Mastering the Lingo

SYNDICATION SUPER★STARS

The following 80+ terms and definitions are ones you need to <u>memorize</u> and know how to calculate immediately before you are ready to become an apartment syndicator. Most of them will come up in every conversation when discussing a deal.

All examples are based on a 216-unit apartment community in Dallas, TX, purchased for $12,200,000.

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Know the lingo.

Active Investing is the finding of, qualifying, and closing on an apartment building using one's own capital and overseeing the business plan through to its successful execution.

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

Apartment Syndication is a temporary professional financial services alliance formed for the purpose of handling a large apartment transaction that would be hard or impossible for the entities involved to handle individually, which allows companies to pool their resources and share risks and returns. In regards to apartments, a syndication is typically a partnership between general partners and limited partners to acquire, manage, and sell an apartment community while sharing in the profits.

Know the lingo.

General Partner (GP) is an owner of a partnership who has unlimited liability. Also referred to as the GP. A GP is a managing partner and is active in the day-to-day operations of the business. In apartment syndications, the GP is also referred to as the sponsor or syndicator and is responsible for managing the entire apartment project.

Limited Partner (GP) is a partner whose liability is limited to the extent of their share of ownership. Also referred to as an LP. In apartment syndications, the LP is the passive investor who funds a portion of the equity investment.

Know the lingo.

Distressed Apartment is a non-stabilized apartment community, which means the economic occupancy rate is below 85%, and likely much lower, due to poor operations, tenant problems, outdated interiors, exteriors, or amenities, mismanagement, and/or deferred maintenance.

Value-Add Apartment is a stabilized apartment community with an economic occupancy rate above 85% and an opportunity to be improved by adding value, which means making improvements to the operations and/or the physical property through exterior and interior renovations in order to increase the revenue and/or decrease the expenses.

Subject Property is the apartment the general partner intends on purchasing.

Know the lingo.

Accredited Investor is a person that can invest in apartment syndications 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 the expectation of earning the same or higher, or a net worth exceeding $1 million either individually or jointly with a spouse.

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 but don't meet the accredited investor qualifications.

Know the lingo.

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

Preferred Return is a threshold return that limited partners are offered with the purpose of counterbalancing the risk associated with investing capital into the deal, which is distributed prior to the general partners receiving payment.

Ex.

- Limited partner invests $100,000
- General partner offers a 8% preferred return

Limited partner receives $100,000 * 8% = $8,000

Know the lingo.

Lease is a formal legal contract between a landlord and a tenant for occupying an apartment unit for a specified time and at a specified rent with specified terms.

Market Rent is the rent amount a willing landlord might reasonably expect to receive and a willing tenant might reasonably expect to pay for tenancy, which is based on the rent charged at similar apartment communities in the area. The market rent is typically calculated by conducting a rent comparable analysis.

Rent Comparable Analysis (Rent Comps) is the process of analyzing the rental rates of similar properties nearby to determine the market rents of the units at the subject property.

Rent Premium is the increase in rent demanded after performing renovations to the interior and/or exterior of an apartment community.

Know the lingo.

Gross Potential Rent (GPR) is the hypothetical amount of revenue if the apartment were 100% leased year-round at market rental rates. Also referred to as GPR.

Ex. 216-unit apartment community

- Average monthly market rent per unit is $873.31

Gross potential rent is $873.31 * 12 months * 216 units = $2,263,624

Know the lingo.

Gross Potential Income is the hypothetical amount of revenue if the apartment community were 100% leased year-round at market rental rates plus all other income.

Ex. 216-unit apartment community

- Gross potential rent is $2,263,624
- Other income is $177,426

Gross potential income is $2,263,624 + $177,426 = $2,441,050

Know the lingo.

Effective Gross Income (EGI) is the true positive cash flow. Also referred to as EGI, total income, or total revenue. EGI is calculated by subtracting the revenue lost due to vacancy, loss-to-lease, concessions, employee units, model units, and bad debt from the gross potential income.

Ex. 216-unit apartment community

- Gross potential rent is $2,263,624
- Loss-to-lease is $67,909
- Concessions are $36,306
- Vacancy loss is $158,454
- Bad debt is $55,147
- Other income is $177,426

EGI is $2,263,624 - $67,909 - $36,306 - $158,454 - $55,147 + $177,426 = $2,123,235

Know the lingo.

Operating Expenses are the ongoing costs of running and maintaining the apartment community and its grounds.

