

RED FLAGS

Multifamily Investing Red Flags And
The Questions That Expose Them



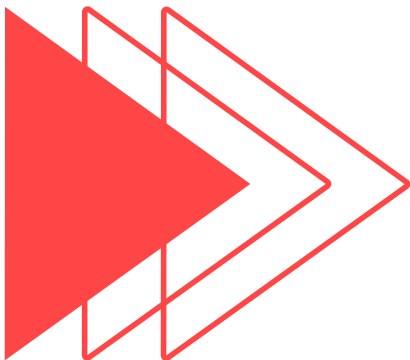
TOBY HANSON

Legal Disclaimer

Thorough due diligence is essential for successful multifamily real estate investments. This guide provides a comprehensive framework for conducting due diligence, covering various aspects such as financial analysis, property condition, market research, legal considerations, and more. However, you should adapt this guide to suit your specific investment goals and property requirements.

This guide is for informational purposes only and is not intended to be a substitute for professional legal or financial advice. The information provided in this guide is based on current laws and regulations as of the knowledge cutoff date, but it is important to note that laws and regulations are subject to change and may differ depending on the jurisdiction. It is strongly recommended that you consult with a securities attorney or financial advisor before making any investment decisions.

Additionally, investing in multifamily syndication deals is a high-risk investment, and it is not suitable for all investors. This guide does not guarantee any returns or outcomes, and past performance does not guarantee future results. It is important to conduct your own due diligence and research before making any investment decisions. Please read all offering documents and documents related to the investment and consult with your financial advisor before investing. Investing in securities, including multifamily syndication deals, can result in the loss of some or all of your investment.



Copyright © 2024

All rights reserved. No part of this book may be used or reproduced in any manner whatsoever without the prior written consent of the author, except as provided by the United States of America copyright law.

When I first started investing in this space, I didn't know what questions to ask, but I quickly learned that the investment strategies that generated asymmetric returns during the last decade would not generate similar returns over the next. Therefore, thorough due diligence will be the determining factor for those who succeed during the next stage of the cycle.

Due diligence involves gathering and analyzing information about a potential investment opportunity to make informed decisions and mitigate risks. It helps investors verify the claims and projections made by the sponsor, evaluate market conditions, assess the property and value-add potential, and understand the risks and rewards involved.

Even after you've completed your due diligence you should listen to gut instincts. If the operator makes you feel uneasy, avoid it. There's always another opportunity around the corner. It's better to feel confident that you're putting your money into a well-suited and legitimate opportunity than to regret handing money over to an unreliable sponsor or investing in a marginal deal. Sometimes the best deals are the ones you don't do.

The purpose of this guide is to provide you with a list of the most common red flags and questions to help thoroughly vet potential investment opportunities, ensuring that the operator has sound strategies to manage risks effectively. Every deal will have some red flags. The way you choose to process the identified risk is what will determine your success as an investor. I hope you find this resource valuable and use it to incorporate recession-resistant alternative investments into your portfolio.

Best Regards,

Toby Hanson



“DON'T WORRY ABOUT HOW MUCH YOU CAN MAKE ON A DEAL UNTIL YOU KNOW HOW MUCH YOU CAN LOSE. YOU NEED TO UNDERSTAND THE RISKS AND HOW THEY ARE BEING MITIGATED.”

— TOBY HANSON

TABLE OF CONTENTS

01

Investment Details

02

Team & Track Record

03

Market

04

Financing

05

Underwriting

06

Property Analysis

07

Business Plan

08

Legal

09

Physical Inspection

10

Resources



Investment Details

Investment opportunities come in all shapes and sizes, so you want to be sure they fit your needs. You want to know if it's a cash flow deal, a deal geared more towards growth, or a deal with a healthy mix of both. Analyze the investment details, focusing on the expected returns and examining various metrics and projections to assess the financial viability of the deal. This provides a high-level understanding of the opportunity.

How long is the hold term for the investment? 5-6 years is normal. Be sure it aligns with your overall investment strategy.

What is the minimum investment? Usually, the minimum is \$50,000-\$100,000 on a deal, but it can be \$250,000 or even a million dollars, depending on the sponsor.

Are you raising extra to cover distributions? Distributions should ideally come from the property's cash flow, not the initial capital raised. Funding distributions from cash flow indicate that the property generates sufficient income to support investor returns, reflecting a sound and profitable investment.

What is the total deal size? This is typically the difference between the cost of the project and the loan. This should not impact your decision unless you want to avoid smaller or bigger deals. When considering the total deal size, it's important to remember that bigger doesn't always mean better.

What is the Year 1 cash-on-cash return? The annual cash flow should not be confused with the Annual Rate of Return. It should be between 4-8% in a growth investment and above 8% for an income investment. New Construction projects may not have cash flow for the first few years but may catch up.

What is the average annual return? The average annual return is calculated by dividing the total return by the number of years of the investment. Look for an average annual return of 15% or higher, but also consider the underlying assumptions and risks.

What is the internal rate of return? Your IRR is affected if you get paid sooner rather than later, even with the same return amount. The higher the number, the better. It means you get your return sooner. We would like to see a 14% or better IRR.

What is the preferred return? Preferred return pays investors first before the operator (GP or General Partnership) is paid. For instance, a 7% preferred return 75/25 split means investors will get paid 7% of the return before the remaining is split 75% to investors and 25% to GP. It should not be lower than 6% for investors.

What type of split is the deal? Straight: All profits are shared between LP/GP, such as 80/20 split. Waterfall: All profits are shared between LP/GP to a certain level or percentage, then split again at a certain percentage.

What is the split? 80/20? 70/30? 80/20 means 80% for investors and 20% for General Partner/Operator. It could be a red flag if the split is 60/40 or lower.

What is the equity multiple? When the investment exits, the total gain in percentage or equity multiplier based on the invested principle should be greater than 70% or 1.7x.

When can I expect my first distribution, and what is the frequency? Depending on the deal, you may receive monthly or quarterly cash flow distributions beginning immediately or in a few months. With development deals, it can be a couple of years.

