



The 5 Metrics Every Investor Should Know

A quick, practical guide that will put you ahead of most new investors

Use this example of an income statement as a guide for understanding the metrics we cover

Category	12 Month Numbers
Rental Income	\$650,000
Other Income	\$54,500
Total Gross Income	\$704,500
Vacancy Adjustment (5%)	\$35,225
Net Income	\$669,275
Property Taxes	\$56,250
Insurance	\$18,475
Utilities	\$54,000
Landscaping	\$4,500
Property Management Fee (5%)	\$33,464
Total Operating Expenses	\$166,689
Net Operating Income (NOI)	\$502,586
Debt Service	\$402,000
Net Cash Flow	\$100,586

Net Operating Income (NOI)

Everybody learns that profit equals revenue minus expenses. There might be different descriptions of what profit means, but that formula is largely consistent. Each type of profit is revenue minus some expense. In the case of Net Operating Income, or NOI, we use the same formula here. Any revenue generated from the property is considered but not all expenses are included. The only ones that are reduced to calculate NOI are ones that are consistent in operations over time. They are called Operating Expenses for that reason. These are expenses that happen every year and include property taxes, insurance, utilities, landscaping, property management, and any other expenditure relating to the day-to-day operations of your building.

Example

Net Income - Total Operating Expenses = NOI

\$669,275 - \$166,689 = \$502,586

The NOI of a property also represents the return you would generate if you acquired a property for cash. With no debt service to pay, your profit is the NOI, thereby representing your returns. In percentage terms, this metric is called the Capitalization Rate and is used to value a property. Without considering debt service in the calculation for NOI, it becomes a great way to compare similar assets with one another since you don't have to account for how that property might be financed. A higher NOI is a great indication that a property is operating with a combination of higher rents or reduced operating costs.

Capitalization Rates (Cap Rates)

Example

To understand what a cap rate is, it is best to use an example. Say you purchased an apartment building in an all cash deal for \$7,350,000. You know from seeing the income statement of the property that the NOI is \$502,586.

NOI ÷ Purchase Price = Cap Rate

\$502,586 ÷ \$7,350,000 = 6.8%

Cap Rate x Purchase Price = NOI

6.8% x \$7,350,000 = \$502,586

NOI ÷ Cap Rate = Purchase Price

\$502,586 ÷ 6.8% = \$7,350,000

The cap rate forms a constant relationship between a property's value and its net operating income (NOI) where if you know any two, you can calculate the third. Investors use cap rates as a comparative measure to assess their property's return potential against other similar assets. A high cap rate can sometimes convey undervaluation due to property-specific risks such as major repairs or deferred maintenance, rather than strong income performance boosting NOI. Cap rates are a consistent metric used in real estate and are widely applied to evaluate individual properties as well as whole markets for investment viability.

Debt Service Coverage Ratio (DSCR)

When you use leverage to acquire an investment property, there are payments that you have to make towards interest and principal each month. On an annual basis, this measure of what you pay to the lender is called Debt Service. The amount that is paid each month / year is based on the terms of the loan, including loan amount, interest rate, and amortization. This can be calculated using online tools or Microsoft Excel. In the income statement example, the annual debt service for the property is \$402,000.

The DSCR is a measure of financial health that lenders use to assess the likelihood of debt payment on time and in full.

Example

$$\text{NOI} \div \text{Debt Service} = \text{Debt Service Coverage Ratio (DSCR)} \quad \$502,586 \div \$402,000 = 1.25x$$

This result of 1.25x means that the NOI of the property can cover the debt service 1.25 times. Lenders will often mandate a threshold that must be met and maintained throughout the term of the loan to remain in good standing.

Cash on Cash Return

The Cash on Cash return is an indicator of how much cash flow your property generates for you in net profit, after considering all operating expenses, capital expenses, and debt service. When you calculate the Cash on Cash return, the result is a percentage based on the amount of money you put in when you acquired the building.

Example

Cost of acquisition = \$7,350,000
Equity Invested up Front (20%) = \$1,470,000
Expected Net Cash Flow = \$100,586

$$\text{Expected Net Cash Flow} \div \text{Equity Invested up Front} = \text{Cash on Cash Return}$$
$$\$100,586 \div \$1,470,000 = 6.8\%$$

The Cash-on-Cash return is a practical comparison tool to measure how much annual cash flow a property generates relative to the initial investment. While some investors target a specific thresholds of annual returns to support income-driven strategies, others may accept lower initial returns if their plan involves renovations to boost long-term profitability.

Internal Rate of Return (IRR)

The Internal Rate of Return, or IRR, is a common way investors measure the annual return on an investment over time. What makes IRR especially useful is that it considers all cash flows, including both income and expenses, and when they occur. Timing plays an important role and earning more money earlier leads to a higher IRR. For example, selling a property after five years instead of ten could result in a higher IRR because the return is realized sooner.

IRR is not typically calculated by hand. Most investors use a financial calculator or software like Microsoft Excel or Google Sheets to determine it.

Another reason IRR is widely used is that it helps investors understand how leverage, or borrowed money, affects returns. When you finance a property with a mortgage, you are putting in less of your own cash upfront. If the property performs well, the profits are measured against a smaller initial investment, which increases the IRR. However, leverage also comes with added risk. If the property underperforms, the debt still needs to be repaid, which can reduce profitability. IRR captures this balance by accounting for both the amount and timing of all cash flows.

Example

Purchase Price = \$7,350,000

Cash Flow Years 1 - 5 (unleveraged) = \$2,512,930 (\$502,586 x 5)

Cash Flow Years 1 - 5 (leveraged) = \$502,930 (\$100,586 x 5)

Sale Price in Year 5 = \$8,500,000

Unleveraged IRR

Cash Outflow to Purchase Property = \$7,350,000

Total Cash Flow Over all 5 Years = \$11,012,930

IRR = 8.9%

In the leveraged example, the cash flow is based on how much you invested after accounting for the loan you were given and considers the loan repayment when the property is sold. For simplicity's sake, we are keeping the loan amount constant and no principal is being paid back over those 5 years until the sale.

Leveraged IRR

Cash Outflow to Purchase Property = \$1,470,000

Total Cash Flow Over all 5 Years = \$2,520,586

IRR = 16.1%