THE ULTIMATE GUIDE FOR THE PASSIVE INVESTOR

What every passive investor needs to know about real estate investing

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Chapter 1

Why Multifamily?

There are many ways to invest in real estate. Multifamily has been a strong investment vehicle and is one of the best passive investments for several reasons:

1. **A Safe Investment** – There is no doubt that over the last 15 years the stock market has had its ups and downs and many people who had the bulk of their wealth invested in the stock market before 2008 lost a vast majority of it with the most recent market correction.

   Thankfully, multifamily real estate is a safe investment choice to make because your rental will continue to generate cash flow for you on a long-term basis and the value of your rental will appreciate while other investments may be underperforming.

2. **More Doors = More Revenue** – Unlike single-family residences which only have one rent every single month, with multifamily real estate, there is more than one tenant in the building. This means that if one or two tenants move out any given month, you will continue to generate cash flow from the remaining tenants and have the ability to pay your mortgage and other expenses until new tenants arrive.

3. **High Demand** – In 2017-2018 more renters, including Millennials, chose to live in multifamily properties. This has been the dominant trend in the past several years, and it is projected to continue. We are a nation of renters.

4. **Easy to Finance** – When buying a single-family home, the bank will look at your income, credit score and other factors related to determine whether they want to grant you a loan. Multifamily is easier to finance because the lender mainly relies on the property's income. As a passive investor, you have minimal risk – you do not need to sign the loan (the Lead Investor might ask you to do so and will give you additional equity in return – usually 5%-10%).

5. **More Control Over the Investment Value** – When investing in startups or in the stock market, you are at the mercy of the company's leadership or the market as a whole, and have little to no control over your investment's performance. However, when investing in an apartment building, you can take actions to increase the property's profitability, such as cutting costs, increasing rents, etc.

6. **Deductions** – Unlike any other investment, when investing in real estate, investors can deduct expenses and lower their taxable income with depreciation. This is a unique benefit that does not exist in any other investment other than real estate.

Chapter 2

How to Assess a Market

When you consider investing with a Lead Investor in a certain market you must evaluate how strong the market is. Do not let the flashy OM (Offering Memorandum) fool you. You absolutely have to know the market. It seems like a lot of work, but in the Internet Age today – the information is at the tip of your fingers. All you have to know is what to look for. In this chapter, I will lay out the critical factors that will help you determine what to look for, as well as where to find the answers.

Let's start with the five main factors that you must take into consideration when you evaluate a market:

1. **Population growth** – A solid market is one that has population growth. Markets that have flat or negative population growth can indicate a problem, while markets that people keep moving to means that there will be more demand for apartments. One of the markets with the highest population growth is Dallas, while the Providence market has shown no significant population growth.

   Where to find information? Simply Google it! For example, type "Jacksonville population" and you will see the trend. Focus on the last 5-10 years.

2. **Job Growth** – Population usually follows jobs, and a great market is one that adds many new jobs every year. I usually look for markets with an unemployment rate that is lower than the national average (4.1%). In addition to evaluating the city job growth, you need to pay attention to any major industry or employer that is responsible for more than 25% of the market. If the dominant industry or employer is in trouble, so is your property (due to layoffs). A solid market is one that has a steady job growth and a diverse economy.

   You can find the information at www.city-data.com and www.census.gov.

3. **Rent Growth** – A strong multifamily market is a market that has increasing rents. If rents are in a downward trend, then your property might suffer from declining rents as well. This is also a rule of thumb, and each investment is unique, but generally speaking I try to stay away from markets that have a negative rent growth trend.

You can find the information at www.census.gov has information on the average rent in the past several years in major cities.

4. **Appreciation Potential** – The lion's share of the profits is made when you sell the property. This is why appreciation is key. I look at markets that have strong appreciation potential, and if property values are increasing, it is more likely that I would be able to sell my investment at a significantly higher price than when I bought it. This way you make money when selling a property, not when you buy it. A word of caution: Real estate is a cyclical business, and even markets with strong appreciation can suffer when the economy turns. A market with increasing prices is not a guarantee that you will make profit when you exit, but it's a safer market to be in when you buy.
   Many large brokerage firms offer free reports that show rents and real estate prices. You can find the reports from reputable companies such as CBRE, Marcus and Millichap, Yardi Metrix, etc.

