



## PENSCO Trust Company's WEDNESDAY WEBINAR SERIES

# Cash Flow Analysis of Real Estate Projects: Inside and Outside an IRA And

# Pros & Cons of Investing Your IRA in an LLC

Wednesday, September 5, 2007

11 am PDT / 12 pm MST / 1 pm CST / 2 pm EST

### Hosted By:

**Tom Anderson**, CEO & Founder, PENSCO Trust Company  
**Robyn Levin**, Marketing Consultant, PENSCO Trust Company

### Guest Speaker:

**Douglas Rutherford**, Founder of Rutherford, CPA & Associates, and  
President and CEO of LandlordSoftware.com

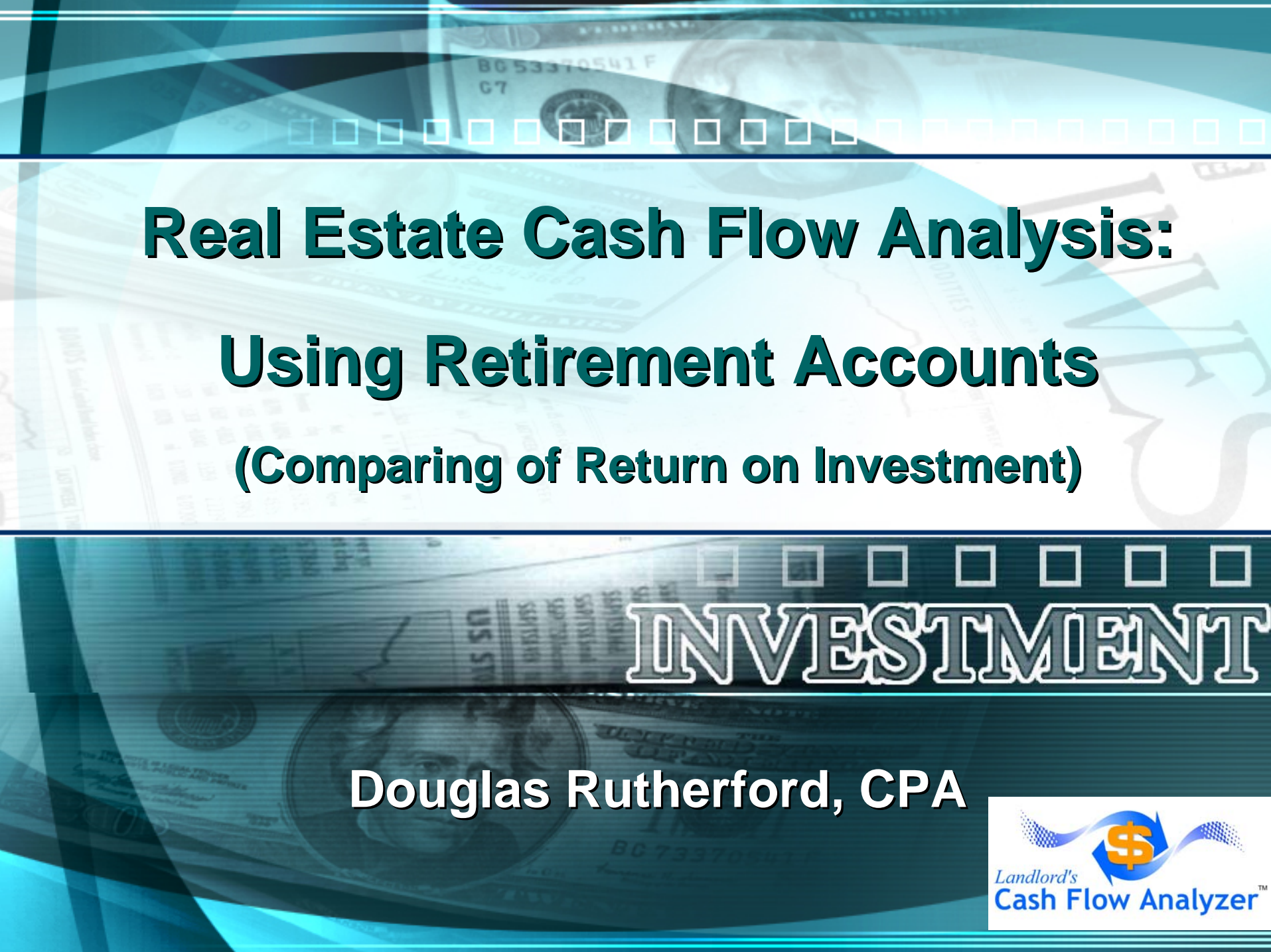
PENSCO Trust does not give legal or tax advice. We do our best to understand and educate about building wealth through self-directed IRAs. However, you are advised to consult your own legal and tax advisors for specific guidance regarding your investments. This document is for educational purposes only.



