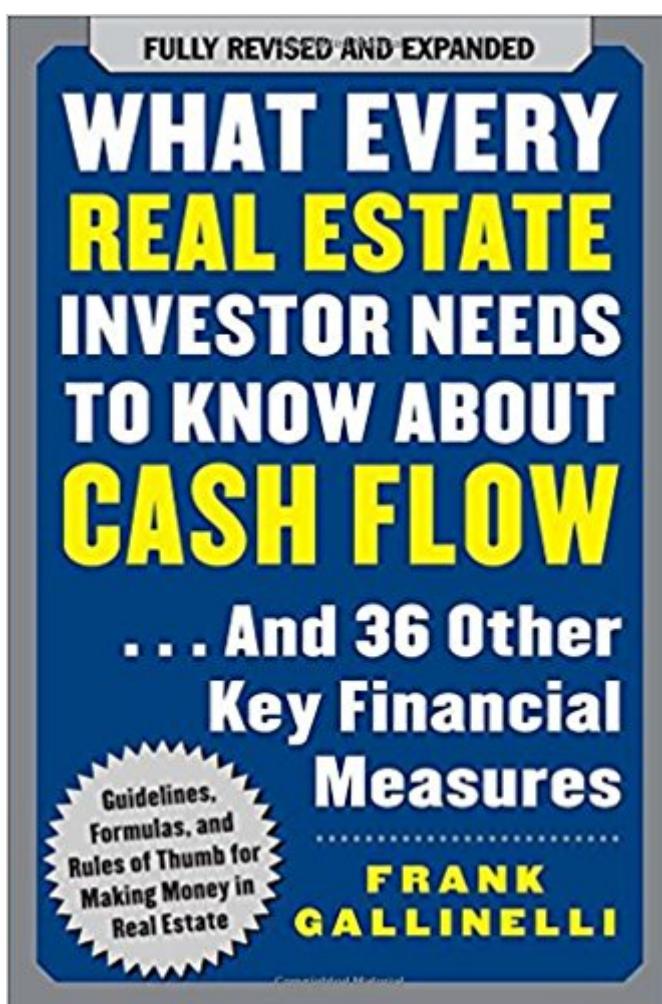


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# What Every Real Estate Investor Needs To Know About Cash Flow... And 36 Other Key Financial Measures



## Synopsis

Formulas that make the difference between making profits and losing equity The only way to win the real estate investing game is by mastering the numbers. This revised and updated edition of the popular reference shows how to target the best investments in the present market. It answers all your real estate questions, and provides new discussions of capital accumulation and internal rate of return. This book's basic formulas will help you measure critical aspects of real estate investments, including Discounted Cash Flow Net Present Value Capitalization Rate Cash-on-Cash Return Net Operating Income Internal Rate of Return Profitability Index Return on Equity

## Book Information

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## Customer Reviews

Can a book filled with numbers possibly be exciting? If you're truly interested in real estate investing then you must first realize that investing in income properties is all about the numbers. It's about discounted cash flow and rates of return and net operating income and cap rates. If you understand how these and other key concepts work, then you're on your way to success and that's exciting. I also believe you'll find the presentation of this material entertaining. I sought to write this in a way that would make it accessible to beginners and professionals alike. I present more than three dozen key concepts and calculations. The book is peppered with "Rules of Thumb" that you can use as benchmarks when you evaluate potential investment properties. I also provide numerous examples and sample problems that you can use to check your understanding. As you progress you'll learn how to read a property's vital signs and how to put financial concepts to work for successful investing in real estate. As important

as these financial measures are, some can be tedious to perform manually. For those I show you how to use simple spreadsheet models to accomplish those tasks. I also provide you with a link to a special website we created where readers of the book can download many of these models as well as other valuable tools. I hope that you'll find many good ideas here and that you'll use what you learn to help you make solid investment choices.

An arsenal of powerful calculations that can the difference between winning and losing the real estate investment game Real estate investing is a numbers game, and the only way to win is by understanding the numbers. "What is a property really worth? How do I determine a building's value based on current rents? How much will I make if I hold onto a building for five, ten, fifteen years?" Real estate investment pro Frank Gallinelli arms you with 37 basic formulas for calculating these and other critical aspects of real estate investments, including: • Discounted Cash Flow • Net Present Value • Capitalization Rate • Cash-on-Cash Return • Debt Coverage Ratio • Gross Operating Income • Net Operating Income • Internal Rate of Return • Profitability Index • Return on Equity • Long-Term Gain • Depreciation • And Many More You don't have to be a rocket scientist to use the formulas in this book. For each formula, Gallinelli clearly explains why it's important, how to calculate it, and provides examples and sample problems to help you master it. On a companion website, he supplies useful forms and spreadsheet templates that simplify many of the calculations. With this handy reference, you'll quickly master the financial formulas you need to be a winner in the real estate investment game.

