

s p e c i a l r e p o r t

Guiding Principles of Real Estate Investing

by Curtis Oakes & Peter Harris



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A Trump University Special Report

By Curtis Oakes and Peter Harris, Oakes Group

Becoming good or best at something requires specific knowledge and understanding. One of our main goals is enable you to become the best at analyzing investments.

First of all, in real estate investing, it is critically important that you increase your knowledge and understanding of exact real estate investment words or terms. The goal here is to attain a level of mastery of these words or terms. Certain terms need to be fully understood to be used effectively in the game of real estate investments.

This exercise focuses on mastering real estate investment terms. Mastering a real estate deal requires mastery of the terms we are about to discuss. Mastery of the following terms will enable you to fundamentally analyze the investment.

Secondly, real estate brokers who are in the game of selling income-producing real estate do know most of the terms. Gaining mastery of the investment terms puts you on par (or above) with them. Your being able to speak “their language” gives you instant credibility and a relationship advantage over someone without your knowledge and understanding.

Lastly, just by increasing your word power, you’ll gain increased certainty – enabling yourself to make sound, efficient decisions

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Real Estate Investing Terms To Master

Gross Income (\$)

Rents, laundry or vending machine income, late fees, could be monthly or annual.

Vacancy (\$)

A unit that is left unoccupied and is not producing income is a vacancy. A unit that is vacated and re-rented in the same month is not considered a vacancy. It is considered a turnover.

Vacancy rate (%)

Number of vacancies divided by number of units

$$\frac{\text{total vacant units}}{\text{\# of total units}}$$

Effective Gross Income (\$)

Gross Income minus vacancy

$$\text{Gross income} - (\text{vacancy rate (\%)} \times \text{income}) = \text{effective gross income}$$

Operating Expenses (\$)

Annual operating expenses of the property typically include taxes, insurance, utilities, management fees, landscaping, maintenance, repairs, and vacancies. This does not include mortgage payments or interest expense.

Net Operating Income (NOI) (\$)

Effective Gross Income minus Operating Expenses

$$\text{effective gross income} - \text{operating expenses} = \text{NOI}$$

Debt Service (\$)

Monthly Mortgage Amount multiplied by 12 Months

$$\text{monthly mortgage amount} \times 12 = \text{debt service}$$

Cash Flow (\$)

Net Operating Income minus Debt Service

$$\text{NOI} - \text{Debt Service} = \text{Annual Cash Flow}$$

If you then divide this number by 12, you end up with the *monthly* cash flow

Cash-on-Cash Return (%)

Annual Cash Flow divided by Down Payment Amount

$$\frac{\text{annual cash flow}}{\text{down payment}}$$

Capitalization Rate (%)

Net Operating Income divided by the Sales Price. Also known as the “cap rate”. It is the measure of profitability of an investment. Cap Rates tell you how much you will make on an investment if you paid all cash for it, therefore financing and taxation are not included.

$$\frac{\text{NOI}}{\text{Sales Price}}$$

Gross Rent Multiplier

Sales Price divided by Gross Annual Income. A “rule of thumb” method of quickly analyzing property. GRM is used mainly to evaluate and compare properties in the same area. Every geographical area has its own GRM, and we use it to compare another property in the area to the area’s GRM. The GRM presupposes that you can multiply a number times the gross income of a property to estimate its value.

$$\frac{\text{Sales Price}}{\text{Gross Annual Income}}$$

Note: Your goal is to memorize the definitions and calculations of each term as we will soon use them in analyzing properties. This is an ongoing part of the process of acquiring mastery.

Mastery of Real Estate Investment Terms – Practice Properties

The purpose of this exercise is to introduce you to and measure your readiness in understanding how property is analyzed by using the investment terms to mastery. As each property is analyzed, each investment term will take on a more definite meaning. The terms will begin to sink in and things will start to “click”.

There are three (3) practice properties. The first practice property on the next page is done for you. All of the calculations of the investment terms are done for you as an example. The next two practice properties will need to be completed by you. Remember, it's practice. It's okay to not know. It's not okay to pretend you know. Take as much time as you need in completing all of the exercises. By the end of the exercise, our goal is to enable you to fundamentally analyze just about any investment by knowing how to calculate **cash flow, cash-on-cash return, cap rate, and gross rent multiplier**.

Each property has its own unique problem or twist. Solving problems and spotting twists are keys in buying poor, average, or great investments. You will learn this.

