# INVESTOR 101 COURSE

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# Investor Education

If you are an accredited investor or you just want to learn more about apartment syndication, then this is the page you want to start with! This resource is here for you to educate yourself on the process of apartment syndication and learn the some of the "Lingo" that will be thrown around by a sponsor or syndicator.

The power is in the knowledge and that is what we wanted to provide to our investors. The sole purpose for this section is to give you, as the investor, all the tools you need to make informed decisions with your investing

# Active vs Passive Investing

### What Are Your Goals?

It is important to understand if you want to be active or passive investor. Before you start into this wonderful journey of investing you need to understand the difference between the two.

## Active vs Passive Investing

**Active Investing:** Finding, qualifying and closing on an apartment complex or multifamily residence using one's own capital and overseeing the business plan through its successful completion.

**Passive Investing:** Investing one's capital into an apartment syndication that is managed in its entirety by a sponsor or general partner.

## So which is right for you?
## There are a few questions you should ask yourself.

Does my job or profession afford me the time to be an active investor?

Do I understand the ins and outs of apartment investing so well that I can do it on my own?

Do I have the resources in my target market to source, close & operate an apartment building on my own? Do I have the capital to purchase an apartment?

If you answered Yes to all of these questions, then you probably don't need to read any further. If you answered No to any of these questions, then passively investing into an apartment syndication might be right for you.

**Our goal for you is to figure out where you want to fall on the Scale of Passivity. 1 =**

**Completely Passive, 10 = Completely Active**

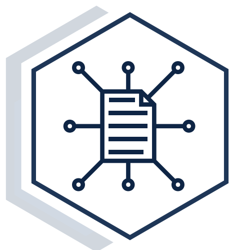
If your goal is to become an active investor, investing passively is a great way to start receiving cash flow while learning alongside some great operators. Most of us got our start by investing passively into other people's apartment syndications. In fact, many investors have found financial freedom and quit their jobs investing passively in other syndications.

Maybe you want to find a blend of both and fall somewhere in the middle of the Scale of Passivity. Either way we hope this will give you some insight into **"passive vs. active"** investing and what is right for you.

# Partnership/ Deal Structure

## Accredited Investor

Is a person that can invest in securities (i.e. invest in an apartment syndication as a limited partner) by satisfying one of the requirements regarding income or net worth. The current requirements to qualify are an annual income of $200,000 or $300,000 for joint income for the last two years with expectation of earning the same or higher or a net worth exceeding $1 million either individually or jointly with a spouse.



## Apartment Syndication

A group of individuals or companies that pool their resources (time, expertise, money, etc.) to achieve a common goal that would otherwise be impossible, or very difficult, to achieve alone. This allows companies to pool their resources and share risks and returns. In regards to apartments, a syndication is typically a partnership between general partners (i.e. the syndicator/sponsor) and the limited partners (i.e. the investors) to acquire, manage and sell an apartment community while sharing in the profits.

## Sophisticated Investor

Is a person who is deemed to have sufficient investing experience and knowledge to weigh the risks and merits of an investment opportunity. If you do not qualify as an accredited investor you can become sophisticated through building a relationship with the sponsor.

## General Partner (GP)

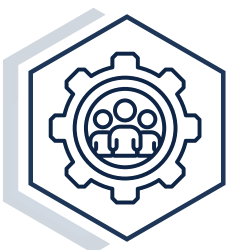
Is an owner of a partnership who has unlimited liability. A general partner is also usually a managing partner and active in the day-to-day operations of the business. In apartment syndications, the GP is also referred to as the sponsor or syndicator. The GP is responsible for managing the entire apartment project starting from sourcing the deal and eventually ending with the sale of the deal..

## Limited Partner (LP)

Is a partner whose liability is limited to the extent of the partner's share of ownership. In apartment syndications, the LP is the passive investor and funds a portion of the equity investment. They are passive investors and have no involvement in the operation of the asset.

## Acquisition Fee

Is the upfront fee paid by the new buying partnership entity to the general partner for finding, analyzing, evaluating, financing and closing the investment. Fees range from 0.5% to 5% of the purchase price, depending on the size of the deal.



