Coty Dolan's

Complete Guide to Investing in Real Estate Syndications & Funds as a Limited Partner.

"Hello,

My name is Coty Dolan, I am the Founder, CEO & Principal at Dolan Capital.

At Dolan Capital, we really love and believe in the power of real estate investing, especially multifamily investing, and we want to share that with you.

I hope this guide is helpful, please enjoy…"

WHAT ARE REAL ESTATE SYNDICATIONS & FUNDS?

A real estate syndication or fund is where a group of people pool their resources to purchase real estate, often a large property like an apartment complex, which would otherwise be difficult or impossible to achieve on their own.
One of the most famous syndications is the purchase of The Empire States Building, which was purchased by Helmsley & Malkin in 1961 for $65 million from 3,000 small investors, many of whom paid only $10,000 for a single share. a Syndication is going to be a property specif based Investment, where a Fund is going to generally target an asset class with specific returns metrics.

SYNDICATION vs. FUND?

Syndications are going to be a property-specific based Investment, where a Fund is going to generally target an asset class with specific returns metrics.

WHO'S INVOLVED?

A real estate syndication typically involves the "general partners" who organize the syndication, including finding the property, securing financing, and managing the property; the general partners are sometimes referred to as the "GP or GPs" "Sponsors" or "Operators".

The people who provide the cash investment are referred to as "passive investors" "LPs" or "limited partners".
In return for their investment, the limited partners receive an equity share in the syndication along with cash flow distributions and profits.

WHO CAN INVEST IN A REAL ESTATE SYNDICATIONS & FUNDS?

A real estate investment fund is typically open to "accredited investors". The Securities and Exchange Commission (SEC) defines an accredited investor as someone who has an annual income of $200,000 (or $300,000 joint income) or a net worth of at least $1M, not including your primary residence. Visit the SEC website for additional information and resources.

Some syndication offerings, such as the ones designed as "506(b)" offerings, are open to unaccredited investors. Many multifamily syndications are 506(b) offerings, which means they are open to unaccredited investors, but these investors have to be "sophisticated".
A sophisticated investor has enough knowledge and/or experience in investing in alternative investments such as real estate, oil, or precious metals. They may have made previous investments outside the stock market or perhaps they attended an investing seminar.

Whether or not they have actual investing experience, the person has the ability to make an informed decision about a particular syndication offering.

Equally important to being "sophisticated", the investor needs to have a pre-existing "substantive relationship" with the deal sponsor (i.e. the partner or partners who are presenting the opportunity). While the SEC doesn't specifically define what "substantive relationship" means, it provided clues in this letter to a company called "Citizen VC".

When you become an investor with Dolan Capital you are taken through a "get to know you" process. These steps allow us to gather pertinent information such as financial information, goals, risk tolerance, investment experience, etc.

WHAT KIND OF REAL ESTATE DO SYNDICATIONS & FUNDS INVEST IN?

Real estate syndications are more common for higher valued commercial real estate, such as multifamily, self-storage, mobile home parks, retail, office, or light industrial, rather than for single-family properties.

Of all of these types of commercial real estate, I recommend multifamily real estate for the following reasons.

WHY INVEST IN SYNDICATIONS & FUNDS?

There are 5 main reasons investors might consider a real estate syndication or fund over the stock market or other investments:

- **Below-Average Risk**: When the housing bubble popped in 2008, the delinquency rates on Freddie Mac single-family loans soared, hitting 4% in 2010. By contrast, delinquency on multifamily loans peaked at 0.4%. So, if you're looking for a recession-proof way to invest your money, there is no better option than apartment building investing.

- **Above Average Returns**: the average stock market return over the last 15 years was 7.04% but after fees, inflation, and taxes that return becomes a paltry 2.5%. On the other hand, multifamily syndications routinely return average annual returns of 10% and above. That's compounded (i.e. without volatility) and after fees, inflation, and yes, even taxes.

- **Passive Income**: Unlike stocks and bonds, multifamily syndications generate cash flow for its investors from the income generated by the property.

- **Extraordinary Tax Benefits**: Because of the magic of "bonus depreciation", your investment income is taxed at a much lower rate than any other investment, in fact, you may actually show a taxable loss that can be used to offset other passive income!

- **Inflation Hedge**: As inflation increases, so does the value of the property, the perfect hedge against inflation.

With our current tax laws, investing in U.S.-based real estate syndications, especially multifamily apartment buildings, is the best investment on the planet.

WHAT ARE THE RISKS OF INVESTING IN SYNDICATIONS & FUNDS?

There are a number of advantages to putting your money in a multifamily deal, but every investment comes with risk, and don't let anyone tell you otherwise. Understanding the potential downside to invest in apartments will help you make the best possible choices and ultimately mitigate the risks.

Here are the 5 risks and disadvantages of investing in syndications:

- **Sensitive to Market Cycles**: Like any investment, real estate is affected by market cycles. You can mitigate this risk by investing in real estate like apartment buildings, which have historically performed better than other real estate types. Also stay away from the west coast and New England, where strong up and down cycles are likely to impact your investment. That's why we tend to invest in more stable areas like the South.

- **Highly dependent on the Operator**: Having the right team in place to run a property is also crucial to the performance of multifamily. If you are dealing with an inexperienced or incompetent operator, they are liable to make mistakes. To mitigate the risk, ensure that you invest with the RIGHT sponsor, I'll cover how to do this later on.

- **Lack of liquidity**: Arguably the biggest disadvantage of investing in syndications is that your money is tied up for 5 years or more. You can't just call up your broker and sell your position. On the other hand, many syndications can refinance before the end of the term and return part or all of your investment. And in the meantime, you're getting cash flow, so you're getting part of your money back!

- **Lack of control**: Not only is your money tied up for years, but you also don't control the investment itself, your Sponsor does. They make all of the day-to-day decisions but they also decide when to refinance or sell. If you're a control freak, this may be an issue for you. On the other hand, that's also the benefit of being a passive investor, you don't have to do anything, just leave it up to your trusted operator!
  Further consideration, how much control do you really have over the stock market?

