EPISODE 1435

[INTRODUCTION]

Whitney Sewell (WS): This is your Daily Real Estate Syndication Show and I'm your host, Whitney Sewell. Today we packed a number of shows together to give you some highlights. I know you're gonna enjoy this show. Thank you for being with us today!

[INTERVIEW 1]

WS: Our guest is Brian Hamrick, thanks for being on the show Brian.

Brian Hamrick (BH): Hey Whitney, it's great to be here, thank you.

WS: Yeah, honored to have you on the show. Brian controls over 32 million dollars in apartment, self-storage, and office commercial real estate as well as performing and non-performing notes. He's raised over nine million dollars from investors through syndications and funds and he also hosts the Rental Property Owner and Real Estate Investor Podcast.

Brian, welcome to the show, give us a little more about your focus in real estate and let's jump into your superpower I think we're going to just dive into today to help the listener.

BH: Yeah, absolutely. Whitney, thanks for having me on your show. You know, I'm an opportunistic investor. I invest in apartments, I invest in offices, a little bit of retail, self-storage is one of my favorites, and performing and non-performing notes and I've also dabbled in some ground-up apartment development too.

I've done a lot, I've worked with a lot of great partners and I always like to come prepared to shows like yours and bring my A-game. I actually thought, you know, I've had a lot of conversations in the past couple of months about fund structure because I've started a fund. I spent about a year trying to figure out how to do a fund and if it's okay with you, I'd love to talk about fund structure today. It's not necessarily my superpower, I'm not an attorney but I've certainly gone down that road and would love to talk about it.

WS: No doubt about it, I would love to talk about that and I appreciate you just bringing it up and that you – I mean, spending a year of research learning this, you're going to be so much more knowledgeable about this than I am for sure but just that you've done it too.

I want us to get into what you're talking about versus say, the normal syndication or deal-by-deal syndication that some people have heard differently. They call it different things

and you just elaborate on the pros and cons and we'll get into some of that. Thank you for that. Thank you for that, thank you for being on the show but let's jump in, tell us a little about maybe, I guess, I want to back up. I was going to say the fund that you did but back up a little bit to you, even your research for a year.

Where did you go to find research, what were your – what were the main things that helped you, Brian, to learn even most of the things you're going to share with us today?

BH: Well, I looked for books on the topic, but could not really find many books. I went to networking events, national networking events and probably, that's the best source to find people who have actually put their own funds together and to talk to them and say, "Why did you structure it this way, how did you structure it? What were some of the considerations?"

Really, when you talk to 10 different people who have started 10 different funds, you get 10 entirely different answers as to how they went about it and what kind of structure they have. It can be confusing and daunting but before I get into that, I mean, let's make sure people understand what a fund is and how it's different from syndication.

WS: Please.

BH: I have certainly syndicated apartment buildings, self-storage, in either single, asset syndications where you identify the property, you identify the closing date, you go out and you raise your money and once you close, you've got your investors, they're locked in and maybe you hold it five years, 10 years, whatever, but that's single asset syndication. I know you've done a hundred million in syndication so you're very familiar with that process.

But let's say you want to go out and you're not sure what you're going to buy but you know, "Okay, there's a lot of retail right now because of the coronavirus pandemic" and – I'm sorry, "There's a lot of distress right now in the retail area," that's what I mean to say.

Let's say you want to go out and just pick up distressed retail centers, shopping malls, strip centers, and things like that, but you're not sure exactly what the asset is going to be. So you might start a fund that is meant to raise the money before you identify the asset and it could be multiple assets that you would pick up in this fund.

That's why you would do a fund structure as opposed to just single asset syndication.

WS: Okay, there's a lot to think through there, right? Why we would do this and when and who should do this? I mean, maybe even some of the timeline, people are thinking, "Okay, when am

I going to be raising the money or when's it going to be deployed?" and some of those things working or to think through.

Maybe we can start with too, even the types of properties we should be thinking about acquiring do they have to be the same or can we purchase different types in that fund. Just elaborate on that.

BH: Yeah, I'm not going to talk about any fund that I may or may not have done because it's a 506(b) but I'll just kind of take you through in general. Kind of from a general perspective because I'm not an attorney or CPA so you should always of course talk to the experts on your team about these things.