Are there different classes of investors in this opportunity? If so, am I a “senior” or a “junior” investor? Ask where you sit in the ‘capital stack.’

What are the fees involved? The acquisition fee should not exceed 2% of the purchase price or more than the operator’s investment amount. The annual asset management fee shouldn't exceed 2% of the equity raised. The construction management fee shouldn't be higher than 5% of the capex budget.

Are there any other fees to the GP that I should know about? And why? Additional fees such as marketing, admin, or others shouldn't exceed 0.5%. The deal should not include a transaction fee for refinances or dispositions. Be wary of complex or confusing fee structures.

When do I need to commit? What is the deadline to transfer the funds? Look for an operator who provides clear, reasonable deadlines and ample time for you to conduct due diligence. They should encourage you to take the necessary time to make an informed decision. A transparent and considerate approach to the commitment and funding timeline reflects well on the operator’s integrity and respect for their investors. Conversely, pressure from the operator to quickly wire funds or sign legal documents can be a major red flag, suggesting potential issues or a high-pressure sales tactic.

If the investment goes bad, will I still get my money back? How? Depending on the investment structure, a few scenarios may play out if the investment goes south. In some cases, you might have priority in recouping your initial investment before other investors receive any returns. This is often known as a preferred return. It's crucial to understand the specifics of the investment agreement and the protections it provides in case things don't go as planned. Always seek clarity on these matters before committing your funds.



Team & Track Record

You've probably heard the saying, "It's better to bet on the jockey than the horse." The same is true when looking at operators in the investment space. The operator team is one of the most important aspects of the investment, but all operators are not created equal. Some may lack experience or be undercapitalized. Others may have a sketchy track record with a history of failed investments.

Who are the team's key members, and what are their roles? Ideally, you want a team with at least three full-time members holding key positions, such as CEO, COO, and CFO, each bringing complementary skills to the table. In addition to these roles, consider asking about other key positions, such as asset managers, acquisition specialists, and investor relations professionals. Each of these roles contributes to the overall success of the investment by bringing specialized skills and knowledge.

Look for a team with a proven track record of successful real estate investments and complementary skill sets that cover all critical aspects of managing multifamily syndication. The depth and experience of the team members, along with their clearly defined roles and responsibilities, will provide confidence that the syndication is managed by a capable and well-rounded team dedicated to achieving the investment's objectives.

How many years has the operator been in business? Experience is another key factor to consider. Look for operators who have been in business for over 5 years, especially those who have weathered a complete market cycle like the 2008 crisis. These operators have proven their resilience and ability to navigate challenging times, earning them valuable experience and insight.

What's the team's track record? How many deals have they gone full-cycle on?

Full-cycle deals refer to investments that have been taken from acquisition through to sale or refinancing, encompassing the entire investment process. Look for a sponsor with a proven track record of at least five full-cycle deals, demonstrating their ability to manage investments from acquisition to exit successfully.

How many properties and units do you have under management? What is the total value?

Understanding the scale of the sponsor's portfolio is essential for assessing their experience, capability, and reliability in managing large investments. A sponsor managing a substantial portfolio, ideally valued at \$100M+ in assets, indicates a higher level of expertise and resource availability to manage your investment effectively.

Are you vertically integrated? A vertically integrated firm has in-house teams for acquisition, construction, and property management, which can lead to better control over the investment process, cost savings, and improved performance.

How much capital are you contributing to the project? A significant investment from the operator demonstrates a shared interest in the deal's success. Look for operators willing to commit an appropriate percentage of equity based on the deal size. The operator should contribute 10% of the equity on deals under \$10M and 5% on larger deals.

How much do you have in reserves? Adequate reserves are essential for ensuring the financial stability of the property and protecting investor capital in times of unexpected expenses or revenue shortfalls. Ask the operator to specify the total amount of cash reserves for the investment. These reserves should cover at least 18 months of operating expenses, debt service, and capital expenditure needs.

Have you encountered significant delays with renovations? Inquire about any significant delays in renovations and ensure that any issues encountered have been resolved to prevent reoccurrence. Timely project completion is vital for maximizing returns.

Have you ever lost an investor's money or done a capital call? Knowing whether the operator has previously lost investor money or had to make a capital call can provide significant insights into their risk management practices, financial acumen, and overall competency in managing investments. I would think twice about investing with someone who has done a capital call and would not invest if they have ever lost investor money.

Have any of the full-cycle deals underperformed projections? Understanding whether previous deals have met, exceeded, or fallen short of their projected returns provides valuable insights into the sponsor's ability to deliver on their promises and manage investments effectively. Investing with sponsors who consistently underperform projections can be risky. Therefore, choosing sponsors with a track record of underpromising and overdelivering is crucial.

What is your investment philosophy, and how do you determine whether or not a deal is worth doing? This should include their market selection criteria, property types, and specific deals. Inquire about the factors they consider essential for a deal to be viable, such as location, property condition, tenant demographics, and market trends.

Ask how they balance risk and return and what metrics they use to evaluate potential investments, such as cap rates, cash-on-cash returns, and internal rates of return (IRR). Understanding their approach to due diligence and how they assess and mitigate risks is also important. Look for an investment philosophy emphasizing thorough research, realistic projections, and a balanced approach to risk and reward. Ensure that their criteria for doing a deal align with your investment objectives.

What is the survival plan in case of death, and who will manage the property? This question is essential for understanding the continuity and stability of the investment in the event of the unexpected death or incapacitation of a key member of the management team. Ensuring that measures are in place to handle such scenarios is crucial for protecting your investment and maintaining the operational and financial performance of the property.

A comprehensive survival plan that includes key-man insurance, a clear succession plan, redundancy within the team, backup management arrangements, and transparent communication assures that your investment is safeguarded against unforeseen events. It shows that the operator is proactive and prepared to maintain the stability and performance of the property under all circumstances, ensuring that your investment remains secure and well-managed.

What are some ways that you mitigate inherent risks? Understanding a sponsor's strategies for protecting and growing your investment is crucial. Ask how they ensure a return of capital (protecting your principal) and a return on capital (earning profits). Inquire about their approach to conservative underwriting, using realistic income, expenses, and market conditions assumptions, and how they stress-test financial models against adverse scenarios. Ask about contingency plans for market downturns, tenant defaults, or unexpected expenses. Knowing their backup plans provides reassurance that they are prepared for various scenarios.