## Asset Management Fee

Is an ongoing annual fee from the property operations paid to the general partner for property oversight and continual management of the asset. Generally, the fee is 1-2% of the collected income or $250 per unit per year.

## Property Management Fee

Is an ongoing monthly fee paid to the property management company for managing the day-to-day operations of the property. This fee ranges from 2% to 8% of the total monthly collected revenues of the property, depending on the size of the deal.

## Refinancing Fee (Capital Transaction Fee)

Is a fee paid for the work required to refinance the property. At closing of the new loan, a fee of 0.5% to 2% of the total loan amount is paid to the general partner.

## Guaranty Fee

Is a fee paid to a loan guarantor at closing. The loan guarantor guarantees the loan. At closing of the loan, a fee of 0.25% to 1% of the principal balance of the mortgage loan is paid to the loan guarantor.

## Equity Investment

Is the upfront costs for purchasing an apartment community, which includes the down payment for a loan, closing costs, financing fees, operating account funding, and the various fees paid to the general partner for putting the deal together. May also be referred to as the initial cash outlay or the down payment.

## Private Placement Memorandum

(PPM) is a legal document provided to prospective investors when selling stock or another security in a business. It summarizes deal and highlights the risks. It is sometimes referred to as an offering memorandum or offering document. The four main sections are the introduction, which is a brief summary of the offering, the basic disclosures, which includes general partner information, asset description and risk factors, the legal agreement and the subscription agreement. In order to invest you must understand PPM and sign the subscription agreement.

# Real Estate/ Operating Terms

## Net Operating Income (NOI)

Is all revenue from the property minus operating expenses, excluding capital expenditures and debt service. This term is important because the value of Commercial Real Estate/Apartments is derived from this number. As we increase the NOI of an asset, the value of the apartment also increases (Forced Appreciation.) You will read more about this concept later.

For example, a 180-unit apartment community with a total income of $1,579,609 and total operating expenses of $873,421 has a NOI of $706,118.

## Capitalization Rate (Cap Rate)

Is the rate of return based on the income that the property is expected to generate. The cap rate is calculated by dividing the property's net operating income (NOI) by the current market value or acquisition cost of a property (cap rate = NOI / Current market value).

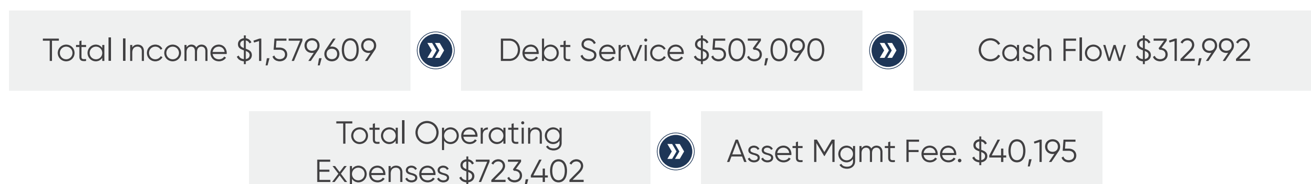
## Price Per Unit

Is the cost of purchasing an apartment community based on the purchase price & the number of units. The price (or cost) per unit is calculated by dividing the purchase price by the number of units. For example, a 180-unit apartment community purchased for $10,864,430 has a price per unit of $60,357.

## Cash Flow

Is the revenue remaining after paying all expenses (cap ex, debt service, operating expenses). Cash flow is calculated by subtracting the operating expense and debt service from the collected revenue.

For example, here is the cash flow of a 180-unit apartment community:



## Capital Expenditures

Typically referred to as CapEx, are the funds used by a company to acquire, upgrade and maintain an apartment community. An expense is considered to be a capital expenditure when it improves the useful life of an apartment and is capitalized – spreading the cost of the expenditure over the useful life of the asset.

Capital expenditures include both interior and exterior renovations.

Examples of exterior CapEx: Repairing or replacing a parking lot, repairing or replacing a roof, repairing, replacing or installing balconies or patios, installing covered parking, large landscaping jobs, rebranding the community(signage), new paint, new siding, repairing or replacing HVAC and renovating a clubhouse.

