

REAL ESTATE



TERMS CONCEPTS & CALCULATIONS



Contents

Foreword	3
Terms & Concepts	
<u>1031 Exchange</u>	4
<u>Absorption Rate</u>	4
<u>Accredited Investor</u>	4
<u>Adjustable Rate Mortgage</u>	5
<u>Amortization</u>	5
<u>Appraisal</u>	5
<u>Appreciation</u>	6
<u>BRRRR</u>	6
<u>Buyer's Market</u>	6
<u>Capital Expenditures vs. Repairs</u>	6
<u>Capital Gains Tax</u>	7
<u>Cash Flow</u>	7
<u>Closing Costs</u>	7
<u>Competitive Market Analysis</u>	7
<u>Conventional Financing</u>	8
<u>Depreciation</u>	8
<u>Due Diligence</u>	8
<u>Earnest Money</u>	9
<u>Equity</u>	9
<u>Escrow</u>	9
<u>Fair Market Value</u>	10
<u>Fixed Rate Mortgage</u>	10
<u>FSBO</u>	10
<u>Foreclosure</u>	11
<u>Hard Money Loan</u>	11
<u>Interest</u>	11
<u>Leverage</u>	12
<u>Long-Term Rental</u>	12
<u>MLS</u>	12
<u>Other People's Money</u>	13
<u>PITI</u>	13

<u>Pre-Approval Letter</u>	13
<u>Principal</u>	13
<u>Promissory Note</u>	13
<u>Property Management</u>	14
<u>Rent to Own</u>	14
<u>Seller Financing</u>	14
<u>Seller's Market</u>	15
<u>Short Sale</u>	15
<u>Short-Term Rental</u>	15
<u>Tenant Estoppel Certificate</u>	16
<u>Title Insurance</u>	16
<u>Turnkey Property</u>	16

Calculations

<u>Cap Rate</u>	17
<u>Cash on Cash Return (CoC)</u>	17
<u>Debt Service Coverage Ratio (DSCR)</u>	17
<u>Debt-to-Income Ratio (DTI)</u>	18
<u>Internal Rate of Return (IRR)</u>	18
<u>Loan-to-Cost (LTC)</u>	18
<u>Loan-to-Value (LTV)</u>	19
<u>Net Operating Income (NOI)</u>	19



Foreword

Real estate can be a complex world, filled with terminology and concepts that often seem daunting, especially when you're just starting out. Even seasoned investors sometimes need a reliable reference to keep track of the myriad terms and ideas that are crucial to making informed decisions. That's why we created this ebook—a comprehensive glossary of real estate terms, concepts, and calculations.

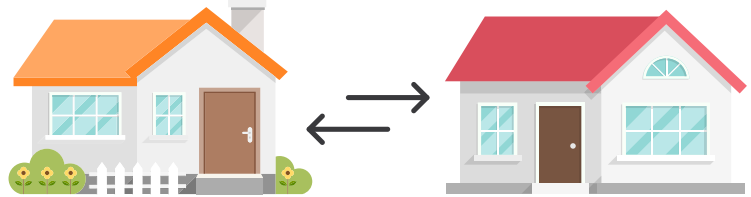
When we began our own real estate journey, we often found ourselves wishing for a resource like this one—a guide that could clarify the jargon and make the learning curve a bit less steep. We repeatedly found ourselves searching the internet for definitions, explanations, and clarity on various concepts, sometimes from not-so-reliable sources. We wished we had a single, trusty resource that could guide us through the terminology, helping us feel more confident in our investments and overall strategy. This ebook was born so it could be that resource for you.

Inside, you'll find a simple, yet comprehensive glossary of real estate terms, concepts, and calculations. It's designed to be easy to navigate, so you can quickly find the information you need, whether you're at the beginning of your real estate journey or well along the way.

We wish you the best of luck in all your real estate endeavors, and we hope this ebook helps you along the way.

1031 Exchange

A 1031 exchange is a tax break that applies when an investor swaps one piece of real estate for another. If utilized, the investor is able to sidestep paying capital gains tax on the sale of the first property. To be eligible, the properties must be of “like-kind,” similar in function (primary residences and vacation homes are not eligible), and the closing of the second property must be within 180 days of the selling of the first property. Additionally, you must provide in writing possible replacement properties 45 days after closing on the first property. Proceeds from the first property sale must be held in escrow until purchasing the new property. There is no limit on how frequently a 1031 exchange can be utilized.



