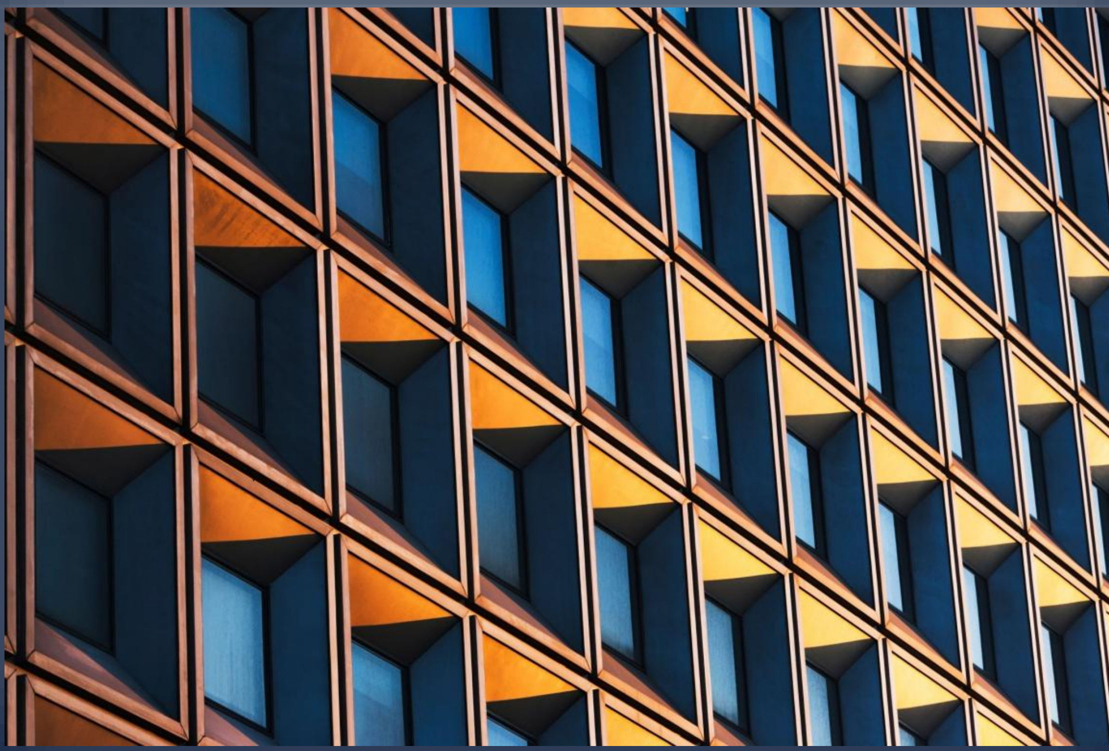
SMK CAPITAL MANAGEMENT LLC
Real Estate - Diversified

Navigating Passive Real Estate Investments: *In A Post COVID Era*

5 Steps To Best Position Your Capital



By Mark Khuri
Principal and Co-founder

www.smkcap.com

INTRODUCTION

Investing successfully and consistently in real estate syndications, requires discipline, strategy and trusted partners. These fundamentals are more important than ever as the commercial real estate industry progresses through a period of heightened volatility, and long-term transformation.

This short guide is an effort to share valuable lessons and assist investors in reducing risk and navigating market volatility.

The following pages provide 5 important steps and action items you can begin to implement when evaluating private real estate investment offerings.

These steps will allow you to make more informed investment decisions and better position yourself to earn high absolute returns.

- To your success!

Mark Khuri
Co-Founder SMK Capital Management

STEP 1: WORK ONLY WITH THE BEST PEOPLE

When investing passively into commercial real estate, the sponsor or operating partner in charge of day-to-day operations, is the most critical aspect to success. Their role is to acquire the property, execute on the business plan and make critical decisions along the way.

When evaluating operating partners ask yourself, "are these the people and the firm that we want to invest with for the next 10+ years?". Ask a lot of questions, seek out clear and consistent communication and set the bar high. It can be an arduous task requiring patience and may take many months or even years to get comfortable, but having a sound operating partner is essential to success in real estate syndications.