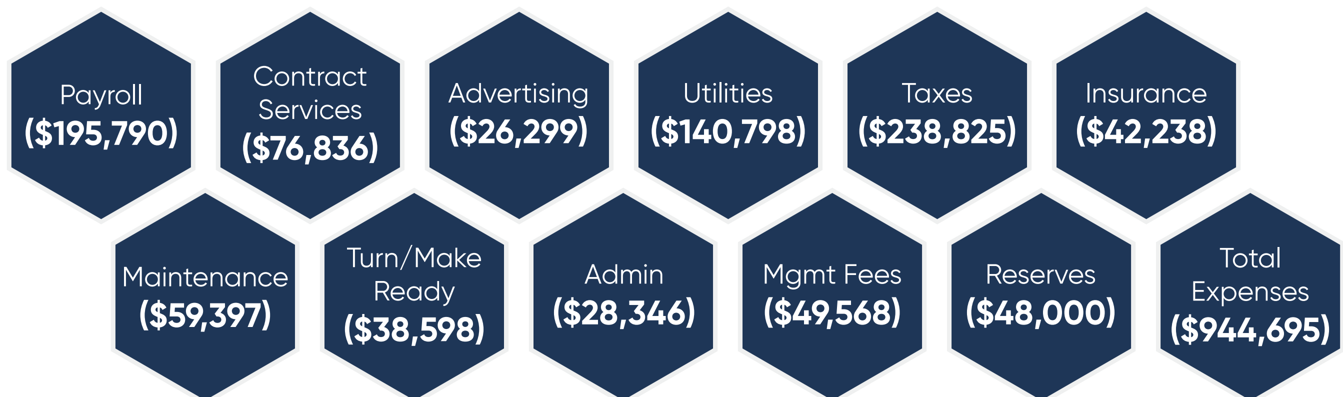
Examples of interior CapEx: New cabinetry, new countertops, new flooring, new fireplaces, new appliances, opening up or enclosing a kitchen, new light fixtures, interior paint, plumbing projects, new blinds and new hardware (i.e. door knobs, cabinet handles, outlet covers, faucets, etc.).

Examples of things that wouldn't be considered CapEx are operating expenses, like the costs associated with turning over a unit (i.e. new carpet, paint, cleaning, etc.), ongoing maintenance and repairs, ongoing landscaping costs, property management expense, utility expenses, etc.

## Operating Expences

Are all the costs of operating and maintaining the property and its grounds.

For example, here are operating expenses for a 180-unit apartment community:




## Operating Account Funding

Is a reserves fund, that is budgeted in to the overall cost to purchase, to cover things like unexpected dips in occupancy, lump sum insurance or tax payments or higher than expected capital expenditures. The operating account fund is typically created by raising extra money from the limited partners.

# Income Occupancy Vacancy

## Market Rent

Is the rent amount a willing landlord might reasonably expect to receive, and a willing tenant might reasonably expect to pay for a tenancy, which is based on the rent charged at similar apartment communities in the area. Market rent is typical calculated by performing a rent comparable analysis(Rent Comps).

## Rent Premium

Is the amount you can increase the rents after performing renovations and updates. The rent premium is an assumption made by the general partner during the underwriting process based on the rental rates of similar units(comps) in the area or previously renovated units.

## Gross Potential Rent

Gross potential rent is the total rental income a property would generate if it were fully rented at market rates without any vacancy. For example, if an apartment building has 10 units, each renting for $1,000 per month, the GPR for a year would be $120,000 (10 units x $1,000/month x 12 months).

## Gross Potential Income

Is the hypothetical amount of revenue if the apartment community was 100% leased year-round at market rates plus all other income.
For example, a 180-unit apartment community with a GPR of $167,800 and monthly other income of $10,163 from late fees, pet fees and a RUBS program has a gross potential income of $177,800 per month.

