THE COMPLETE GUIDE TO

REAL ESTATE SYNDICATIONS

FOR PASSIVE INVESTORS

NIGHTHAWK
EQUITY

WHAT IS A REAL ESTATE SYNDICATION?

A real estate syndication is where a group of people pool their resources to purchase real estate – often a large property like an apartment building - which would otherwise be difficult or impossible to achieve on their own.

One of the most famous syndications is the purchase of The Empire State Building, which was purchased by Helmsley & Malkin in 1961 for $65 million from 3,000 small investors, many of whom paid only $10,000 for a single share.

WHO'S INVOLVED IN A SYNDICATION?

A real estate syndication typically involves the "**general partners**" who organize the syndication, including finding the property, securing financing and managing the property; the general partners are sometimes referred to as the "sponsors" or "operators".

The group of people who provide the cash investment are often referred to as "passive investors" or "limited partners". In return for their investment, the limited partners receive an equity share in the syndication along with cash flow distributions and profits.

WHO CAN INVEST IN A REAL ESTATE SYNDICATION?

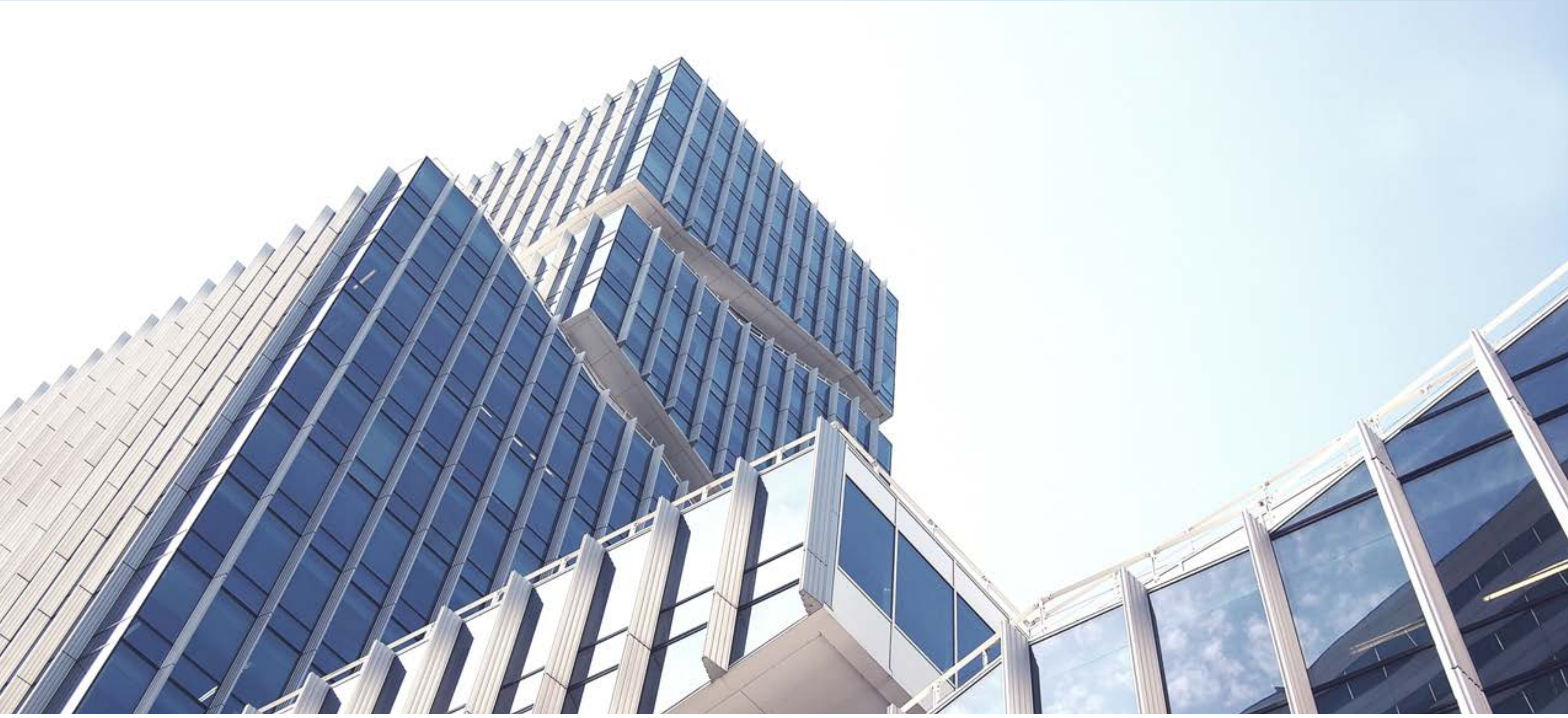
A real estate investment syndicate is typically open to "**accredited investors**". The Securities and Exchange Commission (SEC) defines an accredited investor as someone who has an annual income of $200,000 (or $300,000 joint income) or a net worth of at least $1M—not including your primary residence. Visit the SEC website for additional information and resources.

Some syndication offerings, such as the ones designed as "506(b)" offerings - are open to unaccredited investors. Many multifamily syndications are 506(b) offerings, which means they are open to unaccredited investors, but these investors have to be "sophisticated".

A **sophisticated investor** has enough knowledge and/or experience in investing in alternative investments such as real estate, oil, or precious metals. They may have made previous investments outside the stock market or perhaps they attended an investing seminar. Whether or not they have actual investing experience, the person has the ability to make an informed decision about a particular syndication offering.

Equally important to being "sophisticated", the investor needs to have a pre-existing "substantive relationship" with the deal sponsor (i.e. the partner or partners who are presenting the opportunity). While the SEC doesn't specifically define what "**substantive relationship**" means, it provided clues in this letter to a company called "Citizen VC".

When you become an investor with Nighthawk Equity you are taken through a "get to know you" process. These steps allow us to gather pertinent information such as: financial info and goals, risk tolerance, investment experience, etc.



Real estate syndications are more common for higher valued commercial real estate – such as multifamily, self-storage, mobile home parks, retail, office or light industrial – rather than for single family properties.

Of all of these types of commercial real estate, I recommend multifamily real estate for the following reasons.

WHY INVEST IN REAL ESTATE SYNDICATIONS?

There are **5 main reasons** investors might consider a real estate syndication over the stock market or other investments:

- **Below-Average Risk:** When the housing bubble popped in 2008, the delinquency rates on Freddie Mac single-family loans soared, hitting 4% in 2010. By contrast, delinquency on multifamily loans peaked at 0.4%. So, if you're looking for a recession-proof way to invest your money, there is no better option than apartment building investing.

- **Above Average Returns:** As I describe in the Special Report "What's the Best Investment: The Stock Market or Real Estate", the average stock market return over the last 15 years was 7.04% but after fees, inflation, and taxes that return becomes a paltry 2.5%. On the other hand, multifamily syndications routinely return average annual returns of 10% and above. That's compounded (i.e. without volatility) and after fees, inflation, and yes, even taxes.

- **Passive Income:** Unlike stocks and bonds, multifamily syndications generate cashflow for its investors from the income generated by the property.

- **Extraordinary Tax Benefits:** Because of the magic of "bonus depreciation", your investment income is taxed at a much lower rate than any other investment (in fact, you may actually show a taxable loss that can be used to offset other passive income!).

- **Inflation Hedge:** As inflation increases, so does the value of the property - the perfect hedge against inflation.With our current tax laws, investing in U.S.-based real estate syndications – especially multifamily apartment buildings - is the BEST passive investment on the planet.

There are a number of advantages to putting your money in a multifamily syndication, but every investment comes with risk—and don't let anyone tell you otherwise! Understanding the potential downsides to investing in apartments will help you make the best possible choices and ultimately mitigate the risks, putting you on a sweet little road trip to financial freedom.

Here are the 5 risks and disadvantages of investing in syndications:

- Sensitive to Market Cycle
- Highly dependent on the Operator
- Lack of liquidity
- Lack of control
- Harder to understand than investing in stocks

SENSITIVE TO MARKET CYCLE

Like any investment, real estate is affected by market cycles. You can mitigate this risk by investing in real estate like apartment buildings, which has historically performed better than other real estate types. Also stay away from the west coast and New England, where strong up and down cycles are likely to impact your investment. That's why we tend to invest in more stable areas like the South.

HIGHLY DEPENDENT ON THE OPERATOR

Having the right team in place to run a property is also crucial to the performance of multifamily. If you are dealing with an inexperienced or incompetent operator, they are liable to make mistakes. Mistakes that can cost you a lot of money. To mitigate the risk, ensure that you invest with the RIGHT sponsor (we'll cover how to do this later on).

LACK OF LIQUIDITY

Arguably the biggest disadvantage of investing in syndications is that your money is tied up for 5 years or more. You can't just call up your broker and sell your position. On the other hand, many syndications can refinance before the end of the term and return part or all of your investment. And in the meantime, you're hopefully getting cashflow, so you're getting part of your money back!

LACK OF CONTROL

Not only is your money tied up for years, but you also don't control the investment itself – your operator does. They make all of the day to day decisions but they also decide when to refinance or sell. If you're a control freak, this may be an issue for you. On the other hand, that's also the benefit of being a passive investor: you don't have to do anything just leave it up to your trusted operator! And consider this: how much control do you really have over the stock market? Just saying 😊

HARDER TO UNDERSTAND THAN INVESTING IN STOCKS

It may seem that understanding an alternative investment like a real estate syndication is hard to; and yes – there is a learning curve. But, who really understands the stock market? While most investors should try to understand the stock market, most don't take the time and turn their hard-earned savings over to a financial advisor. The difference here is that you should spend time finding an operator you can trust and then invest with that operator over and over again.

Despite these risks, after studying every other possible alternative, I've come to the definitive conclusion that investing in multifamily syndications is the best investment on the planet. No other investment performed so well in the last recession, offers above average returns (including cashflow), extraordinary (and legal) tax loopholes and provides a built-in hedge against inflation.

HOW ARE SYNDICATIONS STRUCTURED?

Potential investors have lots of questions about how multifamily deals are structured, and rightfully so.

If you're trusting us with your hard-earned money, it's only fair that you understand your rights as a limited partner, the fees you may be asked to pay, and the timeline around getting your money back.

