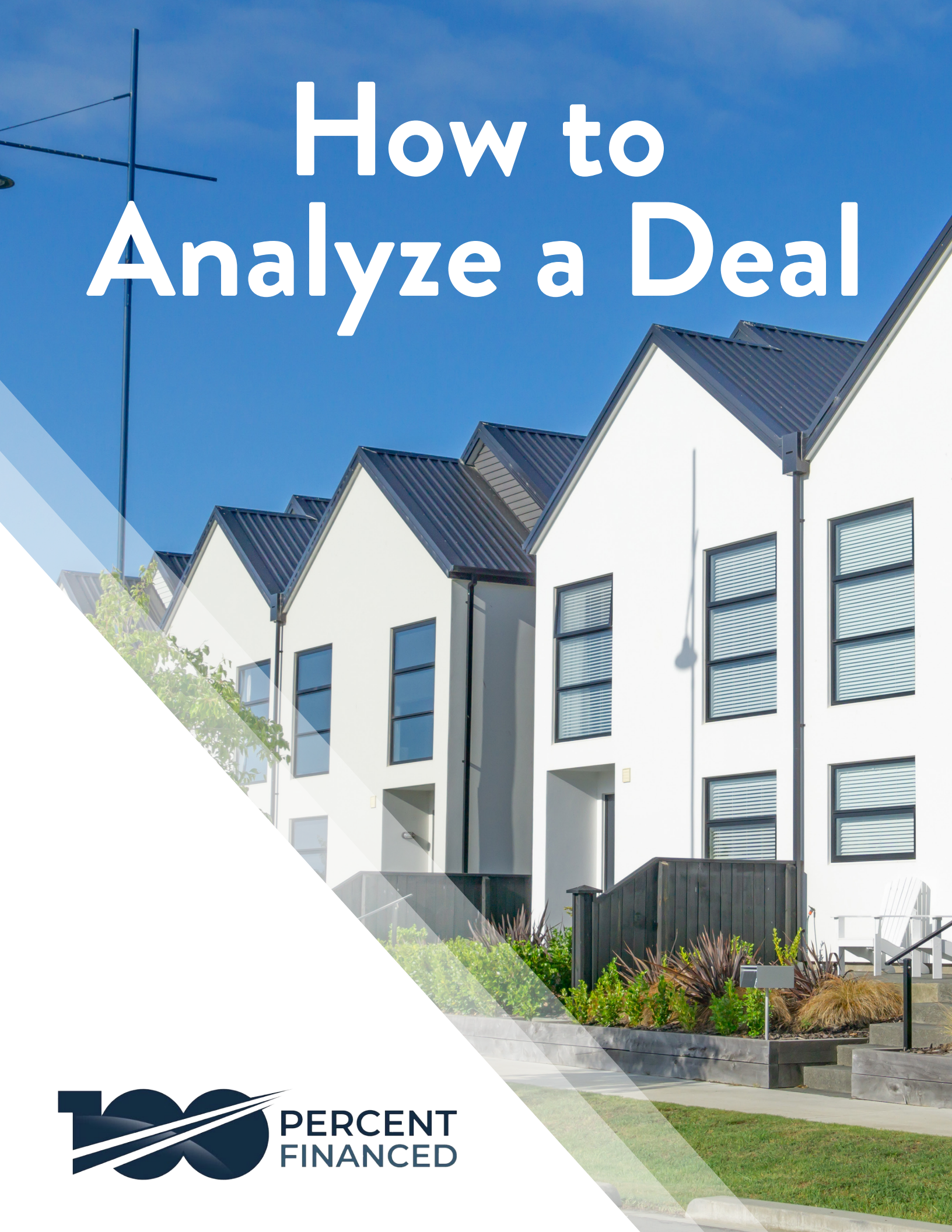
How to Analyze a Deal



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The 2 key things you need to master in real estate is finding the money and finding the deal. Today we're going to dive into finding the deal because once you find one, we need to run those numbers. You must be able to analyze the deal before you decide what actions to take. You never move forward with a property before understanding how the property is performing, so the first stage of qualifying a deal is checking the numbers.

Using the Square Method, you will learn the fundamental steps in analyzing the numbers of a rental property.

Box #1 Income:

Within the first box of the square method, you want to place all of your income streams. It's not uncommon to find multifamily properties that can produce income in more places than just rent. If you have coin laundry, a parking lot, or even a billboard above your property that you can rent, all of the income produced will be put in this box.

Income Streams:

- Rental income
- Laundry
- Storage
- Parking Lots

Example:

If you have a duplex property worth 200k and the rent on this property is 1k per door, the total income is 2k assuming there isn't any additional income.

Income: **Rent: $2,000 monthly**	

Box #2 Expenses

Within the second box of the square method, you are going to place all of your operating expenses. The biggest places new investors go wrong is misevaluating their expenses. In your expense box it's important that you cover all three areas: operating expenses, reserves, & debt services.

Operating expenses are all costs to operate your business on a day to day basis. This could include items like taxes, insurance, and utilities. These are some of the more common expenses that investors do a pretty good job evaluating. The most common operating expense that gets looked over is Property Management. The cost of property management is typically around 10% of the rental income, so this expense can vary based on the rents. If you're serious about being a real estate entrepreneur, I wouldn't recommend anyone self-manage their properties. Some investors try to penny pinch in order to save a few bucks, but it's not worth it in most cases. Put 10% aside for property management when analyzing your deal.

