

Explanation of the Deal Review Process

One of the valuable services that we offer to our students is a customized review of each deal that is submitted to our “Deal Review” mailbox. By combining years of underwriting experience, detailed knowledge of industry best practices, and hundreds of repetitions underwriting our own deals, we are able to offer detailed feedback on the potential issues and risks in each deal.

The Process

The deal review process is initiated when it is submitted to our email address, “dealreview@rodkhleif.com.” As part of the submission, we ask our students to include as much of the following information as possible:

- Lifetime Cash Flow Academy Deal Review Financial Model (with both tabs completed)
- Property Trailing 12 Months Operating Statement
- Property Rent Roll
- Property Offering Memorandum (if available)
- Property Photos
- Property Maps & Aerials
- Renovation Budgets

With the email submission, we compile the above documents and begin the process of reviewing the deal in four components:

1. Preliminary Checks
2. Revenue Checks
3. Expense Checks
4. Capital Checks

While reviewing the components of each section, we are looking to make sure that model’s input is present, reasonable, and supportable. Each section is described in detail below.

Preliminary Checks

The point of the “Preliminary Checks” section is ensure that the right model was used, that the inputs are complete, that all property information was provided, and to identify the property’s hook or story. A screenshot of the Preliminary Checks section is below:

PRELIMINARY CHECKS:		
Rule	Yes	No
Was the right calculator used (Deal Review Spreadsheet)?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Are calculator inputs complete?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Is <i>all</i> property information provided (Address, Zip, Google Maps)?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Does the property have a "hook" or story?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Are the financing terms identified or defined?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Is the Business Plan supported by comps?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Are current Rent Roll and T-12 Expenses included with submission?	<input checked="" type="checkbox"/>	<input type="checkbox"/>

Revenue Checks

The point of the “Revenue Checks” section is to verify that the “Current” revenue modeled is consistent with the Trailing 12 Months Operating statement, to ensure that the modeled “Market” rates are supported by comparable properties, and to check that the “Market” vacancy assumptions are reasonable and consistent with broader macroeconomic trends. A screenshot of the Revenue Checks is below:

REVENUE CHECKS:		
Ref. Cell(s)	Data Element	Target Value
B11:B14	Unit Mix	Supported by market?
C11:C14	Current Rental Rates	Supported by market?
C17	Current Vacancy / Loss	Stated Value in T12?
D11:D14	Market Rental Rates	10% - 15% Increase
D17	Market Vacancy / Loss	5% - 7%

Expense Checks

One of the harder aspects of creating a multifamily model is to project operating expenses into the future, based on the previous 12 months. To that end, the purpose of the Expense Checks section is to verify that “Current” expenses are consistent with those reported on the Trailing 12 Months Operating Statement and that “Market” expenses are consistent with industry best practices and our historical experience. A screenshot of the Expense Checks section is below:

EXPENSE CHECKS:		
Ref. Cell(s)	Data Element	Target Value
G23:G36	Current expenses	Match T12?
G28	Current taxes	Match tax bill?
K23:K36	Market expenses	~50% of NOI
K27	Property Management	3% - 4% / 6% - 10%
K28	Stabilized taxes	Reflect purchase price?
K29	Repairs & Maintenance	\$500 - \$800 Per Unit
K30	Salaries / Payroll	\$1,000 - \$1,200 Unit/Yr
K31	Utilities	\$500 - \$1,000 Unit/Yr
K40	Operating expense ratio	~50% of NOI
K41	Cap Rate	In line with comps
K42	CapEx Reserves	\$250 - \$350/Unit/Yr

Capital Checks

Finally, the Capital Checks section is designed to ensure that the proposed purchased price is in line with comparable properties, that the planned Capital Expenditures are reasonable given the projected rental increases, and that the assumptions used for the loan are consistent with the prevailing market trends. A screenshot of the Capital Checks section is below:

CAPITAL CHECKS:		
Ref. Cell(s)	Data Element	Target Value
T10	T10. Purchase price	In line with comps
T13	T13. Closing Costs	3% - 5% of loan amt.
T14	T14. CapEx	24 - 48 month payback
T14	T14. CapEx	3 - 6 Months Working Cap.
Q15	Q15. LTV	70% - 80%
R16	R16. Interest	4.00% - 4.25% (Agency)
R17	R17. Amort	20 - 25 Years

Notes & Additional Feedback

After each section has been completed, there is a final section for additional notes and feedback. In this section, we provide detailed comments and suggestions on how to improve the model or update assumptions to bring it more in line with market realities and industry best practices. An example Notes section is provided below:

GENERAL NOTES/COMMENTS:

Property appears to be well located in a strong Phoenix sub-market. Given metro area growth and strong employment figures, the location appears to be acceptable.

However, in the financial modeling if the project there are several important considerations:

- (1) Current rent roll shows an average rental rate of \$687, which is below the modeled figure. Modeled market rents are \$1,161, which are a significant increase above current rents. Suggests that property will require significant upgrades to command such an increase. Suggest to perform significant sub-market research on comparable properties and their finished to determine if this level of increase is achievable.
- (2) Market expenses appear to model the broker OM. Suggest to perform independent analysis to determine if these costs are feasible. For example, market taxes are likely to be higher than current taxes given the purchase price, repairs and maintenance and utilities are on the low end of the target range. As a result, market operating expense ratio is 26%, which should be closer to the 50% range.
- (3) No capex reserves are modeled. Should be at least \$250 per unit, per year.
- (4) Modeled closing expenses are 1.5% of the loan amount. They should be in the 3% - 5% range.
- (5) Suggest to create detailed renovation budget and calculate how long it will take to recover the per unit cost in rental increases. Current figures suggest a \$625 per month increase to recover investment in 48 months. Renovation budget dovetails with necessary rental increases and the target is to recover expenses in the ~36 month timeframe.

We aim to complete all deal reviews within 48 hours of receipt and, once complete, we email the comments and deal review spreadsheet back with a summary of the major findings. If a student wishes, they are free to update the model as suggested and return it for a second round of reviews.