REAL CAPITAL PORTFOLIO

Cap Rate vs. IRR Cheatsheet

When to use each metric, how to calculate them, and the traps that catch most investors.

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METRIC COMPARISON

Cap Rate vs. IRR at a Glance

	Cap Rate	IRR
What it measures	Current income yield relative to value	Total return over time including exit
Formula	NOI / Property Value	Discount rate that makes NPV = 0
Time horizon	Snapshot (today)	Full holding period
Includes leverage?	No	Yes (if modeled with debt)
Includes exit?	No	Yes
Best for	Comparing properties quickly	Comparing investments with different timelines
Weakness	Ignores future value changes	Sensitive to assumptions (exit price, timing)
Typical range	3–10%	8–20%+ (leveraged)

CAP RATE DEEP DIVE

Understanding Cap Rate

> **Formula:**
>
> Cap Rate = Net Operating Income (NOI) / Current Market Value × 100 Example: €40,000 NOI / €800,000 value = 5.0% cap rate

What Cap Rate Tells You:

- The unlevered income return on the property's value
- How the market prices risk for that asset type and location
- Whether a property is expensive or cheap relative to its income

What Cap Rate Does NOT Tell You:

- Your actual return (which depends on leverage, appreciation, and exit)
- Whether the property will appreciate or decline
- The quality of income (how stable the tenants are)

Cap Rate by Asset Class (European Averages):

Asset Class	Prime	Secondary	Tertiary
Residential	3.0–4.0%	4.0–5.5%	5.5–7.0%
Office	3.5–4.5%	5.0–6.5%	6.5–8.5%
Retail	4.0–5.0%	5.5–7.0%	7.0–10%
Logistics	4.0–5.0%	5.0–6.5%	6.5–8.0%
Student Housing	4.0–5.0%	5.0–6.0%	6.0–7.5%

*Ranges are indicative and vary by country and market conditions

IRR DEEP DIVE

Understanding IRR

> **Definition:**
>
> IRR is the annualized rate of return that makes the net present value of all cash flows equal to zero. In plain language: it's the annual return you earn when you account for the timing and size of every cash flow — purchase, income, expenses, and sale.

When to Use IRR:

- Comparing investments with different holding periods
- Evaluating fund/SPV opportunities
- Modeling value-add scenarios (renovate and sell)
- Any investment where the exit is a significant component of return

IRR Traps to Avoid:

Trap	What Happens	How to Avoid
Optimistic exit price	IRR looks amazing but depends on selling at a premium	Use conservative exit cap rate (higher than entry)
Short hold period	Small absolute gain looks like huge IRR	Always check equity multiple alongside IRR
Ignoring reinvestment	IRR assumes you reinvest at the same rate	Use MIRR for more realistic comparison
Leveraged inflation	Debt amplifies nominal gains	Check unlevered IRR separately

QUICK REFERENCE

When to Use Which Metric

Situation	Use Cap Rate	Use IRR	Use Both
Quick property screening	✓		
Comparing two apartments in same area	✓		
Evaluating a fund/SPV offer		✓	
Renovate-and-sell analysis		✓	
Full due diligence on a purchase			✓
Comparing apartment vs. REIT			✓
Negotiating purchase price	✓		
Deciding between two fund managers		✓	

Other Metrics Worth Knowing:

Metric	Formula	When to Use
Cash-on-Cash	Annual Cash Flow / Cash Invested	Comparing leveraged returns
Equity Multiple	Total Cash Received / Cash Invested	Fund investments, total return
Gross Yield	Annual Rent / Purchase Price	Quick initial screening only
Net Yield	(Rent – Expenses) / Total Cost	True income return
DSCR	NOI / Debt Service	Financing feasibility
Payback Period	Cash Invested / Annual Cash Flow	How fast you recover capital

No single metric tells the whole story. Professional investors use cap rate for screening, IRR for modeling, and cash-on-cash for ongoing performance monitoring.

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