

**EPISODE 958**

[INTRODUCTION]

0:00:00.0 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.

**0:00:24.4**

**Whitney Sewell**

This is your daily real estate syndication show, and we are introducing a new segment called The Real Estate Syndication Show Highlights, where we're bringing you a look back at episodes focused on a specific topic that we believe have added value to you in your syndication journey.

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[INTERVIEW 1]

**0:00:50.0**

**Whitney Sewell**

Our guest owns over \$130 million of real estate and crushing it in the syndication business. His name is Danny Randazzo. Thanks for being on the show, Danny.

**0:00:59.0**

**Danny Randazzo**

Whitney, thank you so much for having me on. I'm excited to be here.

**0:01:02.0**

**WS:** I get this question a lot about if people that are learning about syndication or like structuring a deal, "What does that mean? What does that look like?" Somebody is talking about structuring

a deal. What are they talking about, explain that a little bit? Let's get in a little bit maybe about a deal that you've worked on. How it was structured and why?

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**DR:** From a structure perspective, there are a few things that you need to get right from a structuring perspective. Number one is the loan or the debt structure that you're going to use. You need to find a couple of lenders to quote debt options for the deal. They're going to be your largest partner, so they have a material impact on the success or detriment to your project. Find a good lender to work with. The other piece inside of that lender, that area that you need to resolve is do you have any experience owning multifamily properties? Most lenders will require a certain resume, meaning you have experience for them to feel comfortable giving you a multimillion-dollar loan for a 150-unit apartment community. If you don't have any experience, you need to bring on a loan guarantor or a key principle as part of your general partnership team.

This is where the structure comes in to help you with that area. Item one is your loan in that configuration and can you do that yourself? Do you need to bring in a loan guarantor or a key principle to help with the experience, the net worth and the liquidity to qualify for the loan? We've got the first one figured out, the loan piece. The second piece to it is your equity portion. Now that you're large, that partner is resolved. The second item is your equity portion. The equity portion is your investors. Either you are going to pay for the remaining equity out of your own pocket, or you're going to syndicate it, which we're reading to The Syndication Show. I'm expecting you've got high-net-worth investors or friends and family that are ready, willing and able to invest in your deal.

They would come in on the equity side of things. If you've never raised for a syndication deal before, raising money is a lot harder than you may think. You may want to bring in a couple of partners to help raise money who have done it before. For that, they would become part of the general partnership structure as well. You've got your second component, your equity portion of your general partnership structure. The third portion is the ongoing and day-to-day asset manager who oversees the deal and ensures that the business plan and that property value add strategy is being carried out. You work with the management company on a regular basis to ensure that numbers are being hit and the property is moving in the right direction. The fourth component, I'm going to say other for anyone else that falls into that other GP part of the team.

Maybe you work with a partner, you guys and gals run your opportunities as a team. They would fit into that general partnership structure as well. Maybe you need an expert to come into that other category who knows the ins and outs of multifamily value-add strategy, if you're doing a deep unit renovation. What I mean by deep unit renovation is it's more than like floor paint and appliances. Maybe you're doing major construction. You need a general contractor or a construction expert to fill that knowledge void to make sure you're getting the best pricing and everything is being carried out accurately. To recap, four areas that you need to figure out for your GP structure. Number one is your loan structure. Number two is your equity structure. Number three is your asset management. Number four is your other general bucket.

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**WS:** Thank you for laying that out. A lot of people ask about what does that mean when they're getting started because you hear that term a lot structuring of the deal. I appreciate you laying out those things that we have to have or that we need in place. Most people don't think about the loan structure, what that looks like, creating that relationship with that bank or that lending institute. However, you're finding your debt, you've got to find it. It's so important.

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**DR:** It's a misconception that you can go out and syndicate a deal. It takes a lot of work to do it at a high level where you're buying 150 unit, a \$10 million-plus deal. You need to go through the steps and get there. If you're new and you want to do large apartment deals, the best way to start out is to invest as a limited partner to learn the ins and outs, gain some of that resume building experience, to say that you're an owner of a property. You have experienced owning multifamily and then that builds the story that you can work with the lenders on to qualify for the deals. Know the ins and outs of investor relations, everything it takes to be a professional and after the very top of the syndication game.

