



REAL ESTATE **INVESTMENT** ANALYSIS

Increase Returns while Reducing Risk

By Chad Corneil, C.A



Cash Flow Focus



TABLE OF CONTENTS

FOREWORD	7
REAL ESTATE INVESTMENT ANALYSIS IS PERFECT FOR:	7
1. INTRODUCTION	9
1.1 OVERVIEW	9
3. PROPERTY ASSUMPTIONS	13
3.1 PROPERTY PRICING	13
3.2 PROPERTY INFORMATION DETAILS.....	14
3.3 LOAN INFORMATION	ERROR! BOOKMARK NOT DEFINED.
3.4 JOINT VENTURE INFORMATION	ERROR! BOOKMARK NOT DEFINED.
3.5 VALUATION AND SALES ANALYSIS.....	ERROR! BOOKMARK NOT DEFINED.
4. OFFER PRICE ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
4.1 MAXIMUM OFFER PRICE CALCULATION	ERROR! BOOKMARK NOT DEFINED.
4.2 COMMON AREA MAINTENANCE FEES ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
5. KEY FINANCIAL INDICATORS & RATIOS	ERROR! BOOKMARK NOT DEFINED.
5.1 GROSS RENT MULTIPLIER	ERROR! BOOKMARK NOT DEFINED.
5.2 OPERATING EXPENSE RATIO	ERROR! BOOKMARK NOT DEFINED.
5.3 EXPENSES/SQ FT	ERROR! BOOKMARK NOT DEFINED.
5.4 BREAK EVEN RATIO.....	ERROR! BOOKMARK NOT DEFINED.
5.5 DEBT COVERAGE RATIO.....	ERROR! BOOKMARK NOT DEFINED.
5.6 DEBT TO EQUITY RATIO	ERROR! BOOKMARK NOT DEFINED.
5.7 BREAK EVEN LEASE RATE	ERROR! BOOKMARK NOT DEFINED.
5.8 LOAN TO VALUE	ERROR! BOOKMARK NOT DEFINED.
5.9 EQUITY IN PROPERTY	ERROR! BOOKMARK NOT DEFINED.
6. KEY RETURN RATES	ERROR! BOOKMARK NOT DEFINED.
6.1 CAPITALIZATION RATE	ERROR! BOOKMARK NOT DEFINED.
6.2 RETURN ON INVESTMENT.....	ERROR! BOOKMARK NOT DEFINED.
6.3 RETURN ON EQUITY.....	ERROR! BOOKMARK NOT DEFINED.
6.4 ANNUAL CASH ON CASH RETURN	ERROR! BOOKMARK NOT DEFINED.
6.5 INTERNAL RATE OF RETURN (IRR)	ERROR! BOOKMARK NOT DEFINED.
6.6 MODIFIED INTERNAL RATE OF RETURN (MIRR).....	ERROR! BOOKMARK NOT DEFINED.
6.7 NET PRESENT VALUE (NPV).....	ERROR! BOOKMARK NOT DEFINED.
7. FINANCIAL ANALYSIS (20 YEARS)	ERROR! BOOKMARK NOT DEFINED.
7.1 ANNUAL NET OPERATING INCOME (20 YEARS).....	ERROR! BOOKMARK NOT DEFINED.
7.2 LEASE RATE ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
7.3 CASH FLOW ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
7.4 PROPERTY EQUITY ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
7.5 TAX ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
7.6 SALES ANALYSIS	ERROR! BOOKMARK NOT DEFINED.
7.7 LOAN AMORTIZATIONS.....	ERROR! BOOKMARK NOT DEFINED.
7.8 FINANCIAL REPORTS.....	ERROR! BOOKMARK NOT DEFINED.

