



Adjusted Funds From Operations (AFFO): Definition and Calculation

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What Are Adjusted Funds From Operations—AFFO?

Adjusted funds from operations (AFFO) refers to the financial performance measure primarily used in the analysis of [real estate investment trusts](#) (REITs). The AFFO of a REIT, though subject to varying methods of computation, is generally equal to the trust's [funds from operations](#) (FFO) with adjustments made for recurring capital expenditures used to maintain the quality of the REIT's underlying assets. The calculation takes in the adjustment to GAAP straight-lining of rent, leasing costs, and other material factors. ^[1]

KEY TAKEAWAYS

- Adjusted funds from operations (AFFO) is a financial measure used to estimate the value of a real estate investment trust



- AFFO is based on funds from operations (FFO), but is considered preferable, because it takes costs into consideration, thus more accurately estimating the REIT's present values and ability to pay dividends.
- Though no one official measure exists, an AFFO formula is along the lines of $\text{AFFO} = \text{FFO} + \text{rent increases} - \text{capital expenditures} - \text{routine maintenance amounts}$.

Understanding Adjusted Funds From Operations—AFFO

Regardless of how industry professionals choose to compute adjusted funds from operations (AFFO), it is considered to be a more accurate measure of residual cash flow for shareholders than simple FFO. Though FFO is commonly used, it does not deduct for [capital expenditures](#) required to maintain the existing portfolio of properties, so it doesn't quite measure the true residual cash flow. Professional analysts prefer AFFO because it takes into consideration additional costs incurred by the REIT—and additional income sources too, like rent increases. Thus, it provides for a more accurate base number when estimating [present values](#) and a better predictor of the REIT's future ability to pay [dividends](#). This is a non-GAAP measure. ^[2]

Calculating Adjusted Funds From Operations—AFFO



from operations (FFO). The FFO measures cash flow from a specified list of activities. FFO reflects the impact from the REIT's leasing and acquisition activity, as well as interest costs. FFO takes into account the REIT's net income including [amortization and depreciation](#), but it excludes the [capital gains](#) from property sales. The reason these gains are not included is that they are one-time events and generally do not have a long-term effect on the REIT's future earnings potential. ^[3]

The formula for FFO is: ^[4]

FFO = net income + amortization + depreciation - capital gains from property sales

Once the FFO is determined, the AFFO can be calculated. Though there is no one official formula, calculations for AFFO typically would be something like:

AFFO = FFO + rent increases - capital expenditures - routine maintenance amounts

FAST FACT

Traditional metrics used in evaluating equities, such as earnings-per-share (EPS) and price-to-earnings ratio (P/E), are not reliable in estimating the value of a REIT.



Example of an Adjusted Funds From Operations—

AFFO Calculation

As an example of the AFFO calculation, assume the following: a REIT had \$2 million in net income over the last reporting period. During that time, it earned \$400,000 from the sale of one of its properties and lost \$100,000 from the sale of another. It reported \$35,000 of amortization and \$50,000 of depreciation. During the period, net rent increases were \$40,000; capital expenditures were \$75,000 and routine maintenance amounted to \$30,000.

Given this information the FFO can be calculated as:

$$\text{FFO} = \$2,000,000 + \$35,000 + \$50,000 - (\$400,000 - \$100,000) = \$1,785,000$$

From this, the AFFO is calculated as:

$$\text{AFFO} = \text{FFO} + \$40,000 - \$75,000 - \$30,000 = \$1,720,000$$

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