Passive Real Estate Investing

A Guide for Doctors

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Practice medicine on your own terms.

INTRODUCTION

Passive Income

What would it take to entirely replace your paycheck with passive income?

When we say passive income, we're referring to money that comes in without you needing to labor or give a service to earn it.

You can sleep soundly at night or take a long vacation knowing that you are still earning money and that revenue is being generated for you without your involvement.

Making money while sleeping has a great ring to it, and who wouldn't want to make some additional cash while doing anything else, such as playing with their kids or watching a game?

Most "passive income" ideas, on the other hand, will not actually meet this criteria. You won't want to take on a second job that you don't have time for because you're already overworked.

The majority of passive income concepts necessitate some effort on your part.

The 4% Rule

Conventional Retirement Planning

The 4 percent rule is used by most financial advisors when planning for retirement. The rule states that one should withdraw 4% of their total retirement assets (i.e., their 'nest egg') each year in order to provide a constant stream of annual income sufficient to pay living expenses.

Let us assume you are drawing a mid-career doctor's salary of $300,000. In order to be able to withdraw that amount, we apply the 4% rule as follows:

$300,000 divided by 4% = $7,500,000

As a result, you'd need to save $7.5 million to replace your income in retirement.

This rule contains a lot of assumptions and flaws.

The 4% rule is intended to provide retirees with a high level of assurance that their savings would survive for a 30-year retirement, which might begin as early as age 65. You'd prefer to be able to replace your income much sooner.

It also assumes that stocks and bonds earn the same historical returns as they have in the past. With present stock valuations at all-time highs and bond interest rates at all-time lows, returns are unlikely to match previous historical norms. As a result, a recent Morningstar research advises a 3.3 percent withdrawal rate in retirement. (https://www.morningstar.com/lp/the-state-of-retirementincome)

For our $300,000 example, this translates to a nest egg of $9,090,909!

If you want to retire early or reduce your work hours in your career or practice, this will not work. Even if you worked full-time until you were 65, according to current trends of longer life expectancy, you would most likely have a retirement period of more than 30 years, putting you at risk of running out of money before you die. Either that or you reduce your lifestyle expenses.

We didn't go through 8-10 years of college and residency training, racking up tens of thousands of dollars in debt, working many hours a week for many years, only to live out our senior years on a shoestring budget.

The traditional financial planning model of saving enough money for retirement, investing it in the stock market, hoping that it grows to a certain amount (in this case, over $9 million), and hoping that you don't run out of money before you die is already a difficult task to accomplish by the age of 65, let alone replace your income anytime soon.

REAL ESTATE INVESTING

What if there was a way to establish a portfolio that provides a stream of tax-free passive income that could equal your pay over the next 30 years without having to set away a ludicrous amount of money?

Real estate is one way to accomplish this.

When most people think of real estate investing, they imagine buying homes or condominiums and either flipping them for a profit, renting them out, or living in or holding them for a few years in the hopes of selling them for a profit in the future. While these approaches are excellent for accumulating wealth and earning money, they are not passive.

Home flipping is glamorized on HGTV shows, with gorgeous 'wow factor' finishes and potentially large profits, but it also comes with sweat equity, setbacks, stress, and cost overruns.

Not to mention the taxes on the earnings from selling the properties, which, in the case of the physician investor described above, can range from 15% capital gains to being taxed as ordinary income (in this example case, in the 35 percent marginal tax rate). So, if you made a $100,000 profit on a property sale, you'd have to pay $15,000 to $35,000 in taxes, not to mention a 6% commission to the real estate brokers.

Long-term rental property ownership, whether for short- or long-term tenants, is not a passive venture, even if a property manager is used.

Issues develop with the properties and the tenants, requiring you to spend time and money in addition to the initial investment to acquire, improve, and manage the property.

The investor must find the property, deal with agents and their commissions, lawyers, property taxes, utility bills, the city, insurance, and upkeep expenditures in both flipping and long-term holding situations. In some ways, it could feel like you're taking on a new job.

PASSIVE INVESTING IN REAL ESTATE SYNDICATIONS

Participating in syndications is a feasible option to truly passively invest in real estate without having to put in a lot of time and effort, and with a lower financial barrier to entry than buying your own properties.

The pooling of cash from a group of investors to invest in a real estate opportunity, which is usually the acquisition of a property, is known as real estate syndication. This allows a larger property (such as an apartment building) to be purchased that one person or a small group of partners might not be able to handle on their own.

