



Real Estate Talk:
Income property / 1

Description

Income property concept and pricing – understanding the Cap Rate and other considerations

By Joseph Marovitch

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Some people invest in the stock market. Some invest in art. I believe in real estate as the best investment. You can invest in a single residence, condominium, duplex, triplex, multi-residential (more than five units) income property or commercial building. For the purposes of this article, I will be discussing duplexes, triplexes and multi-residential income properties.

Investing in a good piece of real estate is like purchasing a government bond. If the price is right, the condition and location are good and the capitalization rate (Cap Rate) is decent, then you have a property that both grows in value and provides a constant income stream.

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To price an income property of six or more units, you must understand what a Cap Rate is. A capitalization rate indicates the amount of return you receive on your investment. A Cap Rate number consists of the following:

1. NOI – The Net Operating Income or profit after expenses, on an annual basis
2. The purchase price of the property

These two factors are applied to the following formula: $\text{NOI} / \text{Purchase Price} \times 100 = \text{CAP RATE}$

Eg: 10 Apple Rd – 10 units fully rented – NOI: \$50,000 – Asking Price: \$1,000,000



NOI / PRICE x 100 = CAP RATE

\$50,000/ \$1,000,000 x 100 = 5 or 5% return

If the Cap Rate was 3 for a ten-unit fully rented income property, you would want to reduce the asking price until the Cap Rate is acceptable at 4.5 or higher.

In Montreal, a Cap Rate can range from 1 to 12 or higher. The higher the Cap Rate, the higher the net income. Generally, the Cap Rate number indicates the following:

1 – 2: These numbers do not indicate a property that is generating a profit or even maintaining expenses.

3 – 4: These numbers would indicate a duplex or triplex that is maintaining expenses such as mortgage, taxes and/or electricity but not generating a profit except for the increased value of the property itself as time passes, called capital gain.

5 or higher: These numbers indicate a property that is maintaining expenses and generating a profit.

'These properties [duplex and triplex] are an excellent investment in the long term as they grow in value and maintain their own expenses via the tenants.'

Duplex and triplex pricing

We do not price a single unit condo, duplex or triplex the same way we price an income property of six units or more. If you try to price a duplex or triplex based on a cap rate, the property would be worth little. Therefore, we price these properties much the way we price a home.

The price is based on the location, condition and comparable sold and active properties in a similar location. These properties are an excellent investment in the long term as they grow in value and maintain their own expenses via the tenants.

Income property price accuracy

There are two ways to find an income property for sale. One is via the Centris system with a broker. The other is via private sale.

The vendor will indicate the income property is for sale, the asking price, gross income, expenses and net income. You will then apply this information to your Cap Rate formula. Most income property that arrives on the market each day are overpriced, with Cap Rates of 3 or 4. If these properties are six or more units, they are not worth spending time on unless the buyer requires tax losses applied to previous gains, or if there is opportunity to raise rents via renovation.

'An income property (six or more units) can be sold quickly in almost any area if the Cap Rate is 5 or higher and the vendor accurately indicates all the expenses.'

If the indicated Cap Rate is 4.5 or higher, you must verify the Cap Rate by examining all the leases, expenses associated with the property, and via a building inspection. If upon examination of all these factors the Cap Rate is less than indicated, the buyer can renegotiate the purchase price, buy as-is or cancel the offer.



An income property (six or more units) can be sold quickly in almost any area if the Cap Rate is 5 or higher and the vendor accurately indicates all the expenses. I say almost any area because the more affluent a neighbourhood, the easier the tenants will be to work with.

In future articles I will be discussing the following:

- Income Property – Process to market
- Income Property – Conditions with promise to purchase
- Income Property – Condition: 1st visit
- Income Property – Condition: Inspection
- Income Property – Condition: Review of leases and expenses
- Income Property – Financing
- Income Property – How to increase your real estate portfolio after your first purchase
- Income Property – Landlord's obligations
- Income Property – Tenant's obligations
- The Tribunal administratif du logement – Who are they?
- How to deal with the Tribunal from a landlord's perspective
- How to deal with the Tribunal from a tenant's perspective

Should you have questions or comments, please refer to the comments section at the bottom of the page. As well, to view past articles, [click here](#).

Next article: **Income property /2 – Process to market income property**

State of the market

Across Canada home sales have dropped by 29% according to the Canadian Real Estate Association, and the decline is not over. In Montreal it has not been that steep of a drop, but higher interest rates have definitely placed a damper on sales. As the Bank of Canada is attempting to reduce inflation and aiming for 2.5% instead of 8.1% where inflation is now, we can expect further interest rate hikes until the goal is met.

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However, once the consumer price index begins to fall from 8.1%, we should see a reduction in interest rates along with the correction in the housing market, leading to lower prices and more inventory. Note that though prices may recede, chances are they will not drop to pre-pandemic levels. If anything, once inflation and rates decrease, prices, at their new level, will begin to increase on the island due to a continued housing shortage and lack of space on the island of Montreal to develop further.

Do not expect any of this to occur soon. A drop in inflation and interest rates may take several months to a year or more, barring further wars and political hiccups like Bill 96.

Have a great week!

Let's not forget that people with cancer are vulnerable too!

You are invited to keep giving to the following organizations since **it's now more important than ever to support cancer research!** Click on the logos below to find out how:



Société de recherche
sur le cancer

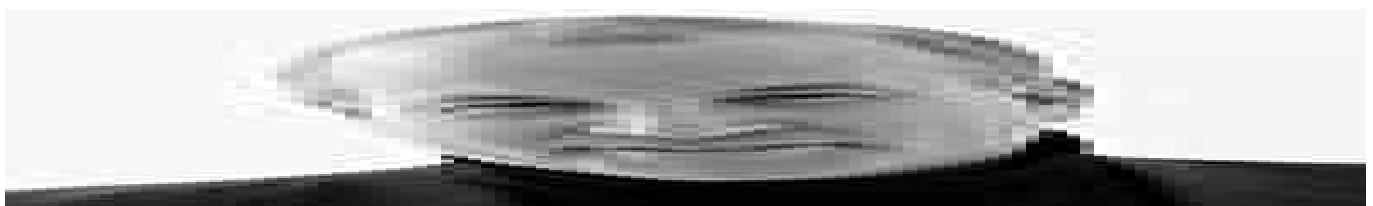
Cancer Research Society

Image: Andrew Burlone

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Joseph Marovitch has worked in the service industry for over 30 years. His first career was working with families from Westmount and surrounding areas, hosting children between the ages of 6 to 16 as the owner and director of Camp Maromac, a sports and arts sleep away summer camp established in 1968. Using the same strengths caring for the families, such as reliability, integrity, honesty and a deep sense of protecting the interests of those he is responsible for, Joseph applies this to his present real estate broker career. Should you have questions please feel free to contact Joseph Marovitch at 514 825-8771, or josephmarovitch@gmail.com



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