

**Investing in Real Estate**

**Learning Objectives** When you have finished reading this unit, you will be able to

- **identify** the advantages and disadvantages of investing in real estate;
- **describe** the real estate investment objectives and the inherent financial concepts involved in the investment process;
- **explain** the essential benefits of leverage, including pyramiding, in the acquisition of real estate investments;
- **describe** the tax benefits inherent in real property investments;
- **describe** the mechanics of real estate investment syndicates, trusts, and mortgage conduits; and
- **define** the following key terms:

|   |                 |   |
|---|-----------------|---|
| accelerated cost recovery system (ACRS) | cost recovery   |   |
| adjusted basis                          | depreciation    | liquidity                                       |
| appreciation                            | equity buildup  | pyramiding                                      |
| basis                                   | exchanges       | real estate investment trust (REIT)             |
| boot                                    | income property | real estate mortgage investment conduit (REMIC) |
| capital gain                            | inflation       | straight-line depreciation                      |
| cash flow                               | intrinsic value | syndicate                                       |
|   | leverage        |   |

**Overview**

Real estate is a popular investment. **Whichever way the overall market turns, the real estate investment market continues to initiate innovative and attractive investment strategies.** These developments make it important for real estate professionals to have an elementary and up-to-date knowledge of real estate investment. **A real estate professional should never act as an investment advisor but should instead refer investors to competent tax accountants, attorneys, or investment specialists.**

**Why Real Estate?**

Real estate has always been an important part of an investment portfolio, but real estate, as any commodity, has good years and not-so-good years. In recent years, real estate values nationwide have gone through significant changes. The peaks in property valuations that were achieved in most areas at the beginning of this century were followed by the troughs that helped cause, and were exacerbated by, the recession years of 2006–2008. Some parts of the country, particularly on the coasts, proved fairly recession-proof in terms of real estate prices, but others still struggle to recoup the losses that have been sustained. **As with any investment, real estate requires careful consideration of both its advantages and its disadvantages.** The advantages and disadvantages of real estate as an investment are summarized in Figure 22.1 and discussed next.

**FIGURE 22.1: Advantages and Disadvantages of Real Estate Investments**

| Advantages   | Disadvantages                    |
|--|----------------------------------|
| Generally, above-average rates of return               | Investment is expensive          |
| Use leverage of borrowed money to purchase real estate | Real estate is not highly liquid |
| Greater control over investment                        | Must actively manage investment  |
| Tax benefits   | High degree of risk              |

### Advantages of Real Estate Investment

Over longer periods—10 to 20 years or more—real estate investments typically have shown above-average (or even high) *rates of return*. In some parts of the country, an impressive return can be received even after a relatively short period of ownership. In theory, this means that an investor can use borrowed money to finance a real estate purchase and feel relatively sure that the asset, if held long enough, will return more money than the cost to finance the purchase.

Real estate investments also offer more immediate advantages. Real estate offers investors a greater control over their investments than other options, such as stocks, bonds, or other securities. The real estate marketplace consists of buyers and sellers who deal directly with each other.

You have already learned about the tax benefits of home ownership. Real estate investors also receive certain tax benefits, which we will discuss here.

### Disadvantages of Real Estate Investment

Real estate investments are expensive. Large amounts of capital are usually required, even when financing is available. Investing in real estate is difficult without expert advice. Investment decisions must be based on careful study of all facts, reinforced by a thorough knowledge of real estate and how it is affected by the marketplace.

**Liquidity** refers to how quickly an asset may be converted into cash. Unlike stocks and bonds, real estate is not highly liquid over the short term. For example, an investor who holds stocks can easily direct a stockbroker to sell stocks when funds are needed; the stockbroker sells the stock and the investor receives the cash. In contrast, a real estate investor may have to sell property at a substantially lower price than desired to bring about a quick sale. If market values are down, the investor who wants to refinance property to free up cash will have to settle for whatever the lender feels the market dictates.

