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Real Estate Syndication/TIC:

Strategy for Small & Self-directed IRA Investors to Acquire High-Valued Properties

By David Tran

Lorain is a Dentist with \$900K in cash to invest in commercial real estate. She has been looking for a commercial property in the Bay Area for the last 2 years. There are few commercial properties in the \$1M - \$3M range for sale in the Bay Area. And if there are, they tend to be very old and in an undesirable part of town with a lot of deferred maintenance and financially-weak tenants. She wonders who would have the courage to invest in such a property. She cannot afford the better and more expensive properties. However, she noticed many good and affordable shopping centers outside of California with brand name tenants and high income. With her busy work schedule and 2 young children, taking time off just to see these properties is a significant task. Moreover, she would not know whether the area is a good place to invest. She would have to find a reliable property manager and then make business decisions like whom to lease the vacant space to, thousands of miles away. She thought there must be a better investment solution.

Sunny has been working as an Engineer in the Bay Area for more than 15 years. Over the years he contributed to his company's 401K plan and has accumulated over \$350K in his IRA rollover account. He notices the return on his IRA funds is underper-

forming. As he grows older, he is concerned about the volatility of the stock market. The recent scandals about backdating stock options, massive restatement of financial results and Enron shook his confidence in public corporations. He now wants to use his IRA money to invest in tangible real estate where he has more comfort and control. He learns that he could put this money in a self-directed IRA to invest in real estate. As he researches more, he can use money from self-directed IRA account as a down payment. But the IRS precludes any personal guarantee for the loan — minimizing his leverage. This personal guarantee is a major restriction because virtually all residential and commercial lenders require it. (A full-length article about how to use self-directed IRA to invest in real estate will be featured in a coming issue.) There is a solution.

What is real estate syndication/TIC? A real estate broker gathers a group of investors like Lorain and Sunny together as an investment club to purchase an income-producing property. The real estate broker is called a syndicator/ sponsor. The syndicator is motivated to look for the best property so he may promote it to investors like Lorain and Sunny. This property is often more expensive, e.g. \$7M-\$15M; thus, most investors cannot purchase individually. Lorain and Sunny are happy to invest in a

good property with strong income. The syndicator earns a commission from the sale and a contingent fee in the form of a 10% ownership of the property. So it's a win-win situation for both syndicator and investors. The syndicator manages the property, provides a quarterly operating income and expense report, and distribute income to investors.

Benefits to investors: The concept behind syndication is "it's better to own a part of a more valuable, stable, well-located property than to own 100% of a lousy property".

1. Lorain is pleased because she can invest in a good property with strong income and strong potential for appreciation. The property is in good hands with the syndicator; so, she can focus on her dental business and family.

2. Sunny is very happy because he owns less than 30% of the property, and thus, he does not have to provide any personal guarantee for the loan. He meets the IRS requirement and can still maximize leverage. His share of operating income will be deposited to his self-directed IRA account.

3. Since the loan amount to finance the property is substantially larger, e.g. \$6-10M, and the property has superior characteristics, the interest rate will be lower, e.g. 6% instead of 7%. As a result, the investors will receive a better return from their investment.



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Title under Syndication: the syndicator may form a Limited Liability Company (LLC) to take title to the property or vest title to the owners as tenants in common (TIC). An LLC will shield the property from potential liabilities exposure. For example, if one of the investors is sued, the creditors cannot go after the property. This is because the investor has an equitable interest in the property but does not legally own it. The LLC is the legal owner of the property. The syndicator is the manager of the LLC so he can make certain decisions, e.g. sign the new lease on behalf of all investors.

The Ownership and Operating Agreement: this is a document with rules to govern the investment club that all investors have to agree to. This will minimize potential disputes among investors. Some of the key rules may be:

1. No single investor can own more than 50% of the club.
2. Major decisions, e.g. to sell the entire property will require unanimous approval among LLC members.
3. Each co-owner has the right of first refusal when any other co-owners want to sell their share.

