

Investor Reference Guide

Commercial real estate often uses specialized terminology. This guide explains several of the most common metrics used when evaluating apartment investments in plain English.

Pro Forma

A projection of future property performance based on assumptions regarding rents, occupancy, expenses, renovations, and operations. Unlike historical financial statements, a pro forma reflects expected future results rather than actual past performance.

Potential Gross Income (PGI)

The total income a property could generate if every unit were occupied and paying full market rent for the entire year. PGI represents the property's maximum income potential before vacancy, concessions, and collection losses.

Vacancy & Collections Loss (VCL)

An allowance for expected physical vacancy, concessions, and uncollected rent (aka credit/collections loss). This combined category reflects total economic vacancy.

Effective Gross Income (EGI)

The income a property is expected to actually collect after accounting for vacancy, concessions, bad debt, and other income. EGI reflects real-world operating performance.

Net Operating Income (NOI)

NOI represents the income a property generates after paying operating expenses. NOI excludes debt service, depreciation, and capital expenditures.

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Capitalization Rate (Cap Rate)

NOI divided by purchase price or value. Cap rate is commonly used to compare investment opportunities and estimate value. Cap rates vary based on a property's risk profile. Lower cap rate, higher value; higher cap rate, lower value (all else equal).

Debt Service Coverage Ratio (DSCR)

NOI divided by annual debt service. DSCR measures how comfortably property income covers loan payments. A DSCR above 1.00x indicates the property generates enough income to cover debt service. Lender requirements are typically at or above 1.20x.

Debt Yield

NOI divided by loan amount. Commonly used by lenders to assess loan risk. Higher debt yields generally indicate lower leverage (lower lender risk).

Cash-on-Cash Return (aka Equity Dividend Rate or EDR)

Annual cash flow after debt service divided by invested equity. Measures the annual cash yield on invested capital.

Equity Multiple

Total cash received over the investment period divided by invested equity. Measures the total amount of money returned relative to the original investment.

Levered IRR

Projected annualized return over the ownership period, including financing and estimated sale proceeds. IRR is highly dependent on assumptions and can be calculated over short or long hold periods.

Important Note

Investment metrics are tools, not guarantees. Results vary based on assumptions, financing, market conditions, and property performance.

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Example:

Pro Forma (Simplified)	
Potential Gross Income (PGI)	\$ 525,000
Vacancy & Collections Loss (VCL)	\$ (25,000)
Effective Gross Income (EGI)	\$ 500,000
Operating Expenses	\$ (200,000)
Net Operating Income (NOI)	\$ 300,000
Purchase Price	\$ 5,000,000
Cap Rate	6.0%

NOI / Purchase Price = Cap Rate

$\$300,000 \div \$5,000,000 = 6.0\%$

A buyer paying **\$5 million** for a property producing **\$300,000 of NOI** is buying at a **6.0% cap rate**.

Apartment values are tied to stabilized NOI. Therefore, increasing income and/or reducing expenses increases property value, all else equal.

About D2 Real Estate Services

D2 Real Estate Services provides apartment brokerage, acquisition analysis, broker opinions of value, and advisory services throughout Central Texas.

Learn more:
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Disclaimer: This guide is provided for educational purposes only and is not investment, legal, tax, accounting, or appraisal advice. Investors should perform their own due diligence and consult appropriate professionals before making investment decisions.

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