**Real estate requires active management.** A real estate investor can rarely just sit and watch the money grow. The investor may choose to personally manage the property or hire a professional property manager, but management decisions still must be made. How much rent should be charged? How should repairs and tenant grievances be handled? What is the long-term goal of the property owner? Is the property manager working to achieve that goal?

**IN PRACTICE** Those who are new to investing or who are too busy to handle the details of property management should hire a professional property manager. While this will entail an additional expense that the property's income will need to absorb, it should be well worth it. As you have already learned, a property manager can screen and select tenants, handle the day-to-day issues that arise, provide an important conduit and

buffer between landlord and tenant, add discipline to the process of allocating funds to maintain and preserve the asset, and increase the property's income potential. All of these will help the property owner achieve the **long-term goal of owning the investment**.

Finally, despite its popularity, a **real estate investment does not guarantee profit**. It involves a high degree of risk. The possibility that an investment property will decrease in value or not generate enough income to make it profitable is a sometimes volatile factor that the investor must consider.

## The Investment

Real estate investors anticipate various investment objectives. Their goals can be reached more effectively depending on the type of property and ownership they choose. **The most prevalent form of real estate investment is direct ownership**. Both individuals and corporations may own real estate directly and manage it as an investment income or cash flow (income). **This type of real estate is known as income property**.

## Appreciation

Real estate is an avenue of investment open to those interested in **holding property primarily for increasing value, which is known as appreciation**. Two main factors affect appreciation: inflation and intrinsic value.

**Inflation** is the increase in the amount of money in circulation. When more money is available, its value declines. When the value of money declines, wholesale and retail prices rise. This is essentially an operation of supply and demand.

The **intrinsic value** of real estate is the result of a person's individual choices and preferences for a given geographic area. For example, property located in a pleasant neighborhood near attractive business and shopping areas has a greater intrinsic value to most people than similar property in a more isolated location. As a rule, **the greater the intrinsic value, the more money a property commands on its sale**.

## Unimproved Land

Often, investors **speculate** in purchases of either agricultural land or undeveloped land located in what they expect to be a major path of growth. In such a case, however, the property's intrinsic value and potential for appreciation are not easy to determine. This type of investment carries many inherent risks. How fast will the area develop? Will it grow sufficiently for the investor to make a good profit? Will the expected growth occur? More important, **will the profits eventually realized from the property be great enough to offset the costs of holding it**, such as property taxes? Because these questions often cannot be answered with any degree of certainty, lending institutions may be reluctant to lend money for the purchase of raw land.

As will be discussed later, **income tax laws do not allow for the depreciation of land because it is not considered a deteriorating asset, so that tax advantage is lost**. Land also might not be liquid (salable) at certain times under certain circumstances because few people will purchase raw or agricultural land on short notice. **Despite all the risks, land has historically been a good inflation hedge if it is held for the long term**.

Investment in land ultimately is best left to experts, and even they frequently make bad land investment decisions.

## Income

A person who wishes to buy and personally manage real estate may find that **rental income property is the best investment**.

**Cash Flow** The objective of directing funds into income property is to generate spendable income, called **cash flow**. Cash flow is the total amount of money remaining after all expenditures have been paid. These expenses include taxes, operating costs, and maintenance. The cash flow produced by any given parcel of real estate is determined by at least three factors: amount of rent received, operating expenses, and method of debt repayment.

Generally, the amount of rent (income) that a property may command depends on a number of factors, including the property's location, physical appearance, and amenities. If the cash flow from rents is not enough to cover all expenses, negative cash flow may result. At a time of high property appreciation, a minimal amount of negative cash flow may be acceptable; at other times, it can be disastrous for a cash-strapped property owner.

To keep cash flow high, an investor should attempt to keep operating expenses reasonably low. Such operating expenses include general building maintenance, repairs, utilities, and tenant services. At the same time, it is unwise to reduce operating expenses to the point at which building condition suffers significant deterioration, which is also likely to be reflected in its perceived desirability and treatment by tenants.

