

Best Practice for Success

Metrics for Investment Property Evaluation – Gross Rent Multiplier and Cash on Cash Return

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This is a continuation of my series on best practice for success in residential property management. This one applies to one of several metrics for evaluating investment properties, Gross Rent Multiplier (GRM) and Cash on Cash Return ((CC).

GRM is a metric used by investors to compare rental property opportunities in each market. The GRM functions as the ratio of the property's market value over its annual gross rental income. Let us take a look at the gross rent multiplier formula that shows you how to calculate the gross rent multiplier for a property:

$$\text{Gross Rent Multiplier} = \text{Fair Market Value} / \text{Gross Rental Income}$$

Example: \$200,000 Fair Market Value / \$24,000 Gross Rental Income = 8.3 GRM. You want to determine how much rent you will collect relative to the property cost. If both properties cost \$200,000, the property that rents for the higher rental amount will give you the most return on your investment. However, this changes when the property costs change. You can use GRM to make that determination. GRM is not equivalent to the length of time it takes for the investment to pay off because it does not include full net operating income.

CC is an equation that looks at your annual property-based income before taxes and compares it to the total cash you have invested in the property.

$$\text{Cash on Cash Return} = \text{Gross Annual Rent} / \text{Down payment or cash into the property}$$

For example, let's say you bought an investment property for \$200,000 in an all-cash deal. You charge \$2,000 a month rent or \$24,000 gross annual rent = 12% CC. Note that you if you lessen the cash into the property and rate goes up.

Both GRM and CC do not represent the only calculations you should use to measure a profitable investment. See my past blog on metrics for investment property evaluation at ranchopropertyworks.com in the More tab under PR and Blog.

If you, your friends, or family need a professional Property Manager / Realtor® that knows how to evaluate investment properties, please contact me.