1965

Real estate syndication for the local realtor

Harold Joseph Lawlor

REAL ESTATE SYNDICATION

FOR THE LOCAL REALTOR

A Thesis

Presented to

the Faculty of University College

University of Richmond

In Partial Fulfillment

of the Requirements for the Degree

Master of Science in Business Administration

---

by

Harold Joseph Lawlor

August 1965

DEDICATION

To Ann, for everything

TABLE OF CONTENTS

CHAPTER I

PURPOSE AND DEFINITION

The great volume of real estate transactions which have been consumated through large-scale syndications during the past fifteen or twenty years runs into the billions of dollars. Most of these transactions were consumated by the "know-how" syndicators of New York, Chicago, Miami and other progressive "smart-money" centers.[1]

I. INTRODUCTION

The tremendous potential for investment by the general public, and the opportunities for the enlightened real estate broker, make the use of syndication tools and methods mandatory if the investors and brokers are to survive to reap the high yields and commissions possible. Norman Bernstein, a successful syndicator, in an editorial on Real Estate Syndication, said:

> It is the writers opinion that within the next 20 years the majority of the large real estate investment holdings in the United States will be controlled by real estate syndicates, or by large real estate investment corporations. It is this enormous potential that represents today's challenging opportunity in the field of real estate syndication.[2]

If Mr. Bernstein is correct in what he predicts, the syndicate will be used more and more by large syndicates and investment corporations, and it is reasonable to assume that local investors and syndicates will become more active.

Most syndications in operation today have been put together by syndicators from the large metropolitan areas of the north. In small localities where it is necessary for $25,000, $50,000 or $100,000 to be raised in order to promote a good investment property, the local realtor has thrown up his hands, because local investors would not invest this kind of risk capital. Then outside investors from larger cities come in with the necessary capital and form a syndicate.[3]

This is particularly true of Richmond, Virginia. Outside money and syndicators have come to Richmond, and have done things that local capital would not, or could not, accomplish. It is true that Richmond is considered a most conservative city, and for outside investors, this conservatism on the Richmonder's part has practically insured success for them. Larry Weekley of the Richmond Times-Dispatch said:

> A plain fact about Richmond's most important private real estate developed in recent years is that it was made possible by outside risk capital. The city's two big regional shopping centers - Willow Lawn and Southside Plaza - are owned by Washington developers. The same is true of the city's first high-rise apartment project since the 1920's - "The 5100", which is outside the city limits.[4]

Many northern investors have invaded the south and west looking for prime properties for investment. "That the south is in the advanced stages of the most far-reaching expansion it has ever witnessed is not speculation, it is a certainty."[5] The increase in population, the expansion of industries, the need for apartments, shopping centers, office buildings and similar type structures all make the south fertile territory for syndication. With the exception of Atlanta, Miami, Dallas and Houston, there are no large syndicates operating from any major city below Arlington, Virginia. There are, however, many small syndications being formed by local realtors to raise capital. Many of the seasoned real estate firms in the south are amateurs in the syndication field. Although some southern realtors realize that through the vehicle of syndication many properties can be built, sold, or acquired, many of these same realtors, and the investors themselves, are not schooled in the basic fundamentals of syndication.[6]

II. PURPOSE OF THIS REPORT

The purpose of this paper is to present a complete, simple and consise report on the techniques and tools of real estate syndication so that the small real estate broker will realize that: (1) putting together a syndicate is not beyond his comprehension; (2) it is not necessary to depend on large syndicators, promotors and attorneys to perform the real estate functions and promotions necessary for the formation of a real estate syndicate; (3) it is not necessary to absorb the hundreds of complicated articles, briefs and legal reports to become an expert in the "know-how" of syndication; and (4) it is advisable for him to pursue a course of study in the fundamentals of real estate syndication.

Syndication not beyond realtors' comprehension. It is unfortunate that the average realtor shies away from syndication. The word syndication makes him uneasy. He believes that the entire process is too complicated for his limited talents and knowledge, and that syndication is reserved only for the million dollar and larger projects.[7]

The real estate salesman may indicate outwardly that he knows all about syndication and possesses the know-how, but inwardly he is petrified. If the small broker stumbles across a transaction that can be syndicated, he will usually "take a stab" at it, but then he gives up easily and returns to the straight, simple transactions which have meant success for him in the past. His reaction is to "let the other broker reach for the moon."[8]

Although the average broker at present may know little or nothing about real estate syndication, this report will try to show that the basic knowledge necessary is not beyond his comprehension and abilities, and that he is capable of participating in syndications that may be as informal as a handshake, or so complicated that they will involve hundreds of investors plus other complications resulting from state and federal regulations.

Large syndicators not needed. The steady but small growth of local syndication has come about as the small realtor has begun to realize that it is not necessary to call in the large promotor or syndicator in order to accomplish the job. Examine most of the large syndication firms in New York City, and you will find that an attorney or attorneys are at the head of these companies. Local real estate men have been timid about heading syndicating ventures because they were under the mistaken impression that the laws and legal implications were too overpowering for them. It is true that legal advice is necessary for a syndication venture, but the acquisition of property and promotion of the project is definitely a function for the real estate professional.

Even though the real estate man is not an accomplished attorney, this report will attempt to show him that basically all that is involved in a syndication is the finding of a good investment property, and then the finding of a number of investors capable of supplying the cash necessary to make a purchase.[9] Attorneys should be consulted on legal matters, but the promotion, acquisition of the property and management should be accomplished by the real estate man.

Material on syndication scattered. Much that is written about syndication is scattered throughout hundreds and perhaps thousands of magazine articles, real estate trade journals, and other publications. From the small syndicators standpoint, there appears to be very little written that is complete. One has to refer to the hundreds of articles in order to get the complete syndication story. There are a few books written in this field, but these are mostly from the standpoint of the investor and not from that of the small syndicator.

Some of the more complete reports available in this field have been written by attorneys. Invariably these reports are written from the legal viewpoint and are usually incomprehensible to the person not trained in law.

Then, too, the successful syndicators are rather "close-mouthed" about their methods and techniques, and are not willing to part with the knowledge they have accumulated. Consequently, these short published articles, and bits of wisdom dropped at random, are just enough stimulus to start the small real estate man thinking in terms of syndication. The small realtor then becomes overpowered with the job of accumulating the necessary information and gives up in disgust.

The third purpose of this report, therefore, is to assemble sufficient information about real estate syndication so that the small real estate man will have a complete, comprehensive study at his fingertips, which should enable him to become a participant in local real estate syndication.

Pursue a course of study. In order for the small realtor to keep pace with his field and actively participate in the potential profits and possible accumulation of wealth through the techniques of syndication, it is advisable for him to pursue a course of study in the fundamentals of real estate syndication and to apply what he has learned in the field.

III. DEFINITION

Syndicate. The word "syndicate" has so many meanings that it is almost meaningless. Webster's New International Dictionary defines syndicate as: "An association of persons officially authorized to undertake some duty or to negotiate some business."[10]

The contemporary word "syndicate" stems from the Latin "syndic", which means delegate, someone appointed to act for or represent others. During the 16th century, members of Dutch clothing guilds pooled their resources for mutual benefit and appointed five men to act in their behalf, and called them "syndics". Rembrandt immortalized some of these men in his famous painting, "The Syndics."[11]

Using Webster's definition as a base, for the purposes of this report, a real estate syndicate may be defined as: two or more persons who pool their money for investment in income-producing real estate and delegate the burden and responsibilities of management to one who is qualified to assume these responsibilities.

The author realizes that there are many other ways to effect group ownership of investment property, like the most recent innovation, the condominium. This paper, however, will be confined to syndication.

CHAPTER I FOOTNOTES

[1]Statement by William Earle White, Jr., Attorney at Law, personal interview, December 15, 1964.

[2]Norman Bernstein, "Real Estate Syndication," National Capitol Area Realtor, (June, 1960), p. 17.

[3]Richard L. Jones, "Opportunity for Realtors," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, 1957, p. 3.