## Guest Speaker:

Douglas Rutherford

Founder, Rutherford, CPA & Associates,  
and President and CEO,  
LandlordSoftware.com



**Real Estate Cash Flow Analysis:  
Using Retirement Accounts  
(Comparing of Return on Investment)**

**INVESTMENT**

**Douglas Rutherford, CPA**



# About: Douglas Rutherford, CPA

Douglas Rutherford is a nationally recognized CPA practicing in the real estate industry. He is an author, businessman, real estate investor, the founder of Rutherford, CPA & Associates, P.C., and RentalSoftware.com LLC.

Doug developed the Cash Flow Analyzer® software series beginning in 1993 to assist his clients in analyzing real estate investments. Today, over 20,000 real estate investors, brokers, agents, bankers, mortgage lenders, and others in the USA, Canada, Australia, and other foreign countries use the Cash Flow Analyzer® software.

Doug is a member of the America Institute of Certified Public Accountants (AICPA), the Georgia Society of Certified Public Accountants (GSCPA), and the National Society of Tax Professionals (NSTP).

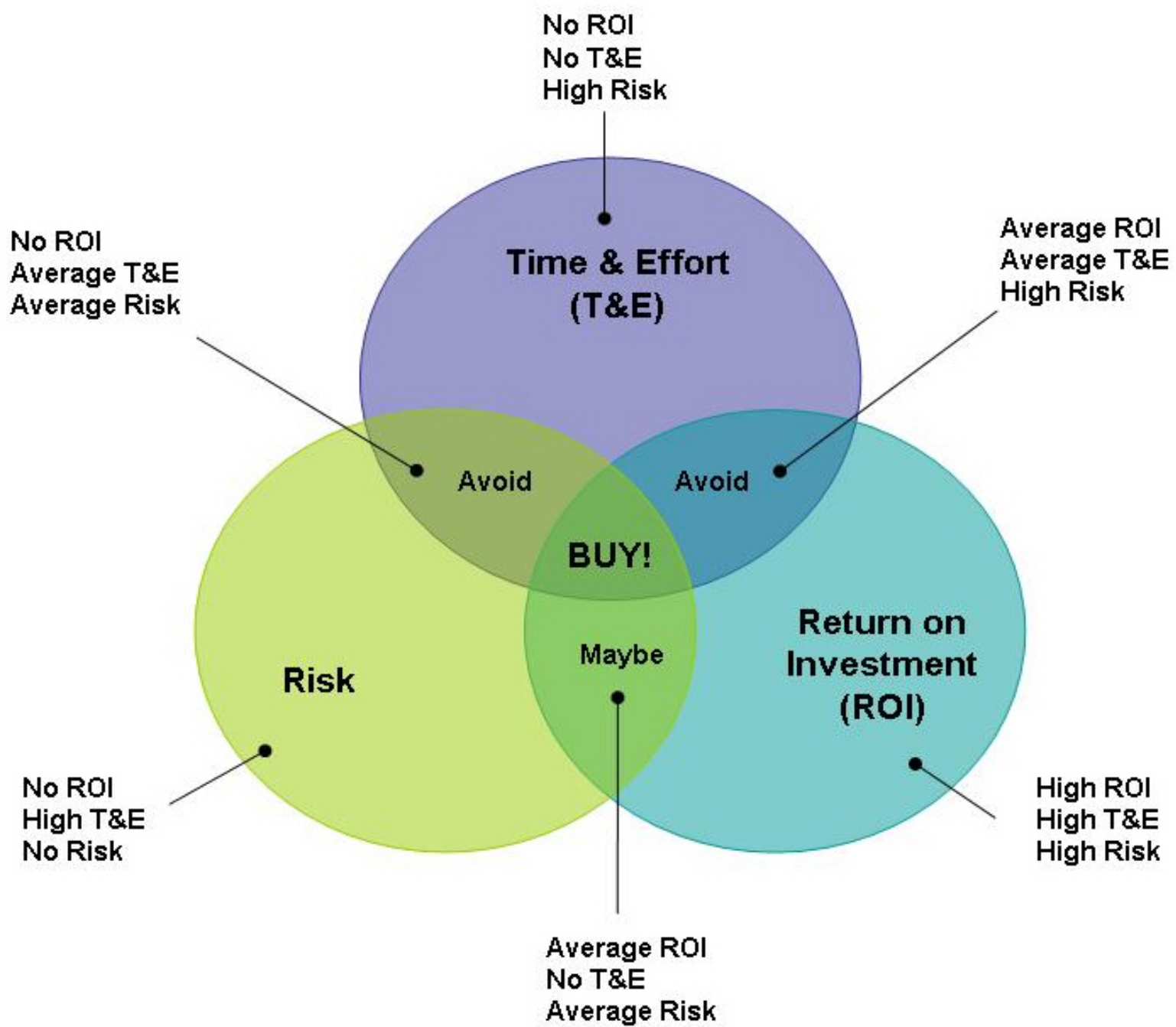


