
# Calculating Property Investment Return

There are several different ways of calculating the performance of a property investment. **Some methods are better** for calculating performance than others.

Gross rental yield is OK as a very rough guide, but net rental yield is much better. The return on investment -- AKA 'Cash on Cash' -- method takes into account 'gearing' or 'leverage': the lovely principle of borrowing to increase your return.

The important thing is that you choose a method and stick to it so that for each transaction, this way, you are **comparing apples with apples**!

## Calculating Gross Rental Yield

Gross rental yield is a measurement used to compare the **potential returns** of different properties.

Although gross rental yield is probably the most commonly used method, it is pretty crude. It should be treated with caution though as it doesn't take into account your monthly running costs.

For example, if there is a £200 monthly block management fee then what appeared to be a good yield may not be so good after all!

**Formula for Gross Rental Yield**

(Monthly rent * 12) / Cost of property = Gross yield

The yields that investors look for will differ depending on the type of property that they are looking at. For example the tolerable yield for a high-end apartment in central London (where you might expect good capital growth) will be less than if you were looking at an HMO investment.

As a rule of thumb, the minimum gross rental yield would normally be about 8%. But take into account prevailing interest rate and other monthly expenses. A *good* yield might be considered to be over 10% and high yield 12% +.

I would only ever use gross yield as a very rough indicator... net yield is better.

**Gross Rental Yield Example**

So, imagine we're looking at a property costing £100,000.

The anticipated monthly rental is £500 so multiplying this by 12 gives us an annual rent of £6,000.

Now dividing the annual rent by the property cost gives us 0.06. Multiply by 100 to get a percentage... 6%.

This is a terrible gross yield, so if buying this for a cash-flow investment, you'd probably want to give it a wide berth.

## Calculating Net Rental Yield

Net rental yield is a much better gauge of potential returns than the gross rental yield. It takes into account the costs of buying and the monthly running costs so is far more accurate.

In the net rental yield formula below, running costs are things like...

- Insurance
- maintenance
- ground rent
- service charges
- allowance for empty periods (voids). Allowing 10% of rent is normal.
- letting agent fees.

Purchase costs are things like...

- Solicitor fees
- valuation
- mortgage costs
- stamp duty.

**Formula for Net Rental Yield**

((Monthly rent - running costs) * 12) / (Cost of property + purchase costs) = Net yield

**Net Rental Yield Example**

Continuing with our example above of a property costing £100,000 renting at £500.

Our monthly running costs are as follows:

Letting agency fee: £50 (10% of rent)
Insurance: £15
Maintenance: £30
Void period: £50 (budget for 10% void)

TOTAL= £145

Now, subtract the running costs from the monthly rent of £500 to give £355 and multiply by 12 to get £4,260.

Now consider that the purchase costs for this property will be...

Solicitor: £700
Mortgage valuation: £200

TOTAL= £900

Adding this to the purchase price gives us £100,900

And finally dividing the net monthly income by the total purchase outlay: £4,260 / £100,900 = 0.42

Multiplying by 100 gives us our percentage... 4.2%

So you can see that our borderline gross rental yield looks very bad once the running costs are considered... good job we checked it!

# Calculating Return on Investment

Return on investment (ROI) or “cash on cash” return is the method preferred by many investors for calculating property investment performance.

It gives an indication of how much income we are receiving in a given year, in relation to the initial investment amount. It also takes account of any leverage (lending) on the property.

This method gives us a **much clearer idea** of the return we are actually getting on our investment. But it does still ignore factors like equity in the property and tax benefits etc.

**Formula for Return on Investment**

(Income / Expenses) x 100 = Return on investment

**Return on Investment Example**

So, first calculate the cash flow before taxes.

Let's assume we're buying the property with a £75,000 mortgage at a rate of 5%. This gives us an annual interest of £3,750 with a monthly payment of £312.50.

Subtract the mortgage interest payments from the gross annual income: £6,000 - £3,750 = £2,250.

Now, to get our cash on cash return, simply divide our net cash flow by our initial investment. (We're buying using a 75% LTV mortgage and so need a £25,000 deposit.)

£2,250 divided by £25,000 gives a cash on cash return of 0.09, or 9%.