5. **Landlord Friendly State** – Landlord friendly markets have a direct impact on real estate and the return of the investments. Some states, such as California, are very tenant friendly, which means that it can take up to 9 or even 11 months to evict an unpaying tenant. In the meantime, the owner pays for the mortgage and the expenses. Other states, such as Texas and Florida, are landlord friendly and provide owners with a quick eviction process.
   To find the information, I simply Google "how long does it take to evict an unpaying tenant in …"

   Summary

   All in all, it might take you 1-2 hours to gather the information. Some of it might also be in the Lead Investor's package, but it's also good to trust your own research. At some point, you will become knowledgeable in certain markets and that will give you the confidence to invest alongside a Lead Investor.

Chapter 3

Terminology

Property Class – Properties and neighborhoods are ranked on a scale of A-D, where A is the highest score. The ranks are guidelines and are subjective, but generally speaking they provide a good understating of the type of property you might be considering as a potential investment.

Property

- Class A: New construction, high-end buildings that are well maintained and have luxury amenities.
- Class B: 10 – 15 year-old buildings, well maintained, and have little deferred maintenance.
- Class C: 15 – 30 year-old buildings, showing signs of aging, and usually have some deferred maintenance.
- Class D: 30+ year-old property, no amenities, low occupancy, needs extensive work.

Neighborhood

- Class A: The most affluent neighborhood, expensive average homes prices in the area
- Class B: Middle class part of town, safe neighborhood
- Class C: Low-to-moderate income neighborhood
- Class D: High crime neighborhood. Stay away!

A great opportunity could be a C property in a B or A neighborhood, since by renovating the property and repositioning it to a B property (and, of course, increasing rent), you can attract upper-class renters who can afford the higher rents and want to live in a good area.

Potential Rent is the amount of income from rent that the property could generate if it were fully (100%) occupied. We ignore vacant units at this point.

Other Income is all other sources of income that the property generates in addition to rent: application fees, late fees, pet fees, income from laundry, reserved parking, etc.

Gross/Potential Income is Potential Rent + Other Income.

Example:

Potential Rents (if 100% occupied) $1,000,000

Other Income (laundry, late fees, etc.) $530,000

Potential Income is $1,530,000

Vacancy Rate is the % of the vacant units and been calculated as total vacant units / total units.

Example:

A 100-unit property has 10 vacancies on average each month. The vacancy rate is 10% (10/100).

Effective Gross Income (EGI) is Total Potential Income *minus* Vacancy.

Example:

Potential Rent for a property is $2,000,000

Other Income (laundry, late fees, etc.) is $300,000

Vacancy is 10% or $200,000

Hence, Potential Income is $2,300,000 ($2,000,000 + $300,000)

EGI is $2,100,000 ($2,300,000 - $200,000)

Operating Expenses are the total expenses that are associated with operating the property. Operating Expenses include insurance, utilities, payroll (personnel that manage the property), repairs and maintenance. A common ratio between Operating Expenses and EGI is 50%, where Operating Expenses are half of the EGI.

Net Operating Income (NOI) is EGI *minus* expenses. NOI is a key parameter and basically shows the total cash flow before mortgage and tax. The NOI of a property is a critical figure because it determines the profitability and value of the property. Overall, it is a very important number and sponsors always look for new ways to increase it, either by increasing income or lowering expenses.

Example:

EGI is $500,000

Expenses are $260,000

NOI is $240,000 ($500,000 - $260,000)

Debt Service is the mortgage. In a strong market, owners can get loans with 2-3 interest only ("IO") for 2-3 years. It helps to increase the cash flow in those years, especially since many deals are value add (during the first 12-24 months the new owner renovates the units and/or the amenities, and an IO can help to maintain a positive cash flow). Many commercial loans are set for 10 years, and amortized over 30 years.

