

# Real Estate Term

## ASSESSMENT GUIDE

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## What is it?

Real Estate Term (Rt) indicates the number of years a client could live on their current real estate equity (assuming no asset growth/decline).

### CALCULATION

$$\frac{\text{Real Estate Equity}}{\text{Annual Living Expenses}} = \text{Real Estate Term}$$



Real estate equity includes any homes or investment properties less related debts.

**Example:** assuming a client has a \$500,000 home with a \$300,000 mortgage, and they spend \$100,000 annually, then their Real Estate Term is 2.0.



# Why is it important?

For generations real estate has been touted as one of the best solutions to achieve financial independence. The reality is that few people truly understand the real implications that owning and maintaining physical real estate will have on their spending and overall financial health.

As a significant part of many clients' net worth, real estate stands as a major consideration when determining if a client is prepared for financial independence. Further, understanding the allocation of real estate assets (i.e. personal-use property vs. investment property) will have major implications on the success of a client's retirement plan.

# How do I use it?

The following process can be used to assess whether a client's Real Estate Term is appropriate or if they need to make improvements:

- 1. Accuracy:** ensure the accuracy of the Real Estate Term inputs.
- 1. Assessment:** assess whether the given Real Estate Term is appropriate.
- 1. Improvement:** Identify areas of improvement

## STEP 1

### Score Accuracy

To calculate Real Estate Term, all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, you can reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.



## STEP 2

# Score Assessment

*Note: While it's important to understand a client's Real Estate Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically. See the Total Term assessment guide for more details.*

Generally, a client with a heavier allocation toward Real Estate assets as part of their total net worth will have less flexibility in their retirement strategies.

Additionally, age is the only clear factor that correlates directly with a client's Real Estate Term because as clients age, their equity will grow as they pay down their real estate debts.

Be sure you know the composition of their real estate holdings. Sometimes clients have real estate they call their vacation home, but it is really more of an investment property (i.e. they are happy to part ways with it). Other times, they would not sell it for any reason. These details will help you better detail the amount of true liquidity behind their Total Term score.

## STEP 3

# Score Improvement

Understanding the objective of each real estate property is essential to making improvements. Consider the following questions for each type of property

### **For personal-use real estate:**

- How much of the client's Real Estate Term is composed of their primary residence?
- When considering a client's retirement readiness, and if



Rt is primarily composed of the primary residence, you should exclude the client's Rt score from Total Term. This gives you a more accurate representation of where they stand.

#### For Investment real estate:

- Should the client invest in real estate?
  - What are their real estate goals?
  - What type of property should the client invest in?
  - Does the client understand the implications of investing in real estate?
- Considering the client's total asset mix, do they need to focus on increasing liquidity before investing in additional real estate?

## Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

**Example:** Given a client in their mid-50s, and the following information, you begin your assessment of whether a client's Qualified Term is appropriate.



#### Real Estate Term Composition:

- 6.0 Primary Residence
- 7.0 Vacation Property
- 8.0 Investment Rental Property



**Step 1 - Determine Score Appropriateness:** By first reviewing the client's asset mix, you determine their allocation toward real estate is too high for their current needs. Additionally, the majority of their real estate composition is in personal-use properties.

**Step 2 - Identify Improvements:** After discussing the objectives of each property, you learn the client does not enjoy their vacation property, and would be happy to rent it out or sell it to increase their total liquidity. You'll discuss with your clients the implications of selling the property versus keeping it for rental income.

If they sell the property their Liquid Term score will improve and their spending will decrease due to no more maintenance expenses. If they keep the property and rent it out, you're essentially shifting their Rt allocation from personal-use to investment property, justifying the high real estate exposure with their Liquid Term and spending remaining the same.