



How to Use the Scaling Options Evaluation Calculator

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Introduction

The Scaling Options Evaluation Calculator is a tool I use to:

- quickly determine the financial state of my portfolio of rental properties,
- project the financial state after new purchases,
- project the financial state after any loan modifications (refinance, HEL, and HELOC),
- streamline the action items in my business plan for when and which properties to purchase, and
- provide a systematic approach to managing my portfolio.

What is the Financial State?

The financials of every financial system can be broken down into:

- total revenue,
- total expenses,

- total assets, and
- total debt.

These components form the financial state of the system, providing a complete overview when these quantities are known.

I like to further categorize expenses into fixed expenses, variable expenses, depreciation, and taxable income. Fixed expenses include recurring monthly costs such as property management fees, property insurance, mortgage interest, property taxes, and homeowners' association (HOA) fees. Variable expenses encompass unpredictable costs like repairs, maintenance, cleaning, utilities, and leasing fees. Depreciation covers the depreciation expense for your rental properties, while taxable income represents the earnings you must report to the IRS. Assets are divided into the total property value of your holdings and the cash you have on hand.

The calculator assesses the financial state of your portfolio based on your inputs, also computing the four profit sources of rentals: cash flow, loan paydown, appreciation, and tax savings from depreciation. The total return is expressed in dollars and as a return on investment (ROI).

What is Scaling?

Scaling refers to the expansion of your rental portfolio through new acquisitions. Funding for scaling can come from various sources including savings from your salary, private lenders, institutional lenders, equity from your existing portfolio, or a combination of these.

How do I use the Financial State to Scale?

The financial state of your property portfolio is the aggregate of the financial states of each individual property. Likewise, you can merge your personal financial state with that of your portfolio. Selecting new properties for purchase involves:

1. calculating your current financial state,
2. setting financial goals such as increasing revenue or reducing taxable income, and
3. choosing properties or other investment vehicles that help achieve your goals.

My criteria (which you should adapt to fit your goals and financial situation) are:

1. Buy a property with a total ROI greater than 20%, preferably 25%.
2. Select properties and loan products that help reduce my taxable income, aiming for a taxable income as close to \$0 as possible.

Initially, I focused on acquiring properties that generated significant cash flow, typically around 10 to 15% cash-on-cash ROI. Subsequently, I began adjusting my portfolio by scaling based on the criteria above, primarily to decrease my taxable income.

How Will my Portfolio Evolve With this Plan?

In my case, the first few properties generated approximately \$300 per month in cash flow and maintained an effective tax rate between 3% to 8%. Over time, rental property revenues tend to outpace expenses, leading to an increased effective tax rate for the portfolio. I then shifted towards purchasing properties that

provided positive cash flow yet resulted in negative taxable income. Over time, I have reduced my taxable income to \$0 while still generating substantial positive cash flow. This is a common outcome based on the historical performance of single-family rentals. I developed this calculator to quickly identify properties that align with my acquisition strategy.

An Explanation of the Inputs

The inputs for the calculator are found under the Portfolio Info, Potential Purchases, and User Input tabs. The inputs for the Scaling Options Evaluation Calculator are highlighted with black backgrounds and white text.

Portfolio Info:

- **Purchase Price:** The amount initially paid or the future cost for properties.
- **Appraised Value:** The changing valuation of your properties, often determined using tools like Zillow's Zestimate.
- **Loan Balance:** The remaining balance owed to the lender, available on your mortgage statement.
- **Interest Rate:** The interest rate applied to your mortgage.
- **Rental Rate:** The monthly rent charged for your properties.
- **Fixed Expenses:** The annual fixed costs associated with your property.
- **Variable Expenses:** The annual variable costs linked to your property.
- **Years Owned:** The duration of property ownership.
- **Investment Funds:** The total capital spent to secure the property, including down payments.

Potential Purchases:

- **Purchase Price:** The listed price for potential acquisitions.
- **Rental Rate:** The anticipated monthly rent for these properties.
- **Projected Appreciation Rate:** The expected increase in property value, with the US average historically around 3.8%. I typically estimate this rate using Zillow.
- **Property Tax:** The yearly tax burden for the property.
- **Property Insurance:** The annual premium for property insurance.
- **Loan-to-Value Ratio:** The percentage of the property's value financed through a loan. Input 0 if purchasing outright. Standard ratios are 75% and 80%.
- **Interest Rate:** The interest rate expected for the property's mortgage.
- **Loan Term:** The length of the mortgage, usually 15, 20, or 30 years.
- **Variable Expenses:** While I typically exclude maintenance and repairs for new acquisitions, this input is for those preferring to include such costs.

Loan Product Info and General Inputs:

- **Tax Bracket:** Your IRS-defined tax bracket.
- **Projected Appreciation Rate:** The appreciation rate for your current portfolio.
- **Cash From Portfolio to Invest:** The liquidity available from your portfolio's cash flow.
- **Additional Cash to Invest:** Personal funds you intend to invest, tracked separately for ROI calculations.
- **Interest Rate:** The prevailing rate for refinancing options.
- **Closing Costs:** The expenses incurred during property acquisition, added to the purchase cost for adjusted basis calculations.

An Explanation of the Outputs

The calculator uses the aforementioned inputs to determine the following outputs, which are highlighted with white backgrounds and black text:

- **Loan-to-Value Ratio of Your Portfolio:** Indicates equity availability for refinancing or securing a HEL or HELOC.
- **Loan-to-Value Ratio of Lowest Property:** Identifies potential for refinancing based on equity.
- **Financial State of Your Existing Portfolio:** Provides a baseline for comparison.
- **Estimated Investment Funds:** Estimates available funds from cash-out refinancing, HELs, and HELOCs.
- **Financial State for Refinancing without Purchasing Properties:** Displays financial outcomes of replacing current mortgages with new ones.
- **Financial State for Cash-Out Refinance with Purchasing New Properties:** Shows portfolio status post-refinance and new property acquisitions.
- **Financial State for HEL with Purchasing New Property(s):** Details portfolio changes after obtaining a HEL and investing in new properties.
- **Financial State for HELOC with Purchasing New Property(s):** Outlines adjustments post-HELOC and new investments.

Four Returns:

- **Cash Flow:** Annual cash flow projections and corresponding ROI, post-tax.
- **Appreciation:** Estimated annual property value increase.
- **Loan Paydown:** Yearly benefits from mortgage reduction.
- **Total:** Aggregate of cash flow, appreciation, and loan paydown.
- **Effective Tax Rate:** The real percentage of income tax paid.
- **Taxable Income:** Estimated reportable income for IRS purposes.
- **Carryover Losses:** Operational losses, potentially offsetting other income.
- **ROI:** Annualized return on your investment.

Financial State:

- **Revenue:** Annual income generated or anticipated from the property.
- **Assets:** Property valuation post-appreciation.
- **Expenses:** Annual operational costs, subdivided into various categories.
- **Debt:** Total property-related indebtedness, including mortgages and other loans.

Conclusion

The Scaling Options Evaluation Calculator is a vital tool for implementing scaling strategies within my business plan. Accompanying this resource, I utilize a detailed checklist outlining the step-by-step scaling process, available in the appendix of “Passive Profits: The Turnkey Rental Investor’s Guide.” For readers of the book, this calculator can reproduce the results discussed in Example 29.5. If you have any queries or feedback, please contact me at:

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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/>