Every investment carries risk. A trustworthy sponsor should openly discuss the risks of the project and have a plan to mitigate them. These may include unexpected renovation costs, fluctuations in the market, or potential vacancies. Look for a sponsor with a balanced approach to risk and return, clear strategies for protecting and growing investments, and a history of successful capital preservation and growth. This will give you confidence in their capability to manage your investment effectively.

Why wouldn't someone want to invest in this deal?

This question is critical for uncovering any potential red flags or downsides that may not have been discussed yet. The sponsor's response will provide valuable insights into their transparency, honesty, and ability to assess the investment critically. Look for a sponsor who provides a balanced view, openly discussing potential downsides and how they plan to mitigate them. This demonstrates their commitment to transparency and their critical assessment of the investment.

Why do you think this is a great deal? Understanding why the sponsor believes the deal is excellent is essential for evaluating the overall strength and potential of the investment. The sponsor's response should integrate all key aspects of the deal, including the property, market, investment plan, and team.

Look for a sponsor who provides a comprehensive, data-backed explanation of why the deal is great. Their conviction should be supported by a well-researched strategy, demonstrating their confidence in the property, market, plan, and team. This thorough and detailed response will give you confidence in the investment's potential for success.

Conducting thorough due diligence on the sponsor is crucial when considering an investment. Begin by asking if any potential issues, such as legal problems or bankruptcy history, might arise during a background check.

Verify the ownership of the properties they claim to own by requesting documentation like property deeds. Additionally, ask for their last quarterly report and financial statement to review their financial health and operational performance.

Request references from previous investors to gain insights into their experiences with the sponsor. Positive feedback can build confidence, while negative feedback can be a warning sign. Thoroughly vetting the sponsor through these steps will help you make an informed investment decision. If you find any significant red flags, it may be wise to pass on the opportunity.

"REAL ESTATE CANNOT BE LOST OR STOLEN, NOR CAN IT BE CARRIED AWAY. PURCHASED WITH COMMON SENSE, PAID FOR IN FULL, AND MANAGED WITH REASONABLE CARE, IT IS ABOUT THE SAFEST INVESTMENT IN THE WORLD."

— FRANKLIN D. ROOSEVELT



Market

Location and market dynamics play a crucial role in an investment's success. Analyze the market area (MSA), population growth, employment trends, and other factors that indicate a thriving environment. This information is available at [City-data.com](https://www.city-data.com), [ESRI Business Analyst](https://www.esri.com/en-us/business-analyst), [BestPlaces.net](https://www.bestplaces.net), and [CoStar](https://www.costar.com).

How do you evaluate location and market dynamics for your investment properties? Ask the sponsor how they analyze the market area (MSA), population growth, employment trends, and other factors that indicate a thriving environment. A thorough understanding of these factors helps ensure that the property is positioned for growth and stability.

What is the market type? Markets are typically classified into primary, secondary, and tertiary categories, each with distinct characteristics that impact investment stability and growth potential.

Primary (Strong, Lowest Risk), Secondary (Good, Medium Risk), Tertiary (Highest Risk). Look for a detailed explanation of the market type and its characteristics from the sponsor. The response should include specific data and examples highlighting the economic fundamentals, growth potential, and risk factors associated with the market. The sponsor should demonstrate a thorough understanding of the market dynamics and how they impact the investment strategy and potential returns.

Is it in a landlord-friendly state? Assessing whether the location is in a landlord-friendly state is crucial. States with lengthy evictions, taking longer than two months, may not be the most favorable for property owners.

How much did the population grow in the last five years? If the city is between a quarter million and 1 million in population, you want 20% population growth between the year 2000 and the year 2017. Look for 15% growth for cities over a million, 10% for cities over 2 million, and 30% for cities under a quarter million. For each year beyond 2017, add 1.25% growth (1% for cities over a million and 2% for cities under a quarter million).

How much did the median home value increase in the last ten years? Look for 40% growth in Median house or condo value between the year 2000 and the year 2016, using www.city-data.com for a city. This applies to cities of all sizes. For each year beyond 2016, add 2.5% growth to the 40% number above.

How much did the median income level rise? You want 30% median household income growth between the year 2000 and the year 2016, using www.city-data.com for a city. This applies to cities of all sizes. For each year beyond 2016, add 2% growth to the 30% number above.

What is the poverty level of the neighborhood? Look for less than 20%, but under 15% is strongly preferred if you are risk-averse. (Less churn due to evictions.)

Who are the major employers in the market? Look for diversification of different employers and sectors. You don't want one industry to account for >25% of employment.

What is the crime rate? Check the crime table on www.city-data.com for decreased crime trends and ensure the latest crime number is below 500. This information applies to cities of all sizes.

What retail stores are present within 5 miles of the property? Indicates the class of property (Starbucks/Whole Foods class A, Walmart Class B, Dollar Store class C). The nicer, the better.

What is the unemployment rate in the submarket? The neighborhood's unemployment rate should be no more than 2.5% higher than the city's unemployment rate.

Are the submarket demographics diverse? Ideally, it's home to a diverse mix of races and ethnicities. Look for multiple slices, with the biggest ethnic mix slice smaller than 75% of the neighborhood's residents. Apartment renters tend to be 18-40 years old.

Can you provide current occupancy rates and how they compare to local market averages? High vacancy rates may indicate oversupply, poor property management, or less demand in the area, which can affect the profitability and sustainability of the investment. Verify the occupancy percentage based on available units online.

What are the average income levels of tenants, and how do these compare to the rental prices at your properties? When average incomes aren't significantly higher than rents, tenants may struggle to make payments, leading to higher default rates and financial instability for the property. Look up the median household income within 1-5 miles of property. Greater than 3 times the asking rent for the property is preferable.

What types of insurance do you carry for your properties, and how do you ensure it covers all significant risks in this market? Adequate insurance protects against unforeseen financial losses due to common regional risks. Ensuring comprehensive coverage is key to safeguarding the investment.