What you need to do for each practice property: calculate the cash flow, cash-on-cash return, cap rate, and gross rent multiplier. A calculator with a mortgage calculator is required.

Practice Worksheet #1

(see the next page for the answers)

Address: 1467-67 Alexis Avenue, Anytown, USA

Description: 2 -3bdrm, 1ba units **Type:** Duplex **Yr blt:** 1939 **Sq. Ftg:** 975sf per unit
Asking Price: \$159,000 **Down payment:** 10%, \$15,900
Mortgage: \$143,100 @ 6.8% - 30yr amt., \$928/mo (proposed)

Details: Victorian design, both units complete rehab, rents recently increased, roof 2 yrs new, long-term tenants and good rental history, close to main highway, and major medical center

Income: Unit 1: \$975/mo	Unit 2: \$975/mo	Total: \$23,400/yr
Vacancy rate: 5%		<u><\$1170></u>
	Effective Gross Income	\$

Expenses:	Hazard/Landlord Insurance	\$ 800
	Real Estate Taxes	\$1600
	Maintenance Budget (\$600/unit)	\$1200
	Landscape	\$ 600
	Electrical	\$ 360
	Water/Sewer	<u>\$1440</u>
	Total Operating Expenses	\$

Building Performance:	Net Operating Income:	\$	/yr		
	Debt Service:	\$	/yr		
	Cashflow:	\$	/yr	\$	/mo
	Cash-on-Cash Return:		%		
	CAP rate:		%		
	Gross Rent Multiplier:				

NOTES:

Practice Worksheet #1 – Answers

Address: 1467-69 Alexis Avenue, Anytown, USA

Description: 2 -3bdrm, 1ba units **Type:** Duplex Yr blt: 1939 **Sq. Ftg:** 975sf per unit
Asking Price: \$159,000 **Downpayment:** 10%, \$15,900
Mortgage: \$143,000 @ 6.8% - 30yr amt., \$928/mo (proposed)

Details: Victorian design, both units complete rehab, rents recently increased, roof 2 yrs new, long-term tenants and good rental history, close to main highway, and major medical center

Income: Unit 1: \$975/mo	Unit 2: \$975/mo	Total: \$23,400/yr
Vacancy rate: 5%		<\$1170>
	Effective Gross Income	\$22,230

Expenses:	Hazard/Landlord Insurance	\$800
	Real Estate Taxes	\$1600
	Maintenance Budget (\$600/unit)	\$1200
	Landscape	\$600
	Electrical	\$360
	Water/Sewer	\$1440
	Total Operating Expenses	\$6000

Building Performance:	Net Operating Income:	\$16,230/yr
	Debt Service:	\$11,136/yr
	Cashflow	\$5094/yr \$424/mo
	Cash-on-Cash Return:	32%
	CAP rate:	10.2%
	Gross Rent Multiplier:	6.79

NOTES:

Practice Worksheet #2

(fill in the blanks from here on)

Address: 23 Jordan Way, Anytown, USA

Description: 3 -2bdrm,1ba & 1 -3bdrm,1ba **Type:** FourPlex **Yr blt:** 1957 **Sq. Ftg:** 3700sf
Asking Price: \$199,000 **Downpayment:** 10%, \$19,900
Mortgage: \$179,100 @7.0% - 30yr amt., \$1191/mo (proposed)

Details: Two story 4-plex, lots of upside, below market rents, needs cosmetics and updating, \$7500 termite report, tenants pay elec, water, garbage.
One 2bdrm (unit 2) complete rehab, buyer to cooperate with seller 1031 exchange.

Income: Unit 1: \$505 Unit 2: \$625 Unit 3: \$500 Unit 4: \$675 **Total:** \$27,660/yr
Vacancy rate: 5% <\$1383>

Effective Gross Income **\$**

Expenses:	Hazard/Landlord Insurance	\$1200/yr
	Real Estate Taxes	\$1640
	Maintenance Budget	\$2000
	Landscape	\$600
	Electrical	tenant
	Water/Sewer	tenant
	Heat	\$3000
	Total Operating Expenses	\$

Building Performance:	Net Operating Income:	\$	/yr	
	Debt Service:	\$	/yr	
	Cashflow:	\$	/yr	\$ /mo
	Cash-on-Cash Return:		%	
	CAP rate:		%	
	Gross Rent Multiplier:			

NOTES:

Practice Worksheet #3

Address: 893 Charlotte Circle, Anytown, USA

Description: 3 -3bdrm, 2ba **Type:** TriPlex **Yr blt:** 2000 **Sq. Ftg:** 4780sf
Asking Price: \$549,000 **Downpayment:** 10%, \$54,900
Mortgage: \$494,100 @7.0% - 30yr amt., \$3287/mo (proposed)

Details: Luxury 3 units, each sep. 2car garg, WIFI-installed, master bdrm w/hot tub, gated community, beautifully landscaped, Home and Gardens model, HOA fees to increase upon completion of fitness complex. Live in one, rent others!

