



By:
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Real Estate: An Ideal Investment?

Is Real Estate an IDEEAL™ investment for you? Is there a reason that over 90% of the millionaires in this country are millionaires because of their real estate ownership? This article looks at why real estate can be the IDEEAL™ investment when following the proven principles outlined in this acronym

When I teach and counsel many clients, I often find myself going back to this acronym as a simple but effective way of explaining why real estate can be an IDEEAL™ investment.

I is for Income: This is what an investor receives from the tenant on a monthly basis. Income is visible, it is cash in the pocket. It is however only the tip of the iceberg.

D is for Depreciation (Cost recovery): Depreciation is a tax benefit given by the government to the investor that can be used on his/her taxes. For a commercial property it is 39 years, and for a residential property it is 27.5 years.

E is for Exchange: A Real Estate owner can, in a 1031 exchange, transfer his/her property into a larger property without paying taxes, which are deferred. For example, an individual that owns a duplex worth \$400,000 can sell that duplex and purchase an office building worth \$800,000. This is contrast to an individual who owns \$400,000 worth of stock in IBM and would like to purchase \$800,000 worth of stock in Intel. He/she must first sell the IBM stock, pay the capitol gains tax and then purchase the Intel stock.

The rule states "The amount of debt relief, plus the amount of cash that would otherwise come to you as the seller, is the target replacement value that you need to reinvest to defer 100% of the taxes" One can see what a powerful tool this can be to increase a portfolio.

E is for expenses: The expenses for Real Estate are tax deductible. Expenses include but are not limited to utilities, insurance, maintenance, management,

supplies, and the interest paid to the lender.

A is for appreciation: The increase in value of the property over time. For example if a three bedroom, 1,000 square ranch style home was purchased for \$120,000 in 1994 and sold for \$270,000 in 2004 that would be an appreciation of 8.5% per year. This is not at all uncommon in many parts of our country including the Boulder-Denver area.

L is for leverage: There are some real estate investors that feel leverage is what sets real estate apart and ahead of other forms of investment. Leverage is the return on the whole value of the property and not just the cash an investor puts into the property. I will use the previous example to illustrate this point.

If one were to purchase the above property for all cash for \$120,000 and sell it for \$270,000 then the cash on cash return is 125%. ($\$270,000 - \$120,000 =$

$\$150,000$, therefore $\$150,000/\$120,000 = 125\%$)

However, if one were to purchase the above property with a 30% down loan (\$36,000) for \$120,000 and sell it for \$270,000 then the cash on cash return is 417%. ($\$270,000 - \$120,000 = \$150,000$, therefore $\$150,000/\$36,000 = 417\%$). Obviously, the less one puts down the higher the return, which means a higher risk.

This article is only a brief introduction to investment real estate. In my next article I will address the question "Why doesn't everyone invest in real estate and prosper". I will focus on what it takes to become a successful real estate investor and how to deal with and even change negative aspects of real estate investing into positive and profitable results.

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