Absorption Rate

Absorption rate is the speed that homes are sold, in a specific market over a specific timeframe. The ratio is simple: the number of homes sold divided by the number of homes available. A high absorption rate means that demand is high, and when the rate exceeds 20%, it is a seller’s market. Lower absorption rates mean that homes are sitting on the market longer, with levels below 15% indicating a buyer’s market.

Accredited Investor

An accredited investor is a wealthy individual or business that has the opportunity to participate in investments that average individuals or businesses cannot. Anyone can participate in the stock market as these investments are registered with the US Securities and Exchange Commission (SEC). Accredited investors are able to place money into investments not registered with the SEC. The rationale is that these types of un-registered investments expose greater risk and greater potential loss, and that only the wealthiest have the ability to weather those storms.

To be an accredited investor, the SEC states that an individual must have a net worth greater than \$1 million (excluding the value of primary residence), or have annually earned \$200,000 for the past two years (\$300,000 if in partnership with a spouse).



Adjustable Rate Mortgage

An adjustable-rate mortgage (ARM) is a home loan that has fluctuating interest rates over time. ARMs generally begin with a low, fixed interest rate for a set number of years (5, 7, or 10). After that introductory period ends, interest rates change at set intervals of time (usually 1 year or 6 months) based on market conditions. As a result, your monthly payment could increase or decrease depending on economic factors.

For most home buyers, ARMs are riskier than fixed-rate mortgages because of the likelihood that monthly payments will rise to unaffordable levels after the introductory period ends. However, if you plan to resell the home before the introductory period ends, that potential drawback could be avoided. Alternatively, you could plan to refinance the property after the introductory period ends.

ARMs come in three flavors: hybrid, interest only (I/O), and payment option. Hybrid is the most common, and it was described above. With an I/O, you make payments toward interest only (not principal) for a fixed length of time before you begin making typical payments (toward principal and interest). Payment option ARMs offer even more flexibility with how loan payments are structured.



Amortization

Amortization has two meanings in finance.

- For loans: the paying off of debt through regular payments of principal and interest. It is essentially the structure of how a loan will be paid back.
- For assets: distributing the cost of an asset over the useful lifetime of the asset, rather than taking on a large cost all at once.

For both scenarios, amortization schedules help project and understand how funds will be distributed over time.



Appraisal

A real estate appraisal is a valuation of a property. It is used to assign a fair market value to a property. To be official, it needs to be conducted by an authorized appraiser who is designated by a regulatory body.

Appraisals vary in thoroughness; some require a property walk-through whereas others are 'drive-bys' that assess the exterior only. Obviously, the more thorough the appraisal, the more accurate the valuation. Appraisals are utilized when homes are bought and sold, as well as refinancing.

Appreciation

In real estate, appreciation is the increase of a property's value over time. In contrast, depreciation is when a property decreases in value over time. Whether a property is appreciating or depreciating depends on multiple factors, only some of which the property owner has control over. Ways that an owner could increase the value of a property include: home improvements, renovations, increasing square footage of the home, adding outdoor living space, etc. Other factors, such as housing market supply/demand, also play critical roles in assessing a property's appreciation or depreciation.

BRRRR

BRRRR is a real estate investment strategy based upon rehabbing distressed properties. BRRRR stands for Buy, Rehab, Rent, Refinance, Repeat. When you rehab a distressed property, you add value (i.e. equity). Refinancing after rehab allows you to tap into that new equity and finance at the after-repair value of the home. If executed optimally, the refinance will net you a chunk of money that you can then use to buy another real estate property, allowing the BRRRR method to operate cyclically.



Buyer's Market

A buyer's market occurs when the supply of houses on the market is greater than the current demand for houses. When there are more houses than buyers, not all houses will sell. As a result, a seller may be willing to sell for a lower price to outcompete other sellers. The buyer would consequently be able to purchase for less, hence the name "buyer's market."

Capital Expenditures vs Repairs

It costs money to operate a business. When funds are used to acquire goods that will benefit the business for less than a year, this is an operating expense (e.g. printer ink and paper). Capital expenditures, in contrast, benefit the company for longer than one year. In other words, capital expenditures are investments. What is considered a capital expenditure will vary based on the industry, but in general, it is when a physical asset (e.g. property, buildings, plants, equipment, etc.) is either acquired, upgraded, or maintained. Repairs that help maintain a physical asset can be capital expenditures also.