- **Harder to understand than investing in stocks**: It may seem that understanding an alternative investment like real estate deals is hard, and yes, there is a learning curve. But, who really understands the stock market? While most investors should try to understand the stock market, most don't take the time and turn their hard-earned savings over to a financial advisor. The difference here is that you should spend time finding an operator you can trust and then invest with that operator over and over again.

Despite these risks, after studying every other possible alternative, I've come to the definitive conclusion that investing in multifamily syndications & Funds is the best investment on the planet. No other investment performed so well in the last recession offers above-average returns, cash flow, extraordinary (legal) tax loopholes, and provides a built-in hedge against inflation.

HOW ARE SYNDICATIONS & FUNDS STRUCTURED?

Potential investors have lots of questions about how multifamily deals are structured, and rightfully so.

If you're trusting us with your hard-earned money, it's only fair that you understand your rights as a limited partner, the fees you may be asked to pay, and the timeline around getting your money back.

Here are the 6 main components of the structure of a multifamily deal:
- The Entity
- Equity Splits
- Preferred Returns
- Control & Voting Rights

- Return of Principal
- Sponsor Fees
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Let's dive into each of these in more detail.

THE LEGAL ENTITY

The legal entity we use to structure multifamily Fund is either a Delaware Statutory Trust or a limited liability company or LLC.
The legal entity we use to structure multifamily syndication deals is the limited liability company or LLC.
Sometimes we create multiple entities, a holding company registered in Texas or Delaware and a local entity in the state where the property is located. The local entity owns the building itself, and the holding company owns the local LLC.

EQUITY SPLITS

Equity splits vary, however, both 70/30 and 80/20 are common. For instance in a 70/30, the limited partners (LPs) get 70% of the ownership, while the general partners (GPs) receive 30%. The operator earns this portion of the equity known as carried interest for putting the deal together, even though the investors put up 100% of the money.

My advice is to focus less on the split and more on the returns, specifically the cash-on-cash (CoC) and average annual return (AAR). If you have a good quality multifamily deal, a strong operator, conservative underwriting, and a 15+% AAR, that's much more important than the equity split.

PREFERRED RETURNS

Some multifamily syndications offer something called a "preferred return", which means a certain minimum is paid out to the investors before the general partner is paid.
One way to think of it is like an interest payment, which is paid out first before the leftover cash flow is split based on the equity arrangement.

Let's do a quick example:

Let's assume a particular syndication or Fund gives investors 70% equity and the operators retain the remaining 30% as carried interest.
Let's further assume that the total cash investment from the investors is $100,000 and that the preferred return is 5%. That means that the first $5,000 of any available cash flow that year is paid out to the investors first, and the rest is split 70/30.

If the annual available cash flow is $15,000, the first $5,000 is paid to the investors, leaving a net of $10,000.
Of this remaining cash flow, the investors would receive 70% or $7,000.
In summary, the investors are paid $5,000 from the preferred return and another $7,000 per the equity split, for a total of $12,000, a 12% cash on cash return.

CHALLENGES WITH PREFERRED RETURNS

The problem with preferred returns is when a project doesn't go as planned for whatever reason. Maybe the operator is unable to execute the original business plan, or it takes longer than planned, or there is a market correction.

Regardless of the reason, let's assume that the available cash flow to be distributed is less than the preferred return. In that case, the preferred return accrues to the following year.
Now imagine that the situation doesn't substantially improve, and the general partners fall short of next year's preferred return and that accrues to the year after that.

If this goes on for too long, the general partners realize they can never catch up to the preferred return. At that point, they may stop trying to turn the property around, or they may force a premature sale to get paid something, but neither scenario is actually good for the investors.
It's my opinion that a preferred return does not put the general partners and the limited partners on the same page.

CONTROL AND VOTING RIGHTS

The nature of being an LP is that you are limited, both in liability and control. Limited liability means you can only lose the principle you invested in the multifamily deal, and you are protected by the SEC in the case of a lawsuit or a loss of the building.
Typically, LPs have no real involvement in the day-to-day operations of the multifamily property, and all decisions are made by the GP.
LPs almost always have the opportunity to vote on anything that may reduce their rights in any way. And sometimes they can vote over a refinance or sale.
The Operating Agreement breaks down the rights of the LPs and GPs, so be sure to read it carefully.

RETURN OF PRINCIPAL

How and when do you get your money back? Through one of two liquidity events:

- Refinance
- Sale

Here is a real-life example, a sponsor buys a 321-unit multifamily property in Memphis for $7M and put $1M into it. 13 months later, they refinance the property and get a $15M valuation! This means the investors got 84% of their initial investment back.

The beauty of this is that the majority of your risk is off the table and you can invest that money in another deal, while you continue to earn returns on the initial investment.

The business plan for a multifamily deal outlines the hold period, and a good operator will honor that commitment. Under normal circumstances, the plan is to hold the property for 3 to ten years, unless a market correction takes place. And if the operator is going to change the business plan, they should poll the LPs for input.

SPONSOR FEES

There are four possible fees you may be asked to cover as an LP in a multifamily deal:

- Acquisition Fees
- Asset Management Fees
- Capital Transaction Fee
- Disposition Fees

Acquisition fees are the most common. Payable to the GP at closing, this fee is 2- 3% of the purchase price.

Asset management fees are typically 1.5% of the gross collected rents. GPs use this money to cover their overhead for managing the property.

Though it is less common, it is not unheard of to be charged a **capital transaction fee**. Set at approximately 1%, this fee is due should a cash-out refi return 100% of the purchase price.

The final fee you might be asked to pay is known as a **disposition fee**. This fee is a small percentage of the sale price, and it is collected when a multifamily property is sold.

Again, don’t get too bent out of shape about fees. Operators DO have overhead, and we use these fees to cover our costs. The only real money we make is on equity when we raise the value of the property.

Now you know how deals are structured let us take a look at the investment process…

WHAT IS THE INVESTMENT PROCESS?

Before I get into the process, I'm going to assume that you've decided you want to invest in a multifamily syndication opportunity with a specific deal sponsor.