# Agenda

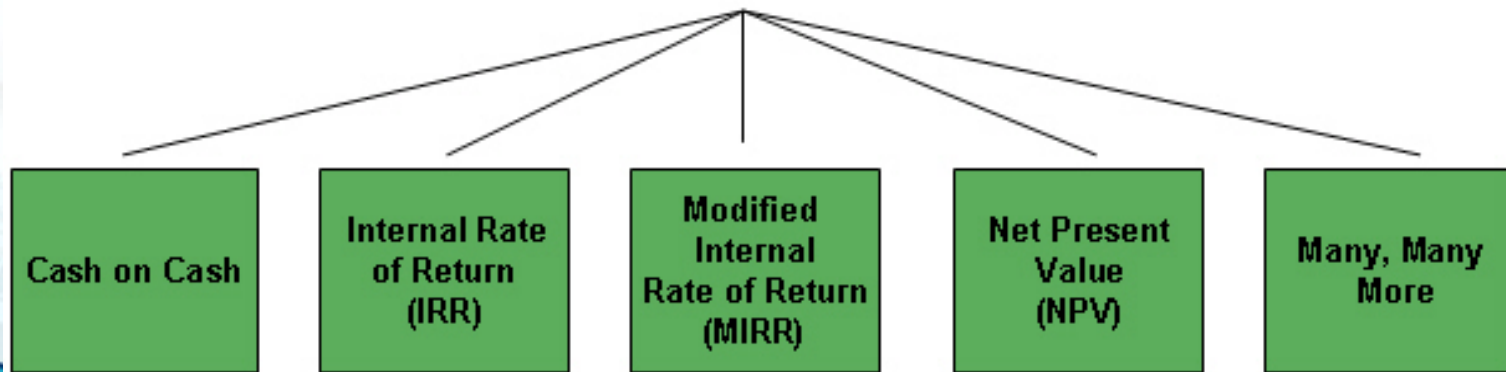
- Decision Making Process
- Return on Investment (ROI) - Definition
- Framework – Cash Flow Analysis
- Financial Ratios
- Income Tax Issues
- Compare Real Estate Investment Return
  - Self-Directed vs. Non Self-Directed

# Decision-Making Process

- Risk
- Time & Effort
- Return on Investment



# ROI – Today's Focus





# Framework of Cash Flow Analysis

## Annual Calculation

Rental Income

- Vacancy Rate

- Rental Expenses

**Net Operating Income**

- Debt Payments

- Income taxes

**Net Annual Cash Flow**

## Year of Sale

Projected Sales Price

- Selling Expenses

**Adjusted Sales Price**

- Outstanding Debt

- Taxes from Sale

**Net Cash Flow from Sale**

# Financial Ratios

- Cash-on-Cash Return
- Internal-Rate-of-Return (IRR)

# Cash-on-Cash Return

- The GREAT EQUALIZER!
- Probably the most important financial ratio for long-term investors.
- Defined as “Net” Annual Cash Flow over “Initial Investment.”
- Best way to understand: think of Cash on Cash return like you would calculate a return from a Certificate of Deposit.

