# Mastering the Multifamily Matrix

## Know these terms to do a deal with ease

MULTIFI

# General Partner (GP)

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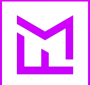
**A partner whose liability is limited to the extent of their share of ownership. Also referred to as an LP.**

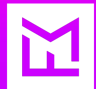
In apartment syndications, the LP is the passive investor who makes an investment.



# Limited Partner (LP)

**A partner whose liability is limited to the extent of their share of ownership. Also referred to as an LP.**

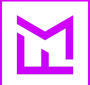
In apartment syndications, the LP is the passive investor who makes an investment.



# Distressed Asset

**A non-stabilized apartment community, which means the economic occupancy rate is usually below 90%, and likely much lower, due to any number of reasons.**

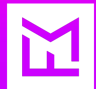
This can include poor operations, tenant problems, outdated interiors, exteriors, or amenities, mismanagement, and/or deferred maintenance. Note that there is a difference between a pre stabilized asset and a distressed asset.



# Value-Add Asset

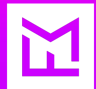
**An asset with an opportunity to increase the value by either improving operations, or also forcing appreciation through renovations.**

Generally, most class B apartment complexes will have some component of both.



# Subject Property

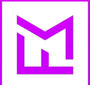
The apartment the general partner intends on purchasing, or the "subject" of the offering.



# Accredited Investor

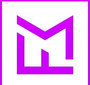
**An investor that meets the SEC definition through one or more qualifications.**

Generally, the two major ways investors reach this qualification are by the net worth or income. Current requirements to qualify are an annual income of $200,000, or $300,000 if married, for the last two years with the reasonable expectation of maintaining the same income, or a net worth exceeding $1 million either individually or jointly with a spouse.



# Sophisticated Investor

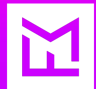
A person who is deemed to have sufficient investing experience and knowledge to weigh the risks and merits of an investment opportunity, but doesn’t meet the accredited investor requirements.



# Passive Distributions

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

These distributions are typically left to the sole discretion of the active partner.

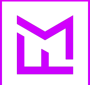


# Preferred Return

**A threshold return that limited partners are sometimes offered with the purpose of mitigating risk, which is distributed in preference (before) other payments.**

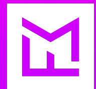
The first 100% of profits are distributed until the preferred return is met.

Ex.
Limited partner invests $100,000
General partner offers a 6% preferred return
Limited partner receives $100,000 * 6% = $6,000/year



# Lease

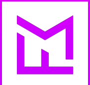
A formal legal contract between a landlord and a tenant for occupying an apartment unit for a specified time and at a specified rent with specified terms.



# Market Rent

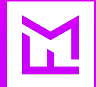
**The dollar amount landlords can expect based on comparable properties in the area and based on what a tenant would pay to lease a unit.**

This number is derived by conducting a market analysis or Rent Comparable Analysis.



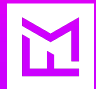
# Rent Comparable Analysis (Rent Comps)

The process of analyzing the rental rates of similar assets (size, quality, and location) to determine the market rents of the units at the subject property.



# Rent Premium / Post Renovation Premium

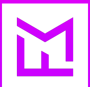
The incremental increase in rent assumed after renovations are completed on the interior and/or exterior.



# Gross Potential Rent (GPR)

Also referred to as GPR. The potential amount of revenue if the apartment were 100% leased year-round at market rental rates.

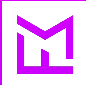
Ex. 200-unit apartment community
Average monthly market rent per unit is $900
Gross potential rent is $900 * 12 months * 200 units = $2,160,000



# Gross Potential Income

The hypothetical amount of revenue if the apartment community were 100% leased year-round at market rental rates, plus all other income assumptions.

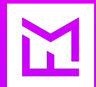
Ex. 200-unit apartment community
Gross potential rent is $2,160,000
Other income is $200,000
Gross potential income is $2,160,000 + $200,000 = $2,360,000



# Effective Gross Income (EGI)

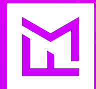
**The true cash flow on an asset. Also referred to as EGI, total income, or total revenue.**

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.



