A Guide to Passively Investing in Commercial Real Estate

By Whitney Sewell, Founder and CEO, Life Bridge Capital

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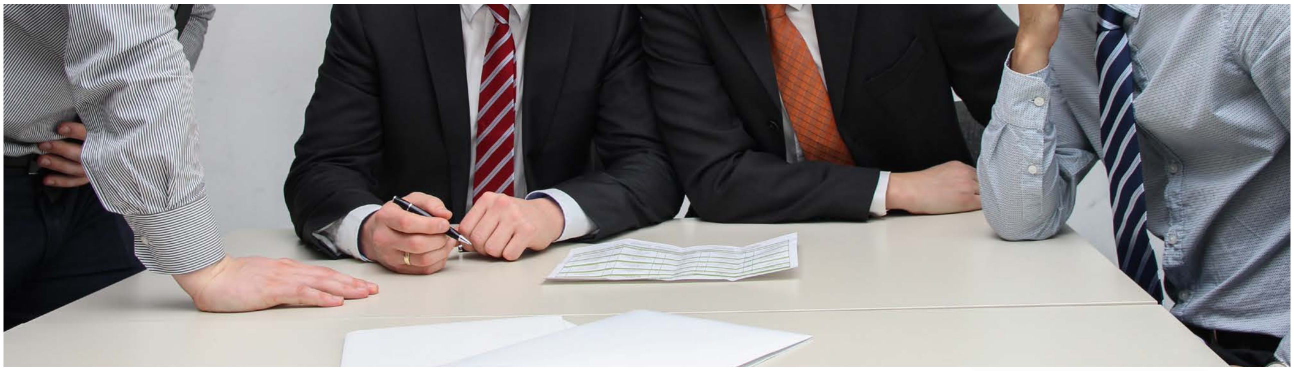

What is Passive Income?

Passive income sounds like a dream to many people, but it's the day-to-day reality for smart investors. It's a form of income that streams in reliably, month after month, with little to no effort to maintain.

When you're receiving passive income, your bank account grows without going to a 9-to-5 job or taking too much time away from your family. You're not glued to your cell phone either, because you can relax knowing your passive income is always flowing while your attention is focused elsewhere.

According to Entrepreneur, a passive income accomplishes 2 out of the top 10 things wealthy people do to get richer and maintain financial freedom:

INVEST

BUILD MULTIPLE INCOME STREAMS

In this guide, we'll specifically look at the type of passive income generated by commercial real estate investing. We'll show how you can leverage the power of real estate syndication by borrowing a sponsor's expertise, so you as the individual financial investor have minimal time investment.

We'll also show how passive income can support your biggest lifestyle goals, like having more disposable income, traveling, retiring, or adopting a child. Finding a passive income can be a truly life-changing experience.

Let's start with an explanation of real estate syndication and how it typically works for the average investor.

What is Real Estate Syndication?

Real estate syndication is an investment arrangement that puts passive property income within reach for the average person. It involves a group of investors who work through a sponsor/operator to make large investments that would otherwise be inaccessible to them.

The idea of real estate syndication has been around for decades, but many people have never heard of it. These days, most people are more familiar with its internet-based cousin, crowdfunding. While crowdfunding and real estate syndication are definitely two different things, the central idea is the same: people come together to invest in something that's bigger than what an individual could support alone.

In practice, this operates as a transaction between a sponsor/operator and a group of investors. The sponsor/operator locates a real estate investment project and seeks financing from the investor group. Generally speaking, a sponsor is someone with deep expertise in real estate investing and can be trusted to handle the research, financial details, and contractual arrangements it will take to make it all happen.

The investor group, also known as Limited Partners, individually evaluates the opportunity using the expertise and insight of the sponsor, who is themselves also financially invested in the project and has an interest in seeing it succeed. If the group chooses to move forward with the investment, they hand the process over to the sponsor/operator to manage the details.

Over time, the investor group sees returns from the project as a steady income. This may be facilitated by an online platform that allows each party to handle their own aspect of the process.

Source: FinancialSamurai.com

Benefits of Building Passive Income With Real Estate Syndication

Passive income comes with incredible freedom. It frees up your choices in life, so you aren't bound by the traditional restrictions that come with limited finances. In terms of your lifestyle, passive income can offer huge benefits and new opportunities for you and your family.

