

Return on Investment Calculation

Frequently you will see income and expense statements that do not include "vacancy & bad debt", "maintenance", or "management" costs. Here is a simple and effective way to ensure accuracy.

Start with G.O.I. "Gross Operating Income"

Less Vacancy and Bad Debts (calculate 2% - 4%)

Equals "Effective Gross Income" (you now have the true income & a starting point)

Next deduct expenses. For those missing expenses plan approximately:

- Management = 4% to 8% (The 4% manager may be the most expensive!)
- Maintenance = 2% to 5% (dependent on age and condition of property)

Deduct all other expenses to arrive at the N.O.I. or "Net Operating Income".

Deduct A.D.S "Annual Debt Service" (the mortgage, principal & interest)

Result is "Annual Cash Flow"

To determine your R.O.I. "Return On Investment", divide the cash flow by your investment (down payment + incidentals)
For example if your annual cash flow is \$4,000 and you have \$50,000 invested, then you are making an 8% return on your money.

In an Agreement of Purchase and Sale (and among many other prudent measures) obtain from the Seller, proof of income statements (copies of leases, etc.) and copies of expenses (utility bills, tax statement, etc.) to ensure the accuracy of your R.O.I.

See an example calculation of cash flow and return on investment on the next page. It assumes a five plex apartment building sold for \$600,000 with the Buyer using a \$150,000 down payment (25%) to avoid paying a CMHC insurance charge.

Example Of Cash Flow Calculation

Income

Annual rental income	\$70,000	
Less vacancy & bad debt (4%)	<u>\$2,800</u>	
Effective rental income	\$67,200	\$67,200
Income from parking	\$2,600	
Income from laundry	<u>\$2,100</u>	
Total "other" income	\$4,700	\$4,700
Gross operating income (GOI)		\$71,900

Expenses

Management (6%)	\$4,200	
Property Tax	\$7,000	
Insurance	\$1,000	
Water/Sewer	\$800	
Heat	\$600	
Hydro	\$600	
Maintenance (5%)	\$3,500	
Total Operating Expenses (TOE)	\$17,700	\$17,700
Net Operating Income (GOI -TOE)		\$54,200
Less Annual Debt Service (Mortgage Of Principal And Interest, Assume \$450,000 @ 5% Amortized Over 25 Years)	\$27,000	\$27,000
Annual Cash Flow		\$27,200
Return On Investment (\$27,200 / \$150,000)		18%