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EX:15

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39

VOLUME 24 | EDITION 06



Richard P. Slaughter Associates Inc.

Brooks Slaughter, MBA, CFP®, President and CEO

“What are the **key areas to analyze** before buying investment property?”

By Brooks Slaughter

Real estate is an attractive investment because it is fundamentally satisfying to own something you can touch, feel and see. This allure, however, often causes investors to overlook the basic investment analysis required to make a sound decision to buy or retain a real property.

Any investment analysis, regardless of the asset, involves assessing the initial purchase price and then discounting future cash flows by a required rate of return. That calculation will reveal whether the asset is undervalued (warranting a purchase) or overvalued (warranting a sale or no purchase).

Real estate offers some unique considerations. Here are six areas that pose particular problems for property buyers.

LOCATION

The old saying about “location, location, location” still applies. That variable will determine the ending cash value from a future sale and the amount of cash flows between the purchase and eventual sale.

LIQUIDITY

Real estate is not as liquid as many other investments. You cannot sell a property as quickly and easily as a publicly traded stock. The costs of the trade are also much higher. All other things being equal, you should demand a higher rate of return on real estate than stock.

LEVERAGE

Most real estate deals involve some sort of loan or leverage. A large part of the projected gains from property sales pitches often is derived not from the fundamentals of the project, but from the financing. Always keep in mind that while leverage helps by magnifying gains in an environment characterized by rising prices and increasing cash flows, it's detrimental in falling-price environments. So, stress test the leverage component for rate changes when floating-rate or balloon-debt financing is used.

LIABILITY

Real estate creates more liability for owners than other investments. Pitfalls include, but definitely are not limited to, irresponsible tenants, bad contractors or partners and unknown environmental hazards. Liability must be addressed with the understanding that the expenses necessarily will be higher than with other investments. You will need insurance for both the property itself, and your own liability. You should also determine the appropriate entity structure to hold real estate in order to protect your other assets.


TAXES

Real estate receives favorable federal tax treatment, and interest is usually deductible. Depreciation is allowed to reduce taxable income, even though

it is not a cash expense. Like-kind exchanges can continue to shelter gains well into the future. And, depending on the ownership structure, a step-up in basis can eliminate income taxes when the property is passed to heirs. However, tax laws do change: Support is growing for tax reform that might remove or restrict some of these favorable tax measures.

HIDDEN COSTS

Be sure you consider all the costs in your analysis. Rental property will require repairs. And at times, that property will be vacant. There will be make-ready and advertising costs to acquire new tenants as well as management costs, even when you are doing these tasks yourself. Put the going rate into your calculation to reveal your true rate of return and keep the property profitable in case you are no longer able to fulfill that role. Bad management in the form of nonmarket rental rates and overpayments for repairs is something many do not take into account as a cost.

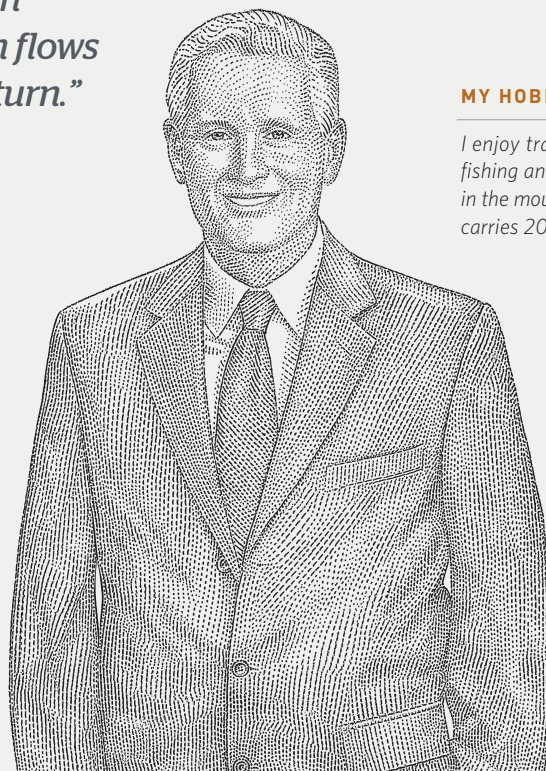
If you break down these areas when considering a real estate investment, you'll be better positioned to maximize the property's value and return potential. Remember, too, that a trusted wealth management advisor can help you sort through these and other investment real estate issues, before and after your purchase. 

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—Brooks Slaughter

How to reach Richard P. Slaughter Associates

You can reach any member of our team at 512.918.0000. We look forward to speaking with you.



MY HOBBIES ARE...

I enjoy travelling, snow skiing, fishing and playing golf, especially in the mountains where my wedge carries 200 yards.

WHAT MAKES A GOOD WEALTH ADVISOR...

An experienced expert who listens to clients and solves problems in a wide variety of financial areas.

WHAT MAKES A GOOD CLIENT...

Someone who is willing to share his or her problems, goals and aspirations and then partner with a trusted expert to realize those goals.

About Richard P. Slaughter Associates

Richard P. Slaughter Associates is a leading wealth management firm, specializing in delivering tailored strategies as a fiduciary and advocate for high net worth individuals, families and businesses. Slaughter Associates constructs wealth management strategies around a financial plan, providing active, diversified and conservative asset management through its internal experts. These experts establish a collaborative relationship with clients and all their financial service professionals, helping clients navigate the financial complexities that high net worth individuals and families face. Founded in 1991 in Austin, Texas, by Richard P. Slaughter, Slaughter Associates is one of the original fee-based firms in the nation. Through its subsidiary, RPS Retirement Plan Advisors, Slaughter Associates works with corporate clients by providing 3(38) fiduciary services, which help mitigate risk for plan sponsors and secure retirement readiness for employees. With offices in both Austin and the Dallas-Fort Worth Metroplex, Slaughter Associates has been recognized by the National Association of Board Certified Advisory Practices as a Premier Advisor and has been awarded Exemplary status for expertise in personal risk management.

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Compensation Method **Asset-based and hourly fees**

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Association Memberships
CFA Society of Austin, CFA Institute, Financial Planning Association, The National Association of Personal Financial Advisors

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