By asking these detailed questions and understanding the sponsor's approach to location analysis, market dynamics, and adaptability, you can better assess your investment's potential success and stability.



Financing

When engaging with an operator regarding a potential real estate investment, it is essential to ask detailed financial questions. These questions help you understand the property's financing structure, risk exposure, and potential financial performance.

What type of loan is on the property? A Fannie Mae or Freddie Mac non-recourse loan is desired. They generally come with an interest-only period. A Bank Loan or commercial loan is usually recourse. A bridge loan may have higher risk and interest rates but is required for deep value-added projects or extensive repositioning. Seller finance or subject-to for smaller properties or specific asset classes is also possible.

What is the interest rate of the bank financing? Assess the cost of capital and its impact on the investment's returns. Look for competitive rates that align with market conditions and the project's risk profile. The interest should be lower than the acquisition cap rate.

Is the interest rate fixed or flexible? Determine if the interest rate is fixed or flexible. Fixed rates offer predictability, while variable rates can bring uncertainty. Ensure that if the rate is not fixed, a rate cap is in place to manage potential increases.

Are there any pre-payment penalties? Prepayment penalties can significantly impact your exit strategy and overall investment returns. Some loans have step-down prepayment penalties, while others might have yield maintenance or defeasance clauses. Evaluate the flexibility of the financing and potential extra costs if they decide to exit the investment early. Look for reasonable penalties that won't overly restrict financial decisions.

What is the duration of the loan term? Consider the duration of the loan term and align it with your investment horizon. Choose a term that matches the property's investment strategy and cash flow projections.

How long is the interest-only portion of the loan? The transition from interest-only to principal and interest payments can affect the investment's cash flow and overall financial planning. Look for a balance that manages cash flow without significantly delaying principal repayment. We usually see 1-2 years in typical loans.

What is the loan-to-cost (LTC)? Compare the loan amount against the total project cost, measuring overall financial risk. Look for a ratio that shows prudent financial planning without over-leveraging, ideally between 65% and 75%. We would like to see LTC at 75% or less but would tolerate deals up to 80% if there was significant positive leverage.

What is the stabilized loan-to-value ratio? This ratio measures the loan amount compared to the property's value and indicates the level of equity invested in the deal. A lower LTV ratio generally signifies less risk for the lender and a higher equity stake for the investor, which can lead to more favorable loan terms. A conservative LTV, ideally less than 75%, can offer a cushion against market volatility if property values decline. The stabilized LTV should end up at least 20% below the LTC for a properly implemented business plan in a value-add strategy. This indicates a significant increase in cash flow and property value.

How is the loan-to-value being established? Verify how the loan-to-value is established by ensuring standard appraisal methods accurately reflect true market values.

Are there additional capital expenditures budgeted in the projections? Ensure funds are allocated for improvements that enhance property value and operational efficiency. Look for adequate budgeting for capital improvements reflective of the property's needs.

Is the completion of the capital expenditure included in the loan-to-value? Confirm if the capital expenditures impact the valuation used for financing calculations. Look for the inclusion of post-improvement value in LTV calculations to strengthen the project's financial stability.

Is the property projected to experience a refinance? You want to anticipate changes in financial terms and potential cash flow impacts. Look for Justified reasons for refinancing that align with improved property performance and market conditions.

What is the assumed loan-to-value at the time of refinance? Evaluate the expected equity position at the refinance, impacting the feasibility and terms of refinancing. Look for conservative assumptions that ensure refinancing is achievable under realistic scenarios.

What must the Net Operating Income be for the refinance to be effectuated? Ascertain the operational performance needed to support a refinancing decision. Look for attainable NOI targets that reflect market trends and property management effectiveness.

What is the assumed interest rate in the event of a refinance? To assess future financial costs and their impact on the investment under new financing terms. Look for conservative interest rate projections that account for potential market fluctuations.

What is the debt-service-coverage ratio (DSCR) in Year One? Ascertain the property's ability to cover debt obligations with its income. Lenders like 1.25. This means the property cash flow is at least 1.25 times the loan payment. A higher ratio is more conservative.

Has the sponsor worked with the lender before? To gauge the relationship and track record between the lender and sponsor, which can influence loan terms and flexibility. Look for a positive history that suggests trust and reliability in financial dealings.

By thoroughly investigating these financial aspects, you can make a more informed decision about whether the real estate investment aligns with your financial goals and risk tolerance.



Underwriting

When evaluating real estate investment opportunities, asking questions based on potential underwriting red flags can help identify risks and ensure informed decision-making. This section dives into financial underwriting and assumptions to determine whether projected returns are based on conservative and realistic underwriting assumptions; this may make or break the deal. Ask for the T12, which is the trailing 12-month income statement. This can usually be found on the sponsor's underwriting model in Excel format. Review existing property performance reports to gain insights into historical financial performance, occupancy rates, and other relevant metrics.

What is the \$/unit discount to sales comps? Determine if the property is being acquired at a favorable price compared to similar properties. Look for a discount that indicates a good purchase value and potential for upside through improvements or market appreciation. Proceed with caution if the operator can't provide current (last 90 days) comps for a project and assumes that they will exit at the purchase or lower cap rates.

What is the market cap rate? The market cap rate is a benchmark for expected returns in the local market. By aligning the property's cap rate with recent sales, investors can gauge the feasibility of projected returns. If the historical cap rate is lower than the market for the specific asset class and quality, ask the operator to justify the discrepancy. This could indicate potential overvaluation or unrealistic assumptions.

What is the cap rate at which the property is being purchased? Evaluating the purchase cap rate against market standards helps determine if the property is priced appropriately. Look for a market cap rate that aligns with recent comparable sales, indicating realistic and achievable projections. Assess whether the purchase price reflects a good value compared to market expectations. Look for a cap rate that is reasonable and justified by the property's condition, location, and income potential.

What is the cap rate based on all-in costs, including all fees? Assess the true cost basis and potential return on the investment. Look for a realistic cap rate that takes into account all expenses, providing a more accurate picture of expected returns.