# Cash-on-Cash Return - Example

- Purchase Price: \$100,000
- Borrow: \$80,000
- Initial investment/Down Payment: \$20,000
- First Year Net Cash Flow: \$2,000

What's the Cash-on-Cash Return?

- \$2,000 Net Cash Flow divided by \$20,000 initial investment
- Equals 10% Cash-on-Cash Return.

# Internal-Rate-of-Return (IRR)

- Defined as the “rate or percentage” needed to discount a future stream of non-even cash flow dollars (negative or positive) to equal your initial investment in the property.
- Most widely used measurement to determine “total” return on investment.
- Takes into account time value of money.
- Takes into account the prospective sale of the property.

# Internal Rate of Return - Example

- You make a net investment of \$100,000.
- As a result, the property generates the following cash flow:
  - Year 1 \$2,000
  - Year 2 \$5,000
  - Year 3 \$1,000
  - Property sale at the end of Year 3 nets \$125,000.
- Total profit equals: \$33,000 or 33% of your initial investment. Is that your return?
- IRR = 10.23%

# Which Return Method is More Important?

- Cash-on-Cash vs. Internal Rate of Return (IRR)
  - The shorter the investment period – IRR
  - The longer the investment period – Cash-on-Cash

# Real Estate Tax Issues/Benefits

- Passive Loss Rules
- Tax Depreciation
  - Time Value of Money
  - Rate Arbitrage
- Capital Gains Tax
- UBIT Tax Issues



# Rental Property Investment

- Purchase Price: \$100,000, FMV: \$125,000
- Appreciation Rate: 3%
- Monthly Rent: \$1,250 2% Annual Increase
- Vacancy Rate: 5%
- Annual Expenses: \$5,700 2% Annual Increase
- Debt: 70% at 7.25% 15 Year Note
- Individual Income Tax Rates:
  - 35% Ordinary, 15% Capital Gain, 6% State
  - UBIT Rules

# Cash Flow Analysis - Comparison

Year 10

## Rental Activity Analysis

Personally    Self-Directed

|   |               |                 |
|---|---------------|-----------------|
| Gross Rental Income                     | \$ 17,926     | \$ 17,926       |
| Vacancy & Credits                       | (896)         | (896)           |
| Operating Expenses                      | (6,812)       | (6,812)         |
| Net Operating Income (NOI)              | \$ 10,218     | \$ 10,218       |
| Total Mortgage Payments                 | (7,668)       | (7,668)         |
| Income Taxes from Rental Activity       | (1,947)       | (273)           |
| <b>Net CASH FLOW from Rent Activity</b> | <b>\$ 603</b> | <b>\$ 2,277</b> |

\$1,674 more  
cash flow.

# Cash Flow Analysis - Comparison

## Year 10

### Property Sale Analysis

|   | Personally | Self-Directed |
|---|------------|---------------|
| Projected Sale Price - Original Cost        | \$ 167,990 | \$ 167,990    |
| Selling Expenses                            | (10,079)   | (10,079)      |
| <b>Adjusted Projected Sales Price</b>       | 157,910    | 157,910       |
| Mortgage #1 Balance Payoff                  | (32,522)   | (32,522)      |
| Income Taxes From Sale: Benefit / (Expense) | (21,142)   | (10,975)      |
| <b>Net CASH FLOW from Property Sale</b>     | \$ 104,246 | \$ 114,413    |

### Cash Position

|  |           |            |
|--|-----------|------------|
| Net Cash Generated This Year                 | \$ 603    | \$ 2,277   |
| Net Cumulative Cash Generated Previous Years | 6,280     | 14,072     |
| Net Cash Generated - Property Sale           | 104,246   | 114,413    |
| Original Initial Investment                  | (30,000)  | (30,000)   |
| <b>Total Net CUMULATIVE CASH Generated</b>   | \$ 81,129 | \$ 100,762 |

\$19,633

### Financial Ratios

|   |               |               |
|---|---------------|---------------|
| Cash on Cash Return after Taxes                 | 2.01%         | 7.59%         |
| <b>Cumulative Internal Rate of Return (IRR)</b> | <b>14.74%</b> | <b>17.35%</b> |