If you're still on the fence, feel free to schedule a CALL with me, and I will answer any questions you may have.

I'm also going to assume that you have a "substantive relationship" with whatever sponsor you intend to invest with.

While the SEC doesn't specifically define what "substantive relationship" means, it provided clues in this letter. In short, the better you know the deal sponsor, the better they know you, and the more interaction you've had, the stronger you can make a case you have a "substantive relationship" and the more likely you'll be invited to invest in the opportunity.

If you'd like to establish a substantive relationship with us, please join our Dolan Capital Investor Network. You'll be asked to fill out a short questionnaire and schedule a phone call with me so that we can get to know each other a bit more. We can then present you with upcoming opportunities.

Assuming you're ready to go and your sponsor has a live investment opportunity, here is generally what happens next.

STEP #1: LEARN ABOUT THE OPPORTUNITY

The best way to learn about multifamily investment opportunities is to get on the syndicator's email list. If you've joined the Dolan Capital Investor Network, you're good to go.
We send out regular emails with educational content. And when a multifamily deal comes through, we forward an Executive Summary and set up a live webinar to present the opportunity, and give you the chance to ask questions.

STEP #2: EXPRESS INTEREST VIA A "SOFT COMMIT"

If you're interested in the opportunity, the next step is to fill out a short form telling us how much you'd like to invest in the multifamily syndication. (The minimum is $100k.)
The "soft commit" doesn't put you on the hook yet, but it does give us an idea of who we can expect to invest in the syndication deal. And the "soft commit" window typically stays open for a couple of days after the live webinar. So, if you want in, act fast!

STEP #3: REGISTER ON THE INVESTOR PORTAL

If you haven't already registered on the Dolan Capital Investor Portal, you will then fill out an online form to get a username and password. The Portal allows us to communicate with you securely through the rest of the process.

STEP #4: SATISFY THE MINIMUM REQUIREMENTS

Next, we double-check that you are either an accredited or sophisticated investor. If you're not accredited, and we don't know you very well yet, we may ask you to hold off until the next deal. Remember, SEC guidelines require a "substantive relationship" between the passive investor and the syndicator.

STEP #5: MAKE A FORMAL INVESTMENT "OFFER"

Those who raised their hand with a "soft commit" now have the chance to let us know they are serious. At this point, you promise a specific amount of money to the multifamily syndication deal.
We usually give prospective investors a day or two, after the "soft commit" window has closed, to make this formal offer. But remember, it's all on a first-come, first-served basis.

STEP #6: REVIEW AND SIGN THE LEGAL DOCUMENTS

At this point, you will receive the operating agreement, a document outlining the parameters of the partnership. It breaks down the role of the General Partners (GPs) and Limited Partners (LPs), explaining who is responsible for what decisions. The operating agreement also covers profits and splits.
Once you looked through the legal documents, you sign them online via DocuSign.

STEP #7: WIRE THE MONEY INTO THE ESCROW ACCOUNT

Once you've signed on the dotted line, you receive the wiring information and send your funds to the escrow attorney. Congratulations, you are an LP in a multifamily deal!

Don't forget, multifamily deals are a limited-time offer. We can't hold your spot if you don't wire your money. If you send money after the deal is full, we'll wire it back to you.

STEP #8: WAIT UNTIL CLOSING

Now, you sit back and relax. And wait for the syndication deal to close.
This usually takes between 30 and 45 days, depending on the deal.
We typically do a live webinar at closing and monthly updates moving forward.

ONCE AN OPPORTUNITY IS IDENTIFIED

- Register in the investor portal

- Satisfy the minimum requirements
- Express interest
- Review and sign the legal documents
- Wire the money to the escrow attorney
- Close the deal

Should you choose to invest with us at Dolan Capital, OUR process is as follows:

1. We notify investors of new opportunities and invite you to a conference call to learn the details.
    a. Pending the opportunity meets your criteria, you make a verbal commitment to the deal.
2. From there, you sign the necessary documents to verify your commitment:
    a. Private Placement Memorandum outlining the deal's structure and risks
    b. Operating Agreement covering the GP and LPs responsibilities and ownership ratios
    c. Subscription Agreement (summarizing the number of shares you own in the LLC set up as the owner of the apartments)
    d. Accredited Investor Qualifier Form (if applicable)
    e. Direct Deposit form to receive your distributions automatically
3. Once you've completed the necessary paperwork to substantiate your commitment, simply wait for us to close the deal!

Other GPs may have a different system, so be sure to ask what's involved in their process and what your responsibilities would be as a passive investor.

WHAT TO EXPECT AFTER CLOSING

You now understand the investment process from the time you're presented with an investment opportunity until it closes.

But what happens next?

Here's what you can expect after a deal closes when you invest with most operators and us at Dolan Capital.

REGULAR UPDATES

Once per month, you should expect to receive an email from your operator with a narrative of what happened in the last 30 days. The narrative will include some of the following information:

- What kind of renovations were done
- What the occupancy and collections were; if it improved, why did it improve; if lower, why was it lower, and what is being done about it
- Were the expenses in line with projections?
- Is the business plan on track or if not, why not, and what is being done about it.
- If a distribution is being made along with the update, what is that distribution and how does that compare to the projected returns.
- Anything else that is newsworthy about the property and the market in general

We've found that this narrative satisfies most passive investors. For those who want more, we can provide more documents such as the Profit and Loss (P&L) statement (including an actual vs. projected analysis), balance sheet, and rent roll.
Once a property has "stabilized" (i.e. it has achieved its targeted net operating income), things get "boring" and most investors stop reading the reports (as long as the distribution checks still keep coming!).
That's why many operators reduce the reporting frequency from monthly to quarterly.

TRANSPARENCY AND ACCESSIBILITY

If you're ever interested in any other information that is not provided with the monthly updates, you should be able to ask for additional documentation and receive it promptly.
In addition, your operator should be readily available via email or phone in case you have any questions or concerns.