Lifestyle benefits

- Pay monthly bills
- Stop living month to month
- Work part-time instead of full-time
- Become a stay-at-home parent
- Build retirement income/savings
- Save for a child's college tuition
- Support an aging parent
- Handle ongoing medical bills
- Fund a new venture
- Vacations/travel

You can probably already imagine the difference in your life that could come with passive income. If you've always wanted to travel more but didn't have the financial resources, this could be the answer. If you want to adopt a child, passive income could provide the money you need to move forward with confidence.

Passive investment typically brings a higher reward than other forms of saving and investment.

- It has higher long-term ROI than flipping a house.
- It values the cost of your time more than trying to run a new business.
- You'll see much faster returns than with an IRA, savings plan, or stock market portfolio.

In fact, some investors convert their IRA to cash available in order to invest in a real estate syndication, because the potential for returns is so much higher. Your investment in a real estate syndication provides a steady income while still leaving money for an otherwise diversified financial portfolio.

Tax benefits

Real estate syndication also comes with five major tax benefits that make a positive financial impact. Here's an overview of how you can take advantage of these tax benefits.

DEPRECIATION

Depreciation is the amount that can be deducted from your income each year as a property ages. The Internal Revenue Service (IRS) views your property through the lens of its useful life, or the number of years it is able to be used. Over this period of time, you can deduct the full cost of the property.

Straight-line depreciation is perhaps the most common form. In this option, you deduct equal amounts of the property value each year, with the annual deduction calculated as the cost of the item divided by its useful life. So if the value of a residential apartment building is $500,000 and the useful life is 27.5 years, the depreciation per year is $500,000/27.5 or $18,181 per year.

DEPRICIATION RECAPTURE

Your gains from the sale of capital property must be reported to the IRS. When the sale price exceeds the assessed value, the difference can be recaptured by reporting it as income to the IRS. Depreciation recapture is a complex aspect of tax management, so if you need a more detailed explanation with examples we recommend discussing with your financial advisor.

BONUS DEPRICIATION

Taxpayers can also use the tax code's bonus depreciation benefit, which means you can depreciate 100% of a qualified property as long as it was purchased after September 27, 2017. If you are investing in property, make sure you talk to your tax preparer or financial advisor about the possibility of taking advantage of bonus depreciation.

COST SEGREGATION

Cost segregation allows a taxpayer who has constructed, purchased, or remodeled real estate to increase their cash flow by deferring income taxes and accelerating depreciation deductions. The goal of cost segregation is to minimize depreciation loss and get the most out of depreciation deductions with the IRS.

For example, your investment could be depreciated over 5, 7, 10, or 15 years. To decide on your depreciation route, you could study all property-related costs and develop a breakdown of which route brings the most benefit. Be advised that your syndicator may hire a cost segregation specialist to do these types of calculations.

CAPITAL GAINS

CIt's also worth considering the capital gains tax at sale. When an asset is finally sold, passive investors receive the equity and profits under their distribution agreement. At this point, the IRS will view a passive investor's profit as a long-term capital gain.

You will pay 0% on the capital gain if it is valued at up to $77,220. Between $77,221 and $479,000 the tax rate is 15% and above $479,000 the rate is 20%. These brackets are built into our nation's tax code.

FACT

About 100,000 investors participate in real estate syndications every year, with an average preferred return of 5% to 10% and an average investment size of $3 million.

Sources of Passive Income in Real Estate Sydication

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New development

An investment in a brand new real estate development project can be tempting because you're contributing something new to the community and creating shiny new structures for everyone to see. However, new development comes with some drawbacks too.

It's generally a higher-risk investment with no guarantee of long-term rewards. Even if you do make money off the project, you could be paid much further down the road than in another type of real estate investment. Having said that, if the project pays off and is extremely successful, you could see a high ROI.

Value-add

In a value-add scenario, the property already exists but it has a problem that needs to be fixed in order for it to become a strong revenue-generating investment. Perhaps the property is currently outdated, mismanaged, or needs a big dose of fresh marketing to attract residents.

Value-add involves creating a plan based around actionable steps to increase the property's market value. This might involve extensive research and project management from your sponsor, who would consider things like the property age, location, square footage, and so forth in an investment analysis.