### Breakeven Occupancy

Is the occupancy rate required to cover the all of the expenses of an apartment community. The breakeven occupancy rate is calculated by dividing the sum of the operating expenses and debt service by the gross potential income.
(Op Ex + Debt Service) / Gross Potential Income
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For example, a 180-unit apartment community with $944,695 in operating expenses, $503,090 in debt service and $2,013,600 in gross potential income has a breakeven occupancy of 77.2%

### Physical Occupancy Rate

Is the rate of occupied units. The physical occupancy rate is calculated by dividing the total number of occupied units by the total number of units.
For example, a 180-unit apartment community with 170 occupied units has a physical occupancy rate of 94%.

### Gross Rent Multiplier (GRM)

is the number of years the apartment would take to pay for itself based on the gross potential rent (GPR). The GRM is calculated by dividing the purchase price by the annual GPR. (Purchase Price/(GPR x 12) = GRM
For example, a 180-unit apartment community purchased for $10,400,000 with a GPR of $165,789 per month has a GRM of 5.2.

### Loss to Lease (LtL)

Is the revenue lost based on the market rent and the actual rent. LtL is calculated by dividing the gross potential rent minus the actual rent collected by the gross potential rent. (GPR-Actual Rent Collected) / GPR
For example, a 180-unit apartment community with a GPR of $167,800 and with an actual rent of $147,890 has a LtL of 11%.

### Bad Dept

Is the amount of uncollected money a former tenant owes after move-out.

### Concessions

Are the credits (dollars) given to offset rent, application fees, move-in fees and any other revenue line item, which are generally given to tenants at move-in.

### Model Unit

Is a representative apartment unit used as a sales tool to show prospective tenants how the actual unit will appear once occupied.

## Employee Unit
Is a unit rented to an employee at a discount or for free.

## Vacancy Rate
Is the rate of unoccupied units. The vacancy rate is calculated by dividing the total number of unoccupied units by the total number of units.
For example, a 180-unit apartment community that has 13 vacant units has a vacancy rate of 7.2%

## Vacancy Loss
Is the amount of revenue lost due to unoccupied units.
For example, a 180-unit apartment community that has 13 vacant units that rent for an average of $750 per unit per month has a vacancy loss of $117,000 per year.

## Effective Gross Income
Is the true positive cash flow of an apartment community. EGI is calculated by the sum of the gross potential rent and the other income minus the income lost due to vacancy, loss-to-lease, concessions, employee units, model units and bad debt.
For example, if a 180-unit apartment community has a gross potential rent of $2,013,600, loses $161,088 due to vacancy (8% vacancy rate) and $110,579 in credit costs (loss-to-lease, concessions, employee units, model unit, bad debt, etc.) and collects $130,462 in other income, then EGI is $1,872,395.

## Economic Occupancy Rate
is the rate of paying tenants based on the total possible revenue and the actual revenue collected. The economic occupancy rate is calculated by dividing the actual revenue collected by the gross potential income.
For example, a 180-unit property charges, on average, $834 per month per unit. Each month, a total of $2,896 is lost due to various concessions. There are 13 vacant units which could be rented for a total of $10,842 per month. Monthly bad debt is $3,995.
The physical occupancy rate is 92%: 167 occupied units / 180 total units.
The economic occupancy rate is 86%.
Current revenue = $1,588,644 = [($834 * 180) – $2,896 concessions – $10,842 vacancy loss – $3,995 bad debt] * 12 months.
Current revenue / total possible revenue = $1,588,644 / (180 units * $834 * 12 months) = 88%.

# Debt Service

## Debt Service

**Is the annual mortgage paid to the lender, which includes principal & interest. Principal is the original sum lent and the interest is the charge for the privilege of borrowing the principal amount.**

**For example, a 5 year $7,840,000 loan with 5.25% interest amortized over 30 years results in a debt service of $45,314 per month.**

## Debt Service Coverage Ratio (DSCR)

Is a ratio that is a measure of the cash flow available to pay the debt service. DSCR is calculated by dividing the net operating income by the total debt service. (NOI / Debt Service). A DSCR of 1.0 means that there is enough net operating income to cover 100% of the debt service. Ideally, the ratio is 1.25 or higher. An asset with a DSCR that is too close to 1.0 is vulnerable, any minor decline in cash flow would result in the inability to service (pay) the debt.

For example, a 180-unit apartment community with an annual debt service of $465,090 and a NOI of $735,789 has a DSCR of 1.58.

