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Real Estate Syndication

Real Estate Syndication:
The Path to Passive Income

Real estate syndication allows non-expert investors to pool their money to purchase real estate and participate in appreciation and cash flow returns.

Syndication is the core of Westland's business – it's what enables us to purchase the right properties, invest in upgrades and manage the properties effectively to deliver solid returns to our investors.

But what is key to successful real estate syndication is the syndicator! Without extensive market knowledge, a network of the right partners and years of experience in a particular real estate asset class, a syndication is basically relying on dumb luck for results….and you might have better odds in Vegas!

In this document, we'll explain what real estate syndication is, how it works well for multifamily housing in particular, and why it offers a valuable path to passive income for investors.

What is real estate syndication?

Real estate syndication offers an efficient mechanism for investors to pool their money together to purchase real estate that they either could not afford or do not want to manage as an individual investor. The syndicator pulls together the investors and the network of other parties that are required to complete a deal – from brokers and lenders to lawyers and accountants – and they manage the entire deal from initial investment through to exit, often over the course of many years.

As anyone who has ever purchased real estate knows, these deals are inherently complex and require extensive subject matter expertise. For starters, knowing what is a "good" potential investment requires in-depth understanding of macroeconomic factors, demographic trends and local market dynamics. Then, in order to realize a positive ROI, you need to understand local property ordinances, construction laws, environmental regulations and more. Next, you need to make the right choices about how to upgrade and maintain your property to the satisfaction of tenants and investors. Now, this is where Westland produces our true special sauce– by closely managing the asset, we add value to the initial investment by creating margin. Our investors don't need to worry about the never-ending needs of the units and their renters, they just watch the incoming cash flow increase year over year thanks to our close management of the properties.

Most investors do not want to take the time to become an expert in all these areas. But they may want to take advantage of the many benefits of real estate investment. This is what makes participating in a real estate syndication an excellent option, enabling investors to leverage the expertise of the syndicator to generate returns from both property appreciation and cash flow income.

Why multifamily housing?

Over its 40+ year history, Westland has always maintained a focus on multifamily housing. This has proven to be a sound strategy, since multifamily has exhibited less volatility during this period than any other commercial real estate asset class and has historically yielded the best risk-adjusted return. Even during difficult economic times and a global pandemic, people still needed a place to live! And looking ahead, there is data that shows that the demand for multifamily will far outstrip supply in the years to come – driving up the value of existing multifamily housing. We've **written extensively** about this topic and continue to strongly believe in its value / potential

The nuts and bolts: How does it work?

Typically, when you participate in a syndicate, you are invited to deals that you can choose to invest in on a deal-by-deal basis. There is no commitment to invest in deals when you join, just the option. An extremely important part of the process, in addition to first selecting a great multi-family property we can upgrade, is the financial engineering of the deal structure, including debt financing. Deals are structured so that the syndicator and investors pool together about 25% of the funds, and the remaining 75% comes from a lender or bank.

We see a lot of benefits of debt financing. **Here's why:**

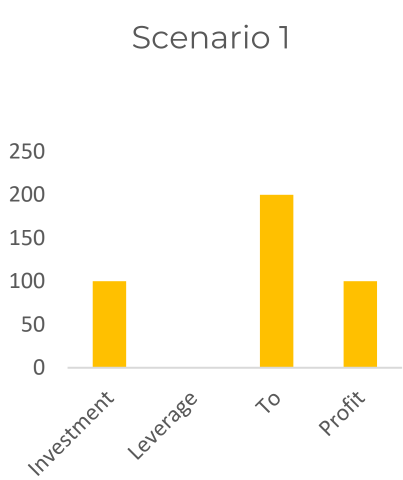
1. The best way to understand debt financing is to compare it against purchasing a property with all cash. In order to make a 100% return on the cash invested in the property, it needs to double in value. When Westland borrows 75% of the purchase price from our trusted banks and adds the 25% equity (our own investment together with our investors') then to achieve a 100% return, the property needs to appreciate by 25%. If you were to achieve the same 100% return on the property but used 75% debt financing and 25% equity (cash), then you would have made 5 times your money. Here's a visual on what leveraging looks like looking at 3 different scenarios. Line one shows input costs and line five is the result.

