



V A A L E R
COMMERCIAL REAL ESTATE

But Wait...

This is **ONLY** on income and does not include the **additional return** you may gain on sale.

WOW

Let's Talk
Cap Rates



V A A L E R
COMMERCIAL REAL ESTATE

$$\text{Net Operating Income} / \text{Purchase Price} = \text{Cap Rate}$$

Divide the **Net Operating Income** (NOI) by the **Purchase Price** to determine your **Cap Rate** percentage.

For Example...

\$90,000 NOI /
\$1.4M Property Value =
6.43% Cap Rate

But it's not exact
science....



V A A L E R
COMMERCIAL REAL ESTATE

3 Things to Evaluate Initial Cap Rate

- Creditworthiness of the tenants
- Deferred maintenance or other capital expenses paid up front
- Is the current rent below or above market rate? Terms left on leases?

Total Income /
Investment /
Years Owned =
Internal Rate of Return

The IRR is a term investors use to look at the overall return over a given period of time. It is the average percentage of the **total income** (money made) divided by the **amount invested**, divided by the **number of years** you owned the property.

Just an FYI...



V A A L E R
COMMERCIAL REAL ESTATE

Where to Start &
What to Look For

Start in Your Own Backyard

Not literally. Most Commercial Real Estate (CRE) gurus will tell you to start in your hometown or somewhere in close proximity to where you live and work.

Look for a property that is the size and type you can handle without too much risk or hassle, like a small multi-family property or retail center.



V A A L E R
COMMERCIAL REAL ESTATE

Look for Accelerated Wealth Opportunities

Also known as a **value add**. These are properties that are:

- Vacant or partially vacant
- Run-down
- Rents way below market
- Leased are short-term with no renewal options
- Owner financing is a bonus

Back to Cap Rate...

Find a **\$1.4M Property** with current rents below market with an **NOI of \$90,000**.

Boost the rent by 10% to \$99,000 and use the **6.43% Cap Rate**. Your new value is \$1,539,658, creating \$140,000 of additional value and an additional \$9,000 a year in cash flow.

This increases the **Return Stack to 24%**



Leverage

The #1 benefit of **buying real estate**. Let's compare what a **\$300k** investment gets you in real estate vs the stock market...

Real Estate

\$300K INVESTMENT =
\$1.4M PROPERTY



V A A L E R
COMMERCIAL REAL ESTATE

Stock Market

\$300K INVESTMENT =

\$300K STOCKS

Leverage (cont.)

If the value of both (\$300,000 invested in stocks or real estate) appreciates by 5% per year, you get 5% return on the **VALUE** of the real estate (\$1,200,000) as opposed to the amount you invested (\$300,000). A 5% return on the investment in stocks would be based on the amount invested.

In this case, **\$60,000** return on the real estate and only **\$15,000** on the stocks.

This is the value of leverage.



V A A L E R
COMMERCIAL REAL ESTATE

PROS AND CONS Of Commercial Real Estate Ownership

Let's start with the Cons:

- Income producing property is not liquid
- You can't get your cash out quickly
- Commercial property ownership takes WORK - to find it, finance it, acquire it, and eventually sell*

PROS AND CONS Of Commercial Real Estate Ownership

For the Pros:

- You can benefit from leverage not available in stocks
- Depreciation benefits not found in 401K (stocks)
- Cash flow every month (if fully leased)
- Appreciation is on the value, not the dollar amount invested



*PRO TIP:
NEVER SELL.

Why **Never** Sell? 1031 Tax Deferred Exchange

In the United States, the **1031 Tax Deferred Exchange** allows you to exchange an income property for another income property as long as:

- You reinvest all the proceeds, **or**
- Buy a property of equal or greater value, **and**
- Use a qualified intermediary to handle the process.

This is not a
loophole!



Don't Leave It To The Kids.

Especially for **elderly investors**, you can exchange your complex investment property holdings into **Single Tenant Net Lease (STNL)** properties- think **Dollar General** or **Burger King** - and leave them to your kids.

Buy One for Each!

When you pass on, your kids can sell these at the stepped-up basis and can **avoid paying capital gains tax and depreciation recapture.**

Or, they can hold on to your legacy and start the cycle over again to **build wealth** for future generations.



V A A L E R
COMMERCIAL REAL ESTATE

THIS IS JUST THE
BEGINNING

Email rich@vaaler.us or visit
www.richvaaler.com to get started
with a consultation today.



V A A L E R
COMMERCIAL REAL ESTATE

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that the author is not engaged in rendering legal, accounting, or securities trading advice, or related professional services. If legal advice or other expert assistance is required, the services of a competent professional provider should be sought by the reader.