**EPISODE 294**

[INTRODUCTION]

**[00:00:00] ANNOUNCER:** Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

**[0:00:24.3] WS:** This is your Daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Rahul Patel. Thanks for being on the show again, Rahul.

**[0:00:32.9] RP:** Thanks for having me, man. I appreciate it. I'm glad you invited me back.

**[0:00:35.7] WS:** No. I'm glad to have you back. Rahul was on the show WS 2017. I would encourage you to go back and listen to that and learn more about his background and his specialty.

A little about him, he's an attorney, licensed MBA agent, real estate developer, professor, speaker and serial entrepreneur. I was able to see him speak at a big event where I was at. Was very impressed at his knowledge and his ability to deliver content. I know everybody in that room who was there could understand that there's many hundreds of people there.

Rahul, if you want to give the listeners a little more about your background and yourself, that would be great. Then let's dive into this big topic of formation of entities and what we need to know about those as a deal sponsor, or syndicator.

**[0:01:17.9] RP:** Sure. Well, I appreciate the introduction as always and a pleasure to be on your show. Actually, we've had a few people already reach out to me after the last show. It feels good to know that people been able to learn something from it and be able to have that opportunity. Much like many other people, I grew up around real estate. My family were small independent business owners and they hustled and they had to find lines of credit and had to find banks, had to find friends and family to give them money.

They were, well, I would say successful in the real estate industry. A lot of that I absorbed in the pre-iPad era, where you just followed your parents around and learned a lot. Now we've been able to transfer a lot of that knowledge for our clients in the legal space. I appreciate the opportunity to be on the show again.

**[0:01:59.1] WS:** Awesome. No, thank you again for that and your time and just sharing your expertise. I know the listeners have learned a lot on the previous show and will this time as well. Rahul, in this business where you're about how many entities, what types of entities? How do we know where to even start to figure this out, right? I guess, get us started with this topic, the formation of entities and what to do and maybe let's go back to when we're just getting our business going, to actually doing this deal.

**[0:02:29.9] RP:** Sure. Take a step back, it tends to be the chicken and the egg conversation for many folks, right? They have an idea, or they have a project that they're looking to go, or what project they might be looking for. They've started talking to some friends and family, or they've started talking to some people that might be potential investors, co-workers. They've got that and they've looked at some deals. Now it's a question of where to start. A lot of folks, they start away, well, first on maybe making the name of a company. What's our company going to be called? More importantly, what entity structure are we going to be in, folks? Do we get the money first, or do we find a deal first? Do we create an entity first and then go figure it out?

That's the challenge that I think a lot of folks have. Breaking down into an entity, let's put it this way, you're going to have to have some sort of corporate structure, period. If you're going to do a deal at some point before you close, you're going to have to have a corporate structure. The two most common corporate structures we see in real estate syndication deals and multifamily primarily are an LLC structure, or a limited partnership structure. Those are two separate types of structures and models. Both of them are very widely respected, widely used and there are pros and cons to each one. It just depends on what you're going towards. Those are your two biggest drivers; a limited liability company, or a limited partnership.

**[0:03:51.6] WS:** Okay. Limited liability company. Limited partnership. Let's dive into how would we know which one we need to use? What are some things we need to be thinking about?

**[0:03:59.4] RP:** Well, so that's the thing that gets a little bit, I would say not tricky in a bad way, but tricky in a good way, right? It really depends on what deal you're doing. We'll spend a little bit of time breaking down those two for a lot of folks that don't know. A limited liability company is what I would say, one of the most simple forms of an organization that you can set up. There are two types of ways that limited liability companies are set up. They can either be member managed, or manager managed. What I mean by the two? Member managed means the members of the LLC.

Let's say you and I were two partners and we were going to go do a real estate project. We didn't need any other partners. We didn't need any other equity. It's just you and I. We were 50/50. Well, we can be member managed in the sense that in order to make major decisions, or do certain things, we would need the members to buy in. You would have to sign off and Rahul would have to sign off.

There are lots of nuances to that that we could figure out and say, "Okay, well half of these things because Rahul is the main boots on the ground, he can do these deals without having to come back and ask me whether it's doing a repair for $500, right? Or hiring a property manager." There might be certain things that each of us can be responsible for, but that's essentially the members of the company are making the predominant day-to-day and business type decisions, the members themselves.

