

Income Capitalization Methods

- a) Direct Capitalization - Converting 1st year (or stabilized) income into an indication of value.
- b) Yield Capitalization - Discounted cash flow analysis for prop.

Pro Forma Operating Statement

Potential Gross Income (PGI)
 - Vacancy + Collection Allowance (V+C)

Effective Gross Income

- Operating Expenses

Net Operating Income

OE Include

- Utilities
- Property taxes
- Property insurance
- Mgmt. fees.
- Maintenance
- Reserve for Replacements.

Not Included

- Mtg. Pmts
- Income taxes
- Depreciation.
- Capital expenditures

Net Operating Income (NOI) is the total cash a property is expected to generate in a year. It is the cash available to repay investors, whether equity or debt.

Multipliers + Ratios

- Gross Income Multiplier (GIM)

$$GIM = \frac{V}{\text{EGI} \text{ Annual}}$$

- Gross Rent Multiplier (GRM)

$$GRM = \frac{\text{Value}}{\text{Monthly Gross Rents}}$$

Advantages - Quick + Easy to calculate.

Disadvantages -

- Quick + dirty way
- One year income only (growth)
- Ignores OE.

Capitalization Rate (cap rate)

$$R = \frac{NOI}{V}$$

Income return
on the property.

Net Income Multiplier

$$NIM = \frac{V}{NOI} = \frac{1}{R}$$

We can use these to estimate
market value

$$V = \frac{NOI}{R} \quad \text{or} \quad V = NOI \times NIM$$

Strengths: Quick + Easy to
calculate; Based on Net income
Comps often available.

Weaknesses:

Still dirty. Cap rates
ignore:

1) Risk

2) Income Growth.

Direct Capitalization Example

Office Building

- Gross Building Area 45,000 sf
- Net Leasable Area 42,000 sf
- Mkt. rent estimate \$ 15.00 psf
- Mkt. Vacancy 5%
- Op. Exp. estimate \$ 5.25 psf.