Ex. 216-unit apartment community

- Payroll costs are $244,630
- Maintenance and repair costs are $66,717
- Contract service costs are $84,509
- Turn/make ready costs are $44,478
- Advertising and marketing costs are $33,359
- Administrative costs are $33,359
- Utility costs are $194,592
- Property management fees are $74,313
- Taxes are $286,494
- Lender reserves are $54,000
- Insurance is $50,038

Total expenses are $1,166,489 (just add em up!).

Know the lingo.

Net Operating Income (NOI) is all the revenue remaining after paying the operating expenses. Also referred to as NOI. NOI is calculated by subtracting the operating expenses from the effective gross income. The NOI is the basis for determining the apartment's value.

Ex. 216-unit apartment community

- Effective gross income is $2,195,715
- Operating expenses are $1,166,489

NOI is $2,195,715 - $1,166,489 = $956,746

Know the lingo.

Cash Flow is the revenue remaining after paying all expenses. Cash flow is calculated by subtracting the operating expenses and debt service from the effective gross income.

Ex. 216-unit apartment community

- Effective gross income is $2,123,235
- Operating expenses are $1,166,489
- Debt service is $581,090

Cash Flow is $2,123,235 - $1,166,489 - $581,090 = $375,656

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Know the lingo.

Cash-on-Cash Return is the rate of return based on the cash flow and equity investment. Also referred to as CoC return. CoC return is calculated by dividing the cash flow by the initial equity investment.

Ex. 216-unit apartment community

- Annual cash flow is $375,656
- Total equity investment is $3,843,270

Cash-on-Cash Return is $375,656 / $3,843,270 = 9.8%

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Know the lingo.

Internal Rate of Return (IRR) is the rate needed to convert the sum of all future uneven cash flow to equal the initial equity investment. That "uneven cash flow" can be cash flow, sales proceeds and principal pay down. Goal is to a IRR that is 15% to 18% or above to the limited partners with a 5-year exit.

Ex. (taken from website referenced below)

A very simple example is say that you invest $50. The investment has cash flow of $5 in year 1, and $20 in year 2. At the end of year 2, the investment is liquidated and the $50 is returned.

The total profit is $25 ($5 Y1 and $20 Y2). 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 $25 cash flow and $50 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.

The timing of when cash flow is received has a significant and direct impact on the calculated return. In other words, the sooner you receive the cash, the higher the IRR will be.

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Know the lingo.

Equity Multiple (EM) is the rate of return based on the total net profit and the equity investment. Also referred to as EM. The EM is calculated by dividing the sum of the total net profit (cash flow + sales proceeds) and the remaining equity investment at sale by the equity investment.

Ex. 216-unit apartment community purchased for $12,200,000 with a 5-year hold

- Equity investment is $3,843,270
- 5-year cash flow is $2,030,172
    - Year 1 is $329,359
    - Year 2 is $323,507
    - Year 3 is $481,209
    - Year 4 is $510,755
    - Year 5 is $385,342
- Profit from sale is $3,803,677
- Return of remaining equity investment is $2,198,439

Equity Multiple is ($2,030,172 + $3,803,677 + $2,198,439) / $3,843,270 = 2.09

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Know the lingo.

Gross Rent Multiplier (GRM) is the number of years it would take for a property to pay for itself based on the gross potential rent. Also referred to as the GRM. The GRM is calculated by dividing the purchase price by the annual gross potential rent.

Ex. 216-unit apartment community

- Purchase price is $12,200,000
- Gross potential rent is $2,263,624

GRM is $12,200,000 / $2,263,624 = 5.4 years

Know the lingo.

Capitalization Rate (Cap Rate) is the rate of return based on the income that the property is expected to generate. Also referred to as cap rate. The cap rate is calculated by dividing the net operating income by the current market value of the property.

The cap rate indicates risk vs. reward. New York City has lower cap rates whereas Flint, Michigan would be higher. If someone asks you "what's the market cap rate?" then they are looking for the average cap rate among similar properties in your subject property's submarket.

Ex. 216-unit apartment community

- NOI is $960,029
- Sales price is $12,200,000

Cap rate is $960,029 / $12,200,000 = 7.87%

Know the lingo.

Appraisal is a report created by a certified appraiser that specifies the market value of a property. For apartments, the value is based on the cost, income, and sales comparison approach.

Cost Approach is a method of calculating a property's value based on the cost to replace (or rebuild) the property from scratch. Also referred to as the replacement approach.

Income Approach is a method of calculating a commercial property's value based on the capitalization rate and the net operating income. Value = net operating income / capitalization rate.

Sales Comparison Approach is a method of calculating a property's value based on the sales price of similar properties recently sold nearby.

Know the lingo.

Appreciation is an increase in the value of an asset over time. The two main types of appreciation are natural appreciation and forced appreciation.

