AFFORDABLE HOUSING WORKSHOP

City of Victoria, Committee of the Whole Meeting
May 16, 2019

Presentation: Terminology Handout - Economics of Residential Development
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When discussing development economics one frequently encounters certain terms:

- **Profit** – revenue minus costs equals profit.
  - Often expressed as a ratio to project costs.
  - Used for determining viability of a short term investment.
  - Standard would be 15% profit as a ratio to total project costs for strata.

- **Yield** – ongoing financial performance over time of an investment.
  - Used for determining viability of a longer term investment.
  - Standards will vary by project and developer, as well as other market influences.

- **Discount Rate** – a factor by which one accounts for how the value of money changes over a period of time.
  - Implicitly accounts for risk, interest, inflation, etc.

- **Net Present Value (NPV)** – the net sum of all revenues and costs after applying a discount rate.
  - Allows for something similar to profit calculation for a long term investment.
  - The key is that any NPV greater than $0 indicates a good investment.

- **Internal Rate of Return (IRR)** – the average return of an investment over a set period of time expressed as a percentage.

- **Hurdle Rate** – the target IRR one wishes to achieve to have an economically viable project.
  - Generally this would be equivalent to the discount rate that would generate a NPV of $0 or higher.

- **Net Operating Income** – income remaining after accounting for debt loss, vacancy, and operating costs.
  - Used for a rental, commercial, industrial, or other income producing property.

- **Capitalization (or Cap) Rate** – observed ratio between the price an income producing property sells for on the open market and the NOI of the building the year prior to sale.
  - NOI / Sales Price = Cap Rate
  - Cap rates are monitored in the real estate industry and published reports are generally available every quarter.
  - Allows one to estimate the sales value of an income producing property in a similar location with a similar use based on the NOI
    - NOI / Cap Rate = Estimated Sales Price