

Real Estate Investment Analysis Formulas

Income and Expense Statement

Income	
Potential Gross Income (PGI)	\$ _____
Less: Vacancy and Bad Debt Allowance	_____
Equals: Effective Gross Income (EGI)	\$ _____
Operating Expenses	
Exclude: Depreciation	
Mortgage Payments	
Non-Operating Expenses, E.G Directors Salaries	
Capital Expenditures	\$ _____
Net Operating Income (NOI)	_____
Less: Debt Service (P + I)	_____
Cash Flow Before Tax (CFBT)	_____
Less: Income Taxes	_____
Equals Cash Flow After Tax (CFAT)	\$ _____

Financial Measures:

Potential Gross Income Multiplier (PGIM)

Also called Potential Gross Rent Multiplier(PGRM)

PGIM

=

Market Value

Potential Gross Income

or

Market Value = Potential Gross Income x PGIM

MV = EGI x EGIM

=

MV

PGI

Effective gross Income Multiplier (EGIM)

Also called Effective Gross Rent Multiplier(EGRM)

EGIM

=

Market Value

Effective Gross Income

or

Market Value = Effective Gross Income x EGIM

MV = EGI x EGIM

=

MV

PGI

Net Income Multiplier (NIM)

NIM

=

Market Value

Net Operating Income

or

Market Value = Net Operating Income x Net Income Multiplier

MV = NOI x NIM

=

MV

NOI

Capitalization Rate (Cap Rate)

Also called Broker’s Yield

Cap Rate(%)

=

Net Operating Income x 100

Market Value

or

Market Value =

Operating Income x 100

Cap Rate(%)

=

NOI x 100

MV

MV = NOI x 100

Cap Rate(%)

Return on Equity(ROE)

Also called: Equity Dividend Rate(EDR)
Cash on Cash Return

ROE(%) =
$$\frac{(\text{Net Operating Income} - \text{Debt Service}) \times 100}{\text{Equity}}$$

Where: Equity = Market Value – Mortgage
Debt Service = Principal & Interest Payment or
$$MV = \frac{(\text{NOI-DS}) \times 100}{\text{ROE(\%)}} + \text{Mortgage}$$

ROE(%) =
$$\frac{\text{Cash Flow Before Tax} \times 100}{\text{Equity}}$$

ROE(%) =
$$\frac{(\text{NOI-DS}) \times 100}{(\text{MV-Mtge.})}$$

Default Ratio (Break-even) (%)

Using Potential Gross Income	Using Effective Gross Income
= $\frac{(\text{Operating Expenses} + \text{Debt Service}) \times 100}{\text{Potential Gross Income}}$	= $\frac{(\text{Operating Expenses} + \text{Debt Service}) \times 100}{\text{Effective Gross Income}}$

Financing Measures.

Debt Service Ratio (DSR)

=
$$\frac{\text{Net Operating Income}}{\text{Debt Service}}$$

Loan to Value Ratio (%)

=
$$\frac{\text{Loan Amount} \times 100}{\text{Market Value}}$$

Rental Apartment Building Measures.

- 1. Price Per Suite
- 2. Price Per Sq. Foot (Using Suite Areas)
- 3. Rents Per Sq. Foot per month
- 4. Operating Costs
 - a. Operating Costs Per Suite Per Year
 - b. Operating Cost per Sq. Foot per Year
- 5. Operating Expense Ratio (OER) =
$$\frac{\text{Operating Expense} \times 100}{\text{Effective Gross Income}}$$

Home Financing:

Gross Debt Service Ratio =
$$\frac{(\text{Principal} + \text{Interest} + \text{Taxes})}{\text{Gross Family Income}}$$

Lenders often modify the basic Gross Debt Service Ratio Formula.

Modified Gross Debt Service Ratio =
$$\frac{(\text{Principal} + \text{Interest} + \text{Taxes} + \text{Heat} + \% \text{ of Maintenance})}{\text{Gross Family Income}}$$

Total Gross Debt Service Ratio =
$$\frac{(\text{Principal} + \text{Interest} + \text{Taxes} + \text{Other Debt Payments})}{\text{Gross Family Income}}$$

Commercial Real Estate Sample Calculations

The following examples illustrate how to use the real estate formulas. In Example No.1 the information is obtained for the property and the financial measures calculated. In Example No. 2 the financial measures such as the Cap Rate are obtained for comparable sales and are used to calculate the Market Value for the subject property.