What is the exit cap rate? Assessing the exit cap rate involves evaluating future market conditions and property performance assumptions. Look for a conservative exit cap rate that accounts for potential market fluctuations, ensuring a realistic assessment of future value. For a conservative assumption, the exit cap rate should be greater than the purchase cap rate.

What is the stabilized Yield-on-Cost? Calculating the stabilized Yield-on-Cost allows for measuring the return on the total cost of acquiring and stabilizing the property. Aim for a Yield-on-Cost higher than the current cap rate, indicating value enhancement through enhancements and leasing strategies.

What is the stabilized Yield-on-Cost spread? To calculate the stabilized Yield-on-Cost spread, you need to compare the stabilized Yield-on-Cost with the market cap rate to see the potential profit margins. Look for a positive spread that reflects a significant return on investment compared to market rates. We like to see a 2% or greater spread between the acquisition cap rate and YOC for value-add projects. If the operator is acquiring the property for significantly less than market (higher cap rate than market), that spread between your going-in cap rate and the stabilized YOC may not be very high.

What is the current occupancy? Assessing the current occupancy rate is essential to gauge the property's immediate income potential and stability. A high occupancy rate indicates strong tenant demand and efficient property management, contributing to the property's overall success and profitability. Be wary if occupancy is less than 90% or has historically high tenant turnover rates.

What is the stabilized occupancy rate compared to the market? Gauge the operator's expectations for property performance relative to the market. Look for a stabilized occupancy rate that aligns with or exceeds market averages, indicating strong demand and management capability.

What is the projected annual rent growth, and how does it compare to the market's organic rent growth? Understand the basis for projected income growth. Look for a conservative rental rate increase justified by market trends and property improvements. If the operator is projecting 5% annual rent growth while the organic rent growth in the market is only 3%, it's a red flag. In the current market, look for a projection closer to 0-2% for the next two years. Substantial rent increases in the first few years should be justified by a clear and achievable value-add strategy.

How long is the sponsor projecting to complete the capital expenditure? Assess the timeline for achieving stabilized operations and improved property performance. Look for a reasonable timeframe for capital improvements that align with the scope of work and market conditions.

Did the sponsor adjust the tax basis to match the new purchase price? Ensure accurate financial projections that reflect the new tax obligations. Look for an adjusted tax basis corresponding to the purchase price, avoiding underestimating tax liabilities.

What percent of the equity raise is reserved and contingency? Ensure sufficient funds are allocated for unexpected expenses and operational needs. Look for at least 5-10% of the equity raise to be allocated to reserves and contingency, providing a safety net for the investment. Watch out for large deferred maintenance issues that could lead to significant unexpected expenses.

Have you conducted a sensitivity analysis, i.e., "stress test?" I like to see some relevant stress tests on the rents, occupancy, interest rate, and Exit CAP projections that provide a few "if/then" scenarios, as the performance is not likely to hit on all estimated metrics throughout the hold period.

What are the property's current and projected income and expenses? A comprehensive analysis of the property's financials will help you understand its current performance and future potential. Review rent rolls, operating statements, and any projections the operator provides. Pay attention to occupancy rates, rent growth assumptions, and expense management. Look for well-justified assumptions based on market data, historical performance, and realistic projections.

Analyzing the property's operating expenses is crucial in understanding the investment's financial health. Are there any unusually high expenses that could impact cash flow projections? Scrutinizing the historical expenses and comparing them to industry benchmarks can reveal insights into the property's efficiency and management.

By delving deep into the financial underwriting process and asking the right questions, investors can mitigate risks and make well-informed decisions when evaluating real estate opportunities.

"DON'T WAIT TO BUY REAL ESTATE, BUY REAL ESTATE AND WAIT" — WILL ROGERS



Property

Understanding various aspects of the property, from its age and renovation history to management practices and market positioning, provides valuable insights into its potential performance and stability.

What is the age of the property? Inquire about the property's age to assess potential maintenance and renovation needs; look for properties with manageable age-related issues and recent renovations.

Has the property been renovated, and if so, when? Ask if the property has been renovated and, if so, when to understand its current condition and potential for future capital expenditures; seek recent renovations that reduce immediate future investments.

What percentage of the units have already been renovated? Determine what percentage of the units have already been renovated to gauge the scope and cost of future renovations; aim for a high percentage of renovated units to reduce immediate renovation costs.

When was the last time the roof, plumbing, elevators, and electrical were replaced or upgraded? Inquire about the last time the roof, plumbing, elevators, and electrical were replaced or upgraded to anticipate major maintenance needs and costs; prefer recent upgrades or replacements to major systems.

What is the replacement cost of the property? Inquire about the replacement cost of the property to compare it with the purchase price and assess value; look for a purchase price below the replacement cost to ensure good value.

What is the cost per square foot? Ask about the cost per square foot to benchmark against market standards and comparable properties; seek a competitive cost per square foot that aligns with market averages.

What is the number of units or tenants? Understand the number of units or tenants to assess the scale of the investment and potential income; look for a sufficient number of units to ensure diversification of income and economies of scale.

Is the property in a flood zone? Check if the property is in a flood zone to assess potential risks and insurance requirements; prefer properties not in flood zones or those with adequate insurance if they are.

What is the unit-to-parking spot ratio, and how does it compare with the competitive set? Inquire about the unit-to-parking spot ratio and compare it with the competitive set to evaluate the convenience and attractiveness of the property to tenants; look for a competitive ratio that meets tenant expectations.

Is there an office on the property? Will it need to be upgraded? Ask if an office is on the property to understand property management needs and operational logistics. An on-site office for effective management and tenant services is ideal. Determine if the office needs to be upgraded to anticipate additional capital expenditures; look for minimal need for office upgrades to reduce immediate additional costs.

What is the physical occupancy of the property? Inquire about the physical occupancy of the property to evaluate current performance and income stability; high physical occupancy indicates strong demand and stable income.

Does the signage need to be upgraded? Ask if the signage needs to be upgraded to identify potential marketing and aesthetic improvement costs; prefer signage in good condition or with a budget for upgrades.