## Interest Rate

Is the amount a lender charges for the use of assets expressed as a percentage of the principal. The interest rate is typically noted on an annual basis known as the annual percentage rate

## Interest-Only Payment (I/O)

An interest-only loan is an adjustable-rate mortgage that allows the borrower to pay just the interest rate for the first few years. After that, the loan converts to a conventional mortgage and the principle and interest are paid together. This helps keep cashflows plentiful during the early stages of the business plan when units are being turned over & renovated.

## London Interbank O ered Rate (LIBOR)

The LIBOR is among the most common of benchmark interest rate indexes used to make adjustments to adjustable rate mortgages. It is a benchmark rate that some of the world's leading banks charge each other for short-term loans. LIBOR serves as the first step to calculating interest rates on various loans, including commercial loans.

## Bridge Loan

Is a short-term loan used until a person or company secures permanent financing or removes an existing obligation. They are short term (6 Months to 3 years with the ability to purchase a 6-month extension), have relatively high interest rates and are usually backed by some form of collateral, such as real estate or inventory. Also referred to as interim financing, gap financing or swing loan. The loan is ideal for repositioning an apartment community. Operators will use Bridge Loans when the apartment complex is Distressed (less than 80-90% occupancy.)

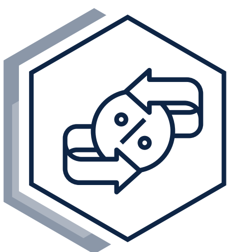
## Permanent Agency Loan

Is a long-term mortgage loan secured from Fannie Mae or Freddie Mac and is longer-term with lower interest rates compared to bridge loans. These loans are typically non-recourse meaning, if we default on the loan they can only go after the asset we purchased (not any personal assets.) Typical loan term lengths are 5, 7 or 10 years amortized over 20 to 30 years.

## Financing Fees

Are upfront fees charged by the lender for providing the debt service and are charged up front. Also known as a finance charge. Typically, the financing fees are 1-2% of the purchase price.

For example, a 180-unit apartment community purchased for $10,864,430 will have an estimated $162,996 in financing fees



## Refinance

Refers to the process of taking out a new loan to pay off one or more outstanding loans. Borrowers usually refinance in order to receive lower interest rates, receive cash or to otherwise reduce their repayment amount. In a distressed or value-add apartment syndication, a general partner may refinance after increasing the value of a property, using the proceeds to return a portion of the limited partner's equity investment.

# Returns and Return Metrics

## Preferred Return

The threshold return that limited partners are offered prior to the general partners receiving any payment. Example would be an 8% preferred(pref), The investors (LP's) receive the first 8% of the cashflows before the GP sees any profit.

If the 8% return is not met for a particular year then the deficiency is carried over and paid in full the following year, plus the 8% for that year.

## Distributions

Are the limited partner's portion of the profits, which are sent on a monthly, quarterly or annual basis, at refinance and/or at sale.

## Sales Proceeds

Are the profits collected at the sale of the asset

For example, here is a how the sales proceeds are calculated for a 180-unit apartment community purchased at $12,200,000 and sold after a five-year value-add business plan:

## Internal Rate of Return (IRR)

Is the rate, expressed as a percentage, needed to convert the sum of all future uneven cash flow (cash flow, sales proceeds and principal pay down) to equal the equity investment. IRR is one of the main factors the passive investor should focus on when qualifying a deal. A very simple example is let's say that you invest $100. The investment has cash flow of $10 in year 1, and $40 in year 2. At the end of year 2, the investment is liquidated(sold) and the $100 is returned.

The total profit is $50 ($10 year 1 + $40 year 2).

Simple division would say that the return is 50% ($25/50). But since time value of money (two years in this example) impacts return, the IRR is actually only 23.43%.

If we had received the $45 cash flow and $100 investment returned all in year 1, then yes, the IRR would be 50%. But because we had to "spread" the cash flow over two years, the return percentage is negatively impacted. This is the concept of "time value of money." The timing of when cash flow is received has a significant and direct impact on the calculated return. Basically, the sooner you receive the cash, the higher the IRR will be

## Cash-on-Cash

Return is the rate of return, expressed as a percentage, based on the cash flow & the equity investment. CoC return is calculated by dividing the cash flow by the initial investment. This is the cash flow you receive calculated on a yearly basis. Cash flow per year/total investment. If you invested $100,000 and received $8,900 in distributions in the first year your CoC would be 8.9%.