An investor often stands to make more money by investing with borrowed money, usually obtained through a mortgage loan or deed of trust loan. Low mortgage payments spread over a long period result in a higher cash flow because they allow the investor to retain more income each month. In turn, high mortgage payments contribute to a lower cash flow.

### **Investment Opportunities**

Income-producing properties include apartment and office buildings, hotels, motels, shopping centers, and industrial properties, as well as single-family residences, including condominiums. When considering the purchase of a single-family residential property, the prospective investor's *due diligence* (exploration of the benefits and drawbacks of the investment) before making a purchase should always include finding out whether or not there are any limitations on property rental.

### **Leverage**

**Leverage** is the use of borrowed money to finance an investment. As a rule, an investor can receive a maximum return from the initial investment by making a small down payment, paying a low interest rate, and spreading mortgage payments over as long a period as possible.

Leveraging a purchase by financing it provides a return that reflects the result of market forces on the entire original purchase price but one that is measured only against the actual cash invested. For example, if an investor spends \$400,000 for a rental property, makes an \$80,000 down payment, and then sells the property five years later for \$500,000, the return over five years is \$100,000. Disregarding ownership expenses, the return is not 25% of the original amount invested (\$100,000 compared with \$400,000), but 125% of the original amount invested (\$100,000 compared with \$80,000).

Risk is *directly proportionate to leverage*. A high degree of leverage translates into greater risk for the investor, as well as for the lender, because of the high ratio of borrowed money to the value of the real estate. Lower leverage results in less risk. When property values drop in an area or vacancy rates rise, or both, the highly leveraged investor may be unable to pay even the financing costs of the property.

### **Equity Buildup**

**Equity buildup** results from the addition to the amount paid as down payment on property of the principal portion of loan payments, plus any increase in property value due to appreciation. In a sense, equity buildup is

like money in the investor's bank account. This accumulated equity is not realized as cash unless the property is sold, refinanced, or exchanged. And, of course, equity is lost when a property's market value decreases, even if the property is not sold.

## Pyramiding

An effective method for real estate investors to increase their holdings without investing additional capital is through pyramiding. **Pyramiding** is the process of using one property to drive the acquisition of additional properties. Two methods of pyramiding can be used: pyramiding through sale and pyramiding through refinance.

In **pyramiding through sale**, an investor first acquires a property and then improves it for resale at a substantially higher price. The profit from the sale of the first property is used to purchase additional properties. The disadvantage of this method is that the proceeds from each sale are **subject to taxation**.

**IN PRACTICE** An investor bought a small, run-down, vacant commercial building for \$125,000. The building was refurbished over the next three months, at a cost of \$45,000. The investor then sold the property for \$375,000. The investor used the \$170,000 he cleared from the sale after remodeling costs and taxes to buy an almost-vacant, run-down, strip shopping center with eight units. He plans to spend \$100,000 renovating the units and then sell each as a tenancy in common for at least \$75,000.

The goal of **pyramiding through refinancing** is to use the value of the original property to drive the acquisition of additional properties while retaining all the properties acquired. The investor **refinances the original property and uses the proceeds of the refinance to purchase additional properties. These properties are refinanced, enabling the investor to acquire further properties.** By holding on to the properties, the investor **may delay the capital gains taxes that would result from a sale.**

**IN PRACTICE** An investor bought a single-family rental property for \$340,000, making a down payment of \$100,000. In 10 years, when the loan balance was \$190,000, the investor refinanced the property for \$600,000. She used the \$410,000 she received after the first loan was paid off to buy three more investment properties. Without adding a single dollar to her original investment capital, she now owns four investment properties.

**Note:** The forms of pyramiding described here are not related to a pyramid scheme, which is an illegal enterprise.

## Tax Benefits

Income tax laws change frequently, and some **tax advantages of owning investment real estate** are altered periodically by Congress. An investor can make a more educated and profitable real estate purchase with **professional tax advice.** The Internal Revenue Service (IRS), [www.irs.gov](http://www.irs.gov), is the best place to start for federal tax information.