Now another way to split up an LLC is to have it manager managed. You have somebody who may not have put in the requisite amount of capital, or may not be an actual member in that sense, but their manager drives many of the decisions. For example, say I'm 80% of the deal, or 90% of the capital, and whether you've got – you're getting started and you're putting some money in and you come up with the rest. We can make you a member at 20%. I'm a member at 80%. We also make you the manager of the entity, okay?

You’ve got a set of responsibilities and duties as the manager, but you're not the owner of the company as the manager. We could have a third person, separate aside, put no money in and be the manager of our entity, right? Essentially like, put it in this way in simple terms, They’re kind of like the CEO of the LLC, right? They're there to make decisions, do things, hopefully make some profit and maybe get some waterfall provisions for them. They're the day-to-day driver of the decisions. Those are your two types of LLCs.

Now the question is which one is right, which is wrong? There's really, there's no right and there's no wrong to that. A lot of factors come into play; what type of equity pool you're using, what your bank requires when you go get debt, what your investors want to? Many times, your investors who have a lot of capital will say, “Look, we want you to be a member. We want to be able to make the decisions. We want to make sure that things that come down to impact our business come back to us to make the decisions,” if that makes sense, right? There's really no right or wrong, but that’s the two most common LLC structures that you see today. You have to elect one, either be member managed, or manager managed.

**[0:07:01.8] WS:** Okay. I want to back up a little bit. When someone is getting into the syndication business, they start an entity that normally an LLC it seems, but that's before they probably have ever had done a large apartment deal, or maybe they've had small multi-families and that type of thing. I guess, we need to understand this is probably going to change, or we're going to have other entities. What does that look like though, going into that first deal and should we still have that first LLC, or is that even connected at all?

**[0:07:29.3] RP:** If you've done a deal, then you probably have set up an LLC. Typically, the small deal, it's the easiest format, it's very easy for you to set that up and get moving. As far as how to set that up, or which one to set up, you really have to decide first, what type of deals you're looking at. That can drive many times your decision. Now, it doesn't mean by the size of the deal. You've seen 20 million dollar deals that can go with an LLC and you've seen two million dollar deals that go with an LLC. It doesn't really matter on the size of the deal, it really matters what are the pieces that are you putting around it.

Most instances, the primary driving factor is going to be your lender, right? What does your lender require you to do? The good thing though is let's say you've set up an LLC and you spent the $300 or whatever it is to set up the entity and you go, “Man, now what do I do?” Most times, we can use that entity and convert it. We can convert it from a member manager to a manager managed. We can also convert that entity altogether to a corporation, or another type of entity.

There are lots of provisions that you can do to do that, or sometimes you can start over, right? It's not that hard to do that. There is no right or wrong, but the best advice, I think I gave it last time, was if you have lender friends and lender contacts, start to ask them what they need and what they like. Your best bet is to give them a structure that they're comfortable with and they know and they recognize, so you're not working harder to get the same amount of money. Does that make sense?

**[0:09:02.7] WS:** Yes.

**[0:09:03.7] RP:** If your bank says, “We really love LLCs and this is how we like to do them and this is how we go,” then why give them something else? Give them what they need, and you can work within the parameters of that structure.

**[0:09:14.1] WS:** I don't want to skip the limited partnership discussion and we talked about the other. I did want to ask you those common ways you're talking about, that either the investors, or they lender, like to see that maybe you could elaborate on.

**[0:09:28.1] RP:** I would tell you, the more complex it gets, typically limited partnership structures can become favored. Here's a big difference generally, now there's always exceptions to every rule, so don't take this as an absolute. In a limited liability company, the members are responsible for the actions and the entity themselves. Let's say I've got an investor who wants to put a $100,000 in, he's getting a 7% return, and that's really what he wants. He doesn't want to be involved. He doesn’t want any day-to-day decisions. He just wants to get his return and he doesn't want any risk, right? The worst-case scenario, this entire project doesn't go well, and I lose my money, but I don't want to be sued. I don't want to be on the hook for further deficiencies.