Here the 6 main components of the structure of a multifamily deal:

- The Entity
- Equity Splits
- Preferred Returns
- Control and Voting Rights
- Return of Principal
- Sponsor Fees

Let's dive into each of these in more detail.

THE LEGAL ENTITY

The legal entity we use to structure multifamily syndication deals is the **limited liability company** or LLC.

Sometimes we create multiple entities—a **holding company** registered in Texas or Delaware and a **local entity** in the state where the property is located. The local entity owns the building itself, and the holding company owns the local LLC.

EQUITY SPLITS

Equity splits vary, however, both 70/30 and 80/20 are common. For instance in a 70/30, the **limited partners (LPs) get 70%** of the ownership, while the **general partners (GPs) receive 30%.**

The operator earns this portion of the equity known as **carried interest** for putting the deal together, even though the investors put up 100% of the money.

My advice is to **focus less on the split and more on the returns**, specifically the cash-on-cash (CoC) and average annual return (AAR). If you have a good quality multifamily deal, a strong operator, conservative underwriting and a 15+% AAR, that's much more important than the equity split.

PREFERRED RETURNS

Some multifamily syndications offer something called a "**preferred return**", which means a certain **minimum** is paid out to the investors **before** the general partner is paid.

One way to think of it is like an interest payment, which is paid out first before the leftover cash flow is split based on the equity arrangement.

Let's do a quick example.

Let's assume a particular syndication gives investors 70% equity and the operators retain the remaining 30% as carried interest.

Let's further assume that the total cash investment from the investors is $100,000 and that the preferred return is 5%. That means that the first $5,000 of any available cash flow that year is paid out to the investors first, and the rest is split 70/30.

If the annual available cash flow is $15,000, the first $5,000 is paid to the investors, leaving a net of $10,000. Of this remaining cash flow, the investors would receive 70% or $7,000.

PREFERRED RETURNS (CONTINUED)

In summary, the investors are paid $5,000 from the preferred return and another $7,000 per the equity split, **for a total of $12,000**—a 12% cash on cash return.

Pretty good, right?

Not so fast.

CHALLENGES WITH PREFERRED RETURNS

The problem with preferred returns is when a project **doesn't go as planned** for whatever reason. Maybe the operator is unable to execute on the original business plan, or it takes longer than planned, or there is a market correction.

Regardless of the reason, let's assume that the available cash flow to be distributed is **less** than the preferred return. In that case, the preferred return accrues to the following year.

Now imagine that the situation doesn't substantially improve, and the general partners fall short of next year's preferred return and that accrues to the year after that.

If this goes on for too long, the general partners realize they can **never catch up to the preferred return.** At that point they may stop trying to turn the property around, or they may force a premature sale to get paid something—but neither scenario is actually good for the investors.

It's my opinion that a **preferred return does not put the general partners and the limited partners on the same page.** That's why we have never offered a preferred return to our investors. They are fine with this arrangement because they get paid when we get paid and vice versa. If there is no cash flow, no one gets paid.

We're now perfectly aligned, and that's the way it should be.

OK, let me get off my soap box :) and let's talk about how control and voting rights are handled.

CONTROL AND VOTING RIGHTS

The nature of being an LP is that you are limited, **both in liability and control.** Limited liability means you can only lose the principle you invested in the multifamily deal, and you are protected by the SEC in the case of a lawsuit or a loss of the building.

Typically, LPs have **no real involvement in the day-to-day operations** of the multifamily property and all decisions are made by the GP.

LPs almost always have the opportunity to vote on anything that may reduce their rights in any way. And sometimes they can vote over a refinance or sale. The **Operating Agreement breaks down the rights of the LPs and GPs**, so be sure to read it carefully.

RETURN OF PRINCIPAL

So, HOW and WHEN do you get your principal back?

Through one of two **liquidity events:**

- **Refinance**
- **Sale**

For example, we bought a 321-unit multifamily property in Memphis for $7M and put $1M into it. 13 months later, we refinanced the property and got a $15M valuation! This means the investors got 84% of their initial investment back.

The beauty of this is that the majority of your risk is off the table AND you can invest that money in another deal—while you **continue to earn returns on the initial investment.**

The business plan for a multifamily deal outlines the hold period, and a good operator will honor that commitment. Under normal circumstances, the plan is to **hold the property for five to seven years**—unless a market correction takes place. And if the operator is going to change the business plan, they should poll the LPs for input.

SPONSOR FEES

There are five possible fees you may be asked to cover as an LP in a multifamily deal:

- Acquisition Fees
- Asset Management Fees
- Capital Transaction Fee
- Disposition Fees

Acquisition fees are the **most common**. Payable to the GP **at closing**, this fee is usually 2-3% of the purchase price.

Asset management fees are typically 1½% of the **gross collected rents**. GPs use this money to cover their overhead for managing the property.

Though it is less common, it is not unheard of to be charged a capital transaction fee. Set at approximately 1%, this fee is due should a **cash out refi return 100% of the purchase price**. While we don't charge these fees, some other groups do.

The final fee you might be asked to pay is known as a disposition. This fee is a small percentage of the sale price, and it is collected when a multifamily **property is sold**.

Again, don't get too bent out of shape about fees. Operators DO have overhead, and we use these fees to cover our costs. The only real money we make is on equity when we raise the value of the property.

Now You Know How Multifamily Deals Are Structured.

OK, that was a lot, but it wasn't that bad, right?

Now you know everything about how real estate syndications are structured, what some of the terms mean, and what to expect.

WHAT IS THE INVESTMENT PROCESS?

Before I get into the process, I'm going to assume that you've decided you want to invest in a multifamily syndication opportunity with a specific deal sponsor.

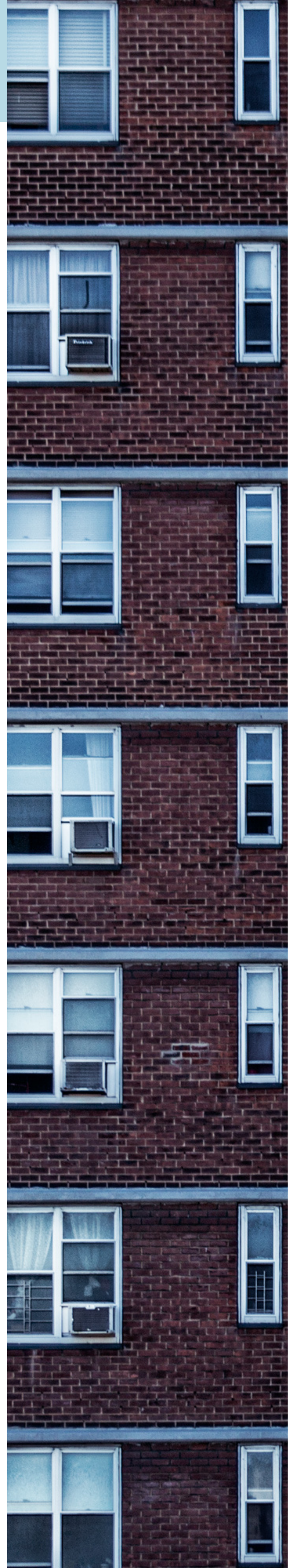
(If you're still on the fence, check out my special report called "*What's the Better Investment: The Stock Market or Real Estate*" - you might find this helpful).

I'm also going to assume that you have a "**substantive relationship**" with whatever sponsor you intend to invest with.

While the SEC doesn't specifically define what "substantive relationship" means, it provided clues in this letter. In short, the better you know the deal sponsor, the better they know you, and the more interaction you've had, the stronger you can make a case you have a "**substantive relationship**" and the more likely you'll be invited to invest in the opportunity.

(If you'd like to establish a substantive relationship with us, please join our Nighthawk Investor Club. You'll be asked to fill out a short questionnaire and schedule a phone call with our Nighthawk team so that we can get to know each other a bit more. We can then present you with an upcoming opportunity.)

Assuming you're ready to go and your sponsor has a live investment opportunity, here is generally what happens next.



These are the 8 steps that make up the investment process:

- Learn About the Opportunity
- Express Interest via a "Soft Commit"
- Register on the Investor Portal
- Satisfy the Minimum Requirements
- Make a Formal Investment Offer
- Review and Sign the Legal Documents
- Wire the Money into the Escrow Account
- Wait Until Closing

STEP #1: LEARN ABOUT THE OPPORTUNITY

The best way to learn about multifamily investment opportunities is to **get on the syndicator's email list**. If you've joined the Nighthawk Investor Club, you're good to go.

We send out regular emails with educational content. And when a multifamily deal comes through, we forward an Executive Summary and set up a **live webinar to present the opportunity**--and give you the chance to ask questions.

STEP #2: EXPRESS INTEREST VIA A "SOFT COMMIT"

If you're interested in the opportunity, the next step is to fill out a short form telling us **how much you'd like to invest** in the multifamily syndication. (The minimum is usually $75k-100k.)

The "soft commit" doesn't put you on the hook yet, but it does give us an idea of who we can expect to invest in the syndication deal. And the **"soft commit" window** typically stays open for a couple **days after the live webinar**. So, if you want in, act fast!

STEP #3: REGISTER ON THE INVESTOR PORTAL

If you haven't already registered on the Nighthawk Investor Portal, you will then fill out an **online form** to get a **username and password**. The Portal allows us to communicate with you securely through the rest of the process.

STEP #4: SATISFY THE MINIMUM REQUIREMENTS

Next, we double check that you are either an **accredited or sophisticated investor**. (You will find a detailed explanation of the difference on my video blog '*Who Can Invest in Multifamily Syndications?*')

If you're not accredited, and we don't know you very well yet, we may ask you to hold off until the next syndication. Remember, **SEC guidelines require a "substantive relationship"** between the passive investor and the syndicator.

STEP #5: MAKE A FORMAL INVESTMENT "OFFER"

Those who raised their hand with a "**soft commit**" now have the chance to let us know they are serious. At this point, you **promise a specific amount of money** to the multifamily syndication deal.