Sponsors, who are sometimes known as General Partners (GPs) depending on the legal form, organize or manage it on behalf of the investors. They are in charge of locating the property, securing and backing funding, purchasing it, and administering it during the ownership time. They're also in charge of making sure that investors get their fair portion of the earnings from their investments.

Limited Partners (LPs) are a term used to describe passive investors.

They are only responsible for providing the funds for the transaction, and their shares give them partial ownership of the asset. They are spared from the responsibility for the upkeep, costs, and maintenance of the properties. They are also not personally liable for any losses above the initial amount they invested in most syndication models.

Passive investors in an apartment complex in a real estate syndication can expect to earn **8-10 percent annual cash flow** on average (distributed monthly, quarterly, or semi-annually). In five years, you can expect an **80-100 percent overall return**, which comprises a combination of: annual cash flow; and gains due to property appreciation on sale.

TAX FREE INCOME

Unlike dividends from equities, the cash flow created by a real estate investment is usually tax-free. The contents of the property (for example, building contents) are treated as depreciating assets since they have a finite life period and must be replaced.

This depreciation is therefore treated as a ‘paper loss,’ meaning that it is simply a loss on paper and not in reality, and it is used to balance the income created from earnings profits when filing taxes. This is a feature that is unique to real estate.

In a syndication, the sponsors pass on the tax savings to the limited partners, who are then required to file a Schedule K-1, which is an IRS-mandated yearly report detailing each partner’s share of the partnership’s earnings, losses, deductions, and credits.

CASE EXAMPLE

Mid Career Doctor - “Dr. Mom.”

Let’s look at our doctor, “Dr. Mom,” who **earns $300,000** each year.

Assume she pays a **35 percent federal** marginal tax rate (for head of family or single filers) and lives in Los Angeles, California.

This effectively leaves her with a net income of **$186,301 after taxes**.

Let’s pretend she is mid-careers (i.e. in her 40s) and has saved **$400,000** to invest.

The assumptions for this example are that the average annual return on all holdings in all real estate syndication investments is 9%, with a total return of 90% over a 5-year period, translating to a 45 percent return on principal in addition to their principal (e.g.: original investment)

Dr. Mom. starts by investing their original $400,000 into a basket of different offerings yielding the average return and terms.

She will continue to invest $24,000 each year ($2000 per month) from her regular wages for the following ten years.

The cash flow created from her passive investments, along with the money set aside the previous year, is invested in fresh syndicated products that generate the same average returns each year.

Furthermore, each time the investment money completes a full cycle (in this case, 5 years), the original principal as well as profits from the sale are reinvested the following year into more syndicated opportunities.

The year by year breakdown of their investment portfolio is as follows:

Year	Cash Flow from Investments	Total Portfolio Value
0	$0	$400,000
1	$36,000	$460,000
2	$41,400	$525,400
3	$47,286	$596,686
4	$53,701	$674,387
5	$60,694	$1,339,081
6	$84,516	$1,534,597
7	$96,712	$1,750,139
8	$110,224	$1,987,727
9	$125,191	$2,249,585
10	$141,765	$3,379,156
11	$183,604	$3,846,258
12	$210,207	$4,369,001
13	$237,855	$4,951,359
14	$268,885	$5,559,936
15	$303,689	$7,541,503
16	$318,397	$8,595,569

Dr. Mom. has a portfolio that generates nearly enough cash flow to match her after-tax income after only ten years. Furthermore, the total portfolio value has climbed to just under $3.4 million from the initial $400,000 investment. This is a significant increase.

After 15 years, the tax-free passive income generated by this technique surpasses $300,000 (almost double the after-tax income from their usual pay), and the overall portfolio has grown to over $7.5 million, more than double from the 10-year milestone. Please note that contributions to the portfolio were stopped at the ten-year mark.

This doctor might easily retire in ten years if they merely collected the'mailbox money' generated by their passive real estate syndications investments. This is done without the headaches and time commitments that come with active property ownership.

Her sole responsibility is to correctly identify and vet the offers, as well as their sponsors, and to file the reports (i.e., the Schedule K-1 provided by the sponsors to the LPs) with their yearly tax return.

In the course of a year, this amounts to only a few hours.

DISCUSSION

In this example, some crucial assumptions are made.

For starters, the entire portfolio was subjected to a single average return of 9% per year, a total return of 90%, and a 5-year hold period. While these assumptions are cautious for this asset class, some particular products underperform while others outperform by a significant margin.

