



Why Exit Assumptions Matter More Than They Seem

How future sale assumptions shape projected returns – and where risk often sits

EXECUTIVE SUMMARY

Real estate returns are generated through three primary drivers: income, value creation, and exit. Of the three, exit is often the most dependent on assumptions about future conditions.

The estimated sale price of a property can materially influence projected returns, yet it depends on variables such as future income, cap rates, market conditions, and timing—many of which are outside an investor's control.

Understanding how an investment's exit is underwritten, and how sensitive projected returns are to changes in those assumptions, can provide important insight into where risk sits within the investment.



KEY INSIGHT

The further into the future an assumption sits, the less control an investor has over the outcome.

Exit values depend on both the performance of the property and the market environment that exists when it is sold. Because relatively small changes in those assumptions can materially affect projected returns, understanding what must happen at exit is an important part of evaluating investment risk.

UNDERSTANDING EXIT VALUE

An exit assumption estimates what a property may be worth when it is eventually sold. While several factors can influence the actual sale price, projected exit value is commonly estimated using two primary inputs: the property's expected net operating income (NOI) at the time of sale and an assumed exit capitalization rate.

The basic calculation is straightforward:

$$\begin{array}{|c|} \hline \text{\textbf{\$1.0M}} \\ \hline \text{Projected NOI} \\ \hline \end{array} \div \begin{array}{|c|} \hline \text{\textbf{6.0\%}} \\ \hline \text{Exit Cap Rate} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{\textbf{\$16.7M}} \\ \hline \text{Estimated Sale Value} \\ \hline \end{array}$$

\$1 million of NOI at a 6.0% cap rate produces an estimated value of approximately \$16.7 million.



**PROPERTY
PERFORMANCE**
*Drives the NOI at the
time of sale.*



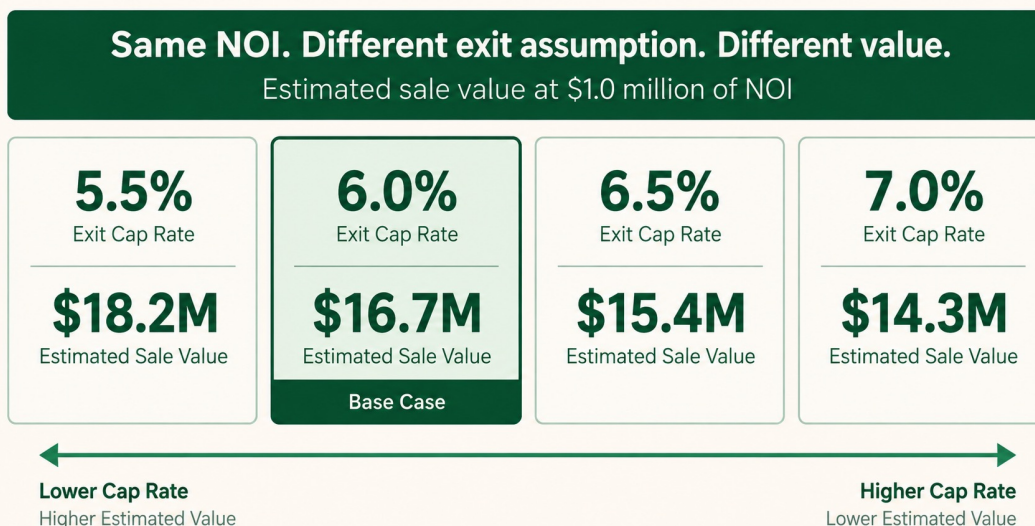
**MARKET
PRICING**
*Determines how the market
values that income*



**EXIT
VALUE**
*The resulting
estimated sale value.*

WHY SMALL CHANGES MATTER

Exit values can be highly sensitive to relatively small changes in the assumptions used to calculate them. A modest change in projected NOI or the exit cap rate can produce a meaningful difference in estimated sale value—and ultimately in projected investor returns.



Same NOI. Different exit assumption. Different value.

In this example, moving the exit cap rate from 6.0% to 7.0% reduces estimated sale value by approximately **\$2.4 million**, even though the property's projected NOI is unchanged. When a meaningful portion of an investment's return is realized at sale, that difference can have a significant impact on investor returns.

WHAT CAN CHANGE BEFORE EXIT?

The challenge is that neither component of exit value is known with certainty. A property's future NOI must be projected, while the cap rate ultimately reflects the market environment that exists when the property is sold.

PROPERTY PERFORMANCE

Can Be Influenced

- Rental income
- Occupancy
- Operating expenses
- Property improvements
- Other income

MARKET PRICING

Largely Outside Our Control

- Interest rates
- Capital availability
- Investor demand
- Market cap rates
- Economic conditions

Owners can influence how a property performs, but they cannot control how the market will price that performance years into the future. The greater the projected return's dependence on favorable market conditions at exit, the more uncertainty is embedded in the investment.

STRESS-TESTING THE EXIT

Every investment requires assumptions about the future. The objective is not to eliminate those assumptions, but to understand how dependent the investment is on them.

Rather than evaluating only a single projected outcome, investors can consider how the investment performs if exit conditions differ from the original underwriting. This may include testing:

Higher exit cap rates — What happens if the market values the property less favorably?

Lower exit NOI — What if the property does not achieve its projected operating performance?

Longer hold periods — What if favorable sale conditions take longer to materialize?

Multiple assumptions changing together — What happens when operating performance and market conditions are both less favorable than projected?

The goal of stress-testing is not to predict exactly what will happen. It is to understand **how much needs to go right for the investment thesis to work.**

1

CHANGE THE ASSUMPTIONS



- Higher exit cap rates
- Lower exit NOI
- Longer hold period
- Multiple assumptions changing together

2

MEASURE THE IMPACT



- Estimated sale value
- Projected investor returns (IRR, cash flows)
- Sensitivity to different scenarios

3

EVALUATE DURABILITY



- Does the investment thesis still work?
- How reliant is the return on favorable market conditions?
- What is the margin for error?

THE ORINOVA PERSPECTIVE

At Orinova, we view the exit as a way to **realize value - not create the investment return.** Our preference is for returns to be supported primarily by current income and value created through execution during the hold period.

That philosophy influences how we underwrite an exit. We seek to ground assumptions in observable market conditions rather than relying on future appreciation or increasingly favorable pricing. We also evaluate how changes in exit assumptions affect projected returns and whether the investment remains compelling under less favorable scenarios.

Ultimately, we want the investment thesis to be supported by what exists today and what we can influence during ownership. A favorable exit can enhance performance, but **we do not want favorable market conditions at sale to be what makes the investment work.**