The 1% Tool Guide

How to quickly tell if a property will cash flow.

The 1% Rule is a quick rule of thumb in real estate investment that helps investors quickly assess the potential cash flow of a property. This rule provides a simple and quick way for investors to evaluate the income-generating potential of a property before delving into a full and detailed financial analysis.

By adhering to the 1% Rule, investors can streamline their property selection process and identify opportunities that align with their financial goals. There are two main components to the 1% rule as seen below.

Part 1: Finding Cash Flow

Expected or Total Existing Gross Rental Income (before all expenses) ÷ 1% = Purchase Price to Earn Cash Flow

$$Y \div 0.01 = Z$$

Example: You are looking at a triplex and you estimate that each unit could be rented for $1,458/ month, based on comparibles in the area or by using The Income AnalyzerTM. That means the total gross rent from the property would be $4,374/month (1,458 × 3 = 4,374). So...

$$\$4,374 \div 0.01 = \$437,400$$

If the purchase price is within the range of $437,400, then the property's cash flow, will exceed all typical expenses related to a rental property, including the financing. And in some cases, depending on interest rates, the cash flow will even cover to up 100% LTV (Loan-to-Value) financing.

Part 2: How to Tell if the Property Will Break Even

A similar calculation can be used to determine the maximum "Offer Price" while still breaking even (before the rent no longer covers all the expenses).

Expected or Existing Gross Rental Income ÷ 0.6% = Maximum Purchase Price

$$Y \div 0.006 = Z$$

Example: So for that same property that could earn $4,374/month...

$$\$4,374 \div 0.006 = \$729,000$$

That means if you really want that property and found yourself in a bidding war, $729,000 gives the maximum price range of the property before you are operating at a loss, or negative cash flow. This will only cover up to a maximum of 80% LTV for financing.

Using the Price to Determine Minimum Rent

Perhaps you are in a situation where you want to determine how much you could rent the property out for based on the asking price. This would be the same calculation in reverse:

Asking Price × 1% = Minimum Rent to Earn Cash Flow

$$Z \times 0.01 = Y$$

Example: So for that same property that could earn $4,374/month...

$$\$437{,}400 \times 0.01 = \$4{,}374$$

That means that if you purchased that property for the asking price of $437,400, $4,374/m would more than cover all expenses including up to 100% LTV financing. And if you wanted to determine a break-even rent:

$$Z \times 0.006 = Y$$

Example: So for that same property that could earn $4,374/month...

$$\$437{,}400 \times 0.006 = \$2{,}624.40$$

If comparable rents in that market are well below, $2,624/month, the this property will not even break with 80% LTV Financing.