[4]Larry Weekley, "Richmond, Va. Opportunities for Outsiders," National Real Estate Investor, (May, 1962), p. 27.

[5]Thomas F. Mains, Jr., "Southland Ripe for Investment," National Real Estate Investor, (July, 1962), p. 24.

[6]Ibid.

[7]Louis S. Laronge, "Small Dollars Can Buy Real Estate," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, 1957, p. 58.

[8]Ibid.

[9]Daniel S. Berman, "Syndication Offers Many Advantages to Realty Man," National Real Estate Investor, (September, 1962), p. 28.

[10]Webster's New International Dictionary, Second Edition, Unabridged, Springfield, Mass., G & C Mirrian Company, 1956.

[11]Norman Bernstein, "Real Estate Syndication - An Introduction," National Capitol Area Realtor, Syndicate Handbook, (June, 1960), p. 7.

CHAPTER II

THE BACKGROUND OF REAL ESTATE SYNDICATION

Real estate syndication, as known today, is practically a new type of investment medium. It is one of the few medias through which the small investor can get into real estate without having the responsibility of managing property. Syndication is just another way to merchandise real estate, and it is the only way that a small investor can become an actual "part owner" in commercial real estate. The small investor can buy shares of stock in publicly-held real estate corporations, but this is not the same, psychologically, as "owning a piece of property."[1] Of course, in a publically held corporation, the small investor does own his proportionate share of the holdings. However, in a local or small syndicate, operated as a partnership, the investor feels closer to the property. The yield will usually be greater in a partnership than in a corporation because proportionate depreciation expense is passed on to the individual investor, thereby releasing tax-sheltered income.

I. BACKGROUND

The fabulous 50's and 60's. One of the greatest phenomena that the "fabulous 50's" brought was greater quantities of money available for investment purposes. As the national income grows, the 1960's are supposed to make available even greater amounts of capital for investment purposes. Stocks and bonds have been providing higher yields to investors; however, these yields are still low when compared to the return on a good real estate investment.[2] One reason for the higher yields is that real estate lacks the liquidity of other investments.

During and after World War II, there was very little new construction in either the residential or commercial real estate fields. As in most industries not engaged in the war effort, there was a decided shortage of materials and of skilled labor. The country was trying desperately to recover economically from the ravages of war. Returning servicemen had to adjust to a new way of life, and many of these veterans entered into the building field. Most of these men had to be trained. These factors, and others, created a backlog of construction, and a latent demand existed. This latent demand practically exploded all at once, and the United States entered into one of it's greatest building booms of all times.[3]

Those who were fortunate enough to have purchased properties during or prior to the war found out that the value of these properties had appreciated. These owners discovered that a considerable profit could be realized by selling.[4] By further investing these profits in real estate, the investors could acquire larger residences or better investment property with greater yields.

Rent control. One factor which brought investment real estate to the attention of the general public was rent control. During the years of rent control, the profits of landlords were brought to the attention of a large segment of the public. The ground work was laid for a fairly rapid acceptance of real estate as an investment medium by the middle class. The general public realized that there were profits available for them in real estate investment, and consequently, in the early 1950's, there was a considerable market waiting for this type of investment.[5]

Evolution of syndication. The private syndicates that developed in the late 1940's very often involved high units of participation. These units of participation usually were $20,000 or more. As time went on, the private syndicate gave way to the public syndicate, which also required high units of participation. The only difference was that the management of the property was turned over to the professional manager from the syndicate group. The investors, at this stage in the evolution of syndication, were usually business associates, friends and relatives, and promotion of the syndicate was usually done by word of mouth. The relationship of the investor and syndicator was a personal one. As more and more investors became involved in syndicates, the relationship of the syndicator and the syndicate group became more impersonal, and the unit of participation dropped from $20,000 or so to $5,000 or even as low as $1,000.[6] Richard L. Jones, a successful syndicator, in a recent article said:

> The increase in the number of small investors with a few thousand dollars, plus a much more attractive return available in real estate than in any other investment, makes it inevitable that the two will get together as they have over the past five years in the stock market. The realtor who performs this introduction will find a substantial benefit and will be performing a service to his clients and to the industry.[7]

Modern techniques of sales and promotion were introduced, and consequently many syndicate offerings were turned over to sales organizations and agents for sale to the general public. With the transfer of selling units of participation through professional agents, syndication was brought into prominence as an accepted investment medium and these syndicates truly became public syndicates.[8]

II. WHO INVESTS IN SYNDICATES?

The majority of people who invest in real estate syndicates are either retired people or those seeking a second income.[9]

It was found that 70% of these investors are in their late 40's, 50's or 60's. It is amazing to note that 75% of these investors are in the lower income brackets, with earnings ranging from $5,000 to $20,000 per year. The fact that these investors are in the lower brackets indicates that the broad investing public is more yield- or return-conscious than tax-conscious, and that in order for public syndication to be successful, high yields must be available. Many large public syndicators have found that low-tax-bracket investors are more concerned with the monthly distribution checks than with the tax features of the investment. The obvious reason for this is that these investors are not in a high enough tax bracket to be greatly concerned about this feature. An investor in the 20% bracket is not as concerned about tax shelter as an investor in the 80% tax bracket. More sophisticated or wealthy investors will be tax-conscious and more concerned about the quality and less concerned about the yield.[10]

III. WHY INVEST IN SYNDICATES?

Castles in Spain. Almost everyone has dreamed about owning "a piece" of a large modern apartment building, a hotel or a large office building. It is natural for people to dream of their "castles in Spain", or to sit back and visualize themselves collecting rent each month.[11]

The general public is not satisfied with collecting interest from a Federal Savings and Loan Association at the rate of $40 per year for each $1,000 saved. They are more contented receiving $80, $100 or $130 per year on a good real estate investment.[12] As Harry G. Silverstein, a successful syndicator and president of the Syndicators Association, says, "The syndication investor is satisfied with the relatively high cash distribution on investment, with tax shelter benefits."[13]

<u>Hedge against inflation</u>. Investing in real estate is usually a good hedge against inflation. Many investments, such as bonds, have fixed incomes, and the purchasing power of these incomes can be decimated by inflation. When money is invested in good real estate, increased rentals may offset inflation. Long term leases on commercial properties usually contain escalator clauses to take care of increased operating costs and increased general cost of living. Investment properties are usually purchased with a large fixed mortgage payment. Therefore, as inflation comes, it is possible to increase the income of the property and at the same time pay the mortgage off in the same inflated dollar, resulting in a decided advantage to the owner of the property.[14] In addition, "the rather steady deterioration of the dollar, about 2% or 3% a year, tends to increase the dollar value of real estate even when demand for its use has not increased."[15]

<u>Leverage</u>. Another reason people invest in real estate is because of the leverage effect that mortgaged property

produces. "We get leverage when we are able to buy property - for income or to speculate on an increase in value - by paying only a portion of the price in our own cash."[16] It is possible to get a larger portion of the price financed in buying real estate than in any other kind of investment or speculative property.[17]

Here's what leverage can do for the investor:

> (1) When the underlying property increases in value, the owner gets the full benefit even though he has put up only part of the price in cash. Thus, if he buys property for 25% in cash and 75% in purchase money mortgage, and the property doubles in value, he quintuples his money thus:
>
> | | Before | After |
> |---|---|---|
> | VALUE | $10,000 | $20,000 |
> | DEBT | 7,500 | 7,500 |
> | EQUITY | 2,500 | 12,500 |
>
> (2) If income property yielding 8% is purchased for 25% cash and 75% purchase money carrying 4% interest, we kick up the yield on equity from 8% to 20%. An example follows:
>
> | | | |
> |---|---|---|
> | COST | $100,000 | |
> | NET INCOME | 8,000 | (8% on full value) |
> | INTEREST | 3,000 | (4% on $75,000 mortgage) |
> | NET INCOME | 5,000 | (20% on cash investment of $25,000)[18] |

Leverage then enables a property owner to limit his cash investment and maximize his return.[19] This enables an investor to free his funds for further investment or diversification.