Distressed property investment

Another option is to locate a highly distressed property that is currently unstable or unusable in its current form. These properties typically have a huge amount of renovations and updating to be done, but if you make the investment, the returns could be quite high.

This is an option that involves delayed cash flow, so you may need a lot of patience. You'll also need to place complete trust in your sponsor to identify the right kind of distressed property that will bring high ROI despite the large investment in renovations.

Investment and Returns With a Real Estate Syndicate

Let's face it: The average person doesn't know enough about real estate to generate a reliable passive income from it. That's why you need the help of a sponsor to make it happen. Your sponsor brings something extremely valuable into the mix: intellectual resources.

With the help of a sponsor's expertise, you can join together with other investors to make exponentially better investments - even if, individually, you only have a modest amount of money to invest. The first successful project leads to passive income, more opportunity for additional investments, and the kind of lifelong wealth-building strategy used by some of the world's richest people.

The million-dollar question: How much will I make?

You're probably wondering what kind of investments and returns you can typically expect in a real estate syndication, so let's look at an example. Of course, no investment is guaranteed to make money and this is purely an estimate of what could happen.

The minimum investment to join a real estate syndication is typically $50,000. Ideally, the investors should be accredited or sophisticated, which in the U.S. means financially secure as defined by the Securities and Exchange Commission (SEC) in Regulation D.

PREFERRED RETURNS

In terms of returns, many operators will offer a preferred return. This is not a guaranteed return, but it means that the passive investor - also known as the limited partner - receives the first portion of the disbursed cash flow. If there is no cash flow, there is no preferred return.

At Life Bridge Capital, we frequently see a preferred returns range of 5% to 10%. This varies depending on the structure of the deal. After the preferred return, there is normally a split of the cash flow between the passive investors and the operators/syndicators. This could range from a 50/50 split to a 90/10 split, or anywhere in-between.

The larger portion commonly goes to the passive investors. This is particularly true if a high-risk investment is involved. The higher the risk, the higher the percentage that goes to passive investors, in most cases.

WATERFALL STRUCTURE

In an investment waterfall structure, profits are split among partners in a structured hierarchy that follows a series of individual distributions. This creates a logical, reliable path for distributing returns especially when certain investors should have a disproportionate share according to the investment agreement.

The term "waterfall" refers to the fact that the distributions flow into pools according to which investor is owed them. Imagine that the water (money) is gathering at the top of the waterfall, then building up and spilling over into several pools below. Some of these pools, in turn, overflow and spill over another waterfall into other pools below them. Again and again this happens, dividing the original amount of water into numerous pools along the way.

Here's something important to realize about this model: As each pool fills and overflows, it only fills the pool below it. This keeps the water flowing along on a certain path and each successive pool can only be filled if the pool above it was filled too.

Here's how the waterfall model works in real estate syndication: As returns build in the form of cash flow, they begin to fill the pool at the top of the waterfall. With enough returns, the money spills over into additional pools below. Each additional pool will have a different split of the cash flow between the investor and operators. At the end of the process, each investor has the right amount of money in the right pools and takes their returns exactly as they were allotted in the investor agreement.

DISTRIBUTION PERIODS

It's important to be aware of the distribution periods you'll be using because they'll affect your personal cash flow. Disbursements may occur monthly, quarterly, or on another non-standard schedule due to your unique situation.

If you're investing in a development deal, there could be a long timeframe before the first distributions start. Your sponsor should communicate exactly how this will happen so there are no surprises.

One of the most important things to investors is the communication cadence of the sponsor, which is the frequency with which they provide official updates about the investment and any distributions. In addition, the sponsor should provide updates on occupancy, progress with renovations, results of advertising efforts, and so forth - all of the updates, good and bad, that affect the group's investment.

Finding a Sponsor and Group Members

One of the most common questions an investor has about real estate syndication is: How do I find a sponsor? Maybe you don't know a real estate investment expert or have a group of like-minded individuals who want to invest together.

Here are our 5 best suggestions for finding sponsors:

1. Attend industry conferences about investing
2. Join investment-focused social media groups
3. Ask for referrals from friends in the financial industry
4. Listen to podcasts about finance and investing
5. Read industry publications and websites

When you've located a potential match with an investment sponsor, ask them for an introductory call or meeting. In the meantime, look into their background and experience. Research them thoroughly, including their credentials with the following two organizations:

FINRA - the Financial Industry Regulatory Authority

SEC - the Securities and Exchange Commission

Ask for professional references and check their track record. It's perfectly acceptable to ask to see examples of previous investment arrangements and their distributions. Discuss how the previous properties have performed vs. projections.