Debt Service Coverage Ratio ("DSCR") is Net Operating Income/Debt Service. DSCR is an indication whether or not a property generates sufficient cash flow to cover the debt payments. If the DSCR is < 1 then cash flow is negative. Lenders typically want to see at least 1.25.

Example:

Annual NOI is $2,000,000

Annual Debt Payment is $1,300,000

DSCR is 1.5 ($2,000,000/$1,300,000)

Cash Flow is the cash that a property is generating after all of the expenses, property tax and mortgage are paid. This number should ALWAYS be positive. If this number is negative, that means the property is operating at a loss and will be taking money out of your pocket on a monthly basis.

Example:

The property's EGI is $3,000,000

Operating Expenses are $1,500,000

NOI is $1,500,000 ($3,000,000 - $1,500,000)

Debt Service is $800,000

Cash Flow will be $600,000 ($1,500,000 - $800,000)

Ration Utility Billing System (RUBS) – Allocating the property's utility bills to the tenants based on occupancy, apartment size, number of beds, and other combinations of factors. You can increase your NOI by applying RUBS back to the tenant.

Cash-on-Cash ("CoC") – The CoC is the annual return on the investor's investment (for the down payment + closing costs + renovation or any other CapEx such as roofs replacements). It's calculated by annual Cash Flow / Cash Invested.

Example: A property that produces annual cash flow of $1,000,000. Investors invested $4,500,000 in the deal ($4,000,000 down payment and $400,000 for unit renovation + $100,000 closing costs). The Cash-on-Cash return is 22.22% ($1,000,000 / $4,500,000).

Internal Rate of Return ("IRR") is the rate needed to convert the sum of all future cash flow to equal your initial investment. IRR takes into account the time it took an investor to receive his initial investment (and profit) back. The best (and frankly the most sane) way to calculate IRR is in Excel.

Example:

Let's say you invested $100,000 in a deal. The property generated cash flow of $4,000 in year 1, and $5,000 in year 2. At the end of year 2, the property is sold and the initial $100,000 is then returned.

The total profit is $9,000 ($4,000+$5,000).

CoC is 9% ($9,000/$100,000), but since two years have passed, the return percentage is negatively impacted. In this example the IRR is only 6%.

Preferred Return – A return on investment that Lead Investors offer to investors with the purpose of mitigating the risk associated with investing capital in the deal. Typically, the investor is promised that they will get first dibs on profit at a rate of X%, as long as the partnership generates enough cash flow to pay it.

Example: Investor invests $500,000 and is promised 8% preferred return. The investor's annual preferred return = $500,000 x 8% = $40,000. The Lead Investor will receive the syndication fees only after the investor will be paid the first $40,000.

Capitalization Rate ("Cap Rate") – NOI/Sales Price. Cap Rate indicates the investment risk and calculates what could have been your return if you paid for it with 100% cash (no bank loan). Cap rates are used to value commercial properties in relation to other comparable properties ("Comps") in the area. As a rule of thumb, an attractive investment would be to purchase a property with a higher cap rate than its comps in the area and sell it at a lower cap rate than the one you bought it for. The reason for this is because the lower the cap rate the more the property will be worth. Strong markets such as LA, NY, and SF have very low cap rates, while other markets have higher cap rates. The stronger the market – the lower is the cap rate. Today, the national average cap rate is 5%.

Example:

Sales Price is $1,670,000

NOI is $170,000

Cap Rate is 10.17% ($170,000/$1,670,000).

Chapter 4

What Is Syndication and How Does It Work?

General

The main goal of a syndication is to gather a group of investors to purchase a property. In a syndication there are two types of investors:

Lead Investor/Syndicator/General Partner ("GP") – The GP is the investor that leads the transaction. The syndicator can be an individual, a small group of investors or a company. They do everything from searching for the right deal, firming relationships with brokers and apartment owners, analyzing deals, negotiating with the owner, performing due diligence, signing on the loan, renovating the property (if it's part of the business plan) and managing the property management company.

