REAL ESTATE EDUCATION SERIES

RE/MAX Properties

Understanding CAP Rate

A simple way to compare income-producing properties

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Capitalization rate, or cap rate, compares a property's annual net operating income (NOI) with its purchase price or current market value. It measures income relative to price before financing, not your total investment return.

THE BASIC FORMULA

CAP RATE = (ANNUAL NOI / PRICE) x 100

STEP 1: CALCULATE ANNUAL NOI

Potential annual rent and other income	$60,000
Less vacancy and collection-loss allowance	- $3,000
Effective annual income	$57,000
Less annual operating expenses	- $21,000
Annual net operating income (NOI)	**$36,000**

Operating expenses include property taxes, insurance, management, routine repairs, and owner-paid utilities or HOA charges. NOI excludes mortgage principal and interest, income taxes, and depreciation. Major capital work is evaluated separately; reserve treatment can vary by analysis.

STEP 2: DIVIDE NOI BY THE PRICE

Assume a purchase price of $600,000. Use the same annual income and expense basis when comparing properties.

($36,000 / $600,000) x 100 = 6%

WORK BACKWARD TO AN INDICATED VALUE

Value = annual NOI / cap rate expressed as a decimal
At an assumed 6% cap rate: $36,000 / 0.06 = $600,000.
At an assumed 8% cap rate: $36,000 / 0.08 = $450,000.

A higher cap rate may reflect greater risk or a lower price. Verify leases, actual expenses, vacancy, condition, and comparable sales. Review debt payments and capital needs separately. Doug Petersen can help you identify questions for a property analysis.

Doug Petersen | 970-290-3000 | Illustrative numbers only; assumed rates are not market quotes or an appraisal. Adapted from your CAP rate outline. Resources: Nareit cap rate definition; income capitalization guidance. Educational summary. Each office independently owned and operated.