[INTERVIEW 2]

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**Whitney Sewell:**

Our guest is Jeff Greenberg. Thanks for being on the show again, Jeff.

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**Jeff Greenberg:**

Thank you, Whitney. I'm happy to be here.

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**WS:** I'd like to know your opinion and your take on some deal structure and how you've structured deals. You've structured them one way or the other. Maybe you could give us an example of a deal and then let's dive into exactly how it was structured and why.

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**JG:** The main concern that people should think about the deal structure is that both sides are going to be benefiting from it. The passive investor coming in, typically he's looking at it as far as is it fair to them? I feel it's extremely important that they also look to make sure that the sponsor is going to be making some money as well if they're doing a good job. When we look at a structure, we want the investor to be protected on the downside if the numbers don't come in. The sponsor should also be protected on the upside but they gained benefits from a great performance. When we're setting up a deal, we try to see what is going to be of interest to the investors. It's also going to protect both sides and get us some cashflow if we're doing the job that we projected that we would do. That's important.

A lot of people want to look at what's in it for themselves. When you're getting on it with a new sponsor and there's not going to be any cashflow for the sponsor or there's not going to be much in it for the sponsor, all of a sudden, the sponsor's got a problem. They need to keep the lights on and if there's no money coming in. We look at a deal when we're even looking at making an offer on the deal. We're looking at what can we offer the investors? What kind of structure is going to allow that? The preferred return is the main thing that we will make sure that the investors are comfortable, that they will get a return prior to the sponsor getting any money. Let me go over a few of the pieces where the sponsors make their money.

Typically, the sponsor would get an acquisition fee. That acquisition fee is for all the effort that these sponsors put into, first of all, getting themselves educated and learning about this business. It's also for finding the deal, getting the deal together and bringing the investors in. That's an initial fee that they get and that could be anywhere from 1% to even 5% on a smaller deal of the purchase price and that they get up front at the closing. The next one they would get

is a percentage of the cashflow. That percentage is going to be after a preferred return. Preferred return essentially is a return on the investor's investment. If you were to get an 8% preferred return, you would get that prior to the syndicator receiving any funds or any cashflow. The preferred return isn't guaranteed and it's handled in many different ways. After the preferred return, the investor would start getting their shares of the distribution.

The third one is the profit at the sale. That profit at sale comes after the investors get all of their investment back and then the profit is split. That split could be anywhere from 80% to the investors, 20% to the sponsor. It could be 70% to the investors, 30% to the sponsor. It could be 60/40. The only time I've seen it at 50/50 is in development deals where there's a lot more work involved for the sponsor. Those may be 50/50. That's your split at the end. The one other fee, which is an ongoing fee would be the asset management fee. That could be anywhere from 1% to 3% of the revenue goes to the person that is on the sponsor's team but is the middle man between the property manager and the sponsor's team. You've got that person that is working for the next several years as that intermediary and working with the property management.

Some of the newer people come in and think, "I'm going to hire professional property management and then I can go back to sleep and do whatever." That's very far from true. You need somebody on your team that is keeping an eye and meeting with the property manager. In the beginning, we meet weekly with the management team. As time goes on and things are going well, you can spread that out maybe every other week, every three weeks we were doing it. My Houston property, we moved to once a month and then when we had nothing to talk about on once a month we started even doing that less. Initially, you're doing that, you're going to go over budget and all kinds of other things, how well things are performing. Those are the essential fees. Let's go back to the preferred return. There are some different ways that I've seen people do this as well.

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**WS:** I want to hit that but I wanted to go back. One thing you mentioned that I liked too is the acquisition fee. I hear people get pushed back about acquisition fees and things like that. I would almost say if the investor doesn't want you to make money then maybe they need to find another deal to invest in. What they don't see is that all the work you've put in not even on this deal, but all the deals you've turned away time and time again, making sure that you have the best deal you can have for them to invest in.

