

Cash Flow Analysis for Rental Properties

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Outline

What this talk is:

- A list of costs/benefits that determine how much you are likely to make year-to-year (after taxes)
- A free spreadsheet to begin playing around with your own numbers

What this talk is *not*:

- A detailed explanation of how all of this is computed
- Recommendations for desirable values of these variables (example numbers given here are reasonable but artificial)

Main Takeaways

- Rental profits depend on *much more* than just your sale price and monthly rent
- The “little costs” cannot be neglected (rental costs are an amalgamation of such little costs)
- Costs can be divided into three categories: purchase costs, operation costs, and sale-time costs
- The two big numbers: ROI (return on investment, after tax), and Margin (number of months needed to break even)
- *Use conservative numbers* (and be pleasantly surprised later)

Purchase-time costs

- down payment
- closing costs
- improvement costs
- debt service/expenses until it becomes rented (which may take time)

Operating costs/income

Income/benefits:

- monthly rent (and projected increases)
- **tax deductions:**
 - depreciation (you are allowed to deduct the entire value of the property (minus land value) over the course of 27.5 years)
 - pretty much any other cost (except loan principal and permanent improvements)

Operating costs/income

Costs:

- debt service (principal + interest)
- PMI (private mortgage insurance)
- maintenance/upkeep (short and long term, occupied and vacant)
- insurance and property taxes
- vacancy
- management costs (advertising, tenant screening, cleaning, etc.)
- income taxes

Sale-time costs

- real estate commissions (around 6% for both)
- capital gains tax (usually 15% of difference between adjusted sale and depreciable basis)
- depreciation recapture (around 25% of how much you've so far depreciated the property)
- additional costs (escrow overlap, little repairs, etc.)

The spreadsheet

An example computation:

- Purchase price: \$80000
- Improvements: \$5000
- Monthly rent: \$1000
- Interest rate: 5%
- Loan term: we'll look at 15 years and 30 years
- Down payment: we'll look at 25% and 5%

Further Reading

For these slides, this spreadsheet, and other stuff, e-mail me at *mikecrumley@hotmail.com* (or see me after)

Recommended reading:

- Steve Berges. *The Complete Guide to Investing in Rental Properties*. McGraw-Hill, 2004.
- Jack Cummings. *Real Estate Finance and Investment Manual*, 9th Edition. John Wiley and Sons, 2008.