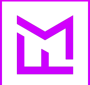
# Operating Expenses

The ongoing costs of running and maintaining the apartment community and its grounds excluding the debt service.



Ex. 200-unit apartment community
Payroll costs are $220,000
Maintenance and repair costs are $60,000
Contract service costs are $72,000
Turn/make ready costs are $39,000
Advertising and marketing costs are $25,000

Administrative costs are $27,000
Utility costs are $175,000
Property management fees are $65,000
Taxes are $250,000
Lender reserves are $50,000
Insurance is $50,000
Total expenses are $1,033,000

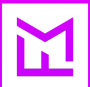


# Net Operating Income (NOI)

Calculated by taking the income minus the operating expenses. This is the basis used to determine market value and cap rate.

Ex. 200-unit apartment community
Effective gross income is $2,084,000
Operating expenses are $1,033,000

NOI is $2,084,000 - $1,033,000 = $1,127,000

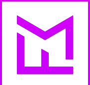


# Free Cash Flow (cash flow)

The cash flow remaining after paying all operational expenses and the debt service of the asset.

Ex. 200-unit apartment community
Effective gross income is $2,084,000
Operating expenses are $1,033,000
Debt Service is $700,000

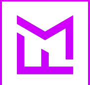
Cash Flow is $2,084,000 - $1,033,000 - $700,000 = $351,000



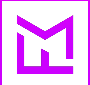
# Equity Multiple (EM)

Also known as the Multiple of Invested Cash (MOIC), is the rate of return based on the total net profit added to the initial investment.

The EM is calculated by dividing the sum of the total profit (cash flow + sales proceeds) plus the remaining equity investment at sale by the initial equity investment.



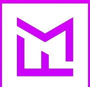
Ex. 200-unit apartment community purchased for $26,000,000 with a 5-year hold
Equity investment is $7,500,000
5-year cash flow is $2,500,000
Year 1 is $427,000
Year 2 is $465,000
Year 3 is $520,000
Year 4 is $555,000
Year 5 is $533,000
Profit from sale is $3,300,000
Return of remaining equity investment is $7,500,000
Equity Multiple is ($2,500,000 + $3,300,000 + $7,500,000) / $7,500,000 = 1.77x



# Gross Rent Multiplier (GRM)

The number of years it would take for an investment to pay for itself based on the gross potential rent.

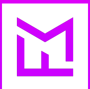
The GRM is calculated by dividing the purchase price by the annual gross potential rent.
Ex. 200-unit apartment community
Purchase price is $26,000,000
Gross potential rent is $2,160,000
GRM is $26,000,000 / $2,160,000 = 12.03 years



# Capitalization Rate (Cap Rate)

The rate of return based on the income that the property is expected to generate. Another way to describe this metric is the yield.

The cap rate is calculated by dividing the net operating income by the market value of the property. Note that there are several types of cap rates active investors utilize in analyzing an asset: going in cap rates, operating cap rates, exit cap rates, etc. The cap rate indicates risk vs. reward. Boston, MA has lower cap rates whereas Mobile, AL has higher cap rates. The “market cap” is the average cap one can expect for similar assets in the same submarket.

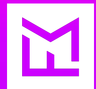


**Ex. 200-unit apartment community**
**NOI is $1,051,000**
**Sales price is $26,000,000**
**Cap rate is $1,051,000 / $26,000,000 = 4.04%**

# Appraisal

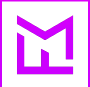
**A report created by a third party, certified appraiser that offers the market value of a property.**

For multifamily, the value is based on a blend between the cost, income, and sales comparison approach.



# Cost Approach

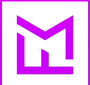
A method of calculating a property's value based on the cost to replace (or rebuild) the property from the ground up.
Also called the replacement approach.



# Income Approach

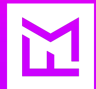
**A method of calculating a commercial property's value based on the capitalization rate and the net operating income.**

Value = net operating income / capitalization rate



# Sales Comparison Approach

A method of calculating a property's value based on the sales price of similar properties recently sold in the same submarket.