Any qualified investment sponsor should have a large portfolio of previous projects for you to examine. Look through it carefully and ask questions. It's the best way to get comfortable with a potential sponsor and see if you're a good match.

And remember, you should be prepared for them to ask you questions, too. They may want to confirm your accreditation and level of investing sophistication, including reviewing your financial background.

Risks and Limitations of Passive Real Estate Investments

Every investment comes with risk. There's no way to completely avoid the risk that naturally comes with real estate investment projects.

However, real estate - particularly multifamily real estate - has proven to be amongst the safest investments available. While many investors are still struggling to recover from their stock market losses during the recent Great Recession, real estate has bounced back and a majority of people age 18 to 35 are now either saving or investing in real estate rather than putting their money in the stock market.

Here's something else to consider: Over the past decades, rent costs have been rising and rising, a trend that is projected to continue for decades to come. By uncovering devalued assets and turning them into desirable ones, you have a solid plan for future ROI (return on investment).

In addition, here are a few more things to keep in mind as you plan for your passive investment:

- The IRS wants to know about sources of passive income, so it's always a good idea to consult a tax professional to discuss your investments.
- Some sponsors require that you be an accredited investor, but if you aren't an accredited investor yet, you can still work toward it.
- You must have an annual income of $200,000 individually or $300,000 in joint income with your spouse.
- The income requirement must have been met for the last two years with the expectation of earning the same amount or higher in the current year.
- You may also be considered an accredited investor if your net worth is in excess of $1 million.

How Passive Investing Can Change Your Life

Can you imagine how passive investing could change your life? Here are some potential long-term outcomes of making smart investments with a real estate syndicate and using the returns to find new opportunities in your life.

- Become financially stable for the first time
- Pay off your bills, old debts, mortgage, and more
- Build a steady stream of disposable income for fun and travel
- Fund a new business venture and become an entrepreneur
- Get a needed medical procedure completed
- Support an ailing/aging family member for years to come
- Create a large, secure college fund for your kids with a 529 Plan
- Quit a job you hate or switch to a lower-stress job
- Head into early retirement or semi-retirement
- Stop stressing out about money
- Gain precious time with your family

In fact, the kinds of life changes listed above are exactly why Life Bridge Capital was founded. A passive income creates new opportunities in your life and helps you build a bridge to a brighter future.

Lincoln Springs Apartments, an investment project from Life Bridge Capital

Whitney's Story: The "Why" Behind Life Bridge Capital

When I founded Life Bridge Capital, I had a personal mission in mind. I've always had a passion for both real estate and helping others, and this company blended them together perfectly.

I also had a drive to find passive income for my family. At the time, my wife and I had only been married a few years. We listened to a pastor talk about adopting a child and discovered that there are more than 160 million orphans in the world.

That's half the size of the US population and it's truly heartbreaking. We immediately asked ourselves: Why wouldn't we adopt?

Two years later, our first son came home from Ethiopia. A year later, our second son came home through adoption and earlier this year, our daughter's adoption became final. My wife and I are now on a mission to help other families through the process of adoption.

Did you know it can cost $40,000 to $60,000 to adopt a child? That cost can become an obstacle for too many families who want to adopt. This quickly became the "why" behind Life Bridge Capital.

If you choose to invest, we welcome you to join us whether adoption is one of your goals or not. Either way, you'll know your investment is in the hands of a devoted family and a team of investment professionals who genuinely care about making the world a better place.

Read more about our mission at Life Bridge Capital

For Additional Information

For more information about investing, contact Life Bridge Capital. We're here to help you understand real estate syndication and the benefits of passive income.

We'd also like to share some additional resources to help you move forward in your investment journey.

- Investment Strategy
- Real-world Investment Projects
- News and Interviews About Investing
- Podcast: The Real Estate Syndication Show
- Invest Now With Life Bridge Capital

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LIFEBRIDGECAPITAL.COM INFO@LIFEBRIDGECAPITAL.COM