We usually give prospective investors a day or two **(after the "soft commit" window has closed)** to make this formal offer. But remember, it's all on a **first-come, first-served basis.**

These are the 8 steps that make up the investment process:

- Learn About the Opportunity
- Express Interest via a "Soft Commit"
- Register on the Investor Portal
- Satisfy the Minimum Requirements
- Make a Formal Investment Offer
- **Review and Sign the Legal Documents**
- **Wire the Money into the Escrow Account**
- **Wait Until Closing**

STEP #6: REVIEW AND SIGN THE LEGAL DOCUMENTS

At this point, you will receive the **operating agreement**, a document outlining the **parameters of the partnership.** It breaks down the role of the General Partners (GPs) and Limited Partners (LPs), explaining who is responsible for what decisions. The operating agreement also covers profits and splits.

Once you looked through the legal documents, you **sign them online** via DocuSign.

STEP #7: WIRE THE MONEY INTO THE ESCROW ACCOUNT

Once you've signed on the dotted line, you receive the **wiring information** and **send your funds to the escrow attorney**. Congratulations, you are an LP in a multifamily syndication deal!

Don't forget, a multifamily syndication is a limited time offer. We can't hold your spot if you don't wire your money. (And if you send money after the deal is full, we'll wire it back to you.)

STEP #8: WAIT UNTIL CLOSING

Now, you sit back and relax. And wait for the syndication deal to close. This usually takes between **30 and 45 days**, depending on the deal.

We typically do a **live webinar at closing** and monthly updates moving forward.

SHOULD YOU CHOOSE TO INVEST WITH US AT NIGHTHAWK EQUITY, OUR PROCESS IS AS FOLLOWS:

1. We notify investors of new opportunities and invite you to a conference call to learn the details. (If you are unable to attend, simply wait for the audio file that send the following day.)

2. Pending the opportunity meets your criteria, you make a verbal commitment to the deal.

3. From there, you sign the necessary documents to verify your commitment:

- Private Placement Memorandum outlining the deal's structure and risks
- Operating Agreement covering the GP and LPs responsibilities and ownership ratios
- Subscription Agreement (summarizing the number of shares you own in the LLC set up as owner of the apartments)
- Accredited Investor Qualifier Form (if applicable)
- Direct Deposit form to receive your distributions automatically

4. Once you've completed the necessary paperwork to substantiate your commitment, simply wait for us to close the deal!

Other GPs may have a different system, so be sure to ask what's involved in their process and what your responsibilities would be as a passive investor.

WHAT TO EXPECT AFTER CLOSING

You now understand the investment process from the time you're presented with an investment opportunity until it closes.

But what happens then?

Here's what you can expect after a deal closes when you invest with most operators (including with our investment company "Nighthawk Equity").

REGULAR UPDATES

Once per month, you should expect to receive an email from your operator with a narrative of what happened in the last 30 days. **The narrative will include** some of the following information:

- What kind of renovations were done
- What the occupancy and collections were; if it improved, why did it improve; if lower, why was it lower and what is being done about it
- Were the expenses in line with projections?
- Is the business plan on track or if not, why not and what is being done about it.
- If a distribution is being made along with the update, what is that distribution and how does that compare to the projected returns.
- Anything else that is newsworthy about the property and the market in general

We've found that this narrative satisfies **most passive investors**. For those who want more, **we can provide more documents** such as the Profit and Loss (P&L) statement (including an actual vs. projected analysis), balance sheet, and rent roll.

Once a property has "stabilized" (i.e. it has achieved it targeted net operating income), things get "boring" and most investors stop reading the reports (as long as the distribution checks still keep coming!). That's why many operators reduce the reporting frequency from monthly to quarterly.

TRANSPARENCY AND ACCESSIBILITY

If you're ever interested in any other information that is not provided with the monthly updates, you should be able to ask for additional documentation and receive it promptly.

In addition, your operator **should be readily available** via email or phone in case you have any questions or concerns.

DISTRIBUTIONS

The fun part of passive investing is receiving the cash flow distribution checks!

Often the first distribution is delayed for two quarters after the deal closes to give the operator some time to see how the property performs and deal with any unexpected issues after the closing. **A good operator always has enough cash on hand for any emergencies!**

Once any issues have been identified and dealt with and the cash flow has become more predictable, the operator can begin paying out distributions.

Many operators send out the distributions quarterly via ACH (and some do this monthly).

A good operator will escrow funds from cash flow to fund periodic expenses such as real estate taxes and insurance. **This is how the amount of distributions is determined:**

Bank Balance
- Escrowed Funds (i.e. Taxes, Insurance, etc)
- Funds for Capital Improvements
- Reserves (typically $250 per unit per year)
- Asset Management Fees to the General Partners

= Funds Available for Distribution

Once the funds available for distribution are determined, they are distributed per the terms of the Operating Agreement.

ANNUAL REPORT AND TAX DOCUMENTS

After the books are closed on a year, a good operator will send out an annual report as well as the K-1 tax documents.

The annual report should provide a narrative of how the project performed versus what was projected, and if not, why not and what is being done about it.

It should provide ProForma projections for the new year along with the plan to achieve those projections.

Finally, it should provide the complete P&L and Balance Sheets (or be available upon request).

Even though tax time is always stressful for the operator and their CPAs, a good operator will send out the K-1 no later than the end of March to give investors enough time to file their own taxes.

CONCLUSION

How an operator communicates with their investors says a lot about them and how they do business. Good operators communicate regularly with their investors, provides additional information when requested, and is always available for questions.

I'd like to think that we at "Nighthawk Equity" are one of those "good" operators, and we'd love to talk with you. Head over to www.nighthawkequity.com and check out our investment club to hear about upcoming deals.

If you're looking for a strong operator, I invite you to join our Nighthawk Investor Club. You'll be asked to fill out a short questionnaire and schedule a phone call with our Nighthawk team so that we can get to know each other a bit more. We can then present you with an upcoming opportunity.

While it can take a while to find and trust an operator, once you do, you can continue investing with them for years. At that point, **passive investing becomes truly passive and FUN!**

HOW (AND WHEN) ARE PASSIVE INVESTORS PAID?

The beautiful thing about passive investing in multifamily syndications is that you receive cash flow, get your principal back and make a return.

But when do you get paid and how much can you expect?

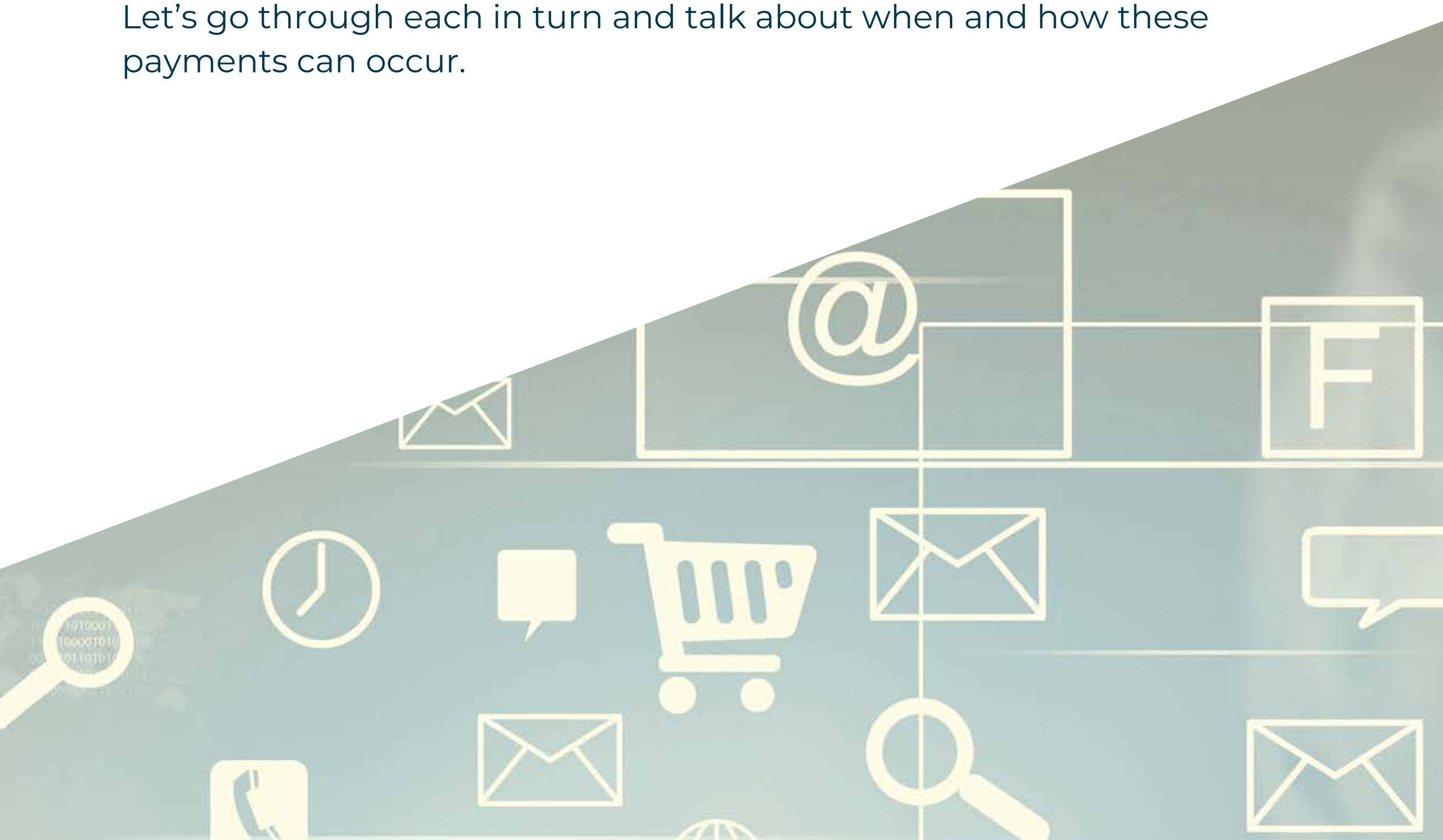
In this section, I'm going to explain when and how often passive investors get paid and how much you can expect to earn.

You'll understand the ins and outs of a cash out refinance and learn how passive investors can redeploy that money for infinite returns!

As a passive investor in a multifamily syndication, there are 3 ways you can get paid:

- Cash flow distributions
- Cash out refinance
- Sale of property

Let's go through each in turn and talk about when and how these payments can occur.



CASH FLOW DISTRIBUTIONS

When your multifamily investment property earns a profit, so do you!