As far as identifying the asset, if you're an apartment investor, you might say, "The assets that we're going to go after are distressed assets that are in the 20-to-40-unit range. We're going to pick these up from a million to a million and a half each. We don't know what they are yet but we're going to raise enough money so that whenever we see those opportunities, we can close quickly because we've already had commitments for the funds to close. We may not even need lender financing because we'll be raising that money from our investors."

That's from the asset side, you want to identify what the asset is going to be. Is it going to be apartments, is it going to be retail centers, is it going to be a cryptocurrency? Whatever it might be, identify that but then also think, "Well, what if we're investing, what if we're only going after retail but we come across an office building that's distressed that we can pick up and it makes sense?"

Do you want to widen the parameters of your fund and make sure it's transparent to your investors in such a way that you, as the operator, have the leeway to include an office in your retail? You have to take these things into consideration when you're putting together your fund.

WS: Any kind of timeframe restrictions or the duration of the fund, things like that we should be thinking about?

BH: Yeah, that's always important because if you're – let's say you're buying apartment buildings. What is the window of time that you need to be able to acquire these? Is your fund only going to be open for a year? You're going to acquire these assets, achieve the upside value and dispose of them within three years, five years, 10 years? You need to figure that out.

Because you're on kind of a staggered schedule, you don't know when you're going to find the asset, you don't know when you're going to close on it, you don't know how many assets you're going to find and over what period of time. You need to build that flexibility into your

fund to say, "You know what? This may not be your traditional three-to-five-year fund, this may be a seven-year fund or a 10-year fund." You have to really think about it in that way as to, well, how are you going to get your investors in and how long do you need to let them know that they're going to be in that fund?

WS: They definitely are going to want to know, right? They're going to want to know when all these things are going to happen. You better have an idea about this time period that you're projecting. Thinking about those people that you're talking about, those investors, you have to project some kind of return, right? How do you do that, the returns you'll be offering to investors?

BH: That's – I always say that's a marketing question. You have to know your investors, what are their timeframes? I mean, I have investors who are in their 70s and they've told me, "I don't want to invest in something for 10 years because I may not be around for 10 years." Does that mean I need to make it a five-year fund and is that – would that even work with the type of asset that I'm buying under the parameters under which I'm buying them?

The returns are always different. As I said, you talk to 10 different fund operators, you're going to get 10 different answers. I've talked to operators in the note world who basically – their fund is, "You invest with me and you're going to get a straight up 8% return. If you invest over 150,000, I'll make it 9%." That's it, it's just a flat, there's no equity upside to that.

And then you have other people who structure their fund much like we might structure our syndications where you have a cash-on-cash preferred return each year. Then IRR, an internal rate of return or annualized return, that's 18, 20%, once you liquidate.

The problem is because it's kind of a blind pool, you don't know exactly what asset you're buying so you're not able to run the numbers really completely before you raise that money. You don't know exactly what the returns are going to be so you have to make sure you build in all kinds of cushions and take into account all kinds of variables to be able to get to a return that you know your investors will get excited about because again, it's always a marketing issue. You don't want to come out with 4% preferred return and 5% annualized return because the investors will just say, "Well, I can go to Whitney and do much better." You want to make sure it's sexy enough for your investors, but not overly sexy in which you can't deliver.

WS: Are there any other things about just specific ways to provide those returns or that you're providing them to the investors?

BH: The easiest way is just a straight-up preferred return. Eight to 12%, that's what you're going to get and you know, it's a five-year fund and we'll get you your money back at the end of five years. That's the easiest way because it requires very little bookkeeping.

As you get into more detailed returns with a preferred return, cash-on-cash, annualized return, once you dispose of the assets, then there's a lot more bookkeeping and you know, it's very easy with the cash-on-cash return to say "All right, when this investor invested on from this date, their cash-on-cash return starts there. They get a certain percentage, prorated for the amount of time they've been in."

But when you get to the annualized return, which is once we've disposed of all the assets in this fund, we've paid back our investors and now we're going to pay out the profit, you need to be able to make sure that the people who got in early and the people who got in later are being compensated equally or their compensation is balanced. Because you don't want to have a lopsided fund where the later you get in, the more profit participation you're going to get in the back end.