Examples: As a real estate investor, acquiring a property is a capital expenditure. The property is an asset that can benefit the company for many years. Replacing the roof on a property you own is a capital expenditure (if the useful life of the roof is extended, thus helping to maintain your asset). Purchasing a work vehicle that allows you to drive to and maintain rental properties is a capital expenditure. Putting fuel in the vehicle is not a capital expenditure, but rather an operating expense.

Capital Gains Tax

A Capital Gains Tax (CGT) is paid by an investor when an asset is sold. The amount taxed is based upon the appreciation of the asset during the time of ownership. Since real estate is a capital asset, CGT applies to all real estate sold.

As of 2023–24, CGT rates are either 0%, 15%, or 20% of the profit, based upon the income of the filer. Income brackets are adjusted annually to reflect inflation.

Long-term capital gains are when an asset was held for more than a year, whereas short-term gains were held for less than a year. Short-term gains are taxed harder than long-term, providing incentive to hold assets for longer periods of time.

Cash Flow

Cash flow describes the movement of money into and out of a property. Money coming into the property is income (i.e. rent), while money leaving the property is an expense (e.g. mortgage payment, utilities, taxes, insurance, etc.). When income exceeds expenses, cash flow is positive. Conversely, cash flow is negative when your expenses are greater than your income.



Closing Costs

Closing costs are fees that are paid at closing to complete a real estate transaction. Buyers and sellers must agree as to how closing costs are distributed between parties. Many fees can be included in closing costs. A few of them are: mortgage origination fees, attorney fees, title search fees, transfer taxes, underwriting fees, appraisal fees, and realtor commissions. All closing costs are in addition to the agreed selling price of the home.

Comparative Market Analysis

A competitive market analysis (CMA) estimates a home's value by comparing it to similar homes that have recently sold in the immediate geographical area. CMAs are conducted by real estate professionals, and they are helpful to both buyers and sellers. CMAs aid buyers in setting asking prices and sellers in determining how much to offer. Since no two homes are completely identical, adjustments are made in CMAs to normalize for subtle differences between properties (square footage, bedrooms, bathrooms, garages, lot size, features, condition, etc.). Although similar, CMAs are not appraisals.

Conventional Financing

Conventional financing is the most common type of mortgage funding in the US. Conventional financing is in contrast to government financing. Government-insured loans (i.e. FHA, VA, and USDA loans) are guaranteed by the government; conventional loans are guaranteed by the private sector (e.g banks, credit unions, online lenders, etc).



Depreciation

In real estate, depreciation is the decrease of a property's value over time. In contrast, appreciation is when a property increases in value over time. Whether a property is appreciating or depreciating depends on multiple factors, only some of which the property owner has control over. As a general rule, a house will depreciate over time unless there is regular upkeep to the property. As a property owner, this signifies the importance of maintenance and repairs. However, other factors, such as housing market supply/demand, also play critical roles in assessing a property's appreciation or depreciation.

Due Diligence

Due diligence is an ambiguous term that, broadly speaking, refers to doing your homework. In real estate, due diligence would typically be conducted both before an offer on a property is made and after the offer is accepted. Your due diligence checklist will be unique to you and the potential property.

Things to consider adding to your pre-offer checklist:

- Analyzing the neighborhood (median rent, crime rate, median household income, schools, etc.)
- Examining the finances of the property (rent, vacancy, taxes, insurance, repairs, etc.)
- Assessing your financing options to purchase the property



Things to consider adding to your post-offer checklist:

- Physical inspections of the property (foundation, roof, HVAC, plumbing, etc.)
- Legal and loan concerns (HOA guidelines, insurance quotes, appraisal, etc.)

The above items are just a start; there are many additional things to consider when building your due diligence checklist. If you do your homework when building that list, you'll have the confidence to know you're making good purchasing decisions.

