



Investor Glossary

Accelerated depreciation

The methods of depreciation for income tax purposes that permit a faster write-off than is permitted by straight-line depreciation.

Acceleration clause

A clause in a loan that requires the loan to be paid off in the event of an occurrence such as unauthorized transfer of title.

Accommodator

A neutral third party that assists in completing a delayed exchange. The accommodator usually is a corporate entity.

Active investor

An IRS classification for a real estate investor who materially participates in running a property.

Adjustable-rate mortgage (ARM)

A loan in which the future interest rate might change, with that change determined by an index of rates. The frequency and amount of change are limited by the mortgage contract.

Adjusted cost basis

For the purpose of computing capital gains or losses, this refers to the original purchase price plus closing costs paid at the time of purchase plus the cost value of improvements done while the property was held less all depreciation claimed.

Adjusted gross income

The income from a piece of property after any adjustments are made for other income or rental losses.

Adjusted sale price

The price of your property after deducting the costs of sale.

Adjusted tax basis

The tax basis of an asset reflecting adjustments for depreciation accounting and other pertinent factors.

Adjustments

Used in the sales comparison approach to value. These are the additions and subtractions that are made to account for differences between comparable properties and the subject property.

After-tax cash flow

Before-tax cash flow adjusted for income taxes that result from ownership of property or from income tax savings realized by property ownership.

After-tax equity yield rate

The internal rate of return on the equity investment after considering federal income taxes.

After-tax income

Sale as After-tax cash flow.

After-tax proceeds from resale

The amount a property seller would receive from a property sale after subtracting transaction costs, capital gains taxes, and other expenses. Generally, the selling price less the sum of the existing debt, the income or capital gains taxes, and the expenses of sale.

All inclusive loan

A loan that incorporates several loans. The borrower makes one payment on the all-inclusive loan, and the person receiving that payment pays on the underlying financing.

Amenity

A feature in real property creating psychological benefits or other attractions. Examples of amenities include scenic view, a swimming pool, a fireplace in the living room, etc.

Amortization

The repayment terms of a loan – including the required principal and interest – based on the interest rate and the period of time allowed to pay down, or amortize, the loan to zero.

Amortized mortgage

A financial debt that is paid off over a term by a series of periodic payments. A loan can be fully amortized, in which case the entire principal is paid back over the term, or it can be partially amortized, in which case a balloon payment is due to satisfy the debt at the end of the term.

Annual debt service

Total payments required in one year by a loan.

Annual depreciation allowance

The deduction you can take on your income tax against earnings to recapture the cost of the structures on your property.

Annual expenses

All the costs you must pay to operate your property.

Annual percentage rate (APR)

A term used in the Truth in Lending Act. It represents the total cost of credit – including interest, discount points, origination fees and loan broker commission – as a percentage of the amount financed.

Annuity

A series of equal payments either made or received at even intervals over a period of time. An example is the series of payments made to satisfy a level-payment mortgage debt.

Appraisal

The process of estimating current market value of a property.

Appreciation

Increase in value due to any cause.

“As is”

When you buy a property “as is”, the seller is not making any warranties or guarantees about its condition.

Asset

Something of value possessed by an individual or entity. This includes both real and personal property.

Assumed mortgage

A mortgage obligation transferred to a purchaser, who becomes liable for any deficiencies that could arise in the event of a foreclosure sale; the original borrower remains secondarily liable.

Assumption

A loan feature providing that the borrower can allow a future buyer to take over payments on the loan as well as responsibility for repayment.

Average rate of return

A technique used to estimate a rate of return. To compute this rate, investment outflows are subtracted from total investment inflows. The result is divided by the number of years the investment was held, and that result is divided by the total investment to arrive at the average annual rate of return.

Average return on equity (AROE)

Each year you own a property, you can calculate the return on the equity for that year. If you add these up for several years and divide by the number of years, you get the average.

Balance sheet

A statement that measures from an accounting viewpoint the financial position of a business enterprise as of a given date.

Balloon mortgage

A partially amortized mortgage with a position of the original principal due at the end of the term; also a straight term mortgage having interest-only payments during the term with the entire principal due at the end of the term.

Balloon payment

The outstanding balance due at the maturity of a mortgage or loan.

Bank repossessions

Property that has been taken by the lender because of the owner's failure to meet the terms and conditions of the loan.

Basis

The cost of the building on your property, plus improvements and fixtures, that can be depreciated but not claimed as deductions. This is calculated as original cost plus capital improvements less depreciation.

Basis point

There are one hundred basis points in 1% of an interest rate.

