

HIRC

The High-Risers Club

3.26.2024 – Valuation & Financing with Alissa Gaines

Coach Jeff Wright

Welcome

HRC
The High-Risers Club

Does anyone have anything great to share personally or professionally?



HRC

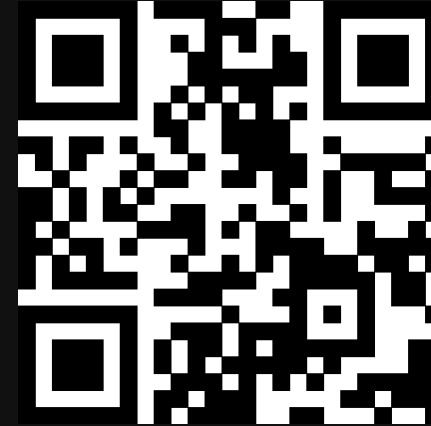
The High-Risers Club

Podcast

Tune in wherever you get your podcasts!

- **Last Week: Ways to Create Business in Commercial Real Estate**
- **This Week: 11G, There is Another Level of Greatness Within You, Part 1**

Listen on Apple Podcast:



Listen on Spotify:



HRC
The High-Risers Club

Greatness is Within



You Can Do This

HRC
The High-Risers Club

Valuation



HRC
The High-Risers Club

Valuation

Measuring Investment Value ($I \div R = V$)

- **I** – NOI – Net Operating Income
- **R** – Capitalization (Cap) Rate
- **V** – Market Value

*If you have any two of these three value, you can solve for the third.

Valuation

Net Operating Income (NOI) is the income available to pay the mortgage (debt service) after all operating expenses have been paid.

Value x Capitalization Rate = Net Operating Income

Valuation

Net Operating Income Formula

	Rental Income
Plus	Other Income + Reimbursements
<hr/>	
Equals	Total Income
	Total Income
Minus	Vacancy and Credit Losses
<hr/>	
Equals	Effective Gross Income
	Effective Gross Income
Minus	Operating Expenses + Reserves
<hr/>	
Equals	Net Operating Income

Valuation

INCOME & EXPENSE STATEMENT

INCOME & EXPENSES	CURRENT			POTENTIAL AT MARKET RENT			
	2-Family	6-Family	Total	2-Family	6-Family	Total	
INCOME							
Apartment Income	23,400	54,900	78,300	31,200	69,600	100,800	
Vacancy Factor	5%	(1,170)	(2,745)	(3,915)	(1,560)	(3,480)	(5,040)
Effective Gross Income	\$22,230	\$52,155	\$74,385	\$29,640	\$66,120	\$95,760	
EXPENSES							
Real Estate Taxes	2,554	6,991	9,546	2,554	6,991	9,546	
Insurance	2,000	2,300	4,300	2,000	2,300	4,300	
Water and Sewer	1,968	3,852	5,820	1,968	3,852	5,820	
Electric	780	780	1,560	780	780	1,560	
Gas	2,016	2,424	4,440	2,016	2,424	4,440	
Trash - City Pick-Up	N/A	N/A	N/A	N/A	N/A	N/A	
Repairs & Maintenance	\$500	1,000	3,000	4,000	1,000	3,000	4,000
Management Fee	5%	1,112	2,608	3,719	1,482	3,306	4,788
Total Expenses	\$11,430	\$21,955	\$33,385	\$11,800	\$22,653	\$34,454	
NET OPERATING INCOME	\$10,800	\$30,200	\$41,000	\$17,840	\$43,467	\$61,306	

HRC

The High-Risers Club

Valuation

INVESTOR VALUATION

	2-Family	6-Family	Total
Buyer's Target Cap Rate - Yr 1	7.0%		
Indicated Value - Rounded	\$154,288	\$431,430	\$585,717

HRC

The High-Risers Club

Valuation

A commercial property is generating an annual net operating income (NOI) of \$200,000. The property is being sold for \$3,000,000 with a cap rate of 7%. What is the value of the property based on the income method of valuation?

- a. The value of the property can be calculated using the formula for the income method of valuation:

$$V = \text{NOI} / \text{Cap Rate}$$

V = the value of the property
NOI = the net operating income
Cap Rate = the capitalization rate

$$V = \$200,000 / 0.07$$

$$V = \$2,857,143$$

Therefore, ***the value of the property*** based on the income method of valuation is \$2,857,143.

Valuation

A commercial property is being sold for \$5,000,000 with a cap rate of 8%. What is the net operating income (NOI) of the property?

$$\text{NOI} = V \times \text{Cap Rate}$$

$$\text{NOI} = \$5,000,000 \times 0.08$$

$$\text{NOI} = \$400,000$$

Therefore, ***the net operating income*** of the property is \$400,000.

