BUYER NAVIGATOR

The Deal Stress Test

For an experienced owner or buyer with an offering memorandum open and a deadline. Print it, tick it, keep it with the file.

Start here: the 10-minute screen

Open the offering memorandum. Answer six questions. Do not call anyone yet. Tick a box when the answer is a flag: it does not match, it is missing, or you cannot tell.

- ☐ **The 10 percent test.** Cut the seller's NOI by 10 percent. Divide by the asking price. Does the deal still work at that cap rate?
- ☐ **Rents.** Do the pro forma rents match the rents on the current rent roll?
- ☐ **The missing lines.** Is vacancy 5 percent or higher? Is there a management fee? Are there reserves?
- ☐ **Unit count.** Does the rent roll count match the public record and the Certificate of Occupancy?
- ☐ **Utilities.** Who pays them? One master meter or individual meters?
- ☐ **Local rules.** In DC, has a TOPA notice started? Is any unit under rent stabilization? Ask an attorney before you rely on the answer.

How to read your answers

- **0 or 1 flag:** the deal earns a full stress test. Request the records (Step 1).
- **2 or more flags:** request the records before you spend more time. Do not write an offer on the seller's numbers.
- **A flag on question 1:** the deal only works at the seller's number. It does not work.

How to use the full test

Work Steps 1 to 6 in order. Enter your numbers in the worksheet on page 4, or in the calculator at apartmentwealthnavigator.com/buyernavigator. Compare your stressed value to the asking price. If the offer is due in days: run the 10-minute screen tonight, send the records request tomorrow morning, and run the worksheet the day the records arrive.

The six steps at a glance

1. Request the records	Price follows NOI. NOI is only as good as the documents behind it.
2. Stress the income	The lender uses the rents tenants pay, not the rents the seller hopes for.
3. Reprice every expense	The seller's expenses are the seller's. Yours reset the day you close.
4. Run the financing check	The lender sizes your loan from NOI. A smaller loan is extra equity you bring.
5. Price it and size your cash	Stressed NOI divided by your cap rate is your value. Then count the cash.
6. Decide	Go, counter, or walk.

Shafiq Hirani, MBA, CCIM | shirani@enterprisere.com | 202-290-1055 | Want a second set of eyes? Book a free Buyer Consultation at apartmentwealthnavigator.com/buyernavigator. Educational only. See the notice on page 4.

Step 1. Request the records

Why: price follows NOI, and NOI is only as good as the documents behind it.

- [ ] **T12**: trailing 12 months of income and expenses, plus the prior full year
- [ ] **Rent roll**: current, with unit, rent, lease start and end dates, deposits and concessions
- [ ] **Leases** for every unit
- [ ] **Bank deposit statements** for 12 months, to confirm the rent roll is being collected
- [ ] **Real estate tax bill** and assessment notice
- [ ] **Insurance** declarations page and claims history
- [ ] **Utility bills** for 12 months, and a list of which utilities tenants pay
- [ ] **Service contracts** (trash, elevator, landscaping, pest, laundry) with terms and cancellation clauses
- [ ] **Capital improvements** over 5 years, open permits, housing code violations
- [ ] **Certificate of Occupancy** and the public record of unit count
- [ ] **Estoppel certificates**, if the seller will provide them
- [ ] **Local-law notices** required before a sale. In DC: tenant purchase rights (TOPA), rent stabilization status and any exemption paperwork, and each unit's rent history

SEND THIS. COPY, PASTE, FILL IN THE BRACKETS.

> [Broker name],
>
> I am reviewing [property address] and want to move quickly. Please send the following: the T12 and the prior full year; the current rent roll with lease dates and deposits; all leases; 12 months of bank deposit statements; the tax bill and assessment notice; the insurance declarations page and claims history; 12 months of utility bills; service contracts; capital improvements over the last 5 years, open permits and code violations; the Certificate of Occupancy; and any estoppels or tenant notices, including TOPA status if the building is in DC.
>
> I will respond within 24 hours of receiving them.
>
> [Your name] [phone]

Step 2. Stress the income

Why: the pro forma shows rents the seller hopes for. The lender uses rents tenants pay.

- [ ] Use rents tenants pay today from the rent roll, not projected market rents
- [ ] Subtract free rent, concessions and tenant credits
- [ ] Compare billed rent to deposited rent (delinquency)
- [ ] Count units against the public record. A rent roll with units the city does not recognize is income that does not exist
- [ ] Underwrite vacancy and credit loss at 5 percent minimum, even if the building is full
- [ ] Count other income (laundry, parking, fees) only if bank records support it
- [ ] Note leases expiring in the next 12 months and any units under rent control limits
- [ ] Underwrite rents at what the law allows, not what the market would pay

Educational only, not investment, legal, tax or lending advice. Rules differ by city, county and state.

Step 3. Reprice every expense as the new owner

Why: the seller's expenses are the seller's. Yours reset the day you close.

