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## CAP rate on investment property

Posted by C. Lochen - 2008/03/28 13:31

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what factors are used to calculate the CAP rate. Also, what is a normal CAP rate on commercial property?

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## Re:CAP rate on investment property

Posted by norton - 2008/03/28 15:10

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This is simply the product of dividing the annual net operating income (NOI) by the appropriate capitalization rate (CAP rate). For income producing real estate, the NOI is the net income of the real estate (but not the business interest) plus any interest expense and non-cash items (e.g. -- depreciation) minus a reserve for replacement. The CAP rate may be determined in one of several ways, including market extraction, band-of-investments, or a built-up method. When appraising complex property, or property which has a risk-adjustment due to unusual factors (i.e. -- contamination), a risk-adjusted cap rate is appropriate. A implicit assumption in direct capitalization is that the cash flow is a perpetuity and the cap rate is a constant. If either cash flows or risk levels are expected to change, then direct capitalization fails and a discounted cash flow method must be used.

In UK practice, Net Income is capitalised by use of market-derived yields. If the property is rack-rented then the All Risks Yield will be used. However, if the passing rent differs from the Estimated Rental Value (ERV), then either the Term & Reversion, Layer or Equivalent Yield methods will be employed. In essence, these entail discounting the different income streams - that of the current or passing rent and that of the reversion to the full rental value - at different adjusted yields.

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## Re:CAP rate on investment property

Posted by Brian - 2008/03/28 15:44

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Take the asking price of the income producing property, say \$300,000

If the net operating income is \$24,000

Then divide the net operating income by the sale price to get cap rate.

Example:  $\$24,000 / \$300,000 = .08$  or 8% (The Capitalization Rate)

If you want a higher return on your investment then you offer should be less.

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