<u>Diversification</u>. "One of the least mentioned reasons

for the growing success of the syndication of investment real estate is that it enables the non-professional to diversify, just as in buying stocks and bonds."[20]

If an investor had $100,000 to invest, he probably would not put it all into one investment, but would elect to "spread the risk". Syndication permits investors to diversify into larger and more desirable properties. $100,000 in syndicates would enable the investor to invest in many hotels, office buildings, apartments or industrial properties. The risk is therefore reduced just as in buying stocks and bonds.[21]

Tax shelter from depreciation. The Internal Revenue Service defines depreciation as follows:

> You may deduct each year, as depreciation, an amount which represents a reasonable allowance for the exhaustion, wear and tear, and obsolescence of depreciable property used in your trade or business or held for the production of income. This enables you to recover your cost or other basis of depreciable property, less the salvage value, during its estimated useful life. There are several methods of computing depreciation. No asset may be depreciated below a reasonable salvage value under any method.[22]

One of the major investment features of real estate is the tax shelter created by depreciation. A real estate investment should not be made without first considering the effect of depreciation on the profits. The depreciation that can be taken plus the earning capacity of the building will determine the income value of a building. Depreciation is an expense, but unlike most deductible expenses, it does not require a cash outlay, and it is charged against current operations. An investor can buy a building with a small down payment and assume a large mortgage. Depreciation is taken on the cost of the building, including the mortgage, and the depreciation will reduce taxable income, but if the depreciation exceeds the mortgage amortization payments, it will release tax free cash.[23] "The amount by which allowable depreciation exceeds the cash used to repay the mortgage (ie., amortization) equals the tax shelter available to the owner."[24]

To illustrate the tax shelter benefit made possible by depreciation, let us assume that an investment property is purchased subject to the following conditions:

Terms of the purchase

Sales price of property	$1,000,000
Down payment in cash	250,000
Balance financed by mortgage	$ 750,000

Other factors

Interest - first year (4½%)	$ 33,750
Amortization rate (2½%)	18,750
Value of land	150,000
Value of building	850,000
Depreciation - 30 years - straight line method. Yearly depreciation	28,333
Net income before depreciation and interest	100,000

From the above information, we can construct the following profit and loss statement:

PROFIT AND LOSS STATEMENT

Net income before interest and depreciation	$100,000
Less: interest (cash outlay)	33,750
Net income before depreciation	$ 66,250
Less: depreciation (no cash outlay)	28,333
Taxable income	$ 37,917

Because depreciation expense does not require a cash outlay, the owner has $28,333 cash income available. However, the amortization payment of the mortgage represents cash outlay, and when this is deducted from the amount of cash made available through depreciation, the difference is tax sheltered income.

Cash available because of depreciation	$ 28,333
Less: amortization - 2½% (cash outlay)	18,750
Difference - tax sheltered income	$ 9,750

It is also interesting to note that tax shelter from depreciation is particularly important to investors in the high tax brackets. The next illustration will show the benefits of depreciation and leverage for this type of owner. Let us assume that the owner is in the 80% income tax bracket.

PROFIT AND LOSS STATEMENT

Taxable income	$ 37,917
Less: 80% income tax	30,334
Net income	$ 7,583
Plus tax sheltered income	9,583
Total net income	$ 17,166

To the owner in the 80% tax bracket, $17,166 in tax free income is equivalent to $85,830 in taxed income. If this owner had elected to invest in stocks or bonds with an 8% return, instead of in real estate, $1,072,875 would have had to be invested in order to realize $17,166 in net income, as follows:

Amount of investment	$1,072,875
8% return (stocks and bonds)	8%
Taxable income	$ 85,830
Less: 80% income tax	68,664
Total net income	$ 17,166

On a $250,000 cash investment in real estate, this owner would realize the same net income as if he had invested $1,072,875 in stocks and bonds at an 8% return.

Reduction of mortgage debt. Another benefit that a good real estate investment can provide is an additional return in the reduction of mortgaged debt. Investment real estate is purchased almost always with a limited amount of cash and a high mortgage. The investment is purchased on the basis of its cash return after meeting interest and principal charges in the reduction of the mortgage. Consequently, there is an additional return realized because of the reduction of principal. This return can range from 40% to 100% of the cash net in the annual reduction of the amortized mortgage.[25] This return is not realized, of course, until the property is sold.

Long term capital gain. One of the desireable tax features of a real estate investment is the favorable capital gains tax rate on property that is sold. When a real estate syndicate sells property the sale is a taxable transaction. As syndicated property is always investment property the gain or loss on the sale is treated as capital gain or loss. If the property has been held for six months or more the gain will be considered as a long term gain and the favorable tax rate will apply.[26]

CHAPTER II FOOTNOTES

[1]"Syndication is Here to Stay," _National Real Estate Investor_, (November, 1961), p. 38.

[2]Morris A. Kravitz, "Syndication," _National Real Estate Investor_, (April, 1960), p. 12.

[3]Bertram Lewis, _Profits in Real Estate Syndication_, (New York: Harper and Brothers, 1962), p. 4.

[4]_Ibid_.

[5]_Ibid_., p. 5.

[6]_Ibid_.

[7]Richard L. Jones, "Opportunity for Realtors," _Real Estate Syndicates and How They Work_, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1957, p. 3.

[8]Lewis, _loc_. _cit_.

[9]Daniel S. Berman, _How to Put Together a Real Estate Syndicate_, (New York: Daniel S. Berman, 1961), p. 5.

[10]_Ibid_.

[11]Richard L. Conway, "A Houseful of Landlords," _Real Estate Syndicates and How They Work_, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1957, p. 5.

[12]_Ibid_.

[13]Harry G. Silverstein, "Syndication," _National Real Estate Investor_, (September, 1962), p. 26.

[14]Lewis, _op_. _cit_., p. 10.

[15]William J. Casey, _Real Estate Investments and How to Make Them_, (New York: Institute for Business Planning, Inc., 1958), p. 11.

[16]_Ibid_.

[17]_Ibid_.

[18] *Ibid*.

[19] Lewis, *op*. *cit*., p. 11.

[20] Joseph L. Rusch, "Case History - New York," *Real Estate Syndicates and How They Work*, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), p. 36.

[21] Lewis, *op*. *cit*., p. 9.

[22] Depreciation, Investment Credit, Amortization, Depletion, *Document No*. *5020*, (12-63), U. S. Treasury Department, Internal Revenue Service, p. 4.

[23] J. K. Lassiter, *Successful Tax Planning for Real Estate*, (Larchmont: American Research Council, 1961), p. 146.

[24] Lewis, *op*. *cit*., p. 11.

[25] Casey, *op*. *cit*., p. 7.

[26] Lewis, *op*. *cit*., p. 81.

CHAPTER III

FUNCTIONS OF THE SYNDICATOR

FIND AND SECURE THE PROPERTY

The first functions of the syndicator, and perhaps these are the most important functions, are to find a suitable property for syndication and then to secure this property for a sufficient length of time to enable him to promote and finance the offering. In the selection of the property, the syndicator must use all of his skill, experience, and managerial judgement. The success of the entire venture may well depend upon his decision.

It is interesting to note that syndication is used almost exclusively in urban areas. It is conceivable that it would be possible to syndicate a farm, or some farm service, in a rural area, but the writer has never heard of such a syndication. Because of the shortage of property in urban areas, the assembly of land in sufficient size to syndicate new construction is becoming more and more difficult.

The primary responsibility of a syndicator is to be certain that the capital invested in the syndicate is secure, and the best insurance for this security is the syndicator's knowledge and analysis of the offering. As the success of a syndicate depends so much on the proper selection of the property, a professional real estate man seems to be the logical person to head the syndicate. A professional real estate man is one who has been successful in his field, and who continuously and dilligently studies, gains valuable experience, and thereby becomes better equipped to perform a superior service to his client. Besides being a professional real estate man, the syndicator, or his staff, must be highly trained in sales, promotion, advertising, and public relations. This operating knowledge and ability is necessary to the success of a syndication, and is the greatest protection that an investor can have.[1]

Although this paper is mainly concerned with the syndication of existing properties, it is important to remember that syndication can be used for the creation of new construction. Syndication of new construction is the most difficult because income and expense, as well as capitalization, has to be estimated, whereas in syndicating existing buildings, there is a pattern established, and income, expense, and capitalization can be ascertained more accurately.

