



SMART Real Estate Investor eGlossary



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CAPITALIZATION RATE (Cap Rate)

- Formula: Net Operating Income / Purchase Price
- Similar to Return on Investment (ROI)
- Example:
 - Monthly Rent: \$4,400
 - Monthly Expenses: \$1,030
 - Net Operating Income: \$3,370
 - Asking \$639,000
 - Cap Rate: 6.3%
- **The higher the cap rate, the better for the buyer**
- *Tip: Compare cap rates in the area you are investigating*

CASH FLOW

- Net Operating Income (NOI) - Vacancy - Debt Service
- Example:
 - NOI: \$3,370
 - Vacancy (e.g., 5% of income): \$220
 - Mortgage: \$2,288
 - Cash Flow: \$862
- *Tip: Set your goal for minimum monthly cash flow*

CASH ON CASH RETURN

- Formula: Annual Net Cash Flow / Purchase Costs
- Expressed as a percentage
- Example:
 - Asking: \$639,000
 - Down Payment: (25%): \$159,750
 - Estimated Closing Costs (1.5%): \$9,585
 - Estimated Initial Rehab (1.0%): \$6,390
 - Total Purchase Costs: \$175,725
 - Annual Net Cash Flow: \$10,350
 - Cash-on-Cash Return: 5.9%
- *Tip: Set your goal for minimum Cash-On-Cash Return %*

CLOSING COSTS

- Costs associated with the escrow process
- Typically includes escrow fees, transfer taxes, ... and commission (on the listing side)
- Generally runs about 1.0-2.0% of the Purchase Price in Southern California

DEBT SERVICE

- Mortgage payments, including principal and interest
- Debt Service is used to determine *Cash Flow* (see above)

DEBT SERVICE RATIO

- Ratio of Net Operating Income (NOI) to Debt Service
- Example:
 - NOI (monthly): \$3,370
 - Mortgage (monthly): \$2,288
 - Debt Service Ratio: 1.9
- Used by lenders to qualify borrowers

EQUITY VALUE

- Property value less loan balance

ESTOPPEL

- Tenant-provided written verification of lease amounts and terms

GROSS RENT MULTIPLIER (GRM)

- Formula: Purchase Price / Gross Scheduled Income (GSI)
- Similar to a stock investor "Price/Earnings Ratio"
- Example:
 - Asking Price: \$639,000
 - GSI (annual): \$52,800
 - GRM: 12.1
- **The lower the GRM, the better for the buyer**
- GRMs under 15 are often positive cash flow, depending on expenses
- *Key Tip for Investors: Compare Gross Rent Multipliers to similar properties in the area in which you are looking!*

GROSS SCHEDULED INCOME (GSI)

- Formula: Sum of Monthly Income per unit for all units
- aka "Scheduled Gross Income (SGI)"
- Can include Auxiliary Income (e.g., washing machines, garage rental, vending machines)
- Example:
 - Unit 1: \$1,900/month
 - Unit 2: \$1,400/month
 - Unit 3: \$1,100/month
 - Washing Machines: \$0/month
 - GSI: \$4,400/month

IMPROVEMENT COSTS

- Costs associated with making the property attractive, safe, habitable and rentable
- Typically includes construction upgrades, landscaping, etc.

LONG TERM RETURN ON INVESTMENT

- Ratio of Total Costs to Total Net Equity Gain over time (e.g., 5 or 10 years)
- Example:
 - Initial Investment:
 - Down Payment (25%): \$159,750
 - Closing Costs (1.5%): \$9,585
 - Up-Front Improvements (1%): \$6,390
 - **Total Initial Investment: \$175,725**
 - 10 Year Gain:
 - Cash Flow (3%): \$118,762
 - Appreciation (3%): \$219,763

- Mortgage Payback: \$101,678
- **Total 10 Year Gain: \$440,202**
- **10 Year ROI: \$175,725 / \$440,202 = 251%**

NET OPERATING INCOME (NOI)

- Formula: Gross Scheduled Income (GSI) - Operating Expenses
- Example:
 - GSI (monthly): \$4,400
 - Operating Expenses (monthly): \$1,030
 - Net Operating Income (monthly): \$3,370
- *Note*: NOI does *not* include Debt Service (mortgage payments) or Vacancy

OPERATING EXPENSES

- Expenses, other than Vacancy and Debt Service
- Generally includes:
 - Property tax
 - Insurance
 - HOA fees
 - Property management fees
 - Maintenance
- Tip: Banks typically use 25% of GSI to calculate operating expenses for loan qualification purposes

Here is a list of some additional typical income property expenses:

- Utilities:
 - Electricity (typically rental property owner-paid)
 - Gas (typically tenant-paid if metered)
 - Cable (typically tenant-paid)
- Water/Sewer
- Trash/Recycle
- Gardener
- Pest Control
- Security
- Supplies
- Licenses
- Maintenance & Repairs:
 - Structure
 - Appliances
 - Carpets

SMARTiScore

Our SMARTiScore© is a composite of scoring factors allowing for quick, clear evaluation of properties. One point is given for each of the following calculated factors:

- Rents better than Market
- Positive Cash Flow
- Cash Flow above \$500/month
- Gross Rent Multiplier (GRM) less than 16.5 (typical break even point)
- Gross Rent Multiplier better than Average for Area
- 10 Year Net Equity Gain over \$200,000
- 10 Year Net Equity Gain over \$500,000
- 10 Year ROI better than 100%
- 10 Year ROI better than 200%
- Doubling Year under 8 years

TOTAL INVESTMENT

- Cash outlay to obtain property
- Includes:
 - Down Payment
 - Closing Costs
 - Initial Improvement Costs

VACANCY

- The average time between tenants, expressed as a percentage of income
- Example: a 5% vacancy rate equates to about 2.5 weeks of lost rent

RESIDENTIAL INCOME PROPERTY ANALYSIS COMPLETE EXAMPLE

BASIC

Asking Price	\$639,000	
# Units	3	
Total Income	\$4,400	Monthly
Gross Rent Multiplier (GRM)	12.1	

EXPENSES

Property Tax	\$666	1.25%
Insurance	\$64	0.12%
HOA	\$0	
Property Management	\$0	
Maintenance/Unit	\$300	\$100
Other	<u>\$0</u>	
Total Expenses	\$1,030	
% Total Income	23%	
Net Operating Income (NOI)	\$3,370	Monthly
Cap Rate	6.3%	
Vacancy	\$220	5%

LOAN

Down	\$159,750	25%
Loan Amount	\$479,250	
Interest Rate	4.000%	

Years	30	
Type	Fixed	
Mortgage	\$2,288	Monthly
CASH FLOW		
Net Cash Flow	\$862	Monthly
INITIAL INVESTMENT		
Estimated Closing Costs	\$9,585	1.5%
Estimated Initial Repairs	<u>\$6,390</u>	1.0%
Total Initial Investment	\$175,725	
Cash-On-Cash ROI	5.9%	
10 YEAR HORIZON		
Total Cash Flow	\$118,762	3.0%
Total Appreciation	\$219,763	3.0%
Total Mortgage Payback	<u>\$101,678</u>	
Total 10 Year Gain	\$440,202	
10 Year ROI	251%	

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