The Cheat Sheet for Passive Investing in Real Estate

Keys2Freedom

A guide to walk you through the essential steps and concepts you need to understand before making your first investment.

Is Passive Investing right for you?

Before diving into passive real estate investing, consider the following:

- Do you believe in real estate as a wealth-building vehicle?
- Are you comfortable being a limited partner (LP), meaning you have no direct control over the property's management?
- Do you have capital to invest? (Most real estate syndications require a minimum investment, typically around $50,000.)
- Do you value long-term wealth generation rather than quick liquidity?
- Do you want to reduce your tax burden through real estate tax benefits?
- Are you an accredited investor? If you're unsure, find out if you qualify, as many syndications follow strict SEC regulations on who is able to participate in investing.

If you answered yes to most of these questions, passive real estate investing might be a great fit for your financial goals.

Understanding the Role of General Partners (GPs) and Limited Partners (LPs)

Who's Involved in a Real Estate Syndication?

- **General Partners (GPs):** Also known as sponsors or operators, GPs are responsible for finding deals, securing financing, managing renovations, raising capital, and overseeing the property's daily operations. They ensure the business plan is executed and that investors receive their returns.
- A strong GP team with a history of successful real estate projects and investor transparency is essential for a good investment experience.
- **Limited Partners (LPs):** These are passive investors who provide capital to fund the deal. LPs have no active management responsibilities but share in the profits.

Vetting a Sponsor (GP)

Before investing, it's crucial to evaluate the experience, transparency, and credibility of the General Partner managing the deal.

Ask questions such as:

- How long have they been in real estate investing?
- What is their track record with previous deals?
- How do they communicate with investors?
- How many syndications have they completed, and how many have gone full cycle?
- How have they handled challenges or market downturns in the past?
- What asset class(es) do they focus on?
- Do they invest their own capital in the deals?
  - **Don't skip this question.**



Even though an LP is passive, treat it as a partnership. You should like and trust who you are co-investing with.

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Assess Your Risk Tolerance

You will be exposed to a variety of asset classes and geographical areas. Each come with their own level of risk. Think about what stage in life and where you place yourself on the risk spectrum to make sure the investment vehicle is the right fit.

- **Low Risk-** Funds with lower returns, collateralized assets, and a high margin of safety. These investments will have less speculation and low-moderate returns. They may offer some level of liquidity. Usually return is lower than other levels due to the low risk.
- **Medium Risk -** Investment returns are consistent and may have upside. Pro forma reports should not have high levels of speculation or obstacles to receive projected return.
- **High Risk -** More attractive returns where your capital is often illiquid. Concentrate on very clear objectives from the management team and make sure you understand exactly how they aim to achieve this goal.
- **Ultra High Risk -** These exist in real estate but we see less of them in this industry and more in other sectors like tech and venture capital. Often comes with "win big or lose all". Proceed with caution and check with someone else outside of the sponsor team to see what they think about it before committing your capital.

Still Interested? You're ready to access deals and get to know sponsors.

Here is how it typically works:

As an LP who is looking for passive investments you typically subscribe to a GP's mailing list first in order to get access to deals. From here you're normally asked a series of questions so the GP can see if you are a good fit.

Questions the GP will likely ask:

- Are you an accredited investor (defined on final page)?
  - This is a requirement of most funds and regulated by the SEC.
- Have you participated in a passive investing fund or syndication before?
- How do you describe your risk tolerance as an investor?
- How much capital do you plan to invest in the next 6 months?

Note: GPs may not be able to proceed with you on a particular deal if you are not accredited based on strict requirements they adhere to with the SEC if their deal is a 506(c). Opportunities come along where an LP does not have to be accredited, but you won't see it as much.

GPs don't let any investor in their deal. Just as you should vet them, they will be vetting you at the same time to make sure you are a good fit. They want to know, like, and trust you as well since they are assessing you to be their partner.

Questions the LP should ask (in addition to "Vetting a Sponsor (GP)" on pg.1)**:**

- What is the GP's background?
- What does their team look like and what are their roles?
- Ask for sample performance reports from current syndications.
- Ask for references of other investors in their deals
- Ask yourself if you like and trust the GP. You need .to feel they are genuine otherwise it is not a wise decision.
- What is your **current** portfolio's actual results compared to pro forma?

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What to Expect Once You're on the Investor List

Standard Emails
- Deal Announcements
- Educational Content
- Investing Tips
- Deadlines

Deals Should Have:

1) One-Pager
Single page document showing deal summary.

2) Pitch Deck
Often called Offering Memorandum (OM) A detailed marketing overview of the opportunity.

3) Webinar
Live or recorded webinar explaining details of investment opportunity.