Example No 1.

Sale Price (Market Value)	\$3,165,000
Potential Gross Income:	\$306,000
Vacancy & Bad Debt Allowance:	4.5%
Operating Expenses	\$58,000
Mortgage	\$2,056,000
Mortgage Payment (P+i)	\$180,538
Number of Suites	30
Total Rentable Area	24,000 Square feet

Note: All figures are annual

- Calculate:
- Potential Gross Income Multitplier (PGIM)
 - Effective Gross Income Multiplier (EGIM)
 - Net Income Multiplier (NIM)
 - Capitalization Rate (Cap Rate)
 - Return on Equity (ROE)
 - Default Ratio (Break even) based on:

Potential Gross Income
Effective Gross Income
Debt Service Ratio (DSR)
Loan to Value Ratio
Price per Suite
Price per Square Foot
Rent per Square Foot per Month
Operating Cost per Suite per Year
Operating Cost per Square Foot per Year
Operating Expense Ratio (OER) based on:
Potential Gross Income
Effective Gross Income

1. Construct an Annual Income andExpense Statement

Potential Gross Income	\$306,000
Less Vacancy & Bad Debt Allowance (4.5%)	<u>13,770</u>
Effective Gross Income	\$292,230
Operating Expenses	<u>58,000</u>
Net Operating Income	\$234,230
Less; Debt Service (P+i)	<u>180,538</u>
Cash Flow Before Tax	<u><u>\$ 53,692</u></u>

2. Calculate the Financial Measures

Potential Gross Income Multiplier (PGIM):

$$\begin{aligned} \text{PGIM} &= \frac{\text{MV}}{\text{PGI}} &= \frac{3,165,000}{306,000} \\ & &= 10.34 \end{aligned}$$

Effective Gross Income Multiplier (EGIM):

$$\begin{aligned} \text{EGIM} &= \frac{\text{MV}}{\text{EGI}} &= \frac{3,165,000}{292,230} \\ & &= 10.83 \end{aligned}$$

Net Income Multiplier (NIM):

$$\begin{aligned} \text{NIM} &= \frac{\text{MV}}{\text{NOI}} &= \frac{3,165,000}{234,230} \\ & &= 13.51 \end{aligned}$$

Capitalization Rate (Cap Rate):

$$\begin{aligned} \text{Cap Rate} &= \frac{\text{NOI}}{\text{MV}} &= \frac{234,230 \times 100}{3,165,000} \\ & &= 7.40\% \end{aligned}$$

Return on Equity (ROE):

$$\begin{aligned} \text{ROE} &= \frac{(\text{NOI} - \text{DS}) \times 100}{\text{EGI}} &= \frac{\text{Cash Flow Before Tax} \times 100}{\text{Equity}} \\ & &= \frac{53,692 \times 100}{(3,165,000 - 2,056,000)} \\ & &= 4.84\% \end{aligned}$$

Default Ratio (Breakeven):

Based on Potential Gross Income:

$$\begin{aligned} \text{Default Ratio} &= \frac{(\text{Operating Expenses} + \text{Debt Service}) \times 100}{\text{Potential Gross Income}} \\ &= \frac{(58,000 + 180,538) \times 100}{306,000} \\ &= 77.95\% \end{aligned}$$

Default Ratio (Breakeven) cont.

Based on Effective Gross Income:

$$\begin{aligned} \text{Default Ratio} &= \frac{(\text{Operating Expenses} + \text{Debt Service}) \times 100}{\text{Effective Gross Income}} \\ &= \frac{(58,000 + 180,538) \times 100}{292,230} \\ &= 81.63\% \end{aligned}$$

$$\begin{aligned} \text{Debt Service Ratio (DSR)} &= \frac{\text{Net Operating Income}}{\text{Debt Service}} \\ &= \frac{234,230}{180,538} \\ &= 1.30 \end{aligned}$$

$$\begin{aligned} \text{Loan to Value Ratio \%} &= \frac{\text{Loan Amount} \times 100}{\text{Market Value}} \\ &= \frac{2,056,000 \times 100}{3,165,000} \\ &= 64.96\% \end{aligned}$$