Earnest Money

Earnest money is a deposit put down on a home prior to closing that signifies the buyer's seriousness about purchasing the home. It's also referred to as a good faith deposit. The amount deposited varies, but it is always held in escrow until closing (never paid directly to seller). A contract is written up with an earnest money deposit (EMD) that is intended to protect both the buyer and the seller. What goes into that contract is up to the parties involved, but there are typically contingencies about home inspections, appraisals, and financing, among others. If the sale goes through, the EMD is applied toward the down payment or closing costs. If the sale does not go through for any reason, the contract will (if written carefully) indicate who keeps the EMD.

Equity

Equity is how much of your home (or other asset) you own. If you bought a house outright with non-borrowed money (i.e. no mortgage/debt), you would have 100% equity of the house. If you do have a mortgage or other loan, your equity would be less than 100%. Specifically, your equity would be the fair market value of the house minus the amount of debt owed.



An example: If the fair market value of your home is \$300,000 and you owe \$210,000 on the mortgage, you would have \$90,000, or 30%, equity.

Escrow

Escrow is a legal concept in which a third party holds funds for a transaction between two parties while the requirements of the transaction are being fulfilled. The intention of escrow is to protect both the buyer and the seller; it adds a layer of security to any transaction. In the sale of real estate, escrow accounts can be used to hold good faith deposits while home inspections and other contractual obligations are fulfilled by both parties.

Another use of escrow in real estate:
When a mortgage begins, lenders typically create escrow accounts to pay for property taxes and insurance over the lifetime of the mortgage. This allows taxes and insurance to be paid monthly, rather than in lump-sum amounts.



Fair Market Value

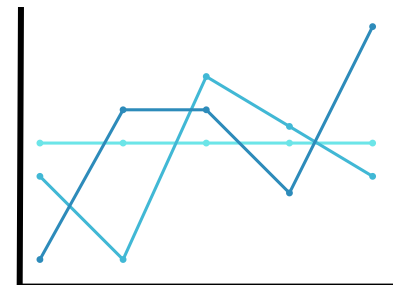
In essence, fair market value (FMV) is the price an asset will sell for on the open market. However, the definition of FMV is surprisingly difficult to summarize in a few sentences for several reasons. First, different states define FMV differently, and each state may or may not be aligned with the federal definition. Further, there isn't a formula to calculate FMV. While there are methods used to obtain FMV (e.g. appraisals, comparative market analysis, etc.), no single method definitively yields an FMV. In the end, FMV is ultimately the price a buyer and seller agree upon, assuming there wasn't undue pressure or circumstances influencing either party (making it not fair). As such, any method used to estimate FMV is only that: an estimate.

Even with those complications, there are situations in real estate where FMV is useful and necessary. In divorces, an FMV of a property will be used to assign its worth and fairly distribute that asset. FMV will also be used for insurance claims and determining how much tax a specific property must pay to the local jurisdictions.



Fixed-Rate Mortgage

Fixed-rate mortgages (FRMs) offer a constant interest rate for the entire lifetime of the home loan (usually 30 years). Because the rate is fixed, FRMs are not subject to volatile market forces. This means that monthly mortgage payment amounts will never change, making FRMs more predictable than adjustable-rate mortgages. 30-year FRMs are the most common home loan product in the United States.



FSBO

For sale by owner (FSBO) indicates that a property owner is selling a property without representation from a real estate agent. The primary reason a seller may choose to sell a home in this manner is to avoid paying commissions to a real estate agent. However, most buyers will still be represented by real estate professionals, requiring their share of commission. So rather than being eliminated, commissions are roughly halved in an FSBO.

Real estate transactions are complicated and require a lot of paperwork. This is one of several reasons real estate professionals are utilized in most home sales. If considering an FSBO as either a seller or buyer, extreme caution should be used, and due diligence will be of utmost importance.

Foreclosure

Foreclosure occurs when a homeowner is no longer able to make the required mortgage payments. After multiple missed payments (usually 3), the loan will go into default, and the lender will take ownership of the home. The homeowners will then be removed from the home, and the lender will sell the property to try to recover the amount owed on the defaulted mortgage.

The foreclosure process varies by state. In some states, the lender must go through the courts, proving that a foreclosure is warranted. Only if the court approves the foreclosure can the lender attempt to sell the property. Selling the property can occur through a local sheriff auction or a more traditional route where the lender becomes the owner and then resells the property. When a lender owns a foreclosed property, it is referred to as Real Estate Owned (REO). Lenders generally try to work with homeowners to avoid the foreclosure process.