Learn More About the Market Where Opportunity is Located

Key Questions to Ask:

- What's the population and projected growth?
- What does demand look like for the product/opportunity offered?
- What are the employment sectors & does 1 employer make up >25% of the market?
- What is the average household income?
- Is the crime rate low or trending in the wrong direction?
- Is the area prone to natural disasters (think: insurance rates)?
  - Are there specific insurance needs as a result (wind, flood, fire, etc)?
- Is there a known environmental risk in the market?
- How many competitors are within a 3, 5, & 10-mile radius of the property?
- Where is income growth relative to home value growth?
- What do market vacancy rates look like in the asset class?

Most of this information is available online for free and the GP should have the info.

Evaluating the Property

Properties are often categorized into different classes based on their condition, age, and location:

- **Class A:** Luxury properties in prime locations, high-end tenants, lowest risk, but lowest returns.
- **Class B:** Well-maintained properties in desirable locations, moderate risk, stable tenants.
- **Class C:** Older properties with deferred maintenance, higher potential returns through value-add strategies, but more hands-on management.
- **Class D:** Distressed or high-risk properties, often in low-income areas, requiring significant renovations.

What's the Story of the Property?

Every property has a story and it's important to know.

- Why are they selling?
- Is it in distress? What major repairs are needed in year one?
- What is the business plan to meet pro forma expectations?
- Is there property management in place and will they be kept or replaced?
- Is there any unique opportunity that this property can capitalize on day 1 after closing?
- Is there a line item on the P&L that isn't obtainable with new ownership?
- What is the investment strategy and how do you plan to add value?

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Understanding Deal Structure

When investing passively, understanding how profits are shared is key:

- **LP/GP Split**: A common structure is 70/30, meaning LPs own 70% of the deal, and GPs own 30%. This ratio is used for profit sharing as well.
- **Preferred Return:** LPs typically receive a 6-10% preferred return first before GPs share in profits. This helps align interest of both parties.
- **Waterfall Structure:** Defines how profits are distributed at different return thresholds.
- **Hold Time**: Most syndications have a 3-10 year hold period before selling.This fluctuates based on the asset and the sponsor's vision. Targets should be identified in the offering.
  - Some operators like to buy and hold indefinitely. Their plan may be to refinance the property once stabilized, return the investor's initial capital contribution, and follow the LP/GP split moving forward.
    - Note: LP investor still retains their equity after a refinance.
- **Different Class Shares:** Deals will often have 1-3 share classes offering different terms and returns. These share classes are often chosen by investor's preference or investment amount. Better terms are standard with more capital invested.

How GPs are Compensated

- **Acquisition Fee:** 1-3% of purchase price typically paid to GP
- **Asset Management Fee:** 1-2% of gross rents.
- **Disposition Fee:** 0.5-1% of sale price paid to GP
- **Profit Splits:** They may share profits after LPs have received their preferred return..

Understanding Financials & Returns

- **Cash-on-Cash Return (CoC):** Annual return divided by initial investment.
- **Internal Rate of Return (IRR):** Measures return factoring in time value of money.
- **Equity Multiple:** Total return on investment (e.g., 2x means doubling money).
- **Debt Coverage Ratio (DCR):** Measures how much cash flow covers loan payments.
- **Exit Cap Rate:** Projected capitalization rate when selling the property. Compare to purchase cap rate.

Typical Return Metrics

Cash-on-Cash Return (CoC) - Annual return based on initial investment.

Internal Rate of Return (IRR) - Measures total return, factoring in time value of money. This is the most commonly used metric to analyze returns.

Average Annual Return (AAR) - Measures performance of investment over a period of time by averaging each yearly return over the life of investment.

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Legal & Underwriting Considerations

Understanding the legal framework ensures your investment is protected and aligned with your goals:

- **Private Placement Memorandum (PPM):** A legal disclosure outlining risks and fees.
  - This document should be very thorough and includes definitions, operating partners, operating agreements, investment returns, and other information specific to the deal.
- **Subscription Agreement:** Investor confirmation and commitment document.
  - This may be is included as part of the PPM.
- **Operating Agreement**: Defines roles, responsibilities, and profit splits.
  - This often is included as part of the PPM.
- **Loan-to-Value (LTV):** Debt financing ratio compared to property value.
- **Break-Even Occupancy:** Minimum occupancy required to cover costs.
- **Reserves:** Funds set aside to cover unexpected expenses.

Further Questions in Underwriting - Loan Specific

- What is the loan-to-value ratio?
- How is the loan-to-value being established?
- Is there additional capital expenditure budgeted in the projections?
- Is the completion of the capital expenditure included in the loan-to-value?
- What is the loan-to-cost?
- Is there preferred equity in the deal that would be senior to your investment?
- What is the loan-to-value, including any senior preferred equity?
- What is the duration of the loan term?
- Is there any pre-payment penalty? How much if so?
- Is the interest rate fixed or flexible?
- What is the amortization schedule?
- How long is the interest-only portion of the loan?
- Is the property projected to experience a refinance?
- What is the assumed loan-to-value at the time of refinance?
- What does the Net Operating Income (NOI) need to be for the refinance to be effectuated?
- Does it have an interest rate cap, what is the cost to extend it, and when does it expire?



