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Transcript

What assumptions drive the projected returns?

Oh, there's a lot of assumptions that go into the returns you see on the cover page of a PPM.

It's very, very important to understand what those assumptions are. Variables would be another word, right? Like what goes into the the rate of return, like if I put money in, how much will I get back. Right. And every offering in the private markets will show you either a range or some of them will give you very specific numbers. We prefer a range because nobody knows the future. There's no crystal ball out there, but there's a lot of assumptions that go into that because we just don't know the future.

So what are some of those assumptions? So if you're in some sort of housing investment, multifamily, senior living, student housing, single family, whatever it might be, there's some rent involved. And so there's assumptions on how that rent will turn out. Right. So you build a building or you buy a building and you go to rent those units. What rent are you going to get?

Well, there's an assumption there.

You can't just go on a national headline either. Real estate is very local very local. You could have one market that's struggling and another couple states away that's doing great, or even a city away that's doing great. But you read the headline and it says everything's bad. Well, that may not be true over here, even though it is true over here.

And you've really got to dial in on that. Another thing that we like to look at besides rent growth is expense growth. You know, a lot of these financial models will assume a certain rate of growth on what it costs to operate a property. We call that expense growth. so a lot of times we challenge our sponsors and developers on let's understand that budget, right. Speaking of budget, if you're going to do a construction project, there's a lot of variables in the cost of that construction project. Is it a guaranteed contract with the general contractor?

What happens if they go over budget? Who's who's going to make up that difference. Right. What kind of reserves are built into the budget.

Assumptions could be the tax rate. Am I assuming the right amount of taxes? Insurance is another one depending on where you are in the country.

Insurance is a is a considerably variable cost.

So there's varying levels. A lot of folks will just operate within a range of historical norms. And that's true if the current environment is equal to the historical environment.

But unfortunately that's not always the case.

What assumptions drive the projected returns?

Right. There's a lot of things that go into this.

And so we've really got to dig into the assumptions that whoever created the financial model, i.e. the developer or sponsor of the real estate, what are they assuming when they created this? Here's what we don't want. What we don't want is to invest in a project where the sponsor created an artificial return.

What that means is they pulled certain levers on the financial model to artificially create a return that they know isn't likely to happen, but they put a return on a piece of paper to get an investor to give them money. I hate that, but unfortunately that does happen sometimes. Our job is to sniff that out and make sure that we never show those type of offerings to our investors.

By being independent, we can sift through all kinds of different things that happen to make sure that everything is fully vetted before we take it out to market.