$$\begin{aligned} \text{Price Per Suite} &= \frac{3,165,000}{30} \\ &= \$105,500 \end{aligned}$$

$$\begin{aligned} \text{Price per Square foot} &= \frac{3,165,000}{24,000} \\ &= \$131.88 \end{aligned}$$

$$\begin{aligned} \text{Rent Per Sq. Foot per Mo.} &= \frac{306,000}{24,000 \times 12} \\ &= \$1.06 \end{aligned}$$

$$\begin{aligned} \text{Operating Costs Per Suite Per Year} &= \frac{58,000}{30} \\ &= \$1,933 \end{aligned}$$

$$\begin{aligned} \text{Operating Cost per Square foot per year} &= \frac{58,000}{24,000} \\ &= \$2.42 \end{aligned}$$

Operating Expense Ratio (OER)

Based on Potential Gross Income:

$$\begin{aligned} &= \frac{\text{Operating Expenses} \times 100}{\text{Potential Gross Income}} \\ &= \frac{58,000 \times 100}{306,000} \\ &= 18.95\% \end{aligned}$$

Based on Effective Gross Income:

$$\begin{aligned} &= \frac{\text{Operating Expenses} \times 100}{\text{Effective Gross Income}} \\ &= \frac{58,000 \times 100}{} \end{aligned}$$

292,230

= 19.85%

Summary.

Potential Gross Income Multiplier (EGIM):	10.83	
Potential Gross Income Multiplier (EGIM):	10.83	
Net Income Multiplier (NIM):	13.51	
Capitalization Rate (Cap Rate)	7.40%	
Return on Equity (ROE)	4.84%	
Default Ratio (Break even) based on:		
Potential Gross Income	77.95%	
Effective Gross Income	81.63%	
Debt Service Ratio (DSR)	1.30	
Loan to Value Ratio	64.96%	
Price per Suite	\$105,000	
Price per Square Foot	\$131.88	
Rent per Square foot per month	\$1.06	
Operating Cost per Suite per Year		\$1,933
Operating Cost per Square Foot per Year	\$2.42	
Operating Expense Ratio (OER) based on:		
Potential Gross Income	18.96%	
Effective Gross Income	19.85%	

Example No 2.

Potential Gross Income:	\$244,800
Vacancy & Bad Debt Allowance:	5.0%
Operating Expenses	\$49,300
Mortgage	\$1,685,000
Mortgage Payment (P+i)	\$147,500
Number of Suites	24
Total Rentable Area	18,720 Square feet

Note: All figures are annual

Calculate the Market Value using the following financial measures

Effective Gross Income Multiplier (EGIM): 9.30
Net Income Multiplier (NIM): 12.50
Capitalization Rate (Cap Rate): 8.00%
Return on Equity (ROE): 5.57%

1. Start by constructing the Annual Income and Expense Statement

Potential Gross Income	\$244,800
Less Vacancy & Bad Debt Allowance (5.0%)	<u>12,240</u>
Effective Gross Income	\$232,560
Operating Expenses	<u>49,300</u>
Net Operating Income	\$183,260
Less; Debt Service (P+i)	<u>147,500</u>
Cash Flow Before Tax	<u><u>\$ 35,760</u></u>

2. Calculate the Market Value based on the:

Effective Gross Income Multiplier (EGIM):

MV = Effective Gross Income xEGIM

= 232,560 x 9.30

= \$2,162,808

Net Income Multiplier (NIM):

MV = Net Operating xNIM

= 183,260 x 12.50

= \$2,290,750

Capitalization Rate (Cap Rate):

$$\begin{aligned} \text{MV} &= \frac{\text{Net Operating Income} \times 100}{\text{Cap Rate}} \\ &= \frac{183,260 \times 100}{8.0} \\ &= \$2,290,750 \end{aligned}$$

Return on Equity (ROE):

$$\begin{aligned} \text{MV} &= \frac{(\text{NOI} - \text{DS}) \times 100}{\text{ROE}} + \text{Mortgage} \\ &= \frac{(183,260 - 147,500) \times 100}{5.57} + 1,685,000 \\ &= \$2,327,011 \end{aligned}$$