

CALCULATIONS IN EVALUATING RENTAL INCOME PROPERTY

GROSS RENTAL MULTIPLIER - GRM

The First Step at looking at a property for the purpose of a rental income property is to do the

The Gross Rental Multiplier - GRM

It is not the most accurate but can point you in the direction to do further work

Getting the GRM for recent sold properties:

Market Value / Annual Gross Income = Gross Rent Multiplier (GRM)

Property sold for \$750,000 / \$110,000 Annual Income = GRM of 6.82

Estimating value of property based on GRM:

Let's say that you did an analysis of recent comparable sold properties and found that, like the one above, their GRM's averaged around 6.75. Now you want to approximate the value of the property being considered for purchase.

You know that its gross rental income is \$68,000 annually.

(GRM) X (Annual Income) = Market Value --- GRM X AI = MV

6.75 X \$68,000 = \$459,000

If it's listed for sale at \$695,000, you might not want to waste more time in looking at it for purchase.

GROSS POTENTIAL REAL ESTATE INCOME -- GPI

We want to know what income will be realized if a property is fully occupied and all rents are collected.

We take the number of units times annual rent for a total. This is a gross income so there are no deductions

Example: An apartment complex with six units. Three rent for \$700 per month and the other three rent for \$800 per month.

Getting the GPI – Gross Potential Income

1. 3 units X \$700/month = \$2100
2. \$2100 X 12 = \$25,200
3. 3 units X \$800/month = \$2400
4. \$2400 X 12 = \$28,800
5. \$25,200 + \$28,800 = \$54,000 Annual Income or GPI

GROSS OPERATING INCOME – GOI

Once we know the GPI then by calculating out our expenses we get our Gross Operating Income

Let's use our already calculated GPI of \$54,000. This is if all units are full and all rents paid.

Based on experience, the current market and rental occupancies, we estimate that our losses due to vacancies and non-payment will be 5%.

\$54,000 *.05 = \$2700

\$54,000 - \$2700 = \$51,300 for our Gross Operating Income

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NET OPERATING INCOME – NOI

Needless to say this is where you are going to have to do the most work. You need to take in all costs other than taxes. Here is a list of a few common ones;

Common areas electric, all water and gas, employees (management companies, accountants, handyman, lawn care etc), service contracts, liability insurance for common grounds, insurance on the building etc etc

GPI – Operating Losses = Gross Operating Income

Then

Gross Operating Income – Expenses = Net Operating Income

Estimating our operating expenses at \$37,000

$\$51,300 - \$37,000 = \$14,300$

GOI - E = NOI

UTILIZING THE CAPITALIZATION RATE TO EVALUATE PROPERTY (CAP RATE)

Now we bring out the heavy guns

Those who invest in real estate via income-producing properties need to have a method to determine the value of a property they're considering buying. By using other properties' operating income and recent sold prices, the capitalization rate is determined and then applied to the property in question to determine current value based on income.

1. Get the recent sold price of an income property, such as an apartment complex.
Example: Six unit apartment project sold for \$300,000
2. For that same apartment project, determine the net operating income, or the net rentals realized by the owners.
Example: The rental income after expenses (net) is \$24,000
3. Divide the net operating income by the sale price to get cap rate.

Example: $\$24,000 / \$300,000 = .08$ or 8% (The Capitalization Rate)

4. By using the Cap Rate You can compare other buildings in the area and determine the cap rate you are willing to pay

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USING THE CAP RATE TO DETERMINE THE VALUE OF A PROPERTY

Knowing the asking price and the capitalization rate of comparable properties will allow you to help your client to determine the net income that will be required in order to justify the price paid.

1. Get the capitalization rate for comparable recently-sold properties in the area.
2. Multiply the capitalization rate by the value of the property to determine the net operating income that would be needed to justify the price.

Example: A cap rate for comparable apartment complexes is 12%, or .12, and asking price for the complex under purchase consideration is \$300,000.

$\$300,000 \times .12 = \$36,000$ in net income that would be required to justify this asking price.