DISTRIBUTIONS

The fun part of passive investing is receiving the cash flow distribution checks!
Often the first distribution is delayed for two quarters after the deal closes to give the operator some time to see how the property performs and deal with any unexpected issues after the closing. A good operator always has enough cash on hand for any emergencies!
Once any issues have been identified and dealt with and the cash flow has become more predictable, the operator can begin paying out distributions.
Many operators send out the distributions quarterly via ACH (and some do this monthly).
A good operator will escrow funds from cash flow to fund periodic expenses such as real estate taxes and insurance.

This is how the amount of distributions is determined:

Bank Balance
– Escrowed Funds (i.e. Taxes, Insurance, etc)
– Funds for Capital Improvements
– Reserves (typically $250 per unit per year)
– Asset Management Fees to the General Partners

= Funds Available for Distribution

Once the funds available for distribution are determined, they are distributed per the terms of the Operating Agreement.

ANNUAL REPORT AND TAX DOCUMENTS

After the books are closed on a year, a good operator will send out an annual report as well as the K-1 tax documents.
The annual report should provide a narrative of how the project performed versus what was projected, and if not, why not, and what is being done about it.
It should provide ProForma projections for the new year along with the plan to achieve those projections.
Finally, it should provide the complete P&L and Balance Sheets (or be available upon request).
Even though tax time is always stressful for the operator and their CPAs, a good operator will send out the K-1 no later than the end of March to give investors enough time to file their own taxes.

CONCLUSION

How an operator communicates with their investors says a lot about them and how they do business. Good operators communicate regularly with their investors, provide additional information when requested, and are always available for questions.

I'd like to think that at Dolan Capital we are one of the "good" operators. We pride ourselves on conservative underwriting, exceptional communication, and impressive returns. We'd love to talk with you.

I invite you to join our Dolan Capital Investor Club. You'll be asked to fill out a short questionnaire and schedule a phone call with me, Coty Dolan so that we can get to know each other a bit more. We can then present you with upcoming opportunities.

While it can take a while to find and trust an operator, once you do, you can continue investing with them for years. At that point, passive investing becomes truly passive and FUN!

HOW & WHEN ARE PASSIVE INVESTORS PAID?

The beautiful thing about passive investing in multifamily deals is that you receive cash flow, get your principal back and make a return.
But when do you get paid and how much can you expect?
In this section, I'm going to explain when and how often passive investors get paid and how much you can expect to earn.
You'll understand the ins and outs of a cash-out refinance and learn how passive investors can redeploy that money for infinite returns!

As a passive investor in a multifamily deal, there are 3 ways you can get paid:

- Cash flow distributions
- Cash-out refinance
- Sale of property

Let's go through each in turn and talk about when and how these payments can occur.

CASH FLOW DISTRIBUTIONS

When your multifamily investment property earns a profit, so do you!
The frequency varies by project and operator, but most passive investors get paid quarterly. \
One thing to keep in mind: Your first cash flow distribution may be delayed depending on the type of project.
If you're passive investing in a stable value-add deal or a heavy value-add deal, it generally takes 6 to 12 months for your cash flow to arrive.
This timeline depends upon the performance of the property.
In other words, your syndicator may need time to make some basic improvements and raise occupancy before the first cash flow distributions can be delivered. Make sure you account for this pause in receiving immediate cash flow.

CASH-ON-CASH RETURN

A related term you need to know is cash-on-cash (CoC) return.
Let's say you made a passive investment of $100K, and you earn $7K in annual cash flow distribution. The CoC return is calculated by taking the initial investment divided by your cash flow distribution:

100K/7K = 7% CoC return

At Dolan Capital, we aim for a CoC return of 7+% upon stabilization of the property, and we want to hit that target no later than Year 2.

Another cool thing to remember here is that adding value to the building will grow your CoC return. As the operator renovates and increases the money coming in, your cash flow distribution checks get bigger too!

CASH-OUT REFINANCE

Passive investors get another, and much bigger payday in the case of a cash-out refinance. If you invest in a value-add deal and the syndicator's team does their job, the building's net operating income will increase over time. Then, they can refinance the property at a higher valuation, it's worth a lot more now that it's earning more. Now the operator can pay off the loan and give their passive investors most of or all of their principal back while continuing to hold the property and bringing in cash flow.

Here's an example of how this works:

A syndicated 321-unit deal in Memphis called. Countryview. Purchased the deal for $6.8M with $1M in capital improvements.

Now listen to this, the property was recently refinanced, and it was valued at $15M!

This allowed a return 84% of investors' principal, and they continue owning 80% of the asset.

When you think about it, this is a pretty great scenario. The passive investors got most of their initial investment back, which reduces their risk. They are now free to redeploy that money in a new multifamily deal. But they still own equity in the original deal.
This leads to what we call infinite returns. Passive investors are still getting cash flow distribution checks based on their initial investment. But they have all their original investment back, and are available to invest in a new deal for another similar payout.

SALE OF THE PROPERTY

Last but not least, passive investors get paid when a property is sold. The Sponsor repays the loan first and returns your principal investment, then, profits from the sale are split by equity.

At Dolan Capital, we plan to return the investor's initial capital when the property is sold 3-7 years after purchase, or earlier if possible with a refinance.

PAYDAY!

So, when do passive investors get paid for putting their money in multifamily deals?

- You earn regular cash flow distribution distributions quarterly
- You get a bigger payday after a cash-out refinance OR sale of the property

If you're ready to take the next step, and you want to invest in one of our upcoming multifamily investment opportunities, please join our Dolan Capital Investor Network. You'll be asked to fill out a short questionnaire and schedule a phone call with me so that we can get to know each other a bit more. We can then present you with upcoming opportunities.

WHAT MONEY SOURCES CAN BE USED TO INVEST IN A SYNDICATION?

Please note, I am not a financial advisor, CPA, or attorney, and we are not giving you advice here based on your personal situation.

Don't have money in the bank to invest in multifamily? Don't count yourself out! There are several ways to access capital for real estate deals.

