EPISODE 649

[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]

[0:00:24.4] WS: This is y our daily real estate syndication show. I'm your host Whitney Sewell. Today, our guest is Gene Trowbridge, thanks for being on the show again Gene.

[0:00:33.9] GT: Happy to be here Whitney.

[0:00:36.0] WS: I'm always honored to have you on the show and I just want to complement Gene on his knowledge of this business and I encourage you to look him up, if you do not know of him. He's been on the show numerous times, we've talked about so many aspects, important aspects of this business on the legal side that you must know if you are an operator or a passive investor.

He's the founding partner of Trowbridge law group LLC. He helps over 400 clients, just 506(c) NB offering, regulation D. I'll point that I like to also make about Gene is that he's a former syndicator. He's done both sides of this business and understands this business extremely well. He's a CCIM senior instructor and won numerous awards, I also want to say, you've written a book called *It's a Whole New Business*, you may not be able to see it but I'll go ahead and hold mine up here, I've got a couple of copies of those, and would sometimes even give them these gifts to other people in the business.

Just encourage you to have that book on your shelf as well. Welcome again to the show and I want to tell the listeners, Gene and I are I should say Gene — he's going discuss some things as an operator and as an investor that you should know about the private placement memorandum. We're also going to do following shows, elaborating on the operating agreement and these subscription agreement as well.

I know, just going through the capital raise process for deals that we're doing, there's so many questions, right? How did you fill out this document or what does this question mean, or if I'm an entity, does this mean this or how do we do that and so looking forward to Gene just elaborating on some of that and you as a listener being able to have a better understanding, whether you're an operator or passive investor, you'll know better about what you're looking at and looking for.

Gene, thank you again and let's get started.

[0:02:14.6] GT: What I've done here is I've put together a sample set of documents that I'm going to demonstrate. This happens to be a sample set on a blind pool. Which you're going to find out there's not specific property and these sponsors, we're going to buy multiple properties and that's a hot topic today in today's environment, but as you're going to see, it's still worth looking at this. There's very little difference between the line pull operating, offering documents and specific property documents.

[0:02:48.4] WS: I would tell the listener too that this would be on YouTube. If you can go even watch it there, you're going to actually see the exact document that Gene's going to be talking about but either way, you're going to learn a lot just by listening into him talk through many of these points, go ahead Gene.

[0:03:02.2] GT: That's right, if you're watching right now, I have the document on the screen and I think I blown it large enough so people can see it, right, Whitney?

[0:03:11.0] WS: I think so, yes.

[0:03:12.2] GT: This is not going to be a monolog, Whitney, you just chime in, interrupt me, whatever, because we got a lot to cover in 30 minutes. I'm like a railroad train, going down the track. Overall, I just want to make one comment. There are a lot of different private placement memorandums out there, every attorney has their own craft, their own art. If this was science, there would be one private placement memorandum for the entire world. But it isn't, it's somewhat art. However, in regulation D, there's something called Guide Five, and Guide Five tells the attorney how to draft the offering documents, tells them how to do a PPM or a real estate investment.

So, every PPM is going to have all the sections that we talk about. We may not all put them in the same order, and we may have different ones like I said, the art of the deal here on what inside each section set is. These are my documents and this is the way I do it. The very first thing we're going to see is a summary. This has it all, start of information unit. It says that this private placement relates to the sale of interest in the Trowbridge apartment group, a Texas limited liability company, the unit price, the minimum and the maximum and what the timeframe is. In this offering, we're going to have $10,000 units.

The minimum is five million dollars so when the sponsor hits five million, they can break impounds and go out and use some money to buy the property or 15 million is the maximum. Now, in a blind pool, you're going to buy multiple properties. The minimum should be enough to at least buy, according to your business plan, to buy one property.

In a specific offering, we may have a property analytics, an awful lot of rehab and maybe you're going to raise the money and do the rehab yourself for maybe three million dollars, you can close on the property but it's going to take you another three million to do the rehab. Well, in that case, the minimum would be just enough to close the property and then you keep raising money until you get the maximum and then you'd have enough to do the rehab.

