Rental Review

LLA LandLord Association of the Inland Northwest

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Burned Out On Landlording?

Have a GREAT and FUN Summer and we will see you this coming September.

Membership meeting on Wednesday, September 20, 2017, 6-8 pm. Speakers: Alexander Scott LLA member, and Chris Bourassa CPA with Omlin, Gunning and Associates, P.S. Topic: How to make your investments more profitable. Now that is one awesome topic. No on should miss out on the dinner meeting. Unless you already have all the money you need. This class is designed to put you in firm control of your finances with a focus on how to make a profit. One more Speaker: Debbie Hamilton with Fletcher Financial Services Presenting: Medicare and Retirement. This a must know when to sign up, Part A, Part B, and D. See the Article in the Rental Review come with Questions, Meetings at Timber Creek Grill & Buffet, 9211 E. Montgomery, Spokane, (Argonne Plaza). Approx. $14.00 at the door includes dinner, beverage, & tax. Beer, wine, and tip extra. Guests welcome.

Become a member of LLA today and be an INFORMED landlord!

Burned Out on Landlording?

Think Smart/What are your Options Decide an exit strategy to protect your equity and cash flow.

One of the most common dilemmas I hear from landlords is that that they are "tired of being an active landlord but don't want to pay a big tax bill or give up the monthly income their rental properties provide". There are many different reasons landlords move on to the next chapter of their life when it comes to their rental property. Some are fed up with dealing with tenant issues or all the laws protecting the bad ones.

Some want to free themselves from spending their weekends working on their properties. Many rental property owners would like to pull cash out of their equity to start checking off their bucket list items or travel to see grandkids. Whatever the reason may be there are often discouraging elements to this process. My hope is this article gives landlords some ideas on how they can empower themselves with choices and get the most out of their property.

The current status quo is to hire a Realtor and pay a 6% commission for them to find a buyer and manage the transaction. Typically, that buyer needs to get a loan from a bank, who will of course need to do an appraisal. Have you ever sold a property and had the appraisal come in under your agreed sales price? It's not a fun process and believe me when I say not all bank appraisers are created equal. There is a laundry list of reasons an appraiser might not bring the building in at value, especially if your records aren't perfect so I won't go down that road. Just understand this can take tens of thousands of dollars out of your pocket if it doesn't go your way.

After you have sold your property, paid for any lender or buyer required repairs, fees, closing costs, etc. You get a check. But hold on! Did you consult your CPA before selling?

Did you know you will be hit with depreciation recapture? That's right, the wonderful depreciation you wrote off all those years of ownership needs to be accounted for when selling. How about capital gains tax? Did you know a large capital gain may not only create a large tax bill, but it could actually bump you up in your capital gains tax bracket!

So, there you are, left with your "seller net". Now what? It's not producing a monthly income anymore and in the bank earning less than 1%. It is also liquid now and vulnerable to predators.

If you're going to stay in the rental property ownership game, there are potentially better solutions like a 1031 tax deferred exchange. But if your done land lording but need a monthly cash flow investment you may want to consider being the bank yourself! This is an exit strategy you may consider to significantly reduce your tax obligation and allow you to maximize the benefits of your rental property by keeping a monthly cash flow with none of the liability!

The exit strategy is to sell and hold the contract! Find a solid, quality buyer and sell on a note. This would allow you to get cash now, while minimizing your tax obligation. The funds you would have paid in taxes and fees, along with the rest of your equity are now making interest that pays you monthly and is secured by the real estate you know and love. This is not some new age strategy, in fact it is much more like the "good old days" before banks and the government decided they should be the ones profiting from your years of hard work.

The process is simple and there are some solid, experienced buyers out there that can make this process easy and customizable for you. *Note* The right buyer is critical because a novice or undercapitalized buyer can be a nightmare, destroying the benefits to this process, so do your due diligence and know who you are dealing with! Here are the basic steps of how it is done.

1. Agree to terms with a buyer that has the track record and capital reserve to perform. Your real estate attorney can help you review the contracts and make sure the right protections are in place for you if something goes wrong and it will likely cost you $500-$1,000.
2. Your money will be secured with a first position deed of trust to go along with your promissory note, which is the document that will spell out how the payments are made and how much money you will make. It will also spell out how you get your property back and owe the buyer nothing if they don't perform.
3. Close with a real estate attorney in town that has experience with seller note and deed transactions. The attorney can help set up a 3rd party escrow account where the escrow company takes automatic payments out of the buyer's bank account each month. They will record the payment so your bookkeeping is covered! Every month they will send you a statement with your check showing that the buyer is performing. Always have the property taxes and insurance built into the escrow payment so they cannot be missed or overlooked.

Now you just collect your monthly checks! Talk with your CPA about using an LLC to do the "business" of holding the note. All your expenses for this LLC may be able to offset the interest income you are receiving, effectively permanently reducing your overall tax obligation.

To show you the power of this strategy I will give you an example of a $900,000 sale for a seller that is looking at a 15% capital gains rate on a building purchased for $500,000 and the mortgage is paid off. Below are two different selling scenarios. (Depreciation recapture is not reflected because it applies to both selling scenarios. You can influence your depreciation recapture but it is beyond the scope of this article.)

<u>Traditional listing and cash out</u>: Your "seller net" after capital gains would be $763,500 and you would no longer have a monthly cash flow from this asset, so that is your total net. This assumes that your $400,000 capital gain didn't bump you into a higher tax bracket in which you could pay up to 23% in capital gains tax and is certainly possible.

<u>Seller Note and Deed with $150,000 down at 5% interest:</u> Your "seller net" after capital gains would be $855,000! Your capital gains obligation would only be on the $150,000 down payment on the sale. You would also have an asset of $750,000 that is making interest and paying you monthly! But it doesn't stop there! If you or your heirs held the note which is paying a monthly cash flow of $4,384.43 until maturity, you would make an additional $565,327.59 in interest from your sold property! That is a total of $1,420,327! (Note: Capital gains tax may be due on future payments, however as described above a good CPA can help minimize or in some cases eliminate certain tax obligations)

This is also a great strategy for those who plan on passing down the rental property to their children. All too often when children who are not working inside the rental business inherit rental property, it gets miss manage and ultimately, they are forced to sell at a deep discount defeating the purpose of passing it down your legacy. I have found that if the heirs have not been working in the business of rental property like mom and dad did then they prefer to inherit an asset like a note that pays them a monthly check with virtually no management or effort versus a property that needs their attention and hard effort.

In the end, the best thing to do is what fits best for your freedom through cash flow plan, whatever that may be. For legal and tax questions always consult a licensed Attorney or CPA.

For a more in depth look at this type of exit strategy and additional real estate investment strategies be sure to join me, Tyler Vinson, at the LLA meeting October 18th, 2017.

For more information on this topic, including a "how it works" video and an easy to use "income calculator" please visit www.easyapartmentsell.com or if you're not the computer type, contact us directly at 509-258-5009 and we would be happy to walk you through the website in person.