THE TERMS OF REHABS, RENTALS, & INSURANCE

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Getting started in the real estate investment space can be challenging and understanding how different terms may apply to an investor's project is crucial for a successful result. To help investors navigate their way around a potential deal, we have created a set of useful terms and definitions that are used over a variety of real estate investment areas.

The Terms of Rehabs, Rentals & Insurance will cover terms that are commonly used when investing in fix and flip properties, growing a buy and hold portfolio, or purchasing necessary insurance. This collection will create a better understanding of the process investors go through from the initial interest in a property to the conclusion of closing day and beyond.

AFTER REPAIR VALUE (ARV)

The value of the property after the listed repairs have been completed. This is determined by the appraisal. Lenders will ask for an estimate ARV when they are determining loan terms.

AS-IS-VALUE

The current value of a property as it is **at that point in time.**

BUILDER'S RISK

Coverage that protects a person's or organization's insurable interest in materials, fixtures and equipment being used in the construction or renovation of a building should those items sustain physical loss or damage from a covered cause. **This is typical coverage required on a fix & flip loan.**

CAPITAL EXPENDITURES

The amount of money a business entity spends to purchase, repair, or improve physical assets like property, buildings and equipment. This can include things like renovations, construction, or purchasing a new vehicle for business use. Capital expenditures can be included as an investment on a balance sheet.

CAPITAL GAIN

The profit made from selling an asset.

Calculation

Purchase Price
– Selling Price

Capital Gain

CAPITALIZATION RATE

Any property that is 5 or more apartment Cap rate is the ratio between the Net Operating Income (NOI) produced by an asset and the original capital cost or, alternatively, its current market value. Higher cap rates may suggest a higher rate on return but also imply higher levels of risk. Cap rates are **typically used with other metrics** to help investors evaluate the potential investment property. This is a tool many buy and hold investors utilize to compare projects.

Calculation

$$\frac{\text{NOI}}{\text{Current Market Value}} = \textit{Cap rate (\%)}$$

DEBT SERVICE COVERAGE RATIO (DSCR)

Debt service is the annual cost of the obligations for the property (principal, interest, taxes, insurance, HOA).

DUE DILIGENCE

In real estate, due diligence is **taking a vigilant approach when evaluating a potential property**. This may include reviewing documents, creating sensible rehab budgets, acquiring insurance, performing calculations to determine profitability, and personally inspecting the property.

EXPANSION

Refers to loans where a borrower will be adding living space (square footage) on a property’s existing lay out. Some **lenders may require a feasibility study** on extensive expansion projects.

FLOOD CERTIFICATE

A document that states the flood zone status of real property. If the flood cert says the property is in a flood zone, the borrower will need to get flood insurance for the property prior to closing.

GROUND RENTS

Ground Rent dates back to the 18th century when homeowners were given an opportunity to buy a house without the additional expense of the property. It was then leased to them at a fixed rate. Ground rent can range from $50-$150 per year and is paid semi-annually. It's often hard to find the rent holders, so the most that can be collected is 3 years of back payments. Some lenders may require the borrower to buy out the ground rents.

HEAVY REHAB

Any loan that involves a rehab budget **greater than the purchase price or "as is" value**, a condo conversion, change of use, or expansion.

HOME OWNER'S ASSOCIATION

An individual person who guarantees
An organization in a subdivision, planned community or condominium that makes and enforces rules for the properties within its jurisdiction. Those who purchase property within an HOA's jurisdiction automatically become members and are required to pay dues, known as HOA fees.

HOLDBACKS

A holdback is a portion of the loan that will be disbursed at a time after closing of the loan when certain conditions are met.

Examples:

- Rehab holdback that gets disbursed through the inspection and draw process.
- Money held back at closing for an interior appraisal to be completed post-closing.

INCOME BASED APPROACH

A method of appraising real estate by using the generated income to determine that value of a property.

Calculation

$$\frac{\text{NOI}}{\text{Cap Rate}} = \textit{Property Value Based On Income}$$

INITIAL ADVANCE

The amount of funds that will be **disbursed at closing**, either to the borrower, a seller, or a third party such as a mortgage company that holds an existing loan on the property.

LOAN TO COST (LTC)

A ratio to compare the amount of the loan used to finance a project vs. the cost to purchase and rehab the project.

LOAN TO VALUE (LTV)

This helps determine how much risk is involved in making a loan secured by collateral. **The lower the LTV, the less risky the loan would be.**

LTV may be used in multiple ways:

- LTV based on purchase (initial advance/purchase price)
- LTV based on “as is” value (initial advance/as is value)
- LTV based on After Repair Value (loan amount/after repair value)

Calculation

$$\frac{\text{Loan Amount}}{\text{Appraised Value}} = \textit{LTV}$$

MARKET RENT

Amount of rent a willing landlord might reasonably expect to receive, and a willing tenant would reasonably expect to pay to rent the unit. This number is determined by the appraiser and can have a big impact on loans for rental properties.

MASTER POLICY

A condo association will have a master insurance policy that covers the building structure of the condo and grounds in the event of damage. It does not cover the interior possessions, appliances, or installed fixtures inside the condo unit. Those items should be covered by an HO6 policy.

MORTGAGEE CLAUSE

A property insurance provision granting special protection for a mortgagee (e.g., financial institution that has an interest in the property) named in the policy that, in effect, sets up a separate contract between the insurer and the mortgagee.

NET OPERATING INCOME (NOI)

The **annual income generated** by an income-producing property. NOI is calculated by subtracting all expenses from the revenue.

Calculation

Potential Rental Income
– Vacancy and Credit Losses
___
Actual Rental Income
+ Other Income
___
Gross Operating Income
– Operating Expenses
___
Net Operating Income (NOI)

PREMIUM

The amount a borrower must pay for an insurance policy. It's important to know if the premium is paid ahead of time or needs to be paid on the HUD at closing. If it's being paid on the HUD at closing, the lender may need send an invoice to the closing coordinator.

REHAB

Repair work that needs to be completed on a property to **improve a property's physical condition.** This work may be verified by an inspector who visits the property and provides a report to the lender's servicing department/company based on percentage of completion of the various rehab budget items.

A lender will want the rehab list to be as detailed as possible so that the appraiser can provide an accurate after repair value with the appraisal report.

The rehab list should include:

- Types of materials to be used
- Where they will be used on the property
- How much material will be used
- How much will it cost

RENT LOSS COVERAGE

A type of insurance that will cover up to 6 months of rental income on a property due to loss of use. Typically required on rental properties.

RENT ROLL

A **snapshot of current income** as represented by the owner of the asset. This can be shown as an excel spread sheet and list each of the apartment units and how much each unit is leased for. Most lenders will make this a required document for any property with multiple units rented.

RENT COVERAGE RATIO (RCR)

Rent Coverage Ratio measures a property's ability to cover its own debt service payments. RCR is calculated by dividing the property's Net Operating Income (NOI) by the total debt service payments plus the annual collected rent amount.

A ratio above 1.0 shows that the property generates enough income to cover the mortgage payments on the property, while a ration below 1.0 indicates that the property does not generate enough income to cover its own debt service.

TENANT

A person who rents a property or unit from a landlord.

VACANT

An unoccupied unit or property.

VACANCY RATE

The **percentage of vacant units** in a rental property.

Calculation

$$\frac{\text{Number of Vacant Units} \times 100}{\text{Total Number of Units}} = \text{Vacancy Rate}$$

About RCN Capital

RCN Capital is a direct private lender that provides funding for non-owner occupied residential properties. Our loan programs are used for purchase, purchase & rehab, refinance, or cash-out of investment properties.

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