Well, a limited liability company structure doesn't allow for that typically because the members by virtue of it in and of itself are those member managers, manager managed, are making decisions. In a limited partnership structure, you could bring that person in and make them a limited partner. What that means is, say, what does that mean? It means that the partner is limited in exposure, typically to the amount of capital that they've contributed.

Unless you somehow can pierce these corporate veils, if you've ever heard that term where you're acting as if you're an actual operating controlling partner, but yet you're hiding behind the veil of being a limited partner; it’s very hard to go after you individually for that, right? A lot of folks who were coming in purely for equity liked that play because it gives them some autonomy and control, but at the same time, it insulates them from the decisions that maybe you and I are making every day as the operators of this business. Does that make sense?

**[0:11:11.7] WS:** It does.

**[0:11:12.2] RP:** Limited partnership structures can be very favorable there. Banks can also replace the general partner, so there's two umbrellas to that. You have a limited partnership structure here, you have a general partner over here and then you have a series of limited partners. I can get you a good graphic that displays that. In that structure, the general partner, sometimes they have on this side of the fence, you need two; you need a general partner and at least one limited partner. You could have a row of limited partners, or one, but this general partner is really a zero percent, usually the owner of the entity. They're there to make decisions and drive the business itself.

The good thing is for a bank, a lot of times is they can replace that GP with somebody that has experience, if for some reason the project's not going so well, keeping the limited partners in place. Does that make sense?

**[0:11:59.9] WS:** It does.

**[0:12:00.9] RP:** It’s a very favored structure as you get more complex. Typically, in deals of I would say, seven to 10 million dollars and up, it can become a good, favorable model that the lenders and banks and different folks really understand, and it makes a lot of investors very safe to come in. It allows for easier entry for folks that come in with trust and IRA investment vehicles, individual LLCs, things like that, to come in on this side as different LPs, under different vehicles as well.

**[0:12:32.1] WS:** How does that make it easier for them to come in as far as from a trust, or IRA?

**[0:12:37.0] RP:** Typically, what happens is in an LLC, what happens is you've got to go back to the members for everything, signatures on anything. If there's a bank, you got to go back to them for everything for every lending. They might have to be on the hook for the debt as well. In an LP structure, what happens is typically a lot of institutional lenders, for example if you're an LP, a limited partner that's under 10%, they won't need anything from them. They'll just need to know who they are, but they won't need to get their sign-off, they won't need to get their credit check, they won't need, again, I use the asterisk, typically, right?

What happened, because then you go, a lot of times what they'll do is they'll say, "Oh, well I'll make all my investors 9%. That way nobody has to do anything." Well, if you have 10 of those and it could be a challenge, but what that allows for you to do is it's a General Partner over here, they get to make all these decisions, sign-off and everything. The credit can be run on them it can be operated on them, but you have these limited partners over here.

That's why it becomes easier, because in an IRA you might have five signature blocks; the trustee, the beneficiary – so on the LLC structure, you're going to have to go back every single time to get their signatures and you open them up to know who they are. Banks then, it gets a little complicated, if that makes sense. That's why in the LP structure, you can come in with different investment vehicles and it becomes very, very understood by the industry.

**[0:13:54.0] WS:** Nice. Okay, so limited partnership. Any other pros and cons of the limited partnership that we should elaborate on?

**[0:14:01.1] RP:** Pros and cons for both of them. Let's talk a little bit about some cons, a limited partnership structure can cost more to set up, because you've got to set up a limited partnership and you also have to set up a general partner, which is typically an entity. Now you got formation of two different entities, right? A limited partnership, for an example, in Texas, it's $700 plus dollars for the limited partnership, $300 plus dollars for the LLC. Already a 1,000 versus just 300.

On top of that, you need an operating agreement for the limited partnership that controls how this runs and then you also need an operating agreement for the LLC, right? How that runs. You do have additional costs in terms of setting of a limited partnership structure, versus setting up an LLC, right? It also requires you to have a strong general partner to understand how that deal is going, right? There are some pros and cons versus the two and how to set them up, typically.