The frequency varies by project and operator, but **most passive investors get paid quarterly.**

One thing to keep in mind: **Your first cash flow distribution may be delayed depending on the type of project.**

If you're passive investing in a **stable value-add deal** or a **heavy value-add deal**, it generally takes **6 to 12 months** for your cashflow to arrive.

This timeline depends upon the performance of the property.

In other words, your syndicator may need time to make some basic improvements and raise occupancy before the first cash flow distributions can be delivered. Make sure you account this pause in receiving immediate cashflow.

(To learn more about earning cash flow distributions as a passive investor, watch my video on *The Potential Returns of Multifamily Real Estate!*)

CASH-ON-CASH RETURNS

A related term you need to know is cash-on-cash (CoC) return. Let's say you made a passive investment of $100K, and you earn $7K in annual cash flow distribution.

The CoC return is calculated by taking the **initial investment divided by your cash flow distribution**:

7k/100k = 7% CoC return

At Nighthawk Equity, we shoot for **CoC returns between 7% and 9%** upon stabilization of the property. And we work to hit that target no later than Year 2.

Another cool thing to remember here is that **adding value to the building will grow your CoC return.** As the operator renovates and increases the money coming in, your cash flow distribution checks get bigger too!

Passive investors get another (much bigger) pay day in the case of a cash-out refinance. If you **invest in a value-add deal** and the syndicator's team does their job, **the building's net operating income will increase** over time.

Then, they can **refinance the property at a higher valuation** (it's worth a lot more now that it's earning more!). Now the operator can **pay off the loan** and **give their passive investors a big chunk of their principal back.** And hold the property to continue bringing in cash flow.

Here's an example of how this works: We syndicated a 321-unit deal in Memphis called Countryview. We **purchased the deal for $6.8M and made $1M in capital improvements.**

Now listen to this... **We recently refinanced the property, and it was valued at $15M!** This allowed us to return 84% of investors' principal—and they continue owning 80% of the asset.

When you think about it, this is a pretty awesome scenario. Our passive investors got most of their initial investment back (which reduces their risk). They are now free to **redeploy that money in a new multifamily syndication.** But they **still own equity in the original deal!**

This leads to what we call **infinite returns.** Passive investors are still getting cash flow distribution checks based on their initial investment in Countryview. But they have a huge portion of that original investment back—and available to invest in a new deal for another similar payout!

SALE OF THE PROPERTY

Last but not least, passive investors get paid when a property is sold. The syndicator repays the loan first and returns your principal investment. And then, **profits from the sale are split by equity.**

At Nighthawk, we plan to return the investors initial capital when the property is sold 5-7 years after purchase (or some portion earlier if a refinance is possible).

SHOW ME THE MONEY!

So, when do passive investors get paid for putting their money in a multifamily syndication?

- You earn **regular cash flow distributions** quarterly
- You get a bigger pay day after a **cash-out refinance OR sale of the property**

If you're still unsure about investing in multifamily syndications, check out my special report called "*What's the Better Investment: The Stock Market or Real Estate*". It might open your eyes about the true returns of the stock market and the absolutely amazing opportunity we have with real estate syndications.

If you're ready to take the next step, and you want to invest in one of our upcoming multifamily investment opportunities, please join our Nighthawk Investor Club. You'll be asked to fill out a short questionnaire and schedule a phone call with our Nighthawk team so that we can get to know each other a bit more. We can then present you with an upcoming opportunity.

WHAT MONEY SOURCES CAN BE USED TO INVEST IN A SYNDICATION?

Don't have money in the bank to invest in multifamily? Don't count yourself out! There are several ways to access capital for real estate deals.

There are different money sources you can use to invest in real estate syndications!

For example, you can convert your stocks and bonds into cash for a multifamily deal or open a line of credit. You can use a portion of your retirement account for passive investing. Let's explore the different money sources you can use to invest in syndications. Now, I am not a financial advisor, CPA, or attorney, and we are not giving you advice here based on your personal situation.

CASH SAVINGS

The easiest way to invest in real estate syndications is with cash. Of the possible sources of capital, it is the most liquid—meaning it is readily available and can be quickly wired to the syndicator you are working with.

STOCKS & BONDS

Another source of funds for real estate syndications is stocks and bonds. You can **sell a portion of your mutual funds or ETFs** for cash and put that money in a multifamily deal.

Of course, you will have to call your broker and have a conversation about why you want to sell. And while I don't recommend pulling ALL of the money from your current investments in stock and bonds, it makes a lot of sense to use a portion of it to add multifamily to your portfolio.

As I've said before, there is **no better investment in the world than apartment buildings.** Nothing else affords you the cash flow, above-average returns AND the extraordinary tax benefits of real estate syndications.

LINES OF CREDIT

Yet another way to access funds involves opening a line of credit. If you have **equity in your home**, for example, you can **get a loan at a relatively low interest rate** and use that money to invest in real estate syndications.

Do be careful, though. It's important that you invest in a multifamily deal with a fairly high return in order to bridge the gap.

SELF-DIRECTED IRA

If you have a **retirement account**, you can **use a portion of that money to invest in real estate syndications** too! Here's how it works:

1. Open an account with a self-directed IRA custodian.

2. Write a letter to the administrator of your existing account, asking them to move a certain amount of money to the new self-directed IRA.

3. When you're ready to invest in a real estate syndication, instruct the custodian of your self-directed IRA to wire the money to the appropriate closing attorney.

4. Congratulations, your self-directed IRA now holds a share in the LLC of that particular real estate syndication!

There are some **limitations** that come with investing through a self-directed IRA. The law requires you receive no direct or indirect benefit from the investment. In other words, you can't touch the money and **cash flow distribution checks must be deposited directly to the IRA.**

Let's take a look at how to choose the right custodian, the processes involved, and the pros and cons of this strategy.

The thing people don't realize is that just by having a self-directed IRA doesn't mean you can use it for real estate investing. A self-directed IRA requires an IRA custodian. Normally, it's a financial institution (like Schwab or Fidelity) that sets up and manages the account so that it abides by the US tax codes.

But if you call your custodian and start asking questions, you might find that you can't actually use these funds to invest in real estate assets. They'll call it a self-directed IRA, but you can only direct it in things like Wall Street. Obviously, you'll need to find a new provider that will allow for real estate investment. And even then, they're not all created equal.

From our experience at Nighthawk, we've found some of these self-directed IRAs are easier to work with than others. Some will allow for real estate, but not for syndications. Others only take paper checks, which we've made a rule to avoid. When we conduct distributions, we actually require a group to take electronic deposits (ACH/Wire). So, if your IRA custodian insists on paper checks, know that you will not be able to invest with us and certainly with other groups.

Another thing to consider is how quickly the custodian can execute documents. The tax code requires an arms-length transaction to happen, and one of the things that involves is the custodian must sign for every transaction on your IRA. While it might be the "Michael Blank IRA" it's really its own separate entity, if you will.

Every time you have a document that needs to be signed, like an operating agreement for example, there's a process for submission. If your custodian insists on receiving a paper document with a wet signature instead of accepting a DocuSign, it will put a delay on the deal.

In all, there are certain things you want to do when looking for a custodian of your self-directed IRA. First, just start a conversation with them and learn how they operate. Second, whether it's Nighthawk or another investment group, ask their opinion about the custodian.

MOVING YOUR IRA TO A NEW CUSTODIAN

Once you've found a custodian for your self-directed IRA, there's a series of paperwork that you'll fill out. The new custodian will then get in touch with your current custodian to process the money transfer, which may take a couple of weeks. It's different for each group, but it's a more involved process than you might expect.

That's why the best time to make a change is before there's an active deal present. You want to put yourself in a ready position, especially in today's environment where deals happen pretty fast. At Nighthawk, our deals typically fill up in just a few days after we start, and we like to move quickly.

THE PROS AND CONS

Like any investment strategy, there are pros and cons.

The main advantage of using a self-directed IRA to invest in syndicated real estate deals is the return. Many people have a lot of money wrapped up in an IRA account that's earning only 1-2% a year. So that makes investing with an IRA very, very powerful.

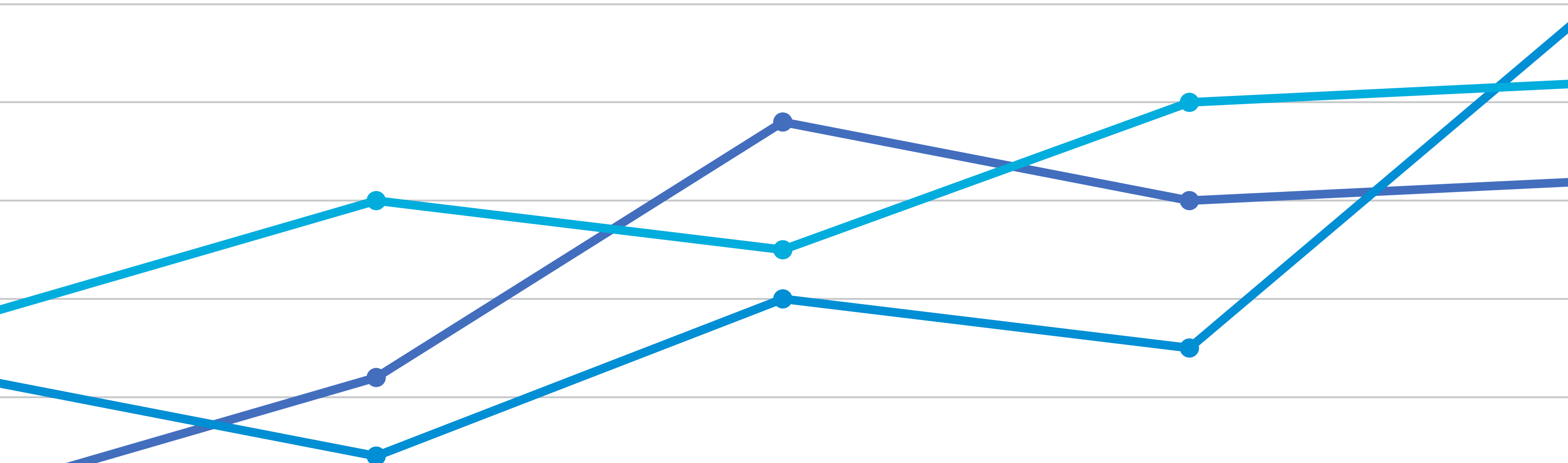
The con is that you may actually have to pay taxes on your IRA. There is something called the UBIT (Unrelated Business Income Tax) which usually affects investments that have some kind of debt associated with it. And of course, all multifamily syndications have debt. That's beautiful, but the tax law doesn't think so, right? This tax law makes you pay income tax on any portion of income that's derived from debt.

