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4 WAYS RESIDENTIAL REAL ESTATE INVESTORS BUILD WEALTH

LOWER YOUR TAXES

Tax incentives for real estate investors can often make the difference in your tax rates. Deductions for rental property can often be used to offset wage income. Tax breaks can often enable investors to turn a loss into a profit.

For which items can investors get tax breaks? You could claim deductions for actual costs you incur for financing, managing and operating the rental property. This includes mortgage interest payments, real estate taxes, insurance, maintenance, repairs, property management fees, travel, advertising, and utilities (assuming the tenant doesn't pay them). These expenses can be subtracted from your adjusted gross income when determining your personal income taxes. Of course, these deductions cannot exceed the amount of real estate income you receive. In addition to deductions for operating costs, you can also receive breaks for depreciation. Buildings naturally deteriorate over time, and these "losses" can be deducted regardless of the actual market value of the property. Because depreciation is a non-cash expense -- you are not actually spending any money -- the tax code can get a bit tricky. For more information about depreciation and various tax alternatives, ask your tax advisor about Section 1031 of the U.S. Tax Code.

HAVE A POSITIVE CASH FLOW

There are two kinds of positive cash flows: pre-tax and after-tax. A pre-tax positive cash flow occurs when income received is greater than expenses incurred. This sort of situation is difficult to find, but they are usually a strong and safe investment. An after-tax positive cash flow may have expenses that outweigh collected income, but various tax breaks allow for a positive cash flow. This is more common, but it is generally not as strong or safe as a pre-tax positive cash flow.

Regardless of what kind of real estate you choose to invest in, timely collections from your tenants is absolutely necessary. A positive cash flow -- whether it be pre-tax or after-tax -- requires rental income. Be sure to find quality tenants; a thorough credit and employment check is probably a good idea.

USE LEVERAGE
One of the most important factors in determining a solid investment is the amount of equity you are purchasing. Equity is the difference between the actual worth of the property and the balanced owed on the mortgage. In order to increase equity, investors often choose to borrow money. Borrowing money allows you to magnify the return on your investment. Borrowing money to increase equity is known as leverage. Leverage can make the money you invest out of your pocket go a long way.

In order to illustrate the value of leverage, let's take a fictional example: assume you bought a $200,000 rental property with a 30% down payment; the remaining 70% of the purchasing price is paid for with borrowed money. Let's further assume that after several years the home is worth $270,000. The $70,000 return on your $60,000 investment -- the amount that you paid directly -- is more than 100%. (There is more to calculating the return on investing, but this will keep it simple.) If you bought that same $200,000 property without borrowing, the return on your investment would be 35%. Leverage puts borrowed money to work for you.

BENEFIT FROM GROWING EQUITY
While investing in real estate is relatively complex, it is often worth the extra work. When compared to other financial investments, like bonds or CD's, the return on investment for real estate purchases can often be greater.

The key to real estate investing is equity. Determine an amount of equity that you want to achieve. When you reach your goal, it's time to sell or refinance. Determining the proper amount of equity may require the assistance of a real estate professional.