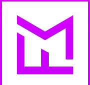


# Appreciation

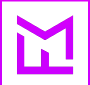
**An increase in the value of an asset over time.**

The increase can occur for a number of reasons, including increased demand or weakening supply, or as a result of changes in inflation or interest rates.

The two main types of appreciation in multifamily: natural appreciation and forced appreciation.



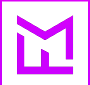
Natural appreciation occurs when the market capitalization rate naturally decreases over time due to supply, demand, etc.
Forced appreciation occurs when the net operating income is increased by either increasing the revenue or decreasing the expenses. Forced appreciation typically occurs by adding value to the apartment through renovations and/or operational efficiencies.



# Depreciation

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

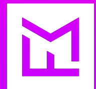
This could be due to supply and demand as well. Note, this is different when utilized in terms of tax structures.



# Vacancy Rate

**The percentage of unoccupied, or vacant units.**

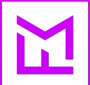
The vacancy rate is calculated by dividing the total number of unoccupied units by the total number of units in the asset.



# Vacancy Loss

**The amount of revenue lost due to unoccupied units.**

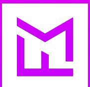
Ex. 200-unit apartment community
8 units are vacant
Average rent of the vacant units is ~$900
Vacancy rate is 8/200 = 4%
Vacancy loss is $900 * 8 units * 12 months = $86,400



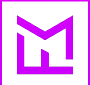
# Economic vs. Physical Occupancy Rate

**Economic Occupancy is the rate of paying tenants in occupied units based on the effective gross income divided by the gross potential income collected. This takes into account any units that have non-paying tenants and how it affects our financials.**

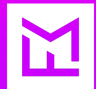
Physical Occupancy is the proportion of occupied units. This is calculated by dividing the total number of occupied units by the total number of units at the property. Physical Occupancy plus Vacancy Rate should always equal 100%.



Ex. 200-unit apartment community
192 occupied units
Gross potential income is $2,360,000
Effective gross income is $2,084,000
Physical occupancy is 192 / 200 = 96%
Economic occupancy is $2,084,000/ $2,360,000 = 88.3%



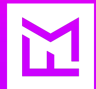
# Mortgage



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

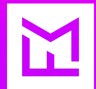
# Principal Balance

The original sum lent to the borrower.



# Interest Rate

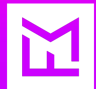
The amount charged by a lender to a borrower for the use of their funds.



# Amortization

**The period of time that the mortgage is reduced by paying principal and interest.**

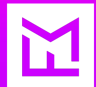
The term of a loan may be only 10 years, but the amortization may be 30 years.



# Prepayment Penalty

**A clause in a mortgage contract stating that a penalty will be assessed if the mortgage is paid down, or paid off sooner than the terms of the loan.**

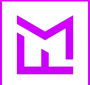
For example, if you pay a mortgage off in 5 years on a 10 year term.



# Yield Maintenance

**A prepayment fee that borrowers pay lenders to reimburse them for the loss of interest resulting from the prepayment of a loan.**

This provision permits the lender to obtain the same yield as if the borrower had made all scheduled mortgage payments until loan maturity.



# Permanent Agency Loan

**A long-term mortgage loan secured from Fannie Mae or Freddie Mac.**

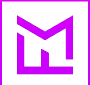
Typical loan term lengths are 3, 5, 7, 10, 12 or more years amortized over up to 25-30 years.

Apartment communities that are non-stabilized (90% occupancy or lower for the last 90 days) will typically not qualify for agency debt.

# Bridge Loan

**A mortgage loan used until the borrower secures permanent financing.**

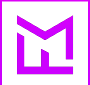
Bridge loans are short terms (six months to three years, with the option to purchase an additional six months to two year extensions). They generally have higher interest rates, and are almost exclusively interest only. Also referred to as interim financing, gap financing, private loans, or swing loans. The loan is ideal for repositioning assets that don’t qualify for permanent agency financing.