8. POWERFUL GRAPHS (20 YEAR PROPERTY PERFORMANCE) ERROR! BOOKMARK NOT DEFINED.

8.1 INVESTMENT ANALYSIS/YEAR **ERROR! BOOKMARK NOT DEFINED.**

8.2 EQUITY ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

8.3 CASH FLOW ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

9. INVESTMENT REPORT SUMMARY ERROR! BOOKMARK NOT DEFINED.

9.1 ACQUISITION & PROPERTY ASSUMPTIONS **ERROR! BOOKMARK NOT DEFINED.**

9.2 KEY FINANCIAL INDICATORS AND RETURN RATES **ERROR! BOOKMARK NOT DEFINED.**

9.3 NET OPERATING INCOME AND CASH ALLOCATION ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

9.4 CASH FLOW ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

9.5 PROPERTY EQUITY ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

9.6 TAX ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

9.7 SALES ANALYSIS **ERROR! BOOKMARK NOT DEFINED.**

10. OFFER SCENARIOS **ERROR! BOOKMARK NOT DEFINED.**

REAL ESATE INVESTMENT ANALYSIS

HELPING INVESTORS UNDERSTAND HOW TO INCREASE
RETURNS WHILE REDUCING RISK

1ST EDITION

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To My Inspiration

I dedicate this book to my wife, Jay Lynn, who has supported me throughout all my crazy ideas. Her focus and dedication to excellence in what she does is a great inspiration to me whether it is when she is being a mother or in her sports training and Taekwondo.

FOREWORD

Real Estate Investment Analysis is perfect for:

- ✓ Experienced Investors with a wealth of knowledge
- ✓ Real Estate Buyers and Sellers
- ✓ Novice Investors who are learning the trade
- ✓ Real Estate Agents and Brokers
- ✓ Bankers, Appraisers and Financial Advisors

Whether you are a novice or expert real estate investor, this is your comprehensive guide to effectively analyze commercial and residential real estate investments you are purchasing, selling or operating.

Leverage 20+ years of expertise and get a comprehensive view of the right way to analyze income properties and understand the key success factors and common pitfalls that enable you to make the right decisions.

Topics covered include cash flow analysis, financial ratios, return rates and critical reports required for investors and financial institutions when evaluating real estate investments. There are detailed definitions, calculations and explanations on how to interpret the results with examples.

Chad Corneil is a Chartered Accountant and has spent 6 years as a business strategist at Microsoft. He obtained his Chartered Accountant designation while working at Deloitte & Touche. He has worked with large enterprises as well as entrepreneurial ventures and has spent 20 years evaluating and investing in real estate.

The contents of the book cover the following areas in detail:

Comprehensive Financial Analysis

- | | |
|---|---|
| ✓ Cash Flow Analysis | ✓ Tax Analysis |
| ✓ Operating Income and Expense Analysis | ✓ Loan Amortizations |
| ✓ Lease Rate Analysis | ✓ Sales & Valuation Analysis |
| ✓ Property Equity Analysis | ✓ Critical Financial Reports For Investors and Financial Institutions |

Key Return Rates

- | | |
|--|------------------------------------|
| ✓ Capitalization Rate | ✓ Internal Rate Of Return |
| ✓ Return On Investment (If Sold) | ✓ Modified Internal Rate Of Return |
| ✓ Annual Cash On Cash Return From Operations | ✓ Net Present Value |

Key Financial Ratios

- | | | |
|---------------------------|-------------------------|----------------------|
| ✓ Gross Rent Multiplier | ✓ Debt Coverage Ratio | ✓ Loan To Value |
| ✓ Operating Expense Ratio | ✓ Debt TO Equity Ratio | ✓ Equity In Property |
| ✓ Expenses/SQ Ft | ✓ Break Even Lease Rate | |
| ✓ Break Even Ratio | | |

If you want to take your experience further, please go to <http://www.cashflowfocus.com/> and leverage our investment software and resources. We provide easy-to-use software that helps analyze commercial and residential income properties.

Our software (**iCash Flow Property**) enables a comprehensive analysis including critical assumptions, what-if scenarios and cash flow analysis which make the contents of this book come alive for an investor.

The ***iCash Flow Property Software*** is an easy to use tool that takes the guess-work out of making real estate investment decisions. The software focuses on cash flow and real returns that drive better decisions around purchasing, selling and operating income properties. The software was designed to turn a complex yet essential analysis into a simple easy to read spreadsheet that works for residential and or commercial real estate investors with any level of experience.

- Our comprehensive tool features powerful cash flow analysis and provides you with all key metrics and detailed reports to evaluate a given property.
- Our easy to use tool helps you identify and evaluate real estate investment opportunities in minutes.
- Standout visual aids provide a clear guide your investment decision making.
- Easy navigation and clear visuals enables user to identify and spot trends and key focus areas.
- Our team has spent years evaluating commercial and residential real estate investment opportunities which has resulted in this easy-to-use software that helps analyze income properties. Our easy-to-use tool packages a comprehensive set of metrics, reports, and cash flow analysis techniques into focused and streamlined criteria for decision making.