I'm a university business teacher and have an MBA, and I've taught a number of introductory courses in business finance, including processes for sizing up general corporate investments. I'm also familiar with methods for valuing stocks and bonds. I'm also a bit new to the United States so the implications of U.S. tax laws aren't entirely second-nature for me. Before reading this book, I had also purchased a couple small, single family investment properties that have worked out satisfactorily so far, but wanted to refine my approach using terms and methods that are native to the real estate investment industry. As an educator, I not only expect authors to provide information, but also, to help you practice your skills. Therefore, I tend to judge a book by how well it guides me in truly learning and understanding its concepts. Overall, this book stood up well against my goals and expectations. The author's methods seemed consistent with general business practices in the various courses I've taught, but have been modified to fit the nuances of the real estate investment

industry. I picked up a few things as well, mostly surrounding the impact of accounting rules on taxable income and financial ratios that are specific to real estate investments. I also liked how the author wasn't short on examples of the math in action. Within each chapter there is usually one or two example calculations, and then, at the end of the book, he repeats each calculation or ratio giving it a bit more explanation. He also gives you a problem to solve, with a solution provided at the end of the chapter to check your knowledge. In this end-section of the book, he also provides a bit more detail for each ratio than you find in the body of his work. I also liked how he appears to have provided some realistic figures in his examples, inadvertently producing some benchmark values for certain key ratios. For example, expected rates of return of 10-12 percent for real estate, debt coverage ratios of 1.2 to 1.3 for most banks, and vacancy allowance rates of 3% to 6% came through consistently. He covers himself by encouraging you to do research to verify these numbers in your specific locality, but they gave me a ballpark figure to which I could compare my own research and make some preliminary judgments. And, to test my knowledge, I ran the numbers for a real estate investment I was considering using his methods. I did this in a spreadsheet I created from scratch. Then I ran those same numbers through Turbo Tax and compared it to the figures the author would have recommended to forecast the tax liability of the investments. I got the same numbers as the author would have, although I did have to research current rules on real estate investments from the IRS website because some of his tax rules were out of date (because the book was published years ago; I was using the 2003 version and its 2011 now). But the book got me started in figuring out where to look. However, I felt there were a few ways the book could have been improved. First, I felt he might have talked about the modified internal rate of return (MIRR) for the investment. This measure takes into account the rate at which proceeds from the property are reinvested, which his Internal Rate of Return measure doesn't account for. The MIRR is therefore more accurate, in my view, producing a lower rate of return that needs to be recognized if you want to hit your investment goals. Second, I thought he could have given a comprehensive example which uses all of the important ratios he describes in the book. He does a good job of describing each ratio in isolation; however, I think it would best to see the important ratios all in one place, their tradeoffs, and an overall interpretation of the investment in terms of net income, cash flow, return, value, debt coverage etcetera. I would have also liked to have seen him analyze two potential properties, and explain which one is the better investment based on the numbers given a fictitious investor's characteristics such as preference for cashflow versus capital appreciation, etcetera. I also thought he ducked out of some of the finer points of sizing up a real estate investment, telling you in a few spots to see your accountant about certain issues, such as rules on gains, disposal,

depreciation, passive loss rules, etcetera. The reason I bought the book was to help me make these decisions without a high-priced accountant. So, I felt the need to buy a second book after reading this one - one on current real-estate taxation rules. But he did point me in the right direction, and perhaps this expectation was beyond the scope he intended for this book. Also to fully internalize the ratios, I would have liked to have seen a summary of all the ratios in table format, showing their formula, when you use the ratio, and its general meaning. And last of all, I feel his book is skewed a bit toward multi-unit investments rather than single-family residential properties I'm interested in. For example, he recommends a vacancy allowance of 3-6%. However, for a single-family dwelling, if you budget only one month's vacancy, you get 1/12 or 8.3%. So, if you blindly use his vacancy allowance, you'll overestimate your gross operating income (gross rental receipts). However, for the price you pay for a used book on , I got more than my money's worth, and I won't be selling this one any time soon. Although I've given a few criticisms here, I think this is quite an excellent book, and I recommend it quite highly. I therefore gave it five stars.