I. FIND THE PROPERTY

Location. Location is one of the most important factors in the selection of a property for syndication. "Mortgage bankers often follow three rules in evaluating a property: 'Location, location and location.' While this is certainly overdoing it in the interest of humor, there is a serious thread of truth running through these rules."[2]

No matter how imposing a building may seem, or how lucrative its income may be, a financial loss may be incurred if the building is located in a deteriorated area, or in an area that is gradually declining. A complete analysis of the area should be made. An exhaustive study of the surrounding property will reveal the general character of the area. Are the surrounding properties old and decrepit? Is the community declining in population? Is industry moving away? If any of these factors are present, the property probably has no future security and would not be considered a good purchase.[3]

If adjoining properties are enjoying a program of improvement and expansion, and the area has a solid long-range planning policy which is enthusiastic and is stimulating new industry and attracting new population, then the property has good possibilities and certainly has location potential.[4] In addition to these factors, the property should have sufficient parking spaces, facilities for waste disposal, good fire and police protection, an adequate system of local transportation, and a road network that will support traffic. New highway construction is important because the availability of these new roads can create new property values or destroy old ones.

Appraisal of the property. The syndicator must look for property that will maintain or increase in value, and the property must produce a profit over the years. The site or building must be carefully selected, and must produce at least 9% return on equity investment. As the degree of risk is incrêased, the yield should increase. No syndicate is better than the intrinsic value, or real and genuine value, of the real estate involved.[5]

In a purchase of properties, with the intent of modernization, a syndicator must be highly selective and choose those with intricsic value. The property selected should cost considerably less than the reproduction cost. The rental base of the property should be less than the prevailing rates in the area. An excellent indication of intrinsic value is to compare the square foot cost of the structure with the square foot costs of new buildings in the area. If this relationship is favorable, then further studies should be initiated to determine whether or not the structure can be renovated at a cost that will provide an early possibility of higher rents. Syndicators are constantly looking for properties where foresight in renovation and improvements can increase the economic value of the structure, create higher yields, and become most attractive for investors.[6]

There are no hard and fast rules about making a property more profitable. This depends upon the ingenuity, experience and imagination of the syndicator. Here is a list of a few approaches for an office building:

1. Convert the basement. Many office buildings have storage basements. Space like this can be converted into restaurants, retail stores, or into garages, thereby turning wasted space into income-producing space.

2. Close up an entrance. Many buildings have two entrances, one on the main street, and one on a side street. Close up one of these entrances, and convert to valuable first floor commercial space.

3. Automate the elevators. Payrolls are usually the largest operating expenses, and cutting labor costs is an important way to increase return.

4. Grant food concessions. The mobile coffee and sandwich dispensor serving the tenants can add revenue to a building.

5. Review cleaning service. Very often it is less expensive to have your building cleaned by professionals. At least, your present staff and methods should be studied to see if costs can be cut.

6. Rent out management office. Often these offices are large and quite lavish. These offices can be converted to rental use and the management office can be put elsewhere.

7. Modernize. This is an excellent way to increase the economic value of a building, since often modernization paves the way for higher rents.

8. Add escalator clauses. When rentals are renewed, add escalator clauses to cover increases in taxes, insurance and labor.[7]

Properties suitable for syndication. Office buildings, hotels, apartment houses, commercial and industrial property have been the traditional properties which have been syndicated throughout the years. Because of a constantly changing mode of life, population mobility, and improvement in our standard of living, new types of investment properties have become interesting to syndicators. Some of these types are:

1. Shopping centers. Shopping centers have provided some of the best opportunities for syndication and management during the past ten years. The increasing use of the automobile, and the move to "suburbia", have had a tremendous influence on the building of shopping centers. In this period of growth, and with the changing pattern of land use, there are usually only two kinds of centers to consider: "The regional centers with one and preferably two department stores, and the neighborhood center which depends primarily on the food and drug store for its major pull."[8]

2. Parking garages. The future business of entire areas may depend upon the willingness of merchants in the downtown areas to join together financially to create new parking facilities. Downtown merchants are usually wary of supporting other ventures, but the appeal of new parking facilities is strong enough to make a syndicate possible.[9]

3. Motels. Motel construction has been greatly accelerated because of greater use of the automobile, and because of the very enthusiastic road building program of the federal government. Some of the types of motel suitable for syndication are:

a. The highway motel
b. The resort motel
c. The suburban motel
d. The airport motel
e. The "In-Town" motel[10]

4. Bowling centers. Since World War II, bowling has become one of the most popular leisure activities,

and is one of the most successful growth industries. Syndicators should normally consider a bowling center with at least 36 lanes, because smaller centers very often have the same fixed charges and are less economical to operate.[11]

5. Marinas. Boating enthusiasts have demanded more and better facilities and therefore have created a new entity - the marina. The marina has become big business, and consequently syndicating groups have been attracted. The number of marinas available has not kept up with the large fleet of pleasure craft, and although the potential profits are great, the risk also is great. In the selection of a marina, location is most important, and fleet owners will demand more and more service.[12]

6. Subdivision syndicates. The work and time involved is about the same for a large or small subdivision, and it is more profitable to syndicate land that can be subdivided into 250 or more lots. If the members of the syndicate are builders, then the lots can be apportioned at some pre-determined price or method. Usually syndicates in subdivisions purchase raw land, subdivide the property, put in roads, water and sewers, and then sell the improved lots to builders or to individuals desiring homesites.[13]

7. Water and sewage disposal facilities. Very often subdivision syndicators will also invest in water and sewage disposal systems. Usually these systems will supply three adjacent subdivisions for a total of about 1000 homes.[14]

As one can see by the list of properties, almost any property can be syndicated as long as it has good investment potential. The types of property are not restricted.[15] Syndicates for secondary financing and trading organizations have been used extensively by real estate organizations. Here, like in trading a car, the old home is taken in trade and these syndicates are used to provide temporary financing until the old home can be sold.

In summary, property for syndication may consist of old buildings, new buildings, or raw land may be purchased with the idea of constructing new buildings. Motels, parking lots, garages, shopping centers, bowling alleys, hotels, business offices, amusement centers, marinas, residential subdivisions and many other types of properties are possibilities for real estate syndication. It appears that "the sky is the limit."

In any type of real estate syndication, the important factor is the protection of the investors. This means that the selection of a property, or an idea, should be such that it can be purchased for less than it will be worth, that the property selected will generate an acceptable yield, and that the investment can be readily sold at a profit.

II. SECURE THE PROPERTY

Time is most important for a syndicator while trying to form a syndicate. The various surveys and analyses necessary for the formulation of plans and the making of a decision concerning an investment property takes time. It is therefore mandatory that the syndicator remove the property selected from the open market for a sufficient length of time to form these plans and to make these decisions. In some cases, three months would be long enough, and in other situations, a year might be necessary. In most cases, the syndicate is not already formed, and sufficient time should be allowed for the formation of the syndicate and the attraction of investors.

Generally, there are three ways that a syndicator may secure the property desired for syndication. They are: (1) an exclusive listing, (2) an option, and (3) a contract.

Exclusive listing. An exclusive listing is "a contract to sell property as an agent, according to the terms of which the agent is given the exclusive right to sell the property or is made the exclusive agent for its sale."[16]

In an exclusive listing, the syndicator or realtor has the exclusive right to sell the property for a stated period of time. The time period of an exclusive listing may be for any length of time, depending upon a meeting of the minds of the owner and the realtor. Some property, like industrial or commercial property, takes longer to sell than residential property, and, therefore, the listing should be for a longer period of time on this type of property. Complete disclosures should be made to the owner of the property that a syndicate is in the process of being formed, because if a syndicator solicited exclusive agencies solely for the purpose of forming syndicates for his own gain, the proceedure would probably be considered unethical by a board of realtors.