## Depreciation (Cost Recovery)

**Depreciation, or cost recovery, allows an investor to recover the cost of an income-producing asset through tax deductions over the asset's useful life.** Though investors rarely purchase property without expecting it to appreciate over time, the tax laws recognize that all physical structures deteriorate (and lose value) over time. Cost recovery deductions may be taken only on personal property and improvements to land. **Land is not depreciated because it is not considered a deteriorating asset.**

**Depreciation taken periodically in equal amounts over an asset's useful life is called straight-line depreciation.** For certain property purchased before 1987, it was also possible to use an **accelerated cost recovery system**

(ACRS) to claim greater deductions in the early years of ownership, gradually reducing the amount deducted in each year of useful life. The Taxpayer Relief Act of 1997 established specific rules governing holding periods and taxability of depreciation for real property. Currently, statutory depreciation for federal tax purposes is 27.5 years for residential real estate and 39 years for commercial real estate. See [www.irs.gov/publications/p527/ch02.html](http://www.irs.gov/publications/p527/ch02.html) for more information on depreciation.

## Capital Gain

**Capital gain** is defined as the difference between the **adjusted basis** of property and its net selling price. At various times, the tax law has excluded a portion of capital gains from income tax and taxed various types of gains differently.

**Basis** A property's cost basis determines the amount of gain to be taxed. The basis of the property is the investor's initial cost of the real estate. The investor adds to the basis the cost of any physical improvements subsequently made to the property. The amount of any depreciation claimed as a tax deduction is subtracted from the basis. The result is the property's adjusted basis. When the investor sells the property, the amount by which the sales price exceeds the property's adjusted basis is the capital gain.

For example, consider an investor who purchased a single-family home for use as a **rental property**. The purchase price was \$95,000. The investor now sells the property for \$300,000. Shortly before the sale date, the investor makes \$25,000 worth of capital improvements to the home by adding a garage to the property. Depreciation of \$15,000 on the property improvements has been taken during the term of the investor's ownership. The investor will pay a broker's commission of 5% of the sales price. The investor's closing costs will be \$1,800. The capital gain is computed as follows:

|                        |                   |                  |
|------------------------|-------------------|------------------|
| Selling price          |                   | \$300,000        |
| Less:                  |                   |                  |
| 5% commission          | \$ 15,000         |                  |
| Closing costs          | + 1,800           |                  |
|                        | \$ 16,800         | - 16,800         |
| <b>Net sales price</b> |                   | <b>\$283,200</b> |
| Basis:                 |                   |                  |
| Original cost          | \$ 95,000         |                  |
| Improvements           | + 25,000          |                  |
|                        | \$120,000         |                  |
| Less:                  |                   |                  |
| Depreciation           | - 15,000          |                  |
| <b>Adjusted basis</b>  | <b>\$ 105,000</b> | <b>- 105,000</b> |
| Total capital gain     |                   | \$178,200        |

## Exchanges

Real estate investors can defer taxation of capital gains by making property exchanges. To qualify for a tax-deferred exchange, the properties involved must be *of like kind* as defined under Section 1031 of the Internal Revenue Code. One parcel of real estate is considered of like kind to another parcel of real estate, even when they have different uses (a shopping center and an industrial complex), as long as both are held for investment (not owner-occupied) and are not located in a foreign country. Real estate and personal property cannot be exchanged in a tax-deferred transaction because they are not of like kind.

Even property that has appreciated greatly since its initial purchase may be exchanged for other property, as long as both are of like kind. A property owner will incur tax liability on the transaction only if additional capital or property is also received; the additional capital or property, called **boot**, is taxed. The value of the boot is added to the basis of the property for which it is given. The tax that would have been paid on the property transferred is deferred, not eliminated. When the investor finally sells the acquired property, the capital gain will be taxed. In many states, state income taxes can also be deferred by using the exchange form of property transfer. Use of a qualified intermediary (also known as an *accommodator* or a *facilitator*) is considered a safe harbor by the IRS and is essential for a delayed exchange.