Foreclosures are lengthy; the national average number of days for the foreclosure process is over 800. In states where the court is not required, the foreclosure process tends to be quicker.

Foreclosed properties can be opportunistic for investors.



Hard Money Loan

A hard money loan (HML) is a short-term loan that does not come from a traditional lender like a bank. Instead, the lenders are individuals or private companies. HMLs utilize the asset itself as collateral, making the lending process generally much quicker and simpler. This is because many of the steps required for a traditional mortgage (debt and income verifications, credit checks, bank statements, etc.) are not necessary. Since HMLs are riskier from a lender's perspective, these types of loans generally come with high interest rates.

Interest

What is costs to borrow money. A loan payment consists of two parts: principal and interest. Principal is what you agreed to pay back to the lender. Interest is the cost of using the lender's money.



Leverage

In the simplest form, leverage is debt. It is the concept of utilizing borrowed money (e.g. a loan) to increase the amount one can purchase or invest. Let's say you have \$60,000. Without borrowed money, you can invest only your \$60,000. If instead your \$60,000 is used as a 20% down payment on a \$300,000 loan, you now would have \$300,000 to invest. This is leverage. As a home buyer, leverage increases what you are able to afford. As an investor, utilizing the concept of leverage enables you to continue to acquire real estate assets.

Another example: When you have a loan with the bank at 80% LTV, you are leveraged at 80% (therefore, you have 20% equity in the asset). The higher the leverage, the less equity you have in the asset which equates to more risk.



Long Term Rental (LTR)

An LTR is a traditional real estate rental. LTRs are typically rented to tenants for 6 months or more. Contracts known as leases are created for landlords and tenants to legally agree to the terms of the rental agreement. LTRs generally have high and consistent occupancy rates.

MLS

MLS stands for Multiple Listing Service, and it is a database that allows realtors and brokers to share information about real estate properties for sale. There are hundreds of MLSs across the United States, each representing a defined regional market. An MLS can only be accessed by licensed agents and brokers that pay membership dues to that MLS.

Without an MLS, buyers would have to search many different individual brokerages to see what was available in their market. Also, a home for sale would only be visible to those who found the listing brokerage. What an MLS does is essentially broaden the market for all buyers and sellers. It combines all real estate properties for sale into one place, increasing opportunities for buyers and sellers alike, and enabling brokerages and realtors to better serve their clients.

While most homes sold are included on an MLS, properties can legally be bought and sold without listing on an MLS.



Other People's Money (OPM)

Other people's money is exactly what it sounds like; it is money that is not your own. It's a debt from one of several sources (e.g. a hard money loan, a line of credit, etc.). You will generally have to pay interest, in addition to paying back the debt owed, for the privilege of using OPM.

PITI

Principal. Interest. Taxes. Insurance.

The total cost of home ownership. The four major parts of a mortgage payment. Failing to consider each part can lead to under-estimating what it will actually cost to own a property.



Pre-Approval Letter

A pre-approval letter from a lender indicates how much money you can borrow to purchase a home. Lenders typically evaluate your income, assets, and credit score to determine that value. Although sometimes used interchangeably with pre-qualification, the terms differ in thoroughness. A pre-qualification is an initial review of your finances using estimates. A pre-approval is more accurate, generally requiring income documentation and hard credit pulls.

As a buyer, having a pre-approval letter makes your offers stronger. It shows that you are serious and able to secure a mortgage, whereas another potential buyer may make an offer but then not be able to secure a mortgage for that amount.

Principal

The money that you borrowed from a lender. A loan payment consists of two parts: principal and interest. Principal is what you agreed to pay back to the lender. Interest is the cost of using the lender's money.

Promissory Note

A promissory note (or simply 'note') is a written agreement to repay money borrowed from a lender. The note is what contains the terms of a loan (amount, interest rate, payment plan, etc.). Promissory notes are used for most loans in general, and they are always required as part of a mortgage. When you get a mortgage, the lender holds the note until the debt plus interest is repaid in full. If you aren't able to make the payments set forth in the promissory note, the note is what gives the lender legal authority to reclaim ownership of the home and foreclose.

