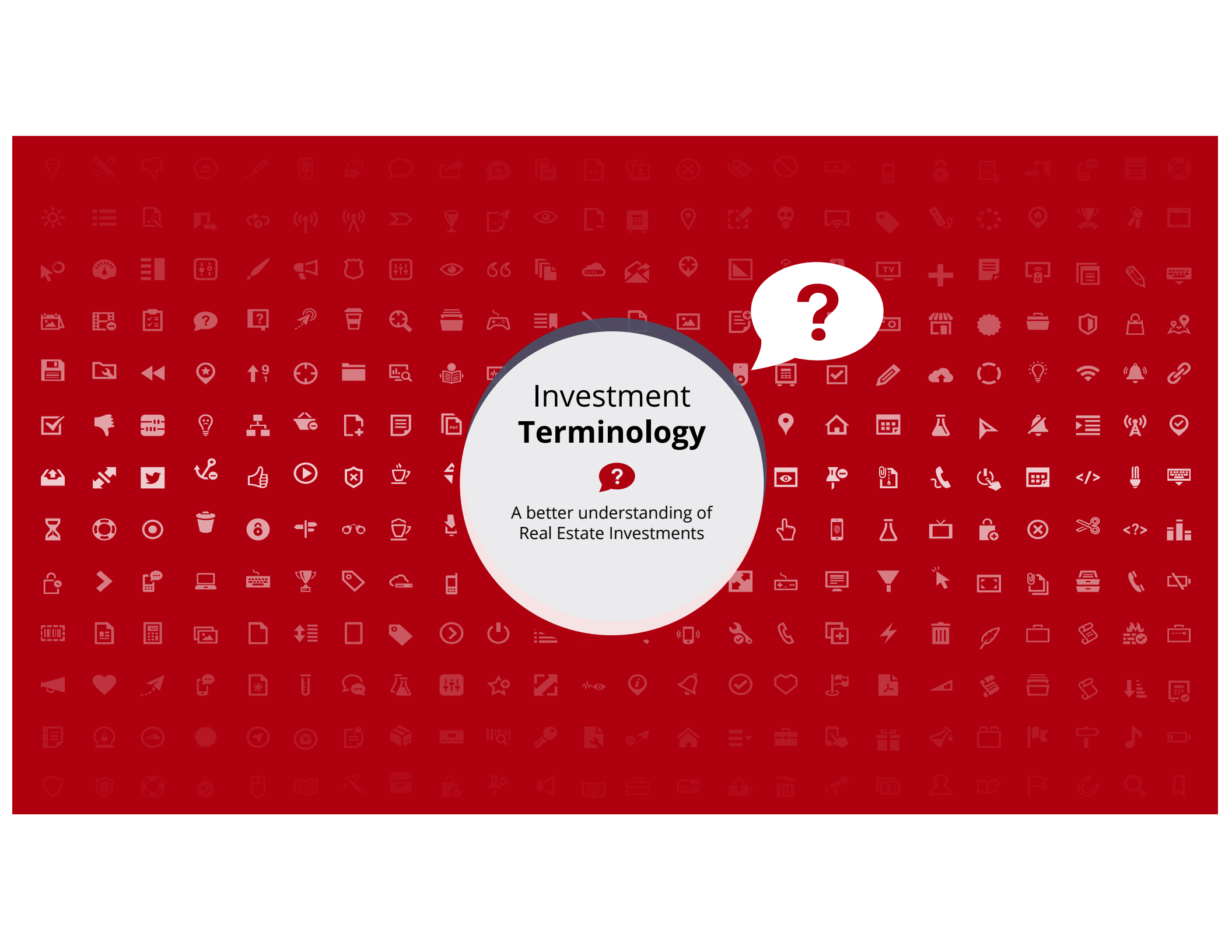




Investment Terminology

A better understanding of
Real Estate Investments

Residential Income **Analysis**

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Net Operating Income

Net operating income (NOI) equals all revenue from the property minus all reasonably necessary operating expenses.

Aside from rent, a property might also generate revenue from parking and service fees, like vending and laundry machines. Operating expenses are those required to run and maintain the building and its grounds, such as insurance, property management fees, utilities, property taxes, repairs and janitorial fees.

NOI is a before-tax figure; it also excludes principal and interest payments on loans, capital expenditures, depreciation and amortization.

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The **Cash Flow**

Cash flow is generally used as another term for the net operating income. In most cases, this represents the net profit produced by the property after all expenses including any financing and tax costs.

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The **Capitalization Rate**

The capitalization rate is the rate of return on a real estate investment property based on the expected net income. The capitalization rate is used to estimate the investor's potential return on investment.

The cap rate of an investment is calculated by dividing the investment's net operating income (NOI) by the current market value of the property. NOI is the annual return on the property minus all operating costs. The formula for calculating the capitalization rate can be expressed in the following way:

Capitalization Rate =

Net Operating Income / Current Market Value

The capitalization rate is expressed as a percentage and is also often known as the "cap rate."

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The **Market Value**

The fair price that the property would fetch on the open marketplace.

The greatest difficulty in determining market value lies in estimating the value of illiquid assets like real estate and businesses, which may necessitate the use of real estate appraisers and business valuation experts respectively.

For multi-family properties, the value is generally dictated by comparable sales and the rate of return.

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Vacancy **Rates**

When there is not an active lease in place for a residential unit, it is considered vacant. The vacancy rate represents the percentage of vacant units compared with occupied units over a period of time.

The ideal scenario for a property owner is a vacancy rate of 0% which means the property is fully occupied and producing the maximum amount of income at that time.

Most lenders will use a default vacancy rate of 25% when evaluating future expected earnings.

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The **Market Rents**

Market Rents represent the fair market value the property can command for monthly rents. This is generally based on comparable rentals.

This represents the value in the present days, not necessarily the current tenants,

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The **Expenses**

When evaluating a potential multi-family acquisition, it's important to have a clear understanding of the expenses that must be paid by the owner.

Examples of expenses include:

- Property Insurance
- Management Fees
- Trash Service
- Water Service
- Garding Service
- Maintenance Expenses
- Property Taxes
- etc...

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Appreciation

When evaluating a potential multi-family acquisition, it's important to have a clear understanding of the expenses that must be paid by the owner.

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Depreciation

Depreciation is an accounting method of allocating the cost of a tangible asset over its useful life.

Residential Income Owners depreciate long-term assets for both tax and accounting purposes. For tax purposes, businesses can deduct the cost of the tangible assets they purchase as business expenses; however, businesses must depreciate these assets in accordance with IRS rules about how and when the deduction may be taken.

In terms of accrual accounting, no building lasts forever and thus the value of the structure can legally be reduced over a period of time.

Due to the current U.S. tax code, depreciation is generally used to reduce the yearly taxable net operating income.

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Amortization

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Disposition

Disposition refers to the act of getting rid of an asset or security through a direct sale or some **other** transfer method. Insider trades often report a disposition of a **certain** number of shares to board members and executives, which simply means that they have sold the assets in question.

In plain english, Disposition means to sell a property.