There are different money sources you can use to invest in real estate syndications & funds, for example, you can convert your stocks and bonds into cash for a multifamily deal or open a line of credit. You can use a portion of your retirement account for passive investing.
Let's explore the different money sources you can use to invest in syndications & funds.

CASH SAVINGS

The easiest way to invest in real estate syndication or fund is with cash. Of the possible sources of capital, it is the most liquid, meaning it is readily available and can be quickly wired to the Sponsor you are working with.

STOCKS, BONDS, & CRYPTO

Another source of funds for real estate deals is stocks and bonds. You can sell a portion, or all, of your mutual funds, ETFs, Stocks, Bonds, and or Crypto for cash and put that money in a multifamily deal.

As I've said before, there is no better investment in the world than apartment buildings. Nothing else affords you the cash flow, above-average returns, and the extraordinary tax benefits of multifamily real estate investing.

LINES OF CREDIT

Yet another way to access funds involves opening a line of credit. If you have equity in your home, for example, you can get a loan at a relatively low-interest rate and use that money to invest in real estate syndications.
Do be careful, though. It's important that you invest in a multifamily deal with a fairly high return in order to bridge the gap.

SELF-DIRECTED IRA

If you have a retirement account, you can use a portion of that money to invest in real estate syndications too.

Here's how it works:

1. Open an account with a self-directed IRA custodian.
2. Write a letter to the administrator of your existing account, asking them to move a certain amount of money to the new self-directed IRA.
3. When you're ready to invest in a real estate syndication, instruct the custodian of your self-directed IRA to wire the money to the appropriate closing attorney.
4. Congratulations, your self-directed IRA now holds a share in the LLC of that particular real estate syndication.

There are some limitations that come with investing through a self-directed IRA. The law requires you receive no direct or indirect benefit from the investment. In other words, you can't touch the money and cash flow distribution checks must be deposited directly to the IRA.
Let's take a look at how to choose the right custodian, the processes involved, and the pros and cons of this strategy.

How to Invest Using Retirement Funds;
the thing people don't realize is that just by having a self-directed IRA doesn't mean you can use it for real estate investing. A self-directed IRA requires an IRA custodian. Normally, it's a financial institution like Schwab or Fidelity that sets up and manages the account so that it abides by the US tax codes. But if you call your custodian and start asking questions, you might find that you can't actually use these funds to invest in real estate assets. They'll call it a self-directed IRA, but you can only direct it in things like Wall Street.
Obviously, you'll need to find a new provider that will allow for real estate investment, even then, they're not all created equal.

From our experience, we've found some of these self-directed IRAs are easier to work with than others. Some will allow for real estate, but not for syndications. Others only take paper checks, which we've made a rule to avoid. When we conduct distributions, we actually require a group to take electronic deposits (ACH/Wire).
So, if your IRA custodian insists on paper checks, know that you will not be able to invest with us and certainly with other groups.
Another thing to consider is how quickly the custodian can execute documents. The tax code requires an arms-length transaction to happen, and one of the things that involve is

the custodian must sign for every transaction on your IRA. While it might be the "Michael Blank IRA" it's really its own separate entity, if you will.

Every time you have a document that needs to be signed, as an operating agreement, for example, there's a process for submission. If your custodian insists on receiving a paper document with a wet signature instead of accepting a DocuSign, it will put a delay on the deal.

In all, there are certain things you want to do when looking for a custodian of your self-directed IRA. First, just start a conversation with them and learn how they operate. Second, whether it's us at Dolan Capital or another investment group, ask their opinion about the custodian.

MOVING YOUR IRA TO A NEW CUSTODIAN

Once you've found a custodian for your self-directed IRA, there's a series of paperwork that you'll fill out. The new custodian will then get in touch with your current custodian to process the money transfer, which may take a couple of weeks. It's different for each group, but it's a more involved process than you might expect.

That's why the best time to make a change is before there's an active deal present. You want to put yourself in a ready position, especially in today's environment where deals happen pretty fast. At Dolan Capital, our deals typically fill up in just a few days after we start, and we like to move quickly.

THE PROS AND CONS

Like any investment strategy, there are pros and cons.

The main advantage of using a self-directed IRA to invest in syndicated real estate deals is the return. Many people have a lot of money wrapped up in an IRA account that's earning only 1-2% a year. So that makes investing with an IRA very, very powerful.

The con is that you may actually have to pay taxes on your IRA. There is something called the UBIT (Unrelated Business Income Tax) which usually affects investments that have some kind of debt associated with it. And of course, all multifamily syndications have debt. That's beautiful, but the tax law doesn't think so, right? This tax law makes you pay income tax on any portion of income that's derived from debt.

For example, let's say you're using a mortgage to fund 80% of a multifamily apartment deal. This is a debt, which means that 80% of any profits you make are taxed at your current tax bracket. This is triggered when we sell, and will now be a taxable event in your IRA, and if you didn't create a tax ID for your IRA prior to getting it set up, you may have to pay a penalty and interest when your CPA files your returns.

What a nightmare.

The good news is there's a solution for the headaches I experienced. It's a different kind of 401k called a Solo 401k.

THE BOTTOM LINE

- You can use retirement funds within a self-directed IRA to invest in real estate, with the main advantage being an increase in your average annual return.
- The key is to find a custodian that understands the tax code, will allow you to invest specifically in syndicated real estate deals, is set up to allow for electronic money transfers, and works swiftly to execute documents on your behalf.
- Don't wait until you have an active deal to transfer your funds. Start the process now so you are in the ready position, and be sure to ask the opinion of groups like ours about the custodians you are vetting.
- Be aware that there may be serious tax implications in this strategy unless you set yourself up correctly.

QRP

The one problem with investing through a self-directed IRA? There's a good chance you will get taxed on the money you earn from a real estate syndication.
I know this is hard to believe since you're investing with your retirement fund, and theoretically your taxes are deferred.
But when investing in something that uses debt, like real estate, there's this pesky thing called the Unrelated Business Income Tax (UBIT) that you have to pay when the real estate is sold.
So, what's the alternative? Well, there's this little thing called the Qualified Retirement Plan or QRP, and it just happens to be exempt from UBIT taxes IRA investors are subject to when an asset sells.