# Loan-to-Value (LTV) Ratio

**The ratio of the value of the loan amount divided by the appraised value of the asset.**

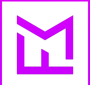
When securing financing from a lender for a loan that excludes the capital expenditure costs, maximum LTV is usually 80%.



# Loan-to-Cost (LTC) Ratio

**The ratio of the loan amount divided by the total project costs (purchase price + capital expenditure costs).**

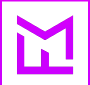
When securing financing from a lender for a loan that includes the capital expenditure costs (i.e. a bridge loan), they may offer financing up to a maximum LTC (65% to 80% is standard).



# London Interbank Offered Rate (LIBOR)

**A benchmark rate that some of the world's leading banks charge each other for short-term loans.**

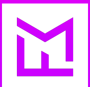
Also referred to as LIBOR. The LIBOR serves as the first step to calculating interest rates on various loans, including commercial loans, throughout the world.



# Debt Service

**The annual mortgage amount paid to the lender, which includes principal plus interest, or on an "interest only" period, just the interest calculations.**

Ex. 200-unit apartment community purchased for $26,000,000
Loan term: 120-months (24-months of interest-only payments)
Loan amount: $20,800,000
Interest rate: 3.5%
Amortization: 30 years
$60,667 monthly debt service (months 1 to 24)
$93,401 monthly debt service (months 25 to 60)



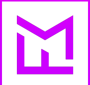
# Debt Service Coverage Ratio (DSCR)

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.

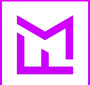
A DSCR of 1.0 means that there is just enough net operating income to cover 100% of the debt service. Ideally, the DSCR is 1.25 of higher to qualify for agency debt. With COVID adjustments, most agency loans are looking for a 1.35x DSCR. A property with a DSCR too close to 1.0 is vulnerable, and a minor decline in revenue or increase in expenses would result in the inability to service the debt.

Ex. 200-unit apartment community
Annual NOI is $1,051,000 during the first two years of I/O
Annual NOI is $1,460,000 after the I/O period
Annual debt service is $700,000 (during I/O period)
Annual debt service is $1,120,800 after the initial I/O Period
Debt Service Coverage Ratio is $1,051,000 / $700,000 = 1.5 during I/O period
Debt Service Coverage Ratio is $1,460,000 / $1,120,800 = 1.3 after I/O period



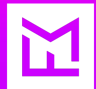
# Interest-only (I/O) Payment

The payment on a mortgage where the lender requires the borrower to pay only the interest on the principal. The principal balance doesn't decrease during this time.



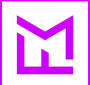
# Recourse

The rights of the lender to go after personal assets above and beyond the collateral if the borrower defaults on the loan.



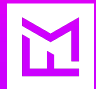
# Nonrecourse

The rights, or non rights, 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

**The replacing of an existing debt obligation with another debt obligation with different terms.**



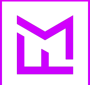
# Capital Expenditures (CapEx)

**The funds used by a company to acquire, upgrade, and maintain a property. 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 includes 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).

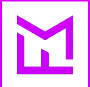
Examples of things that wouldn't be considered CapEx are the operating expenses, debt service, fees, and distributions to investors.



# Equity Investment

The upfront costs for purchasing a property. For multifamily 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.

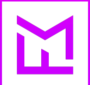
Ex. 200-unit apartment community purchased for $26,000,000
Down payment for the loan is $5,200,000
Closing costs are $260,000
Financing fees are $210,000
Operating account funding is $260,000
Acquisition fee is $520,000
Cap Ex is $1,050,000
The Equity Investment required is ($26,000,000 - $20,800,000) + $260,000 + $210,000 + $260,000 + $520,000 + $1,050,000 = $7,500,000



# Closing Costs

**The expenses, over and above the purchase price of the property, that buyers and sellers normally incur to complete a real estate transaction.**

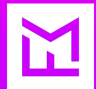
These costs can include origination fees, application fees, recording fees, attorney fees, underwriting fees, due diligence fees, and credit search fees.