Property Management

The oversight of real estate. The goal of property management is to keep a property in good working order, while preserving the value of the property and producing income. Tasks associated with this could include: repairs, maintenance, landscaping, snow removal, security, general upkeep, finding tenants, and collecting rent. Property management in general is essential toward preserving the value of a property, but how it is accomplished varies quite a bit. Some property managers do all of the required work themselves, while others delegate those tasks to others. Similarly, a landlord may choose to act as the property manager, or the landlord may hire a third-party property management company. Hired property managers collect a fee or percentage of rent from the properties they manage, and they must be licensed to do so in most states.



Rent to Own

Rent to own is an agreement where a tenant is allowed to purchase the rented home after a defined period of renting it. There are no defined rules for how a rent to own contract needs to be structured, so each contract will have its own specificities. Therefore, it's important to thoroughly understand a rent to own contract, regardless of which side of the agreement you are on. Some variations include: having the option to buy vs. being required to buy at the end of rental period, purchase price (both amount and when that amount is decided), rent amount (rent may be higher, with excess going toward an ultimate down payment), and paying an "option fee" to reserve your right to purchase at the end of the rental period.

Seller Financing

Seller financing is an arrangement where the seller, rather than a financial institution, handles the mortgage process. Since a typical mortgage isn't used, the seller is not paid in full immediately. Instead, the sale price is paid from the buyer directly to the seller in installments over time. The terms of a seller financing transaction are made up and agreed upon by the parties involved. This means these types of transactions can be written in ways that make the deal appealing to both parties. Whether seller financing makes sense for your situation will depend on many factors, including how the deal is written and even the state of the current mortgage market.

Seller financing is synonymous with the terms 'owner financing' and 'purchase-money mortgage'.



Seller's Market

A seller's market occurs when the demand for houses is greater than the current supply of houses on the market. In this scenario, there are many potential buyers for any given property. As a result, a buyer may be willing to pay a higher price to outcompete other buyers, and so the seller may be able to sell for a higher price. This kind of leverage for the seller is what is referred to as a seller's market.

Short Sale

A short sale is when a homeowner sells their home for less than the remaining balance on the mortgage. In a short sale, the lender of that mortgage gets all the proceeds of the sale. The outstanding balance is then either forgiven, or a deficiency judgment is issued that requires the borrower to pay back the remaining balance. While it may initially sound confusing why a lender would agree to this, a short sale can be more beneficial than a foreclosure for all parties involved.

For a short sale to be initiated, a homeowner in financial hardship must reach out to the lender prior to the property being foreclosed. For a lender to agree to a short sale, two criteria must be met:

1. The home must be worth less than what is owed on the mortgage.
2. The homeowner must be able to prove financial hardship, that funds are unavailable to pay back the outstanding balance.

The short sale process is lengthy and complicated for both the seller and the end purchaser.

Short-term Rental (STR)

Also known as a transient rental or vacation rental, a short term rental (STR) generally refers to renting residential space for one month or less at a time. STRs can be entire homes, accessory dwelling units, or individual rooms within a building. STRs can make substantial money per night, but they also tend to have high vacancy rates (think of seasonal variations as well as weekdays vs. weekends).

Different states and local municipalities define STRs differently, so it is important to check the rules and regulations at both levels if you are considering turning a property into a STR. In certain areas, STRs are not allowed at all.



Tenant Estoppel Certificate

A legally binding document that is intended to describe thoroughly the relationship between landlord and tenant, as well as the terms and status of the lease. Estoppel certificates will often be used when a third party is purchasing a property that has existing tenants. By doing so, all agreements and terms of the existing lease, whether verbally or in writing, will transfer and be honored by the new landlord.

Title Insurance

A form of insurance that protects lenders and homebuyers from financial losses incurred from defects in a title to a property. Common types of defects include outstanding liens, backtaxes, and conflicting wills. If you are working with a traditional lender, you will be required to obtain title insurance in order to get a mortgage.

APPLICATION:

If you purchase a home, and then find out that the previous owner owed \$20,000 in back taxes, you (the new owner) are the one responsible for this debt. Title insurance protects you from this type of unfortunate situation.

Turnkey Property

A turnkey property is one that is rent-ready, with appliances, and without any obvious issues. As opposed to a fixer-upper, a turnkey property will not require any major renovations. Even if some cosmetic upgrades may still be required, the overall process of getting a tenant in place should be relatively quick and seamless.