For example, let's say you're using a mortgage to fund 80% of a multifamily apartment deal. This is a debt, which means that 80% of any profits you make are taxed at your current tax bracket. This is triggered when we sell, and will now be a taxable event in your IRA. And if you didn't create a tax ID for your IRA prior to getting it set up, you may have to pay a penalty and interest when you CPA files your returns.

I've gone through this myself and it's a real nightmare. But I now know how to properly set these things up from the start, and I think it's a great way to get started. The good news is there's a solution for the headaches I experienced. It’s a different kind of 401k called a Solo 401k.

THE BOTTOM LINE

- You can use retirement funds within a self-directed IRA to invest in real estate, with the main advantage being an increase in your average annual return.
- The key is to find a custodian that understands the tax code, will allow you to invest specifically in syndicated real estate deals, is setup to allow for electronic money transfers, and works swiftly to execute documents on your behalf.
- Don’t wait until you have an active deal to transfer your funds. Start the process now so you are in the ready position, and be sure to ask the opinion of groups like ours about the custodians you are vetting.
- Be aware that there may be serious tax implications in this strategy, unless you set yourself up correctly.



The one **problem** with investing through a **self-directed IRA**? There's **a good chance you will get taxed** on the money you earn from a real estate syndication.

I know this is hard to believe since you're investing with your retirement fund, and theoretically your taxes are **deferred.**

But when investing in something that uses **debt** (like real estate), there's this pesky called **the Unrelated Business Income Tax (UBIT)** that you have to pay when the real estate is sold.

So, what's the alternative? Well, there's this little thing called the Qualified Retirement Plan or QRP—and it just happens to be **exempt from UBIT taxes** IRA investors are subject to when an asset sells.

Full disclosure, it does cost more to set up a QRP trust up front, but it has benefits beyond avoiding the UBIT tax:

- You **don't need a custodian** to sign your paperwork. You do that yourself!
- You can **borrow up to $50K** from the trust without penalty.

To learn more about how the QRP works, get a free copy of Damion's book, *How to Get Checkbook Control of Your 401(k) & IRA Money Now*.

SO, WHAT'S BEST?

If you have access to several different sources of capital, cash is best—simply because it’s the easiest to deploy.

Multifamily deals move quickly, and once an opportunity is announced, **syndicators take investors on a first come, first served basis.** If you have cash, you can get into a deal quickly and wire the money right away.

Investors using a self-directed IRA are at a slight disadvantage because it does take a few days to complete the paperwork and get your custodian to wire the money.

Conclusion -

So, what are the different money sources you might use to invest in real estate syndications?

- Cash
- Stocks & Bonds
- Lines of Credit
- Self-Directed IRA
- QRP

Explore all the available options. Beyond cash savings, there are many different ways to invest in real estate syndications!

If you've made the decision to put your money in multifamily as a passive investor, there are a number of questions you should ask any syndicator who's pitching a deal so that you can properly

- Vet the integrity of the sponsor and their team,
- See if their overall investment strategy fits with your goals,
- Fully understand the specific investment they are raising money for, and
- Learn more about the market where a potential investment is located.

In a perfect world, the answers to most of these questions will be found on the GP's website and/or in their offer package. In fact, I would hesitate to invest with a team that doesn't provide the vast majority of this information up front. But use this section as a guide to help you understand what additional questions you may need to ask and how to make an informed investment decision.

Vetting the Sponsor Team

Here are the questions to ask your sponsors and some of the answers to look for:

- What is your track record?
- Why should I invest with your company? *What differentiates you from the other apartment syndicators?*
- Who's on your team?
- Do you use the same property management company for all of your properties?
- Who is my point person?
- Have you ever been sued?
- How many of your investors have invested in multiple assets with you?

WHAT IS YOUR TRACK RECORD?

Find out how many deals the GP has completed AND how they performed in comparison to projected returns.

Underperforming compared to projections is not necessarily a deal breaker, but the syndicator should be able to speak to the processes they've put in place to reduce the chances of it happening again! Ideally, you want to work with a syndication team that has dealt with challenges and come out on the other side.

Be cautious if the GP has acquired and managed a deal but not yet finalized a business plan through to the exit (i.e.: refinance and/or sale of the property).

Also be cautious of a GP who has not had to deal with a challenging project or situation.

It's important in my opinion to invest with a seasoned team who's been through hardships. Maybe they've been through the great recession or they had another major business challenge.

These are the people I prefer to invest with because they tend to remain calm and stick with solving the problem during tough times or in difficult situations.

WHY SHOULD I INVEST WITH YOUR COMPANY?

What differentiates you from other apartment syndicators?

The passive investors who choose to invest with us at Nighthawk Equity do so because of our conservative approach, transparency and trustworthiness.

Unlike some other sponsors, we're conservative when we underwrite deals to protect our investors from any type of market correction. We have plenty of reserves at closing and grow that reserve while we hold the property. We always buy for cash flow from day one and use long-term debt to ride out a recession if necessary, and we're projecting higher interest rates (and lower values) when it's time to sell.

We are transparent, sending investors progress reports around the status of our business plan on a monthly basis. We also make ourselves available to our passive investors, responding to email within a few hours if at all possible.

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- **Who's on your team?**
- **Do you use the same property management company for all of your properties?**
- Who is my point person?
- Have you ever been sued?
- Do you have friends or family members who invest with you?
- How many of your investors have invested in multiple assets with you?

We also align our interests with our passive investors. Each Nighthawk GP invests a significant amount of capital in each deal. We become investors alongside our passive investors which helps to achieve alignment of interests.

Finally, we build trust with our passive investor community by way of an educational platform. I host a weekly apartment building investing podcast, and prospective investors tend to feel like they already know me through the podcast—or because they've read my book, *Financial Freedom with Real Estate Investing*.

And I've created this resource to help you make better decisions about investing in multifamily syndications!

The reasons why you trust one GP with your money over another is, of course, based on your personal preferences, so look for one who aligns with your goals and makes you feel comfortable.

WHO'S ON YOUR TEAM?

Having the right team in place to run a property is crucial to the performance of multifamily. If you are dealing with an inexperienced or incompetent operator, they are liable to make mistakes. Mistakes that can cost you a lot of money.

To mitigate the risk, learn about the background and experience of the real estate attorney, mortgage lender and CPA the sponsor works with.

Most importantly, ensure that their property manager has a strong track record. How many units do they manage?

How long have they been in business? Has the GP worked with them before?

Do they have tenant screening systems in place? What is their policy around routine maintenance and inspections? How well do they communicate with renters and ownership?

The property management team plays a fundamental role in finding the right tenants and maintaining the property—which translates to consistent cash flow and the ultimate success of your investment.

Vetting the Sponsor Team

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- Do you use the same property management company for all of your properties?
- Who is my point person?
- Have you ever been sued?
- How many of your investors have invested in multiple assets with you?

DO YOU USE THE SAME PROPERTY MANAGEMENT COMPANY FOR ALL YOUR PROPERTIES?

The benefit to GPs who work with a single management company is that processes are streamlined and reporting is consistent.

On the other hand, a GP may need to use more than one property management company if they source deals in multiple markets. If this is the case, ask if they are using a single **asset manager** across all of their properties and get to know that individual's experience and track record.

WHO IS MY POINT PERSON?

You should have a point of contact in the general partnership to reach out to with questions or concerns. Best case, they are an experienced team member who is actively involved in the deal.

HAVE YOU EVER BEEN SUED?

Although you have limited liability as a passive investor, a settlement or fine can have an impact on your returns. If the GP has been sued, find out why and what happened.

Again, this isn't necessarily a deal breaker, but a deal sponsor who's been through a lawsuit should have implemented policies to minimize the risk of it happening again.

HOW MANY OF YOUR INVESTORS HAVE INVESTED IN MULTIPLE ASSETS WITH YOU?

The GP's retention rate is a good indication of their ability to meet or exceed expected returns.

We also recommend contacting several of the GP's references to get a feel for their reputation in the community.

Evaluating the Sponsor's Investment Strategy

Questions to ask:

- How do you source deals?
- What is your reporting or communication schedule?
- Can you guarantee a return?
- What is your policy for establishing reserves to cover potential shortfalls? *How much capital are you setting aside for reserves each year?*
- How do you make money on a deal?
- What will you do to protect me from a market downturn?

HOW DO YOU SOURCE DEALS?

GPs can look for on-market deals (advertised publicly on the MLS) or find them off-market through a broker. The benefit to off-market deals is that they are less competitive and leave more room for negotiation—which translates to better purchase terms and higher cash-on-cash returns.

WHAT IS YOUR REPORTING OR COMMUNICATION SCHEDULE?

Perhaps the most crucial trait to look for in a deal sponsor is strong communication or 'investor relations.'

We send monthly updates to our investors; however, some GPs provide quarterly or annual reports.

The information included in an update will vary from GP to GP. Our monthly reports include occupancy rates, updates on the number of renovated units, details on our rental premiums and how they compare to our projections, capital expenditure updates, relevant updates on the market, and resident events. On a quarterly basis, we provide a link to the apartment's financial statements, including the T12 and the rent roll.

Generally speaking, you want to stay on top of the investment's performance and be informed right away should things not go according to plan.

CAN YOU GUARANTEE A RETURN?

If you're dealing with a credible GP, the answer to this question will be no. Any return they offer should be a projection rather than a promise.

Evaluating the Sponsor's Investment Strategy

QUESTIONS TO ASK:

- How do you source deals?
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- What is your policy for establishing reserves to cover potential shortfalls? *How much capital are you setting aside for reserves each year?*
- How do you make money on a deal?
- What will you do to protect me from a market downturn?

What is your policy for establishing reserves to cover potential shortfalls?

How much capital are you setting aside for reserves each year?

The GP should ALWAYS have a contingency fund to cover shortfalls, especially if they do value-add or distressed deals that require renovations.

