MULTIFAMILY SYNDICATION DEEP DIVE

How Investors Pool Money to Buy Large Assets

Our Goals for this Module

The Agenda

- Explain how groups of investors buy Multifamily properties together
- Talk about all the basics and key terms of a syndication
- To go through the Lifecycle of a Multifamily project
- Review

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Syndication: Concept of Group Buying

Multifamily complexes are expensive, so are commonly purchased by groups of investors using a mechanism called Syndication

If you want to become a syndicator, it's important for you to know that the rules of the Syndication process are governed by the SEC, for the protection of investors

The resource kit contains contact info of a strong Syndication attorney that can lead you through the process.

Syndication: How Does It Work?

An experienced Multifamily syndication team finds an asset to purchase and offers the opportunity to their pre-screened investors, who then choose to participate or not in the acquisition

Individuals, self-directed retirement plans, family trusts or entities (LLCs) invest varying amounts and receive a proportional equity share of the cash flow and value gain

The syndication team finds, contracts to purchase, performs all due diligence on the asset, organizes the offering and pools investor funds, and manages the property until sale. For making the opportunity available to investors they receive share of cash flow and profits, and a small management fee

Syndication: Governing Rules

Federal and state securities laws typically apply to real estate syndication transactions. Normally, securities may only be sold if the securities are registered with the SEC or otherwise exempt.

Traditionally, most real estate syndications have taken the form of a private placement exemption under Regulation D (Reg D).

Syndication: Governing Rules

Reg D has 2 commonly used exemptions, each of which requires the investors to be either an accredited investor or a sophisticated investor. Let us examine each type.

Offerings: 506(b) vs 506(c)

	506B Offering	506C Offering
Communications with Investors	Companies may not advertise their security offering. Generally, companies may approach potential investors if there is a substantive, pre-existing relationship	General advertising permitted. Companies may advertise via social media, email, or offline. No substantive, pre-existing relationship with potential investors required
Eligible Investors	Accredited investors and up to 35 non-accredited investors who meet sophistication requirements	Only accredited investors
Accreditation Process	Self-certification via a questionnaire is the general standard	Companies must take reasonable steps to verify accredited investor status. Self-certification via a questionnaire is not permissible. The SEC issues examples of reasonable steps for verification

Offerings: 506(b) vs 506(c)

Accredited Investor

An individual that has made $200,000 or more on an annual basis for the past two out of three years and is likely to make that same amount this year. If it is a couple qualifying together that amount is raised to $300,000. If they do not meet the income requirements, they can qualify using a net worth of over $1 million excluding their primary residence.

Sophisticated Investor

The SEC mentions sophisticated Investor as someone with enough financial and business knowledge to be capable of making an educated decision about an investment, although he may not meet the Accredited Investor requirements.

If the SEC were to ask why you thought this person was sophisticated you should be able to point to an internal set of standards so you can prove that caution was taken when making these decisions.

Management of the Property

The management team assigns an asset manager and a property management company to run the property

Investors have no involvement in day to day running of the property. No tenants or toilets

Cash flows are typically disbursed quarterly to investors, who often receive preferred returns before management team is paid

Partner Types: GP vs LP vs Equity Partner vs Key Sponsor

GENERAL PARTNER:

When a team of individuals work together to put a property under contract with the intention of managing that property, the members of that team are commonly referred to as General Partners. The GPs typically stay in the deal from beginning to end and receive a chunk of the profits. They are also often known as Promoters.