Before-tax cash flow

Net operating income minus debt service. The amount available to the equity owner of the income producing real estate after cash operating expenses and debt service are subtracted from the effective gross income. Same as cash flow and cash throw-off.

Before-tax resale proceeds

The amount left over from the sales price after subtracting selling expenses, the remaining principal balance on existing mortgages, and any prepayment penalties. Sale as reversion.

Boot

In federal taxation, this is anything that is not considered like kind property in a tax-free exchange; included to equalize the value of properties exchanged.

Break-even point

In finance, the point at which total income is equal to total expenses. Same as default ratio.

Building cost tables

Tables that show the current cost to build structures in various parts of the United States.

Buyer's market

A market in which buyers are able to achieve very favorable terms and prices. It is usually due to general economic conditions or oversupply of a particular land use in a community.

Cap

A limit on the amount of increase a lender can impose under the terms of an adjustable-rate mortgage. The annual cap specifies the maximum annual increase, and the lifetime cap specifies the overall increase the lender is allowed to pass on to the borrower.

Capital asset

In taxation, property other than inventory, receivables, or depreciable property used in a trade or business, and certain other assets. In general, assets of a more or less permanent nature.

Capital expenditure

In accounting, an amount paid to acquire something of lasting value in contract to something that will be consumed in the current year.

Capital expense

The outlay to purchase any asset with a useful life of more than one year. (The tax treatment for such expenditure allows the asset to be "capitalized", which means its cost is deducted over its useful life according to the applicable depreciation method rather than an expense in the current period.)

Capital gain

In taxation, gain from the sale of a capital asset that is sold for more than its adjusted tax basis. In general, a gain when a long-term asset is sold for more than its book value.

Capitalization of income

A valuation method achieved by dividing the net income of a property by the capitalization rate of that kind of property.

Capitalization rate (cap rate)

A rate used to convert an income stream into a lump-sum capital value. The periodic income is divided by the capitalization rate to estimate the capital value of the income stream. In real estate, the capitalization rate must include a provision for interest and, in many cases, a provision for a return of capital.

Capitalize

To convert a future income stream to a present lump-sum value.

Cash flow

The amount of money received from rental income each month less the amount paid out in mortgage payments, the purchase of capital assets, and the payment of any operating expenses. Cash flow is not the same as profit because it includes nondeductible payments.

Cash-on-cash return

The cash profit from an investment divided by the cash invested to buy the investment.

Chain of title

A history of all titles to a piece of real estate, beginning with the original transfer from government to private ownership and ending with the latest document transferring title.

Clear title

A history of all titles to a piece of real estate, beginning with the original transfer from government to private ownership and ending with the latest document transferring title.

Co-insurance

A clause in an insurance policy that says the property owner will assume some of the liability for any loss.

Collected rents

Amount of rental income actually collected.

Commercial loans

Any loan not classified as a residential loan, usually on five units or more.

Commercial property

Income property used for offices, stores or services, not including residential, public or industrial uses.

Common area

Space not used and occupied exclusively by tenants such as lobbies, corridors and stairways. In a condominium, the property in which a unit owner has an undivided interest.

Comparative analysis

A method of appraisal in which selling prices of similar properties are used as the basis for arriving at the value estimate. This also is known as the market data approach.

Component depreciation

Depreciation estimated by breaking a depreciable capital asset down into separate parts such as the roof, carpeting, foundation, shell and mechanical equipment and depreciating each part individually.

Compound interest

Interest earned on both principal and on any accrued interest earned in a previous compounding period.

Compound interest algorithm

A mathematical formula used to calculate the percentage return when the profits from an investment are reinvested over a given period of time.

Condominium

A legal form of ownership involving a separation of property into individual ownership elements and common ownership elements.

Condominium association

A condominium's governing body to which every unit owner automatically belongs.

Constructive receipt

An IRS term that means the IRS will tax you as though you had received monies even though you might not have been in physical possession of them during that tax period.

Consumer price index

A figure constructed monthly by the U.S. Bureau of Labor Statistics that weighs products by their importance and compares prices to those of a selected base year, expressing current prices as a percentage of prices in that base year.

Contract for deed

A type of financing agreement between a seller of property and a purchaser. The seller passes possession but retains title to the property until the total or a substantial portion of the purchase price is paid. If the purchaser defaults, the

seller can normally cancel the contract and keep all payments as rent. Same as installment contract and land contract. Also known as a land sales contract and installment sales contract.

