REAL ESTATE EDUCATION SERIES

RE/MAX Properties

Understanding ROI

Return on investment in real estate - the numbers that matter

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Return on investment (ROI) compares profit with the amount invested. It helps you evaluate a property or project, but the result is only useful when you define the costs, returns, and time period consistently.

1 Start with a clearly defined formula

For a simple all-cash purchase and resale, divide net project profit by total project cost, then multiply by 100. Include every project expense once. This is a total return for the project period, not automatically an annual return.

ROI = (Net project profit / Total project cost) x 100

2 Include the full cost of the investment

Account for purchase and closing costs, renovations, holding expenses such as taxes, insurance and utilities, and selling costs. Financing adds interest and fees. For rental property, include vacancy and operating expenses; gross rent is not profit.

3. An easy all-cash resale example

Purchase price	$300,000
Purchase closing costs	$20,000
Renovations	$40,000
Holding costs	$15,000
Selling costs	$25,000
Total project cost	**$400,000**
Sale price	$440,000

Net profit: $440,000 - $400,000 = $40,000
ROI: ($40,000 / $400,000) x 100 = 10%

Illustration only. Assumes no loan, no rental income, and no income taxes. A 10% return over two years is not a 10% annual return.

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Rental returns, borrowing, time, and risk

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Real estate returns can come from rental cash flow, appreciation, and equity growth as loan principal is repaid. Keep these components separate so you do not count the same benefit twice.

4 Distinguish cash-on-cash return from total ROI

Annual cash-on-cash return measures annual pre-tax cash flow against your cash invested. Cash flow is rent collected minus operating expenses and loan payments, with relevant capital spending reflected. It excludes unrealized appreciation and principal paydown as separate gains.

Example: $80,000 cash invested; $6,400 annual net cash flow
Cash-on-cash return = ($6,400 / $80,000) x 100 = 8%

Illustration only; pre-tax and after operating expenses and debt payments.

5 Borrowing changes the calculation and the risk

A loan reduces the upfront cash you contribute, but adds payments, interest, and fees. Leverage can magnify gains and losses. For an equity ROI, use your own cash contributions and net proceeds after loan payoff; do not mix a cash-invested denominator with an all-cash profit calculation.

6 Compare the same time period and stress-test the plan

A total return over several years differs from an annual return. Compare investments over the same period and test lower rent, vacancy, larger repairs, higher costs, and a slower or lower-priced sale. For complex cash flows, professional analysis may use discounted cash flow or internal rate of return.

7 Keep taxes and actual cash flow separate

Eligible rental expenses and depreciation may affect taxable income, subject to tax rules and limits. Depreciation is not a cash receipt, and selling can have tax consequences. Ask a tax professional to estimate after-tax results rather than assuming every deduction creates an immediate benefit.

Ask Doug Petersen to help review local sales, rent assumptions, property condition, and your resale plan. Use qualified financial and tax professionals for the complete investment analysis.

Adapted from the supplied “Understanding ROI” document. Tax reference: IRS Publication 527. Examples are hypothetical, not forecasts. Educational information, not personalized investment or tax advice.