HOW IT WORKS

How a Multifamily Investment Is Structured

A plain-English look at how the investment fits together.

A private multifamily investment can look complicated when you first see the organizational chart and legal documents. At a high level, however, the structure is usually built around a few basic pieces.

THE BASIC FRAMEWORK

Investors contribute equity. A sponsor organizes and manages the investment. An investment entity owns the property directly or indirectly. A lender may provide part of the capital. The property generates income, and available cash moves back through the structure according to the governing documents.

01 THE BASIC INVESTMENT STRUCTURE

Most private multifamily investments bring several parties together through one or more legal entities.

PASSIVE INVESTORS
Contribute investment capital

↓

INVESTMENT ENTITY
Usually an LLC or limited partnership

Sponsor/ GP organizes & manages

↓

PROPERTY-OWNING ENTITY
May be the same entity or a separate entity

Lender provides secured financing

↓

APARTMENT PROPERTY
The operating real estate

WHAT TO IDENTIFY

- Where investor capital goes
- Which entity ultimately owns the property
- Who controls the investment
- Where the lender fits
- How money eventually flows back to investors

THE IMPORTANT IDEA

You do not need to memorize an organizational chart. You should be able to identify who owns what, who controls what, and how money moves through the structure.

02 WHY USE AN INVESTMENT ENTITY?

The investment entity provides the legal framework through which multiple investors can participate in one property. It establishes matters such as:

- Who owns interests in the investment
- Who has authority to make decisions
- How profits, losses, and distributions are allocated
- What rights investors have
- How interests may be transferred
- What happens when the property is refinanced or sold

Key question: *What entity am I investing in, and what does that entity actually own?*

03 WHERE THE SPONSOR FITS

The sponsor, sometimes called the general partner or GP, organizes the investment and generally:

- Identifies and evaluates the property
- Forms the investment entities
- Arranges financing and raises capital
- Coordinates due diligence and acquisition
- Oversees the property and business plan
- Communicates with investors
- Manages the refinance or sale process

Passive does not mean disconnected. You rely on the sponsor to execute the plan, but you still decide whether the people, structure, economics, and risks make sense before investing.

CAPITAL AND CASH FLOW

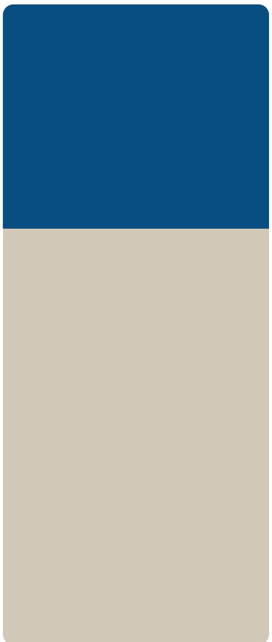
How Money Enters - and Moves Through - the Investment

Start with the sources of capital, then follow the cash after the property begins operating.

04 HOW CAPITAL GETS INTO THE INVESTMENT

An apartment acquisition usually uses two broad sources of capital: equity and debt.

A $10 million purchase



35% EQUITY
$3.5 million

65% DEBT
$6.5 million
lender loan

Total purchase price
$10 MILLION

ACTUAL TRANSACTIONS MAY ALSO REQUIRE CAPITAL FOR:

- Closing costs
- Financing costs
- Initial reserves
- Renovations
- Capital improvements
- Other business-plan needs

KEEP THE CONCEPT SIMPLE

The lender provides 65% of the purchase price. Investors and the sponsor provide the remaining 35%. Together, that capital allows the ownership entity to acquire the property. Actual investments can use different leverage levels and capital structures.

Equity:
Money contributed by passive investors and, in many cases, the sponsor.

Debt:
Money borrowed from a lender and generally secured by the apartment property.

05 HOW MONEY MOVES AFTER CLOSING

Once the apartment property is operating, resident payments flow through the property before any cash is available for investors.

PROPERTY INCOME
Rent and other property-related charges

↓

OPERATING EXPENSES
Payroll, repairs, utilities, taxes, insurance, property management, and other operating costs

↓

DEBT OBLIGATIONS
Interest and principal payments required by the lender

↓

RESERVES & CAPITAL NEEDS
Cash retained for repairs, improvements, unexpected expenses, or future obligations

↓

AVAILABLE CASH
Cash remaining after required property obligations

↓

INVESTORS & SPONSOR
Distributed through the investment entity according to the governing documents

WHY THIS MATTERS

Not every dollar collected at the property becomes an investor distribution. The property must first meet its operating, financing, reserve, and capital requirements.

