Passive Investor Glossary

Key Terms that LPs Should Understand

CHAD ACKERMAN
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Accredited Investor

An Accredited Investor is an individual or entity that meets certain financial thresholds set by the SEC, allowing them to invest in private securities. Individuals typically qualify by having a net worth over $1 million (excluding primary residence) or annual income of $200,000 ($300,000 with a spouse) for the past two years. Accreditation ensures investors have the financial sophistication and capacity to absorb potential losses.

Active vs. Passive Investing

Active investing involves hands-on management of properties, such as handling tenants, maintenance, and financing. Passive investing, by contrast, means providing capital to a deal managed by others—usually in a syndication—while receiving returns without direct involvement. Passive investors focus on vetting the sponsor and investment but are not involved in daily operations.

Asset Class

An asset class refers to the category of real estate investment, such as multifamily, self-storage, industrial, retail, or mobile home parks. Each class has different risk-return profiles, capital needs, and operational complexities. Understanding asset classes helps investors align opportunities with their goals and risk tolerance.

Average Annual Return (AAR)

AAR represents the average yearly return on an investment over the hold period, not accounting for compounding. It is calculated by dividing total return by the number of years held. Formula: AAR = (Total Return / Number of Years). It is a simple way to evaluate potential performance but may not capture time value of money.

Bonus Depreciation

Bonus depreciation allows investors to accelerate depreciation deductions, enabling them to offset income and reduce taxes in early years. Often used after a cost segregation study, it can create significant 'paper losses' that benefit LPs even when the property is cash-flowing. This tax advantage is currently being phased down in stages, so timing matters for strategy.

Break Even Occupancy

Break even occupancy is the minimum occupancy rate a property needs to cover all operating expenses and debt service. A property below this threshold will operate at a loss. Formula: Break Even Occupancy = (Operating Expenses + Debt Service) ÷ Gross Potential Income.

Capital Call

A capital call is a request from the General Partner (GP) for Limited Partners (LPs) to contribute the funds they previously committed. This typically occurs shortly before or after deal closing or during a major renovation or expense. It's important to understand when and how capital calls may be triggered.

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Capital Expenditures (CapEx)
CapEx refers to large, non-recurring expenses used to improve, upgrade, or replace property components, such as roofs, HVAC systems, or renovations. These are different from regular maintenance costs and are usually planned in advance. CapEx is often funded upfront as part of the business plan and impacts the overall return on investment.

Capital Stack
The capital stack outlines the layers of financing used in a real estate deal—typically senior debt, mezzanine debt, preferred equity, and common equity. Each layer has its own risk and return profile, with senior debt being the lowest risk and equity the highest. Understanding where you are in the stack helps assess your risk and priority for distributions.

Cap Rate (Capitalization Rate)
Cap rate is a metric used to evaluate and compare the profitability of real estate investments. It is calculated by dividing a property's Net Operating Income (NOI) by its purchase price. Formula: Cap Rate = NOI ÷ Purchase Price. Lower cap rates usually indicate lower risk but higher valuations.

Cash-on-Cash Return
Cash-on-Cash Return measures the annual pre-tax income earned on the cash you invested. It is a key metric for assessing how efficiently your money is generating income each year. Formula: Cash-on-Cash Return = Annual Cash Flow ÷ Total Cash Invested.

Cost Segregation
Cost segregation is a tax strategy that breaks down property components into shorter depreciation schedules. This allows investors to accelerate depreciation and reduce taxable income, especially in the early years of ownership. It often enables the use of bonus depreciation on qualifying items like appliances and flooring.

Debt Service Coverage Ratio (DSCR)
DSCR measures a property's ability to cover its debt obligations using its Net Operating Income (NOI). A DSCR above 1.0 means the property generates more income than needed to pay its debt; below 1.0 suggests it doesn’t. Formula: DSCR = Net Operating Income ÷ Debt Service.

Distributions
Distributions are the periodic payments made to Limited Partners (LPs), typically monthly or quarterly. These payments usually come from rental income, refinance proceeds, or a sale. They represent the return on your investment and can be a key indicator of deal performance.