Full disclosure, it does cost more to set a QRP trust upfront, but it has benefits beyond avoiding the UBIT tax:

- ***You don't need a custodian to sign your paperwork. You do it yourself.***
- ***You can borrow up to $50K from the trust without penalty.***

SO, WHAT'S BEST?

If you have access to several different sources of capital, cash is best, simply because it's the easiest to deploy.
Multifamily deals move quickly, and once an opportunity is announced, syndicators take investors on a first-come, first-served basis. If you have cash, you can get into a deal quickly and wire the money right away.

Investors using a self-directed IRA are at a slight disadvantage because it does take a few days to complete the paperwork and get your custodian to wire the money.

CONCLUSION

So, what are the different money sources you might use to invest in real estate deals?

1. Cash
2. Stocks & Bonds
3. Lines of Credit
4. Self-Directed IRA
5. QRP

Explore all the available options. Beyond cash savings, there are many different ways to invest in real estate syndications.

HOW TO EVALUATE REAL ESTATE SYNDICATION OPPORTUNITIES

If you've made the decision to put your money in multifamily as a passive investor, there are a number of questions you should ask any Sponsor who's pitching a deal so that you can properly;

- Vet the integrity of the sponsor and their team.
- See if their overall investment strategy fits with your goals.
- Fully understand the specific investment they are raising money for.
- Learn more about the market where a potential investment is located.

In a perfect world, the answers to most of these questions will be found on the GP's website and/or in their offer package. In fact, I would hesitate to invest with a team that doesn't provide the vast majority of this information upfront. But use this section as a guide to help you understand what additional questions you may need to ask and how to make an informed investment decision.

VETTING THE SPONSOR TEAM

Here are the questions to ask your sponsors and some of the answers to look for:

WHY SHOULD I INVEST IN YOUR COMPANY? WHAT DIFFERENTIATES YOU FROM OTHER APARTMENT SYNDICATORS?

The passive investors who choose to invest with us at Dolan Capital do so because of our conservative approach, transparency, and trustworthiness.
Unlike some other sponsors, we're conservative when we underwrite deals to protect our investors from any type of market correction. We have plenty of reserves at closing and grow that reserve while we hold the property. We always buy for cash flow from day one and use

long-term debt to ride out a recession if necessary, and we're projecting higher interest rates, and lower values when it's time to sell.

We are transparent, sending investors progress reports around the status of our business plan on a monthly basis. We also make ourselves available to our passive investors, responding to email within a few hours if at all possible.

We also align our interests with our passive investors. Each Dolan Capital GP invests a significant amount of capital in each deal. We become investors alongside our passive investors which helps to achieve alignment of interests.

Finally, we build trust with our passive investor community by way of an educational via social media platforms, and I've created this resource to help you make better decisions about investing in multifamily syndications.

The reasons why you trust one GP with your money over another is, of course, based on your personal preferences, so look for one who aligns with your goals and makes you feel comfortable.

WHO'S ON YOUR TEAM?

Having the right team in place to run a property is crucial to the performance of multifamily. If you are dealing with an incompetent operator, they are liable to make mistakes. Mistakes can cost you a lot of money.

To mitigate the risk, learn about the background and experience of the real estate attorney, mortgage lender, and CPA the sponsor works with.

Most importantly, ensure that their property manager has a strong track record. How many units do they manage? How long have they been in business? Do they have tenant screening systems in place? What is their policy around routine maintenance and inspections? How well do they communicate with renters and ownership?

The property management team plays a fundamental role in finding the right tenants and maintaining the property, which translates to consistent cash flow and the ultimate success of your investment.

DO YOU USE THE SAME PROPERTY MANAGEMENT COMPANY FOR ALL YOUR PROPERTIES?

The benefit to GPs who work with a single management company is that processes are streamlined and reporting is consistent.

On the other hand, a GP may need to use more than one property management company if they source deals in multiple markets. If this is the case, ask if they are using a single asset manager across all of their properties and get to know that individual's experience and track record.

WHO IS MY POINT PERSON?

You should have a point of contact in the general partnership to reach out to with questions or concerns. Best case, they are an experienced team member who is actively involved in the deal.

HAVE YOU EVER BEEN SUED?

Although you have limited liability as a passive investor, a settlement or fine can have an impact on your returns. If the GP has been sued, find out why and what happened.
Again, this isn't necessarily a deal breaker, but a deal sponsor who's been through a lawsuit should have implemented policies to minimize the risk of it happening again.

EVALUATING THE SPONSOR'S INVESTMENT STRATEGY

Here are some questions to bring to your sponsor regarding the investment strategy:

HOW DO YOU SOURCE DEALS?

GPs can look for on-market deals advertised publicly on the MLS, or find them off-market through a broker. The benefit to off-market deals is that they are less competitive and leave more room for negotiation, which translates to better purchase terms and higher cash-on-cash returns.

WHAT IS YOUR REPORTING OR COMMUNICATION SCHEDULE?

Perhaps the most crucial trait to look for in a deal sponsor is strong communication or "investor relations".

At Dolan Capital we pride ourselves on our exceptional communication, we send monthly updates to our investors. However, some GPs provide quarterly or annual reports.
The information included in an update will vary from GP to GP.
Our monthly reports include: occupancy rates, updates on the number of renovated units, details on our rental premiums and how they compare to our projections, capital expenditure updates, relevant updates on the market, and resident events. On a quarterly basis, we provide a link to the apartment's financial statements, including the T12 and the rent roll.

Generally speaking, you want to stay on top of the investment's performance and be informed right away should things not go according to plan.

CAN YOU GUARANTEE A RETURN?

If you're dealing with a credible GP, the answer to this question will be **NO**. Any return they offer should be a projection rather than a promise.

WHAT IS YOUR POLICY FOR ESTABLISHING RESERVES TO COVER POTENTIAL SHORTFALLS? HOW MUCH CAPITAL ARE YOU SETTING ASIDE FOR RESERVES EACH YEAR?