Equity Partners/Limited Partners ("LP") – The LPs are passive investors who invest their money with the Lead Investor, but usually do not have a decision-making power. They are strictly passive and receive investment reports periodically.

The Benefits for Limited Partners

1. **You do not do all the hard work and have minimal risk** - By investing along with a Lead Investor, who takes care of all aspects of the deal from A to Z, you have the opportunity to own real estate and receive proceeds from the property without doing all the hard work. In addition, the lead investor signs on the loan, so your risk is limited to your investment amount. It's a classic passive investment.

2. **You can diversify** – You can invest in other properties or investment vehicles such as stocks, bonds, startups, etc. Investing in a syndication is a great way to diversify your investment portfolio and spread the risk.

3. **You do not need to be an expert in real estate** – Multifamily investing is not rocket science, but it does require education and experience – and both can be achieved over time. However, many passive investors have satisfying high-paying jobs and some own businesses, so they simply do not have the time to allocate to learn about real estate. By partnering with a Lead Investor, they can join a group of investors on great deals without changing their status quo.

When a property is purchased, the transaction lawyer opens an LLC that holds the property, and its members are the Limited and the General Partners. In each deal, there will be an agreed equity distribution between the GP and the LP, such as 80%-20% or 70%-30% (where the lion share goes to the LP, since they usually invest most of the money in the deal).

The equity allocation works in a way that the income that the property generates is distributed between the GPs and the LPs based on the agreed percentage. For example, if the property generated $1,000,000 in year 1, and the equity allocation is 20% to the GPs and 80% to the LPs, then the GPs will receive $200,000 and the LPs will receive $800,000.

<u>Fees</u>

The Lead Investor can charge various types of fees, but I'll focus on the most common ones.

1. **Transaction Fee** – Compensation for all the hard work s/he performed until they find the right deal. Sometimes it takes 3 and even 6 months to find the right deal, especially in hot markets. The fees are usually 1%-3% of the transaction value.

2. **Asset Management Fee** – The Lead Investor usually does not manage the property but brings in a professional property management company to do so. The property management company knows the market inside and out and takes care of the daily building operations and managing tenant's turnover. The Lead Investor is being compensated for finding the property management company, contracting with them and managing them on a weekly basis (holding weekly/monthly meetings with them, reviewing property reports, etc.). The fees are usually 1%-2% of the effective income.

   If the investors were promised preferred returns, the Lead Investor will collect the Asset Management Fees only after the investor receives the preferred return first.

3. **Disposition Fee** – Many syndications hold on the property for 3-5 years and then sell it. The Lead Investor is being compensated for managing the sale process. The fees are usually 1%-2% of the sale price.

Chapter 5

The Deal's Business Plan: Value Add vs. Turn Key

Generally speaking, there are two main approaches to buying multifamily properties: Turn Key and Value Add.

Turn Key

In a Turn Key investment, the buyer does not plan on making any significant changes to the property. They might change the property management company, but the property simply changes hands and everything else stays the same: the rents, the design, the amenities, etc. Turn Key deals usually provide lower returns.

Value Add

This is a very popular type of investment today, and I usually do not consider deals that do not have any value add component. In a Value Add deal, the buyer is looking for a way to increase the property's profitability. It can be done by applying any of these methods:

1. Renovating the amenities, property exterior or the units and increasing rents
2. Applying a RUBS plan to charge tenants more for a more accurate use of utilities
3. Finding a property that has below market rents and increasing them to match market rents
4. Bringing in a new property management company to manage the property more efficiently and reduce costs

Since multifamily property's value is mainly based on the property's income, by adding value to it, the Lead Investor will be able to sell it for a higher price in the future. That is the main reason why many investors are focused on value add deals.

Chapter 6

Evaluating a Real Estate Deal

Here are 5 steps you should follow when considering an opportunity to join a syndication as a passive investor.

