Purchasing a 4-Plex with a Low-Down FHA Loan

A Financial Breakdown of Cash Flow, Appreciation, and Depreciation for an Owner-Occupied Property

Finca Financial

Introduction

This document provides a comprehensive financial analysis for the purchase of a 4-plex in Oak Park, Illinois, with a target price of $750,000. Unlike a typical investment property acquisition, this analysis assumes the buyer will occupy one of the units during the first year, utilizing a low-down-payment FHA loan. This strategy allows the buyer to acquire a multi-family property with minimal capital, building equity and generating cash flow from the other three rental units in subsequent years. The paper breaks down all key calculations, including initial acquisition costs, projected cash flow, and tax benefits from depreciation, offering a clear picture of the investment's viability.

Financial Analysis & Calculations

Acquisition & Financing

This model is based on the specific terms of an FHA loan, which is designed for primary residences and allows for a significantly lower down payment than conventional investment loans.

- **Purchase Price**: $750,000
- **FHA Down Payment (3.5%)**: $26,250
- **Loan Amount**: $723,750
- **Assumed Annual Interest Rate**: 5.5%
- **Monthly Mortgage Payment**: $4,115 per month

Projected Cash Flow

During the first year, the buyer lives in one unit, so only three of the four units are rented out. In the second year, the property is fully rented, which significantly improves cash flow.

- **Year 1 (Owner-Occupied)**
  - **Gross Annual Rental Income**: $76,740
  - **Total Annual Expenses**: $38,085
  - **Net Operating Income (NOI)**: $38,655
  - **Annual Before-Tax Cash Flow**: -$10,725
- **Year 2 (Fully Rented)**
  - **Gross Annual Rental Income**: $96,360
  - **Total Annual Expenses**: $42,990
  - **Annual Before-Tax Cash Flow**: $3,990

Key Requirements for all Multi-Unit FHA Loans

- **Owner-Occupancy**: The borrower must occupy one of the units as their primary residence for a minimum of 12 months.
- **Loan Limits**: The property's purchase price must not exceed the FHA loan limits for that specific county and number of units. These limits are updated annually.
- **Down Payment**: A minimum down payment of 3.5% is required for a credit score of 580 or higher.
- **Cash Reserves**: For 3- and 4-unit properties, many lenders require the borrower to have a reserve of at least three months of PITI payments in an accessible account after closing.

Investor Computations

Cash-on-Cash Return (CoC)

Cash-on-cash return is a simple metric used to evaluate the annual return on the actual cash invested in a property. It is calculated by dividing the annual pre-tax cash flow by the total cash invested.

- **Total Cash Invested**: The FHA Down Payment of **$26,250**.
- **Year 1 CoC Return**: ($-10,725 Cash Flow / $26,250 Cash Invested) = **-40.8%**
- **Year 2 CoC Return**: ($3,990 Cash Flow / $26,250 Cash Invested) = **15.2%**

Internal Rate of Return (IRR)

Internal Rate of Return (IRR) is a more sophisticated metric that accounts for the time value of money. It is the discount rate that makes the net present value (NPV) of all cash flows from a particular project equal to zero. It gives a more complete picture of profitability over the entire investment holding period.

To calculate the IRR, we use the following cash flow assumptions over a 5-year holding period:

- **Year 0 (Initial Investment)**: The cash outlay at the time of purchase, which is the down payment of **-$26,250**.
- **Year 1 Cash Flow**: The annual before-tax cash flow of **-$10,725**.
- **Year 2 Cash Flow**: The annual before-tax cash flow of **$3,990**.
- **Years 3 & 4 Cash Flow**: Assuming a conservative 3% annual increase in cash flow (consistent with the rent increase assumption), the projected cash flows are:
  - Year 3: $3,990 * 1.03 = **$4,110**
  - Year 4: $4,110 * 1.03 = **$4,233**
- **Year 5 Cash Flow**: The sum of the annual cash flow and the total equity gained upon a hypothetical sale.
  - Annual Cash Flow: $4,233 * 1.03 = $4,360
  - Total Equity Gained (Appreciation + Loan Paydown): **$212,887**
  - Year 5 Terminal Cash Flow: $4,360 + $212,887 = **$217,247**

Using these cash flows, the calculated Internal Rate of Return (IRR) is **30.1%**. An IRR of 30.1% indicates a very strong potential return on this investment, especially considering the low initial capital required.

