



Buying a Rental Property? Key Questions to ask when Looking at Proforma Financials to Avoid Costly Mistakes

When evaluating the financial projections provided by realtors or sellers, for a prospective investment property, investors must recognize that these figures may not always reflect a full financial picture. While due diligence is a given, knowing which pointed questions to ask—and understanding what might be omitted—can make all the difference. Here are eight essential questions to direct to the seller or listing agent and to keep in mind as you assess their forecasts:

Are Increases in Rent and Operating Expenses Accurately Modeled?

Is the property subject to rent control, and if so, have these restrictions been factored into future rental increases? If the property is currently vacant, consider whether the rates used are for comparable units in the area.

At the same time, check that ongoing operating expenses are realistically projected for increases, over and above the cost of living or inflation rate. Consider, for example, if utilities are included in tenant rent, the risk for potential increases in utilities falls on the owner rather than the tenant. Inquire if contractual escalations in maintenance contracts are accurately reflected in the projections.

Are Repairs, Maintenance, and Capital Expenditures Properly Estimated?

Do the projections include a contingency reserve for unexpected repairs and planned capital improvements like roof replacements or HVAC upgrades? Clarify whether these cost estimates assume the buyer will handle repairs in-house or outsource them to professional and licensed contractors. If you do not intend to manage repairs yourself, ensure the projections account for the full cost of outsourcing.

How Realistic Are the Vacancy Assumptions?

Do the projections assume full occupancy, or do they account for inevitable vacancies? Be wary of projections that forecast rental rates for properties without a reserve for vacancies or delinquent tenants. Use market data to validate vacancy assumptions for the local area.

How Are Tenant Turnover Costs Accounted For?

What provisions are made for expenses incurred during tenant turnover? Ask about typical timelines for filling vacancies or replacing tenants, as well as associated costs like marketing expenses, administrative fees, and commissions.

Is the Insurance Coverage Up-to-Date and Sufficient?

Does the insurance expense reflect a policy with adequate coverage for the property's risks and current market value? Insufficient or outdated insurance coverage can lead to unexpectedly higher insurance costs and exposure to potential liabilities.

Have All Financing-Related Expenses Been Included?

Are appraisal fees, loan fees, and potential interest rate fluctuations part of the financial model? The seller may not account for these costs unless the financing is to be renewed and will vary depending on the type of lender and qualifications of the borrower.

What Does "Other Income" Really Include?

Is the additional income—such as fees from laundry facilities, parking, or storage—clearly itemized? Verify that these revenue streams aren't simply duplicated within the base rent figures or disallowed based on the rental agreements.

What Are the True Costs of Property Management?

Property management expenses typically cover administrative duties such as tenant screening, rent collection, lease enforcement, and general oversight of the property. These differ from repairs and maintenance costs, which relate to the physical upkeep of the property, including fixing structural issues, plumbing, electrical systems, and landscaping.

These services are usually charged as a percentage of rent by the property manager. In properties managed directly by the owner, these costs are often omitted or understated. Ask if the property management is outsourced and what level of services are included. Also consider whether any inefficiencies from owner-managed properties might affect long-term operations.

Engaging Specialists.

While these questions serve as a due diligence framework for reviewing seller- or realtor-prepared financial projections, investors should independently verify all figures against market benchmarks, historical performance data, documentation, and expert assessments. Consider engaging an independent resource—such as an accountant, inspector, or buyer agent acting on your behalf. By honing in on these details, you'll be better equipped to spot what's missing and make more informed, confident investment decisions in today's evolving real estate market.

Ready to take the next step in your real estate investing journey? Get started by booking a discovery call: <https://calendly.com/nidhichoprealtor>

Disclaimer

This article is not intended to serve as a guide for investors to create their own financial projections. Instead, it provides key questions to help investors critically assess financial projections prepared by realtors, sellers, or clients when evaluating a commercial or multiplex property. Investors should conduct independent due diligence and seek professional financial advice before making investment decisions.