That was something that I really had to struggle with to figure out mathematically, well, how do we make sure that someone who gets in early is going to have the same annualized return or internal rate of return as someone who gets in late?

That was probably the biggest challenge. Do you want to hear the answer?

WS: Yeah, of course.

BH: Okay. What you have to do is you have to take a weighted ownership ratio for each investor and that, you're basically weighting the number of days, when I say weight, it's weighting. Weighting the number of days that they're in the investment with the number of units or shares that they've purchased.

Then that gives them a percentage of ownership that is then applied toward that annualized return when it comes time to pay that out.

[INTERVIEW 2]

WS: Our guest is Michael Episcope. Thanks for being back on the show, Michael.

Michael Episcope (ME): Thanks for having me with me, Whitney.

WS: Yeah, I know. Michael and I discussed strengthening investor relations to scale your business and scaling your syndication business on May the 25th. I encourage you to go back and listen to that show. That Michael has lots of skill sets in this business, they've grown an amazing brand and business, just in the syndication space and has many things we're gonna discuss today, but specifically about funds and how they have structured funds, how they operate funds, and just giving us some advice there from his expertise. But a little about him in case you missed the last show, is a principal of Origin Investments, co-chairs the investment committee and oversees investor relations, marketing and company operations. It reached 25 years of investment risk management experience to the company and believes that calculated risk-taking in inefficient markets is the key to building wealth.

Michael again, welcome back to the show. Why don't you just give us… I'm gonna encourage the listeners to go and listen to other show, 'cause there's so much value into that as well, and I know someone you're going to want to hear as they're growing their syndication brand and business and working and scaling their business, working with investors. But why don't you just at a high level, talk about funds a little bit, you know, what you are using funds for now? And let's dive into some of the details of how you all pick maybe certain types of funds or structured them.

ME: Sure, absolutely. Yeah, I wanna comment too, 'cause it's funny hearing you read my bio there and calculated risk taking, and what that really comes down to is the rule number one, don't lose money in investing. And that's what it's about. We've been investing since 2007 – that's when my partner and I started the firm, and it was very quickly that we decided to structure things as a fund and a little bit different than a lot of syndicators out there and things… And the reason why we did that was, we just believe it's a better way to invest, it's better for us as managers, and I'll get into that, but it's also a better way for investors to invest as well because it provides diversification. You know, fund is really like a company as well, and you think about the managers promote and when you do individual deals, the manager promote is not cross-collateralized meaning…meaning great on one deal, the manager is gonna get paid, if you don't do well on another deal, the manager won't get paid but that net they do get paid on those deals. So in a fund all of those promotes our performance fees are cross-collateralized in one, so when we're really thinking about adding deals to the fund, there's a lot of time and effort and discipline that goes into that. And our whole team is compensated through the fund structure as well, so we have a credit committee that goes well beyond my partner and I. It's also all the team members who have a vested interest in the fund, and when people bring deals to the committee, what our acquisition officers do, those are scrutinized and they're heavily scrutinized because the wrong deal contain the entire funds, though from a discipline standpoint, there's a much higher bar for what gets into the fund because when you have 20 or 300 million in a single fund and one deal has the potential to

kind of bring the whole thing down and bring you below that prefer return, it's a different threshold.

And then when I say it's better for us as managers, what I mean by that – I'm sure most people's minds are going to the fees, the fees are actually not any different, so we charge an asset management fee, in most cases, you're gonna get that on a syndication, will either charge a committed fee on that capital or an acquisition fee, and you're gonna get those same things on syndication as well. But for us, when we're going out to the market and we're competing for deals, the biggest thing is proving that you have capital. And when you come to the table and you are one of three, one or five, one of 10 investors who are looking at a deal and the seller is trying to qualify you and somebody's coming, "Well you know, we don't actually have the capital, but we can close. Trust us." That's not as good of a story and saying, "Look, we've got a 200 million dollar fund, we can close in 30 days" and in today's market, that's incredibly important to have that advantage, to be able to close quickly use the fund capital knowing that you have investors there who are ready to write a check for a deal that's approved within a box itself. So there are a multitude of advantages to a fund. I know some people don't like to give up that control. They like to actually pick and choose their deals, but I think understanding, you know, the benefits, the pros and cons of both is really, really important.