Step 1: Determine the Exact Nature of the Opportunity

Ostensibly, this is the very first step that one should take before considering a real estate opportunity. It is imperative to determine the nature of deal.

- Location: Is the property located in an area you feel comfortable with? Is it in a market that you are familiar with or at least comfortable with? Some investors like to invest in their own 'backyard' and some are comfortable investing out of state. Additionally, make sure you understand the location's demographics profile – is the property located in a decent area or in a crime zone? If you are unfamiliar with a certain city or neighborhood, look up the crime rate on Trulia and Google the city/neighborhood name to gather more information that will help you assess whether the property is located in a decent area or in a crime zone. Some investors have a higher appetite for risk, where returns are high but the risk is high as well. Knowing your preference when it comes to property's location can help you save time and focus on the right deals for you.

- Hold period: Take a close look at the business plan – does the syndicator plan to hold the property for 3-5 years? 10 years? Longer? Every investor is comfortable with a different time frame and knowing your ideal hold period will help you screen the numerous investment opportunities out there and focus on the ones that fit your needs.

- Risk Profile: Is the deal a low risk (core or core plus, no renovation or raising rents needed) or a high risk (repositioning of a Class B apartment building in a Class D neighborhood)? Make sure you understand your appetite for risk before making a decision to join a syndication. Do not be tempted by high returns! The higher the returns, the higher the risk, so make sure you are comfortable with the risk associated with the deal.

- Return Driver: Is the opportunity based on appreciation (low cash flow throughout the hold period and high appreciation factor), cash flow (high cash flow during the hold period with a modest appreciation projections), or both. Finding opportunities that have strong cash flow and appreciation is ideal but very hard to find these days. It's a balancing act and you should know in advance if you favor cash flow or appreciation as a main driver for returns.

Step 2: Evaluate the Sponsor's Experience

Once you decide that an investment opportunity is the right opportunity for you, the next step involves evaluating the experience of the sponsors. Consider the experience level and competence of not only the sponsor but of the sponsorship team as a whole. A sponsorship team with well-balanced backgrounds and experiences in real estate and outside of it can be a great asset and will add unique value to the deal.

Step 3: Look for Your Ideal Return

The most experienced and seasoned players in the realm of passive investment provide effective clues and guidance when it comes to looking for an appropriate and most preferred return. In fact, in their book it's not feasible to consider any passive opportunity unless and until it does not include a preferred return for them. It's best to take a leaf out of their book as a preferred return essentially guarantees receipt of the first installment of the profit amount before it is split for the manager's share. When this happens, it helps in recouping the original investment amount on a priority basis. At the end of the day, the amount of return definitely depends upon the level of experience.

Step 4: Review the Profit Distribution

Profit distribution is one of the most critical factors in any investment, as this determines the ROI. Thus, it's extremely important to review this factor before considering any opportunity of passive investment. Profit distribution ironically depends upon the managers' experience and their share of contribution in terms of work and labor throughout the lifespan of the investment opportunity. Some sponsors offer an equity spilt that ranges between 5%-95% and 30%-70% (where 95% and 70% goes to the investors, respectively). Generally speaking, the more experienced the sponsor, the higher their share. In this scenario, the sponsor will receive an agreed portion of the profit regardless of their performance (with the exception of a preferred return payout).

Another format of profit distribution is waterfall. Waterfall distribution is directly related to the sponsor's performance and allocates a higher portion of the profit the higher returns the sponsor provides. Today, however, the vast majority of sponsors do not offer this option.

As a passive investor, you should decide which profit share mechanism you are most comfortable with.

Step 5: Evaluate the Pro Forma Assumptions

One of the most effective mechanisms to ascertain whether one is dealing with an aggressive management or a conservative one is by reviewing the assumptions used in pro forma. These assumptions provide a first-hand feel of whether the opportunity is going to perform as ascertained. However, the goal should be to look for a conservative manager who will be using the conservative assumptions to make sure that they are able to under-promise as well as over-perform for setting up long-term relationships with the investor. The main assumptions you should review are the rent growth trajectory, the occupancy and the exit cap rate. It is advised to have a conversation with the sponsor and ask how they arrived at the assumptions. We will dive deeper into the pro forma assumptions in the next chapter.