Option. An option is "an agreement granting the exclusive right during a stated period of time, without creating any obligation to purchase, sell, or otherwise direct or contract the use of a property."[17]

This is the definition of a true option, and will entitle a syndicator to recover the money in the event that the option is not exercised. This type of option is most desirable from the syndicators standpoint, but is very difficult to obtain. Usually the money deposited with the seller will be forfeited unless the option is exercised, and if exercised, the money will be applied against the purchase price.

Sales contract. Many large syndicators maintain that the syndicate manager must enter into a sales contract for the property, either in his own name, or if not in his own name, then certainly with his own money. Daniel S. Berman says, "If you are not willing to put up the risk money, you are not a syndicate manager."[18] It goes without saying that a syndicate manager would have a release clause in the contract stating the maximum liability to be forfeited in the event the purchase was not consumated. Usually the amount of the deposit is forfeited, and specific performance on the contract is waived.

Because the syndicate manager is willing to invest his own funds in the project, a measure of good faith is indicated, and this makes selling shares an easier task. However, entering into a contract for a property is not necessarily a requisite for proper syndicate operation.[19]

CHAPTER III FOOTNOTES

[1]Harold H. Yassky, "Sound Syndicating Practice Calls For Professionals," National Real Estate Investor, (November, 1961), p. 42.

[2]Bertram Lewis, Profits In Real Estate Syndication, (New York: Harper and Brothers, 1962), p. 39.

[3]Mortimer L. Schultz, "A Syndicator's Yardstick For Value," National Real Estate Investor, (November, 1961), p. 32.

[4]*Ibid*.

[5]Norman Bernstein, "Real Estate Syndication - An Introduction," National Capital Area Realtor, Syndicate Handbook, (June, 1960), p. 7.

[6]J. M. Tenney, "Success Formula For New Syndicates," National Real Estate Investor, (November, 1961), p. 34.

[7]Real Estate Investment Letter, Institute For Business Planning, Inc., March 12, 1963.

[8]James F. Kelley, Jr., "Site Selection and Development," Creating Commercial Deals, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1960, p. 48.

[9]Thad E. Murphy, "Syndication of Parking Garages," Creating Commercial Deals, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1960, p. 44.

[10]Allen J. Block, "The Prom Motor Motel," Creating Commercial Deals, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1960, p. 38.

[11]Lewis, *op. cit.*, p. 154.

[12]Lewis, *op. cit.*, p. 160.

[13]Clem B. Mulholland, "Subdivision Syndicates," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1957, p. 57.

[14] *Ibid*.

[15] Vivien H. Emmer, "Small Real Estate Group Ownership Venture," *Real Estate Syndicates and How They Work*, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1957, p. 39.

[16] *Real Estate Salesman's Handbook*, National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago, Illinois), 1956, p. 145.

[17] *Ibid*., p. 151.

[18] Daniel S. Berman, *How To Reap Profits in Local Real Estate Syndicates*, (Englewood Cliffs, N. J., Prentice Hall, Inc., 1964), p. 15.

[19] William J. Casey, *Real Estate Investments and How To Make Them*, (New York: Institute For Business Planning, Inc., 1962), p. 44.

CHAPTER IV

FUNCTIONS OF THE SYNDICATOR

VEHICLES OF OWNERSHIP

After the syndicator has found and secured the property suitable for syndication, the next step is to select the form of ownership. This chapter will discuss the major forms of ownership which are currently being used in real estate syndication.

It seems to be a natural instinct of man to seek company in many of his activities. A joint venture appears to offer participants greater security, and to attract people into undertakings that they would normally ignore. This same instinct is present in those who are attracted to a real estate investment.[1]

Before a syndicator can sell units of participation in a project, a decision must be made as to how title is to be taken. What kind of entity is the syndicate going to be? Generally, there are five types of structures which are usually used in real estate syndication. They are: (1) the corporation, (2) the general partnership, (3) the limited partnership, (4) the land trust, and (5) the real estate investment trust.

The ideal structure for a real estate syndication includes six characteristics. They are: (1) associates, (2) an objective to carry on a business and divide the profits, (3) continuity of life, (4) centralization of management, (5) limited liability, and (6) free transferability of interests. These characteristics are also the main characteristics of a corporation, and if a syndication included all of these characteristics into its ownership agreement, the syndicate definitely would be taxed as a corporation. The practical solution to avoiding double taxation* is to keep as many of the corporate characteristics as possible, and at the same time avoid the corporate tax.[2]

The Internal Revenue Service, of course, is aware that real estate syndicators are usually trying to avoid the corporate tax when they design their ownership agreements. Consequently, some years ago, the Internal Revenue Service recognized the "association taxable as a corporation". The association may be defined as any organization, other than a corporation, that closely resembles a corporation, regardless of what it may be called. The characteristics listed in the previous paragraph are about the same tests made by the United States Supreme Court, in a series of rulings made in 1935, which resulted in taxing many trusts as corpo-

---

*The author realizes that according to the Constitution, there is no such thing as "double taxation"; however, the term is used in "real estate jargon".

rations.[3]

In 1960, the Treasury Department adopted regulations, commonly known as the Kintner Regulations. Under these new regulations, an organization will be taxed as a corporation only if it more nearly resembles a corporation than a partnership. In determining whether there is a corporate resemblance, the regulations outline the six major characteristics, listed above, which distinguish a corporation from other organizations. The regulation also states that the first two characteristics, (1) associates, and (2) an objective to carry on a business and divide the profits, are common to both a partnership and a corporation, and therefore the Internal Revebue Service will only look to the other four characteristics to determine whether or not the organization is a partnership or an organization.[4]

The regulations provide in paragraph 2(a)3 as follows:

> An unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than non-corporate characteristics. In determining whether an organization has more corporate characteristics than non-corporate characteristics, all characteristics common to both types of organizations shall not be considered. For example, if a limited partnership has centralized management and free transferability of interests, but lacks continuity of life and limited liability, and if the limited partnership has no other characteristics which are significant in determining its classification, such limited partnership is not classified as an association. Although the limited partnership also has associates and objectives to carry on a business and divide the gains

therefrom, these characteristics are not considered because they are common to both corporations and partnerships.[5]

The clarification and liberalization brought about by the Kintner Regulations have done much to facilitate the continued expansion of partnership syndication.[6]

I. THE CORPORATION

Although it is realized that there are more businesses in operation using the individual proprietorship or partnership form of ownership, the corporation form fits the needs of most business organizations. When a real estate syndicate uses this form of ownership, the title of the real estate is held by the corporation. Members of the syndicate own the outstanding stock and debentures of the corporation.

The advantages associated with the corporate form of real estate ownership are:

1. Continuity of life. The death, insanity, withdrawal or bankruptcy of any of its stockholders has no legal effect on the existence of the corporation.