Does upgrading the signage require city approval? Check to understand potential regulatory hurdles and costs; look for clear approval processes and minimal regulatory barriers.

Why is the seller selling? A business decision for liquidity or reinvestment typically fulfills the business plan once the exit strategy is achieved. Check if there have been any operational issues in terms of tenant base or expensive structural expenses that the team has experience and capacity to handle

What is the class of the property and how does that align with the surrounding area tenant base? Understand the property class and how it aligns with the surrounding area tenant base to ensure the property is appropriately positioned within its market; look for a property class that matches or is slightly higher than the area.

What is the “walk score” of the property? Many people work from home and/or don’t own a car. Look for a score above 70 on <https://www.walkscore.com>.

What type of security will be provided at the property? Inquire about the type of security provided at the property to evaluate the level of safety and attractiveness to tenants; look for comprehensive security measures that enhance tenant peace of mind.

How does the property compare to the competition in terms of amenities? Ask how the property compares to the competitive set in terms of amenities to assess its competitiveness and attractiveness; look for amenities that are at least on par with or exceed those of comparable properties.

What are the future development plans in the area? Inquire about any upcoming development projects in the vicinity to understand how they might impact property values and tenant demand. New infrastructure, businesses, or residential developments can significantly influence the property's attractiveness.

What are the lease terms and conditions? Review the lease terms and conditions to assess the stability of rental income and the rights and responsibilities of both the landlord and tenants. Favor properties with long-term leases and stable tenants to minimize turnover and vacancy risks.

How does the property handle tenant disputes and complaints? Understanding the process for resolving tenant issues can provide insight into management's commitment to tenant satisfaction and a positive community atmosphere.

What are the property's maintenance and management practices? Inquire about how the property is maintained and managed. Well-maintained properties with responsive management teams are more likely to retain tenants and preserve their value.

Thoroughly exploring these aspects, you can gather a comprehensive view of the property's strengths and weaknesses, helping you make a well-rounded assessment of its potential as an investment opportunity.



Business Plan

The Business Plan provides insight into the syndication team's operational approach. A well-designed plan not only indicates professionalism but also reflects the sponsor team's experience and ability.

What is your business plan, and is it reasonable given the current market situation, rehab budget, and other conditions?

Request a detailed explanation of the operator's business plan, including their strategy for property improvements, tenant management, and overall financial goals. Assess whether the plan is realistic in the current market conditions, including rental demand, economic trends, and local competition. Evaluate if the proposed rehab budget is sufficient to achieve the desired property upgrades and whether the anticipated rent increases are achievable without overburdening the tenant base.

Additionally, consider how external factors, such as regulatory changes or economic shifts, might impact the feasibility of the business plan. A reasonable and well-supported business plan should demonstrate a thorough understanding of the market and provide clear, achievable steps for enhancing property value and ensuring investor returns.

What is your net operating income (NOI) optimization strategy? The purpose of the business plan is to increase operating income and decrease expenses to increase NOI, which increases value by forced appreciation in a value-add deal. Check how the team plans to implement the strategy.

What is the rehab budget per door, the expected rent premium, and the number of remodeled units? Investigate how the budget adds value to the property and supports the expected rent premiums. Ask what percentage of units have been remodeled and ensure the planned renovations are sustainable. Determining if the tenant base can absorb the proposed rent increases is crucial. For instance, Class C properties may not afford higher-end upgrades like granite countertops and stainless steel appliances. This understanding helps ensure the investment strategy aligns with the property's market and tenant demographics.

What is the hold period, and does it fit your investment goals? Understanding the hold period is essential as it indicates the expected duration of the investment before an exit strategy, such as a sale or refinance, is implemented. A standard hold period in multifamily syndications is typically 5-6 years. Ensure this timeframe aligns with your investment goals and liquidity needs. Look for a clear rationale behind the proposed hold period and consider how it fits your investment strategy.

How do you plan to exit the deal? Understanding the sponsor's exit strategy is crucial for assessing your investment's potential returns and timing. Ask for a detailed explanation of the planned exit strategy, including whether they intend to sell the property, refinance it, or pursue another exit route.

Evaluate the timeline for this exit and the market conditions required to succeed. Consider how the exit strategy aligns with the overall business plan and market trends. For instance, if the plan is to sell the property, ensure that the expected market appreciation and demand support this approach. If refinancing is the goal, check if the projected property improvements and increased rental income justify this move. Additionally, inquire about contingencies in place if market conditions change unfavorably. A clear and realistic exit strategy should demonstrate that the sponsor has thoroughly considered all factors to maximize returns and provide investors with a clear path to liquidity.

The business plan should encompass a thorough risk assessment and contingency strategies. Delve into how the team plans to mitigate potential risks, such as market fluctuations, unexpected repair costs, and tenant turnover. An effective business plan will outline clear exit strategies, ensuring investors understand possible scenarios for withdrawing their investments or reaping returns. By scrutinizing these aspects, you can better determine the feasibility and potential success of the operator's business plan, ensuring it is not only ambitious but also grounded in realistic and responsible practices.

“RULE NO 1: NEVER LOSE MONEY. RULE NO 2: NEVER FORGET RULE NO 1. INVESTMENT MUST BE RATIONAL; IF YOU CAN’T UNDERSTAND IT, DON’T DO IT. IT’S ONLY WHEN THE TIDE GOES OUT THAT YOU LEARN WHO’S BEEN SWIMMING NAKED.” — WARREN BUFFETT 1930



Legal

It's important to read and understand the various legal documents. Investors should pay special attention to the potential risks outlined in the PPM, the structure and terms of the partnership outlined in the operating agreement, and the representations and warranties made in the subscription agreement.

Have a securities attorney review the offering documentation for conflicts of interest. Seeking guidance from a real estate attorney, accountant, or other professionals is recommended to comprehend the legal, financial, and tax implications. These experts can assist in recognizing any hidden red flags or potential risks.

Is there a capital call provision? Understanding if there is a capital call provision is crucial. A capital call provision allows the sponsor to request additional funds from investors if the initial capital is insufficient to cover expenses or unexpected costs. Knowing this helps you prepare for future financial commitments beyond your initial investment.