2.61%

# Cash Flow Analysis – Solo 401(k) Comparison

## Year 10

### Property Sale Analysis

|   |
|---|
| Projected Sale Price - Original Cost        |
| Selling Expenses                            |
| <b>Adjusted Projected Sales Price</b>       |
| <br>Mortgage #1 Balance Payoff              |
| Income Taxes From Sale: Benefit / (Expense) |
| <b>Net CASH FLOW from Property Sale</b>     |

### Personally    Self-Directed

|    |          |    |          |
|----|----------|----|----------|
| \$ | 167,990  | \$ | 167,990  |
|    | (10,079) |    | (10,079) |
|    | 157,910  |    | 157,910  |
|    | -        |    | -        |
|    | (32,522) |    | (32,522) |
|    | (21,142) |    | N/A      |
| \$ | 104,246  | \$ | 125,388  |

### Cash Position

|  |
|--|
| Net Cash Generated This Year                 |
| Net Cumulative Cash Generated Previous Years |
| Net Cash Generated - Property Sale           |
| Original Initial Investment                  |
| <b>Total Net CUMULATIVE CASH Generated</b>   |

|    |          |    |          |
|----|----------|----|----------|
| \$ | 603      | \$ | 2,550    |
|    | 6,280    |    | 15,029   |
|    | 104,246  |    | 125,388  |
|    | (30,000) |    | (30,000) |
| \$ | 81,129   | \$ | 112,967  |

\$31,838

### Financial Ratios

|   |
|---|
| Cash on Cash Return after Taxes                 |
| <b>Cumulative Internal Rate of Return (IRR)</b> |

|               |               |
|---------------|---------------|
| 2.01%         | 8.50%         |
| <b>14.74%</b> | <b>18.45%</b> |

3.71%



## Attend This One-Day Content-Rich Event in Boston on Thursday, September 20, 2007

PENSCO Inc. is hosting a series of one-day educational sessions for professionals who want to learn more about investing using self-directed IRAs. Topics include: 1031 exchanges, land trusts, non-recourse loans, and marketing strategies.

Learn from industry leaders how to capitalize on this \$4.2 trillion emerging market!

### Upcoming Event Dates:

- Thursday, September 20, Boston, MA
- Thursday, October 25, San Francisco, CA
- Thursday, November 15, Chicago, IL

**Created For:** CPAs, attorneys, financial advisors, real estate and mortgage professionals who want to learn about self-directed IRAs and how they can grow their business.

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To register and for more information, go to:

[http://www.penscotrust.com/symposium/mini\\_symposium.asp](http://www.penscotrust.com/symposium/mini_symposium.asp)

# Advanced Education: Self-Directed Investing

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## Upcoming *Free* Seminars for Professionals:

- Thursday, September 13, 2007, Ft. Lauderdale, FL
- Thursday, October 11, 2007, Portsmouth, NH
  - Tuesday, October 30, Atlanta, GA

To register and for more information, please visit the  
Events section on our website at:

[www.penscotrust.com](http://www.penscotrust.com)

## Self-Directed IRA Investor Panel:

Listen to IRA Investor Success Stories with Real Estate & Private Equity

- How they got started
- Investments details
- Successes and results
- Their due diligence process and how they avoided prohibited transactions

Register Online At:

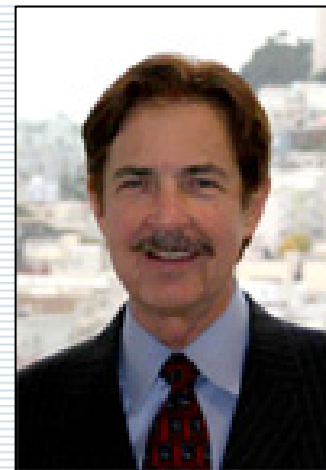
[penscotrust.com/events/WebAndTeleseminars.asp](http://penscotrust.com/events/WebAndTeleseminars.asp)

Free 1-Hour Webinar On  
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Listen to Success Stories  
Wednesday, October 3rd  
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# Self-Directed Investing: The Use of LLCs, "C" Corps and Partnerships

Tom Anderson  
CEO and Founder,  
PENSCO Trust Company





# What Are LLCs?

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- LLC Limited Liability Company
- "C" Corporation
- Limited Partnership
- General Partnership
- "S" Corporation

# How IRAs Invest In These Entities

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- IRA needs to be a self-directed IRA
- IRA gets funded
- IRA Owner instructs custodian to make purchase
- IRA owner submits entity documentation to custodian for administrative review
- Custodian conducts review and accepts investment
- Custodian funds investment