1. INTRODUCTION

1.1 Overview

Over the course of 20 years, I have had the opportunity to invest in agriculture land, speculative land deals, residential and commercial real estate in Canada and the United States. Over the course of those years and multiple investments I have learned some valuable lessons that led me to write this book as well as develop a website www.cashflowfocus.com with financial resources that investors can leverage. The contents of this book and the website is a culmination of years of gathering information and analyzing data to evaluate investments. I have made lots of mistakes along the way that were a direct result of not having access to the resources in this book and a good real estate investment analysis tool.

The resources I am now making available have been gathered, tested and used as part of my own real estate investment deals and leveraged more broadly by the investor groups and customers. Through use and feedback, I have provided the insights in this book to enable users to gain greater insight into their investments to increase returns and reduce risk.

This book and the financial resources I am providing answer the following questions that I have regularly received over the years and include:

1. I have the opportunity to buy a rental property in my area. What is the maximum offer that I should make and will the property offer the cash flow as advertised?
2. I am currently renting my building. Should I purchase it vs. sign up for another long term lease contract?
3. What is the right mortgage that I should take out on this property and can I afford it?
4. I have a current building that I am leasing out to my tenants and I am getting ready to renew their lease terms. What lease rate should I set for my tenants and what will the financial impact be?
5. I would like to purchase a commercial building, what offer price makes sense?
6. I have a vacation property, but I am not sure if I should hold or sell it. Can you help?
7. I would like to purchase some land on speculation. What is the cash outlay I will have, and what price will the land have to sell for to make it profitable?
8. How can I determine if I will make money over the long run with this real estate investment?
9. I am interested in getting into real estate. What should I watch out for and what do I need to know about evaluating a potential real estate investment?
10. I have a real estate investment and would like to pay it off quicker than the current mortgage term. When will I be able to pay of the current mortgage based on the cash flow of the property?

In this book you will review some of the fundamentals that are used when evaluating a residential or commercial real estate investment to answer the questions above. By understanding some of the key concepts you will realize the following benefits. In order to allow investors to take a natural and easy step from information and knowledge gained in this book to using the iCash Flow Property software, I have included examples and results directly from the software as content for this book.

Real Estate Investors	
Make decisions in minutes	Evaluate property in seconds vs. hours to analyze investment returns and relative risk.
Know how much you will make from the property before you buy it	Understanding a detailed cash flow analysis gives you the confidence of know what you are getting into.
Understand the property cash flow	Comprehensive analysis of rate of return, cash flow, and equity as well as a set of metrics and investor reports results from minimal data entry. Perform a break even analysis of an income property to determine if it is financially viable and sustainable.
Negotiate better:	Reduce negotiation times and focus on the key issues.
Establish a realistic price:	Set prices for client's property that is backed by cash flow analysis and is easily supported with buyers.
Evaluate the competition	Evaluate competitive property on the market.

Real Estate Agents	
Increase Property Turnover Rates	Quickly evaluate and provide the right property to their clients matching predetermined criteria.
Reduce Days On The Market	Set property prices for their client's property that is backed by cash flow analysis and is easily supported by the numbers.

Property Sellers	
Establish a realistic price	Set property prices that are backed by cash flow analysis and is easily supported by the numbers.
Evaluate the competition	Evaluate competitive property on the market.

Property Owners	
Understand the property cash flow	Comprehensive analysis of rate of return, cash flow, and equity as well as a set of metrics and investor reports results from minimal data entry. Perform a break even analysis of an income property to determine if it is financially viable and sustainable.
Establish Lease Rates	Quickly understand the effects of increasing your lease rate on the cash flow of the property and how cash flow will be generated
Evaluation of the competition	Evaluate comparable property on the market and set competitive lease rates with your tenants.

Figure 1: Advantages Of Understanding Real Estate Investing

Critical to increasing your returns while reducing risk is a fundamental understanding of the key financial indicators and ratios, metrics and detailed financial analysis that set some real estate investment properties apart of others.

This book provides detail about key definitions and examples of how to evaluate property based on the following key financial indicators, critical financial analysis and key return rates.