**For example, a 180-unit apartment community with a cash flow of $285,673 and an initial equity investment of $3,180,345 results in a CoC return of 8.9%.**

## Equity Muliplier

Is the rate of return based on the total net profit (cash flow plus sales proceeds) and the equity investment. EM is calculated by dividing the sum of the total net profit and the equity investment by the equity investment.

**For example, if the limited partners invested $3,180,345 into a 180-unit apartment community with a 5-year gross cash flow of $1,860,365 and total proceeds at sale of $5,018,465, the EM is ($1,860,365 + $5,018,465) / $3,180,345 = 2.16. In this example the investor will receive 2.16x (double) their money in 5 years.**

# Market/General/Misc. Terms

## Appreciation

is an increase in the value of an asset over time. There are two main types of appreciation: natural and forced. Natural appreciation occurs when the market cap rate "naturally" decreases... When there is more demand than supply.

Forced appreciation occurs when the net operating income is increased (either by increasing the revenue or decreasing the expenses). This is the value-add component of apartment syndication. We have more control over market swings because we can force appreciation by increasing the Net Operating Income (NOI).

## Ration Utility Billing System (RUBS)

Is a method of calculating a tenant's utility bill based on occupancy, apartment square footage or a combination of both. Once calculated, the amount is billed back to the resident, which results in an increase in revenue. This is a value-add component if the current owner is not implementing this system.

## Property and Neighborhood Classes

Is a ranking system of A, B, C, or D given to a property or a neighborhood based on a variety of factors. These classes tend to be subjective, but the following are good guidelines:

**Property Classes**

**Class A:** New construction, command top rents in the area, high-end amenities(Pool, gym, etc)
**Class B:** 10 – 15 years old, well maintained, little deferred maintenance
**Class C:** Built within the last 30 years, shows age, some deferred maintenance
**Class D:** Over 30 years old, no amenity package, low occupancy, needs work

**Neighborhood Class**

**Class A:** Most affluent neighborhood, expensive homes nearby
**Class B:** Middle class part of town, safe neighborhood
**Class C:** Low-to-moderate income neighborhood, work force housing
**Class D:** High crime, very bad neighborhood, warzone

**Subject Property**
Is the apartment the general partner intends on purchasing.

**Underwriting**
is the financial evaluation of an apartment community to determine the projected returns and an offer price.

**Pro-Forma**
Is the projected budget of an apartment community with itemized line items for the income and expense for the next 12 months and 5-7 years, which is an output of the underwriting.

## Rent Roll
A rent roll is a document or spreadsheet containing the details of the lease terms for all tenants in a property. An example of a rent roll might include information such as tenant names, unit numbers, lease start and end dates, monthly rent amounts, and total annual rent. For instance:

Tenant: John Doe, Unit: 101, Lease: Jan 1, 2023 – Dec 31, 2023, Monthly Rent: $1,000, Annual Rent: $12,000.

## Profit and Loss Statement (P&S)
Is a document or spreadsheet containing detailed information about the revenue & expenses of the apartment community over the last 12 months. Also referred to as a trailing 12-month profit and loss statement or a T12.

## Exit Strategy
Is the plan of action for selling (disposition) of the apartment building at the end of the business plan.

## Rent Comparable Analysis
Is the process of analyzing similar apartment communities in the area to determine market rents of the subject apartment community.

## Submarket
A submarket refers to a specific, smaller segment of a larger real estate market, usually defined by geographic boundaries or similar characteristics. In Atlanta, Georgia, examples of submarkets could include Buckhead, Midtown, and Downtown. These areas have distinct economic & development characteristics that differentiate them from other areas within the city.

## Metropolitan Statistical Area
Is the formal definition of a region that consists of a city and surrounding communities that are linked by social and economic factors, as established by the U.S. Office of Management and Budget (OMB).

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