PASSIVE INVESTING BASICS

Hold Periods, Liquidity and Distributions

What passive investors should understand before committing capital.

Private apartment investing is different from owning a publicly traded stock.

You generally cannot sell your investment with the click of a button. Your capital may remain invested for several years, distributions can change, and the timing of your eventual return of capital depends on what happens at the property and in the broader market.

Before investing, understand three separate concepts:

HOLD PERIOD	How long the sponsor expects to own the property.
LIQUIDITY	How easily you can access or sell your investment before the property is sold.
DISTRIBUTIONS	Cash that may be paid to investors during the ownership period.

THE IMPORTANT IDEA

They are related, but they are not the same thing.

01 WHAT IS A HOLD PERIOD?

The Expected Length of the Investment

The hold period is the amount of time the sponsor expects to own the property before selling it or otherwise completing the investment.

A sponsor might present an expected hold period of 3 years, 5 years, 7 years, or longer. That estimate is usually based on the business plan.

FOR EXAMPLE, THE SPONSOR MAY EXPECT TO:

- Acquire the property
- Complete renovations
- Stabilize performance
- Improve operations
- Increase income
- Eventually refinance or sell

AN EXPECTED HOLD IS NOT A MATURITY DATE

If an investment is presented as a five-year hold, that does not necessarily mean you will receive your capital back exactly five years later. The actual hold may be shorter or longer depending on circumstances.

THE QUESTION

What has to happen for the sponsor to complete the investment within the expected hold period?

02 WHY CAN THE HOLD PERIOD CHANGE?

Real Estate Does Not Operate on a Fixed Schedule

Several things can affect timing:

PROPERTY PERFORMANCE	Occupancy, renovations, rents, collections, expenses, and stabilization may take longer than expected.
MARKET CONDITIONS	The sponsor may decide that selling into a weak market would not be in investors' best interests.
INTEREST RATES	Rates can affect property values, buyer demand, refinancing proceeds, and debt-service costs.
CAPITAL MARKETS	Even a well-performing property may face a period when buyers or lenders are less active.
BUSINESS PLAN	Unexpected repairs, construction delays, insurance costs, or operating challenges can extend the timeline.

THE IMPORTANT IDEA

The hold period is an expectation, not a promise.

03 WHAT DOES LIQUIDITY MEAN?

Can You Access Your Money When You Want It?

Liquidity describes how easily an investment can be converted into cash.

Publicly traded securities are generally relatively liquid because there is an active market for buying and selling them. Private apartment investments are usually much less liquid.

ONCE YOU INVEST, YOUR CAPITAL MAY REMAIN COMMITTED UNTIL:

- The property is sold
- The sponsor provides another liquidity event
- The investment is refinanced
- Your ownership interest is transferred, if permitted

You may own a valuable investment and still be unable to access the money when you want it.

THE QUESTION

Am I comfortable committing this capital even if I cannot access it for longer than originally expected?

04 CAN YOU SELL YOUR INTEREST EARLY?

Sometimes - But Do Not Assume You Can

Private investment documents commonly place restrictions on transfers. The governing documents may require sponsor approval, compliance with securities laws, qualification of the new investor, legal documentation, and payment of transfer costs.

There also may not be an active market of buyers waiting to purchase your interest. Even if a transfer is allowed, you may have difficulty finding a buyer, and a buyer may not be willing to pay what you originally invested.

BEFORE INVESTING, UNDERSTAND:

- Whether transfers are permitted
- What restrictions apply
- Whether any secondary market exists
- Who must approve them
- Whether there are costs

THE PRACTICAL RULE

Assume your money may remain invested for the full hold period - and possibly longer.

05 WHAT IS A DISTRIBUTION?

Cash Paid to Investors During the Investment

A distribution is money paid from the investment to its owners. Distributions may come from:

PROPERTY OPERATIONS	Cash remaining after operating expenses, debt service, capital expenditures, reserves, and other obligations.
REFINANCING	A refinance may sometimes generate proceeds that can be distributed to investors.
SALE	Sale proceeds may be distributed after selling costs, loan repayment, other obligations, and the governing distribution rules are applied.

Important: A distribution is not automatically the same thing as profit. Some distributions may represent operating income. Others may include a return of invested capital. Tax treatment can also differ from cash received.

06 ARE DISTRIBUTIONS GUARANTEED?

No

A sponsor may provide a projected distribution schedule, such as quarterly distributions or a projected annual cash yield. Those are expectations based on the underwriting. They are not guarantees.

Distributions may be higher than projected, lower than projected, delayed, suspended, or eliminated for a period of time.

THE BETTER QUESTION

What circumstances could cause distributions to be reduced or stopped?

07 DISTRIBUTIONS AND PREFERRED RETURNS ARE NOT THE SAME THING

A Common Source of Confusion

Suppose an investment has an 8% preferred return. That does not necessarily mean the investor will receive an 8% cash distribution every year.

A preferred return generally describes the priority of economic distributions under the investment structure. It does not create cash.

If the property does not generate enough distributable cash, the preferred return may not be paid currently. Depending on the governing documents, unpaid preferred return may accumulate, be paid later, affect the distribution waterfall, or be treated differently.

THE IMPORTANT IDEA

A preferred return describes the distribution structure. It does not guarantee property performance or cash availability.