Are LPs required to participate in capital calls? Determining whether limited partners (LPs) are obligated to contribute additional capital if a capital call is made is important. This affects your financial planning and risk assessment. If participation is mandatory, you must be ready to provide additional funds as required.

What happens if additional capital is required and an investor does not contribute? Ask what the consequences are if an investor fails to meet a capital call. The sponsor may dilute the non-contributing investor's ownership interest or impose penalties. Understanding these terms helps you gauge the financial risks and potential impact on your investment.

Does the sponsor use Return of capital or return on capital? Clarify whether distributions are considered a return of capital or a return on capital. Return of capital distributions reduces your initial investment basis, which can have tax implications and affect the calculation of your total returns.

Can the sponsor participate in profit splits before LPs get all their money back? Determine if the sponsor is entitled to share in profits before investors have received their full return of capital. This provision can impact the alignment of interests between the sponsor and investors, affecting the order and priority of profit distributions.

Are there any catch-up provisions for the sponsor? Ask if there are catch-up provisions that allow the sponsor to receive a larger share of profits once investors have received a certain level of return. Catch-up provisions can significantly affect the overall profit split and the timing of investor distributions.

How is capital split in the event of a refinance? Understand how proceeds from a refinance are distributed among investors. This affects the return of capital and profit-sharing arrangements, as refinance proceeds might be used to pay down debt or distribute to investors.

Are there restrictions for selling or transferring shares? Inquire about any restrictions on selling or transferring your shares in the investment. These restrictions can affect your liquidity and flexibility in managing your investment portfolio.

Under what circumstances do the investors get to vote? Determine the specific situations in which investors have voting rights. Common circumstances might include major decisions like selling the property, changing the business plan, or removing the manager. Understanding your voting rights helps you gauge your level of influence in the investment.

Can the investors remove the manager? Ask if there is a provision that allows investors to remove the manager. This provision protects your investment if the manager is underperforming or acting against the investors' best interests.

What percentage of the vote is required to remove the manager? If investors can remove the manager, determine the vote percentage needed. A high threshold may make it difficult to remove an underperforming manager, while a lower threshold provides more flexibility for investors to take action.

What percentage of the depreciation is passed through to investors? Determine how much of the property's depreciation is passed through to investors. Depreciation can provide significant tax benefits by reducing taxable income, so understanding this helps you evaluate the investment's tax efficiency.

Are the sources and uses clearly outlined? Ensure the sponsor gives a clear and detailed breakdown of the sources and uses of funds. This transparency is crucial for understanding how your capital will be used and for evaluating the financial feasibility of the investment. Check the credibility and roles of all involved parties in the investment as specified in the sources and uses. Recognizing and understanding these parties helps guarantee that the investment is overseen by reliable and capable entities.

What percentage of the depreciation is passed through to investors? Determine how much of the property's depreciation is passed through to investors. Depreciation can provide significant tax benefits by reducing taxable income, so understanding this helps you evaluate the investment's tax efficiency.

If distributions are suspended, do the asset management fees stop as well? Ask whether asset management fees are suspended if distributions to investors are halted. This provision ensures that the sponsor is incentivized to maintain the property's performance and align their interests with those of the investors.

Is there a buyout clause? Determine if a buyout clause allows the sponsor or investors to buy out the other party under certain conditions. A buyout clause provides a mechanism for exiting the investment if necessary and can offer a way to resolve conflicts or changes in investment strategy.

By thoroughly understanding these aspects, you can make more informed decisions, ensuring your interests are protected and aligned with the sponsor's goals.



Physical Inspection

When considering a real estate investment, inspecting the physical property is key. The goal is to assess the property's condition to ensure the structure and fixtures are solid. Conduct a comprehensive inspection of the property to assess its overall condition, including the building structure, roof, windows, plumbing, electrical systems, and other physical components.

Consider engaging a third-party appraiser or inspector to evaluate the property's condition and value and furnish a comprehensive report. The following are areas to be checked.

General Property Condition

Building Exteriors: Assess the exterior condition. Look for signs of damage, such as cracks, peeling paint, or rust, which can indicate neglect or future maintenance costs.

- Are there any visible signs of damage, such as cracks, peeling paint, or rust?
- Is the roofing in good condition, with no signs of leaks or damage?
- Are the windows and doors secure and functional?

Interior Common Areas: Evaluate cleanliness and maintenance: Well-maintained common areas reflect good property management and tenant satisfaction.

- Are the hallways, lobbies, and common areas clean and well-maintained?
- Is the lighting adequate and functional?
- Are there any signs of water damage or mold?

Landscaping and Grounds: Examine grounds and landscaping: Well-kept grounds can enhance curb appeal and tenant satisfaction, while poor maintenance might indicate potential issues.

- Is the landscaping well-maintained and aesthetically pleasing?
- Are the walkways, parking lots, and driveways in good condition and debris-free?
- Is there adequate drainage to prevent water pooling or flooding?

Structural and Mechanical Systems

HVAC Systems: Assess the condition and age of major systems within the property, such as heating, ventilation, air conditioning (HVAC), plumbing, and electrical systems.

- Are the heating, ventilation, and air conditioning systems in good working order?
- When were the HVAC systems last serviced or replaced?

Plumbing: Efficient plumbing systems are essential for tenant satisfaction and operational efficiency. Check for any signs of leaks or outdated systems.

- Are there any signs of leaks, corrosion, or other plumbing issues?
- Are the water pressure and temperature adequate in all units?

Electrical Systems: Safe and modern electrical systems are crucial for tenant safety and property value. Ensure all systems are up to code and functioning properly.

- Is the electrical wiring up to code and in good condition?
- Are there enough electrical outlets, and are they functioning properly?

Safety and Security

Fire Safety: Fire safety is a top priority for any property. Ensure all fire safety measures are updated and properly maintained to protect tenants and the property.

- Are there functional smoke detectors, fire alarms, and sprinkler systems in place?
- Are fire extinguishers readily available and properly maintained?

Security Measures: Adequate security measures enhance tenant safety and can reduce the risk of property damage or theft. Evaluate the effectiveness of current security systems.