- [ ] **Taxes:** ask how the assessment could change after a sale at your price
- [ ] **Insurance:** get a current quote for your coverage, not the seller's old premium
- [ ] **Utilities:** check for a single master meter and for leaks the seller paid out of pocket
- [ ] **Management:** include a professional fee even if the seller self-manages; get local quotes
- [ ] **Payroll and contracts:** confirm what you will actually pay to run the building
- [ ] **Repairs:** compare the T12 to the building's age and condition
- [ ] **Reserves:** include replacement reserves, commonly $250 to $350 per unit per year; confirm with your lender
- [ ] **Value-add:** price the renovation, the lost rent during the work, and the inspection surprise before you count the upside

Step 4. Run the financing check

Why: the lender sizes your loan from NOI, not from the asking price. A smaller loan is extra equity you bring.

- [ ] Debt service coverage ratio (DSCR) = NOI divided by annual mortgage payments
- [ ] Lenders commonly require 1.20x to 1.25x. Confirm current terms with your lender
- [ ] Maximum annual debt service = stressed NOI divided by required DSCR
- [ ] **Maximum loan = maximum annual debt service divided by the loan constant.** The loan constant is the year-one payment per $1 of loan. At about 6.5 percent interest and 25-year amortization it is about 0.081. Ask your lender for the real one
- [ ] If the loan you can get is smaller than you planned, the difference is extra equity

Quick rule: at about 6.5 percent interest, 25-year amortization and 1.25x coverage, each $1,000 of NOI supports roughly $10,000 of loan.

Step 5. Price it and size your cash

- [ ] Your value = stressed NOI divided by your target cap rate. Compare it to the asking price. The gap is your negotiating case
- [ ] Cash needed = price minus loan, plus closing costs, plus your reserve
- [ ] Your reserve is the number from your buy box. Write it down before you see the building
- [ ] If your cash needed exceeds what you have, the building fails your buy box, whatever the cap rate says

Step 6. Decide: go, counter, or walk

- [ ] **Go:** your stressed value is at or above the asking price and the cash fits your reserve rule.
- [ ] **Counter:** your stressed value is below the asking price. Offer your number. Bring the worksheet line by line.
- [ ] **Walk:** the seller's price only works at the seller's numbers, or the cash needed breaks your reserve.
- [ ] Whatever the decision, protect it in the contract: contingencies, due diligence period, financing timeline, and the dates your deposit goes hard.

Red flags that need answers before you go further

- [ ] Pro forma rents well above the current rent roll
- [ ] Vacancy below 5 percent, or no vacancy line
- [ ] No management fee, payroll or reserves
- [ ] Rent roll income that does not match bank deposits
- [ ] Unit count that does not match the public record
- [ ] Many leases expiring right after closing, or recent large concessions
- [ ] Seller reluctant to provide the T12, deposits or utility bills
- [ ] A TOPA notice already started, or rent stabilization status unclear (DC)

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Worked example: a 12-unit building at a $2.8M asking price

Line item	Seller	Stressed	Change
Gross potential rent (12 units)	$266,400	$266,400	$0
Vacancy (2% seller, 5% stressed)	($5,328)	($13,320)	($8,000)
Operating expenses as presented	($93,072)	($93,072)	$0
Management fee (omitted by seller)	$0	($10,000)	($10,000)
Insurance repriced to current quote	$0	($4,000)	($4,000)
Net operating income (NOI)	**$168,000**	**$146,000**	**($22,000)**
Cap rate at the $2.8M asking price	6.0%	5.2%	
Value at a 6.0% cap rate	$2,800,000	$2,433,000	($367,000)
Maximum loan at 1.25x, 6.5%, 25 years	$1,659,000	$1,442,000	($217,000)
Equity at the asking price, before closing costs and reserve	$1,141,000	$1,358,000	$217,000

Illustrative figures for education only, rounded to the nearest $1,000. Loan constant 0.08102.

Worksheet

Property _____ Units _____ Asking price _____ Target cap rate _____

Interest rate _____ Amortization (years) _____ Required DSCR (1.25) _____

Line item	Seller	Stressed	Change	Source (T12, rent roll, quote, lender)
Gross potential rent (in place)				
Loss to lease and concessions				
Vacancy and credit loss (5% minimum)				
Other income (verified)				
Effective gross income				
Real estate taxes (post-sale)				
Insurance (current quote)				
Utilities				
Repairs and maintenance				
Payroll and contract services				
Management fee				
Administrative and legal				
Replacement reserves				
Total operating expenses				
NOI				
Annual debt service				
DSCR (NOI divided by debt service)				

Stressed value (NOI / cap rate) _____ Gap to asking price _____ Maximum annual debt service _____

Maximum loan _____ Cash needed _____

Decision: ☐ Go ☐ Counter ☐ Walk

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This checklist is for educational purposes only and is not investment, legal, tax, or lending advice. Consult your attorney, CPA, and lender before making a purchase decision. Rules differ by city, county and state. Have a professional licensed where the property is located review your deal.