Chapter 7

Critical Deal Components You Must Examine Closely

As a passive investor, you receive deal packages and executive summaries from syndicators, and most of the time they all look great. As a former lawyer, I can tell you that the written word, in this case, should be taken with a lot of caution. In Israel, where I am from, there is a phrase lawyers use frequently, "the paper will suffer anything," which means there are no limits to what you can write on a piece of paper. It will carry it.

Most syndicators are honest. The vast majority will not try to present false information in their investment package. However, as a passive investor, you should be aware of several components in every deal that can significantly affect the returns the syndicator predicts. In this article, I will discuss the 5 most critical components that you should pay close attention to and thoroughly investigate if needed. Knowing where to look is key to making an informed decision and choosing the deals with the highest chance of success.

The Exit Cap

I chose to start with the Exit Cap because it seems like a small factor in the syndicator's underwriting and is often overlooked by many passive investors. However, it's one of the most important factors in any underwriting that can significantly affect returns and can be the difference between a failing investment and a successful one.

The Cap or Cap Rate is the ratio between the Net Operating Income (NOI) and the purchase price. The lower the cap rate – the more you pay for a property, relative to its NOI, and vice versa. Sellers always aim to sell their properties at the lowest cap rate, and the buyers' interest is to buy properties with the best cap rates.

The Exit Cap is the cap rate that the syndicator assumes they will be able to sell the property for by the end of the holding period (at time of exit). If you only change the Exit Cap by, say, half a percent, that can increase the IRR and CoC significantly. Yet the Exit Cap is the most speculative part of the underwriting – none of us have a crystal ball and nobody knows how the market will behave in 3-5 years from now, when it's time to sell, or even a year from now. Hence, two syndicators can look at the same deal and share similar assumptions when it comes to purchase price, rent, expense increases and even premiums (the increase in rents achieved by implementing a value-add plan – rehabbing the property and renovating the units). If they assume different Exit Cap rates, the more conservative syndicator – the one who assumes a higher Exit Cap than the cap rate at purchase – may pass on the deal, since the underwriting will show low returns, while the other syndicator – who assumes a lower cap rate – might end up buying the property, since their calculations will show much higher returns.

Actionable Advice: Always ask the syndicator what cap rate they purchased the property at and what is their assumed Exit Cap. Then try to assess if the gap is reasonable. For example, I usually assume an Exit Cap that is 0.5% to 1% HIGHER than the cap rate at purchase. I am very conservative in nature (something I inherited from my years of practicing law) and assume that in 5-6 years the market will not be as strong as it is today and property prices will DROP. If the deal still works with conservative assumptions, then it's a great deal.

Expense Ratio

As a rule of thumb, and it changes based on the market and property size, expenses should be around 50% of the income. Many syndicators find deals where the income-expense ratio is higher (say 65%) and optimize expenses, usually by bringing an experienced property management company to manage the property. As a passive investor, you should look at the NEW income-expense ratio closely and ask yourself: is the ratio reasonable? If the syndicator assumes a 33% ratio, that might not be realistic.

Additionally, examine by how much the syndicator predicts they can narrow that ratio. Does the syndicator assume they can bring that ratio from 70% to 50%? It's a pretty significant change and could be hard to achieve in some cases.

If a syndicator assumes they can manage the property better than the seller, it's important to understand their experience in managing multifamily properties, and the same goes for the property management company that will manage the building.

Actionable Advice: Look at the current income-expense ratio and the one that the syndicator is aiming to achieve (as indicated in the pro forma). If the pro forma ratio is lower than 50% or if the syndicator assumes they can significantly lower expenses, ask the syndicator how they arrived at those numbers.