Syndicators should also have money set aside to cover unexpected dips in occupancy or unforeseen maintenance issues.

A smart GP will save $300 per unit per year for reserves to cover shortfalls or unexpected CapEx projects. (If they fail to do this and unforeseen expenses pop up, they may come to you for additional capital.)

HOW DO YOU MAKE MONEY ON A DEAL?

Usually, GPs receive an acquisition fee and earn money for ongoing asset management and equity ownership.

The GP should only charge fees based on the value they provide, but it is up to you to keep them honest! (The GP’s comprehensive list of fees should be included in the PPM for any given deal.)

WHAT WILL YOU DO TO PROTECT ME FROM A MARKET DOWNTURN?

- Experienced Team
- Long-Term Debt
- Conservative Exit Cap Rates
- Plenty of Reserves at Close
- Monthly Reserves from Cash Flow ($250/Unit/Year)
- Value-Add to Build Equity

QUESTIONS TO ASK:

- How do you source deals?
- What is your reporting or communication schedule?
- Can you guarantee a return?
- How frequently are investors paid?
- What is your policy for establishing reserves to cover potential shortfalls? *How much capital are you setting aside for reserves each year?*
- How do you make money on a deal?
- What will you do to protect me from a market downturn?
- What is your policy for establishing reserves to cover potential shortfalls?

What is your policy for establishing reserves to cover potential shortfalls?

There's no way to predict what's going to happen in the real estate market.

With the ongoing threat of tariffs and an upcoming election, many passive investors are skittish about putting their money in multifamily.

But there are things you can do to protect yourself from a recession while you continue to grow your wealth with apartment building investing!

INVEST WITH AN EXPERIENCED TEAM

The most important thing you can do to protect yourself from a market downturn is to choose an operating team with a track record of success. When the General Partners (GPs) on a deal know what they're doing, you can rest assured that they will pick the right kind of property in the right market.

Does that mean you should run from a syndicator who's only done one or two multifamily deals? Not necessarily. Look at the team they have built and consider their background in apartment building investing. Does the operator have experienced team members, mentors or advisors? Look at their professional track record outside of real estate. Has the operator set and achieved noteworthy goals?

CASH FLOW FROM DAY 1

Another way to keep your investment safe from the possibility of a market downturn is to put your money in deals that cash flow from Day 1. If the property is bringing in money when you buy it, you can ride out any economic storm.

This is a big part of the reason why we stay away from ground-up development. There is no cash flow to service your debt should the economy go south. But if you invest in a stable value-add deal, for example, the rental income you're getting from the very beginning will pay the bills.

Plenty of Reserves at Close

A smart syndicator will have plenty of money in the bank at closing to cover unexpected expenses regardless of market conditions. But it is especially crucial to have reserves in an uncertain market.

Unforeseen circumstances (e.g.: roof repair, flood damage, etc.) will arise--that's just part of the process. So, to protect yourself from a market downturn, be sure that your operator has a good chunk of change in escrow to handle emergencies. They should also be taking money out of cash flow regularly to add to those reserves.

Debt to Match Your Business Plan

How does debt structure affect a multifamily investment in a market downturn? Bottom line, your debt needs to align with the business plan for the property.

If you're planning a cash-out refinance in Year 2 of a value-add deal, a 10-year loan is not appropriate. You'll be stuck with a prepayment penalty! On the flip side, a bridge loan or short-term note is a bad choice for a stable value-add deal you plan to hold long-term (five to seven years). Instead, you'd want to use long-term debt to lock in the current interest rate.

That way, if you're planning to sell in Year 5, but a market downturn hits in Year 4, you're not forced to put the property on the market at a bad time. You have the option to hold and a three-year runway for things to turn around.

Evaluating the Sponsor's Investment Strategy

QUESTIONS TO ASK:

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- What is your reporting or communication schedule?
- Can you guarantee a return?
- How frequently are investors paid?
- What is your policy for establishing reserves to cover potential shortfalls? *How much capital are you setting aside for reserves each year?*
- How do you make money on a deal?
- What will you do to protect me from a market downturn?

Conservative Assumptions

Last but not least, you can protect yourself from a market downturn by investing in deals with conservative underwriting. Operators who make projections based on best-case scenarios are asking for trouble. So, what should a passive investor keep an eye out for?

- Rental Increases
- Vacancy Rates
- Exit Cap Rate

Projections of rental increases of $150 per unit per month in Year 1 are unreasonable. It takes at least two to three years to raise rents by that much. Use extreme caution if your syndicator is promising crazy-high numbers like that.

When it comes to vacancy rates, consider both physical and economic vacancy. In a heavy value-add deal, for example, vacancy rates of 5% or even 8% are NOT conservative numbers, especially if you're facing a market downturn. You may have to deal with tenants who don't pay their rent. Other units will be empty while you renovate. To be on the safe side, look for projected vacancy rates of at least 10%.

The last number you should consider carefully is the operator's projected exit cap rate (the multiplier we use to gauge the value of commercial real estate).

The current market cap rate in our area is between 5% and 7%--which is pretty low. This means that the cap rate is unlikely to go down. Do the projections take that into consideration?

At Nighthawk, we assume that the cap rate will be 0.5% higher at sale, and our underwriting reflects that.

Evaluating a Specific Investment Opportunity Pt. 1

QUESTIONS TO ASK:

- Why is the owner selling?
- Is the property being acquired for less than comparable apartment buildings in the area?
- What is the cap rate going in? *What is the stabilized cap rate - and how does it compare to the market cap?*
- What are the major risks associated with this project?
- Have you inspected the major systems of the multifamily property?
- How long will my money be tied up in the deal?
- What is the minimum investment?
- How much are YOU investing in the deal?

WHY IS THE OWNER SELLING?

Here are some reasons why owners sell:

- They want to retire
- They want to upgrade to larger or "nicer" properties
- If the property has been underperforming, they may be tired of trying to make it work, or they may not have the capital to fix the problem
- They're "flipping" the property, meaning they've implemented the majority of the renovations but have kept "meat on the bone" for the buyer to continue to add value

At the end of the day, we don't much care why a seller is selling, as long as it's a good deal!

IS THE PROPERTY BEING ACQUIRED FOR LESS THAN COMPARABLE APARTMENT BUILDINGS IN THE AREA?

The sum of the costs associated with purchase + capital expenditures should be lower than the value of comps in the area. If that is not the case, the GP is paying too much for the property.

WHAT IS THE CAP RATE GOING IN?

What is the stabilized cap rate—and how does it compare to the market cap?

If you're investing in a value-add or distressed deal, the cap rate is less important because the NOI is lower than what it should be at purchase. In a case like that, ask about the stabilized cap rate and see how it compares to the market cap. The higher the cap rate at stabilization, the more equity is being created in the property.

WHAT ARE THE MAJOR RISKS ASSOCIATED WITH THIS PROJECT?

Beware of a GP who claims that there are no risks. A competent syndicator should be familiar with any potential issues related to the deal itself, the market, or their team—and have a plan in place to mitigate those risks.

Evaluating a Specific Investment Opportunity Pt. 1

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- Have you inspected the major systems of the multifamily property?
- How long will my money be tied up in the deal?
- What is the minimum investment?
- How much are YOU investing in the deal?

HAVE YOU INSPECTED THE MAJOR SYSTEMS OF THE MULTIFAMILY PROPERTY?

The GP (or qualified member of their team) needs to have examined the plumbing, roof, siding, windows and HVAC themselves, rather than relying on the current owner or a real estate broker for accurate information.

This is important in putting together the capital expenditures budget, and if one or more of these things needs work, that is a risk you need to be aware of.

HOW LONG WILL MY MONEY BE TIED UP IN THE DEAL?

The GP should have a projected timeline and be able to articulate the hold period and exit strategy for the project at hand. An “exit” could be a cash-out refinance (where most or all of the investor’s principal is returned) or an outright sale. Multifamily business plans typically take 5 to 7 years to execute.

- Liquidity Events
- Exit

WHAT IS THE MINIMUM INVESTMENT?

A GP’s minimum investment tends to increase with their experience and/or the size of the project. Ask this question early on so you know whether you have the necessary capital to participate in the deal.

HOW MUCH ARE YOU INVESTING IN THE DEAL?

Our Nighthawk GP's invest capital into every deal to assure that your interests are aligned. It also demonstrates that they are confident in the deal and its projected returns.

HOW MUCH CAPITAL SHOULD YOU HAVE IN A DEAL?

The general thinking is that when sponsors invest their own capital, they're more incentivized to ensure the investment is good and the deal won't lose money. But the real question is this – how important is it for a sponsor to invest their own capital? And is it a deal-breaker if they don't?

As a sponsor, there's no better place to park our money than in these syndications. It's important to understand exactly why a syndicator would put less money into the deal and, seemingly, have less skin in the game.

Typically, it's not so much that the sponsor doesn't want to invest their own capital. It's that they're not in a position to put money in. The reason is that liquidity is really important as an operator for a variety of different reasons.

1. Sponsors need to show liquidity to secure bank loans.
2. Sponsors need some liquidity set aside as an emergency fund.
3. Sponsors need liquidity to put deposits down on new deals

If a sponsor doesn't have cash, it can put them in difficult positions. If we're putting bids on multiple multifamily deals, it could tie up $300,000 to $400,000 pretty easily.

It's a fair question, though. If an investor asks a sponsor how much of their own capital they are putting into the deal sponsor replies with "none" it's totally fair to ask – "Why not?"

Obviously, if the sponsor indicates that they don't want to personally invest because they are unsure about the deal, that's a red flag. But typically, at least in our case, if we're not putting in money or putting in less than the minimum, it's due to these issues of liquidity.

In order to preserve deal flow, it's important to have liquidity.

ALIGNING THE INTERESTS OF THE GP'S AND LP'S

At the heart of the question about having “skin in the game” is the determination of how aligned the General Partners (a.k.a “GPs” or “operators” or “sponsors”) are with the Limited Partners (a.k.a. “LPs or “investors”). In other words, how much are the operators going to care about the deal and, if the deal goes south, will the GPs be affected in the same way as the LPs?

Could one party simply walk away?