**[0:14:53.7] WS:** Yeah. Could you just go through that? I know it's hard if someone's not watching this on YouTube, probably, but if they're just listening. Maybe go through that structure there. I know you said the limited partnership and then an LLC over here, that's the operators. I guess, go through that flow just a little bit to help us understand.

**[0:15:09.3] RP:** On the LLC side, or on the LP side?

**[0:15:11.9] WS:** Yeah, LP side.

**[0:15:14.3] RP:** On the LP side, if you're not following along, or not able to watch, imagine we've got a piece of paper. At the very top of that paper, we draw a box that says, “limited partnership.” There are two arrows going to be stemmed south of that, one going to the left, one going to the right. Imagine the left arrow saying, “general partner” and the right saying “limited partner,” or “limited partners.”

Now on the right is your general partner. You usually create one entity, that's the general partner. What that does is that company, or that LLC’s sole purpose is to make and run the actual business itself, whatever it is that the LP, the limited partnership owns. In this case, a multi-family. The general partner makes decisions on where we should get the financing, whether we should do a capital improvement project, whether we should change leasing rates, whether we should do all these things. They're basically making the predominant body of decisions.

What you do is you create a standalone entity that owns nothing. It's called SPE. You ever hear of SPE? Single-purpose entities, or banks require SPEs? What they're saying is, “We don't want this entity to be viewing a whole bunch of other things. We wanted it to do one thing, run this business that it owns, okay? We don't want to exposure, because if they're doing five other things, something happens over there, guess what it does, it opens us up to liability here.”

Let that entity do the decision-making from there. Now the reason why you don't put a person there individually, but you put an entity there, is it allows for you to shield some exposure possibly if you made a mistake, right? That's why you still get the protections of an LLC for your general partner. Now the other side of that, those two arrows I talked about, was the LPs. On the LPs, whether it's one or 10, doesn't matter, consider them your primary capital partners. They're limited, they’re termed ‘limited partners’ for a reason. Limited in their exposure, also limited in their involvement.

Now you could be an individual on the limited partnership side, but you could also be one of the members of the LLC that's running the GP as well. It doesn't prevent you from being on both sides. It's just saying, “This entity, this $200,000 I put in, it's coming in with this limited partner, but we're limited in our decision-making, limited in our exposure as well,” if that make sense.

Those are the two umbrellas that you have to have is at least a GP and at least an LP, or a limited partnership to run.

**[0:17:47.0] WS:** Well, that makes sense, if I'm the operator, but I'm also investing passively in the deal. I'm going to be on both sides.

**[0:17:52.4] RP:** You could be on both sides, right? You could be in the general partner under operating general partner, LLC, right? Let's just say, WS Investments LLC. You and I are the two members of that one. Then on the LP side, you've got WS Family Trust. So, money that you've set aside, you come in as a trust over there and be an LP over there. Does that make sense?

**[0:18:16.7] WS:** It does. It does. As far as – I was going through that structure there. I was thinking about that. What are some maybe common mistakes that you see people making when either setting up these structures, or on the sponsorship side, coming up with entities too quickly, or how this is messed up more times than not, that we should be watching out for?

**[0:18:35.4] RP:** Typically, how they're messed up, is sometimes you put all these vehicles in place and then you don't give yourself – you lose the protection. In the general partner side, don't make yourself an individual over there as a general partner. Or the same thing possibly as a limited partner, don't make yourself an individual in the limited partnership side too, because you've just taken away the protections that you tried to put in there.

The other side of when you form them, it's typically what I would suggest is you lay out your general structure of how you plan on doing this with your partners and your investors and with your bank. Now as you get closer to it, as you involve your legal team and then you figure out what deal you're going towards, that's when you can determine whether the LLC needs to be a member managed, or manager managed. Quite frankly, nobody may care. Your investor may not care. Your debt structure may not care.

At that point, you make a decision that's best for you. Sometimes they may care, right? At this point, I would say lay out the general structure and then you can always pick. If you've already picked, let your legal team know what you've picked. The biggest challenge is people hold on those documents and don't let them know, come as you get driving down the form, you say, “Well, we've set all of this up as a manager managed LLC and now everything needs to be converted to a member managed,” or vice versa. Now you create a lot more work, you create a lot of confusion at the last minute.