2. Transferability of shares. Transfer of stock or bonds both before and after death is relatively simple.[7]

3. Limited liability. As in most corporations, the individual liability of the members, or stockholders, of the syndicate, both for financing indebtedness and damage claims, are eliminated.[8]

4. <u>Centralization of management</u>. A real estate syndicate needs centralized and professional management. In a publicly held corporation, the stockholders usually meet once a year to elect the directors. The directors elect officers, and this is the group which manages the corporation or syndicate. Management is not by the stockholders, but by the officers, and is centralized in the directors.[9]

From the investors viewpoint, another advantage to the corporate form is that greater diversification is possible when many different kinds of residential buildings, motels and shopping centers can be brought into the corporation from different parts of the country. There is also a greater latitude in financing large acquisitions through the use of blanket mortgages in order to receive maximum financing.[10]

There are basically two major disadvantages to the corporate form of ownership in a real estate syndicate. These disadvantages are usually the main attractions to investors interested in real estate investment. First, there is double taxation. The earnings of the corporation are taxed, and the dividends to the stockholders are taxed. Second, the allowable depreciation is consumed by the corporation and cannot be directly claimed by the stockholders individually.[11]

II. THE GENERAL PARTNERSHIP

One of the most common and best understood forms of business organization is the simple or general partnership. There are many small syndicates that have used this form of ownership. The general partnership exists when two or more individuals pool their capital and actively engage in a business venture. All partners have an equal voice in the management of the business, regardless of the amount of money invested by each of the partners. The life of the general partnership is directly related to the lives of the partners, and upon the death of one partner, the partnership is dissolved. The liability is joint and several, and any one partner can be sued for the debts of the entire partnership.[12]

The main advantages of this type of ownership in real estate are the avoidance of double taxation, and the fact that allowable depreciation is passed on directly to the partners. An example follows:

Partnership

Net income before depreciation	$100,000
Depreciation	50,000
Taxable income to partners	$ 50,000
Available for distribution	$100,000
Less: Amount taxable to partners at their individual income tax rates	50,000
Cash income, non-taxable to partners	$ 50,000

Corporation

Net income before depreciation	$100,000
Depreciation	50,000
Taxable income to corporation	$ 50,000
Corporate income tax (assume 52%)	26,000
Corporate income for distribution	$ 24,000
Non-taxable corporate cash	$ 50,000
Net corporate income available	24,000
Cash distribution to shareholders, taxable at individual income tax rates	$ 74,000

In summary, it appears that the partners in the partnership are receiving $100,000, of which only $50,000 is taxable at their individual income tax rates. The corporation shareholders are only receiving $74,000, all of which is taxable at their individual tax rates. It is obvious that the tax shelter produced by depreciation is available to the owners of the property. In a partnership, the depreciation is passed on directly to the partners, and if the owner is a corporation, there is a definite dilution of the return to the shareholders.

The obvious disadvantages of this form of organization are the unlimited liability of the partners, and the lack of continuity of life. Because of these two disadvantages, this form of ownership puts rather serious limitations on the attracting of public capital, and is usually confined to the family and close friend type of syndicate.

III. THE LIMITED PARTNERSHIP

Today, most investors and lawyers consider the limited partnership as the best format for real estate syndication. Under this vehicle of ownership, one or more participants, usually the promoting group, become the general partners under a legally prepared and recorded partnership agreement, and the remaining participants, or investing group, become the limited partners. The general partners have unlimited personal liability in the venture, and they cannot limit their loss to their investment in the partnership; general partners' liability is joint and several. A limited partner in a syndication venture, on the other hand, has no liability with the exception of the original capital investment.[13]

In a real estate syndicate using the limited partnership, there should be very little concern by the general partners about personal liability. Their exposure can usually take only two forms: exposure for property damage or bodily injury, and liability for the payment of a mortgage. Adequate insurance can nullify the first, and the second can be eliminated by the mortgage company looking to the building for security.

The general partners in a limited partnership have the right to manage the entity. On some matters, such as selling or refinancing the property, the general partners may consult with the limited partners, but on the whole, the limited partner plays no management role. It is interesting to note that if a limited partner seeks to participate in the management of the property, he becomes a general partner, and therefore also becomes personally liable for the debts of the partnership along with the general partners.

Usually the death, insanity, withdrawal, or bankruptcy of a general partner will terminate the limited partnership; however, the death, withdrawal, insanity or bankruptcy of a limited partner will not affect the legal functioning of the partnership. From a practical standpoint, most limited partnerships in real estate provide for a reorganization of the partnership in the event of a death or removal of one of the general partners.[14]

The principal advantages in this type of organization are the avoidance of double taxation, the direct proportionate allocation of depreciation allowances to individuals, centralized professional management, limited liability of the investors, and actually little liability of the general partners.

The disadvantages in the limited partnership are several. No appreciable surplus can be accumulated for future activities, since all net earnings accrue to the partners; continuity may be difficult to incorporate into the general partnership agreement; and disposition of an interest in a partnership is usually more difficult than selling shares in a corporation.

IV. THE LAND TRUST

Under the land trust, the entire title to the real estate is conveyed to a trustee, and the beneficiaries do not receive legal or equitable title to the property. At the end of a fixed period of time, the trustee is obliged to sell the property. The rights of the beneficiaries are limited to the right to direct the trustee to deal with the title to the trust property, the right to manage and control the property, the right to receive income from the property, and the beneficiaries reserve the right to amend or revoke the trust agreement.[15]

The advantages of the land trust are: a convenient title holding device, continuity of life through a limited time, transferability of interests, no double taxation, and no exposure by the syndicate manager to personal liability.[16]

The disadvantages of the land trust are: joint and several tort liability imposed on beneficiaries; the possibility that beneficiaries may be deemed partners; the sale of the property at a fixed time, when such a sale might not be beneficial to the beneficiaries; and the possible double tax if the land trust be deemed an "association" by virture of its centralized management, continuity of life, and free transferability of shares.

V. THE REAL ESTATE INVESTMENT TRUST

The new vehicle for stimulating public investment in real estate is the real estate investment trust. In this vehicle, there must be at least 100 beneficial owners, and five or less persons (direct or indirect) may not own fifty percent of the trust. Seventy-five percent of the total assets must be real estate assets, cash and cash items, and government securities. No more than twenty-five percent can be in other securities, and no more than five percent in any one security. The trust may not be a dealer in real estate; that is, it may not hold any property primarily for sale in the ordinary course of business. At least ninety percent of the trust's income must be derived from dividends, interest, rents from real property and gains from sale of stock, securities and real property. Over this ninety percent rule, Congress superimposed a rule that at least seventy-five percent of the trust's income must come from real property, interest on mortgages, gains from the sale of real property, and other real estate sources.[17]

The advantages in using the real estate investment trust are: avoidance of the corporate tax, centralized management, continuity of operation, transferability of interests, and diversification of investments.[18]

The main disadvantages to the use of the real estate investment trust are: state law may limit or restrict real estate ownership in an investment trust; this type of ownership restricts the use of this vehicle to the larger real estate investment; the use of capital is restricted and limited; the prospectus must be filed with the Securities and Exchange Commission; and the corporate tax is avoided only if ninety percent or more of the trust income is currently distributed.[19]

V. SPECIALISTS NEEDED

Once a syndicator has decided to purchase a property, and has decided on the form of ownership, specialists are needed to develop this phase properly. A real estate attorney, experienced in drawing up contracts, should be consulted when purchasing the property. A tax attorney, experienced in the development of partnership papers and brochures, should be consulted so that the documents will meet the state and federal regulations. If the property is to be offered publicly, an attorney well versed in Securities and Exchange regulations should also be consulted. An accountant is necessary to develop the proper depreciation schedule and work out the tax data.[20] If the syndicator is not a real estate professional, it is advisable to employ a real estate specialist to select and manage the property.

CHAPTER IV FOOTNOTES

[1]Lloyd D. Hanford, Sr., Development and Management of Investment Property, Institute of Real Estate Management of the National Association of Real Estate Boards, (Chicago, Illinois), 1964, p. 111.

[2]Daniel S. Berman, How to Reap Profits in Local Real Estate Syndicates, (Englewood Cliffs, N. J., Prentice Hall, Inc., 1964), pp. 56-57.

[3]Bertram Lewis, Profits in Real Estate Syndication, (New York: Harper and Brothers, 1962), pp. 126-127.

[4]Leonard Richman, "The Future and Mechanics of Real Estate Syndication," Journal of Property Management, (Spring, 1963), p. 159.

[5]Ibid.

[6]Ibid.

[7]Carl A. Mayer, "Real Estate Syndicates and How They Work," Journal of Property Management, (Winter, 1955), p. 80.

[8]Ibid.

[9]Ibid.

[10]Richman, op. cit., p. 155.

[11]Hanford, op. cit., p. 113.

[12]Lewis, op cit., p. 15.

[13]Hanford, op. cit., p. 113.

[14]Lewis, op. cit., p. 18.