Here's the timing, it tells you when the offering commences, there's a minimum, we have to raise the minimum dollar amount by August 31st and then we have until February 28th. Now, this isn't a normal document, I did this to demonstrate that you have one year under regulation, these maximum times you have to raise money — is one year. The way D form, the form D file is only good for a year so if it's more than a year, you have to come back and do some modifications but I set this up so you'd see it starts in march and ends in February.

And then, this offering is interesting because it says that the sole discretion of the manager, we could go to 20 million. Why that's important is, I have clients come to us Whitney, well, I want to raise 20 million and I say, well that's good but if you raise 15, you know, you're going to be a failure. Some people are going to think you're a failure. Why don't you just try to raise 15 and if it's going well, you can always go to 20. There's an example of the art in the deal, right?

That's an important part, the summary and then and I'm not going to go through all this is all the disclaimers. One important part about this offering is this is a 506(c). This offering allows us to advertise and to anyone but only take accredited investors. That really will show up more importantly in the operating agreement and then the subscription agreement.

That just really tells you what's happening in 506(c), we can advertise limited to accredited investors in 506(b), we can't advertise, we can take sophisticated and accredited investors. All this stuff is here. One of the things that I mean, there's a reason it's capitalized, because Guide Five tells you to capitalize it so that's al it is and this is really, really boiler plate. Okay.

Now, the PPM is the story. Okay, the PPM is really the story of all of it and should be as much as you can, written in plain English. The operating agreement is the legal document that tells you the legal rules of how you're going to implement this story and the subscription agreement is really the investor's offering to buy part of this offering and some background information they're giving their sponsor to justify whether the sponsor would accept them.

We start out in my documents telling the story through the executive summary. This is really important to read, maybe it's two pages but it has a lot of stuff that talks about the company's objectives and here is what we're going to do this one is going to just buy two or more properties — in major population centers in Texas, Arizona, and in Florida.

Even though it's a blind pool, we're putting handcuffs on the sponsor, right, Whitney? The sponsor can't buy retail property in Nova Scotia. Okay, you've got to buy multi-family in Texas, Arizona, and Florida. And then it tells who the manager is.

[0:09:27.9] WS: Should they limit themselves too much right there in those objectives?

[0:09:32.1] GT: Well, I think they should limit themselves reasonably, I think Texas, Arizona, and Florida — it's a big market.

[0:09:37.7] WS: Right.

[0:09:39.5] GT: I think that's okay, that's somewhat of a marketing question. If I put together an offering and say I can buy an apartment anywhere, you'd have to have pretty good confidence in me but if my track record is Texas, Arizona, and Florida. That's where you want me to buy properties, right?

[0:09:59.2] WS: Right.

[0:10:01.0] GT: So, here is the company information, the manager, the company is separate entity, Trowbridge Manager LLC, and that's who is going to be in charge, and that will be descried all the sections will be described more thoroughly in are the rest of the PPM.

What are we going to do? We're going to purchase, rehab, manage, refinance two or more properties in these states and the properties will typically have a minimum of a 150 units. Now, I think that's another restriction but I also think it tells people what we're going to do. One of the reasons you would invest in a blind pool is so that you could get the diversification multiple properties.

We don't want all the money to be spent on one property, we go on an 800-unit property in 40-unit property. We want to know what's going on and this is based on the manager's track record and their experience. Here we go, a kind of repeating everything, how many units we're going to sell, the 10,000, how much we're going to raise and one thing that's important is, in this case, the manager has said that no investor would invest more than 10%.

That's important for a couple of reasons, someone, sometimes lenders put requirements on how much any one person can invest, the bad actor questionnaire is going to be required, if an investor invest more than 20% and sometimes a sponsor just doesn't want any investor with a large share who can command too much attention.

