Expenses Associated with Owning a Single-Family Rental

Let's talk about the expenses associated with owning a Single-Family Rental (SFR) and how to quickly calculate the estimated Cap Rate ((Annual Revenue - Operating Expenses)/Total Investment).

NOTE** *Cap Rate is based on total investment and does not consider debt and interest expense, for the purposes of this post we will not discuss debt.*

For starters, here are the typical Operating Expenses:

Property Taxes

Property Insurance

Repairs and Maintenance

Property Management

HOA Fees

Utilities (typically only while the property is vacant)

Vacancy (not an expense, but loss of revenue that needs to be considered)

Now, in order to quickly underwrite an SFR and calculate the estimated Cap Rate to determine if it fits your investment criteria you need a few key numbers and a formula.

Let's start with the Key Numbers:

Total Purchase Price (including all closing costs)

Estimated Total Renovation

Monthly Rental Rate

Expense Factor (Detail to come below). Now, once you have these four number you plug them into the following formula to calculate the Cap Rate:

((Monthly Rent x 12)(1-Expense Factor)) / (Total Purchase Price + Estimated Renovation) = Cap Rate

Monthly rent is easy to estimate, our team typically performs manual searches on Zillow and looks at comparable properties within 1/2 mile or less.

Total purchase price and estimated renovation are also easy to calculate and plug in.

Lastly, you need to figure out the Expense Factor. The Expense Factor is the percentage of your rent that goes to all of the Operating Expenses listed above.

For every purchase you need to use actual numbers, but having rough percentages allows you to perform a quick underwrite on a potential SFR investment.

We use the following percentages to estimate the Cap Rate:

Property Taxes - 9%

Property Insurance - 5%

Repairs and Maintenance - 8%

Property Management - 8%

HOA Fees - 1.5% (unless no HOA)

Utilities - 1.5%

Vacancy 4%

Our total Expense Factor with these assumptions is 37%. Key to note, every market and vintage of property will vary in the percentages outlined above. For simplicity, I am referencing a 1980 or newer remodeled single family home in a market with average property taxes and insurance (looking at you Florida and Texas).

Now that we have the Expense Factor, we can calculate the cap rate.

Let's look at a real example:

$225,000 Purchase Price

$30,000 Renovation

$2,100 Monthly Rent

37% Expense Factor

((Monthly Rent x 12)(1-Expense Factor)) / (Total Purchase Price + Estimated Renovation) = Cap Rate

((2,100 x 12)(1-.37)/(225,000+30,000)= 6.23% Cap Rate.

Is a 6.23% Cap Rate good? Well, it depends on the market.

Real estate investing is hyper local, you need to know your markets Cap Rate to determine whether or not the property is a reasonable investment.

I put together an Excel Calculator for anyone interested.

Click here to download.