KEY FINANCIAL INDICATORS	FINANCIAL ANALYSIS
Gross Rent Multiplier	Annual Net Operating Income
Operating Expense Ratio	Cash Flow Analysis
Expenses/Sq Ft	Lease Rate Analysis
Break Even Ratio	Property Equity Analysis
Debt Coverage Ratio	Tax Analysis
Debt To Equity Ratio	Loan Amortizations
Break Even Lease Rate	Financial Reports
Loan To Value	
Equity In Property	

KEY RETURN RATES
Capitalization Rate
Return On Investment
Return On Equity
Annual Cash On Cash Return
Internal Rate Of Return (IRR)
Modified Internal Rate Of Return (MIRR)
Net Present Value

Figure 2: Key Financial Indicators

3. PROPERTY ASSUMPTIONS

It is important to gather the right level of information to evaluate an investment property. I find all too often that investors do not know the right questions to ask and do not get the right level of detail to do an effective evaluation of an investment property. The following section provides detail on the specific pieces of information and how they are used in evaluating an investment property.

3.1 Property Pricing

The acquisition details of the property are required to determine what the overall costs of the land, building and other costs to set up and capitalize your investment. Figure 3: Property Pricing details out the property pricing details. These are typical costs that need to be gathered as part of initial assessments of your real estate investments. Below is a sample of how you might collect and represent the information as well as the definition of the information below.

1 Property Pricing				
Property Address:		Sample Property		
Property Asking Price	Offer Adjustment (+or-)	Total Offer Price	% Of Asking Price	
Land Cost	\$ -	-	-	0%
Building Cost	\$ 4,100,000	(2,000,000)	2,100,000	51%
Total	\$ 4,100,000	(2,000,000)	2,100,000	51%
Total Acquisition Costs	\$ 250,000	-	250,000	11%
Total	\$ 4,350,000	\$ (2,000,000)	\$ 2,350,000	54%

Figure 3: Property Pricing

3.1.1 Land Costs

The value of the acquired land and any improvements done on it. Land values increase when the demand for land is higher than its supply.

3.1.2 Building Costs

The net value of an acquired building or home, minus amortization. It could also include construction cost if the building is constructed from scratch on the acquired land.

3.1.3 Acquisition and Commission Expenses

The expenses paid out as commissions to brokers/dealers for selection and finalizing the purchase of a property.

3.1.4 Offer Adjustments

The discounted amount offered to the property buyer on the market price at the time of the purchase. The offer adjustment varies depending upon the existing market conditions.

3.2 Property Information Details

Additional details about the property are required to complete the analysis. You can run various scenarios based on entering the information in the green cells below in the spreadsheet. Key details about the property are important to determine the year over year financial details. *Figure 6: Property Information* details out the typical required and optional details to perform the analysis of the income property.

Property Information			
Key Property Inputs	Data		
Calculate Gross Revenue (Choose Residential Or Commercial)	Commercial	Lease Rate \$/Sq Ft	\$ 33.00
Total # Of Units In Property	1	Square Footage	11,193
Depreciaton Rate %	4.0%	Cost/Unit	2,350,000
Income Tax Rate %	35.0%	% Inflation Rate	3.0%
Annual % Lease Rate Increases Yr 1-10	2.5%	Property Management Fee %	5.0%
Annual % Lease Rate Increases Yr 11-20	1.0%	Vacancy Rate %	6%
Break Even Occupancy Rate	48%	Property Appreciation Rate	2.0%

Figure 6: Property Information

Property Information			
Key Property Inputs	Data		
Calculate Gross Revenue (Choose Residential Or Commercial)	Commercial	Lease Rate \$/Sq Ft	\$ 33.00
Total # Of Units In Property	Residential Commercial	Square Footage	11,193
Depreciaton Rate %	4.0%	Cost/Unit	2,350,000
Income Tax Rate %	35.0%	% Inflation Rate	3.0%
Annual % Lease Rate Increases Yr 1-10	2.5%	Property Management Fee %	5.0%
Annual % Lease Rate Increases Yr 11-20	1.0%	Vacancy Rate %	6%
		Property Appreciation Rate	2.0%

Figure 7: Commercial Gross Revenue

3.2.1 Calculate Gross Revenue

3.2.2 Lease Rate/Sq Foot

Gross revenue is typically determined differently depending on if you are evaluating a residential or a commercial property