Let’s dissect that here. It’s nice for a sponsor to show skin in the game through their own capital investment, and trust me they would LOVE to put their own capital into every multifamily deal, but what’s really more important is that the GPs have liquidity.

This is the real question that investors should be asking of sponsors – **how much liquidity do they have available to ensure the deal stays on track?**

What happens if something doesn’t go quite right with the deal? One of the things that sponsors don't want to do is call up our investors and go “gosh, uh, something went wrong and we need another half million dollars.” We’re much more inclined to simply pay for it out of pocket, making liquidity very important to sponsors.

What’s MOST important is that interests are aligned so that the operators are motivated to do a good job. One way to make sure of that, for example, is to have the equity aligned and the fees aligned.

In other words, if the property makes money, the General Partners should make money as well as the Limited Partners.

SIGNS OF MISALIGNMENT

A sign of misalignment is when the property makes money and the General Partners make money, but the Limited Partners don’t. Or, it could even be the other way around. The LPs make money and the GPs don’t, which happens with preferred returns. This is also a misalignment of interests. Remember, the GPs don't make any money in the actual deal. When one party gets paid and the other does not, interests are not aligned.

The GPs are very, very incentivized to make that equity worth something because, if they don't, it won't. It'll be worthless and we'll find ourselves working for free.

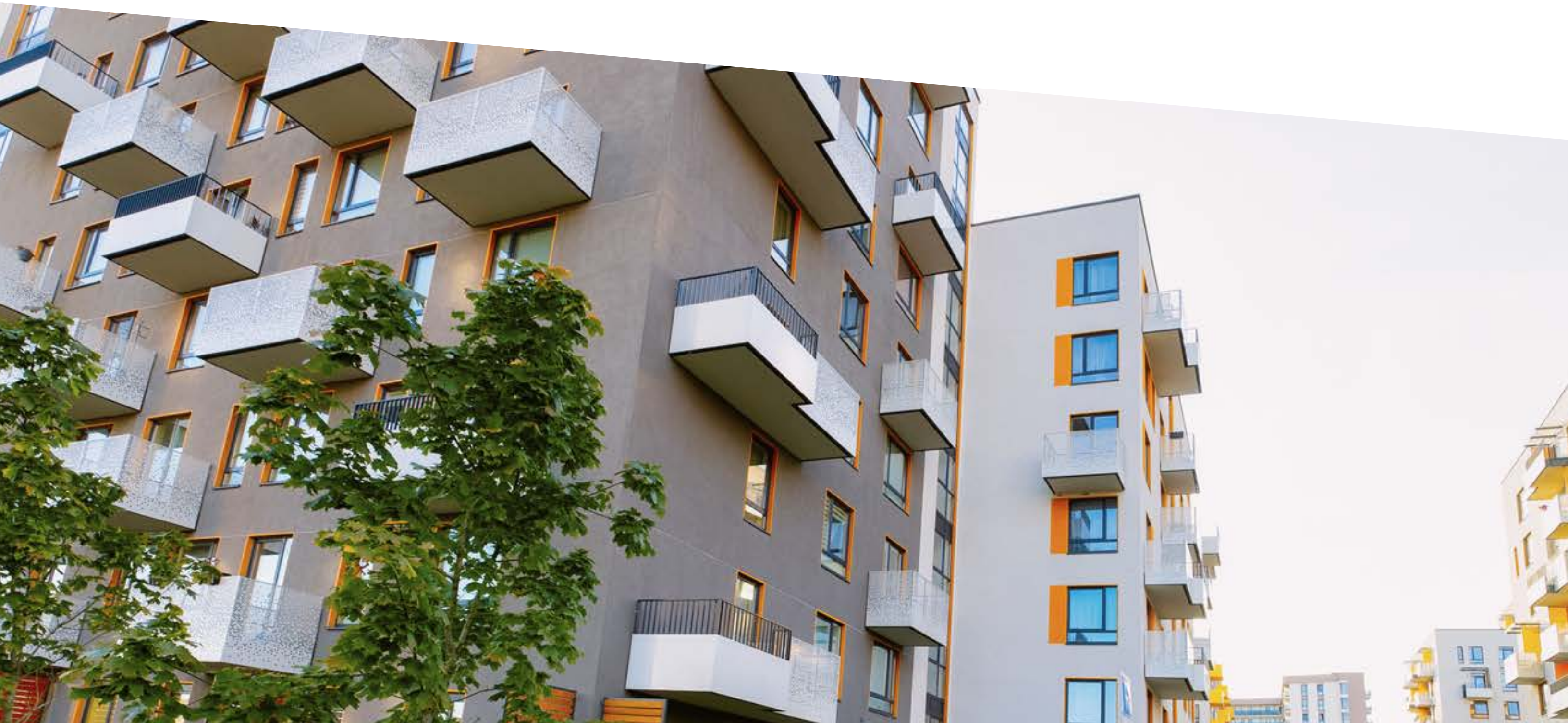
Also keep in mind that the General Partners are guaranteeing the loans. If there's ever a default situation the Limited Partners might lose a part or even all of their capital, but the General Partners now have lawsuits on their hands.

The downside could be very severe for the GPs. So while it's worthwhile to ask how a sponsor has skin in the game, it should not be a showstopper if the sponsor isn't investing their own cash into the deal itself.

The partnership between multifamily operators and their investors should be seen as a long-term relationship where both parties are looking after the best interest of their partner.

- Operators need to be transparent with investors about their liquidity requirements, and show confidence in the team.
- Investors need to understand the additional amount of risk that the Operator is taking on by guaranteeing loans, and recognize the importance of available liquidity.

For our current investors, I want to say THANK YOU for taking the time to educate yourself because as you do, you're getting better. No one cares about your wealth quite like you do.



Evaluating a Specific Investment Opportunity Pt. 2

QUESTIONS TO ASK:

- Is this a 506(b) or 506(c) offering?
- How did you come up with the capital expenditures budget for this investment deal?
- Are the tax assumptions based on what the current owner is paying? Or the purchase price?
- What is the debt structure on this deal?
- What assumptions are being made to calculate the sales proceeds?
- How do you calculate the exit cap rate?

IS THIS A 506(B) OR 506(C) OFFERING?

What's the difference? The 506(c) allows the GP to advertise the deal to the public while the 506(b) does not.

More importantly, the 506(b) allows for up to 35 unaccredited investors to contribute capital to the security, but 506(c) offerings are open to accredited investors only—and the GP must verify your status as an accredited investor via a third-party review of tax returns or bank statements, or written confirmation from a broker, attorney or CPA.

HOW DID YOU COME UP WITH THE CAPITAL EXPENDITURES BUDGET FOR THIS INVESTMENT DEAL?

The CapEx budget you review should include a detailed explanation of how much money will be allotted to each project. Did the GP assume the approximate costs? Or are the numbers based on bids from contractors who inspected the property? Obviously, the latter scenario is preferable.

In addition, you will want to know what percentage of the CapEx is dedicated to a contingency fund. (Ideally, it should be 10% to 20% of the total CapEx budget.)

ARE THE TAX ASSUMPTIONS BASED ON WHAT THE CURRENT OWNER IS PAYING? OR THE PURCHASE PRICE?

The GP should be using the purchase price to make assumptions regarding taxes. You can get this information yourself by looking up the tax rate on the county auditor's website and multiplying it by the purchase price.

WHAT IS THE DEBT STRUCTURE ON THIS DEAL?

Has the GP already secured financing for the deal, or are they basing projected returns on assumptions?

Is the loan short- or long-term? What is its interest rate? And is that interest rate locked-in or variable?

Evaluating a Specific Investment Opportunity Pt. 2

QUESTIONS TO ASK:

- Is this a 506(b) or 506(c) offering?
- How did you come up with the capital expenditures budget for this investment deal?
- Are the tax assumptions based on what the current owner is paying? Or the purchase price?
- What is the debt structure on this deal?
- What assumptions are being made to calculate the sales proceeds?
- How do you calculate the exit cap rate?

WHAT ASSUMPTIONS ARE BEING MADE TO CALCULATE THE SALES PROCEEDS?

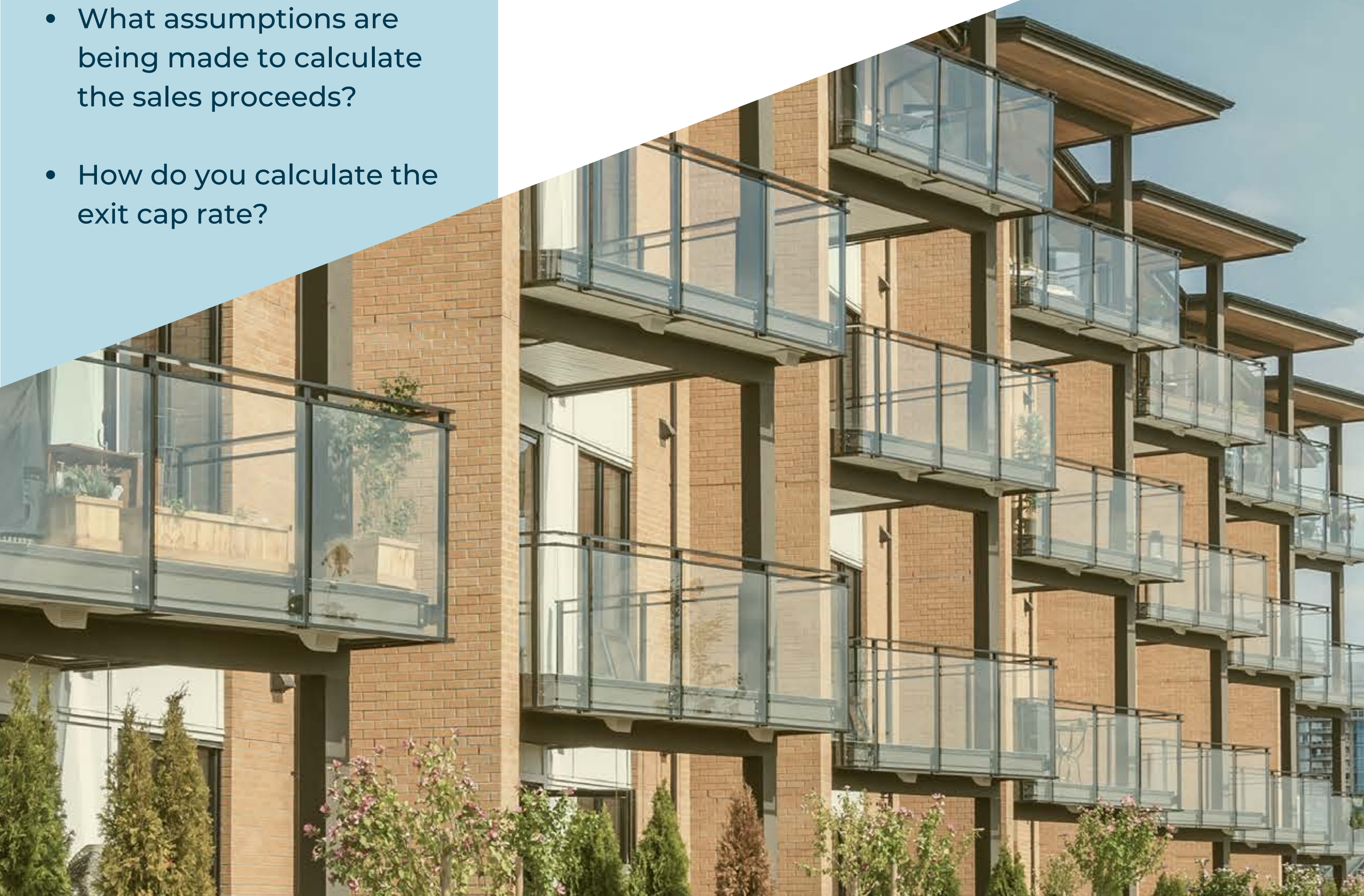
In the case of distressed or value-add deals, you earn the majority of your profit when the property sells.