Cost approach

An approach in appraisal analysis based on the premise that an informed purchaser would generally pay no more for a property than the cost of producing a substitute property having the same usefulness. Requires an estimate of current reproduction cost new (replacement cost new in some situations) and accrued depreciation.

Cost basis

Your basis for calculating the capital gain on a property you own.

Damages

Financial compensation awarded to a person who was injured by another.

Debt coverage

The comparison between the net income of a property and the loan payments on the property.

Debt service

Interest and principal payments for a loan. Same as mortgage requirement.

Declining-balance depreciation

Accelerated depreciation method in which the remaining undepreciated balance is the base for calculating the next year's depreciation.

Deduction

An expense of property ownership that can be written off against income for tax purposes.

Deed of trust

A deed in real property financing transactions that serves the same purpose as a mortgage but involves three parties instead of two. The third party (trustee) holds title for the benefit of the lender (beneficiary). Same as trust deed.

Default

In mortgage financing, any failure to perform contractual obligations that would justify steps by the lender to institute foreclosure proceedings.

Deferred maintenance

Ordinary maintenance that is not performed and that negatively affects a property's use and value. Sometimes repairs are postponed to understate the expenses in a particular year.

Delayed exchange

An IRS approved technique for completing an exchange of equity to postpone taxes. Also called a "Starker" exchange.

Demand appreciation

Appreciation in value related to an increase in the desire to possess the property.

Depreciable improvements

The value of the structures on a property that the IRS allows you to depreciate.

Depreciation

In appraisal, the loss in market value of an asset; also a forecast value change. See also Depreciation accounting.

Depreciation accounting

A systematic method of allocating the cost of an asset over time.

Depreciation allowance

The dollar amount the IRS allows you to deduct each year from the earnings from a property.

Depreciation method

In taxation, the method used to determine the depreciation deduction for qualified assets. In general, depreciation methods can be classified as straight-line or accelerated.

Depreciation recapture

Treatment as ordinary income of that portion of gain that is a result of excess accelerated depreciation over straight line as described in Sections 1245 and 1250 of the Internal Revenue Code.

Discounted mortgage

A mortgage sold below the amount of the remaining principal balance in order to provide a satisfactory yield to the purchasing mortgage investor.

Discounting

The process of converting investment inflows to a present value.

Discount point

One percent (1%) of the loan amount. Discount points are a fee charged by a lender at the time a loan is made; they have the result of increasing the lender's effective yield above the contract interest rate.

Down payment

The amount of cash paid by a purchaser which, added to the mortgage amount, equals the total sales price. At the time of closing this is referred to as equity.

Due diligence

The effort made to study and research a property and all the components of a purchase before you make the final decision to purchase.

Due-on-sale clause

A clause in a mortgage that permits the lender to accelerate the loan if an attempt is made to sell or transfer mortgaged property without obtaining prior approval by the lender. Also known as due-on-transfer clause.

Earned increment of value

That part of the increase in a property's value attributed to the efforts of the owner.

Economic obsolescence

A loss in value due to factors outside the subject property, such as changes in competition or surrounding land uses.

Economic rent

The amount of rental revenues a building would receive if the amount was set by the market, as opposed to contract rent, which is specified in the lease.

Equity

The excess of a property's fair market value over the outstanding indebtedness.

Equity growth from appreciation

The increase in a property's value because of the effects of inflation.

Equity growth from loan reduction

The increase in the owner's equity in a property from the payoff of the financing.

Escalation

Raising the interest rate or rent upon the occurrence of certain stipulated events or conditions, or passing expense increases to tenants.

Fair market value

A legal concept defined as the price, in terms of money, at which a willing seller and willing buyer will agree when both parties are acting prudently, knowledgeably and under no compulsion.

Feasibility

The reasonable likelihood of satisfying certain investment objectives with the context of the market, finances and other resources or constraints.

Financial leverage

Use of borrowed funds to complete the acquisition of an investment.

Financial management rate of return (FMRR)

A modified internal rate of return model developed by M. Chapman Findlay and Stephen D. Messner.

Financial statement

Statement containing a report of assets and liabilities or income and expenses.

Fixed expenses

Expenses such as property taxes or insurance that do not vary with changes in the occupancy level.

Financial obsolescence

Impairment of capacity or efficiency due to changes in tastes, preferences, technical innovations or market standards.

Gross rent (income) multiplier

The result of dividing the sales price of property by the potential or effective gross income.

Guaranteed replacement clause

A clause in an insurance policy whereby the policy will pay to replace a damaged property regardless of changes in valuation or the cost of replacement.

