**Unit 3**

**Lecture Outline**

**LEARNING OBJECTIVES**

When the student has completed this unit, they will be able to accomplish the following.

* Explain why investing in real estate has become a customary way for wealth accumulation in the U.S. economy.
* Explain how correctly performed income approaches to value will help licensees assess the strengths and weaknesses of investment properties and, thereby, provide competent and trustworthy guidance to their investor clients.
* Explain how to measure and evaluate the financial viability of a particular investment property.

**KEY TERMS**

adjusted basis

after-tax cash flow (ATCF)

annuity capitalization rate

appreciation

basis

before-tax cash flow (BTCF)

boot

built-up rate

business risk

capital gain

capital loss

capitalization rate

capital risk

cash breakeven ratio

cash-on-cash return

cost recovery

debt service coverage ratio

debt service

depreciation

depreciable basis/book value

discounted cash-flow analysis

discounting

discount rate

dynamic risk

effective gross income (EGI)

equity dividend rate

exchange

fixed expenses

general partnership

gross rent multiplier (GRM)

holding period

inflation hedge

installment sales

leverage

limited liability companies (LLCs)

limited liability partnerships (LLPs)

limited partnership

liquid/liquidity

loan-to-value ratio

long-term gains

marginal tax rate

mortgage debt service

negative cash flow

net operating income (NOI)

net operating income multiplier (NOIM)

operating expenses

operating statement

other income

passive income

potential gross income (PGI)

pro forma statements

pyramid

rate of return

real estate investment

reserves

risk assessment

real estate investment trusts (REITs)

real estate mortgage investment conduit (REMIC)

reserves for replacements

return

reversion

Section 1031 property exchange

short-term gains

silent partners

straight-line depreciation

static risk

syndicate

tax basis

tax credit

tax-deferred/like-kind

tax shelter

time value of money

vacancy and collection loss

variable expenses

**LECTURE OUTLINE**

**I. THE NATURE OF THE REAL ESTATE INVESTMENT**

1. Real property as a hedge against inflation
2. Risk management
   1. Risk
   2. Liquidity
   3. Leverage
3. Tax shelter (tax deferred)
4. Limited disadvantages
5. Implementation

**II. HOLDING PERIOD AND REVERSION**

**III. TYPES OF INVESTMENT PROPERTIES**

**IV. INVESTMENT ANALYSIS TECHNIQUES**

1. Discounted cash-flow analysis

**V. INVESTMENT OWNERSHIP STRUCTURE**

1. Forms of syndicates
2. Real estate investment trusts
   1. Equity trusts
   2. Mortgage trusts
   3. Combination trusts
3. Real estate mortgage investment conduits

**VI. PREPARING TO BE AN INVESTOR**

1. Start small
2. Avoid vacant land
3. Income analysis

**VII. MEASURING AND EVALUATING THE FINANCIAL VIABILITY OF INVESTMENT PROPERTY**

1. Risk and reward
2. Built-up rate

**VIII. ANALYZING PROPERTY INCOME**

1. Acquisition
2. Current rent roll
3. Pro forma statements
   1. Step 1: Income analysis
   2. Step 2: Operating expense analysis
4. Net operating income/leverage and capitalization
5. Deriving the before-tax cash flow
6. Deriving the after-tax cash flow
7. Pro forma statements—depreciation
   1. Depreciation and the calculation of a property’s depreciable basis
      1. Physical deterioration
      2. Functional obsolescence
      3. External obsolescence
   2. Straight-line depreciation method
   3. Recovering periods
   4. Calculating the depreciable basis
   5. Calculating taxable income
   6. Calculating the gain or loss

**IX. INCOME TAX CONSIDERATIONS**

1. Depreciation
2. Depreciation: income tax issues
3. Capital gains

**X. TAX CUTS AND JOBS ACT OF 2017**

1. Long-term capital gains tax
2. Standard deduction
3. Personal exemptions
4. Health care
5. Inflation gauge
6. Deductions/family child tax credits
7. Head of household
8. Itemized deductions

**XI. A BRIEF OVERVIEW OF THE TAX REFORM ACT**

1. Corporate tax rate
2. Pass-through income
3. Treatment of interest
4. Basis

**XII. LIKE-KIND EXCHANGES (IRS SECTION 1031 EXCHANGES)**

1. Exchanges
2. Section 1031 (like-kind) exchange
3. Tax credits
4. Installment sales
5. Calculating multiplier ratios
   1. Potential gross income multiplier (PGIM)
   2. Effective gross income multiplier
   3. Net operating income multiplier
   4. Gross income multiplier (GIM)/gross rent multiplier
6. Calculating income property ratios
   1. Equity dividend rate
   2. Loan-to-value ratio
   3. Debt service coverage ratio (DSCR)
   4. Operating expense ratio
   5. Cash breakeven ratio
   6. Margin of safety

**XIII. SUMMARY**