Natural appreciation occurs when the market capitalization rate naturally decreases over time, which isn't always a given.

Forced appreciation occurs when the net operating income is increased by either increasing the revenue or decreasing the expenses. Forced appreciation typically occurs by adding value to the apartment through renovations and/or operational improvements.

Depreciation is a decrease or loss in value of an apartment due to wear, age, or other cause, or when the market capitalization rate increases.

Know the lingo.

Vacancy Rate is the proportion of unoccupied units. The vacancy rate is calculate by dividing the total number of unoccupied units by the total number of units.

Vacancy Loss is the amount of revenue lost due to unoccupied units.

Ex. 216-unit apartment community

- 17 units are vacant
- Average rent of the vacant units is ~$776.74

Vacancy rate is 17 / 216 = 7.9%
Vacancy loss is $776.74 * 17 units * 12 months = $158,454

Know the lingo.

Economic vs. Physical Occupancy Rate

Economic Occupancy is the rate of paying tenants based on the total possible revenue and the actual revenue collected. The economic occupancy is calculated by dividing the effective gross income by the gross potential income

Physical Occupancy is the proportion of occupied units. Physical occupancy is calculated by dividing the total number of occupied units by the total number of units at the property.

Ex. 216-unit apartment community

- 199 occupied units
- Gross potential income is $2,441,050
- Effective gross income is $2,123,235

Physical occupancy is 199 / 216 = 92.1%
Economic occupancy is $2,123,235 / $2,441,050 = 87.0%

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Know the lingo.

Mortgage is a legal contract by which an apartment is pledged as security for repayment of a loan until the debt is repaid in full.

Principal is the original sum lent to the borrower.

Interest rate is the amount charged by a lender to a borrower for the use of their funds.

Amortization is the paying off of a mortgage loan over time by making fixed payments of principal and interest.

Prepayment penalty is a clause in a mortgage contract stating that a penalty will be assessed if the mortgage is paid down or paid off within a certain period.

Yield Maintenance is a penalty paid by the borrower on a loan if the principal is paid off early.

Know the lingo.

Permanent Agency Loan is a long-term mortgage loan secured from Fannie Mae or Freddie Mac. Typical loan term lengths are 3, 5, 7, 10, 12 or more years amortized over up to 30 years. Apartment communities that are non-stabilized (85% occupancy or lower) will typically not qualify for agency debt.

Bridge loan is a mortgage loan used until the borrower secures permanent financing. Bridge loans are short terms (six months to three years, with the option to purchase an additional six months to two years), generally have higher interest rates, and are almost exclusively interest only. Also referred to as interim financing, gap financing, or swing loans. The loan is ideal for repositioning an apartment community that doesn't qualify for permanent agency financing.

Know the lingo.

Loan-to-Value (LTV) Ratio is the ratio of the value of the loan amount divided by the apartment's appraised value. When securing financing from a lender for a loan that excludes the capital expenditure costs, they will offer financing up to a maximum LTV (70% to 80% is standard)

Loan-to-Cost (LTC) Ratio is the ratio of the value of the loan amount divided by the total project costs (purchase price + capital expenditure costs). When securing financing from a lender for a loan that includes the capital expenditure costs (i.e. a bridge loan), they will offer financing up to a maximum LTC (65% to 80% is standard)

Know the lingo.

London Interbank Offered Rate (LIBOR) is a benchmark rate that some of the world's leading banks charge each other for short-term loans. Also referred to as LIBOR.

The LIBOR serves as the first step to calculating interest rates on various loans, including commercial loans, throughout the world.

Click here for the current LIBOR and other interest rate indexes.

Know the lingo.

Debt Service is the annual mortgage amount paid to the lender, which includes principal plus interest.

Ex. 216-unit apartment community purchased for $12,200,000

- Loan term: 60-months (24-months of interest-only payments)
- Loan amount: $11,505,500
- Interest rate: 5.28%
- Amortization: 30 years

$48,424 monthly debt service (months 1 to 24)
$60,977 monthly debt service (months 25 to 60)

Know the lingo.

Debt Service Coverage Ratio (DSCR) is the ratio that is a measure of the cash flow available to pay the debt obligation. Also referred to as the DSCR. The DSCR is calculated by dividing the net operating income by the total debt service.

A DSCR of 1.0 means that there is enough net operating income to cover 100% of the debt service. Ideally, the DSCR is 1.25 of higher. A property with a DSCR too close to 1.0 is vulnerable, and a minor decline in revenue or increase in expenses would result in the inability to service the debt.

