Cash-on-Cash Return Definition

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What Is a Cash-on-Cash Return?

A cash-on-cash return is a rate of return often used in real estate transactions that calculates the cash income earned on the cash invested in a property. Put simply, cash-on-cash return measures the annual return the investor made on the property in relation to the amount of mortgage paid during the same year. It is considered relatively easy to understand and one of the most important real estate ROI calculations.

Return

$$\text{Cash on Cash Return} = \frac{\text{Annual Pre-Tax Cash Flow}}{\text{Total Cash Invested}}$$

where:

$$\text{APTCF} = (\text{GSR} + \text{OI}) - (\text{V} + \text{OE} + \text{AMP})$$

$$\text{GSR} = \text{Gross scheduled rent}$$

$$\text{OI} = \text{Other income}$$

$$\text{V} = \text{Vacancy}$$

$$\text{OE} = \text{Operating expenses}$$

$$\text{AMP} = \text{Annual mortgage payments}$$

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What's a Cash-On-Cash Return?

What Does the Cash-on-Cash Return Tell You?

A cash-on-cash return is a metric normally used to measure commercial real estate investment performance. It is sometimes referred to as the cash yield on a property investment. The cash-on-cash return rate provides business owners and investors with an analysis of the business plan for a property and the potential cash distributions over the life of the investment.

Cash-on-cash return analysis is often used for investment properties that involve long-term debt borrowing. When debt is included in a real estate transaction, as is the case with most commercial properties, the actual cash return on the investment differs from the standard return on investment (ROI).

Calculations based on standard ROI take into account the total return on an investment. Cash-on-cash return, on the other hand, only measures the return on the actual cash invested, providing a more accurate analysis of the investment's performance.

KEY TAKEAWAYS

- Cash-on-cash return measures the amount of cash flow relative to the amount of cash invested in a property investment and is calculated on a pre-tax basis.

- The metric can also be used as a forecasting tool to set a target for projected earnings and expenses.

Example of How to Use Cash-on-Cash Return

Cash-on-cash returns use an investment property's pre-tax cash inflows received by the investor and the pre-tax outflows paid by the investor. For example, suppose a commercial real estate investor invests in a piece of property that does not produce monthly income.

The total purchase price of the property is $1 million. The investor pays $100,000 cash as a down payment and borrows $900,000 from a bank. Due are closing fees, insurance premiums, and maintenance costs of $10,000, which the investor also pays out of pocket.

After one year, the investor has paid $25,000 in loan payments, of which $5,000 is a principal repayment. The investor decides to sell the property for $1.1 million after one year. This means the investor's total cash outflow is $135,000, and after the debt of $895,000 is repaid, he is left with a cash inflow of $205,000. The investor's cash-on-cash return is then: ($205,000 - $135,000) / $135,000 = 51.9%.

In addition to deriving the current return, the cash-on-cash return can also be used to forecast the expected future cash distributions of an investment. However, unlike a monthly coupon payment distribution, it is not a promised return but is instead a target used to assess a potential investment. In this way, the cash-on-cash return is an estimate of what an investor may receive over the life of the investment.

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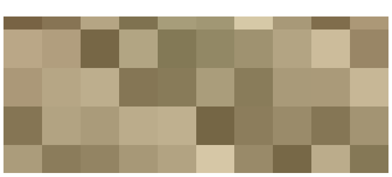

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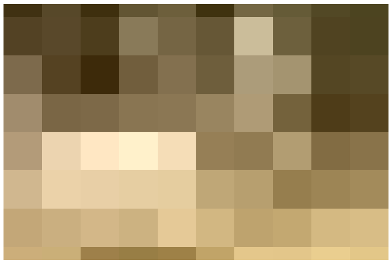

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