[15]Land Trusts, Trust Department, The Central National Bank of Richmond, (April, 1962), p. 2.

[16]Robert P. Buford, Jr., Real Estate Syndication, (Lecture), Sponsored by the Continuing Legal Education Committee of the Bar Association of the City of Richmond, (Sept. 21, 1962).

[17]John C. Williamson, "The Real Estate Investment Trust Act," Journal of Property Management, (Winter, 1961), pp. 68-69.

[18]J. K. Lassiter, Successful Tax Planning for Real Estate, (Larchmont: American Research Council, 1961), p. 52.

[19]Ibid.

[20]Richard H. Swesnik, "Syndication Offers Many Advantages to Investors and Syndicators," Journal of Property Management, (Spring, 1961), p. 148.

CHAPTER V

FUNCTIONS OF THE SYNDICATOR

THE BROCHURE AND THE INVESTORS

After the syndicator has selected the form of ownership for the project, the next steps are to prepare the brochure or prospectus, find the investors, and sell the investors.

Because of the recent undesirable publicity, lawsuits, and convictions of some prominent syndicators, principally in New York City, it is felt that the Code of Ethics for syndicators should be discussed at this time. A portion of this Code will also be extremely helpful in the preparation of the prospectus.

I. CODE OF ETHICS

Growing public investment in real estate syndication requires that the syndicators establish proper standards for themselves and their staffs. The entire reputation of the industry is dependent upon the public's opinion of the syndicator. Investors in real estate syndications are entitled to certain reasonable safeguards. Large industrial corporations in the past had a similar situation, and consequently, the stock exchanges were created with their quasipolice powers and code of ethics and conduct for participating firms.[1]

The expansion of syndication depends upon the public's confidence in the syndicator and his staff. The industry will be able to maintain its growth and profits only so long as the syndicator retains the faith and support of the public. It is the syndicator and his staff who create the image of the industry.[2]

Most real estate syndicators are honest, and want to give full disclosure in their brochures. Many of the full-time syndicators are members of the Association of Real Estate Syndicators, Inc. This Association requires a full disclosure of all the material facts. Mr. Nat Berger, a prominent syndicator and president of Nat Berger Associates, headed the committee within the Association which drafted the following code of ethics:

BASIC CODE OF ETHICS FOR REALTY INVESTMENT

1. The principal consideration of every syndicator shall be to protect the interest of the investing public.

2. Full and truthful disclosure of all material facts shall be made to all investors. A written prospectus or brochure, in clear factual language, shall be made available to every prospective investor and shall fairly and honestly set forth the material facts respecting the in-

vestment, including without limitation:

a. A full and accurate description of the property.

b. A statement of estimated income and expense.

c. Complete information of mortgages and other liens against the property stating by whom held, terms of payment, maturity, etc.

d. A statement of any interest, direct or indirect, owned by the syndicator in the property being offered.

e. The syndicate managers and any other persons who will direct the affairs of the syndicate shall be identified and brief resumes of their experience in the real estate field shall be set forth.

f. Projections, if any, into the future shall be clearly identified as estimates by the syndicators and stated as such.

g. A statement of all compensation and profit, direct or indirect, of any nature, paid or to be paid to any of the syndicate managers or to any other person who will direct the affairs of the syndicate.

h. A statement of the amount of compensation, if any, paid or to be paid for the management of the property or for the management of the syndicate.

i. If the property is under contract, the salient terms and conditions of the contract of purchase.

3. Participants shall be given all necessary protection for funds deposited with the investment managers. Such funds shall be deposited in a special account and shall not be co-mingled with the syndicator's personal funds.

4. False, misleading or exaggerated claims or statements in advertisements or other publicity are expressly condemned.

5. The purchase contract and all other documents in connection therewith, pertinent to the transaction, and which are in the possession of the syndicate manager shall be made available for inspection by prospective participants.

6. In all their dealings with each other and with the public in general, syndicators shall maintain the highest standards of honesty, frankness, fair dealing and dignity.

7. The foregoing basic code of ethics may be clarified, supplemented or amended from time to time, as provided in the by-laws of the Association.[3]

Most state laws require full disclosure of all the important facts in the brochure or prospectus. However, the fact that the state does require full disclosure may give a false impression to the investor concerning degree of protection. If the offering is in "interstate commerce", the prospectus must conform to the provisions of the Securities and Exchange Commission.

II. PREPARE THE BROCHURE

The brochure or prospectus contains all of the details and data about the syndication being offered. Every conceivable analysis of the offering should be included. As the brochure is also going to be used as a sales tool, it is essential that the prospectus be done in a dignified, logical and attractive manner. Among the things which should be included are: photographs, aerial views, occupancy surveys, insurance rates, tax rates, statement of rents showing name of tenant and the date of lease expiration, rates per square foot, statement of present expenses, plat plans, individual floor plans, and statement of estimated income and expenses.[4]

As so much depends upon the prospectus, it is desirable for the syndicator to have a check list so that an important item may not be overlooked. An excellent check list follows:

CHECK LIST OF ITEMS ABOUT WHICH MEMBERS OF A SYNDICATE MUST BE INFORMED AT INCEPTION OF THE SYNDICATE:

1. Property - location and purchase price.
2. Terms of purchase.

3. Mortgage or other obligations assumed, due dates, interest rates.

4. Rental data.

5. Present amount required from each syndicate member and any expectancy of future calls for additional contributions to syndicate.

6. A schedule of potential repayments of principal contributions and expected earnings.

7. The rights of the syndicate manager to call for said funds, and if not paid within a certain number of days after call, to permit others to pay, and reduce original percentage of member not paying, pro-rata.

8. Regular reports - audited statements and other details at regular intervals.

9. Assurance to members of syndicate of qualified experienced broker to promote, manage, acquire and dispose of property.

10. A copy of syndicate agreement to each member.

11. Copies of any amendment, alterations or changes to agreement.

12. Schedule of each member of syndicate, his percentage of interest and amount of contribution to fund.

13. The appointment of legal representatives of syndicate, as well as certified public accountant.

14. The management contract.

15. The exclusive broker's contract.

16. The schedule of fees and commissions to be charged.

17. Disclose title company to be used.

18. Decide questions of insurance coverage.

19. Appointment of bank-depository.

20. Fix calendar or fiscal year.

21. Interest rates, repayment dates of any special loans made, not considered as additional capital contributions.

22. Approvals in writing of any special policies or procedures.

23. Keep members well informed so they know you are working for them and earning your fees and their confidence.

24. Proper vouchers and supporting data for all transactions.[5]

After the prospectus has been prepared, with the advice and consent of an experienced attorney, the syndicator must then find the investors.

III. FIND THE INVESTORS

Most syndicators begin in this field by offering the shares of the syndicate to family, friends, business associates, and acquaintances. It is true that one satisfied customer will bring another. When the initial investors find that the project is run with unquestioned integrity and honesty, the investing partners will bring in their families, friends, and business associates. This is the healthiest growth for the small syndicator. This type of growth is also the least expensive.[6] Almost every active realtor has business associates and acquaintances asking him "to let them in on the next good deal". If a small syndicator can wait for normal growth by virture of a "job well done", this is a healthy situation, and such syndication will always have investors waiting in line to participate in the next venture.

In some sections of the country, extensive advertising has been used. In other cases, mailing lists have been purchased, and many of the large syndicators on the East Coast have been using full-time underwriters.[7]

It is extremely important, from the small syndicators standpoint, that the investors be chosen carefully. Failure to observe certain principles may seriously imperil the success of the syndication attempt. Three general principles are:

1. <u>Participants must have substantially the same objectives</u>. Investors who primarily seek capital gain do not mix well with investors who are interested in income flow. Investors who believe in large buildings

are usually incompatible with those who desire many small buildings.

2. <u>Participants should have the same financial capabilities</u>. A man of limited means is "out of company" with a man of great wealth. By the same token, a large investor can be at a disadvantage when the vast majority of the investors are small investors.

