



What Drives Returns in Real Estate?

Breaking down where returns actually come from — and how to evaluate them

Real estate investments are often presented through projected returns — IRR, equity multiples, and other performance metrics.

While these numbers can be helpful, they do not always explain *how* those returns are generated.

A more useful way to evaluate an investment is to break returns down into their underlying components.

At a high level, most real estate returns are driven by a combination of three factors:

- Income (cash flow)
- Growth (changes in income over time)
- Exit (the value at which the asset is sold)

Understanding how these components interact can provide a clearer picture of both potential performance and risk.

Income: The Foundation of Returns

The most direct source of return in real estate is income.

This is the cash flow generated by the property and distributed to investors over time.

Income is driven by:

- Rent levels
- Occupancy
- Operating expenses
- Financing structure



Because it is tied to current operations, income is typically the most observable and stable component of return.

In many cases, it provides the foundation for overall performance, particularly in investments focused on consistency and durability.

Growth: Improving Performance Over Time

In addition to current income, many investments aim to increase performance over time.

This may include:

- Increasing rents
- Improving occupancy
- Enhancing operations
- Repositioning the asset

When executed successfully, these improvements can increase both cash flow and the overall value of the property.

However, growth introduces an additional layer of complexity.

Unlike in-place income, it depends on execution and market conditions. The more a return relies on future improvements, the more important it becomes to evaluate how achievable those improvements are.

Exit: Realizing Value

The third component of return is the exit — the sale of the asset.

At exit, investors typically realize:

- The accumulated value created during the hold period
- Any appreciation in the asset's value
- Return of remaining capital



In many investments, a meaningful portion of the projected return is tied to this event.

Because of this, exit assumptions — including pricing, timing, and market conditions — can have a significant impact on overall performance.

As discussed in prior sections, these assumptions are inherently uncertain and should be evaluated carefully.

How These Components Work Together

While these three drivers — income, growth, and exit — are present in most investments, their relative contribution can vary significantly.

Some investments are:

- **Income-driven** — where the majority of return comes from ongoing cash flow
- **Growth-driven** — where performance depends on improving operations
- **Exit-driven** — where a large portion of return is realized at sale

Understanding which component is doing the most work is critical.

Two investments may present similar projected returns, but if one is primarily income-driven and the other is heavily dependent on exit assumptions, the risk profile can be very different.

The Role of Leverage

Leverage interacts with all three components.

It can:

- Enhance income by increasing capital efficiency
- Amplify growth if performance improves
- Magnify outcomes — both positive and negative — at exit



At the same time, leverage introduces fixed obligations and reduces flexibility.

As a result, the level and structure of debt play a meaningful role in how returns are experienced.

A Practical Framework for Evaluation

When evaluating an opportunity, it can be helpful to ask a few simple questions:

- How much of the return is supported by current income?
- How much depends on future improvements?
- How much is tied to exit assumptions?

These questions help shift the focus from headline metrics to underlying drivers.

They also provide insight into where risk is concentrated within the investment.

How We Think About It

We view income as the foundation of returns.

From that starting point, growth should enhance performance, and exit should reflect value that has already been created — not value that must occur in order for the investment to succeed.

This approach aligns with a focus on:

- Durable cash flow
- Strong underlying fundamentals
- Disciplined execution

Rather than relying on any single component, the objective is to build investments where returns are supported across all three drivers, with an emphasis on what is already in place.



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Final Considerations

Real estate returns are not driven by a single number, but by a combination of factors that evolve over time.

Understanding how those factors interact can provide a clearer view of both opportunity and risk.

In many cases, the most resilient investments are those where performance is grounded in current income, supported by achievable improvements, and less dependent on specific outcomes at exit.