[0:11:40.6] WS: If they invest more than that or the lender may require that the individual to be underwritten just like the operator.

[0:11:46.9] GT: Well, as you know, most lenders have either 15 or 20% limit and if in fact you were going to let people invest as much as they want, somewhere else in the document, we tell them that if you do invest more than 20 — if that's the one there's rule then you can expect to be underwritten. And at all times, if you invest more than 20, you can expect to fill out the bad actor questionnaire.

So, we kind of want to limit it, this is a 506(c) so only accredited investors may purchase and manager's going to do something to take reasonable steps — we'll look at what that something is in the subscription agreement but basically, what we're going to do is we're going to send the investor through a third party verification company to verify that they're accredited.

Now, the timing of the offering which kind of been through that but I'm going to talk on this term. We're spending a lot of time on this summary but that's what it is, a summary and all the other section just spam them. It say, after breaking impounds which is the five million dollars, the offering may remain open through the end of February next year but if in fact the manager wants to stop, let's say the deal isn't going.

Let's say there's a virus in the country and all of a sudden, people aren't investing, the manager can just end the offering, send people their money back and bring it out later, that's fine. At any time, the manager can stop — the manger may very well, and I've had this happen before, raise enough money to buy one property and find that buying in second property isn't so easy and just stops the fund.

Gives people their money back except for the one property and tells investors this is what we're going to do, one property. But in a specific property, it's enough to buy the property, enough to go ahead and do the rehab and all the other things, so that's good. Allocation, profit and losses, just the summary, this is simply an 80/20 deal with no deferred return.

On a blind pool when it takes a while to buy properties we typically don't deal with the preferred return on a specific offering, you're buying the property and in three to six months you can start making some distributions, then I would see a preferred return. Then it talks about risk, liquidity and all that's going to be covered in the operating and rest of the documents. This is an important clause; I get this question all the time. Probably one of the third most asked question. It is Gene, I've got an investor who has got some money sitting in a 1031 account, can they invest in your deal and the answer is no. I say that three different times.

Short story, buying in this deal doesn't buy real estate, the only way 1031 works is if you're buying real estate. What you're buying here is a share of whatever. Okay.

[0:15:01.2] WS: If this wasn't a blind pool, could you accept 1031 then?

[0:15:04.4] GT: No, because all you're buying is a share of it says, the interest being offered at personal property. Partnership and as such they're excluded from a 1031, you have to get a D and I'm sure you've have someone come and talk to you about tending the common offering so that's where that will come up. So, no, I put this in my document, I give people instructions.

What should you do with this? I say, the offering package has several documents, the private placement memorandum, the operating agreement, the subscription booklet and the additional exhibits and I talk about how you should read this and then there is the infamous table of contents. That's helpful. So, we start out with suitability standards. I don't have to go through this, this is a 506(c) offering so basically the suitability issue got to be accredited. However, just because you're accredited doesn't necessarily mean –

You may have net worth but you have little liquidity and this is $150,000 minimum, one of the questions I have in the subscription agreement for this is, after you invest your 150,000, how much cash have you have left over? You want to make sure the investors are suitable.

[0:16:35.1] WS: If somebody said $10,000, you might say okay, this is probably not the best investment for you.

[0:16:42.0] GT: And then that sponsor has absolute discretion to discriminate, absolute discretion. Duration, everyone is interested, how long are you going to have my money and here it says, three to seven years but we'd like to sell it somewhere between five and seven. I'm looking at that and 72 years old and my question is, do I want to be in a deal that's going to go for another seven years. Well, that might depend upon if I've invested my IRA money or other money or what my portfolio is, so that's where you find it.

Then we have a clause on general solicitation is accepted, see if this was a 506(b), this clause would be totally different. No solicitation. Here is an accredited investor, we all know what an accredited investor is so all I've done is gone through all the different definitions of an accredited investor, we're usually using a one million dollar net worth or two or $300,000 of annual income.