Income: Unit 1: \$1500	Unit 2: \$1500	Unit 3: \$1400	Total: \$52,800/yr
Vacancy rate: 5%			<u><\$2640></u>
		Effective Gross Income	\$

Expenses:	Hazard/Landlord Insurance	\$1750/yr
	Real Estate Taxes	\$6148
	Maintenance Budget	\$900
	HOAs	\$3000
	Electrical	tenant
	Water/Sewer	tenant
	Total Operating Expenses	\$

Building Performance:	Net Operating Income:	\$	/yr	
	Debt Service:	\$	/yr	
	Cashflow:	\$	/yr	\$ /mo
	Cash-on-Cash Return:		%	
	CAP rate:		%	
	Gross Rent Multiplier:			

NOTES:

Practice Worksheet #2 – Answers

Address: 23 Jordan Way, Anytown, USA

Description: 3 -2bdrm,1ba & 1 -3bdrm,1ba **Type:** FourPlex **Yr blt:** 1957 **Sq. Ftg:** 3700sf
Asking Price: \$199,000 **Down payment:** 10%, \$19,900
Mortgage: \$179,100 @7.0% - 30yr amt., \$1191/mo (proposed)

Details: Two story 4-plex, lots of upside, below market rents, needs cosmetics and updating, \$7500 termite report, tenants pay elec, water, garbage.
 One 2bdrm (unit 2) complete rehab, buyer to cooperate with seller 1031 exchange.

Income: Unit 1: \$505 Unit 2: \$625 Unit 3: \$500 Unit 4: \$675	Total: \$27,660/yr
Vacancy rate: 5%	<\$1383>
Effective Gross Income	\$26,277

Expenses:	Hazard/Landlord Insurance	\$1200/yr
	Real Estate Taxes	\$1640
	Maintenance Budget	\$2000
	Landscape	\$600
	Electrical	tenant
	Water/Sewer	tenant
	Heat	\$3000
	Total Operating Expenses	\$8,440

Building Performance:	Net Operating Income:	\$ 17,837 /yr
	Debt Service:	\$ 14,292 /yr
	Cashflow:	\$ 3,545 /yr \$ 295 /mo
	Cash-on-Cash Return:	17.8 %
	CAP rate:	8.96 %
	Gross Rent Multiplier:	7.19

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Practice Worksheet #3 – Answers

Address: 893 Charlotte Circle, Anytown, USA

Description: 3 -3bdrm, 2ba **Type:** TriPlex **Yr blt:** 2000 **Sq. Ftg:** 4780sf

Asking Price: \$549,000 **Downpayment:** 10%, \$54,900

Mortgage: \$494,100 @7.0% - 30yr amt., \$3287/mo (proposed)

Details: Luxury 3 units, each sep. 2car garg, WIFI-installed, master bdrm w/hot tub, gated community, beautifully landscaped, Home and Gardens model, HOA fees to increase upon completion of fitness complex. Live in one, rent others!

Income: Unit 1: \$1500	Unit 2: \$1500	Unit 3: \$1400	Total: \$52,800/yr
Vacancy rate: 5%			<u><\$2640></u>
		Effective Gross Income	\$50,160

Expenses: Hazard/Landlord Insurance	\$1750/yr
Real Estate Taxes	\$6148
Maintenance Budget	\$900
HOAs	\$3000
Electrical	tenant
Water/Sewer	<u>tenant</u>
Total Operating Expenses	\$11,798

Building Performance:	Net Operating Income:	\$ 38,362 /yr	
	Debt Service:	\$ 39,444 /yr	
	Cashflow:	\$ -1,082 /yr	\$ - 90 /mo
	Cash-on-Cash Return:	- 1.9 %	
	CAP rate:	6.9 %	
	Gross Rent Multiplier:	10.39	

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