What I always say is whatever you going to do, lay it out there, because at the early onset if you're getting advice to change it, you can change it. Again, one of the biggest things people is that, “Well, my other attorney told me this.” They're not wrong. That's just could be their preference of how you organize it and how you set it up. There really is no right or absolute wrong way. Now there are some wrong ways. Don't buy a multi-family project in your own individual name and say, “I'm going to do it under Rahul Patel.” Don't do that. That I would tell you is probably a wrong way to do it, right?

**[0:20:27.9] WS:** Of course.

**[0:20:28.8] RP:** It enhances whether you pick a manager managed, member managed, limited partnership. You really aren't making a wrong decision. It just may not be the most effective, or it may not be the most protective measure. At the end of day, there is really no right or wrong.

**[0:20:42.0] WS:** Are there any specific things though that protect, say the LPs the most?

**[0:20:46.6] RP:** Yeah. I think the best part about a limited partnership structure is if you have LPs that are under 10%, most banks don't really care who they are. They just know that they’re LPs for a reason. They can't come in and hijack the company. They can't do a lot of things, unless you've been doing fraud, willful misconduct, things like that. They can't really just come in and take over. They don't really care who they are, like in a manager managed – I mean, or on an LLC. They need to know who every member is, because every member has a say, right? They have an ability to run the decisions of the company versus in an LP, or a limited partnership structure. The LPs are limited. They don't care as much.

You can get over some hurdles of well, “My investor has XYZ, or they've got this on their record, or they don't really want to sign on a bank loan for whatever reason,” or whatever those things are, right? They don't want to take a lot of risk. A lot of folks were looking for good passive income, they want to get a good return, but they don't want to take any additional risk, right? It's like a stock. If you buy a stock and it tanks, you never get your money back. There's upside, but there's no additional downside. You don't get a call from Apple and say, “Hey, our stocks slid. You owe me an extra 50 bucks to keep your shares, right? If not, you're on the hook.”

There are some things that limited partners really like in that structure. Again, it depends on what investor you're going for, right? Some investor might say, “No, no, no. I want as much involvement in this as possible.” In that structure, you might want to bring them from an LP, and also, add them to your GP structure, right? Because maybe they're bringing a lot of capital, a significant amount of capital. Even around that, there's a solution. It doesn't mean you have to switch to an LLC, it just means “Okay, let's make you a part of my general partner. How does that look?” Does that make sense?

**[0:22:31.4] WS:** It does. It does.

**[0:22:32.5] RP:** Yeah. A lot of times, the general partner, that's where the fees and the upside and the things are sitting, because you're saying, "Look, I'm going to run this show. I'm getting all the money from all of you guys on the right-hand side over here. If there's thing cranks, makes money and I'm able to sell it, or I'm able refinance it, that's where my general partner gets to earn my money, right?" We brought all this to the table, so that's where that a lot of those fees and earnings can sit, even if you didn't necessarily bring in capital for that. Does that make sense?

**[0:23:02.1] WS:** It does.

**[0:23:02.6] RP:** That's why it's a good structure for a lot of folks who are raising capital, but may not necessarily have their own capital to invest in.

**[0:23:10.1] WS:** I want to dive into that general partnership side a little bit. Of course, we have the LP, then we have another entity under that that the operators are in. What if there's – let's say there's a couple of managers, two or three managers. Would you recommend them having their own individual entities that are part of that entity then, or is that overkill?

**[0:23:29.7] RP:** Yeah, on the LLC side?

**[0:23:31.1] WS:** Yes.

**[0:23:32.3] RP:** I mean, people do it. People do it all the time and it's not that it's overkill, but it can become challenging then for a lot of reasons, right? As long as you've got your LLC structure and you're a member, the exposure is already there as a member or manager, right? I'm not saying that people don't do it, people don't put entities within entities, it's just a matter of sometimes preference of how it's coming in. We do it all the time and I've done it myself. It's not like, "Hey, I'm giving you…" You shouldn't, but it's sometimes it could be overkill.