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Due Diligence
Due diligence is the research and evaluation process investors use to assess a sponsor, market, and investment deal. This may include reviewing the sponsor's track record, market trends, financial projections, and legal documents. Thorough due diligence helps investors reduce risk and make informed decisions.

Equity Multiple
The equity multiple shows how much money you receive for every dollar invested, including your original capital. It's a simple way to understand total return over the life of the investment. Formula: Equity Multiple = Total Cash Received ÷ Total Cash Invested.

Exit Strategy
An exit strategy is the planned method for concluding a real estate investment and returning capital to investors. Common strategies include selling the property, refinancing it, or merging into a larger portfolio. Understanding the exit timeline helps investors manage expectations and liquidity.

General Partner (GP)
The General Partner (GP) is the active manager responsible for acquiring, operating, and eventually selling the investment property. They make decisions, oversee business plans, and manage investor relations. In return, GPs often receive fees and a share of profits after the LPs receive their preferred return.

Hold Period
The hold period is the expected duration that the investment will be owned before a planned exit. Most syndications have a hold period of 3–7 years. This timeframe impacts liquidity, return timelines, and overall investment planning.

Internal Rate of Return (IRR)
IRR is a time-weighted return metric that reflects the annualized rate of return, accounting for the timing of cash flows. It's useful for comparing investments with different payout schedules. IRR considers both the size and timing of distributions and is widely used in real estate syndication analysis.

K-1 Statement
A K-1 Statement is a tax document issued to each investor in a partnership, including LPs in real estate syndications. It reports your share of income, losses, deductions, and credits from the investment. Investors use this to file their personal tax returns and often see large paper losses due to depreciation.

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Limited Partner (LP)
An LP is a passive investor who contributes capital to a deal but does not participate in day-to-day management. LPs earn returns through distributions and equity growth while relying on the GP to execute the business plan. They have limited liability, meaning their risk is generally capped at their investment amount.

Loan-to-Value (LTV)
LTV measures the amount of leverage used in a real estate investment. It compares the loan balance to the value of the property. Formula: LTV = Loan Amount ÷ Property Value. A lower LTV typically indicates a more conservative investment.

Preferred Return
A preferred return is the minimum annual return LPs are entitled to receive before the GP shares in profits. This incentivizes GPs to perform and ensures LPs are paid first. Preferred returns are typically around 6–10%, depending on the deal.

Private Placement Memorandum (PPM)
The PPM is a legal document that outlines the investment opportunity, including the risks, terms, business plan, and structure. It must be reviewed carefully before investing. Signing the PPM typically finalizes your commitment to the investment.

Pro Forma
Pro forma refers to forward-looking financial projections used to estimate a property's future performance. It includes assumptions about rent growth, vacancy, expenses, and exit price. While helpful, it's important to remember that pro formas are only estimates and not guarantees.

Profit Splits
Profit splits determine how remaining profits are divided between LPs and GPs after preferred returns are met. Common splits include 70/30 or 80/20 in favor of the LPs. They are often structured within a waterfall to reward the GP for strong performance.

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Return ON Capital
Return on capital refers to the earnings generated on the original investment amount while it remains invested. It typically comes from cash flow or profits that don't reduce your initial capital. This is different from return of capital, which repays your principal.

Return OF Capital
Return of capital is the portion of your original investment that is paid back to you over time. It does not represent profit but instead lowers your remaining investment balance. Understanding this distinction is important for evaluating true performance and tax implications.

Syndication
A syndication is a group investment where multiple investors pool capital to buy a large real estate asset. The GP manages the deal, and the LPs provide the funding. This model allows individuals to access deals that would be difficult to fund on their own.

Waterfall Structure
A waterfall structure outlines how returns are distributed among LPs and GPs at different performance levels. It often includes preferred returns, profit splits, and performance hurdles. This incentivizes GPs to exceed minimum targets to earn a larger share of profits.