Then there are other definitions, family offices and banks and institutions can invest. That's good. Once again, the dreaded unsuitable for 1031 clause comes in here. No matter what, my sponsors don't read this and they still call me and then here is something restrictions for the Patriot Act. This particular sponsor is willing to accept to foreign investors. You have to go through and talk about what happens when you take someone in the Patriot Act, it's really confusing.

I really suggest that you don't, this is where this whole section is really a catch all. Here is a comment about a Riza and basically, this comment says. Yes, we've been taken IRA money, but a lot of people think that there is a limit on how much money can be invested through IRA's in real estate offering. There isn't, I quote the law that when 50% or more of the assets are operated by the company and our real estate assets, this 25% exception doesn't qualify.

We can raise 100% of our money in an offering like this and this tells you, "Hey, you're going to give me a subscription agreement and I will review it," so that's all boiler plate stuff. Here is the summary, so the summary is really an explanation or expansion of the objective summary here. It talks about the company, it talks about the manager, how to reach people, talks about how there are going to be two classes. This is important, investors are going to buy a class A units and they are going to be called class A investors.

And we can raise five million up to 15 up to 20. Then there's class B members, here comes the managers or members of the manager as it will. They are going to retain 20% of the ownership in the company. Of the ownership. So this says that the class A members would put up a 100% of the money and own 80%. The class B members don't put up any money as the managers to own their class B membership and gets 20%. Somewhere along the line you are going to wonder if the class B members actually invest.

And this document will tell you how much the class B members in this case are class B members were going to invest collective $300,000 as A unit holders. So if you are going to invest just like you would and I would Whitney, but in addition to after doing all of the work, we are going to get 20% ownership that is extraordinary — and then we go back and talk about the minimum investment amount, the timing, we did all of that. It is a blind pool.

So in a blind pool we have an acquisition strategy that tells people what we are going to do but here is how I write my offering. I want the sponsor whether it is a blind pool or a specific offering to give me a separate document that's their business plan. In a blind pool because we don't have any properties, it's track record, bio and what is our acquisition strategy. Whitney in a blind pool –

[0:21:17.9] WS: Is there a name for that document that's a separate document?

[0:21:21.0] GT: Yeah it is called exhibit four but probably we call it the investment summary or the business plan. It is exhibit four. In a specific offering it's the property package. It is the offering the memorandum, and whatever you call it, it's got pictures and rentals and all of that stuff.

[0:21:36.8] WS: Right, so like the investment summary that we would provide.

[0:21:39.8] GT: Right and what's important about it is it's a separate document because while you are going through three or four weeks of due diligence and long underwriting and all of these things change. Well, let's keep it in a separate document. That's how the changes happen so these documents are kind of set and you can use that separate document to show to investors while you are waiting for these documents to be done to get initial indications of interest as you marketing package, right?

Keep them separate and that's what it is and it talks about properties, what type of financing we're looking at, can the manager make advances on loans. You know if we need the manager to advance money, yes the manager can but were specified in the interest rate, so that everyone understands. And here is the objectives and then we get into voting rights and what's really important on the voting rights — is that the unanimous vote of all the members that would be all the A members would be required to substantially amend the agreement.

However, there are other voting things. 75% of the class A members are not included in the interest owned but the manager would be required to remove the manager, and then 50% will be required to do major decisions. Now, that needs more explanation. That is the operating agreement. The operating agreement is in article six. We will give you bullet points, what are major decisions. If we want to get rid of the manager, it has to be for a cause. What do we mean by for a cause?

That is all covered in the operating agreement and then there is some information on what depreciation methods we can use, sometimes accountants want to know that. Some companies are going to be self-liquidating when the properties sell the money goes back. That is a whole other clause from the days when we are doing a lot of flipping. We let the person who sells the property retain the money and buy another property during the first three years.

But now, people want to know how is this going to happen well when the property sold whether it is one or two or five the money goes back and it is over. And then we throw in a second single definitions are in section 13. Here is an important part — sourced and used to the proceeds. What we need to do is we need to tell new investors exactly how the money is being spent. We are only interested in the cash that we raise, telling the investor what are we going to do with it.