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**JG:** The thing is the syndicator is bringing people together. If you look at any other type of deal where somebody is acting in that capacity, where they're bringing people together, they're bringing a buyer and seller together, bringing some group together, creating a company or whatever it happens to be, bringing in some synergy, they're going to get paid for that. That's a lot of work that they've done. It's a lot of time that they've spent and they need to be compensated for that. They need to keep the lights on and keep things going.

We don't want to be greedy when we are deciding what the percentage is. If you look at it on a small deal, maybe it's going to be 5% or maybe on a bigger deal it's going to be 1% or 2%. That way the sponsor is also compensated and can keep their business running. That's important. The thing is a lot of times when we get into a deal, if we haven't done a full raise, that we have to continue the raise after the closing, we don't get that acquisition fee until all the money is in. Once the money is all in and everything is set up and things are rolling, then we can go ahead and take that fee.

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**WS:** I appreciate you elaborating on that. Please elaborate on the preferred return.

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**JG:** On the preferred return, there are people that do it in all different fashions. The preferred return, and this is not a guaranteed return, will be on the cashflow. Available and distributable cash will go to the investor until they received whatever that percentage is, let's say it's an 8% return. Let's say I invested \$100,000 once on an annual basis. The preferred return will give them \$8,000 a year. Typically, in your first year, you may not reach that. Here is where some of the differences come in. There are some sponsors that will carry that over to the next year. Let's say you only got \$6,000, so you only got a 6% return.

The next year comes around, that 8% picks up that too that you didn't get. Now, your preferred return for that year coming up is 10%. Maybe they still only received the 6%, that could be continued to be carried forward until the end when finally the property is sold. That can be a problem because if you notice, the sponsor isn't getting anything during this time. They may be getting that money from the asset management fee. I know some people that have their own

property management company. They're getting money from there but otherwise, if you see a deal where that's the proposal, the sponsor may not be getting any money during the whole, which is not a great thing.

The next thing is let's say we do get that 8%. Instead of that \$8,000 for example, there's \$10,000 that's available for distribution. You give out the \$8,000 which is the preferred return. I've seen some sponsors that will say, "That last \$2,000 or that last 2%, we're going to do whatever the split is." Let's say we were going to do a 70/30 split. Now we're going to take that 2% and do a 70/30 split on that. That sponsor is not getting much money out of that either. The 70% is going to the investor and 30% going to the sponsor, that sponsor is not going to be able to pay the bills with that limited amount of money. What we do is we allow a catch-up. If it was let's say an 80/20 split, because I will make the numbers easy, now the sponsor has gotten their 8%. They have gotten their \$8,000 and there's \$2,000 more. We're going to take that as a sponsor because that's our catch up. That's our 80/20 split.

The next year, let's say there's \$12,000 to distribute. That one, we're going to give the first 8% to the investor. We're going to get the next 2% or the next \$2,000, that catches us up on the 80/20 split. Now we're going to do an 80/20 on whatever's left over because now we're at uneven scale. Typically, we will tell people that they're going to get a preferred return or they're going to get the split, whichever is higher. If we took that \$12,000 and did a straight 80/20 split, they would get the same amount of money that they would get more than the \$8,000, whatever that comes out to. It can be a little confusing. There are some people that will take that accumulation of money that they didn't get from that preferred return and give that at the end.

I know this is a little confusing but it's good to be clear how that preferred return is going to be used and if it's going to be accumulated all the way and held back at the end and where you're going to get it. I want to emphasize that it's important to make sure that the sponsors are getting money as well. We did a deal, the first deal I get, we had an 8% preferred. We held that property because this was a small property, probably a little small to be syndicated. It was in a very stable market. There wasn't a lot of money in there. We expected to raise rents.

This was a three-year-old property. The rent is where they probably should have been and we weren't able to raise the rent. We weren't able to get beyond that 8% preferred return. For a few years, we didn't make any money. We didn't make a dime. We didn't have an asset

management fee in there. For a few years, we ran the property without getting any money at all and we got a small profit at the end. We proved to our investors that we were dedicated and that we supported them but we weren't being paid. We made a set of small profit at the end.

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