

Cash Flow Analysis of Real estate

Real Estate Cash Flows

There are two sources of cash flow in Real Estate ownership

- 1) Cash Flow After Tax (CFAT) from operations**
- 2) Cash Flow After Tax (CFAT) from sale proceeds**

Real Estate Cash Flows

Real Estate cash flows are seldom the same year after year:

- **Operations have a yearly ebb and flow**
- **Interest payments change every year when amortizing a loan**
- **Income and Expenses increase/Inflate at different rates**
- **Capital Improvement needs aren't always incurred when predicted**
- **Life is Life**

Internal Rate of Return (IRR)

Evaluating Uneven Cash Flows: Use IRR Calculations

Definition of Internal Rate of Return (IRR): That rate of discount wherein the present value of all future cash flows exactly equal the initial investment

IRR Calculations are the same as compounding and discounting equations when solving for “i” (Rate of Return)

IRR is useful in arriving at a rate of return for a projection of cash flows which can then be compared to other similar investments and their cash flows

IRR is useful strictly as a comparison of alternative similar investments and should be a part of the overall decision criteria

IRR Proof

Consider the following Investment

You have the opportunity to invest \$300,000 today and receive \$600,000 four years from today. Are you interested?

Upon further investigation you conclude that along with your \$300,000 investment you will need to invest \$12,000 in year 1 and another \$10,00 in year 2, then in year 3 you will breakeven and when the investment concludes at the end of year 4 you will then get \$600,000.

This Investments assumptions are: You owned the property for 4 years, survived the process and negative cash flow, then achieved a net 30% growth in value on the property which you made a 30% down payment on

What is your Internal Rate of Return (IRR)?

IRR Proof

Year	Amount Invested BOY	Interest Due EOY	Principal plus interest	Cash Flow	Remaining Balance EOY
1	(\$300000)	\$51,738	351,738	(\$12,000)	363,738
2	363,738	62,730	426,468	(\$10,000)	436,468
3	436,468	75,273	511,741	0	511,741
4	511,741	88,255	599,996	\$600,000	0