08 WHY MIGHT A SPONSOR KEEP CASH AT THE PROPERTY?

Cash Retained Can Protect the Investment

Investors naturally like receiving distributions. But paying out every available dollar is not always prudent.

A SPONSOR MAY RETAIN CASH TO MAINTAIN:

- Operating reserves
- Renovation funds
- Insurance reserves
- Capital reserves
- Debt-service reserves
- Tax reserves

EXAMPLE

Suppose a property generates $400,000 of excess cash. The sponsor might decide that only $250,000 should be distributed because the property expects roof repairs, unit renovations, higher insurance costs, or seasonal operating needs.

Keeping money at the property can reduce the chance that investors later face a capital call.

THE BETTER QUESTION

What level of reserves is appropriate for this property and business plan?

09 WHAT HAPPENS IN A REFINANCE?

A Refinance May Create Liquidity Without Selling the Property

If a property increases in value, produces more income, and qualifies for new financing, the sponsor may refinance the existing loan. In some cases, the new loan may be larger than the old loan.

After paying off the original debt and transaction costs, some proceeds may be available for distribution to investors. The property is still owned, so investors may continue participating in future distributions, future appreciation, and the eventual sale.

But refinancing is not guaranteed. The amount available depends on property value, net operating income, interest rates, loan-to-value limits, debt-service coverage, lender requirements, and market conditions.

THE CAUTION

A business plan should not depend on refinancing proceeds as though they are certain.

10 RETURN OF CAPITAL IS DIFFERENT FROM RETURN ON CAPITAL

Know Which One You Are Receiving

RETURN ON CAPITAL	Income or profit generated from the investment.
RETURN OF CAPITAL	Your original invested money being returned to you.

EXAMPLE

You invest $100,000. Over several years you receive $20,000 of operating distributions. Later, a refinance returns $30,000 of your original capital. You may still own the investment, but only $70,000 of your original $100,000 remains unrecovered.

Understanding this distinction helps you evaluate what the investment has actually produced.

11 WHAT HAPPENS WHEN THE PROPERTY IS SOLD?

The Final Liquidity Event

At sale, the property receives cash from the buyer. That cash generally must first cover selling expenses, the outstanding loan balance, and other property obligations.

The remaining proceeds are then distributed according to the investment's governing documents, which may determine return of investor capital, preferred return, sponsor promote, profit-sharing, and other distribution priorities.

THE QUESTION

After all obligations and partnership economics are applied, how are sale proceeds divided?

12 HOW HOLD PERIOD, LIQUIDITY AND DISTRIBUTIONS WORK TOGETHER

YEAR 0	Investor contributes $100,000.
YEARS 1-2	Property is being improved. Distributions may be modest while cash is used for renovations.
YEARS 3-4	Operations stabilize. Cash distributions may increase.
YEAR 4	Property is refinanced. Investor may receive part of the original capital back.
YEAR 6	Property is sold. Remaining capital and profits are distributed according to the partnership waterfall.

The exact outcome could be very different. The example simply shows why these concepts need to be understood together.

ROBERT'S PERSPECTIVE

I ASSUME THE MONEY IS NOT AVAILABLE UNTIL THE INVESTMENT IS OVER.

When I evaluate a private investment, I do not want my personal financial plan to depend on receiving my capital back at an exact date.

If the sponsor says the expected hold is five years, I assume it could be longer. If distributions are projected quarterly, I do not treat those distributions as guaranteed income.

That gives the investment room to operate without forcing me to make personal financial decisions based on assumptions the property may not be able to meet.

MY RULE

Do not invest money in an illiquid investment if you may need the money before the investment is ready to return it.

Liquidity outside the investment gives you patience inside the investment.

QUESTIONS TO ASK BEFORE INVESTING

HOLD PERIOD	What is the projected hold period? What milestones support that timeline? What could cause it to extend? Who determines when the property is sold?
LIQUIDITY	Can I transfer my ownership interest? What approvals are required? Is there a practical secondary market? What happens if I need liquidity unexpectedly?
DISTRIBUTIONS	How often are distributions expected? What assumptions support them? Are they discretionary? What reserves will be maintained? Can the lender restrict distributions?
REFINANCING	Is a refinance assumed in the business plan? Are projected returns dependent on it? What happens if refinancing is unavailable?
EXIT	How are sale proceeds distributed? How is investor capital returned? How does the sponsor participate in profits?

FIVE THINGS TO REMEMBER

1. A HOLD PERIOD IS AN ESTIMATE

It is not a guaranteed exit date.

2. PRIVATE REAL ESTATE IS GENERALLY ILLIQUID

Assume your capital may remain invested through the full business plan.

3. DISTRIBUTIONS ARE NOT GUARANTEED

They depend on property cash flow, reserves, financing, and other obligations.

4. A PREFERRED RETURN IS NOT A PROMISED CASH PAYMENT

It describes economic priority, not cash availability.

5. LIQUIDITY OUTSIDE THE INVESTMENT MATTERS

Your personal financial plan should not require the property to sell on your schedule.

THE MOST IMPORTANT TAKEAWAY

Time, access to capital, and cash flow are three different things. Using long-term, illiquid investments to meet short-term financial needs can create a serious mismatch.

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