# Financing Fees

**The one-time, upfront fees charged by the lender for providing the debt service. Also referred to as financing charges.**

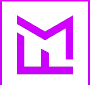
Typically, the financing fees are approximately 1-2% of the purchase price.



# Operating Account Funding

**A reserve 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. Stabilized and lower risk assets require less operating expenses.



# Price per unit

**The cost per unit of purchasing the property.**

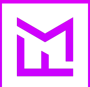
The price per unit is calculated by dividing the purchase price of the property by the total number of units. The price per unit is a metric used to quickly compare apartment communities, but is just an initial screening tool to indicate the asset.

Ex.

200-unit apartment community

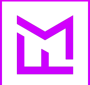
Purchase price is $26,000,000

Price per unit is $26,000,000 / 200 units = $130,000 price per unit



# Ration Utility Billing System (RUBS)

A method of calculating a resident's prorated share of the 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.



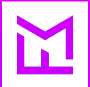
# Breakeven Occupancy

**The occupancy rate required to cover all of the expenses including debt service at the property.**

The breakeven occupancy rate is calculated by dividing the sum of the operating expense plus debt service by the gross potential income.

Ex. 200-unit apartment community
Operating expenses are $1,033,000
Annual debt service is $700,000
Gross potential income is $2,360,000
Breakeven Occupancy is ($1,033,000 + $700,000) / $2,360,000 = 73.4%

*Breakeven occupancy is not a very useful data point because as markets change, a good operator will recognize the change in rental rates in the area, and the rental rate will decrease in order to maintain occupancy. Most lenders will have an occupancy metric that will indicate a technical default if the occupancy drops too low, meaning that the borrower is not meeting the loan obligations.

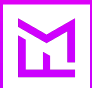


# Class A, B, C and D Property & Neighborhood

**Rankings based on multiple factors and can be somewhat subjective. Classes are determined based on the asset itself, as well as the neighborhood and location of the asset. A is highest and D is lowest grade.**

Property
Class A: new construction, commands highest rent in area, high end amenities
Class B: Slightly older, well maintained, little deferred maintenance
Class C: Older than Class B, shows age, some deferred maintenance
Class D: Very old property, 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, low crime neighborhood
Class C: low-to-moderate income neighborhood
Class D: high crime, very bad neighborhood
It is better to have a lower class property in a higher class neighborhood than vice versa.

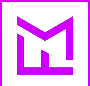


# Loss-to-Lease (LtL)

**The revenue lost based on the market rent and the actual rent of a particular unit at that point in time.**

The LtL is calculated by dividing the gross potential rent minus the actual rent collect by the gross potential rent.
Ex. 200-unit apartment community
Gross potential rent is $2,160,000
Actual collected rent is $2,010,000

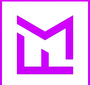
LtL is ($2,160,000 - $2,010,000) / $2,160,000 = 6.9%



# Bad Debt

**The amount of uncollected money owed by a tenant after move-out.**

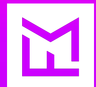
Ex.
Tenant skips out in the middle of the night
Damages to the unit that are not covered by the security deposit
Rent owed by tenant after they move out



# Concessions

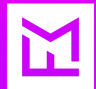
**The credits given to offset rent, application fees, move-in fees, and any other cost incurred by the tenant, which are generally given at move-in to entice tenants into signing a lease.**

Ex: First month rent free.



# Employee Unit

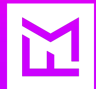
An apartment unit rented to an employee at a discount or for free.



# Model unit

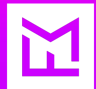
**A representative apartment unit used as a sales tool to show prospective tenants how the actual unit will appear once occupied.**

Having a model unit will mean that you are decreased in revenue because this will not be rented out and generating income.



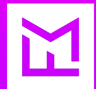
# Exit Strategy

## The general partners’ plan of action for selling the apartment community at the conclusion of the business plan.



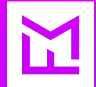
# Holding Period

The amount of time the general partner plans on owning the apartment from purchase to sale.