So, how is the GP determining the exit NOI, exit cap rate, closing costs and any remaining debt?

HOW DO YOU CALCULATE THE EXIT CAP RATE?

In an effort to be as conservative as possible, we assume that the market will be worse at sale than it was at purchase.

We typically set our exit cap rate by adding at least 0.50% to the current market cap rate when we project our exit valuation. This, of course, depresses our valuation at exit, which is more conservative. If the market goes down, we've anticipated this, and our returns are on track. If the market stays the same or goes up, our returns will be even higher.



Understanding the Market

It's time to do some research. Here are some questions you can ask to get to know your market:

- What factors do you use to qualify a market and what attracted you to the market(s) where you currently invest?
- What can you tell me about the school district where the apartment community is located?
- What are the crime stats in the area?
- What is the median income in this particular market?
- What is the market vacancy rate and how was it calculated?

WHAT FACTORS DO YOU USE TO QUALIFY A MARKET AND WHAT ATTRACTED YOU TO THE MARKET(S) WHERE YOU CURRENTLY INVEST?

The market factors a GP should consider include unemployment, population growth, demographics, job diversity, top employers, and supply + demand. You're ultimately looking for a market that is growing.

Is the market fairly stable? Or is it subject to strong up and down cycles? We prefer to avoid volatile markets and focus instead on stable markets that performed well in the last recession, which allows us to produce consistent and predictable returns for our investors.

WHAT CAN YOU TELL ME ABOUT THE SCHOOL DISTRICT WHERE THE APARTMENT COMMUNITY IS LOCATED?

High-quality local schools are attractive to prospective tenants and offer a general sense of what to expect from the area as a whole.

WHAT ARE THE CRIME STATS IN THE AREA?

It is difficult to talk renters into moving in if the market (or neighborhood) is dealing with significant crime issues. Look specifically at the trends and be aware that a downward trend is a good sign. You can find crime statistics online at CrimeReports.

WHAT IS THE MEDIAN INCOME IN THIS PARTICULAR MARKET?

Understanding the median income of an area is crucial in determining if prospective tenants make enough money to support the rent projections for a property.

People typically spend 25% to 35% of their annual income on housing, so you can use the Census Bureau data to verify that median income is 3 to 4 times more than the annual projected rent.

WHAT IS THE MARKET VACANCY RATE AND HOW WAS IT CALCULATED?

It is important to know the average vacancy rate (the # of unoccupied units divided by the total # of units in a multifamily building) in any market you are considering, so you can compare it to the assumed vacancy rate for a specific deal.

If you're ready to show off your new knowledge of passive investing by becoming a part of the Nighthawk network, visit http://nighthawkequity.com/ to get started!

MULTIFAMILY SYNDICATION GLOSSARY

WHO'S WHO IN A SYNDICATION

Accredited Investor	An Accredited Investor satisfies certain criteria when it comes to income or net worth. At present, you must have an annual income of $200,000 (or $300,000 joint income) or a net worth of at least $1M—not including your primary residence. Visit the SEC website for additional information and resources.
Sophisticated Investor	Sophisticated Investors have enough knowledge and experience in the realm of apartment building investing to assess the pros and cons of a multifamily opportunity and make an informed decision. While these investors may not be accredited, they may have attended investing seminars or made investments outside the stock market.
General Partner	The General Partner (GP) is responsible for managing the day-to-day operations of a property. As the owner of the syndication, they have unlimited liability and are accountable for executing the business plan. In multifamily, the GP is also known as the syndicator, sponsor or operator.
Limited Partner	In a multifamily syndication, the Limited Partner (LP) is a passive investor who provides a portion of the capital necessary to purchase a property. The LP's liability is limited to their share of ownership in the apartment building.

FINANCIAL TERMS

Net Operating Income	Net Operating Income (NOI) is a property's income minus its expenses, excluding capital expenditures and debt service (i.e.: the mortgage payment).
Capital Expenditures	Also abbreviated to "CapEx," Capital Expenditures refer to the funds we use to make major renovations to an apartment community. Examples include repairing a parking lot, replacing a roof, or installing new cabinetry.
Debt Service	Debt Service denotes the annual mortgage paid to a lender, including principal and interest.
Capitalization Rate	The Capitalization Rate or "cap rate" reflects the expected return on an investment property. It is calculated by dividing the property's NOI by its current market value. Note that the cap rate has an inverse relationship with the value of a property: The lower the cap rate, the higher the price and the higher the cap rate, the lower the price.

FINANCIAL TERMS (CONTINUED)

Average Annual Return	The Average Annual Return (AAR) is all of the returns – a combination of cash flows and profit at resale – divided by the amount that was invested, and then divided by the number of years of the investment. For example, let's say you made a total of $75K of cashflow and profit over 5 years. Divide that by an investment of $100K. Take the resulting 0.75 and divide that by 5 years, and you have an average annual return of 15%.
Internal Rate of Return	The Internal Rate of Return (IRR) is the most accurate way to compare one investment vehicle with another. It also happens to be the most complex (which is why we tend to use the Average Annual Return instead). In general terms, the IRR is calculated based on all future anticipated cash flow distributions, the principal paydown of debt, and the proceeds from a refinance or sale. IRR also accounts for net present value (NPV), the fact that money loses value over time.
Cash-on-Cash Return	Cash-on-Cash Return (CoC Return) is a metric we use to evaluate real estate earnings. It is calculated by taking the annual cash flow and dividing that by the amount of money invested. For example, if you receive a distribution of $10K in one year, and you invested $100K in the property, your cash-on-cash return is 10% for that year.
Preferred Return	A Preferred Return is a minimum threshold return that LPs receive BEFORE GPs collect payment.
Distributions	Distributions are the LP's portion of the profits. They might be paid on a monthly, quarterly or annual basis, and upon refinancing or sale of the property.

DUE DILIGENCE AND DEAL DESIGN TERMS

Underwriting	Underwriting involves evaluating a multifamily community to assess its potential returns and determine an offer price.
Pro-Forma	A Pro-Forma is the projected budget for an apartment building (income and expenses) over the next 12 months and 5 years.
Rent Comparable Analysis	Performing a Rent Comparable Analysis refers to the process of studying similar multifamily properties in the area to establish market rents and understand the competition in order to establish the Pro-Forma projections.
Letter of Intent	A Letter of Intent (LOI) is a non-binding agreement the GP submits to the seller to propose the most important purchase terms, such as price, down payment, and time to close. Once the parties agree on the LOI, it's then handed to the attorneys to draft a Purchase and Sales Agreement (PSA).

DUE DILIGENCE AND DEAL DESIGN TERMS (CONTINUED)

Private Placement Memorandum	The Private Placement Memorandum (PPM) is a legal document required by the Securities and Exchange Commission (SEC) that outlines the objectives, risks and terms of making a particular investment. This document is prepared by an attorney that specializes in private placements and syndications.
Exit Strategy	The Exit Strategy is a plan for cashing investors out of a multifamily deal, either by refinancing the property or selling it once the business plan is realized.

LOANS AND FINANCE

Permanent Agency Loan	A Permanent Agency Loan refers to a guaranteed government mortgage secured through either Fannie Mae or Freddie Mac. These are the cheapest loans you can get with the longest amortization and do not have to personally be guaranteed. Multifamily buildings must have an occupancy of at least 90% to qualify.
Bridge Loan	A Bridge Loan is a short-term mortgage product with a higher interest rate. Bridge Loans become necessary when a property has an occupancy under 90% and doesn't quality for an agency loan. To reposition an apartment community, multifamily syndicators will secure a bridge loan to get started and then refinance with an Agency Loan once occupancy has been raised.
Refinance	A Refinance involves replacing the debt obligation on a property with a new loan—with different terms. In the case of a value-add or distressed multifamily syndication, the GP may choose to refinance after increasing the property's value and use the proceeds to return a portion of the LP's equity investment.

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My mission with Nighthawk Equity is helping passive investors become financially free by providing high-quality investment opportunities that generate passive income and long-term wealth.

If you're a sophisticated or accredited investor with a $75,000 minimum to invest in a multifamily syndication, then I invite you to join our Nighthawk Investor Club at http://www.nighthawkequity.com.

THE NIGHTHAWK TEAM

MICHAEL BLANK
Founder and CEO

GARRETT LYNCH
Director of Acquisitions

DREW KNIFFIN
President

DANIEL SIMPSON
Asset Manager

Before we can share investment opportunities with you, it's important that we get to know you better. Please complete our short investor questionnaire and then schedule a call with us.

Join the Nighthawk Investor Club.We look forward to having you in the Club!

Michael Blank
CEO, Nighthawk Equity

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