Hard money loans

Loans made by non-conventional lenders. They usually have high interest and high fees.

Holding period

The period of property ownership from the date of purchase to the date of sale.

Illiquidity

Inability (of an asset) to be readily converted into cash.

Improvement ratio

A ratio or fraction that compares the value of improvements to the value of all property.

Improvements

All real estate except land. Includes building, fixtures, fences, curbs, sewers, etc.

Income

Financial and other benefits. Income should be qualified as to the degree of netness. Potential gross income, net operating income, before-tax cash flow, after-tax cash flow.

Income approach

One of the traditional means of appraising property, based on the assumption that the value is equal to the present worth of the rights to future income.

Income-producing property

Property that generates periodic income for its owner, for example, an office building or apartment complex, duplex or single family home.

In-fill project

A construction project in an area where most of the land already is developed with structures.

Inflation

Decrease in the purchasing power of currency, typically measured by the Consumer Price Index published by the Bureau of Labor Statistics.

Inflationary appreciation

Refers to the value of a product increasing due to inflation taking place in the economy.

Installment note

The name of the note carried by a seller of a property that gives the seller special tax benefits.

Installment sale

A seller-financed sale whereby, for income tax purposes, the receipts are spread over a number of years and the transaction meets certain requirements.

Internal rate of return (IRR)

The rate at which discounted returns from an investment equal the cost of the investment.

Investment

The outlay of money for income or profit; property acquired for income or profit.

Investment analysis

An examination of investment property that considers its suitability for the unique situation of a particular investor.

Investment property

An asset acquired for income or profit.

Lease

An agreement by which a landlord gives a tenant the right to use and to have exclusive possession but not ownership of realty for a specific period in consideration for the payment of rent.

Leasehold

The interest that the tenant has, created by a lease.

Leverage

Use of borrowed capital to finance the purchase of real estate or other assets. See also Financial leverage.

Lien

A legally recognized right to enforce a claim or charge on the property of another for payment of some debt, duty or obligation.

Liquidated damages

A definite sum of money to be paid under a contract in the event of a breach of the contract.

Liquidity

The ease with which an asset may be converted into cash.

Loan-to-value ratio

The relationship between the amount borrowed and the appraised value of the property.

Long-term capital gain

The gain realized from the sale or exchange of a capital asset held for more than one year.

Management fixer-upper

A property with management problems that need to be corrected.

Marginal tax bracket

The rate of federal income tax that will apply to the next increment of taxable income.

Market rent

The rental income that a property is likely to command in the current market. See also Economic rent.

Market value

The price in terms of cash or its equivalent at which a willing buyer and a willing seller will agree upon, where neither is under any undue pressure and both are

typically motivated, have adequate knowledge, and are acting in their own best interest. See also Fair market value.

Master-metered properties

A property that only has one meter for the utilities.

Modified Accelerated Cost Recovery System (MACRS)

The IRS system for determining the depreciation schedule for capital items.

Mortgage

The financing obligation by which the borrower or mortgagor pledges property to secure the debt represented by a promissory note or bond.

Mortgagee

A lender who receives a pledge of property to secure a debt.

Mortgagor

A borrower who pledges property through a mortgage to secure a debt.

Negative leverage

The condition experienced when expenses incurred to repay an interest-bearing debt exceed the financial benefits of assets that were acquired with the borrowed money. Same as Reverse leverage.

Net income

In accounting and taxation, income after all expenses or deductions, see Net operating income.

Net operating income (NOI)

Property operating expenses subtracted from effective gross income. Same as Operating income. See also Income and NIBD.

Net present value

The value of an income stream and reversion at a given discount rate, less the original investment cost.

Net worth

Equity; total assets minus total liabilities.

NIBD

Net income before depreciation.

Obsolescence

A loss in value due to a decrease in the usefulness of property caused by decay, changes in technology, people's behavior patterns and tastes or environmental

changes. See also Economic obsolescence, Functional obsolescence, Locational obsolescence and Depreciation.

Occupancy rate

The ratio of the space rented to the total amount of space available for rent.

Operating expenses

Expenses of operating income-producing property other than debt service and income taxes.

Operating income

See Net operating income.

Opportunity cost

The principle that a prudent investor would pay no more for a particular piece of property than for equally attractive substitutes, whether those substitutes are real estate or other investments that promise to offer equal financial benefits and the same risk.

Option

A right, given for consideration to a party (optionee) by property owner (optionor), to purchase or lease property within a specified time at a specified price and terms.

Overall rate of return

The mathematical rate obtained by dividing net operating income by the selling price or value of income-producing real estate. Also called overall capitalization rate.