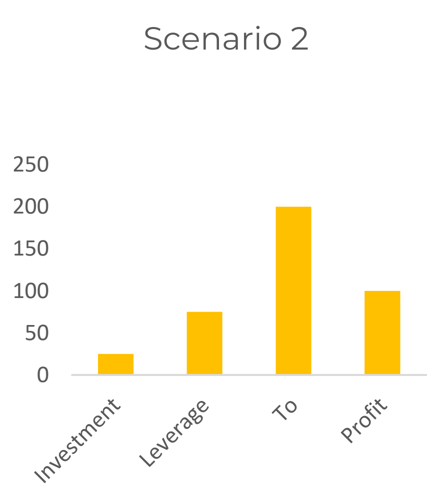
Investment Scenario

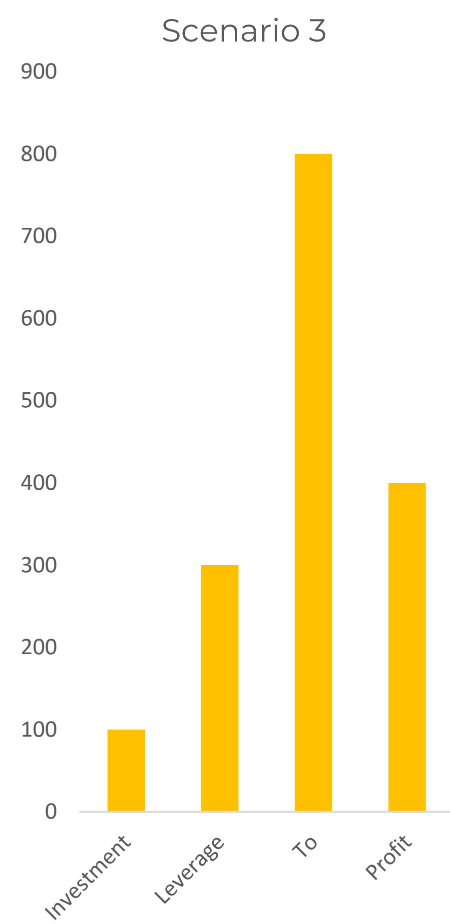
100% of investment	25% of investment	25% of investment
Invest $100	Invest $25	Invest $100
Increase 100%	Increase 100%	Increase 100%
ROI- 2x	ROI- 5x	ROI-5x
Made $200	Made $125	Made $500

Or to picture this same information on a graph, see below.

	Scenario 1	Scenario 2	Scenario 3
Investment	100	25	100
Leverage	0	75	300
To	200	200	800
Profit	100	100	400
Return Multiple	2	8	8
Property % Return	100%	100%	100%







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2. Often less understood is how depreciation works and the ensuing tax benefits for our investors. If you need a quick review on depreciation, here you go: since property is made of physical materials, the government knows that it will deteriorate over time and the owners will have to reinvest money for physical replacements. To account for this, the government allows you to "depreciate" your property. The IRS determines the lifespan of each of these physical components- it is now codified in law that residential property depreciates over 27.5 year schedules. Each year is assessed equally, which ends up being 3.63% of the total value each year. The best way to think about depreciation is to divorce it from the actual investment. It lives in the paper world of taxes. As an investor, you make money and, at the same time, you report a paper loss to the IRS.

3. Does this mean that our investors then actually lose value? Thankfully, not. In fact, when you care for properties as Westland does, you ultimately create value. Depreciation is a loss that only exists on paper. In fact, real estate is one of the only businesses where the IRS allows cash flow from the investment, but when you report your income to the IRS, they require you to deduct your paper loss from that amount!

Revenue & increase in value

The inflow of cash is generated two ways from our investments. On the one hand, unit rentals essentially cover operating expenses like taxes, insurance, maintenance, property management, and utilities. Also, we must factor in partnership expenses such as mortgage, tax filings, etc. Then, all remaining inflows from rentals are allocated to investors. The second way to increase cash flow is a combination of increased rents fused together with lower management fees, since we manage operations in-house. We also look to maximize the assets we hold- renting out parking spaces and storage units. As operations become more profitable, we create more cash flow. At that point, we can either maintain positive cash flow, or we can refinance the property with a cash out financing. As we grow the profitability of the property, we increase the value. It can support a higher loan payment and thus higher loan amount. Oftentimes the value extracted from a cash out refinancing would equate to 4 or 5 years worth of cash flow. And finally, the absolute best part about a cash out refinance is that the cash delivered to the investor is a non-taxable event, and the new interest payments are tax deductible!

Westland strategy is investing for growth so that as income increases, the property actually becomes more valuable than the price at which it was purchased. I can get into some nitty gritty equations here, but the easiest way to explain this concept is to picture making a cake and selling it to your neighbor. You spend $10 in ingredients, put some time in the kitchen and then turn around and sell it for $50. If you were part of a “cake syndication”, you would have put up $2.50 and made $12.50! This is the same type of magic formula that happens with our real estate investments.

There are many components to consider when looking at investments. The paramount question we ask ourselves is how to make a profit margin on every element of our work. Are we getting cash flow or-- can we grow the profits enough to make the value higher than the input cost to get there? If yes, then the venture is worthwhile, and we proceed. Our philosophy is that there is no bad piece of real estate (once we feel confident in regards to local market dynamics), only the wrong price. So, if we can get the purchase and project cost affordable enough, we can make our properties a successful investment.

For those wondering more about the debt financing mentioned above, here is a little more on how that is engineered. We prefer to use debt financing to purchase the property and subsequently upgrade the property. Debt financing is excellent in two ways—one, it allows higher profit margins on appreciation. The second is that the interest paid on the financing is 100% tax deductible. Lastly, for those that are wary of debt, the property’s rents pay for the financing.

But we don’t stop there—we then look at the tax code and see if there are advantages to be utilized. And here is a reason why this consideration comes at the end of our process. If the first two elements of the investment don’t work, it’s not worth a second of time contemplating tax advantages. They are simply sprinkling a little extra flavor to an investment. But assuming that

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In real estate we use a formula that looks like the following: earnings divided by price= % return for investors. On average, every $1 we invest turns to $17 in value

1) the investment is good and 2) the financial engineering is sound, then tax advantages become more important.

To summarize, here’s the elements that make Westland’s syndication model interesting.

- The business endeavor must work on its own and create margin.
- Next, we leverage financial engineering with debt financing with equity to boost returns.
- We harness tax codes to use “paper loss” from depreciation and layer it on the debt financing (leverage).
- Finally, we carefully look at other tax benefits and create a sound exit plan.

A previous Westland Investment – Tigard, Oregon

(Name withheld for privacy reasons)

Year bought/ sold	2014 to 2019
Purchase price	$1.5m
Sale price	$7.0m
ROI	40%

If you are an accredited investor and are interested in learning more about our work and prospective opportunities, please reach out to Carson Halley at Carson@westlandinvestors.com.