And the last thing I would add is sometimes it's not an "or," it's an "and." So we actually in our funds tend to use sidecar vehicles. So for deals that, you know, maybe are too big for the fine before we're only gonna put 15 million dollars of equity into the fund, but the deal requires 25 million dollars, then 10 million dollars, then goes to investors in a side car vehicle to fund investors generally had more favorable fees, so they can invest in that deal. But they can know investing in that deal that this has already been vetted by us, by the fund managers, this is something that we're putting into the fund, so really short cuts that, 'cause you've already made the decision to invest with us, with Origin in this fund, it most likely fits your risk profile, so those are actually advantages as well when it comes to even we're syndicating ideals and participating in individual deals.

WS: So incredible there. Have you answered so many of my questions before I even ask them, which is great. But what you're talking about side cars, it's something I've heard a lot more about recently, and I think as more people are looking into fun structures and how to do this, it's something that's coming up. Can you speak though to which investor is going to invest in the fund versus the sidecar and why?

ME: Well, believe in a lot of fund investors, I would say 80% of them are interested in sidecarS, side car vehicles, 'cause for the reasons I just mentioned, they know that they've already been vetted – these are deals that we like, these are deals that we have high conviction in. And

oftentimes, if somebody's putting half a million dollars into a fund, they have more money that they're willing to invest, so they're, you know, very likely to come in to a side car vehicle like this. So it's a large portion and what we found, more than anything is that this is gonna be a bigger part of our business going forward, and it's something that's in high demand and for the few deals that we have syndicated, the demand has been so overwhelming that it's difficult to give a piece to everybody because in our funds, we might have 3 or 400 people, and when you have a 17, 10, even 15 million dollar deal, those end up being fully subscribed within a day or two. And so there are a lot of investors who end up not participating because we generally do this on a pro rata basis, so we're gonna go out to our largest investors first and give them a piece and then kind of work our way down the reins. But, you know, what we found is that everybody really wants to participate that 80%. So going forward, even as we're concepting a new fund that's gonna be out or we'll be marketing in the third quarter, and then we'll be coming out with it in the fourth quarter, but almost every single deal will have a syndication component to it, so that investors can get a piece of those individual deals as well.

WS: Okay, so just to bring some clarity there for the listener, so you're gonna have this big fund that will be purchasing numerous projects, right? And the investors may invest in the fund and they don't know the exact deals at that time yet. Right, they're trusting you all, they're trusting your group, they understand the risk level, those things, the type of fund that you're doing, but then the side car is going to be deal specific. Right, and so you have this deal or you're moving forward with, and then you have a side car that's attached to a specific project. Is that correct?

ME: That's 100% correct. And, you know, I'll give some tangible examples. So we come out of this funding in fourth quarter right now, we're targeting 150 million dollars in fund size, and so what we're looking at from a risk management perspective about how to allocate and diversify across this fund, this will be a round of development, we'll have about 8 to 10 deals in there. And there's also what we call a GP sleeve – a general partner sleeves, so those are high margin deals where we are participating in the general partnership. But the other, you know, eight or nine deals that will be in this fund, we don't want any more than 10% of the deal in the fund. So if you're a typical around a multi-family development deal is 25 million dollars, and we're putting 15 million dollars in the fund that requires 10 million dollars of additional equity as that side car vehicle and investors are participating right alongside the fund and those. But when you add that up, that's almost 100 million dollars in syndication, so the net of it is the fund will have about 150 million dollars in committed to equity. Those fund investors will get the first look at those sidecar opportunities which will be about 100 million dollars, so in all, that's about 250 million dollars in deals that we'll do in that particular fund itself.

WS: Were your fund to be 506 P, 506 C?

ME: 506 C.

WS: And then something… I've learned recently though, what about your side cars? Because they could be a 506 B then, is that correct? Or do you all do that?

