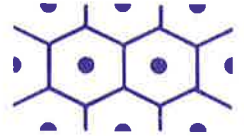


newsletter



Vol. 2, No. 22

Fall 1986

Update

Our 10th anniversary...hard to believe...how the years have flown! In those early days, we were young, eager, hard-working...and hard up. Things haven't changed much.

The Small Investor Series - Part Three



In our last Newsletter, we took a look at Financial Leverage...why it may be advantageous to buy a property with borrowed money...even though you have the cash. In this issue, we are going to look at "Break-Even Analysis", a useful conversation stopper, guaranteed to mark you as a real expert with the other guys on your baseball team (o.k., o.k....and girls in the craft club). Just relax, drop in the contact lenses...here we go.

Break Even Analysis

Most income producing properties have fixed expenses e.g. real estate taxes; so before buying the property you should work out the amount of income the property needs to generate, to break even. The break-even point is the point at which revenues just cover costs.

- (1) Break Even Point for Number of Units - You use this to find the maximum number of units that must be occupied in order to break even. This is the formula (write it on your cuff for ready reference):-

$$\text{BEP (Q)} = \frac{\text{FE} + \text{DS}}{\text{gr} - \text{ve}} \quad \text{where: } Q = \text{Number of rental units occupied.}$$

FE = Fixed expenses e.g. real estate taxes, etc.
 DS = Debt service i.e. mortgage payments.
 gr = Gross rent (per unit).
 ve = Variable expenses (per unit).

Example #1

You and a friend are thinking of buying a small office building with a net leaseable area of 5 000 ft.². The office space can be rented at \$20/ft.² per annum gross (you pay all operating expenses), variable expenses are estimated at \$3/ft.² per annum (\$15,000); fixed expenses are estimated at \$2/ft.² per annum (\$10,000). Your mortgage payments will be \$42,000 per annum. How many ft.² must be rented to break even?

$$Q = \frac{\$10,000 + \$42,000}{(\$20 - \$3)}$$

$$Q = 3\,059 \text{ ft.}^2$$

- (2) Break Even for Rental Income - You use this to find the break-even point in terms of rental income. This is the formula:

$$\text{BEP}(\$) = \frac{\text{FE} + \text{DS}}{1 - \frac{\text{VE}}{\text{GI}}}$$

where: BEP(\$) = Break-even income
 FE = Fixed expenses eg. real estate taxes
 DS = Debt service ie. mortgage payments
 VE = Total variable expenses
 GI = Gross Income

Example #2

You are thinking of purchasing a 6 unit apartment building. It brings in a gross income of \$43,000 per annum. You estimate the variable expenses at \$2,000 per apartment per year (\$12,000) and the fixed expenses at \$7,000 per annum. Your mortgage payments will be \$17,000/annum. What is the break-even gross income?

$$\text{BEP}(\$) = \frac{\$7,000 + \$17,000}{1 - \frac{\$12,000}{\$43,000}}$$

$$\text{BEP}(\$) = \$33,290$$

- (3) Break Even for Rental Income per Unit - This is used to find the break-even point in terms of rent per unit. This is the formula (please pay attention!!).

$$\text{BEP}(\text{gr}) = \frac{\text{FE} + \text{DS} + Q_{\text{ve}}}{Q}$$

where: Q = Number of units occupied
 ve = Variable expenses (per unit)
 DS = Debt service ie. mortgage payments
 FE = Fixed expenses eg. real estate taxes
 gr = Gross rent (per unit)

Example #3

Assume the same investment as Example #2 with 5 units occupied. What is the break-even gross rent per apartment?

$$\text{BEP}(\text{gr}) = \frac{\$7,000 + \$17,000 + (5 \text{ units} @ \$2,000/\text{unit})}{5}$$

$$\text{BEP}(\text{gr}) = \$6,800/\text{year i.e. } \$566.67/\text{month per apartment}$$

Q.E.D.?

Quote of the Day.....

"People get the kind of government they deserve"

.....surely not!