Ex. 216-unit apartment community

- Annual NOI is $956,746
- Annual debt service is $581,090

Debt Service Coverage Ratio is $956,746 / $581,090 = 1.65

Know the lingo.

Interest-only (I/O) payment is the payment on a mortgage where the lender requires the borrower to pay only the interest on the principal.

Recourse is the right of the lender to go after personal assets above and beyond the collateral if the borrower defaults on the loan.

Nonrecourse is the right of the lender to go after personal assets above and beyond the collateral if the borrower defaults on the loan AND a carve-out is triggered (i.e. gross negligence or fraud).

Refinance is the replacing of an existing debt obligation with another debt obligation with different terms.

Know the lingo.

Capital Expenditures (CapEx) are the funds used by a company to acquire, upgrade, and maintain a property. Also referred to as CapEx. An expense is considered CapEx when it improves the useful life of a property and is capitalized – spreading the cost of the expenditure over the useful life of the asset. CapEx include both interior and exterior renovations.

Examples of exterior CapEx are repairing or replacing a parking lot, repairing or replacing a roof, repairing, replacing, or installing balconies or patios, installing carports, large landscaping projects, rebranding the community, new paint, new siding, repairing or replacing HVAC, and renovating the clubhouse.

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

Examples of things that wouldn't be considered CapEx are the operating expenses, debt service, feeds paid to the syndicator, and distributions to investors.

Know the lingo.

Equity investment is the upfront costs for purchasing a property. For apartment syndications, these costs include the down payment for the mortgage loan, closing costs, financing fees, operating account funding, capital expenditures (if excluded from the loan) and the fees paid to the general partnership for putting the deal together. Also referred to as the initial cash outlay or the down payment.

Ex. 216-unit apartment community purchased for $12,200,000

- Down payment for the loan is $2,806,000
- Closing costs are $143,003
- Financing fees are $214,700
- Operating account funding is $435,567
- Acquisition fee is $244,000

Equity investment is $2,806,000 + $143,003 + $214,700 + $435,567 + $244,000 = $3,843,270

Know the lingo.

Closing Costs are the expenses, over and above the purchase price of the property, that buyers and sellers normally incur to complete a real estate transaction. These costs include origination fees, application fees, recording fees, attorney fees, underwriting fees, due diligence fees, and credit search fees.

Financing Fees are the one-time, upfront fees charged by the lender for providing the debt service. Also referred to as financing charges. Typically, the financing fees are approximately 1.75% of the purchase price.

Operating Account Funding is a reserves fund, over and above the purchase price of an apartment, to cover things like unexpected dips in occupancy, lump sum insurance or tax payments, or higher than expected capital expenditures. The operating account funding is typically created by raising extra capital from the limited partners. The standard amount is 1% to 5% of the purchase price.

Know the lingo.

Price per unit is the cost per unit of purchasing the property. The price per unit is calculated by dividing the purchase price of the property by the total number of units. The price per unit is a metric used to quickly compare apartment communities.

Ex.

- 216-unit apartment community
- Purchase price is $12,200,000

Price per unit is $12,200,000 / 216 units = $56,481.48

Know the lingo.

Ration Utility Billing System (RUBS) is a method of calculating a resident's utility bill based on occupancy, apartment square footage, number of beds, and some combination of factors so that you can bill the expense back to the tenant and increase your NOI

Know the lingo.

Breakeven Occupancy is the occupancy rate required to cover all of the expenses at the property. The breakeven occupancy rate is calculated by dividing the sum of the operating expense and debt service by the gross potential income.

Ex. 216-unit apartment community

- Operating expenses are $1,166,489
- Annual debt service is $581,090
- Gross potential income is $2,441,050

Breakeven Occupancy is ($1,166,489 + $581.090) / $2,441,050 = 71.6%

*Breakeven occupancy isn't the most relevant data point. Not because you naively believe that the markets cannot change the much. It's because as occupancy begins to dip into the 80% range, assuming it's not a staffing issue, you will adjusted the rental rates in order to maintain occupancy.

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Know the lingo.

Class A, B, C and D Property & Neighborhood are ranking based on multiple factors. A is highest and D is lowest. It tends to be subjective but these are good guidelines.

Property

Class A: new construction, command highest rent in area, high end amenities
Class B: 10 – 15 years old, well maintained, little deferred maintenance
Class C: built within last 30 years, shows age, some deferred maintenance
Class D: over 30 years old, no amenity package, low occupancy, needs work

Neighborhood

Class A: most affluent neighborhood, expensive homes nearby, maybe golf course
Class B: middle class part of town, safe neighborhood
Class C: low-to-moderate income neighborhood
Class D: high crime, very bad neighborhood

$$$ Making Tip: Buy Class C property in a Class B neighborhood.