Overachievers can create higher cash flows, higher total returns, or accomplish their goal total return in a faster time frame, returning the principle plus profits to their investors in fewer than five years. There are deals currently being run by colleagues of mine that have reached or exceeded their target returns and have finished their cycle in as little as 36 months.

Also expected is that the Dr. Mom has $400,000 to invest right away, which may not be the case for everyone. In any case, this example demonstrates that there is a reasonable and less hazardous road to financial independence and income replacement in a pretty short period of time. Dr. Mom, for example, began investing in her mid-40s and is now able to retire well before the age of 60.

And they just required a ten-year investment of $640,000. In contrast, assuming an optimistic 5% annual return on investment and taking 4% distributions in retirement, they would have to save a staggering $67,000 per year for the next 30 years (totaling over $2.4 million) just to get to an annual taxable income in retirement equivalent to their salary using conventional financial planning strategies, with the original assumed $400,000 available to invest.

COMPARISONS

Real Estate Syndications vs. Other Asset Classes

Why don't most people know about these less risky real estate syndications that generate higher returns than the more risky stocks and bonds?

To begin with, these assets have always existed, but they have hitherto only been available to the exceedingly rich. The acquisition of the Empire State Building for $65 million in the 1960s was a significant syndication, with many investors paying merely $10,000 each.

Wall Street has dominated the financial industry, leading many to assume that its platforms, which only comprise equities, bonds, mutual funds, and exchange traded funds, are the only and safe method to build wealth. Most employer-sponsored retirement plans only allow you to invest in these platforms. Furthermore, financial advisers are paid based on the size of your portfolio within their platforms (assets under management), motivating them to invest as much of your money as possible on their preferred platform with these limited options.

Real Estate vs. Stocks

Because there are still so many inherent inefficiencies in real estate, whether in terms of asset quality or property operation, it is still possible for investors to produce higher returns and profits by enhancing these assets, increasing income, and thereby increasing the value of the properties. Stocks do not have the same inefficiencies.

People bid up and down on publicly listed equities depending on their own and the market's whims and sentiment. While it is impossible to foresee the value of a stock, it is possible to predict the value of an apartment building, and **a real estate syndication sponsor can predictably increase the revenue and value of a property.**

At the time of writing, Apple's stock is trading at 28 times earnings, while Tesla's stock is trading at 351 times earnings. The disparity in these firms' values has no rhyme or reason, and one could argue that Apple is a better (and probably more successful) company than Tesla.

The value of a real estate property, on the other hand, is **directly proportional to its net operating income (NOI)**, which is the equal of an apartment's profit. We know that a typical middle-class apartment complex in Houston, Texas sells for around 20 times its net operating income, and that this applies to all comparable properties in the market. The same cannot be said for stocks, as shown above.

Cryptocurrencies

Cryptocurrencies are all the rage these days, with Bitcoin in particular generating 70x returns in the last five years. Would you risk your entire portfolio (or a significant portion of it) on an asset class that generates no passive income, has no predictable method of assessing its value, can fluctuate in value by as much as 50-70 percent multiple times each year, and can yet go down to zero?

Other Real Estate Investments

Single-family homes behave more like stocks, with their prices fluctuating according to market whims and mood, as well as supply and demand. There is no other way to predict the value of them but to compare them to similar properties in the area.

REITs (Real Estate Investment Trusts), which hold real estate in corporations with publicly traded shares, operate similarly to stocks, fluctuating based on market whims and sentiment. They also lack the tax benefits that real estate syndications and direct ownership of real estate provide.

CONCLUSION

Do you want to rely on traditional financial planning, which invests solely in stocks, bonds, and mutual funds in the hopes of having enough money in your nest egg someday in the distant future, and not running out of money before you die?

Or do you want to look into other ways to earn really passive income so that you can scale back, or perhaps retire from your job and practice, and have the leisure to do the things that really important outside of work, on your own terms, much before the traditional 'retirement age' of 65?

It's entirely up to you.

If you wish to replace your income in a passive manner, you should educate yourself on and investigate other channels for investing your money in less hazardous and unpredictable assets that consistently create cash flow tax-free.

If you would like to learn more about passively investing in real estate syndications:

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About the Author

Dr. Rajkumar Venkatramani is a Pediatric Oncologist and internationally renowned cancer researcher. He has published more than 100 academic papers and book chapters. He lectures and presents at national and international meetings.

He is the founder and principal at REIDOC Capital, a boutique investment firm that helps doctors invest in real estate. His portfolio includes more than 6 properties and 685 doors. In his free time, he takes care of his two children and volunteers his expertise for care of children with cancer in low- and middle-income countries.