This offering has a minimum dollar amount of $5 million and a maximum — and because we really don't know a lot in a blind pool we raise five million that is the minimum. There is five million available for this sponsor to invest and we are saying that he can spend $4,900,000 on pro forma acquisition costs — defined as: the acquisition cost of the property, cost associated with the acquisition, cost associated with preparing the property for its intended use.

Everything, come on four million and nine. And then we have a $100,000 leftover for working gap. Now to jump over here to the maximum — at 15 million we can reimburse the sponsor for the legal fees. So now we have this amount of money and we're going to have 14 770 000 and we plan on $200,000 for working capital. Now Whitney, if you're going on a specific offering there are many more lines down here, many more lines. Closing costs, rehab, reserves, all of that stuff but we don't know in a blind pool. So you get the picture.

[0:25:54.0] WS: So it is a good place for a limited partner to go to, to see what some of the funds are being applied to and how we're doing that.

[0:26:00.5] GT: And this is only having to do with the funds. Sometimes I see the sources and uses of capital description that starts with the mortgage and all of that. That is not what we're doing. We are showing people how the money is spent. Two most important columns are the percentages. How are you going to compare this offering, which is five million and 15 with another offering that's three million and five? Not comparable, but as far as the source and uses of cash it's comparable if you break it down into a percentage.

And this offering at the maximum, we've got 99.8% going to investment. A lot of money goes into the property and here we have working capital. What is missing from here? An organization, a due diligence fee, an acquisition fee, an organizational fee that the sponsor might take at the very beginning especially in specific offering. We don't do that. Oh my god, these guys are working for free.

No, they're going to take an acquisition fee when they buy a property, which is a very typical in a blind pool. In a specific offering they might say here is a lying acquisition fee, and we are going to get paid 3% or whatever the property is worth buying. So what does that do? That money doesn't go into the property that goes to the sponsors so then this number is less. So you compare offerings based on the percentages not the dollar amount and that is right out of Guide Give — that is what we have to do. You like that Whitney?

[0:27:37.4] WS: Yeah. Yes.

[0:27:39.1] GT: And so then it goes through and discusses minimum and maximum. So article four, this is called section four in the operating agreement, takes you through the distributions. It explains how the cash is going to be distributed. This is just an expansion of the executive summary. Article five has a nice table in it. It tells you how the manager's fees are going to get paid. This one has an annual managing fee, it has an acquisition fee, a refinancing fee and a disposition fee.

This is just in the chart. In the operating agreement we explain it in more legal language, then the document goes through the conflicts. There is all sorts of conflicts when a manager, a syndicator is doing more than one deal and the duties of the manager to the members that is kind of boiler plate, typically the duty is you've got to treat a member the way that you want to be treated and here is all the risk. You should read this, the risk factor is certainly some relate to the company.

This is a brand new company, it has no track record. Let's talk about that, there are risk factors associated with real estate where we're going to take 8.2 here — relating to the properties okay? What projections are we going to have? We don't have any right now. How about owning real estate? How about investing in a group? All of these things, man if you put these first no one would invest. I don't put this in the PPM first, but those are all very good things to read.

Income taxes, doing income taxes ever change? Sure, they do. You are going to have a property for seven years, some things are going to change. Now we get down to a lot of stuff, high performance but there's information about the track record, Whitney, it's going to be in exhibit four. It is going to be in the investment summary and then we go through some boiler plate stuff. Let's regurgitate the investment, objectives and policies.

Article 11 is what else is here, how are we going to do insurance? Are we going to do other documents and here is the exhibit list. In the PPM exhibit one is going to be certificate formation so you can see that the company is actually formed in the state and when that was done, exhibit two is the company agreement. Exhibit three is a subscription book and four is the executive summary over the property package or the business plan, whatever you want to call it for this specific offering.