Renovation Plan

Many value-add syndicators, like myself, buy multifamily properties that need some work. They will improve the amenities, add new ones, and renovate the units. By improving the overall look and functionality of the building, they will be able to increase rental rates as well as making the property more attractive to the next buyer.

Passive investors who examine a new opportunity should inquire about the renovation plan and understand the specifics, instead of simply evaluating a high-level plan. A good passive investor will ask:

- *Can local demographic pay for the renovated units?* A syndicator can turn an old unit to a state-of-the-art apartment – but if the building is in a bad neighborhood – not many will be able to pay $200 more for a nicer apartment. Now the situation might not be that extreme, and yet, even in a decent neighborhood, some syndicators struggle to find tenants who will pay a higher price for a renovated unit. Look at the rent comps if provided by the syndicator or ask them for the information. Understand if there are other nearby buildings with similar vintage (age) and amenities that charge higher rents this will be a good indication that it's possible to increase rents.

- *How many units does the syndicator plan to complete every year?* Does the syndicator assume they can complete a large scope renovation in a short period of time? Renovating a 200-unit apartment building can take 24 months, and sometimes longer. As a passive investor, try to assess if the time frame for a complete renovation is reasonable, and ask the syndicator how they plan to complete it within the anticipated time frame.

- *How experienced is the syndicator and the property management in rehabbing properties in this market?* An experienced team would know what features are popular among the locals, where to buy high quality materials for the best prices, and whether, as I mentioned earlier, the locals will be willing and able to pay premiums for the upgraded units.

- *How high are the premiums?* Generally speaking, bumping rents by $400 for a renovated unit might not be easy. Most premiums fall into the $75-$150 range and are considered reasonable. It depends on the specifics of each deal and the market (if rents are under market, for instance, it can be achieved). A passive investor who sees a projected high premium should inquire about the achievability of new rents.

Demand Drivers

Demand drivers are key in every investment. It's what draws people to a specific market/area/neighborhood. Look for demand drivers in the syndicator's materials – is there any reference to job growth? Population growth? Is there a new and promising project nearby – such as a new shopping center, employment center, or even a major road? All these factors will strengthen tenant's demand for the property. If this aspect is missing in the summary – ask yourself why? Is it because the area is not desirable or strong enough? Is it because the syndicator does not know the area that well? Or it is something else?

Actionable Advice: Look for demand drivers and understand them. Always talk with the syndicator about the demand drivers and try to assess how familiar they are with the area. You obviously want someone who knows the location very well.

Refinance and Bridge Loan

Many syndicators project a refinance after 2-3 years, after they improve the NOI. Similarly, if the property is not eligible for an agency loan (if it's not 90% occupied for the last 90 days), then many syndicators take a bridge loan – which is often, if not always, at a higher rate than an agency loan, hoping to stabilize the property and take an agency loan then.

This strategy can definitely work, but there is also some risk involved. What happens if the syndicator would not be able to stabilize the property and get an agency loan? What if in two years interest rates rise even more and a refinance will not be attractive? Or if the syndicator will not be able to improve the NOI? As a passive investor, you need to understand that when a syndicator assumes a refinance event or a bridge loan it can significantly affect the returns calculation. Without getting too technical, a sensitivity analysis can reveal returns you can expect if a refinance event will not happen, or if it would take longer to stabilize the property and get out of a bridge loan.

Actionable Advice: Make sure to ask the syndicator to show you the returns WITHOUT refinancing or with a longer period of a bridge loan. This way you can make sure that your money is more likely to be safe, even if the financing plan does not go as planned.

Chapter 8

Summary

Passive investment is an excellent way of diversifying your investment portfolio for better returns. In particular, investing in multifamily properties can provide a steady cash flow that can either supplement or replace your main income. Some passive investors give up highly paid jobs and make their living from the proceeds of their passive investments. Whether you are a seasoned passive investor or just beginning to consider becoming one, I hope this e-book provides you with valuable information and guides you down the passive investment road.

Ellie Perlman