Tips to reduce risk when selecting partners:

- Look for an established team both in the back office and on the ground handling day to day operations. Vertically integrated firms with in-house property and asset management can often lead to economic efficiencies.
- Run background checks on principals and evaluate their track record including current asset performance and exited investments. Call and speak to references!
- Seek out an operating partner that is a specialist in 1 asset class and strategy.
- Experience, track record and history are often a good indicator of pedigree. Firms with decades of experience through varying market cycles can often be a good place to start.
- Select the operating partners' opportunities where the deal matches closely to many of their prior successful deals. You can reduce risk by selecting opportunities that are more of a "rinse and repeat" strategy vs unique and not yet proven.

"It takes longer to choose the right people than it does the right property."
- Mark Khuri

An experienced operating partner will react quickly and efficiently should a hurdle in the business plan arise. They will steer the ship successfully for the life of the investment, putting investor interests first.

STEP 2: DIVERSIFY ACROSS ASSET CLASSES

The commercial real estate market is undergoing a major shift in investor and user demand, which will have long-term effects on many sectors. The recent downturn from 2022-2024 has reminded us that not all asset classes are created equal. Office and Hospitality have been hit the hardest and many feel these asset classes will be changed forever.

Diversifying your capital across asset classes can greatly reduce your portfolio risk.

Capital has been redirected out of Office and Hospitality and into 'safer' real estate sectors and this is a trend that one must take into consideration when selecting asset classes to invest into.

Buyers are likely to shift capital into real estate that is accessible, provides stability, comparable returns and capital preservation. If demand for an asset class is growing, there is a good chance you will see a larger pool of end buyers when it comes time to exit and sell your property.

"Understand the trends of your exit strategies, before investing."
- Mark Khuri

Asset Classes That Are Seen As Safe Havens:

- **Multifamily** – affordable housing apartments, in growth markets, continue to see high demand from residents and investors. High construction and land costs reduce new supply risk. Newly built apartments are often 30-50% more expensive for tenants, and often do not compete with more affordable existing properties. Keep an eye out on rising prices as many investors on the sidelines reenter the sector.
- **Mobile Home Parks** – one of the most affordable housing options, MHP's remain in high demand from residents and are experiencing a surge in demand from investors. Supply is fixed and potentially declining, making this asset class stand out on its own. Similar to multifamily, the surge in demand for MHP's comes with a high risk of overpaying.
- **Self-Storage** – a resilient asset class through varying market cycles, self-storage remains in demand from users and investors, as many folks downsize during difficult times. New construction is one of the biggest risks in the sector, barriers to entry are low and new storage facilities compete with existing. Oversupply in many markets has resulted in lower than projected performance.
- **Industrial** – the accelerated shift in consumer purchasing from brick and mortar to ecommerce, has reduced industrial real estate vacancy in many core markets. These trends have also increased the demand for industrial real estate and although very competitive, the opportunity for exceptional rent growth is high.

STEP 3: LOCATION

The location of the property is more essential than ever. There have been significant changes recently effecting the supply and demand of asset classes across many markets. Primary, urban core markets, such as New York and San Francisco, have recently been impacted greatly with significant occupancy and rental rate declines. Secondary markets that have experienced a surge of supply along with tertiary markets lacking a robust and diverse employment base, have also had challenges.

Meanwhile, many regions that are affordable and experiencing growth including Dallas, Houston, Kansas City, Denver and Salt Lake City, continue to see ample demand and have proven to be more stable over the long term.

The economic diversification and size of the local submarket, employment trends, populations trends, median household income and industry growth are all key factors to consider when selecting an investment location.

When Analyze Location, Follow These Key Indicators:

- **Population growth** – where are people moving? Why are they moving there? Is the trend projected to continue?
- **Affordability and quality of life** – can the median area income sustain the median cost of living? Does the region have a high quality of life?
- **Employment trends** – Where are companies and jobs growing and relocating to? Is the trend projected to continue?
- **Economic strength** – what industry(s) support the local economy? What are the historical and projected economic trends? Growth? Stagnation? Decline?
- **Diversified employer base** – what is the job base by industry sector in the region? Is the area supported by only a few industries or is it widely diverse?

