#1 - **The Time Value of Money (TVM)**

*Rules of Money*

1. It's better to have it than not have it!
2. It's better to have more of it than less of it!
3. It's better to have it now than latter!
4. It doesn't clash with anything you wear!

*What is the Time Value of Money?*

The Time Value of Money (TVM) is the concept that money available at the present time is worth more than the identical sum in the future due to its potential earning capacity.

This core principle of finance holds that, provided money can earn interest, any amount of money is worth more the sooner it is received.

Time Value of Money is also sometimes referred to as present discounted value.

*Formula:*

**FV = PV x [ 1 + (i / n) ] (n x t)**

#2 **Net Operating Income (NOI)**

Example:

$800,000 Rental Property

Income $ 75,114/year (10% vacancy)

less Expenses $ 30,000

NOI $ 45,114

### *What is Net Operating Income (NOI)?*

Net Operating Income (NOI) is a calculation used to analyze real estate investments that generate income.

Net Operating Income equals all revenue from the property minus all reasonably necessary operating expenses. NOI is a before-tax figure that excludes debt service (principal and interest payments on loans), capital expenditures, depreciation and amortization.

As NOI goes up, Cash Flow goes up, Property Value goes up. Important for Cash Out Refi.

*Formula:*

Potential Rental Income

- Vacancy and Credit Losses

Effective Rental Income

+ Other Income

Gross Operating Income

- Operating Expenses

*Net Operating Income*

*Simplified Formula:*

NOI = Income – Expenses

#3 – **Capitalization Rate (Cap Rate)**

Example(s):

$800,000 Rental Property

$ 45,114 Net Operating Income

Cap Rate = $45,114 / $800,000 = 0.056 = 5.6%

NOI = $800,000 X 0.056 = $44,800

Value = $45,114 / 0.056 = $805,607

*What is “Cap Rate”?*

The capitalization rate is used in the world of commercial real estate to indicate the rate of return that is expected to be generated on a real estate investment property. Often called as the "cap rate," this measure is computed based on the net income which the property is expected to generate.

It is used to estimate the investor's potential return on their investment and a rough indicator of how quickly a real estate investment will pay for itself.

For a Buyer the higher the Cap Rate the better, for a Seller the lower the Cap Rate the better.

*Formula:*

Cap Rate = NOI

Property Value

(or Sales Price)

NOI = Property Value X Cap Rate

Property Value = NOI

Cap Rate

\*As the Cap Rate goes higher the neighborhood gets worse

#4 – **Gross Rent Multiplier (GRM)**

*What is the Gross Rent Multiplier (GRM)?*

The Gross Rent Multiplier is another capitalization method used for calculating the **approximate value** of an income producing commercial property based on the property's gross rental income.

*Formula*:

Gross Rent Multiplier (GRM) = Property Value / Annual Gross Rents

Property Value = Annual Gross Rents X Gross Rent Multiplier

Annual Gross Rents = Property Value / Gross Rent Multiplier

Example(s):

$800,000 Rental Property

$ 75,114 Annual Rental Income

Gross Rent Multiplier = $800,000 / $75,114 = 10.65

Property Value = $75,114 X 10.65 = $799,964

Annaul Gross Rents = $800,000 / 10.65 = $75,117

#5 - **Cash Flow**

*What is Cash Flow?*

Cash flow is the net amount of cash and cash-equivalents being transferred into and out of a business. At the most fundamental level, a company’s ability to create value for shareholders is determined by its ability to generate positive cash flows, or more specifically, maximize long-term free cash flow.

It is the incomings and outgoings of cash, representing the operating activities of an organization.

In accounting, cash flow is the difference in amount of cash available at the beginning of a period (opening balance) and the amount at the end of that period (closing balance).

Cash Flow is called positive if the closing balance is higher than the opening balance, otherwise called negative.

Some of the ways to increase Cash flow is by:

1. selling more goods or services,
2. selling an asset,
3. reducing costs,
4. increasing the selling price,
5. collecting faster,
6. paying slower,
7. bringing in more equity, or
8. taking a loan.

