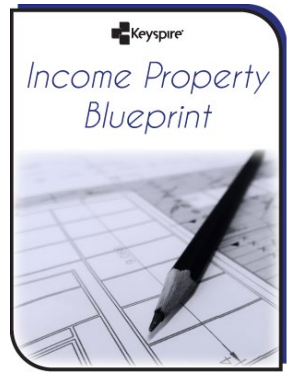


Module 4 – Lesson 3

Buy and Hold – The 4 Ways to Win

RESULT

Week 44

One of the key components of being a confident real estate investor is knowing how to perform calculations on investment properties. By knowing your Return on Investment (ROI), you can determine if a property aligns with your investing goals.

An example has been provided below on how to calculate the ROI. Following the example, there are two activities to complete. Work on this activity as many times as you require to feel confident about this skill.

Calculating ROI Example

Purchase Price:	$349,000	**Passive Appreciation:**	3%
Down Payment 20%:	$69,800	**Principal Recapture:**	$5,954.24
Gross Annual Rental Income:	$26,400	**Active Appreciation:**	$0
Total Expenses:	$23,566.40	**Vacancy Rate:**	5%

Note: All Numbers Annual. Principal Recapture based on 30 year amortization, monthly payments at 2.89%

1. **Determine Cash Flow**

Vacancy Allowance = Gross Annual Rental Income x Vacancy Rate
= $26,400 x 0.05
= $1320

Gross Operating Income = Gross Annual Rental Income - Vacancy Allowance
= $26,400 - $1320
= $25,080

Cash Flow = Gross Operating Income - Total Expenses
= $25,080 - $23,566,40
= $1,513.60

2. **Determine ROI**

$$\textbf{ROI} = \frac{\text{Passive Appreciation + Cash Flow + Principal Recapture + Active Appreciation}}{\text{Cash Invested}}$$

$$= \frac{\$10,470.00 + \$1,513.60 + \$5,954.24 + \$0}{\$69,800.00}$$

$$= \frac{\$17,937.84}{\$69,800.00}$$

$$= \textbf{25.69\%}$$

Practice Activity 1

Purchase Price:	$424,000	**Passive Appreciation:**	3%
Down Payment 20%:	$84,800	**Principal Recapture:**	$7,233.91
Gross Annual Rental Income:	$35,400	**Active Appreciation:**	$0
Total Expenses:	$32,557.15	**Vacancy Rate:**	5%

Note: All Numbers Annual. Principal Recapture based on 30 year amortization, monthly payments at 2.89%

1. Determine Cash Flow

Vacancy Allowance = Gross Annual Rental Income x Vacancy Rate

= $__________ x __________

= $__________

Gross Operating Income = Gross Annual Rental Income - Vacancy Allowance

= $__________ - $__________

= $__________

Cash Flow = Gross Operating Income - Total Expenses

= $__________ - $__________

= $__________

2. Determine ROI

ROI = Passive Appreciation + Cash Flow + Principal Recapture + Active Appreciation / Cash Invested

= $____ / $

= $__________ / $

=

Practice Activity 2

Purchase Price:	$232,000	**Passive Appreciation:**	1%
Down Payment 20%:	$46,400	**Principal Recapture:**	$3,958.19
Gross Annual Rental Income:	$21,600	**Active Appreciation:**	$0
Total Expenses:	$32,557.15	**Vacancy Rate:**	5%

Note: All Numbers Annual. Principal Recapture based on 30 year amortization, monthly payments at 2.89%

1. Determine Cash Flow

Vacancy Allowance = Gross Annual Rental Income x Vacancy Rate

= $__________ x __________

= $__________

Gross Operating Income = Gross Annual Rental Income - Vacancy Allowance

= $__________ - $__________

= $__________

Cash Flow = Gross Operating Income - Total Expenses

= $__________ - $__________

= $__________

2. Determine ROI

ROI = Passive Appreciation + Cash Flow + Principal Recapture + Active Appreciation / Cash Invested

= $____

$

= $__________

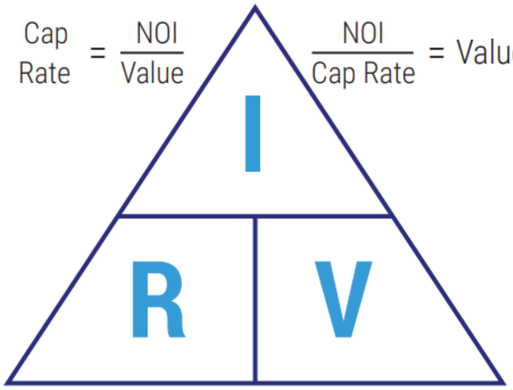
$

=

Confident Calculations

Income & Value

$$\text{Cap Rate} = \frac{\text{NOI}}{\text{Value}} \qquad \frac{\text{NOI}}{\text{Cap Rate}} = \text{Value}$$



$$\text{NOI} = \text{Cap Rate} \times \text{Value}$$

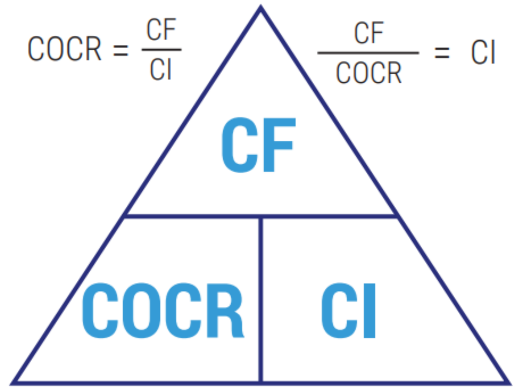
Net Operating Income (NOI), represented as "I", is the Gross Operating income (GOI) minus the Gross Operating Expenses (GOE).

Market Cap Rate (R) is the capitalization rate that your income producing property is bought and sold at. Cap rate is set by the market and is different for every market.

Value (V) is the market value of a property.

Cashflow & Return

$$\text{COCR} = \frac{\text{CF}}{\text{CI}} \qquad \frac{\text{CF}}{\text{COCR}} = \text{CI}$$



$$\text{CF} = \text{COCR} \times \text{CI}$$

Cash Flow (CF) is equal to NOI minus all debt service payments.

Cash-on-Cash Return (COCR) measures the actual return realized on your **Cash Invested (CI)**. This is often compared against the **"Opportunity Cost"** of the cash.

Cash Invested (CI) is the amount of cash that actually comes from your resources. This does not include any borrowed money.

Other Formulas

$$\text{Total ROI} = \frac{\text{CF+PR+AA+PA}}{\text{CI}}$$

GOI=GSI-5% vacancy allowance

GOE=Property Tax+Utilities+Condo Fees+R&M+(all other operating costs)

Important Terms

GSI - Gross Scheduled Income: The amount of income the property is scheduled to collect as per the rental agreement.

GOI - Gross Operating Income: The GSI minus 5% for vacancy allowance.

GOE - Gross Operating Expense: The sum of all expenses associated with operating the property. Does not include any debt payments.

DS - Debt Service: The payments made to service all debt on the property. DS payments include both principle and interest.

OC - Opportunity Cost: The return forgone by choosing one investment over another investment.

R&M - Repair and Maintenance: An estimated amount set aside to repair the property during the year. 5% of GOI is used as a general standard.

ROI - Return on Investment.

PR - Principle Recapture: The portion of a mortgage payment that is allocated to principle balance payoff.

CF - Cash Flow: The amount of free cash available at the end of the year.

PA - Passive Appreciation: The increase in property value driven by external market forces.

AA - Active Appreciation: The increase in value driven by the property owner.