Valuation

A commercial property generates an annual net operating income (NOI) of \$300,000. If the cap rate is 6%, what is the value of the property?

a. $\text{Value} = \text{NOI} / \text{Cap Rate}$
 $\text{Value} = \$300,000 / 0.06$
 $\text{Value} = \$5,000,000$

Therefore, the value of the property is \$5,000,000.

Valuation

A mixed-use real estate property has 6 residential tenants and 2 commercial tenants. The residential tenants pay a total of \$10,000 per month in rent, while the commercial tenants pay a total of \$5,000 per month in rent. The property also generates \$1,000 per month in other income. The property has a vacancy and credit loss percentage of 5%.

The effective gross income is subject to the following expenses: real estate taxes of \$15,000, insurance of \$5,000, utilities of \$2,000 per unit, repairs and maintenance of \$1,000 per unit, a management fee of 4% of the effective gross income, landscaping of 1% of the effective gross income, trash pick-up of \$500 per month, and a reserve of \$20,000 per year.

Valuation

What is the net operating income (NOI) of the property?

- a. Total Monthly Rental Income = Residential Rent + Commercial Rent + Other Income
- b. Operating Expenses = Real Estate Taxes + Insurance + Utilities + Repairs and Maintenance + Management Fee + Landscaping + Trash + Reserves
- c. Net Operating Income (NOI) = EGI - Operating Expenses

Valuation

Total Monthly Rental Income

Apartment Rental Income:	\$120,000	(\$10,000 x 12)
Commercial Rental Income:		\$60,000 (\$5,000 x 12)
<u>Other Income:</u>	<u>\$12,000</u>	<u>(\$1,000 x 12)</u>
Total Monthly Rental Income =	\$192,000	
<u>Vacancy and Credit Loss:</u>	<u>(\$9,600)</u>	<u>(\$192,000) x (1 - 0.05)</u>
Effective Gross Income =	\$182,400	

Operating Expenses

Real Estate Taxes:	(\$15,000)	
Insurance	(\$5,000)	
Utility Expenses	(\$12,000)	(\$2,000 x 6)
Repairs and Maintenance	(\$6,000)	(\$1,000 x 6)
Management Fee:	(\$7,296)	(0.04 x \$182,400)
Landscaping:	(\$1,824)	(0.01 x \$182,400)
<u>Trash/Refuse:</u>	<u>(\$20,000)</u>	
Operating Expenses =	(\$67,120)	

Net Operating Income

Effective Gross Income:	\$182,400
<u>Operating Expenses:</u>	<u>\$67,120</u>
Net Operating Income =	\$115,280

Therefore, the *net operating income* of the property is \$115,800.

Valuation

An investor is looking to purchase an office building that has five tenants. The building has a total potential rental income of \$350,000 per year, but due to a vacancy rate of 10%, the actual rental income is \$315,000 per year. The purchase price of the building is \$2,500,000.

The operating expenses of the building include real estate taxes of \$20,000, insurance of \$5,000, utilities of \$3,000 per unit, repairs and maintenance of \$1,500 per unit, a management fee of 5% of the effective gross income, landscaping of 1% of the effective gross income, trash pick-up of \$1,000 per year, and a reserve of \$25,000 per year. What is the cap rate of the building?

Valuation

5. a. Total Rental Income:

Rental Income	\$350,000	
<u>Vacancy Rate:</u>	<u>(\$35,000)</u>	<u>$(\\$350,000) \times (1 - 0.10)$</u>
Effective Gross Income (EGI) =	\$315,000	

Operating Expenses:

Real Estate Taxes	(\$20,000)	
Insurance	(\$5,000)	
Utilities	(\$15,000)	$(\$3,000 \times 5)$
Repairs and Maintenance	(\$7,500)	$(\$1,500 \times 5)$
Management Fee	(\$15,750)	$(\$315,000 \times 0.05)$
Landscaping	(\$3,150)	$(\$315,000 \times 0.01)$
Trash	(\$1,000)	
<u>Reserves</u>	<u>(\$25,000)</u>	
Operating Expenses =	(\$92,400)	

Net Operating Income:

Effective Gross Income (EGI) =	\$315,000
Operating Expenses =	(\$92,400)
Net Operating Income (NOI) =	\$222,600

Cap Rate = $\text{NOI} \div \text{Purchase Price}$

Cap Rate = $\$222,600 / \$2,500,000$

Cap Rate = 0.089 or 8.90%

Therefore, *the cap rate* of the building is 8.90%.

Valuation

An investor is looking to buy an apartment building with 8 units. The building has four 1-bedroom apartments, two 2-bedroom apartments, and two 3-bedroom apartments. The monthly rental rates for the apartments are as follows:

- Four 1-bedroom apartments: \$1,000
- Two 2-bedroom apartments: \$1,500
- Two 3-bedroom apartments: \$1,800

The building also generates \$500 per month in parking income and \$200 per month in laundry income per tenant. The vacancy factor percentage is 5%. The effective gross income is subject to the following expenses: real estate taxes of \$10,000, insurance of \$2,500, utilities of \$2,000 per unit, repairs and maintenance of \$1,000 per unit, a management fee of 4% of the effective gross income, landscaping of 1% of the effective gross income, trash pick-up of \$500 per year, and a reserve of \$15,000 per year.