#6 – **Cash on Cash Return (COC)**

**(also known as Return on Investment (ROI))**

Example(s):

$800,000 Rental Property

$ 75,114 Annual Rental Income

*10% Down Payment deal:*

Cash on Cash = $45,114 / $80,000 = 0.564 = 56.4%

(or 1.78 years to recover you cash invested)

*25% Down Payment deal:*

Cash on Cash = $45,114 / $200,000 = 0.226 = 22.6%

(or 4.43 years to recover you cash invested)

*All Cash deal:*

Cash on Cash = $45,114 / $800,000 = 0.056 = 5.6%

(or 17.85 years to recover your cash invested)

*What is Cash on Cash (COC) or Return on Investment (ROI)?*

In investing, the cash-on-cash returnis the ratio of annual before-tax cashflow to the total amount of cashinvested, expressed as a percentage. It is used to evaluate the cashflow from income producing assets usually on an annual basis.

This is also the determination of the “velocity of money”.

By the way the ROI and Cap Rate are the same thing if you paid cash for a property.

This is important because you can't manage your way out of a bad deal!

*Formula:*

Cash on Cash = Cash Flow

Down Payment

#7 – **Debt Coverage Ratio (DCR) (or Debt Service Coverage Ratio (DSCR))**

*What is the Debt Coverage Ration (DCR)?*

The Debt Coverage Ratio (DCR), also known as Debt Service Coverage Ratio (DSCR), is the ratio of cash available to debt servicing for interest, principal and lease payments. It is a popular benchmark used in the measurement of an entity's (person or corporation) ability to produce enough cash to cover its debt (including lease) payments.

The phrase is also used in commercial banking and may be expressed as a minimum ratio that is acceptable to a lender and it may be a loan condition. (Breaching a DSCR covenant can, in some circumstances, be an act of default.)

Why is this an improtant ratio?

1. The higher this ratio is, the easier it is to obtain a loan.
2. The higher the ration is the lower the down payment will typically be.
3. Who do you typically pay first? The Lender!

Example:

DCR (DCSR) = $45,114 / $43,168 = 1.05

Total Debt Service includes:

Expenses = $30,000

Financing = $3597.30 X 12 = $43,167.60

($600,000 financed, 25% down,

6% interest, 30 year amortization)

Lenders typically want a 1.2+ DCR …

your target should be 1.4 to 1.5.

*Formula:*

DCR (DCSR) = Net Operating Income

(Annual) Total Debt Service

(Includes Financing)

#8 – **Price Per Square Foot, or**

**Price Per Door, or**

**Price Per Unit**

This may seem basic, but it's always an inportant number to know in the area or neighborhood where you are working.

Knowing the numbers will help you guage your offer and not overpay.

Especially if you are a Wholesaler you need to know this so you will know where you need to be and where the price is your Buyer will pay.

*Formula:*

Example:

Price/Sq Ft = $800,000 / 9800 sq ft = $83.33

Price/Unit = $800,000 / 8 unit = $100,000

Price Per Square Foot = Price / Total Square Feet

(living area)

Price Per Unit, or

Price Per Door = Price / Total Number of Units

#9 – **Building & Area Classifications**

**“A”** - Newest, Best location and Highest rents

**“B”** - Next notch down, Older but still good

* Most stable,
* Look for a “B” in a “A” neighborhood

**“C”** - Oldest, Lowest rents, Needs updating

* Always in demand,
* Highest risk,
* You can afford to build a new “C” property,
* Look for a “C” in a “B” or better area,
* Look for a small, or “bad”, or worst house in a good area

“D” and “F” - ????

#10 – **Types of Leases**

*What is a Lease?*

A Lease is an Agreement the Landlord and a Tenant that gives you the right to collect

rent and evict.

*What is a are the types or Leases?*

1. Full Service Lease – Landlord pays everything
2. Triple Net Lease (NNN) – Tenant pays everything
3. Modified Gross Lease - In between, Landlord and Tenant pay specific items

\* The value of the Lease can actually determine the value of the property.

**Sources for Real Estate Terms:**

[www.biggerpockets.com/renewsblog/2015/08/28/16-investing-terms-newbie/](http://www.biggerpockets.com/renewsblog/2015/08/28/16-investing-terms-newbie/)

[www.realestatewords.com](http://www.realestatewords.com/)

[www.investopedia.com/categories/realestate.asp](https://www.investopedia.com/categories/realestate.asp#_blank)

[www.homeunion.com/real-estate-investing-glossary](http://www.homeunion.com/real-estate-investing-glossary)

[www.realestateagent.com/real-estate-glossary](http://www.realestateagent.com/real-estate-glossary#_blank)

(This one not only has Real Estate definitions but also Mortgage and Insurance.)