Commercial Real Estate Financial Glossary of Terms

1031 Exchange:

U.S. Internal Revenue Code Section 1031 permits the deferral of capital gains taxes on the sale of property held for investment or productive use in a trade or a business. With a 1031 exchange, property owners can sell their real estate and then reinvest the proceeds in ownership of a like-kind property or several like-kind properties, thus deferring the capital gains taxes. The like-kind exchange under Section 1031 is tax-deferred, not tax-free. When the replacement property is ultimately sold (not as part of another exchange), the original deferred gain, plus any additional gain realized since the purchase of the replacement property, is subject to tax.

Base Year:

The base amount of operating expenses a tenant is expected to pay. Usually the amount in the year that they lease is signed. These are the expenses covered by the full-service lease.

Cash Flow Before Taxes (CFBT):

The result of calculating the effective rental income, plus other income not affected by vacancy, less total operating expenses, less annual debt service, funded reserves, leasing commissions, and capital additions.

Cash on Cash Return:

The ratio of annual before-tax cash flow to the total amount of cash invested, expressed as a percentage.

Capital Expense or Cap Ex:

Improvements (as opposed to repairs) to a fixed asset that will increase the value or useful life of that asset. A capital expenditure is typically amortized or depreciated over the useful life of the asset, as opposed to a repair, which is expensed in the year incurred.

Capitalization Rate or Cap Rate:

Unlevered initial return from the acquisition of a real estate asset calculated by dividing net operating income (NOI) by the property sales price. For example, a property's capitalization rate (cap rate) is 10 percent if it is purchased for $10 million and produces $1 million in NOI during one year. The cap rate is typically calculated using the NOI generated in the first year of ownership, so investors can normalize and compare potential returns among competing investment properties.

Concessions:

Discounts given to tenants whether as money off on a lease or free rent, paying moving expenses, etc.

Commercial Real Estate Financial Glossary of Terms

Debt Coverage Ratio:

The debt coverage ratio is the ratio of the net operating income to the mortgage payment. If net operating income is projected to change over time, the investor typically reports the first year's net operating income.

Discount Rate:

Interest rate used in discounted cash flow (DCF) analysis to determine the present value of future cash flows.

Equity:

The difference between the value of the assets and the value of the liabilities of something owned.

Financial Management Rate of Return (FMRR):

The difference between the value of the assets and the value of the liabilities of something owned.

Gross Operating Income:

The result of subtracting the credit and vacancy losses from a property's gross potential income.

Gross Rent Multiplier:

Gross Rent Multiplier is the ratio of the price of a real estate investment to its annual rental income before accounting for expenses such as property taxes, insurance, and utilities; GRM is the number of years the property would take to pay for itself in gross received rent.

Internal Rate of Return (IRR):

For income properties, it is the interest or discount rate needed to discount the sum of future net cash flows, including amortization and payments of loans and depreciation of the real property, to an amount equal to the initial equity of the property.

For development projects, it is the interest or discount rate needed to convert (or discount or reduce) the sum of the development expenditures and incomes to equal zero.

Loan Constant (K):

A percentage that shows the annual debt service on a loan compared to its total principal value.

Commercial Real Estate Financial Glossary of Terms

Loan to Value Ratio (LTV):

The ratio between a mortgage loan and the value of the property pledged as security, usually expressed as a percentage.

Net Cash Flow:

Net cash flow is the annual income produced by an investment property after deducting allowances for capital repairs, leasing commissions, tenant inducements (after the initial lease is up) and debt service from net operating income.

Net Present Value (NPV):

The value in the present of a sum of money, in contrast to some future value it will have when it has been invested at compound interest.

Net Operating Income (NOI):

The income generated after deducting operating expenses but before deducting taxes and financing expenses.

Real Estate Investment Trust (REIT):

A REIT is a company that owns or finances income-producing assets, such as apartments, shopping centers, offices and warehouses. It may also invest in air or water rights, unharvested crops, permanent structures and structural components that are part of a structure but don't themselves produce income. Shares of REITs can be traded like stocks and can allow owners of the shares to participate in the real estate market.

Real Estate Owned (REO):

A sale in which a lender, either institutional or private, sells a property that the lender has taken back through foreclosure.

Recapitalization:

A term used when owners liquidate some or most of their ownership position in an asset by selling some or most of their equity position.

Return on Equity (ROE):

A measure of financial performance calculated by dividing net income by shareholders' equity.

Return on Investment (ROI):

A measure of the value created by a real estate investment. It is the difference between the net gains from investing in the property less the net cost from investing in the property divided by the purchase price of the property. Usually, it is reported as a percentage.

Sale – Lease Back:

When a company sells their building to an investor and then signs a long-term lease for the space, providing income for the investor.

Short Sale:

When the sale price of an asset is less than the amount owed to the lender and when the lender accepts this amount as full payment for the loan. Those funds not repaid to the lender will be written off.

Tenant Improvements:

The amount of money given to a company to improve the space.

Triple Net Lease (NNN):

A lease that represents only the rent on the space. The utilities, taxes, etc. are paid separately by the tenant.

Vacancy Rate:

The percentage of space that is vacant – calculated by dividing vacant space by total square feet.