



How to Use the Four Returns / Financial State Calculator

Table of Contents

Introduction	1
What are the Four Returns?	1
What is the Financial State?	2
How do I use the Financial State?	2
An Explanation of the Inputs	3
An Explanation of the Outputs	3
Conclusion	4
Further Reading	4

Introduction

The Four Returns / Financial State Calculator approximates the four returns and financial state of a rental property. You can use this calculator to:

- reproduce the examples in my book “Passive Profits: The turnkey Rental Investor’s Guide”,
- adjust input variables to model other scenarios,
- evaluate the performance of one of your properties, and
- evaluate properties you are considering purchasing.

This calculator is intended to help educate you about the financial performance of a rental property and assist you in building or modify your rental business plan for your portfolio.

What are the Four Returns?

The four returns are the distinct sources of profit generated by a rental property, including:

1. **Cash Flow:** The net monetary return received each month after servicing all expenses.

2. **Loan Paydown:** The increase in equity from reducing your mortgage balance.
3. **Appreciation:** The increase in your property's value over time.
4. **Depreciation:** The monetary return from tax savings due to depreciation.

I like to quantify the tax savings from depreciation using the effective tax rate. For example, if my tax bracket is 24% and my effective tax rate after depreciation is 4%, then depreciation reduced the rate from 24% to 4%. Furthermore, if the taxable income were \$1,000, then the tax savings would be \$200:

$$\$200 = (24\% - 4\%) \times \$1,000$$

The income tax *bill* with and without depreciation would have been \$40 and \$240, respectively:

$$\$40 = 4\% \times \$1,000$$

$$\$240 = 24\% \times \$1,000$$

The calculator determines the four returns from your inputs.

What is the Financial State?

The financials of every financial system can be reduced to:

- total revenue,
- total expenses,
- total assets, and
- total debt

These quantities are the financial state of the system. The calculator determines the financial state from your inputs.

How do I use the Financial State?

You can determine the financial state of your portfolio by summing the revenue, expenses, assets, and debt for each property. Your current financial state can be modified by acquiring new properties. Start by reviewing the financial state of your portfolio and set a clear objective. For example, if you project a taxable income for your portfolio of \$10,000, you might aim to add one or two properties to reduce your taxable income to \$0 or as close as possible. You may require that the new properties have a total ROI greater than 20%.

In this scenario, you would evaluate potential rental properties aiming to find those with an ROI > 20% and carryover losses < \$0 to reduce your taxable income. To reach a goal of \$0 taxable income, you would want the total carryover losses from the new property(s) to sum to -\$10,000.

You could establish many different objectives for your portfolio, all of which can be evaluated by examining the financial state, which is what this calculator is designed to assist you with.

An Explanation of the Inputs

The inputs for the calculator are located at the top of the Calculator sheet, highlighted in a light blue box. The inputs include:

- **Purchase Price:** The price you paid or will pay for the property.
- **Loan-to-Value Ratio:** The ratio that describes how much money the bank loaned you compared to the property's value. Enter 0 if purchasing with cash. Typical values are 75% and 80%.
- **Mortgage Interest Rate:** The interest rate of your mortgage.
- **Loan Term:** The duration of your mortgage. Typical values are 15, 20, and 30 years.
- **Closing Costs:** The expenses incurred when purchasing the property. These are added to the purchase price for an adjusted basis.
- **Operational Year:** The year you wish to evaluate; for example, year 1, 2, 3, etc. This year affects mortgage interest, principal, and appreciation calculations.
- **Appreciation Rate:** The rate at which you expect your property to increase in value.
- **Tax Bracket:** Your tax bracket according to IRS guidelines.
- **Monthly Rental Rate:** The rental rate of your property.
- **Other Income:** Additional income, such as from parking or laundry facilities.
- **Property Tax:** The annual property tax expense.
- **Property Insurance:** The annual insurance premium for the property.
- **Property Management Fee:** The management fee for your property.
- **HOA Fees:** Homeowners Association fees.
- **Maintenance:** Any maintenance fees you have incurred or anticipate.
- **Repairs and Cleaning:** Any repair or cleaning expenses incurred or anticipated.
- **Legal and Professional Fees:** Costs for evictions or legal fees associated with business setup.
- **Utilities:** Utility expenses, typically incurred between tenants.
- **Other Expenses:** Any additional expenses not listed above, such as annual LLC renewal fees.

An Explanation of the Outputs

The inputs listed above are used to estimate the outputs, which are located below the inputs in a light green box. The outputs include:

- **Invested Funds:** An estimate of your out-of-pocket costs to purchase the property

Four Returns:

- **Cash Flow:** The annual cash flow estimate and the corresponding ROI, after accounting for income tax expenses.
- **Appreciation:** The estimated annual property appreciation.
- **Loan Paydown:** The annual benefit from paying down the mortgage.
- **Total:** The sum of cash flow, appreciation, and loan paydown.
- **Effective Tax Rate:** Your actual income tax percentage, as earlier described.
- **Taxable Income:** An estimate of the income you will report to the IRS.
- **Potential Carryover Losses:** Losses from operating the property, which can offset other taxable income, subject to discussions with your CPA.
- **ROI:** The return on investment, representing the annualized return from your investment.

Financial State:

- **Revenue:** The annual revenue generated or projected for the property.
- **Assets:** The property's value after accounting for appreciation.

- **Expenses:** The total annual expenses from operating the property, broken down into categories like Fixed and Variable Expenses, Depreciation, and Income Tax.
- **Debt:** The total debt associated with the property, including the mortgage balance and any other loans.

Conclusion

The Four Returns / Financial State Calculator is one of several tools I use to evaluate existing or potential properties. It aids in evaluating different scenarios to help develop business objectives or modify the business plan. If you have any questions or comments, please reach out to me at

scott@scottastanfield.com.

Thanks for reading,

-Scott

Further Reading

1. My book, "Passive Profits: The Turnkey Rental Investor's Guide".
<https://scottastanfield.com/book/>
2. My blog: <https://scottastanfield.com/blog/>