The book I read this week was *What Every Real Estate Investor Needs to Know About Cash Flow* by Frank Gallinelli. I feel I have gone back in time... sitting in the University library stewing over an accounting book. If I were reading an accounting book for this blog, I wouldn't even know what to tell you without risk of having you pass out due to boredom half-way through my first sentence. This will not be a long post because I will not be going into detail on how to calculate a present value or future value formula. I will not be computing simple or compound interest and I certainly won't be laying out a amortization table. If that's something you are interested in learning you can buy an old accounting book on for pennies (literally). There is no doubt that the formulas and knowledge in this book have a purpose. Even though computer programs can compute the majority of these formulas it is nice to know what is really happening and what it means. For instance, you don't need to know how to do your own taxes and create a maximum refund, but you should know the skeleton of what your tax pro is going to be doing for you and what formulas are used. For real estate, pretty much every computation that you'll ever have to do can be done in Microsoft Excel. The more familiar you are with setting up an excel formula, the easier it will be to complete your pro forma. The author has a website that has almost every formula you'll ever need. It makes a great reference when you are making your own formulas. Here is where you can find them [...] The biggest eye-opener for me from this book were the 4 different means of making money from a real estate investment. I never thought of two of the ideas as means for making money, but they really are. I always combined appreciation and, what he calls, loan amortization in one over-arching field called equity, but it

makes sense to separate the two because they can't be calculated with a single formula and can value independently of each other. The obvious ways to create money are through cash flow and appreciation. The two less looked at are loan amortization and tax shelter.

**Cash Flow:** This is a obvious function of real estate. The fruits of your labors.... the money left over from your rent payments after mortgage, taxes, maintenance, property management etc. This is the key to any investment property.

**Appreciation:** More often than not, real estate will increase in value over time. The difference in the building price between now and 5 years from now is the appreciation on that property. It can be due to several factors including: inflation, developing area, better school systems, crime rates and more.

**Loan Amortization:** With your investment property, the tenants will be paying off your mortgage payment and you interest payments associated with your mortgage. That means that they are helping you buy the property. So, if you originally have equity equal to your down-payment, in 5 years your equity will be much more than that because your tenants have been adding to that.

**Tax Shelter:** This is a means of making money through net profits. You don't directly receive any money when using an investment property as a tax shelter, but you will be paying less taxes than you normally would so you indirectly have more money in your pocket. With current regulation you have several methods of cutting back taxes with real estate. A couple include depreciation and interest. Depreciation is a funny one because even though your property is appreciating in value, you can write off the wear and tear over a certain amount of time. And you can write off the interest paid on the mortgage, which is actually being paid by your tenants. This book will stay on my book shelf as a good reference because it has plenty of formulas that might be nice to consult someday (if there is a blackout and I can't use a computer). The first chapter when the author explains evaluating properties is very helpful and a lot of the commentary about the other calculations are helpful because you can get into the mind of the seller and ensure you aren't getting "taken." I think this book could be helpful for any soon-to-be investment property investor. If you have any questions on the book don't hesitate to ask. I would be more than happy to help anyone that wants it.

If you are new in commercial mortgage. This is the book you must have. Commercial mortgage is all about income and expenses. Add another book "Mortgage 101" then you are set. if you are a residential loan officer. Put all the residential underwriting guide behind you head.

I've read many real estate books in my life and this book is the one that really helped to jump start my career. Its content is extremely informative yet simple to understand. Many new investors aren't

aware of the financial side of a real estate investment and the metrics needed to properly measure that investments merit in a financial market. The book took me from seeing real estate as a fix and flip or long term hold investment to understanding that real estate is an asset class, a financial vehicle, whose returns can be more accurately reflected and maximized by understanding a few metrics of measurements and their value to different stakeholders.

This is an absolutely fantastic book. If you like crunching numbers---as every commercial investor probably should---this book is for you. It is chock full of formulae, explanations and examples. Based on this book, I created an Excel spreadsheet that performs many of these calculations, but the author also includes links to online calculators and spreadsheets. Would give this 10 stars if I could.

The one book in real estate that I'm planning already to read several times. Through Frank's calculations, you basically learn all the "math" you'll most likely encounter as an investors. He gives examples and then short quizzes with answers to test yourself. I've read a lot of other books that touch on the topics Frank discusses, and I always find his explanations to be the simpler, clearer way to think about these concepts. Definitely worth the price.

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