

VALUE-ADD OPPORTUNITIES FOR SUCCESSFUL INVESTMENTS

The managing partners of Real Estate Midwest LLC deploy their expertise in identifying value-add opportunities in the multifamily asset class. The goal is to provide our investors with projected, risk-adjusted returns generated from successful investments.

This value-add strategy is a powerful mechanism in our toolkit. The purpose of this article is to explain our plan to our investors and outline why it is the key to our success.

The overall strategy is to identify multifamily communities with potential for increased value by implementing upgrades and effective management practices at costs less than the value created. Our experience demonstrates that a hands-on investment style, which goes beyond the typical buy-and-hold strategy, effectively mitigates risk and produces returns that exceed the project return hurdles.

Key Takeaways

- Our hands-on investment style mitigates risk and produces risk-adjusted returns.
- We target communities that are at least break-even and require no capital improvements.
- Identifying and addressing risks and challenges is an important step in our approach.
- Open lines of communication with our tenants and partners are key.
- Conservative underwriting mitigates the risk of an under-performing investment.

Our Strategy Success

Every real estate investment has risk. However, we approach every opportunity with targeted courses of action. Our path to success follows five avenues:

1. Understanding the Opportunity,
2. Creating the Work Scope,
3. Identifying the Challenges,
4. Targeting Financing Partners, and
5. Executing the Strategy.

Intertwined with these strategies is timing and leveraging our reputation and relationships in the market. There are more members involved in an investment than just the managing partners and their investors.

The managing partners serve as team leaders, assemble the right professionals, and maintain the synergies within the team. All team members work together in trust and share a common goal of achieving a successful project.

The five avenues to our success are explained below.

1. Understanding the Opportunity

No project will be successful if an opportunity is misidentified. The factors we are looking for in a multifamily community with the best potential for our value-add strategies are those that are:

- maintaining at least a 70% occupancy level,
- meeting current operating expenses and debt service,
- under-performing because of inefficient management, deferred maintenance, poor tenant mix, and ineffective marketing, and
- operating with outdated systems, amenities, and décor in the units and common areas.

You will note that the areas of opportunity involve upgrades to furnishings, fixtures, and procedures, without requiring any significant capital improvements to the structure and systems. An effective management strategy is to establish a capital reserve account from operations for future capital improvements once the property has stabilized following the renovations.

Risk is mitigated when capital and operating reserve accounts are funded from operations without a capital call from the equity investors.

2. Creating the Work Scope

This aspect of our approach involves analyzing the property's condition and the market. The location must have the proper economic fundamentals to support the higher rent commanded by the improvements and the investors' returns.

The property must be inspected, and the upgrades priced to ensure financial feasibility. No project will increase in value if the improvements render the projected rent as overpriced for the market.

3. Identifying the Challenges

More than the others, this approach involves honesty and realism. Important questions need to be asked.

- Is the work scope for rehabbing the property under-estimated?
- Are the rent projections over-estimated for the market?
- What will it really cost to elevate the property's potential to support the targeted rent rates?
- Who will be the future tenants in the renovated community?

Risk will be mitigated if these questions are answered honestly and realistically. The answers will be the product of the cumulative talents within the development team. However, it is the ultimate responsibility of the managing partners to apply these answers against their market knowledge and the renovation budget.

In this process, attention is given to the cost of the improvements and the projected rent rates.

4. Targeting Financial Partners

Managing partners must also know how to create a feasible capital stack for the project and understand the workings of debt and equity. In addition to targeting investors for equity, lenders are targeted for debt.

Investors and lenders are key components of the capital stack, and each will evaluate a project based on the timing of completion, the risk of market shifts during renovation, and the implementation of the new management plan.

While team members can create models and operating proformas, it is the team leaders who must evaluate the feasibility of the assumptions from the views of an investor and lender.

A thorough business plan must be presented to potential lenders, just as offering documents are presented to investors.

We are well aware that no potential investor or lender will take an endeavor seriously if the risks and challenges are not identified and addressed with a plan to overcome and resolve them.

The packages presented to the equity and debt partners must explain the complete project cycle from Day 1 through stabilization. Each potential partner will evaluate the project with an eye to their return hurdles and risk tolerances.

5. Executing the Strategy

This is the step where the assumptions relating to the market, timelines, and due diligence meet the realities of implementation. An important part of an ongoing project is flexibility, as well as planning for potential delays and cost overruns. These are a part of every project.

Parallel efforts involve introducing new management and marketing plans to address the concerns of existing tenants and attract new tenants. Effective communication with both sets of tenants is key.

It is exciting for existing tenants to see and be a part of the renovations to improve their community. If marketed properly, new tenants will want to become part of the new community early, before demand catches up to supply and rent rates increase.

It is our experience that tenants balance a rent increase against improvements to their living spaces and the shared common areas.

An open line of communication must also be kept with our equity and debt partners. Our partners must be informed of the progress, and sometimes delays are a natural part of the process toward the end result.

Delays will occur, but it is the response to any delay and the time it takes to rectify it that an investor needs to know.

The Successful Project



Achieving a value-add opportunity is more than just renovation and number-crunching. While these are the tangible factors that require constant management, the intangibles —like the quality of the construction work, effective communication, and the roll-out of management and marketing plans going forward —are the essence of a successful project.

Conservative budgets that allow for delays and contingency funds could be out-performed with aggressive and professionally managed schedules in the field. Higher rents could be received earlier under a conservative operating proforma.

If a project pencils out under conservative underwriting, then the risk of an under-performing investment is mitigated.

The key to our success is maintaining a clear focus on the big picture and placing our trust in the professionals within the development team. We need local brokers to present properties, accountants to prepare our operating proformas, inspectors to assess the property's condition, and contractors to implement the work plan.

All members of the development team want a successful project for their achievements and for the financial partners to make the project a reality.

Investing with REM Capital Partners

Investors with a low risk tolerance who seek high-quality assets must invest in a professionally managed blind pool offering, where transparency is the core business model.

The focus of our management team is value-add opportunities in the multifamily asset class. The team aims to deliver risk-adjusted returns to our investors and create a Class A community experience for our tenants.