Passive investors

An IRS term that refers to someone who is limited in the deductions that can be claimed against earnings.

Physical depreciation

A reduction in the usefulness or attractiveness of property due to impairment of its physical condition.

Point

One percent (1%). See also Discount point and Basis point.

Positive cash flow

A situation in which cash receipts are greater than cash payment.

Prepayment penalty

The charge levied by the lender for paying off a mortgage before its maturity date.

Present value

The value of an income stream and/or reversion at a given discount rate.

Prime rate

The interest rate charged to a bank's highest credit rated customers for short-term loans.

Private mortgage insurance (PMI)

Insurance to protect lenders from loss on a loan. This usually is required when the loan-to-value ratio is over 80 percent.

Pro forma statements

A financial statement that shows forecast or projected amounts.

Recapture of depreciation

See Depreciation recapture.

Recovery period

Under depreciation rules, the number of years over which depreciation is claimed.

Refinance

To repay one or more existing mortgagee loans by simultaneously borrowing funds through another mortgage loan.

Reinvestment rate

The interest rate at which cash flows from income-producing property, particularly the portion of cash flows that represent a recovery of capital, are presumed to be reinvested.

Reproduction cost

The cost to rebuild a property today.

Residential rental property

Property from which 80% or more of the gross rental income is rental income from dwelling units.

RESPA

The Real Estate Settlement Procedures Act, a federal law that ensures that buyers and sellers in certain federally related residential real estate deals receive full disclosure of all settlement costs so they can shop around for settlement services.

Return on equity

The internal rate of return on initial equity based on cash flows and resale proceeds. Status should be qualified as to before or after tax.

Return on investment (ROI)

Interest or profit from an investment.

Reversion

See Before=tax resale proceeds.

Risk

Variability; the possibility that a real estate investor will not receive expected returns; also, the possibility of a loss.

Risk-free rate

The interest rate available on investments having the least risk, such as short-term U.S. Treasury obligations and liquid deposits insured by an agency of the U.S. Government.

Safe rate

A rate of return on investment that can be earned through relatively risk-free investments.

Schedule C

The schedule used to report income and expenses from an investment property for tax purposes.

Second mortgage

A mortgage that is second in priority because of time of recording or subordination.

Section 1231

Section 1231 of the Internal Revenue Code, which refers to real and personal property used in a trade or business. Net gains on Section 1231 assets are taxed at long-term capital gains rates; net losses are ordinary.

Simple interest

Interest earned only on the initial principal, not on accrued interest.

Slumlord

A slang term used to describe the owner of a building in which overcrowding and deterioration are evident.

Speculating

To enter into a transaction or venture in which the profits are conjectural or subject to chance; to buy or sell with the hope of profiting through fluctuations in price.

Starker exchange

A type of tax-deferred exchange that got its name from the court case with the same name. Also called a delayed exchange.

Straight-line depreciation

A method of computing depreciation for income tax purposes in which the difference between the original cost and the salvage value is deducted in equal installments over the depreciable life of the asset.

Supply and demand, principle of

The principle that together supply and demand interact to establish prices. Supply is the quantity of goods available at a given price schedule; demand is the quantity of goods desired at a price schedule.

Tax benefits

The tax savings from property ownership.

Tax shelter

An investment with paper losses that can be used to lower one's otherwise taxable income. In other words, the tax loss from the tax shelter investment is a write-off against regular salary or other income, therefore "sheltering" that income.

Taxable income

Income that is subject to taxation.

Tax-deferred exchange (1031 tax-deferred exchange)

A method of deferring capital gains by exchanging real property for other like-kind property.

Tax rate

A rate defining the proportion of income or value to be paid as a tax.

Tax shelter

A reduction of taxable income allowed by an investment.

Three party exchange

A tax-deferred exchange that involves three different parties.

Time value of money

A concept based on the idea that money is assumed to earn interest; the concept that money today is more valuable than the same amount to be received in the future.

Triple net leases

A type of lease in which the tenant not only pays rent but also might pay for property taxes, insurance and property maintenance.

Unearned increment of value

An increase in the value of property not brought about by the owner, due primarily to the operation of social forces, such as an increase in population/

Useful life

The period over which property is expected to have utility in the function the property was designed for.

Vacancy allowance (vacancy rate)

The percentage of a building's space that is not rented due to oversupply, tenant turnover, etc.

Vacancy rate

The average percentage of units vacant in a given market area.

Value appreciation

An increase in the value of a property due to any cause.