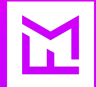
# Sales Proceeds

## The profit collected at the sale of the apartment community.



# Proforma

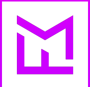
The projected budget with itemized line items for the revenue and expenses for the next 12-months and/or the next 5 years.



# T12 / Operating Statement / Profit and Loss Statement (T-12)

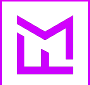
A document or spreadsheet containing detailed information about the revenue and expenses of an apartment over the last 12 months on a rolling basis.

Also referred to as a trailing 12-month, profit and loss statement, P&L, operating statement, or T-12.



# Rent Roll

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.

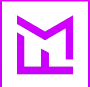


# Acquisition Fee

**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.**

This accounts for all the projects that have been evaluated but didn't meet the threshold for investment as well. Acquisition fees range from 1% to 5% of the purchase price, depending on the size of the deal.

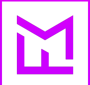
For example, if the acquisition fee is 2% on a 200-unit apartment community purchased for $26,000,000 total project cost, the syndicator will receive $520,000 at closing.



# Guaranty Fee

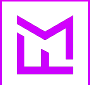
**A fee paid to the loan guarantor at closing for signing for and guaranteeing the loan.**

The guaranty fee can be as low as 0.5% to 1% and as high as 3.5% to 5% of the project cost. In some instances, the loan guarantor also receives a percentage of the general partnership (2-20%) in addition to or instead of the one-time upfront fee.



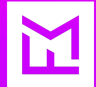
# Asset Management Fee

A type of fee a syndicator can earn. This on-going annual fee is paid from the property operations, typically below the NOI on a T12, under partnership expenses, for property oversight. Generally, the fee is 2% of the gross receipts or $250 per unit per year, or 2% of equity under management.



# Property Management Fee

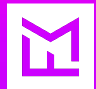
The ongoing monthly fee paid to the property management company for managing the day-to-day operations of the apartment community.



# Refinancing Fee

A fee paid to the general partner for the work required to refinance a loan balance.

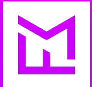
At the closing of the new loan, a fee of 1% to 3% of the total loan amount is paid to the general partner.



# Disposition Fee

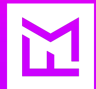
A fee paid to the general partner in exchange for managing the disposition, or exit of the project.

This varies, but can be 1-2% of the total exit price.



# Operating Agreement

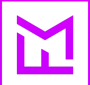
A document that outlines the responsibilities and ownership percentages for the general and limited partners in the entity.



# Private Placement Memorandum (PPM)

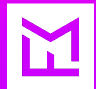
A document that outlines the terms of the investment and the primary risk factors involved with making the investment. Also referred to as the PPM.

The PPM typically has four main sections:
The introduction - a brief summary of the offering
basic disclosures - including general partner information, asset description, and risk factors
the legal agreement
the subscription agreement



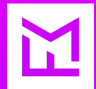
# Subscription Agreement

A document that is an outline by the LLC that owns the property to sell a specific number of shares to a limited partner at a specified price, and contractual obligations by the limited partner to pay that price.



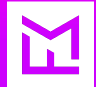
# Letter of intent (LOI)

A non-binding agreement created by a buyer with their proposed purchase price and terms.



# Purchase and Sale Agreement (PSA)

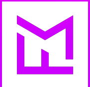
A binding agreement between the buyer and the seller of the property. This is usually negotiated once the LOI is accepted.



# Earnest Money / Hard Money

**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.**

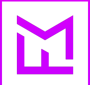
This can also be called a good faith deposit and each deal can have various specifications on how or when the Earnest Money or Hard Money is refundable.



# Metropolitan Statistical Area (MSA)

**A geographical region containing a substantial population nucleus, together with adjacent communities having a high degree of economic and social integration with that core.**

MSAs are determined by the United States Office of Management and Budget (OMB).



# Submarket

# A geographic subdivision of a market.