Seven Reasons Why Investing in Apartments Can Make You a Millionaire

Seven truths that favor rental owners can help you become a millionaire and build your legacy. The seventh truth is most powerful and especially applicable in supply-constrained markets such as San Diego, California.

1 Leverage

Almost everyone who buys real estate uses leverage. It is rare that people save all the money for their home before they buy. Instead, most households save enough for a down payment, buy, and then a generation later pay it off. The home almost always increases in value between the purchase date and the date the loan is paid off. The homeowner benefits from the appreciation that accrued from the date of purchase to the date that the home is sold or the loan is paid off.

Similarly, most investors obtain a prudent loan. Almost none pay all cash. Look at the math. Suppose you have $300K for investment and were deciding between buying a rental house or some apartments. Also suppose that values increase 10% over time. The $300K house could be worth $330K. The $1 million apartment could be worth $1.1 million. After paying off the $700K loan, the leveraged equity would have grown to $400K for the apartment. Clearly, $400K equity is better than $330K.

2 Cash flow

Many people focus on this measurement: "How much cash do I receive after all expenses and paying the mortgage?" It is simple to calculate but far less important than growth of capital. Most investors don't consider the tax refunds that usually come from owning rental property.

Over the past 25 years, initial cash return on the invested capital (often called the *cash-on-cash return*) has varied from 2% since 2017 up to a peak of 10% during San Diego's most severe recession. Generally, cash flow increases over the years. Rents increase and mortgages remain the same.

Initially the investment's cash flow is weak and uneven. With passing years, the rents increase. Suppose gross income increased 10% from $100K to $110K. The mortgage payment is fixed, and increases in other costs are relatively small. The owners' cash flow might increase $7.5K. Many rental owners find that their property generates more cash flow than all their other retirement and social security combined.

3 Tax shelter

Apartment investors pay lower income taxes because a tax fiction called *depreciation* implies that residential buildings become valueless in 25-30 years in the 2017 tax law. If you don't own income property, you may not know that the government subsidizes landlords by giving extra tax deductions, which, in effect, means extra refunds.

A rough example is that if a $1 million building only breaks even in terms of income and expense, the owner can claim a taxable loss of $25K. That means the owner can offset, or shelter, $25K of ordinary income. Depending on your tax bracket and state, it might mean $5K to $10K in tax refunds for owning rentals.

4 Inflation protection through appreciation

Democracies vote benefits to more and more people. Currency is printed and inflation happens. In the last hundred years, US inflation has averaged 3% per year. So last decade's $1 million building can be worth $1.3 million or more now.

5 Mortgage pay-down

Each mortgage payment has interest and principal reduction. After a decade, the loan may be 20% paid, yet after two decades it may be half paid. In 30 years the loan is gone. In other words, the tenants make your mortgage payments. Once the loan is paid off, then you keep all the cash flow.

6 Tax-deferred exchange

In effect, a savvy investor can trade up and receive an interest-free loan from the government and have the equity compound for decades; the family may never have to pay that tax liability.

With income property, you can sell an asset, buy or "exchange into" another one, but not have to pay the taxes on the appreciation at time of sale. Instead, the tax is deferred to the time when you sell the last property you "exchanged into." This is not true for stocks or bonds. When you die, your heirs receive the property based on its value at date of death. In effect, tax-deferred exchange may allow you to disinherit the tax authority and eliminate the tax liability on the accumulated profit.

7 Monetize your cash flow

You may have heard about initial public offerings, IPOs. Tech geeks bring the company to the stock exchange, and they sell it for 10, 20, or maybe 100 times earnings. In effect, they are selling an income stream. The market values apartments at a multiple of rents: 5, 10 or 20 times the annual rental income. So, $1K of additional rental income increases the value of the property by many times.

Excerpted from the Introduction to *Building Legacy Wealth* by Terry Moore, CCIM.

Americans want to build wealth, but few people really know how. Terry Moore, CCIM shows clients low-risk ways to invest in rental property, so they can enjoy financial security. Terry is an award-winning broker and author of *Building Legacy Wealth*.

Find out more at BuildingLegacyWealth.com