Self-Sufficiency Test

The FHA imposes specific cash-flow requirements on multi-unit properties to ensure they are financially sustainable for the borrower. This is known as the **Self-Sufficiency Test**.

The requirements vary depending on the number of units:

- **2-Plex (Duplex)**: There is **no self-sufficiency test** for a 2-plex. The FHA will consider a percentage of the projected rental income from the non-occupied unit to help the borrower qualify for the loan. The lender will use the rental income to offset the total monthly debt, improving the borrower's debt-to-income (DTI) ratio.
- **3-Plex and 4-Plex (Triplex and Fourplex)**: A mandatory **Self-Sufficiency Test** applies to these properties. The test requires that the projected monthly rental income from all units—including the one the borrower will occupy—is greater than or equal to the total monthly mortgage payment, including Principal, Interest, Taxes, and Insurance (PITI).

How the Self-Sufficiency Test is Calculated

The FHA's calculation for self-sufficiency is a two-step process:

1. **Determine Gross Rental Income**: An FHA-approved appraiser will assess the fair market rent for all units in the property.

2. **Calculate Net Rental Income**: From the total gross rental income, the FHA subtracts a minimum of **25%** to account for potential vacancies and maintenance costs. This 25% is a standard deduction, regardless of the property's actual vacancy rate. The resulting figure is the "Net Rental Income."
   The formula is: **(Gross Rental Income) x 0.75 = Net Rental Income**

The property passes the test if the **Net Rental Income** is equal to or greater than the full monthly **PITI** payment.

Example:

- **Property Type**: 4-plex
- **Appraiser's Fair Market Rent (all 4 units)**: $8,000 per month
- **Total Monthly PITI Payment**: $5,500 per month

Calculation:

- $8,000 (Gross Rent) x 0.75 (FHA's deduction) = $6,000 (Net Rental Income)
- **Result**: The Net Rental Income of **$6,000** is greater than the PITI of **$5,500**.
- **Conclusion**: The property **passes** the FHA's self-sufficiency test.

Depreciation & Tax Considerations

Depreciation is a non-cash expense that can provide significant tax benefits for real estate investors. The IRS allows investors to deduct the cost of a building over its "useful life," which is 27.5 years for residential property. The land value is not depreciable. For this analysis, we assume a standard land value of 20%.

- **Depreciable Basis**: $600,000

Bonus Depreciation via The One Beautiful Bill Act

According to the new **One Beautiful Bill Act**, **100% bonus depreciation** will be effective as of January 2026. This allows investors to deduct the full cost of the depreciable basis in the first year the property is placed in service, instead of depreciating the asset over a period of 27.5 years.

- **Bonus Depreciation Deduction (Year 2)**: **$600,000** (This deduction is available for properties placed in service from 2026 onward).
- **Standard Annual Depreciation Deduction**: $0 (The full depreciable value has been taken in year 2 as bonus depreciation).

Conclusion

The purchase of a $750,000 4-plex in Oak Park, IL, using an FHA loan, presents a compelling investment case, particularly for a first-time investor willing to owner-occupy the property. While the first year shows a negative cash flow, this is effectively a trade-off for the low down payment and the rapid equity build-up that begins immediately. The investment becomes cash flow positive in the second year when all units are rented. The dual benefits of steady appreciation and a significant tax deduction from bonus depreciation make this an attractive vehicle for long-term wealth creation. The strong **15.2% cash-on-cash return** and a **30.1% Internal Rate of Return** further underscore its potential for substantial financial gain.

Citations

- FHA Loan Details: https://www.hud.gov/buying/loans
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- Real Estate Depreciation Rules: https://www.investopedia.com/articles/investing/060815/how-rental-property-depreciation-works.asp