STEP 4: DEAL ANALYSIS AND UNDERWRITING

While many asset classes have seen post Covid pricing declines, it is imperative that you understand the financial projections of an investment opportunity and ensure the deal is being conservatively underwritten.

Watch out for overly rosy projected returns!

It can be relatively easy to manipulate a pro-forma to show high projected returns, and this is exactly what you should watch out closely for. Analyzing the trailing 12- and 3-month performance of an asset can often provide a current trend and baseline to work from.

Does the investment have a high likelihood of overperforming and beating projections?

Running sensitivity analysis to determine how the performance of the property may be affected by changes in the underlying assumptions, can help reduce risk of investing in overly zealous deals.

By adjusting and testing several key metrics including exit cap rates, occupancy rates and net operating income, we measure and gauge how the investment may perform under various scenarios.

When Analyzing Financials, Look At These Metrics:

- **Projected Occupancy** – once you determine the historical occupancy trends, assume occupancy is going to go down in the near term. Plug in a decline of 5%, 10%, 20% and determine how your overall return will be affected in these scenarios, should the asset experience a reduction in demand and occupancy.

- **Rental Growth Projections** – a conservative strategy is to assume the property is not going to experience rental increases for the first 1-2 years. Although this may not be the reality, this conservative approach will help absorb potential hurdles and changes in demand along the way.

- **Cap Rates** – The going-in capitalization rate represents the current net operating income divided by the acquisition cost. In general, a lower going-in cap rate implies tighter margins, particularly when minimal or no value-add improvements are planned. Incorporating a projected cap rate expansion of 10–20 basis points per year provides a conservative buffer that helps account for market shifts and supports more realistic valuation growth assumptions over the hold period..

- **Acquisition Price** – after coming off all time highs, commercial property pricing has declined in recent years. it is important to understand local pricing trends. Analyzing and comparing property sales, price per unit, price per square foot and nearby rental rates, to ensure the asset is being acquired in line with or below similar properties trading in the local market, will help reduce risk of overpaying.

- **% of Return From Cash Flow vs Appreciation** – ensure you understand the business plan and how the projects' overall return is comprised. New construction/development deals often have no cash flow through the holding period and 100% of the investor ROI is earned when the property is sold or refinanced. On the other hand, light value-add investments often provide consistent cash flow from rental income, plus profits from the sale. Seeking a balanced overall return derived from cash flow and appreciation, can often lead you to towards lower risk opportunities.

STEP 5: UNDERSTAND THE "NEED" FOR CAPITAL

Pooled real estate investments (syndications) have been around for a long time. Today, as we live in an age experiencing a rapid rise of accessibility to real estate syndications, it is important to remember that not all investments will perform.

A simple google search will yield an endless amount of investment opportunities. Crowdfunding platforms may be a great place to source opportunities, but one must recognize that operating partners utilizing their platform, are paying for investors.

While utilizing the previous 4 steps can help you pick winners, you should also take a step back and look at the bigger picture.

Ask: Why does the operating partner need investors?

Needing capital is not necessarily a red flag, but understanding why there is a need, is important.

Here are a few tips and scenarios to watch out for:

- Is the operating partner a "young" firm and very focused on growth? If so, proceed cautiously to ensure you aren't just a pawn in a "get rich quick" strategy.
- Perhaps they have a poor track record and previous investors are no longer their clients? Check multiple references.
- Does the operating partner focus heavily on marketing and advertising?!
- Or, perhaps through their experience and network they have access to many great deals which require more equity than they can currently procure? This may prove to be a positive alignment and partnership.

Some of the best operating partners do not need your money and won't be found on crowdfunding platforms. They often have stellar track records and a long list of investors ready to write a check for their next deal.

If your investments are primarily sourced from operating partners paying for capital, it may be time to diversify your people risk, and seek out "quieter" firms.

Connect With Us

[Join Our Investor Group]

Info@smkcap.com

1-888-803-4803

www.smkcap.com

LinkedIn

Bend, Oregon