THIS IS WHY DISTRIBUTIONS CAN CHANGE

Even if the property is producing income, the amount available for distribution may increase or decrease based on actual operating results and capital needs. Projected distributions are not guaranteed.

FOLLOW THE CASH

A useful habit is to ask what obligations must be paid or funded before cash can be distributed to investors. That helps separate property revenue from actual investor cash flow.

DURING THE HOLD

What Happens After the Property Is Acquired

Cash flow, refinancing, sale proceeds, and investor rights all operate through the structure.

06 REFINANCE OR SALE

Operating cash flow is only one way money may move through an investment

REFINANCING

The sponsor may replace the existing property loan with new financing. Depending on the property value, operating performance, interest rates, financing terms, and loan amount, a refinance may produce additional cash that can be distributed to investors. It also may not.

SALE

When the property is sold, sale proceeds generally must first cover transaction and closing costs, outstanding property debt, and other obligations. Remaining proceeds then flow through the investment entity and are allocated according to the governing documents.

A SIMPLE SALE FLOW

1. SALE PROCEEDS
   Cash received from the buyer at closing.
2. PAY OBLIGATIONS
   Transaction costs, property debt, and other amounts due are paid.
3. REMAINING PROCEEDS
   Cash remaining after obligations moves through the investment entity.
4. ALLOCATE UNDER THE WATERFALL
   Investors and sponsor receive proceeds according to the governing documents.

WHAT IS A DISTRIBUTION WATERFALL?

The formula that determines how available cash is divided among investors and the sponsor. You do not need to master waterfalls at this stage. The important point is that cash follows contractual rules - it does not move directly from the apartment property to each investor.

07 YOUR ROLE, RIGHTS AND LIMITATIONS

Being passive generally means you are not responsible for operating the apartment property.

You typically do not make daily decisions involving leasing, staffing, maintenance, resident relations, renovations, vendor management, property-level accounting, or routine financing decisions.

YOUR RIGHTS MAY INCLUDE

- **Economic rights:** Your share of distributions and investment proceeds when available and payable under the governing documents.
- **Information rights:** Specified financial reports, investor updates, tax information, and required communications.
- **Voting rights:** Certain major decisions may require investor approval; others may remain within the sponsor's authority.
- **Transfer rights and restrictions:** Private investment interests are generally not freely tradable and may be subject to transfer limits.
- **Capital obligations:** Some structures may permit additional capital requests or capital calls under specified circumstances.

THE PRACTICAL DISTINCTION

The sponsor manages the investment.

The passive investor evaluates the opportunity, understands the terms, monitors the investment, and exercises whatever rights are provided by the governing documents.

BEFORE YOU INVEST

The Documents and Questions That Define the Deal

The presentation explains the opportunity. The legal documents establish the rights, obligations, and economic rules.

08 THE DOCUMENTS THAT DEFINE THE STRUCTURE

PRIVATE PLACEMENT MEMORANDUM - PPM

Provides information about the offering, structure, risks, conflicts, use of proceeds, and other disclosures.

OPERATING OR PARTNERSHIP AGREEMENT

Establishes decision-making authority, investor rights, fees, distributions, voting, transfers, capital provisions, and other ownership terms.

SUBSCRIPTION AGREEMENT

The document through which an investor agrees to purchase an interest and makes certain representations required to participate in the investment.

A USEFUL RULE

The investment summary explains the story. The governing documents define the deal. If something in the presentation appears inconsistent with the governing documents, it deserves clarification before investing.

09 QUESTIONS YOU SHOULD BE ABLE TO ANSWER

Before investing, you should be able to explain the structure in plain English.

1. What entity am I investing in?
2. What does that entity ultimately own?
3. Who controls the entity and the major investment decisions?
4. Where does the lender fit into the structure?
5. What type of ownership interest am I purchasing?
6. What economic and voting rights do I have?
7. How does cash move from the property to investors?
8. Can investors be asked to contribute additional capital?
9. What restrictions apply if I later want to transfer my interest?
10. How are the sponsor and other parties compensated?
11. What happens to proceeds when the property is refinanced or sold?

YOU DO NOT NEED TO MEMORIZE EVERYTHING

You do not need to become an attorney or memorize every entity on an organizational chart. You should understand the structure well enough to explain who owns what, who controls what, and how money moves.

THE MOST IMPORTANT TAKEAWAY - FOLLOW THE OWNERSHIP. FOLLOW THE MONEY.

When reviewing an investment, begin with two basic questions: What am I actually investing in? and How does my money get into the investment - and how can money eventually come back to me? If you can answer those clearly, the rest becomes much easier to understand.

EDUCATIONAL PURPOSE