The GP should ALWAYS have a contingency fund to cover shortfalls, especially if they do value-add or distressed deals that require renovations.
Sponsors should also have money set aside to cover unexpected dips in occupancy or unforeseen maintenance issues.
A smart GP will save $250 per unit per year for reserves to cover shortfalls or unexpected CapEx projects. (If they fail to do this and unforeseen expenses pop up, they may come to you for additional capital.)

HOW DO YOU MAKE MONEY ON A DEAL?

Usually, GPs receive an acquisition fee and earn money for ongoing asset management and equity ownership.
The GP should only charge fees based on the value they provide, but it is up to you to keep them honest. The GP’s comprehensive list of fees should be included in the PPM for any given deal.

WHAT WILL YOU DO TO PROTECT ME FROM A MARKET DOWNTURN?

- Experienced Team
- Long-Term Debt
- Conservative Exit Cap Rates
- Plenty of Reserves at Close
- Monthly Reserves from Cash Flow ($250/Unit/Year)
- Value-Add to Build Equity

WHAT IS YOUR POLICY FOR ESTABLISHING RESERVES TO COVER POTENTIAL SHORTFALLS?

There’s no way to predict what’s going to happen in the real estate market.
With the ongoing threat of tariffs and an upcoming election, many passive investors are skittish about putting their money in multifamily.
But there are things you can do to protect yourself from a recession while you continue to grow your wealth with apartment building investing.

CASH FLOW FROM DAY 1

Another way to keep your investment safe from the possibility of a market downturn is to put your money in deals that cash flow from Day 1. If the property is bringing in money when you buy it, you can ride out any economic storm.

This is a big part of the reason why we stay away from ground-up development. There is no cash flow to service your debt should the economy go south. But if you invest in a stable value-add deal, for example, the rental income you're getting from the very beginning will pay the bills.

PLENTY OF RESERVES AT CLOSE

A smart Sponsor will have plenty of money in the bank at closing to cover unexpected expenses regardless of market conditions. But it is especially crucial to have reserves in an uncertain market.
Unforeseen circumstances (e.g: roof repair, flood damage, etc.) will arise, that's just part of the process. So, to protect yourself from a market downturn, be sure that your operator has a good chunk of change in escrow to handle emergencies. They should also be taking money out of cash flow regularly to add to those reserves.

DEBT TO MATCH YOUR BUSINESS PLAN

How does debt structure affect a multifamily investment in a market downturn? The bottom line, your debt needs to align with the business plan for the property.
If you're planning a cash-out refinance in Year 2 of a value-add deal, a 10-year loan is not appropriate. You'll be stuck with a prepayment penalty. On the flip side, a bridge loan or short-term note is a bad choice for a stable value-add deal you plan to hold long-term (five to ten years). Instead, you'd want to use long-term debt to lock in the current interest rate.
That way, if you're planning to sell in Year 5, but a market downturn hits in Year 4, you're not forced to put the property on the market at a bad time. You have the option to hold and a three-year runway for things to turn around.

CONSERVATIVE ASSUMPTIONS

Last but not least, you can protect yourself from a market downturn by investing in deals with conservative underwriting. Operators who make projections based on best-case scenarios are asking for trouble. So, what should a passive investor keep an eye out for?

- Rental Increases
- Vacancy Rates
- Exit Cap Rate

Projections of overinflated rental increases in Year 1 are unreasonable. It takes at least two to three years to raise rents by that much. Use extreme caution if your syndicator is promising crazy-high numbers like that.
When it comes to vacancy rates, consider both physical and economic vacancies. In a heavy value-add deal, for example, vacancy rates of 5% or even 8% are NOT conservative numbers, especially if you're facing a market downturn. You may have to deal with tenants who don't pay

their rent. Other units will be empty while you renovate. To be on the safe side, look for projected vacancy rates of at least 10%.
The last number you should consider carefully is the operator's projected exit cap rate (the multiplier we use to gauge the value of commercial real estate). The current market cap rate in our area is between 4% and 7% which is low. This means that the cap rate is unlikely to go down. Do the projections take that into consideration? At Dolan Capital, we assume that the cap rate will be 0.5% higher at the sale, and our underwriting reflects that.

EVALUATING A SPECIFIC INVESTMENT OPPORTUNITY

WHY IS THE OWNER SELLING?

Here are some reasons why owners sell:

- They want to retire
- They want to upgrade to larger or "nicer" properties
- If the property has been underperforming, they may be tired of trying to make it work, or they may not have the capital to fix the problem
- They're "flipping" the property, meaning they've implemented the majority of the renovations but have kept "meat on the bone" for the buyer to continue to add value

At the end of the day, we don't much care why a seller is selling, as long as it's a good deal!

IS THE PROPERTY BEING ACQUIRED FOR LESS THAN COMPARABLE APARTMENT BUILDINGS IN THE AREA?

The sum of the costs associated with purchase + capital expenditures should be lower than the value of comps in the area. If that is not the case, the GP is paying too much for the property.

WHAT IS THE CAP RATE GOING IN? WHAT IS THE STABILIZED CAP RATE AND HOW DOES IT COMPARE TO THE MARKET CAP?

If you're investing in a value-add or distressed deal, the cap rate is less important because the NOI is lower than what it should be at purchase. In a case like that, ask about the stabilized cap rate and see how it compares to the market cap. The higher the cap rate at stabilization, the more equity is being created in the property.

WHAT ARE THE MAJOR RISKS ASSOCIATED WITH THIS PROJECT?

Beware of a GP who claims that there are no risks. A competent syndicator should be familiar with any potential issues related to the deal itself, the market, or their team, and have a plan in place to mitigate those risks.

HAVE YOU INSPECTED THE MAJOR SYSTEMS OF THE MULTIFAMILY PROPERTY?

The GP (or qualified member of their team) needs to have examined the plumbing, roof, siding, windows, and HVAC themselves, rather than relying on the current owner or a real estate broker for accurate information.

This is important in putting together the capital expenditures budget, and if one or more of these things needs work, that is a risk you need to be aware of.