Know the lingo.

Loss-to-Lease (LtL) is the revenue lost based on the market rent and the actual rent. Also referred to as LtL. The LtL is calculated by dividing the gross potential rent minus the actual rent collect by the gross potential rent.

Ex. 216-unit apartment community

- Gross potential rent is $2,263,624
- Actual collected rent is $2,195,715

LtL is ($2,263,624 - $2,195,715) / $2,263,624 = 3.0%

Know the lingo.

Bad Debt is the amount of uncollected money owed by a tenant after move-out.

Ex.
- Tenant skips out in the middle of the night
- Damages to the unit that are not covered by the security deposit
- Rent owed by tenant after they move out

Concessions are the credits given to offset rent, application fees, move-in fees, and any other cost incurred by the tenant, which are generally given at move-in to entice tenants into signing a lease.

Employee unit is an apartment unit rented to an employee at a discount of for free.

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

Know the lingo.

Exit Strategy is the general partners' plan of action for selling the apartment community at the conclusion of the business plan.

Holding Period is the amount of time the general partner plans on owning the apartment from purchase to sale.

Sales Proceeds is the profit collected at the sale of the apartment community.

Know the lingo.

Pro forma is the projected budget with itemized line items for the revenue and expenses for the next 12-months and/or the next 5 years.

Profit and Loss Statement (T-12) is a document or spreadsheet containing detailed information about the revenue and expenses of an apartment over the last 12 months. Also referred to as a trailing 12-month profit and loss statement, P&L, operating statement, or T-12.

Rent Roll is a document or spreadsheet containing detailed information on each of the units at the apartment community, including the unit number, unit type, square footage, tenant name, market rent, actual rent, security deposit amount, move-in date, lease-start, and lease-end dates, and the tenant's balance.

Know the lingo.

Acquisition Fee is a type of fee a syndicator can earn. This upfront fee is paid by the new buying partnership entity for finding, analyzing, evaluating, financing, and closing the property investment.

Acquisition fees range from 1% to 5% of the purchase price, depending on the size of the deal. For example, if the acquisitions fee is 2% on a 216-unit apartment community purchased for $12,200,000, the syndicator will receive $244,000 at closing.

Guaranty Fee is a fee paid to the loan guarantor at closing for signing for and guaranteeing the loan. The guaranty fee can be as low as 0.5% to 1% and as high as 3.5% to 5% of the principal balance of the loan. The riskier or more complicated the deal, the higher the guaranty fee. If the general partner doesn't have a good relationship with the loan guarantor, that individual will charge a higher fee as well. In some instances, the general partner will offer the loan guarantor a percentage of the general partnership (10% to 30%) in addition to or instead of the one-time upfront fee.

Know the lingo.

Asset Management Fee is a type of fee a syndicator can earn. This on-going annual fee is paid from the property operations, typically below the NOI under partnership expenses, for property oversight. Generally, the fee is 2% of the collected income or $250 per unit per year.

Property Management Fee is the ongoing monthly fee paid to the property management company for managing the day-to-day operations of the apartment community.

Refinancing Fee is a fee paid to the general partner for the work required to refinance an apartment community. At the closing of the new loan, a fee of 1% to 3% of the total loan amount is paid to the general partner.

Know the lingo.

Operating Agreement is a document that outlines the responsibilities and ownership percentages for the general and limited partners in an apartment syndication.

Private Placement Memorandum (PPM) is a document that outlines the terms of the investment and the primary risk factors involved with making the investment. Also referred to as the PPM. The PPM typically has four main sections: (1) the introduction, which is a brief summary of the offering, (2) basic disclosures, including general partner information, asset description, and risk factors, (3) the legal agreement, and (4) the subscription agreement.

Subscription Agreement is a document that is a promise by the LLC that owns the property to sell a specific number of shares to a limited partner at a specified price, and a promise by the limited partner to pay that price.

Know the lingo.

Letter of intent (LOI) is a non-binding agreement created by a buyer with their proposed purchase price and terms. Also referred to as the LOI.

Purchase and Sale Agreement (PSA) is a binding agreement between the buyer and the seller of the property.

Earnest Money is a payment by the buyers that is a portion of the purchase price to indicate to the seller their intention and ability to carry out the PSA.

Metropolitan Statistical Area (MSA) is a geographical region containing a substantial population nucleus, together with adjacent communities having a high degree of economic and social integration with that core. Also referred to as MSA. MSAs are determined by the United States Office of Management and Budget (OMB).

Submarket is a geographic subdivision of a market.