LWS
Investments

IMPORTANT TERMINOLOGY

APARTMENT SYNDICATION

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

NET OPERATING INCOME (NOI)

Net operating income (NOI) is all revenue from the property minus operating expenses, excluding capital expenditures and debt service.
For example, a 220-unit apartment community with a total income of $1,979,770 and total operating expenses of $1,140,524 has a NOI of $839,246.

CAP RATE

Capitalization rate, typically referred to as cap rate, is the rate of return based on the income that the property is expected to generate. The cap rate is calculated by dividing the property's net operating income (NOI) by the current market value or acquisition cost of a property (cap rate = NOI / Current market value)
For example, a 220- unit apartment community with a NOI of $839,246 that was purchased for $13,200,000 has a cap rate of 6.4%.

BREAKEVEN OCCUPANCY

Breakeven occupancy is the occupancy rate required to cover the all of the expenses of an apartment community. The breakeven occupancy rate is calculated by dividing the sum of the operating expenses and debt service by the gross potential income. For example, a 220-unit apartment community with $1,266,489 in operating expenses, $615,090 in debt service and $2,650,600 in gross potential income has a breakeven occupancy of 71. %change Commission (SEC).

SOPHISTICATED INVESTOR

A sophisticated investor is a person who is deemed to have sufficient investing experience and knowledge to weigh the risks and merits of an investment opportunity.

ACCREDITED INVESTOR

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

GENERAL PARTNER

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

LIMITED PARTNER

The limited partner (LP) is a partner whose liability is limited to the extent of the partner's share of ownership. In apartment syndications, the LP is the passive investor and funds a portion of the equity investment.

GROSS RENT MULTIPLIER

The gross rent multiplier (GRM) is the number of years the apartment would take to pay for itself based on the gross potential rent (GPR). The GRM is calculated by dividing the purchase price by the annual GPR.
For example, a 220-unit apartment community purchased for $13,200,000 with a GPR of $203,980 per month has a GRM of 5.4.

INTERNAL RATE OF RETURN (IRR)

The internal rate of return (IRR) is the rate, expressed as a percentage, needed to convert the sum of all future uneven cash flow (cash flow, sales proceeds and principal pay down) to equal the equity investment. IRR is one of the main factors the passive investor should focus on when qualifying a deal. A very simple example is let's say that you invest $50. The investment has cash flow of $5 in year 1, and $20 in year 2. At the end of year 2, the investment is liquidated and the $50 is returned. The total profit is $25 ($5 year 1 + $20 year 2). Simple division would say that the return is 50% ($25/50). But since time value of money (two years in this example) impacts return, the IRR is actually only 23.43%. If we had received the $25 cash flow and $50 investment returned all in year 1, then yes, the IRR would be 50%. But because we had to "spread" the cash flow over two years, the return percentage is negatively impacted. The timing of when cash flow is received has a significant and direct impact on the calculated return. In other words, the sooner you receive the cash, the higher the IRR will be.

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GROSS POTENTIAL INCOME

The gross potential income is the hypothetical amount of revenue if the apartment community was 100% leased year-round at market rates plus all other income. For example, a 220-unit apartment community with a GPR of $203,980 and monthly other income of $17,150 from late fees, pet fees and a RUBS program has a gross potential income of $221,130 per month.

RENT ROLL

The rent roll is a document or spreadsheet containing detailed information on each of the units at the apartment community, along with a variety of data tables with summarized income.

PROFIT AND LOSS STATEMENT

The profit and loss statement is a document or spreadsheet containing detailed information about the revenue and expenses of the apartment community over the last 12 months. Also referred to as a trailing 12-month profit and loss statement or a T12.

UNDERWRTITING

Underwriting is the process of financially evaluating an apartment community to determine the projected returns and an offer price.

PRO-FORMA

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

RENT PREMIUM

A rent premium is the increase in rent after performing renovations to the interior or exterior of an apartment community. The rent premium is an assumption made by the general partner during the underwriting process based on the rental rates of similar units in the area or previously renovated units.

CAPITAL EXPENDITURES

Typically referred to as CapEx, are the funds used by a company to acquire, upgrade and maintain an apartment community. An expense is considered to be a capital expenditure when it improves the useful life of an apartment and is capitalized – spreading the cost of the expenditure over the useful life of the asset.
Capital expenditures include both interior and exterior renovations.
Examples of exterior CapEx 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 a 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 (i.e. doorknobs, cabinet handles, outlet covers, faucets, etc.).
Examples of things that wouldn't be considered CapEx are operating expenses, like the costs associated with turning over a unit (i.e. paint, new carpet, cleaning, etc.), ongoing maintenance and repairs, ongoing landscaping costs, payroll to employees, utility expenses, etc.

OPERATING EXPENSES

The operating expenses are the costs of running and maintaining the property and its grounds.

DEBT SERVICE

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

CASH FLOW

The cash flow is the revenue remaining after paying all expenses. Cash flow is calculated by subtracting the operating expense and debt service from the collected revenue.

OPERATING ACCOUNT FUNDING

The operating account funding is a reserves fund, over and above the price of the property, to cover things like unexpected dips in occupancy, lump sum insurance or tax payments or higher than expected capital expenditures. The operating account fund is typically created by raising extra money from the limited partners.