PASSIVE INVESTING BASICS

Who Does What?

Investor, Sponsor, Property Manager and Lender

A private apartment investment brings together several different parties. Each has a different role. Understanding those roles helps you know who makes decisions, who operates the property, who provides the capital, who monitors performance, and who is responsible when something is not going according to plan.

THE IMPORTANT IDEA

The passive investor owns an economic interest in the investment. The sponsor oversees the investment. The property manager operates the property. The lender provides debt capital and protects its loan.

01 THE FOUR MAIN ROLES

PASSIVE INVESTOR

Provides equity capital and participates economically, but is generally not involved in day-to-day operations.

SPONSOR / OPERATOR

Organizes the investment, raises capital, arranges financing, and oversees execution of the business plan.

PROPERTY MANAGER

Runs the apartment community day to day: leasing, residents, maintenance, collections, staffing, and operations.

LENDER

Provides debt capital and focuses on protecting repayment of the loan.

02 HOW THEY WORK TOGETHER

PASSIVE INVESTORS	SPONSOR / OPERATOR	PROPERTY MANAGER	APARTMENT PROPERTY
Provide equity	Oversees investment	Runs operations	Produces rent and executes the plan

Lender: Provides debt capital to the property-owning entity and receives priority repayment under the loan documents.

These roles work together, but they do not have the same authority or responsibilities.

03 THE PASSIVE INVESTOR

Provides Equity Capital

The passive investor contributes money to the investment and generally receives an ownership interest through an investment entity. Depending on the structure, passive investors may be called limited partners, members, limited members, or equity investors.

THE PASSIVE INVESTOR GENERALLY DOES NOT:

- Hire onsite employees
- Approve leases
- Manage residents
- Collect rent
- Supervise maintenance
- Run renovations
- Make day-to-day operating decisions

THE PASSIVE INVESTOR SHOULD:

- Understand the investment before committing capital
- Review the offering and governing documents
- Understand the business plan and risks
- Read investor reports
- Monitor material developments
- Ask questions when something is unclear
- Keep tax and investment records

THE QUESTION

What am I responsible for before and after I invest? Passive does not mean uninformed.

04 THE SPONSOR / OPERATOR

Responsible for the Investment Strategy

The sponsor generally organizes the investment and takes primary responsibility for carrying out the business plan. The sponsor may also be referred to as the general partner, GP, managing member, or operator.

BEFORE CLOSING, THE SPONSOR MAY:

- Find the property
- Negotiate the acquisition
- Underwrite the investment
- Arrange financing
- Complete due diligence
- Develop the business plan
- Raise investor equity
- Select the property manager

AFTER CLOSING, THE SPONSOR SHOULD OVERSEE:

- Property performance
- Property management
- Renovations
- Budgets
- Financing
- Cash reserves
- Investor reporting
- Refinancing or sale

The sponsor usually does not personally answer leasing calls, collect resident rent, repair HVAC systems, or turn apartments. But the sponsor is still responsible for making sure those things are being handled effectively.

05 THE PROPERTY MANAGER

Operates the Apartment Community

The property manager is responsible for the day-to-day operation of the property. The management company may be owned by the sponsor or may be an independent third-party company.

TYPICAL RESPONSIBILITIES INCLUDE:

- Leasing apartments
- Resident communication
- Rent collection
- Delinquency management
- Maintenance
- Work orders
- Unit turns
- Vendor coordination
- Payroll and staffing
- Property-level accounting
- Expense control
- Regulatory compliance
- Property inspections

Property management is where the business plan meets reality. A sponsor may underwrite higher occupancy, higher rents, lower delinquency, better renewals, or lower expenses. But the property-management team is often responsible for executing many of the daily actions required to achieve those results.

THE QUESTION

Who is responsible for turning the sponsor's strategy into daily operating performance? The property manager.

06 THE LENDER

Provides Debt Capital

Most apartment acquisitions use a combination of equity and debt. The lender provides the debt. Depending on the transaction, the lender could be a bank, agency lender, insurance company, debt fund, credit union, or another institutional lender.

THE LENDER IS NOT AN EQUITY PARTNER

The lender generally does not participate in most of the property's upside. Instead, the lender expects the borrower to pay interest, repay principal when required, maintain required reserves, meet financial covenants, and operate within the loan documents.

THE LENDER HAS PRIORITY

Debt generally sits ahead of equity in the capital stack. That means debt obligations usually must be satisfied before cash is distributed to equity investors.

IF THINGS GO WRONG

The lender may have contractual remedies. Depending on the loan and circumstances, these can include restricting distributions, requiring additional reserves, enforcing loan covenants, or exercising remedies against the property.

WHAT DOES THE LENDER CARE ABOUT MOST?

Protecting repayment of the loan.

07 WHO IS RESPONSIBLE FOR WHAT?

A Simple Responsibility Matrix

Different parties contribute different things. The chart below is a simplified way to think about who typically handles what.

RESPONSIBILITY	PASSIVE INVESTOR	SPONSOR	PROPERTY MANAGER	LENDER
Provide equity capital	YES	Sometimes		
Provide debt capital				YES
Create business plan		YES	Assists	
Arrange financing		YES		Provides
Lease apartments		Oversees	YES	
Collect rent		Oversees	YES	
Manage maintenance		Oversees	YES	
Monitor property performance	Reviews	YES	YES	Monitors loan
Communicate with investors		YES	Supports	
Refinance or sell property		YES	Supports	May approve*

* Rights depend on the governing and loan documents.

08 WHO SHOULD HOLD THE PROPERTY MANAGER ACCOUNTABLE?

The Sponsor

The property manager is responsible for operations, but that does not mean the sponsor can simply hand over the property and wait for reports. The sponsor should actively evaluate leasing, occupancy, collections, delinquency, expenses, staffing, maintenance, renovations, and budget performance. If management is not performing, the sponsor should respond.

ROBERT'S PERSPECTIVE

The property manager operates the property. The sponsor manages the investment. A sponsor can hire an excellent property-management company, but the sponsor still needs to know what is happening, why it is happening, whether the business plan is working, and what needs to change when it is not.

FIVE THINGS TO REMEMBER

1. The investor provides capital.
2. The sponsor oversees the investment.
3. The property manager runs the property.
4. The lender protects the loan.
5. Delegation does not eliminate oversight.

THE MOST IMPORTANT TAKEAWAY

Know who is responsible. Passive investing means someone else operates the property. It does not mean nobody is accountable for the results.

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