Case Study #2:

Rev. Oct. 2020

Jane Radcliffe:

- is considering the purchase of a commercial condo.
- is willing to pay $280,000
- will pay $3,150 in closing costs.
- is advised by his tax advisor to attribute 70% of the purchase price and closing costs to the improvement (building) and 30% of the purchase price to the land. The building is commercial so its depreciable life is 39 years.
- is taking out a first mortgage of $210,000 @ 5% for 30 years (25% down).
- will pay approximately $10,500 yearly interest on the loan and $3,028 yearly toward principal. He will not have any other financing on this property.
- estimates the following expenses for this commercial condo:
    - Monthly rent (potential): $3,000
    - Vacancy allowance: 8%
    - Property taxes: 6,800 yearly
    - Insurance: $500 (just for the interior)
    - Utilities: paid by tenants
    - Maintenance/Assessments: $6,000 yearly
    - Parking: $900
- is in the 35% tax bracket. His capital gain tax will be 20%.
- plans to hold on to this investment for 5 years.
- expects that the property will appreciate by 3% each year.
- expects that selling expenses (commissions, etc.) five years from now will be 6% of the sales price.
- thinks that he can find an alternative investment yielding a before-tax investment rate of 3% (for example, a taxable bond) right now.
- advises that the capital gains tax for people in his marginal tax bracket is 20%.
- calculates that the mortgage balance in five years is $192,840.