# Rules Affecting When And How Such Investments Can Be Made

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- Plan asset rules
- Prohibited transaction rules
- Co-investment rules
- IRS notice 2004-8
- IRS Notice 2006-1a
- Rollins tax court case
- Swanson case

# When Entities Make Sense For Self-Directed Investments

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- When there are large numbers of transactions
- When someone need to purchase tax liens or properties at auction
- When there is a large group of investors combining funds to make investments
- When there is a significant risk or liability associated with the investment(s)

# Responsibilities With LLCs

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- General business responsibilities to be handled by the LLC members:
  - Pay annual franchise tax
  - File K-1 reports (a CPA should be hired to do this for multiple member LLCs)
  - Maintain books and records, bank accounts, etc.

# Costs Associated with LLCs

- Costs that can be associated with LLCs (examples of approximate costs):
  - Legal fees for LLC formation and ongoing support (generally \$2,000-\$10,000)
  - Annual state franchise taxes, if applicable (\$200-\$1,000)
  - K-1 preparation for multi-member LLCs (\$1,000-\$3,000)
  - Ongoing “maintenance fees” to hire someone to manage the “checkbook” (one major facilitator charges \$200/quarter)
  - Maintenance of bank account(s), books and records (N/A)

# “Checkbook Control” and Self-Directed IRAs

## Checkbook Control vs. A Custodian:

- What “Checkbook Control” means—the Hype vs. the Reality
  - “Invest with your self-directed IRA simply writing a check from your IRA account, without asking for trust or custodial approval...”
- What a Custodian handles for the client
  - Why the client would need (and want) a custodian
- Information on topic on PENSCO Trust website:
  - Articles page in News and Press section:  
[http://www.penscotrust.com/news/article\\_anderson\\_072507.asp](http://www.penscotrust.com/news/article_anderson_072507.asp)
  - Entry on Tom Anderson blog: [www.tomandersonblog.com](http://www.tomandersonblog.com)  
<http://www.tomandersonblog.com/2007/01/30#a63>

# The LLC Decision

- With self-directed IRA investing, lots of discussion about the use of LLCs (some by interested parties)
- Largely, these factors should drive the decision:
  - Level of responsibility desired (and able to be handled) by the investor
  - Associated costs
  - Type of deals investor is interested in



# An Informed Choice

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- **Summary:**
  - Thousands of PENSCO Trust clients use LLCs
  - Thousands don't
- **Client needs to find the best fit for him/her but should be:**
  - Fully aware of what is entailed to avoid prohibited transactions
  - Able to handle all required responsibilities

# Missed Previous Webinars?

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Listen to Success Stories  
Wednesday, October 3rd

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# New Opportunities!

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## New PENSCO Trust Product for Sole Proprietors:



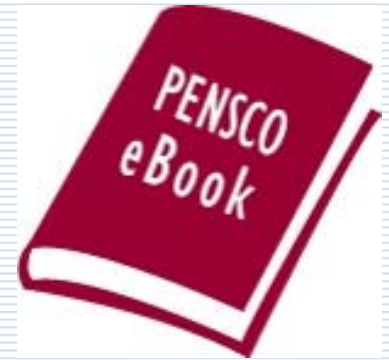
*For information go to:*

<http://www.penscotrust.com/account/solok.asp>

# Available Reference Materials

## ➤ eBook

Get the Answers to Investors'  
Top 50 Questions on Investing  
with a Self-Directed IRA!



Go to: <http://www.penscotrust.com/education/pdfs/Ebookweb.pdf>

Or click on the eBook icon on the right side of any page at [www.PENSCOTrust.com](http://www.PENSCOTrust.com).

## ➤ Get Started CD

This interactive CD for your computer gives you the quick overview of the references needed to self-direct your IRA and helpful direct links to the web pages at [www.PENSCOTrust.com](http://www.PENSCOTrust.com).

Please email [takecontrol@pensco.com](mailto:takecontrol@pensco.com) to request one.





# Contact PENSCO Trust

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## For More Information:

Call: **Business Development Center**

866-818-4IRA(4472)

Email: [takecontrol@pensco.com](mailto:takecontrol@pensco.com)

Web site: [www.PENSCOTrust.com](http://www.PENSCOTrust.com)

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