**[0:24:05.4] WS:** Okay. Okay. Well, unfortunately we are running low on time.

**[0:24:08.6] RP:** No worries.

**[0:24:09.4] WS:** Anything else you want to leave us with before we have to go?

**[0:24:12.6] RP:** You know what I would say is, I was giving somebody some advice the other day. Actually, they called me from the last podcast we did. I said “Look, at some point you could only think things through so many times. You just got to get off the bench and go in the game. Don't regret it if you don't and don't regret it if you do. Just figure out which one you want to do,” right? At some point, you're going to learn very quickly. You may form an entity. You may spend some money and you might go, “Oh, my God. I got to redo all this.”

Yeah, you may, but at the end of the day, you will never really learn until you're in there. If you're not going to go in, don't worry. If you do go in, just go. Start making some decisions. I go back to the last podcast. You have to have as many conversations with people as possible. Ask them, start with the bank that you might – because if you're going to go buy a three million dollar project, right? You need two million dollars a day, you better have at least had some conversation, who's going to borrow you the two million dollars, right? Or loan you the two million dollars? Ask them first.

Then as you start to get people who committed to money, ask them, “Hey, do you have a preference? This is most likely leaning – my lender is most likely going to require me to be a limited partnership structure, do you have a problem being an LP?” “No.” “I’d like to see how that looks.” “Fantastic.” Now you've set down the course, versus doing something and nobody likes that structure, or at least who you're working with. Does that make sense?

**[0:25:35.2] WS:** It does.

**[0:25:36.6] RP:** Really what I would say is ask a couple of questions and just start, because at the end of the day if you go to an investor and you've got documents, you've got a structure in place, they will at least look at you and say, “Look, you’ve put some thought into this. You know where you're going with this and now, you'll feel more confident.”

**[0:25:51.7] WS:** Awesome. Rahul, you're a great guest. I really appreciate your time and sharing your expertise on the show. Tell the listeners though how you like to give back.

 

**[0:26:00.6] RP:** Just like this, being given an opportunity to educate. I never bother people to say, “Hey, you have to call us. You have to do this.” If it can help one person make a good decision, start a business, follow their dreams, I think that's the biggest to be able to give back as possible. A lot of folks didn't really grow up around the business community or business world, and so this is completely foreign to them, right? The opportunity to really be able to educate somebody – and sometimes you have to be the biggest believer in yourself.

If you've thought this through, you've done enough research, you’ve done enough homework, sometimes you just need a little bit of advice. Hopefully, if somebody heard this, listened to it and said, “Okay, you know what? I'm over my fear. I'm going to start this.” Go for it. The best start is doing something. Once you do that, you'll find out hey, what you did right or what you did wrong, but whatever you did wrong you can learn from that if you know it.

**[0:26:48.0] WS:** How can they get in touch with you and learn more about your practice?

**[0:26:51.2] RP:** You can go to our website which, is www.patelgaines.com. Patelgaines.com. Or you can always send an e-mail at info@patelgaines.com. We’re happy to help you. We've run through a 100 plus syndicates, multi-family has been a huge area our firm anywhere. We’ve dealt with Fannie Mae, Freddie Mac, institutional lenders. I mean, you name it, we've seen it all. I've gone through CMBs up and down, turn cycle two. There's so many different things you've seen.

What I would say, no matter whatever you choose do two things, your lawyer should be your counselor not your document prep guy. It should be somebody who's advising you, telling you, listen to them, listen to them when their advice is critical of you, of what you're doing. Listen to them when their advice is saying, what are you doing? Find somebody that you can jive with, at the end of the day they're on the same boat with you, trying to shovel the water out of the boat just like you are and they're trying to plug holes. They're not trying to make you sink, because it doesn't do you any good.

So, what I always say is final lawyer, find somebody that can help advise you and guide you through this and there's no shortcut to that. I've seen a lot of folks who genuinely make mistakes by just finding forms, finding documents, trying to run through that. There's no shortcut. If you're going to do a one, two, five million dollar deal, get good advice, especially if you haven't done this 25 times, right? If you ever have a question, hopefully – I've seen a lot of your podcasts, you offer a wealth of knowledge. Hopefully, this is an opportunity and get back.

[END OF INTERVIEW]

**[0:28:20.2] ANNOUNCER:** Thank you for listening to The Real Estate Syndication Show, brought to you by Lifebridge Capital. Lifebridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Lifebridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success

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