

The Landlord System

System For Real Estate Automation & Profit

Deal Evaluation Cheat Sheet

TERMS

Gross Income: This is the money that comes in each month from the tenants, including rent payments, late fees, laundry, etc. Example: \$2,500

Debt Service: This is your monthly mortgage payment(s) on the property. Example: \$650

Operating Expenses: These are all of the property's regular operational expenses, such as utilities, property management, landscaping service, insurance, property taxes, handyman labor, supplies, cleaning lady, etc. This does not include debt service. Example: \$1,325

Value: This is the dollar amount that someone believes the property is worth. It may be the listing price generated by the seller, or the offer amount given by a buyer. Example: \$141,000

FORMULAS

Net Operating Income (NOI): This is a measure of the net income that is generated by the operations of the property. This does not take your debt service into account, because this will be different for each investor, depending on their situation.

NOI = Gross Income minus Operating Expenses (not including debt service)

Example: \$1,175 = \$2,500 - \$1,325 per month

Cap Rate (Capitalization Rate): This is how commercial property and multi-unit apartment buildings are typically valued. The higher the cap rate percentage, the better the deal for the buyer. This can be used as a guideline for any property.

Cap Rate % = Total Annual NOI divided by Purchase Price

Example: 9.7% = \$14,100 ÷ \$145,000

Cash Flow: The amount of money, positive or negative, that you have at the end of a particular term (month, year).

Cash Flow = Rental Income minus Operating Expenses minus Debt Service

Example: \$525 = \$2,500 - \$1,325 - \$650 per month

Cash on Cash Return (COCR, CoCR, COCROI): This is the return on investment you earn on the money you originally put into the investment (down payment and closing costs). Many investors set a minimum COCR as a criteria for buying a property because this measure can easily be compared to the yield your money would make if you put it into another investment (such as the stock market or a different property).

COCR % = Annual Cash Flow divided by Cash Outlay at closing

Example: $20.3\% = \$6,300 \div \$31,000$

HOW TO APPLY THE FORMULAS

Once you establish your own criteria for what defines a “good deal” to you, you can play with the numbers and determine if you will make an offer, and for how much. For example, if you decide your lowest acceptable Cap Rate is 10%, and you have the Gross Income and Operating Expenses from the seller, you can derive your offer:

Total Annual NOI divided by Cap Rate = Offer Amount

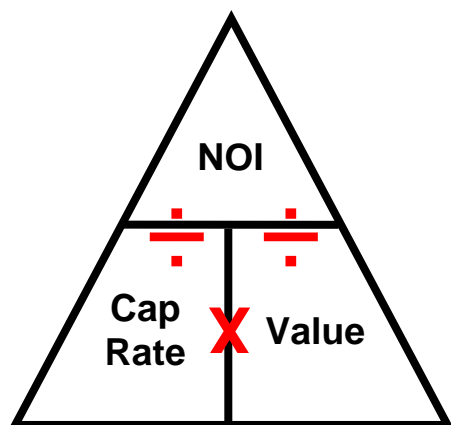
Example: $\$14,100 \div .10 = \$141,000$

If you are selling a property, research what cap rates are typical for your type of property in your area. A realtor should be able to tell you. Calculate what your NOI is, divide it by the cap rate you want to use (let’s use 9%), and you derive your asking price:

Total Annual NOI divided by Cap Rate = Offer Amount

Example: $\$14,100 \div .09 = \$156,667$

You can remember the following diagram and use it to evaluate deals within seconds:



Take your finger and cover up whichever of the three values in the triangle you want to calculate. Use the two values that remain exposed, along with the operator (multiplication or division symbol) that you see between them, and perform the calculation.

Example: You’re looking at a deal and you want to know what the cap rate is. Cover up the Cap Rate section of the triangle with your finger and you will see that you need to take the NOI and divide it by the Value. $\text{NOI} \div \text{Value} = \text{Cap Rate}$.

Example: You want to sell your property and you’re not sure what your asking price will be. Cover up the Value section of the triangle with your finger and you will see that you need to divide the NOI by the Cap Rate that is used in your area. $\text{NOI} \div \text{Cap Rate} = \text{Value}$

Example: You know what cap rates typically are in your area, and you know the asking price for a piece of property you’re interested in. Now you want to know what the maximum NOI should be for this property. Cover up the NOI section of the triangle with your finger and you will see that you need to multiply the Cap Rate by the Value (asking price). $\text{Cap Rate} \times \text{Value} = \text{NOI}$