ME: Yeah, but we operate under the 506 C rules even in sidecars. So, you know, with those again, we don't market those per se on a broad marketing…is generally all of those sidecar interest, they get gobbled up by fund investors, so there's no reason for us to broadly market those. And it's usually an hour each by our investor relations department going out with the individuals in batches and letting them know about the opportunity. But nonetheless, you know, there's no reason for us to use 506 B when we can use 506 C. It gives us a little bit, which is, you know, more room to maneuver.

WS: Sure. What about just the structure of the fund? And so, just so the listener can understand me, you can structure them almost any way you can think of, right? But some common ways, and I recently upper people talking about just like 70-30 split or some people call it like a 80-22, you know, like a 80-20 split, then it like a 2% acquisition fee or something like that, but how do you all structure that? How do you think through? How to do that?

ME: Yeah, so you're talking about fees, and I think there's a couple of things. So in our funds, I'll start with the legal structure, if you will. So we have two funds that are already today, and then one that was down the horizon. With ouir funds today, we have an income plus fund that's more for the income-oriented investor that has about a 6.2% annualized yield, and then there's another called the three, 4% of appreciation that we're targeting that fund for a total return of about 10%. And that fund actually has a re-blocker in it, for tax advantages and then, but you're investing through an LLC. So, you know, for people who are investing in non-taxable accounts, the re-blocker helps with locking UBTI and it has under tax advantages which 20% deduction as well. In our QOZ fund, we do not have a re-blocker. That is purely an LLC that you're investing in, and that has some great tax advantages.

And then in the next fund that we're gonna be coming out with, there will also be an LLC, a limited liability corporation to which investors will get one, and I'm not sure if we're going to do a re-blocker or not in that fund, but we are talking about specifically fees – Whitney I'll get to that. In our income plus fund, what we charge is a 1.25% annual asset management fee on that fund, then a 10% performance fee. Now, the advantage that fund is, it's open-ended, and so when investors are coming in to that fund, they're investing all of their capital at once and they're diversified across the existing deals in that fund. So it's a little bit different than closed and fund where you committed your capital and then it's called over a period of time, and there's a big advantage to having all of your account there working at once. And that fund is then the mark to market on a monthly basis and dividends are provided on a monthly basis as well. If you don't want to dividend it, you can enroll and drip, and you can just re-invest those

along the way. And then in our QOZ fund that is purely grown-up development, that is also one point. I think it's 1 and a half or 1.25, a little higher number, so people don't call me out. It's still a good number. 1.5% and then a 15% performance fee, and it all are performance fees. And the thing about this market is, it's kind of all over the place where people charge fees, and I understand this. What you have to look at from an investor really compare the gross to net, so you look at it what it is at the end of the day if two invest with the managers are saying, "Look at the end of five years, you're gonna double your money." Right? That's the pro forma. Right, let's throw that out, how accurate those are for a second? But what matters is the gross to net.

Right, there's always going to be fees, and these funds, we have a team of 30 or working on behalf of, you know, almost 1,600 investors, so our fees are annual asset management fees. In some cases, we do get an acquisition fee. In some cases, if we're structuring a fund, we might do a committed fee, but in fact, for this fund that was coming out in the fourth quarter, we've actually decided to go away from the committed fee after talking to our investors, because they would much rather have the variable cost of an acquisition fee than the committee fee. And what a committed fee means is that if you wanna close that fund and you commit a million dollars to the fund, you're paying whatever that annual committed fee is from the day that you make that commitment. So it's 1.5%, you would be paying that manager $15,000 a year starting on day one. If you look at it from an acquisition fee standpoint, then you're only paying once the manager finds a deal, right? The fees generally come out to the same as long as there's a velocity of capital, and the manager is doing their job. If we're doing our job and putting out capital and, you know, call it two, two and a half years. But if we're not, then the risk falls on us and not the investor. So that's always a risk of investing in a fund. You committed a million dollars and the manager can only put out, you know, 6 or 700,000 dollars and you paid fees on the whole thing. But the way that we're operating, you know, going forward is we'll just try to create better structures more friendly to investors and meeting the market demand and continuing on our structures going forward.

[END OF INTERVIEW]

[OUTRO]

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