Straightforward Investor Questions to Ask:

- How will I be taxed on this investment?
- When will I receive a K1 tax form? **The GP's team should provide this to you at no cost.**
- Do you have an investor dashboard/portal and what information can be found there?
- Is there a depreciation strategy I will benefit from (likely from a cost segregation study)?
- When should I expect distributions and what would it take to make those stop?
- Have you had a capital call before, and if so, why?
- Is my money illiquid? If so, how long should I anticipate it is tied up?

BIG ONE: Ask the GP for worst-case scenarios and make sure you are comfortable with the response.

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What Steps are Taken Once You're Ready to Move Forward

Submit a "Soft Commit/Reserve"
This is a non-binding form that expresses your interest & investment amount.

Make a formal offer
GP sends you legal docs (PPM)

Wire the funds
Funds get placed into escrow before investment gets formally placed.

You're now an LP on the deal!
Congrats partner! Access your investment through a online portal.

Final Thoughts: Passive real estate investing isn't just about returns—it's about building financial freedom, reducing tax burdens, and diversifying wealth. If you want to explore opportunities in real estate syndications, the first step is educating yourself, vetting strong operators, and making informed decisions.

21 Key Terms You Could Hear in Discussion

Accredited Investor - An individual or entity that meets financial criteria (e.g., $1M+ net worth excluding primary residence or $200K+ annual income for individuals, $300K for couples) required to invest in certain private securities, including syndications.
Acquisition Fee – A one-time fee (typically 1-3% of the purchase price) paid to the general partner (GP) for sourcing, analyzing, and securing the deal.
Asset Management Fee – An ongoing fee (usually 1-2% of collected revenue) paid to the GP for managing the investment, overseeing operations, and ensuring business plan execution.
Capital Expenditures (CapEx) – Large, non-recurring expenses (e.g., roof replacement, unit renovations) that improve a property's value and extend its useful life.
Capitalization Rate (Cap Rate) – A key valuation metric calculated as Net Operating Income (NOI) ÷ Property Price, indicating the expected return on investment.
Cash-on-Cash Return (CoC) – Measures annual cash flow as a percentage of the initial capital invested by LPs. Formula: Annual Cash Flow ÷ Initial Investment Amount.
Debt Service Coverage Ratio (DSCR) – A metric lenders use to assess risk, calculated as Net Operating Income ÷ Annual Debt Payments; a DSCR of 1.25+ is usually a minimum.
Fund of Funds Model - A fund of funds is a fund (a pool of money gathered through investors) that invests in other funds (which are bundles of investment assets). Benefits include exclusive investments that may have not otherwise been obtainable, leveraging the experience and track record of the sponsor, more personalized investor relations, and an added layer of due diligence. These are legally formed partnerships that operate under the same framework as the original fund. Fund of funds allow the sponsor of the investment to bring in more capital to secure an asset(s). Returns to the LP should be the same in a fund of funds model as they would be working directly with the sponsor.
Interest Rate Cap – A financial tool that limits how high a variable loan's interest rate can increase, protecting investors from excessive debt costs.
Loan-to-Value Ratio (LTV) – A metric showing loan size relative to property value. Formula: Loan Amount ÷ Property Value. Lower LTV means less leverage and lower risk.
Net Operating Income (NOI) – A property's total income minus operating expenses (excluding loan payments). Formula: Revenue – Operating Expenses. Even though loan payments are excluded, they're important, and must be part of financial underwriting.
Preferred Return (Pref) – The minimum annual return (e.g., 6-8%) LPs receive before the GP gets performance-based profits.
Ratio Utility Billing System (RUBS) – A cost-sharing method where landlords pass utility expenses (water, gas, electricity) to tenants based on usage estimates.
Rent Roll – A detailed breakdown of all occupied units, tenant lease terms, rents collected, and vacancies, showing a property's income potential.
Soft Commitment Form – A non-binding form LPs fill out to express interest in a syndication before making a formal investment.
Tax Benefits (Depreciation) – Investors can reduce taxable income by writing off depreciation, often through bonus depreciation or cost segregation studies.
Underwriting – The detailed financial analysis of a property's projected income, expenses, financing, and risk factors before acquisition.
Vacancy Rate – The percentage of unoccupied units in a property, impacting revenue projections and NOI calculations.
Waterfall Structure – Defines how profits are distributed between LPs and GPs, typically in tiers (e.g., Pref Return → GP Catch-up → Profit Splits).
Working Capital Reserve – Cash set aside for unexpected expenses, capital improvements, or short-term cash flow shortages.
Weighted Average Cost of Capital (WACC) – The overall cost of financing an investment, considering both debt (loans) and equity (LP capital) sources.

We hope this helped you in your investing journey!

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