Tax-deferred exchanges are governed by strict federal requirements, and competent guidance from a tax professional is essential.

**IN PRACTICE** A person owns an apartment building with an adjusted basis of \$225,000 and a market value of \$375,000. That person exchanges the building plus \$75,000 in cash for another apartment building having a market value of \$450,000. That building has an adjusted basis of \$175,000. The owner's basis in the new building is \$300,000 (the \$225,000 basis of the building exchanged plus the \$75,000 cash boot paid), and there is no tax liability on the exchange. The previous owner of the new building must pay tax on the \$75,000 boot received and has a basis of \$175,000 (the same as the previous building) in the building now owned.

## Deductions

In addition to tax deductions for depreciation, investors may be able to deduct losses from their real estate investments. Again, tax laws can be complex and must be strictly followed. The amount of loss that may be deducted depends on whether an investor actively participates in the day-to-day management of the rental property or makes management decisions. Other factors are the amount of the loss and the source of the income from which the loss is to be deducted. Investors who do not actively participate in the management or operation of the real estate are considered passive investors. Passive investors may not use losses to offset active income derived from active participation in real estate management, wages, or income from stocks, bonds, and the like. The tax code cites specific rules for active and passive income and losses and may be subject to changes. See [www.irs.gov/publications/p925/index.html](http://www.irs.gov/publications/p925/index.html).

Certain tax credits are allowed for the renovation of older buildings, low-income housing projects, and historic property. A tax credit is a direct reduction in the tax due rather than a deduction from income before tax is computed. Tax credits encourage the revitalization of older properties and the creation of low-income housing.

## Installment Sales

A taxpayer who sells real property and receives payment on an installment basis pays tax only on the profit portion of each payment received. Interest received is taxable as ordinary income. See [www.irs.gov/taxtopics/tc705.html](http://www.irs.gov/taxtopics/tc705.html).

## Real Estate Investment Options

Various structures exist for real estate investment, including syndicates, trusts, and mortgage conduits.

### Real Estate Investment Syndicate

A real estate investment syndicate is a business venture in which people pool their resources to own or develop a particular piece of property. This structure permits people with only modest capital to invest in large-scale operations. Typical syndicate projects include highrise apartment buildings and shopping centers. Syndicate members realize some profit from rents collected on the investment, but the main return usually comes when the syndicate sells the property.

Syndicate participation can take many legal forms. For instance, syndicate members may hold property as tenants in common or as joint tenants. Various kinds of partnership, corporate, and trust ownership options are possible.

Private syndication generally involves a small group of closely associated or experienced investors.

Public syndication involves a much larger group of investors who may or may not be knowledgeable about real

estate as an investment. Any pooling of individuals' funds raises questions of securities registration under federal and state securities laws, known as *blue-sky laws*. Both federal and state laws must be followed.

### Real Estate Investment Trust

By directing their funds into a **real estate investment trust (REIT)**, real estate investors take advantage of the same tax benefits as do mutual fund investors. A real estate investment trust does not have to pay corporate income tax as long as 90% of its income is distributed to its shareholders. Certain other conditions also must be met. To qualify as a REIT, at least 75% of the trust's income must come from real estate. Investors purchase certificates in the trust, which in turn invests in real estate or mortgages (or both). Profits are distributed to investors. The National Association of Real Estate Investment Trusts has an informative site at [www.reit.com](http://www.reit.com).

### Real Estate Mortgage Investment Conduit

A real estate mortgage investment conduit (REMIC) has complex qualification, transfer, and liquidation rules. The REMIC must satisfy the asset test, which requires that after a start-up period, almost all assets be qualified mortgages and permitted investments. In addition, investors' interests may consist of only one or more classes of regular interests and a single class of residual interests. Holders of regular interests receive interest or similar payments based on either a fixed rate or a variable rate. Holders of residual interests receive distributions (if any) on a pro rata basis. Find information on REMICs at [www.freddiemac.com/mbs/html/product/remics.html](http://www.freddiemac.com/mbs/html/product/remics.html).