Valuation

What is the market value of the property assuming a cap rate of 7%?

a. Rental Income

Four 1-Bedroom Apartment:	\$48,000	(\$1,000 x 4 x 12)
Two 2-Bedroom Apartment:	\$36,000	(\$1,500 x 2 x 12)
<u>Two 3-Bedroom Apartment:</u>	<u>\$43,200</u>	<u>(\$1,800 x 2 x 12)</u>
Total Monthly Rental Income =	\$127,200	

Parking Income:	\$9,600	(\$100 x 8 x 12)
<u>Laundry Income:</u>	<u>\$19,200</u>	<u>(\$200 x 8 x 12)</u>
Total Other Income =	\$28,800	

Total Monthly Rental Income =	\$127,200	
Total Other Income =	\$28,800	
Total Income =	\$156,000	
<u>Vacancy and Credit Loss:</u>	<u>(\$7,800)</u>	(\$156,000) x (1 - 0.05)
Effective Gross Income =	\$148,200	

Valuation

Operating Expenses

Real Estate Taxes:	(\$10,000)	
Insurance:	(\$2,500)	
Utilities:	(\$16,000)	(\$2,000 x 8)
Repairs and Maintenance:	(\$8,000)	(\$1,000 x 8)
Management Fee:	(\$5,925)	(0.04 x \$148,200)
Landscaping:	(\$1,482)	(0.01 x \$148,200)
Trash:	(\$500)	
<u>Reserves:</u>	<u>(\$15,000)</u>	
Operating Expenses =	(\$59,410)	

Net Operating Income:

Effective Gross Income =	\$148,200
<u>Operating Expenses =</u>	<u>(\$59,410)</u>
Net Operating Income (NOI) =	\$88,790

Market Value = NOI ÷ Cap Rate

Market Value = \$88,790 ÷ 7.00%

Market Value = \$1,268,429

Therefore, *the market value* of the building is \$1,268,429.

If NOI is \$304,652

And cap rate is 6.75%

What is the asking price?

Answer:

$$\text{NOI} / \text{Cap Rate} = \text{Asking Price}$$
$$304,652 / 6.75 = \$4,513,363$$

HRC

The High-Risers Club

Valuation

Capitalization (cap) rate is your return on an investment if you paid all cash.

Example: If you paid \$800,00 for a mixed-use property and the net operating income (NOI) was \$70,000:

What is the cap rate?

$$\text{NOI (I)} / \text{Sale Price (V)} = \text{Cap Rate (R)}$$

$$\text{\$70,000} / \text{\$800,000} = 8.75\%$$

Valuation

Relationship between cap rate and sales price

Higher cap rate = Lower sales price

Lower cap rate = Higher sales price

*The goal is to sell a property with a lower cap rate than you purchased it with.

Valuation

Cap rates are determined based on the following:

- Risk
- Upside potential for cash flow and value
- Interest Rates
- Location
- Property type
- Appraisers market comps

Valuation

Cap rate challenges as it relates to valuation

- Cap rate is a snapshot of the property's performance (cash flow) over the last 12 or 24 months
- Cap rates are subjective

Confidence Building Exercises

A commercial property is being sold for \$8,000,000 with a cap rate of 6%. What is the net operating income (NOI) of the property?

ANSWER: \$480,000

$$\text{NOI} = \$8,000,000 \times 0.06$$

$$\text{NOI} = \$480,000$$

Confidence Building Exercises

A commercial property generates an annual net operating income (NOI) of \$120,000. If the cap rate is 9%, what is the value of the property?

ANSWER: \$1,333,333

$$\text{Value} = \$120,000 \div 0.09$$

$$\text{Value} = \$1,333,333$$

HRC

The High-Risers Club

Confidence Building Exercises

A commercial property generates a total income of \$425,000 per year. If the property has a vacancy and credit loss of 15%, what is the effective gross income (EGI)?

ANSWER: \$361,250

$$\text{EGI} = \$425,000 \times 0.85$$

$$\text{EGI} = \$361,250$$

HRC

The High-Risers Club

Join Our Facebook Group

<https://www.facebook.com/groups/commercialrealestateforresidentialrealtors>



**COMMERCIAL REAL ESTATE
FOR RESIDENTIAL REALTORS®**
Coach Jeff Wright

Commercial Real Estate for Residential REALTORS®

 [+ Invite](#) 

[Discussion](#) [Rooms](#) [Members](#) [Events](#) [Media](#) [Files](#)  

HRC
The High-Risers Club

Next Session

Next Session

Tuesday, April 2, 2024
@ Noon Eastern

Greatness is Within



You Can Do This

HRC
The High-Risers Club