Loan for the property: the property normally has a non-recourse

loan in which the property is the only collateral for the loan. The lender cannot go after other assets of the investors in case of default. The lender will require all investors who own more than 20-30% (this number is specified by individual lender) of the property to fill out loan application. So, Sunny needs to keep his ownership at less than 20-30% limit because his self-directed IRA is the owner of the property.

Income Tax: All the income may be reported by individual investors on the Schedule E. For example if Lorain owns 30% of the property, she will receive an Operating Statement with income and expense information from the syndicator. She will report 30% of the income, 30% of the expenses, and 30% of the depreciation from the property on her schedule E. For Sunny, all the positive cash flow is deposited to his self-directed IRA account, and he defers some income.

1031 Exchange: The ownership interest can be 1031 exchange property if the co-ownership is not classified as a partnership for tax purposes. Thus the investors may get tax deferral on

a like-kind exchange of their fractional ownership interest.

The Happy Ending: The syndicator suggests both Sunny and Lorain to consider investing with 2 other investors in a \$7.9M, 2-year old, 30,900 SF, 12-tenant, and 100% NNN leased upscale shopping center in Lawrenceville, a fast growing and prosperous city in the suburb of Atlanta, GA. The property is located in front of a Walmart Supercenter; so, they both know it's in a prime location. The property currently has a \$6M non-recourse loan at below market rate of 5.6% interest through 2016. So while the cap rate is respectable at 7.25%, the cash on cash return is over 10% because the interest rate is so low. After reviewing the brochure and financial information of the property, they sign the subscription agreement to move forward with the investment.

DISCLOSURE: To ensure compliance with requirements imposed by IRS Circular 230, we hereby inform you that the U.S. Federal tax advice contained in this article is not intended to be used nor has this article been written to be used, and it cannot be used, by any taxpayer for the purpose: (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. No tax advice is being given by this article for any specific transaction. If you desire advice about any particular transaction, then please consult a professional tax advisor.

Q&A

Q: What's your thought on retail condos for sale in San Jose?

A: There are a couple retail condo projects in San Jose. The price is about \$600-700/SF. The upside is they are in good location where there is a shortage of retail spaces. However,

1- Most likely you will have problems financing your purchase because the unit is vacant initially. So you need to purchase in all cash.

2- With tenant improvement credit to tenant and leasing fee, the cost is close to \$700/SF. To get 6% cap, you will need to lease it at \$3.50/SF plus NNN. This is the fair market rent for retail space.

3- In a retail condo project, you don't have control about other tenants' businesses. If your tenant has a good business, others can open the same business next door to compete & take your tenant out of business. Besides, if other units around your unit have businesses that need a lot of parking spaces like restaurant business, you may have problem leasing your unit.

Have a question? Email to qna@efundingcom.com.

Commercial Real Estate Investment Club FREE Membership

Examples of Discussion topics

1. How to get started
2. Property Management tips
3. 1031 Exchange Information
4. Funding for commercial properties with lowest rates
5. Conduit vs. Portfolio Loan
6. Property Analysis
7. Forming LLC to take title
8. Taxes & Asset Protection
9. Opportunities in all 50 states
10. Real Estate Syndication & Partnership
11. Using IRA fund to invest
12. Best properties for sale in 50 states

To sign up, please email to creic@efundingcom.com.

3 Free Seminars

1. TIC/Syndication: Strategy for small and self-directed IRA investors to acquire high-valued properties.
2. How to maximize cash flow with 1031 tax-deferred exchange.
3. How to invest in commercial real estate for retirement income **NOW**.

Please call Maria at 408-288-5500 to for schedules & reservation.

Testimonial from an attendee:

"At first I was a little skeptical coming to David's seminar. But in 2 hours, I learned more about Commercial Real Estate Investing than I have from books or other investment programs."

Michael Cuthrell