### Key Point Review

Investment in real estate offers the **advantages** of

- the **leverage** enabled by the use of borrowed money,
- the possibility of an above-average **rate of return**,
- greater **control** than ownership of securities,
- **tax benefits** in certain situations,
- **income (cash flow)** production, and the
- possibility of property **appreciation** (increase in value over time).

**Disadvantages** of investment in real estate include its

- high cost to acquire;
- lack of liquidity;
- need for active management or hiring of a professional property manager; and
- a high degree of risk, although an investor's ability to hold into property long term tends to reduce risk.

The **cash flow** of income property, the amount remaining after all ownership expenses have been paid, tends to make it the safest form of real estate investment. **Rent** paid by tenants is a major source of property income and depends on the property's location, physical appearance, and available amenities, but when rent does not cover property expenses, negative **cash flow results**.

**Pyramiding** is a method of using the ownership of one property to drive the acquisition of additional properties. In **pyramiding through selling**, the investor acquires a property, improves it for resale at a substantially higher

price, and then uses the profit from the sale to purchase another property. In **pyramiding through refinancing**, the investor uses the refinance proceeds of one property to purchase new properties.

The **tax benefits** of owning investment real estate depend on current tax law. **Capital gain** is the difference between the adjusted cost basis of a property and its net selling price, and it may be taxed at a more favorable rate than a taxpayer's earned income. **Adjusted cost basis** is the investor's acquisition cost, plus the cost of any physical improvements made to the property and less the amount of any **depreciation** claimed as a tax deduction.

**Depreciation (cost recovery)** allows an investor to recover the cost of an income-producing asset through tax deductions over the asset's useful life. **Losses** from the sale of a real estate investment may be deductible. **Tax credits** (direct reductions of tax owed) are available for the renovation of older buildings, low-income housing projects, and historic properties.

**Exchanges** offer investors the opportunity to **defer** the payment of taxes on profit indefinitely. Property may be **exchanged** for other **like-kind** property. The property owner is taxed only on additional capital or property received as part of the exchange (**boot**). Tax is **deferred** (not eliminated), with the capital gain taxed on the eventual sale.

A **real estate investment syndicate** is a business venture in which participants pool resources to own or develop property. Pooling of funds may involve **securities registration** under federal and state securities laws.

A **real estate investment trust (REIT)** does not pay corporate income tax as long as 90% of its income is distributed to its shareholders and other conditions are met. Restrictions and regulations on the formation and operation of REITs are complex.

A **real estate mortgage investment conduit (REMIC)** has qualification, transfer, and liquidation rules; it is notable because of the asset test requirement.

## Unit 22 Quiz

1. A small multifamily property generates \$50,000 in rental income, \$10,000 in expenses, and \$25,000 in debt service. The property appreciates about \$25,000 each year. What is the cash flow on this property?
  1. \$15,000
  2. \$25,000
  3. \$35,000
  4. \$40,000
2. Cash flow is
  1. equivalent to operating expense.
  2. the total amount of spendable income left after expenses.
  3. the use of borrowed money to finance an investment.
  4. selling costs plus depreciation.
3. The primary source of tax shelters in real estate investments comes from which accounting concept?
  1. Recapture