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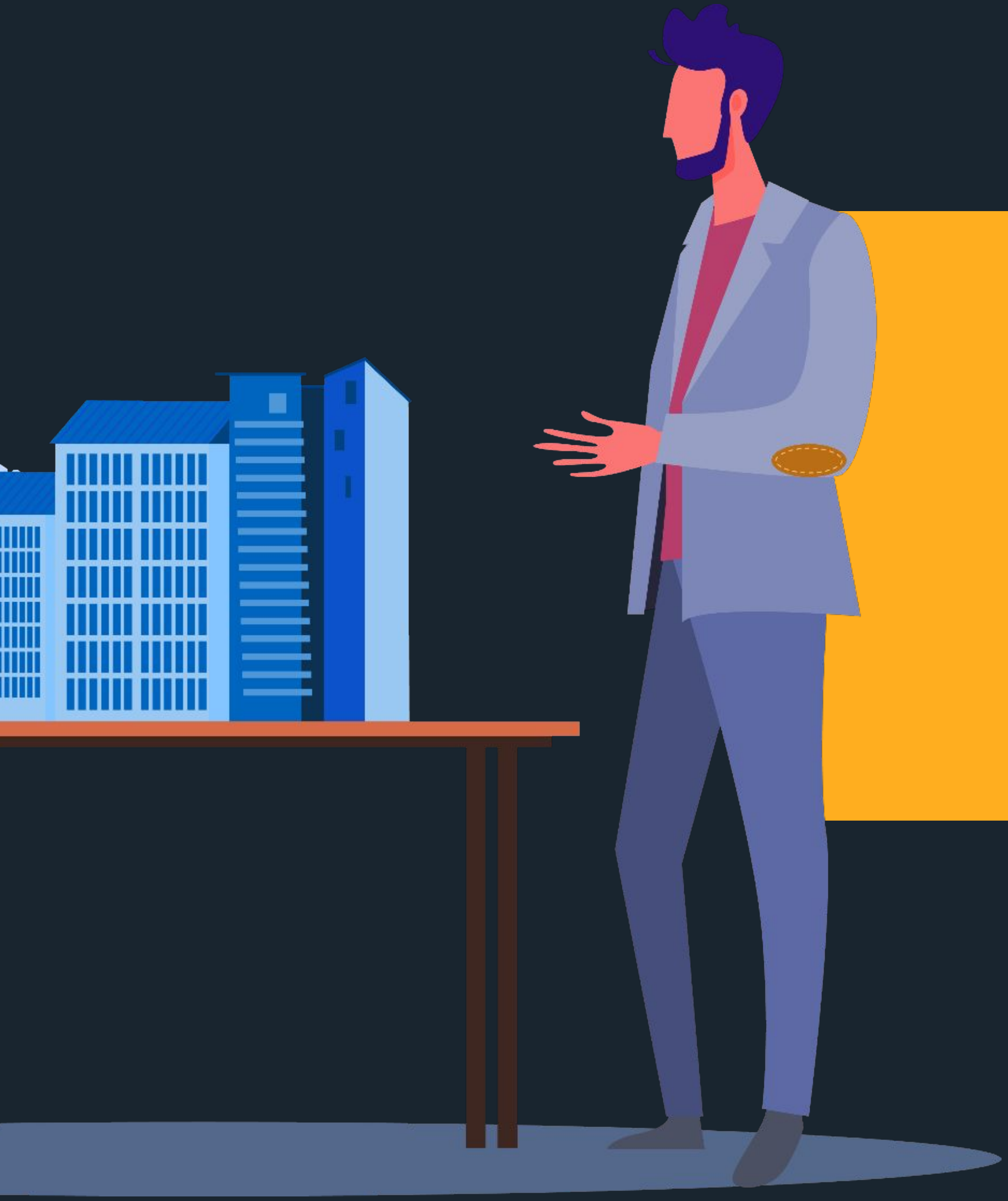
Partner Types: GP vs LP vs Equity Partner vs Key Sponsor



ASSET MANAGER:

The phrase is also often used to refer to GPs, though it has a slightly different meaning. The Asset Manager could be the same as the GP, could be a salaried employee, or could be a local partner.

Partner Types: GP vs LP vs Equity Partner vs Key Sponsor

EQUITY PARTNER:

As part of the GP team, their role and focus is to help raise money. Mostly, the equity partner helps the GP raise money, find investors, help to sign docs. Some equity partners also manage the investors and their tax docs for the entire duration of the project. Equity partners receive a chunk of the project, but there are strict restrictions on how their deal share can be structured. Examples are...

Partner Types: GP vs LP vs Equity Partner vs Key Sponsor

KEY SPONSOR OR PRINCIPAL:

A key sponsor or Principal is someone with a high net worth and a resume/track record of managing the type of asset being purchased.

Partner Types: GP vs LP vs Equity Partner vs Key Sponsor

KEY SPONSOR OR PRINCIPAL (CONT):

A key sponsor's net worth typically has to be at least as high as the loan amount on the property (other GPs net worth can also be used)

The key sponsor must have 10% loan amount liquid in bank account on the day of closing (other sponsor's liquidity can also be used).

For small properties, the GP (you or your team) can act as the key sponsor. For larger properties, you would need a key sponsor, and they would take a percentage of the deal for signing on the loan.

Partner Types: GP vs LP vs Equity Partner vs Key Sponsor

LIMITED PARTNER:

An LP or Limited Partner is the passive investor. While passive investors do not have any say in the running or disposition of the project, they typically provide most of the equity for the project.

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Case Study: To Understand These Terms

John and Joe get together and put a 100 unit building in Boston under contract for $5 Million	**Limited Partner**
John and Joe live in California so they ask Ken, a friend of theirs who lives in Boston to help to manage the property.	**Equity Partner**
Brad helps John and Joe raise the money for the down payment	**General Partner**
The down payment comes from Jason, Audrey and Keith	**Asset Manager**
The bank loan is for $3.5 Million. John and Joe's net worth is not that high, so they bring in Ken to get them up to that mark	**Key Sponsor or Principal**

Typical Fees: Charged in a Syndication Project

ACQUISITION & REFINANCE FEES

Promoters commonly charge an acquisition fee for the property. Let's discuss typical acquisition fees. These fees are paid when the property is purchased, except the Refi fee, which is paid later.

ASSET MANAGEMENT FEES

Asset management fees of 1-2% of Effective Gross Income are quite common. Some syndicators charge 1% of the equity amount instead, which usually tends to be about twice the amount.

SHARE OF RENT PROFITS

Promoters receive a percentage of the rent profits.