A turnkey property requires minimal effort up front from an investor. This aspect is a double-edged sword. A higher price is generally paid because of it, but it also allows for generating cashflow quickly.

Whether or not a turnkey property would be desirable to an investor will ultimately depend on that investor's personal situation. More money can be made from value-add properties, but not everyone has the time, energy, and resources to take on properties requiring renovations.



Calculations

Cap Rate

Cap rates (short for 'capitalization rates') are used to measure expected rates of returns on investments.

While cap rates are metrics that can be applied to any investment property, they are primarily used in commercial real estate.

Formula

Cap rate = net operating income ÷ current market value



Example

If a property's NOI is \$13,000 and its current market value is \$250,000, then its cap rate is 5.2%.

$$\$13,000 \div \$250,000 = 0.052 = 5.2\%$$

Cash on Cash Return (CoC)

A rate that measures the annual return an investor made on a property compared to the amount of mortgage paid during that year. AKA cash yield on property investment.

Formula

CoC = annual pre-tax cash flow ÷ total cash invested

Example

- A property produces \$10,000 in one year (pre-tax).
- That same year, it cost \$100,000 to operate the property (utilities, maintenance, mortgage payments, etc.).
- The property's CoC for that year is 10%.



$$\$10,000 \div \$100,000 = 0.1 = 10\%$$

Debt Service Coverage Ratio (DSCR)

Expressed as a ratio, DSCR measures a property's ability to generate cash, while taking into consideration all property expenses (mortgage principal and interest, utilities, etc).

Formula

DSCR = net operating income ÷ total debt service



A DSCR < 1 = negative cashflow.

A DSCR > 1 = positive cashflow.

Lenders generally have DSCR minimums for mortgages on investment properties.

Debt-to-Income Ratio (DTI)

Debt-to-Income Ratio (DTI) compares individuals' total monthly income to their total monthly debt. More specifically, DTI is the percentage of your gross monthly income that goes toward paying recurring monthly debts. This ratio is often used by lenders to assess your borrowing risk. **The higher your DTI, the less money you have left each month after paying the bills.** In the eyes of a lender, this makes you a riskier lendee as you have less financial wiggle room for unforeseen events. Payments for mortgages or rent, student loans, vehicles, alimony, credit cards, or any other monthly debts are used to calculate DTI. DTI requirements vary between lenders, but generally, a DTI of less than 50% is necessary to be considered for a loan.

Internal Rate of Return (IRR)

Internal rate of return (IRR) is used to measure the profitability of an investment, specifically, the expected annual growth of an investment. IRRs can be useful for comparing multiple investment opportunities. In general, **the higher the IRR, the more desirable the investment.** The formula for IRR is rather complicated, and it would be advised to use an IRR calculator if this is a metric you plan to analyze.



Loan-to-Cost (LTC)

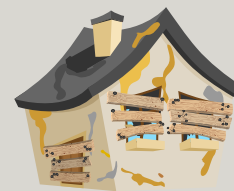
The ratio of loan amount compared to cost of project. If you plan to rehab a distressed property, the project cost is the purchase price + construction costs.

Example

If you purchase a property for \$100,000 and will put \$50,000 worth of improvements into the property, your project cost is \$150,000.

Let's say you have \$30,000 of your own money to fund the construction, so you take a loan for \$120,000. Your LTC is then 80%.

$$(\text{loan} \div \text{project cost}) = (120,000 \div 150,000) = 80\%$$



A higher LTC is considered a riskier loan. Therefore, lower LTC values increase your chances of obtaining both the loan and lower interest rates.

Loan-to-Value (LTV)

The ratio of mortgage amount compared to the appraised value of a property.

Similar to LTC, a higher LTV is a riskier loan from a lender's perspective. Therefore, a lower LTV increases your chances of obtaining a mortgage and getting lower interest rates on the loan.

Example

If you take a loan for \$80,000 on a property worth \$100,000, the LTV is 80%.

$$(\text{loan} \div \text{value}) = (80,000 \div 100,000)$$

Net Operating Income (NOI)

Net Operating Income (NOI) is the **total revenue of a property minus operating expenses**. It is the profitability of a property.

Example

- A property generates \$24,000 a year in revenue.
- The annual operating expenses are \$6,500.
- The property's NOI is \$17,500.



$$(\text{revenue} - \text{operating expenses}) = (24,000 - 6,500)$$