

What to Look for When Buying Investment Real Estate

When Buying Real Estate for Investment, There are Four Financial Areas for Consideration.

Although each area makes intuitive sense, it is the total interplay amongst the four that is important. In this article we will briefly define and identify these areas as cash flow, tax considerations, equity build up and appreciation. Future articles will delve deeper into each.

Cash Flow – is the rental or lease income, less the expenses to operate the building, less debt service. Raw land, for example, has no income but does have real estate taxes and often a bank loan to pay off, thus has a negative cash flow. Office buildings, retail centers, apartment buildings, and the like, have rents that are collected. In addition to the real estate taxes and loan payments, there are often other expenses, including insurance, maintenance, perhaps utilities, etc. Depending on the leases, and whether they are the landlord or tenant's expense, this can often be quite costly. If the collected rents are greater than the expenses, you have positive cash flow. Intuitively, you know that is a good thing. This raises the question as to "why would someone invest in real estate if the cash flow is negative." The answer is, "the next

three areas must more than make up for this shortage."

Tax Savings – There are two areas of tax saving that come into play here. First is the "paper" loss that offsets income from the building and/or from personal taxation. In addition to the operating expenses of a building, the owner is allowed to have a "paper" expense called "cost recovery", or commonly known as "depreciation". The second is capital gains. If a property was held for more than a year when sold, the gain due to appreciation of value is taxed lower (15%) than the same income if taxed at ordinary income (say 35%).

Equity Buildup – This is simply the principal or debt reduction earned with every mortgage payment that reduces the loan balance and thus increases equity in the property. Hold onto a property long enough, you will own it free and clear with 100% equity even if there was no increase in value.

Appreciation – This is the increase in the value of property due to inflation, demand, or both. This is often the largest area of the total return. Just think back 5 or 10 years ago. What could you buy property for then?

There are many people with cash who want to invest in real estate, but

they just don't, because they look at just one of these areas, not all four, in calculating their return. How often we hear "the numbers don't work" or "the market is soft." My guess is they are only looking at Cash Flow or only the short term Appreciation. Year after year they sit on the sidelines, while the wise real estate investor factors in all of these considerations and is building wealth.



Welcome to



Kit Foster

Kit Foster is our newest agent and will be serving the Naples, Bridgton, and Fryeburg communities. During his 35-year real estate career, he has been a developer of both commercial and residential real estate as well as brokering both commercial and residential real estate. As a former partner of the ERA of Maine Master Franchise, he worked as a business consultant and corporate trainer with over 50 real estate offices.