- Are security cameras, locks, and lighting in place to ensure tenant safety?
- Is there a secure access control system for entering the building?

Environmental Hazards: Identifying environmental hazards is essential to avoid future legal and health issues. Ensure the property is free from hazardous materials.

- Are there signs of asbestos, lead paint, or other hazardous materials?
- Is the property in a flood zone or an area prone to natural disasters?

Amenities and Services

Recreational Facilities: Well-maintained recreational facilities add value to the property and attract quality tenants. Assess the condition and appeal of these amenities. size.

- Are amenities like pools, gyms, and playgrounds well-maintained and safe to use?
- Are there any additional costs associated with these amenities?

Laundry Facilities: Functional and clean laundry facilities are important for tenant convenience. Ensure they are adequate for the property size.

- Are the laundry rooms clean, functional, and conveniently located?

Parking: Adequate parking is crucial for tenant satisfaction. Evaluate the number and condition of parking spots to ensure they meet tenant needs.

- Is there sufficient parking available for tenants and visitors?
- Are the parking areas well-lit and secure?

Tenant Spaces and Occupancy

Unit Interiors: Inspect the condition of individual units to assess overall property maintenance and potential costs for renovations. eriod.

- Are the individual units in good condition, with no major repairs needed?
- Are the appliances, fixtures, and finishes modern and functional?

Occupancy Rates: High occupancy rates indicate strong demand and effective property management. Check for any units that have been vacant for an extended period.

- What is the current occupancy rate of the property?
- Are there any units that have been vacant for an extended period?

Tenant Satisfaction: Happy tenants are more likely to renew leases. Assess tenant satisfaction through surveys or conversations with current tenants.

- Are tenants satisfied with the property management and maintenance?
- Have there been any recent complaints or issues reported by tenants?
- Is there a strong cell phone signal for each of the major carriers?

Financial and Legal Aspects

Lease Agreements: Ensure lease agreements are legally compliant and standardized to avoid legal issues and ensure consistent terms across all tenants.

- Are lease agreements standardized and legally compliant?
- Are there any upcoming lease expirations or renewals to be aware of?

Operating Expenses: Review operating expenses to ensure they are within a reasonable range and identify potential areas for cost savings.

- Are there any unexpected or unusually high operating expenses?
- Are maintenance and repair costs within a reasonable range?

Legal Compliance: Confirm that the property complies with all relevant local, state, and federal regulations to avoid future legal complications.

- Is the property compliant with all local, state, and federal regulations?
- Are there any ongoing legal disputes or issues related to the property?

Future Maintenance and Capital Improvements

Planned Improvements: Understanding planned capital improvements helps evaluate future property value and potential returns on investment.

- Are there any planned capital improvements or major renovations?
- What is the budget and timeline for these improvements?

Maintenance Plans: A proactive maintenance plan ensures the long-term upkeep of the property, reducing unexpected repair costs and enhancing tenant satisfaction.

- Is there a proactive maintenance plan in place to address future needs?
- How often are routine inspections and maintenance conducted?

Final Considerations

Overall Impressions: A combination of the above factors can influence your overall impression of the property. Ensure it aligns with your investment goals and criteria.

- Does the property align with your investment goals and criteria?
- Are there any red flags or concerns that need further investigation?

Photographs and Documentation: Documenting your observations with photos and notes provides a valuable reference for later analysis and decision-making.

- Take detailed photographs and notes during the site visit.
- Request copies of relevant documents, such as inspection reports and maintenance records.

By thoroughly evaluating these aspects during an on-site property visit, you can understand the property's condition, operational efficiency, and potential risks, aiding in making an informed investment decision.

Due diligence is not a one-time process; it's an ongoing commitment to protect and grow your investment. Remember, every deal and investor is unique. Customize this process according to your unique requirements and risk tolerance. With this guide, we hope to provide you with a road map to successful investing. Always consider working with professional advisors and fund managers who can provide specialized insights and manage some of these processes on your behalf.

“RISK COMES FROM NOT KNOWING WHAT YOU ARE DOING.” - WARREN BUFFET

Resources

- [Building Wealth With Multifamily Real Estate: Recession-Proof Your Retirement With Hands-Off Real Estate Investing](#)
- [Background Checks](#)
- [Underwriting Software](#)
- [Financial Analysis](#)



Join Our Investment Club

The Legacy Wealth Collective is a private group of investors looking to passively grow their capital and share in all the tax benefits through multifamily real estate investments.

We empower busy entrepreneurs and high-net-worth individuals with streamlined access to exceptional real estate investments. Our expertise is in identifying and vetting lucrative opportunities that align with your financial aspirations. With us, you gain more than investments; you gain a dedicated partner committed to navigating the complexities of the real estate market for you, maximizing your returns while minimizing your risk and involvement.



LEGACY WEALTH
COLLECTIVE

Never miss out on a lucrative opportunity! You'll also get access to:

- Our Private Investor Portal
- Private Webinars
- Our Resources
- Exclusive Investments
- And Much More!

www.LegacyWealthCollective.com

What Our Investors Say...



Armin K., Investor since 2023

"I have had the privilege of working with the Accelerated Capital team on two investments. Their track record is consistently meeting or surpassing my expectations."

Brian G., Investor since 2019

"James and Toby's opportunities have consistently outperformed my other investment avenues. Their approach to investing is innovative and thorough, ensuring I get great returns without the usual risks."

Steve Y., Investor since 2022

"The detail and care Accelerated Capital puts into their due diligence is remarkable. They prioritize my success and security, making each investment decision easier and more comfortable."

ABOUT

Accelerated Capital

Accelerated Capital is a real estate investment firm that pools investor capital and allocates it to the best multifamily deals in the South and Sunbelt regions. We maintain strong relationships with sponsors in our target markets and invest in less than 1% of opportunities.

Our check size is significantly larger than that of the typical investor, allowing us to negotiate superior deal terms on behalf of our investors. You can schedule a call using the link below to learn more about our investment opportunities and how we can help you achieve your financial goals through multifamily investing.

[Schedule A Call ->](#)

