



Cash Flow vs IRR: What Actually Matters

A practical framework for evaluating projected returns in real estate investing

When evaluating a real estate investment, projected returns are often summarized using a single metric — most commonly, IRR.

While useful, IRR is also frequently misunderstood. It can obscure the underlying drivers of performance, particularly when the assumptions behind it are not closely examined.

A more practical approach is to look beyond the headline return and ask:

How much of the return is supported by current cash flow, and how much depends on future assumptions?

What IRR Measures

IRR estimates the annualized return of an investment by incorporating both the timing and magnitude of expected cash flows.

It includes:

- Cash distributions during the hold period
- The projected sale value
- The timing of those cash flows

Because IRR is sensitive to timing, relatively small changes — particularly around exit — can materially impact the reported return without improving the underlying economics.

It also relies on forward-looking assumptions such as rent growth, operating improvements, and exit pricing — variables that introduce uncertainty and are often outside of direct control.

As a result, two investments with similar IRRs can carry very different risk profiles depending on how those returns are constructed.



What Cash Flow Represents

Cash flow reflects the income generated by a property and distributed to investors over time.

Unlike IRR, it is grounded in current operations and less dependent on future outcomes.

It is primarily driven by:

- In-place rents
- Occupancy
- Operating performance
- Financing structure

Because of this, it provides a more immediate measure of performance.

For many investors, consistent cash flow also provides stability, particularly when market conditions or valuations become more volatile.

Where Return Profiles Can Be Misleading

Projected returns can appear attractive when driven by favorable assumptions, particularly around exit value and timing.

Common examples include:

- **Exit-dependent returns** — a meaningful portion of the return is realized only upon sale
- **Aggressive growth assumptions** — projections not supported by current fundamentals
- **Compressed timelines** — shorter holds that increase IRR without improving total profit
- **Execution-heavy business plans** — outcomes that depend on multiple variables aligning



In each case, the return may be technically accurate, but less durable in practice.

How We Evaluate Opportunities

When reviewing an investment, one of the first considerations is how the return is generated.

We focus on opportunities where:

- Cash flow is already in place or achievable in the near term
- The underlying asset and market fundamentals are stable
- The business plan enhances existing performance rather than relying on future outcomes

This reflects a preference for investments where performance is driven by what is known and controllable.

From that foundation, we look to create additional value through execution — rather than underwriting that upside at the outset.

Final Considerations

IRR can be a useful metric, but it should not be viewed in isolation.

Understanding how a return is constructed — and where the key assumptions sit — is critical to evaluating both risk and performance.

In many cases, durability is less about the projected return and more about the strength of the underlying fundamentals.