2. Boot
  3. Net operating income
  4. Depreciation
4. A man made an initial real estate investment of \$245,000. He subsequently made \$80,000 worth of improvements to the property. If the man subtracts depreciation from the initial cost and adds the cost of improvements, what will be the result?
1. Adjusted basis
  2. Capital gain
  3. Basis
  4. Salvage value
5. All of the following are associated with a Section 1031 exchange EXCEPT
1. boot.
  2. qualified intermediary.
  3. like kind.
  4. the elimination of capital gains tax.
6. A woman refinanced her house and used the proceeds to purchase two rental properties. This method of increasing her holdings is called
1. exchanging.
  2. pyramiding.
  3. syndicating.
  4. depreciating.
7. Which statement is TRUE about a syndicate?
1. Members must hold title as joint tenants.
  2. Most profit on the investment is realized from rents.
  3. It is a private or public business venture to own property.
  4. Blue-sky laws do not apply.
8. A real estate mortgage investment conduit (REMIC) has complex rules regarding
1. qualification.
  2. transfer.
  3. liquidation.
  4. all of these.
9. A seller is selling an investment property. The original cost of the property was \$80,000. The selling price is \$225,000. The seller paid an 8% commission and \$2,000 in closing costs. Two years ago, the

seller made \$10,000 worth of improvements to the property. Depreciation is \$15,000. What is the seller's adjusted basis in the property?

1. \$65,000
2. \$75,000
3. \$80,000
4. \$90,000

10. A seller is selling an investment property. The original cost of the property was \$800,000. The selling price is \$1,250,000. The seller paid an 8% commission and \$10,000 in closing costs. Two years ago, the seller made \$100,000 worth of improvements to the property. Depreciation is \$150,000. What is the seller's total capital gain?

1. \$390,000
2. \$450,000
3. \$800,000
4. \$900,000

11. Advantages of an investment in real estate include all of the following EXCEPT

1. the possibility of a tax-deferred exchange.
2. high liquidity.
3. the use of leverage to increase rates of return.
4. tax deductions.

12. The investor who sells property on an installment sale basis

1. is taxed on all of the gain in the year the property is sold.
2. is taxed on that part of the gain received in each year's installment payments.
3. gives the buyer all the federal income tax liability.
4. gives the buyer the privilege of deferring all the federal income tax liability.

13. One method a real estate investor may use to defer capital gains tax is to

1. sell property for cash only.
2. obtain the maximum amount of leverage.
3. exchange property for like-kind property.
4. build a reserve account for items that are likely to wear out.

14. As part of a Section 1031 exchange, an investor had to give the other party \$111,500 and a 1957 Chevrolet. The cash and car are

1. equity.
2. boot.

3. collateral.
  4. like kind.
15. Which situation would result in the highest degree of leverage?
1. Using your own funds entirely
  2. Using more of your own funds than those you borrow
  3. Using more of the funds you borrow than your own funds
  4. Using borrowed funds entirely
16. Someone looking for a tax-advantaged investment similar to a mutual fund would probably invest in a
1. real estate investment trust.
  2. general partnership.
  3. limited partnership.
  4. corporation.
17. When considering an investment in real estate, the prospective investor should consider all of the following EXCEPT
1. anticipated appreciation of the property.
  2. possible effects of inflation on the property.
  3. assessed valuation of the property.
  4. intrinsic value of the property.
18. Cash flow is a term that refers to the
1. amount of money flowing into and out of a property.
  2. bookkeeping function that accounts for the cash each day.
  3. taxes, operating expenses, and loan payments on the property.
  4. total amount of income left after all expenses have been paid.
19. Purchasing a property using leverage, refinancing it after it has appreciated, and using the cash from the refinancing to purchase additional property is one form of
1. plottage.
  2. pyramiding.
  3. consolidation.
  4. contribution.
20. The type of real estate investment that is required by federal law to distribute 90% of its income to its shareholders is the
1. general partnership.

2. limited partnership.
3. real estate investment trust.
4. time-share estate.

**Unit 22 Quiz Answers**  
Investing in Real Estate

1. a (428)
2. b (428)
3. d (430)
4. a (431)
5. d (432)
6. b (430)
7. c (433)
8. d (434)
9. b (431)
10. a (431)
11. b (426)
12. b (433)
13. c (432)
14. b (432)
15. d (429)
16. a (433)
17. c (427–429)
18. d (428)
19. b (430)
20. c (433)