Deal Syndication

Video 2

Syndication Structure

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What's covered in this training?

Video 2: What's Covered?

- Legal structure of a syndicated deal
- Distribution waterfall
- Sponsor fees
- Who signs on debt

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Basic Syndication Legal Structure

- Sponsor forms LLC
- LLC purchases the property
- Sponsor sells "A" shares to investors
- "A" shares receive a preferred return (i.e., the first right to collect from property up to a certain return percentage)

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Basic Syndication Legal Structure

- Sponsor receives “B” shares
- B shares are entitled to share in the returns from the property if preferred returns to A shares is fully paid

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What is a "Preferred Return"?

- A preferred return is a right to receive the first distributions up to an agreed return
- Example: an 8% preferred return gives the preference holder the right to collect an amount equal to 8% of its investment each year, before the sponsor can participate
- Thus, if the investment is $100,000 and the preferred return is 8%, each year the investor must collect $8,000 before the sponsor can participate in the proceeds

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Cumulative vs. Non-Cumulative Preferred Returns

Two types of "Preferred Return"

- Cumulative: Preferred return arrears accumulate, so if the investors receive only 7% in Year 1, the sponsor does not participate in Year 2 unless the investors receive 9%.
- Non-cumulative: Arrears do not accumulate, so even if investors receive only 7% in Year 1, sponsor participates in Year 2 if investors receive the full 8% return that year.
- Cumulative is preferred by investors

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Sponsor Participation

- After the preferred return is fully paid, (including any arrears from prior years if cumulative) the sponsor may participate in the proceeds
- Many ways to do this. Typical examples are:
- 50/50 split over the preferred return
- Sponsor participation bucket (e.g., 25% of the preferred return amount), then a split between sponsor and investor

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Sponsor Participation

- We use an overall 80/20 split to investors
- Cumulative preferred return, followed by:
- Manager participation (25% of preference amount), followed by:
- 80/20 split to investor

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Sponsor Fees

- Sponsors are usually entitled to collect a number of different fees, including
- Acquisition fee
- Asset management fee
- Refinance fee
- Disposition fee

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Sponsor Fees

- We charge acquisition fee and asset management fee
- Acquisition fee = 3% of capital raised from investors, paid at closing
- Asset management fee = 1% of the capital raised from investors, paid every year

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Overall Annual Cash Waterfall

Waterfall we use:

- 1% asset management fee (off the top)
- 7-8% preferred return (cumulative)
- Manager participation = 25% of preferred return, paid if no preference arrears
- If manager participation bucket is filled, everything over that is split 80/20 in favor of investors

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What Happens on Sale?

On sale of the property, cash is allocated as follows:

- Mortgage balance
- Sale expenses (brokers, lawyers, etc.)
- Preferred return arrears
- Invested capital balance (to investors)
- Split remaining money 80/20

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What About the Mortgage?

- Only sponsors sign on the mortgage guarantees – one reason you're entitled to collect an acquisition fee and management fee.
- If you have an outside balance sheet partner (aka credit partner) sign with you, their compensation comes out of your end of the deal and does not affect investors.
- If it's an investor, they get to split your sponsor participation, so they collect from two buckets

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Other Syndication Considerations

- The higher the preferred return, the easier to sell the deal. But you have to make money too, so you must balance.
- Investors like to see "skin in the game." Invest a little if you possibly can. Investors usually happy if <u>someone</u> from sponsor side has money invested in deal.
- Often times, sponsors are putting up all the money for the deposit (getting it back at closing) and non-refundable costs and taking 100% of the risk of not closing. This is also "skin" and justifies taking acquisition fee.
- If you cannot, remind investors that you are signing on the debt and they are not, so you have skin in the game that way.
- If you put cash in the deal, you purchase an A shares, and your "investor" money is treated like every other investor's money.