UPSIDE (PROFIT) ON SALE

At the sale of the asset, investors are repaid their initial investment 1st, then net profits (after accounting for investor capital, debt and selling costs) are commonly split between investors and Promotors in some ratio. If returns for the property are higher than a threshold, then returns ABOVE that threshold are split, but this time, the Promoters have a higher split.

Legal (LLC) Structure: What Does It Look Like?

Managers LLC

- Only GPs are part of this LLC
- GP splits disclosed in Op Agreement
- Higher liability
- Created in the state that property is

Investors LLC

- Asset lives here
- Managed by the Manager's LLC
- Lower liability
- LP/GP splits disclosed in Op Agreement
- Created in the state that property is in

Questions to Think About

How much money would you (as the General Partner or GP) need to put into the project yourself?

Does the equity partner invest his own money into the property?

Does the key sponsor invest his own money into the property?

What about due diligence, travel and legal expenses? Do they come out of acquisition fees?

Can you pay someone a fee to invest the Earnest Money?

Do the sponsors need to keep the liquid cash for the project in the bank for the entire duration of the project?

Lab Activity: How Much Do GPs Make?

Let's Figure Out the Amount of Money a General Partner Team Makes on a Typical Project

- The property purchase price is 10 million. Total LP equity is 3 million
- Acquisition fees are 2%
- Gross rents are 1 million a year, and they go up by 2% a year
- Asset management fee is 1.5%. For simplicity assume that total asset management fees were \$75,000 over 5 years (they did not go up or down).
- Splits between limited partners and general partners are 70/30
- LP Investors received total cash flow of 1.2 million over 5 years. GPs did not receive any cash flow and there was no refinance.
- The project was sold after exactly 5 years, and the total profit after paying buying and selling costs and all fees was \$3.8 million, not including cash flow.

Lab Activity: How Much Do GPs Make?

Let's Figure Out the Amount of Money a General Partner Team Makes on a Typical Project

- **Exercise 1:** Calculate total returns for General partners assuming THERE IS NO Pref for investors, just straight 70/30 split
- **Exercise 2:** Assume there were 3 general partners and each had 1/3rd of the GP pie. How much money did each GP make over 5 years on this one deal?
- **Exercise 3:** What was the Average Annualized Return for the LP investors.

Lab Activity: How Much Do GPs Make?

Let's Figure Out the Amount of Money a General Partner Team Makes on a Typical Project

- **Exercise 4:** What was the GP's Return-on-equity-raised. In other words, for every dollar that the syndicator raised, how many cents did the GP make?
- **Exercise 5:** For every dollar that the LPs made, how many cents did the GPs make? Was it 30 cents? Was it more?
- **Exercise 6:** If each LP investor invested $100K, and the syndicator's marketing cost to find the investor was $2,000, was this a good deal for the syndicator?

LIFECYCLE OF A MULTIFAMILY PROJECT

Let’s Walk Through an Entire Purchase to Sale Lifecycle

Phases: Multifamily Projects

Note that every Multifamily real estate project has a life and character of its own, but the goal is to understand the broad strokes of a Multifamily project lifecycle.

THE FOUR PHASES OF THE PROJECT

1

2

3

4

PRE-OFFER

POST OFFER

PRE-OFFER

- **Metro Research:** Jobs, path of progress, pricing trends
- **Team Creation:** Realtors, Inspectors, Property managers, Contractors
- **Opportunity Search:** Within target areas
- **Walk:** Comparably sized properties for sale in target areas
- **Opportunity Found:** First offer made based on seller's financials

POST OFFER

Due Diligence #1: Roof, sewers, repairs, unit condition, carpets, hallways, exteriors, electrical, plumbing, mechanical

Due Diligence #2: Verification of financials, rents, occupancy levels, delinquency, staff competency

Due Diligence #3: Walk comparable properties on sale to ensure that our pricing and assumptions are sound, and the property is a good buy

Repair Credit Negotiated: Price reduction negotiated after financial verification. If seller does not agree, restart at Phase 1

Promote: Team promotes opportunity to investors, through webinars and detailed Investor Summary and financial projection documents

Legal Entity Creation: Lawyers create LLCs to protect investors and management. Purchase completed typically within 75 days, property handed over

POST PURCHASE

Retrain/Replace: Management makes changes to property management team

Upgrades: Management make upgrades to amenities, interiors and exterior to enhance satisfaction & curb appeal

Evictions: Management transitions out or evicts undesirable tenants, and brings in better tenants with higher rents

Repair Budget: Used to improve the asset, increasing rents , lowering expenses, and enhancing profitability

Distributions: Investors receive checks for available cash flow, and receive financials & a property report from the team

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SALE

Operations: Management runs complex for 3-5 years. With market appreciation & better management, the property's income increases steadily

Exit: Typically, by Year 5 or before, the property's Net Operating income reaches the exit projections

Sale: Management puts property up for sale, and aims to complete the sale within a 6-month timeframe

Payment: Investors receive their principal back, along with profits

Questions: On This Module?

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