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Apartment Investing - Terminology

For our first time Buyers . . . and maybe some veterans too!

The following descriptions will familiarize you with the basic terminology associated with multifamily apartment investing.

Unit Mix

- Example: An 8 unit property may contain a unit mix of --
  (1) 3 bedroom – 2 bath
  (3) 2 bedroom – 1.5 bath
  (4) 1 bedroom – 1 bath

Price per Unit (PPU)

- The Purchase Price divided by the number of Units to be purchased.

Vacancy Allowance (%)

- This is a monitory allowance to account for potential vacancies that the property may experience over the course of a year. It is normally expressed as a percentage of Gross Scheduled Income (GSI). Depending on the size of the property, vacancy allowances typically range from 3.0-5.0% of the GSI.

Gross Rent Multiplier (GRM)

- The price of the property divided by the Gross Rental Income per year. The lower the number, the better the potential cash flow. Properties in Southern California typically sell for gross rent multipliers in the 8.0-10.0 range on the most challenged properties in the toughest areas to as high as 20.0-25.0 on premium properties in the most desirable coastal areas.

Gross Scheduled Income (GSI)

- The total amount of income that potentially could be generated if all the units remained rented for an entire year. This income could include other miscellaneous income generated from laundry equipment, rented storage units, garages, etc.

Gross Operating Income (GOI)

- Equals the Gross Scheduled Income minus a designated vacancy allowance. Depending on the size of the property, vacancy allowances typically run from 3.0-5.0% of the GSI.

Gross Operating Expense

- The total of all operating expenses related to the property. Does not include the monthly payment or interest expense associated with any loans or mortgages against the property

Net Operating Income (NOI)

- Equals Gross Operating Income minus Gross Operating Expense (not including any mortgage payments or interest expense)

Gross Spendable Income (GSI)

- Also commonly known as “Cash Flow”. Equals the Net Operating Income (NOI) minus any loan payments, including principal & interest.

Capitalization Rate (Cap Rate)

- The rate of return (%) from a property obtained by dividing the Net Operating Income (NOI) per Year by the Purchase Price. While the Cap Rate is an important variable, it is only one of many tools used by investors when evaluating a property. Cap Rates can vary widely depending on a property’s location, age, size, and condition.

Cash-on-Cash Return (COC)

- Also known as the Equity Cap Rate. This is the percentage return on just the money you personally invested, which is typically the sum of the down payment and any closing costs. This figure is derived by dividing the annual Gross Spendable Income or net Cash Flow by the total amount of money you came out-of-pocket with to purchase the property.

Total Return on Investment (ROI)

- This is the total investment return on a property taking into account the portion of any mortgage payment that is applied to reducing the loan principal. This percentage is calculated by adding the net Cash Flow together with any Principal Reduction and then dividing by the total cash necessary to close.

Net Profit or Loss

- For IRS and tax purposes (i.e., Schedule E), this is the amount of money remaining after deducting from the Gross Scheduled Income all expenses of the property including, but not limited to, the following: Property Taxes, Insurance, Utilities, Landscaping, Maintenance, and Mortgage Interest, Management, Advertising, Trash Removal, etc.

“Bread & Butter” Properties

- This phrase is used to describe properties that are generally older, often in need of some repairs, and typically located in lower quality neighborhoods. These properties generally produce more rental income relative to the purchase price (i.e. lower GRM’s) than “pride of ownership” properties.

Master Metered Building

- This is a building that has only one meter for all of the gas and/or electric utilities associated with the property. Generally this means that the owner of the property pays for all of the gas or electricity used by the tenants. Many buildings have a central hot water heater, thereby causing the owner to be responsible for the cost of heating the water as well. In the case of properties having separate hot water heaters, gas meters, and electric meters, the expense charged to the owner of the property is typically less than in the case of master metered buildings.

Leveraged Investment

- Financial leverage as it relates to Real Estate is the ability to own property that is worth an amount usually much greater than the amount actually invested.

<u>Example</u>: When an investor purchases a property and does not pay all cash, in other words he obtains a loan to purchase the property, the investor is considered to have purchased a leveraged investment. Using 20% of the purchase as a down payment would be considered greater leverage than putting down 50%. In this instance, the investor would be purchasing property 5 times the amount of his cash invested as opposed to 2 times the amount of his cash invested, thereby yielding the investor greater leverage through more efficient use of the down payment funds.