Debt services are all expenses that need to be paid back. These are the costs that have been financed scheduled to pay back over a pre-determined period. Your mortgage payment is the most common debt service that should be entered when analyzing your deal. Other debt services could be seller financing, business credit and even hard money loans.

Reserves are money that needs to be set aside for a rainy day. This is another expense new investors tend to miss. Evaluating your cashflow without putting money aside is a huge no-no.

- ***Maintenance*** reserves are the money you set aside every month in case of any maintenance issues that can go wrong throughout the life of your property. Investors that don't set this reserve aside end up eating their properties cashflow or even their personal SAVINGS to handle these occurrences. 10% of your rental income should be set aside every month to build your maintenance reserve.
- ***Vacancy*** reserves are the funds you set aside just in case you have any vacant units that are not receiving rents. As a real estate investor understand that you may deal with evictions, non-paying tenants and other situations that may have your units empty. An ounce of prevention is better than a pound of cure, so let's set aside 5% of your rental income every month to have a fund for these unplanned events.

Not properly analyzing the expenses can be destructive to your cash flow. Keep in mind, the more you understand the market you are shopping in, the easier this process will get. In most cases, this box will be bigger than the others and that's okay. Don't spare any expenses just to make the numbers work. Evaluate everything upfront so there are no surprises on the back-end.

Expenses

- Taxes
- Insurance
- Utilities
- Service Contracts
- Property Management - 10%

Debt Services

- Mortgage
- Business Credit
- Seller Financing

Reserves

- Vacancies - 5% of Income
- Maintenance -10% of income

Income: • **Rent: $2,000 monthly**	
Expenses: • Taxes • Insurance • Utilities • Service Contracts • Property Management **Reserves** • Vacancies - 5% of Income • Maintenance -10% of income **Debt Services** • Mortgage • Business Credit • Seller Finance **Total** • $1,610	

Box #3 Cash Flow:

Now in the third box, this is where you will place your cashflow. Simply put, Cashflow is the money you are taking home after all bills are paid. This is why we invest in rental properties. We invest for the passive income, so it's imperative that you know how to calculate this number.

Formula:
Income - (Expenses+Reserve+Debt Service) = Cash Flow
- ex: $2000 - $1610 = $390 cashflow

All investors should have their own standard of what kind of cashflow they want from their Deals. At 100 Percent Financed, if we can't receive $100 per door in Cashflow then we are not moving forward with the deal. This will help you stand firm in negotiations so you can know where to start and when to run.

Income: • **Rent: $2,000 monthly**	**Cash Flow:** • **$2,000 - $1,610 = $390**
Expenses: • Taxes • Insurance • Utilities • Service Contracts • Property Management **Reserves** • Vacancies - 5% of Income • Maintenance -10% of income **Debt Services** • Mortgage • Business Credit • Seller Finance **Total** • $1,610	

Box #4 Cash-on-Cash Return:

Last but certainly not least is your Cash-on-cash return! Just because your property is cash flowing, doesn't mean it's a good return. It's important to have a target cash-on-cash return to set your standard as an investor. Cash-on-cash return measures how quickly your cash invested will return to your pocket. Although the cash-on-cash return is often a percentage, this metric actually represents time in years. A 25% cash-on-cash return or a quarter, will let an investor know that their investment will return back to them in 4 years while a 50% cash-on-cash rerun will tell an investor that they will receive their initial investment back in 2 years. Many investors shoot for a 10% cash-on-cash return which means your money will return in 10 years. As an investor it's your responsibility to determine what cash-on-cash return will work for you, so you can know when to move forward with a deal and when to say no.

Formula:
Annual Cashflow / Total out of pocket cost invested

- Calculate your TOTAL out of pocket costs investment. This means to take everything you have invested into the deal (down payment, closing cost, soft costs, closing costs, rehab, misc, etc.) and add them all up to calculate your total investment. Your out of pocket costs investment does not include debt service.
- Qualify your Cashflow. Take your annual cashflow (monthly cashflow x 12 months) and divide it by your out of pocket costs investment. This will give you your cash-on-cash return.

Income: • **Rent: $2,000 monthly**	**Cash Flow:** • **$2,000 - $1,610 = $390**
Expenses: • Taxes • Insurance • Utilities • Service Contracts • Property Management **Reserves** • Vacancies - 5% of Income • Maintenance -10% of income **Debt Services** • Mortgage • Business Credit • Seller Finance **Total** • $1,610	**Cash on Cash ROI:** • Down Payment - $40k • Closing - $3k • Rehab - $4k • Soft costs - $3k • Misc - $0 **Total Investment:** $50k **Annual Cash Flow:** $4,680 $4,680 = 9.36% $50,000 **COCR =** 9.36%

This eBook was only intended to teach you the fundamentals of analyzing deals. When you are ready to start putting in your offers, it will be important that you use 100 Percent Financed own deal analyzer. This is the deal we use ourselves running the numbers on our deals. I can't stress to you enough how important it is to take this step seriously and do your due diligence upfront. This step will prevent a ton of headaches and issues on the back-end so start practicing. Download our deal analyzer and run the numbers!

Do you want to see how 100 Percent Financed can help you analyze your next deal?
Visit us at 100percentfinanced.com.

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