And then our favorite section is section 12, that everyone devours it is in section nine, the IRS. Okay, no one reads it, but we put it in there. That is really in there for the accountants, right? And here comes all the definitions, all the way through the documents we have, capitalize that and so they are all defined and as you're reading you can look at this. Now this document gets signed by the manager, by the syndicator — no investors ever sign this document, so here is the signature page.

So that's all that's in the PPM. There is not an awful lot of the "legal-lese" here. The legal is really in the operating agreement and we'll have to plan better at a better use of my time when we go through the legal lease and the operating agreement. Maybe we'll cover five sections that are really important and delve into it with the allotted time.

[0:31:30.9] WS: Yeah, let us talk about the PPM again and let's elaborate on some more things if we need. We just have a couple more minutes Gene, but if you had to pick let's say three to five things or some things that let's say a limited partner needs to focus on for sure, a lot of them I know do not read the whole 100 pages of a PPM. If you had to pick just a few things that okay, you know if I had 30 minutes today to review this PPM because I have to make a quick decision, what are some things that they definitely need to read?

[0:31:56.7] GT: All right, what they need to read they need to look at the table of contents and this summary of the company really tells the whole story. They need to read that. Then if they want to know what's being done with the money, article three or section three, the sources and uses, four distributions, five, managers fees and compensation. Two, three, four and five that will give you the real story about how this offering compares to other offerings.

A lot of the other stuff is really important but it is present in every offering but two, three, four and five separate this PPM from other PPM's.

[0:32:46.4] WS: Nice. I am grateful for you just elaborating on the entire PPM, but then also highlighting those points that are important and it makes sense because those things are going to be different per deal or per operator while a lot of the other parts of the document are going to be standard.

[0:33:00.6] GT: You know as an attorney, my art is drafting the documents and helping the sponsor and helping the investors out there. However, there is no doubt, boiler plate comes into play but every PPM has to be specific for this offering. I say this to the sponsors who are out there who think they can draft their own documents. They can take the boiler plate, things go bad, you are on the witness stand and the other attorneys, the attorney representing investors says something on like this:

You know, I don't even know what this offering governs. You know you didn't say anything about this stuff. And the judge will say, you know I remember this offering myself and I have no idea what it's talking about. It's got to be specific — and where is it specific? Sections two, three, four and five.

[0:33:58.9] WS: There is no way that I could imagine trying to draft my own documents like this, there is no way. I just think every penny spent to somebody like Gene is so worth it because he is the expert and this is not some place I want to spend. It is not the best use of my time. I am not an expert there but that is why we're going to hire somebody like Gene. Unfortunately, we're out of time but tell the listeners how they can get in touch with you and learn more about you.

I want to tell the listeners as well, over the next few days we are going to do other shows on the operating agreement and the subscription agreement and go through some of those as well. So it is great information and it's a must listen if you are an operator or a limited partner or passive investor but Gene, how can they get in touch with you?

[0:34:37.7] GT: How about I just give you my website. Trowbridgelawgroup.com and there, people can set up an appointment. You can talk to me and find out how to get a hold of me. That's probably just the easiest thing, trowbridgelawgroup.com and it is gene@trowbridgelawgroup.com. One last comment, I know you're out of time but this is valuable, you showed a thick book. My thick book, volume two, the second edition. The second edition had sample documents.

The third edition doesn't because people ripped that book apart and took my sample documents to write their own documents and some people will even have the nerve if I would caught to say, "Hey, I've drafted my own documents would you review this?" And they're my documents. How I know they're my documents is in the private placement memorandum spell check didn't catch "manger member" as oppose to "manager member."

And so I get this documents and I look at it and I know they're my documents. So the third edition, which is thin, doesn't have single one of the documents. Bye.

[0:35:57.7] WS: All right, bye Gene. Thank you.

[END OF INTERVIEW]

[0:36:00.2] WS: Don't go yet, thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[OUTRO]

[0:36:40.0] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge 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. Life Bridge 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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