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Limiting Your Liability As A Sponsor

- You have fiduciary duty to your investors
- You need to limit your liability to your involvement in this deal
- Do not want to be doing anything in your individual capacity
- You need entities for holding your B shares and for managing the property

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Business Structure Suggestion

- Holding company to own your B shares
- Asset management company to manage the deal
- Asset management company is the "non-member manager" of the property LLC and manages the property LLC pursuant to an "asset management agreement"
- You are managing member of the Holding Company and the Asset Management Company
- You are the Managing Officer (not a member) of the Property LLC

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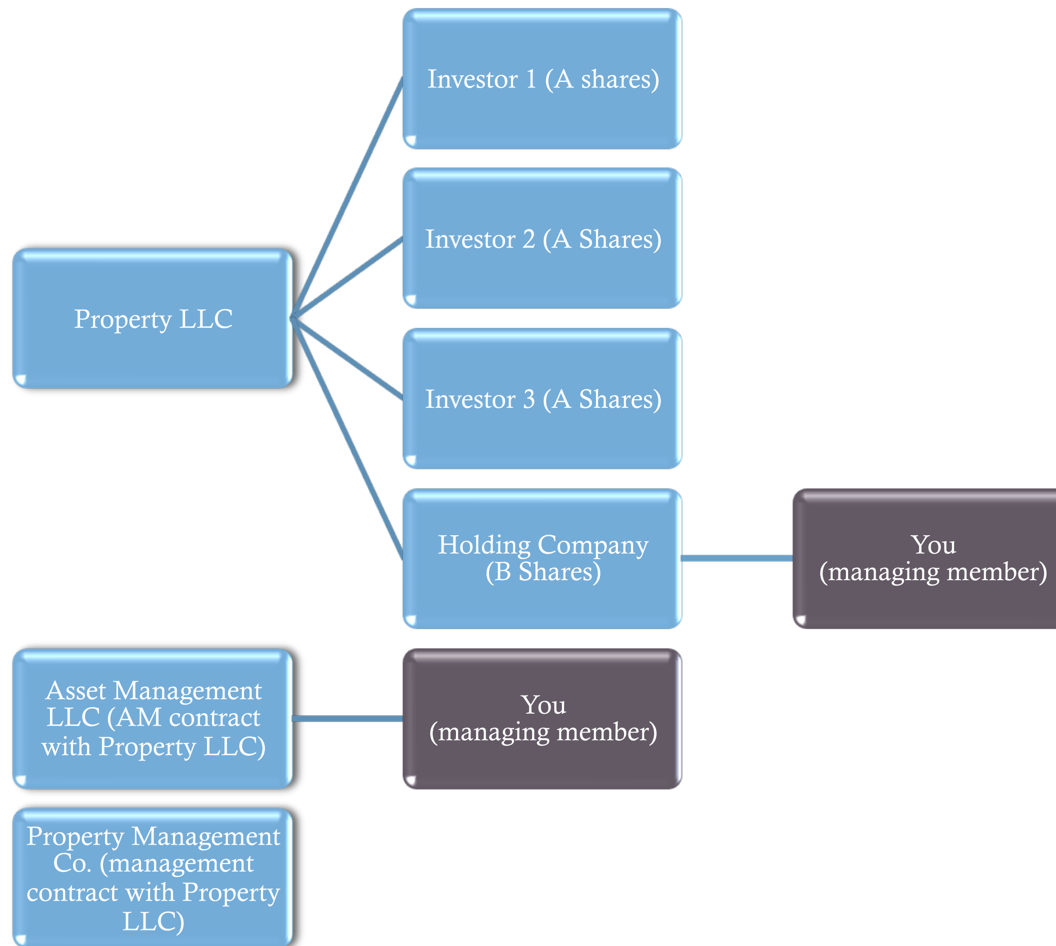
Example of Structure



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Up Next

Video 3: Raising Investor Funds (2 parts)

- What to do before the deal
- How to nurture your leads
- How to sell a deal to your investor list

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