

# Monthly Newsletter

July 2014

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## The four ways to make money from investment real estate

There are four general ways to make money from investment real estate:

1. Cash flow;
2. Capital appreciation (or depreciation);
3. Equity build-up; and
4. Tax savings.

**Cash flow** is the movement of money into and out of your investment account. If California West rents your property for \$2,000 per month to a tenant, you pay operating expenses of \$200 per month, and you pay a mortgage of \$1,500 per month then your cash flow is \$300 per month. In other words, there is \$300 per month that is moving into your investment account.

**Capital appreciation** is the increase in the value of your investment over time. If you purchased an investment property for \$500,000 in 2010 and today it is worth \$600,000 then the capital appreciation on your investment is \$100,000.

**Equity** equals the market value of an investment minus any loan balance. If you have a thirty year loan with an original balance of \$400,000 at 5% interest then the remaining balance at the end of 12 months will be 394,098. Even with no capital appreciation, you will have equity build-up of \$5,902 in the first year of that loan because the amount that you owe will have fallen by that amount.

**Tax savings** from investment real estate include such things as the mortgage interest deduction and depreciation. Using the \$400,000 loan example above, you will pay \$19,866 in interest during the first twelve months of the loan and that amount is deductible as an investment expense. In addition, the value of improvements on the property can also be deducted over 27.5 years for a residential property and 39.5 years for a commercial property. There are important limitations to these deductions, so you should inquire with a tax professional for the finer details.

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## Smoke alarm rules in California.

Smoke alarms approved by the State Fire Marshal are required to be placed in all residential properties in California. The State Fire Marshal lists all approved smoke alarms. Smoke alarms are to be installed on each floor and in each sleeping room. Proper smoke alarm placement also depends on local ordinance.

Beginning July 1, 2014, the State Fire Marshal will require all battery-operated smoke alarms to contain a non-replaceable battery that lasts at least ten years.

Beginning January 1, 2015, the State Fire Marshal will require all smoke alarms (battery-powered, or powered by electricity) to:

1. display the date of manufacture;
2. provide a place where the date of installation can be written; and
3. incorporate a hush feature.

*Operable alarms which were approved and listed when they were installed don't need to be replaced immediately.*

This does not mean all the existing smoke alarms need to be replaced to meet these new alarm requirements. Operable alarms which were approved and listed when they were installed don't need to be replaced immediately.

When an existing smoke alarm no longer works, the replacement smoke alarm is to meet all new requirements. For example, a battery-powered smoke alarm installed on July 2, 2014 is required to have the non-replaceable ten-year battery, but is not required to display the date of manufacture.

Owners (or property managers, as owners' agents) are required to ensure smoke alarms are operable when a new tenancy is created. Also, if a smoke alarm defect can be reasonably ascertained visually during a landlord's visit to the unit, the landlord needs to repair or replace the device.

However, tenants are responsible for notifying the owner or property manager if the smoke alarm becomes inoperable. The owner is not in violation of smoke alarm requirements if they are unaware of a malfunction in the smoke alarm after the tenant is given possession.

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