HOW LONG WILL MY MONEY BE TIED UP IN THE DEAL?

The GP should have a projected timeline and be able to articulate the hold period and exit strategy for the project at hand. An "exit" could be a cash-out refinance (where most or all of the investor's principal is returned) or an outright sale. Multifamily business plans typically take 3 to 7 years to execute.

- Liquidity Events
- Exit

WHAT IS THE MINIMUM INVESTMENT?

A GP's minimum investment tends to increase with their experience and/or the size of the project. Ask this question early on so you know whether you have the necessary capital to participate in the deal.

SIGNS OF MISALIGNMENT

A sign of misalignment is when the property makes money and the General Partners make money, but the Limited Partners don't. Or, it could even be the other way around. The LPs make money and the GPs don't, which happens with preferred returns. This is also a misalignment of interests. Remember, the GPs don't make any money in the actual deal. When one party gets paid and the other does not, interests are not aligned.

The GPs are very, very incentivized to make that equity worth something because, if they don't, it won't. It'll be worthless and we'll find ourselves working for free.

Also, keep in mind that the General Partners are guaranteeing the loans. If there's ever a default situation the Limited Partners might lose a part or even all of their capital, but the General Partners now have lawsuits on their hands.

The downside could be very severe for the GPs. So while it's worthwhile to ask how a sponsor has skin in the game, it should not be a showstopper if the sponsor isn't investing their own cash into the deal itself.

The partnership between multifamily operators and their investors should be seen as a long-term relationship where both parties are looking after the best interest of their partner.

- Operators need to be transparent with investors about their liquidity requirements and show confidence in the team.
- Investors need to understand the additional amount of risk that the Operator is taking on by guaranteeing loans and recognize the importance of available liquidity.

For our current investors, I want to say THANK YOU for taking the time to educate yourself because as you do, you're getting better. No one cares about your wealth quite as you do.

IS THIS A 506(B) OR 506(C) OFFERING?

What’s the difference? The 506(c) allows the GP to advertise the deal to the public while the 506(b) does not.

More importantly, the 506(b) allows for up to 35 unaccredited investors to contribute capital to the security, but 506(c) offerings are open to accredited investors only, and the GP must verify your status as an accredited investor via a third-party review of tax returns or bank statements, or written confirmation from a broker, attorney or CPA.

HOW DID YOU COME UP WITH THE CAPITAL EXPENDITURES BUDGET FOR THIS INVESTMENT DEAL?

The CapEx budget you review should include a detailed explanation of how much money will be allotted to each project. Did the GP assume the approximate costs? Or are the numbers based on bids from contractors who inspected the property? Obviously, the latter scenario is preferable.
In addition, you will want to know what percentage of the CapEx is dedicated to a contingency fund. (Ideally, it should be 10% to 20% of the total CapEx budget.)

ARE THE TAX ASSUMPTIONS BASED ON WHAT THE CURRENT OWNER IS PAYING? OR THE PURCHASE PRICE?

The GP should be using the purchase price to make assumptions regarding taxes. You can get this information yourself by looking up the tax rate on the county auditor’s website and multiplying it by the purchase price.

WHAT IS THE DEBT STRUCTURE OF THIS DEAL?

Has the GP already secured financing for the deal, or are they basing projected returns on assumptions?
Is the loan short- or long-term? What is its interest rate? And is that interest rate locked-in or variable?

WHAT ASSUMPTIONS ARE BEING MADE TO CALCULATE THE SALES PROCEEDS?

In the case of distressed or value-add deals, you earn the majority of your profit when the property sells. So, how is the GP determining the exit NOI, exit cap rate, closing costs, and any remaining debt?

HOW DO YOU CALCULATE THE EXIT CAP RATE?

In an effort to be as conservative as possible, we assume that the market will be worse at sale than it was at purchase.
We typically set our exit cap rate by adding at least 0.50% to the current market cap rate when we project our exit valuation. This, of course, depresses our valuation at the exit, which is more conservative. If the market goes down, we've anticipated this, and our returns are on track. If the market stays the same or goes up, our returns will be even higher.

UNDERSTANDING THE MARKET

WHAT FACTORS DO YOU USE TO QUALIFY A MARKET AND WHAT ATTRACTED YOU TO THE MARKET(S) WHERE YOU CURRENTLY INVEST?

The market factors a GP should consider include unemployment, population growth, demographics, job diversity, top employers, and supply + demand. You're ultimately looking for a market that is growing.
Is the market fairly stable? Or is it subject to strong up and down cycles? We prefer to avoid volatile markets and focus instead on stable markets that performed well in the last recession, which allows us to produce consistent and predictable returns for our investors.

WHAT CAN YOU TELL ME ABOUT THE SCHOOL DISTRICT WHERE THE APARTMENT COMMUNITY IS LOCATED?

High-quality local schools are attractive to prospective tenants and offer a general sense of what to expect from the area as a whole.
You can learn more about the school districts near your prospective investment at GreatSchools.

WHAT ARE THE CRIME STATS IN THE AREA?

It is difficult to talk renters into moving in if the market (or neighborhood) is dealing with significant crime issues. Look specifically at the trends and be aware that a downward trend is a good sign.
You can find crime statistics online at CrimeReports.

WHAT IS THE MEDIAN INCOME IN THIS PARTICULAR MARKET?

Understanding the median income of an area is crucial in determining if prospective tenants make enough money to support the rent projections for a property.
People typically spend 25% to 35% of their annual income on housing, so you can use the Census Bureau data to verify that median income is 3 to 4 times more than the annual projected rent.

WHAT IS THE MARKET VACANCY RATE AND HOW WAS IT CALCULATED?

It is important to know the average vacancy rate (the # of unoccupied units divided by the total # of units in a multifamily building) in any market you are considering, so you can compare it to the assumed vacancy rate for a specific deal.

Look at that! Now you are well on your way to becoming a truly passive investor! You are now armed with the knowledge now it is up to you to take action.

If you're ready to show off your new knowledge of passive investing by becoming a part of the Dolan Capital Investor Network, visit to www.DolanCap.com to get started today.