3. <u>Participants should be of one mind as to the permanence of the association</u>. It is unwise for investors desiring a temporary investment to be associated with other investors who desire to conduct operations on a generally continuing basis.[8]

After the syndicator has selected his investors, and has decided upon the minimum and maximum size unit of participation, he must start to sell the investors on the syndication.

IV. SELL THE INVESTORS

In selling the investors, the approach must be honest and straight-forward. It is particularly important to make the first syndication offering extra-attractive to the investors. Do not enter the field with a weak offering. Basically, tell the investors why you think the current plan is a good offering. Substantiate your sales talk with facts and figures. Investors care as much about the syndicator as they do about the property.[9] From the investors' standpoint, one of the most important elements in a syndication is the people who will create and manage the syndication. Most investors know little or nothing about real estate, and they are more concerned with the background, past performance, and integrity of the syndicator than they are with the property.

In selling the syndicate, one should analyze it as an investment from the following standpoint:

1. Safety of principle. The investor can usually judge this factor because he knows the facts on the property and the mortgage from the brochure and from personal inspection of the property. His judgement will have to be based on the durability of the income.

2. Rate of return. In real estate investments, the rate of return is usually higher than in other kinds of investments. Liquidity is sacrificed for higher returns. The rate of return can usually be estimated fairly accurately.

3. Marketability. Ordinarily in this type of investment, an investor sacrifices liquidity for the high rate of return. By keeping the size of the investment down, a ready market is usually created among the investors themselves.

4. Tax advantage. In this type of investment, there

is the possibility of depreciating on the declining balance method and selling after seven or eight years, or depreciating on the straight line method and holding for longer periods. A very interesting comparison with other types of investments can be made by showing the advantage of the tax shelter created by depreciation. An illustration of this comparison was shown in Chapter II, pages 18, 19, and 20. The advantages here can be so great that this alone will sell the investor a share.[10]

Of course the multi-million dollar properties will use high-power promotion. Experienced promotors, or even independent sales organizations which will work on a sales commission, will be hired. Direct mailing and extensive advertising will be used. Booklets on the advantages of syndication will be included in the mailings. Brochures will be put in dramatic leaflet form, and cards for interested investors to complete and return to the syndicator will be included in these mailings.

To sum up the sales technique for selling an investor in a syndicate, the syndicator must first interest the investor in the idea of syndication. Then the syndicator must interest the investor in the specific syndication. Finally, after securing the interest with the full prospectus, the investor's signature as a participant must be obtained.

CHAPTER V FOOTNOTES

[1]Nat Berger, "Syndicators' Need Grows for Code of Ethics," National Real Estate Investor, (November, 1961), p. 35.

[2]Ibid., p. 76.

[3]Hugo Rothschild, How To Invest and Protect Your Profits in Real Estate Syndicates, (New York: Doubleday & Company, Inc., 1964), pp. 11-12.

[4]Carl A. Mayer, "Real Estate Syndicates and How They Work," Journal of Property Management, (Winter, 1955), pp. 83-84.

[5]J. William Markheim, "The Mechanics of Syndicates," Journal of Property Management, (September, 1958), p. 5.

[6]Leonard Richman, "The Future and Mechanics of Real Estate Syndication," Journal of Property Management, (Summer, 1963), p. 224.

[7]Ibid.

[8]Lloyd D. Hanford, Sr., Development and Management of Investment Property, Institute of Real Estate Management of the National Association of Real Estate Boards, (Chicago, Illinois), 1964, p. 112.

[9]"Syndicate Merchandising," National Real Estate Investor, (August, 1960), p. 15.

[10]Ralph J. Silverwood, "How Small Investment Syndicates Work," Money Making Ideas from Fellow Realtors, The National Institute of Real Estate Brokers of the National Association of Real Estate Boards, (Chicago: April, 1961), p. 1.

CHAPTER VI

FUNCTIONS OF THE SYNDICATOR

FINANCING AND MANAGEMENT

It is felt by the author that, before discussing financing the property, three basic definitions are necessary. They are:

> Mortgage - "A written instrument that creates a lien upon real estate as security for the payment of a debt."[1]
>
> Purchase Money (P. M.) Mortgage - "A mortgage that is executed by the purchaser as a part of the purchase price."[2]
>
> Second Mortgage - "A second lien upon property that can only be exercised after the first lien has been satisfied or removed."[3]

Mortgages are the financial foundations of real estate investments. A mortgage is a debt, but it is different from other debts in that a building is pledged as security. Most mortgages provide for monthly payments with a portion of the payment being applied to interest, and the remainder being applied to principle amortization. If the owner of the building fails to make the payments as specified in the deed of trust, the lender may foreclose and sell the property.

"Equity growth" is a term used to describe a characteristic of real estate investment. It refers to the potential growth of the capital invested in the property. Investors in the stock market refer to this as "capital appreciation", and it is based on the increased earning power of the investment. Real estate investments have a dual source of growth: the increased earning power of the investment, and the growth from mortgage amortization. This growth from mortgage amortization is a characteristic found in real estate and not generally found in other investments.[4] Technically, this is not growth, but it is considered as growth, or a hidden savings, by most realtors.

This dual source of equity growth can be illustrated as follows:

1. Price of the property — $300,000
   Subject to first mortgage (15 years) — 200,000
   Investment in cash — $100,000

2. After fifteen years, all other things being equal, the amount of equity would be $300,000, or three times the original investment.

3. Now assume that this same property after fifteen years could be sold for $400,000. The initial investment now would be worth four times its original value.

The next logical function of the syndicator is, therefore, to arrange for the financing of the property being considered for syndication. Bear in mind that the financing arrangements should not be delayed until after the prospectus is prepared, but should be initiated immediately upon the selection of a property, and before the actual purchase.

I. FINANCING THE PROPERTY

First mortgage. The best time to consult a mortgage banker about financing a syndication property is before the property is bought. Mortgage bankers are experts in their fields, and can be of considerable assistance to the syndicator. Perhaps the syndicator has underestimated the equity required, or the annual interest payment. Perhaps the property could not support a satisfactory mortgage because the building had too many local leases, or perhaps it had too many low rent national leases and the income could not substantiate the loan. A local lease is a lease entered into by a local tenant who is not rated very high financially by Dun and Bradstreet. If too many local leases are involved in a project, the lending company will not consider the leases strong enough to substantiate a loan. By the same token, if there are too many national companies, or companies with the best Dun and Bradstreet rating, the lower rents agreed upon by these strong companies will not yield sufficient income. Therefore, the proper proportion of local and national leases is necessary in a project to arrive at the desired yield and strength to substantiate a suitable loan. These are some of the errors which could be made by even an experienced real estate syndicator, and the mortgage banker is the one to consult because the mortgage company is not going to lend the money until it is assured that the syndicate is going to be a profitable operation.[5]

It is safe to rely upon one's own judgement and experience as a syndicator in the mortgage market only if the experience has been very recent and of the same type. If the last investment in the same type of property was six months ago, the information may be obsolete. Even if one, as a syndicator, has been successful previously in an apartment project, for an office building the value, equity necessary, interest rate and length of the loan may not be the same. The conventional mortgage market varies and is so fluid because it is one of the most responsive markets in the economy. The market is made by many institutions, societies, life insurance companies, banks, credit unions, and other institutions seeking outlets for surplus funds. No two of these sources ever view things the same way. The market responds instantly to supply and demand, good and bad experience, economic and population trends, architectural fashions, and urban growth patterns.[6]

Here are some of the questions a mortgage banker can answer for the syndicator:

1. Can the investment make a profit?

2. How much loan can be given on the project?

3. What is the interest rate?

4. What is the length of the loan?

5. What type of loan will bring the best return on investment?

6. What kind of leases will be acceptable to the lender?

It is interesting to note that existing or future leases play a very important part in the obtaining of a mortgage. Strong, long-term leases by desirable tenants will favorably impress a mortgage banker, and the banker will lend money on the strength of the leases rather than on the building itself. Take the Willow Lawn Shopping Center as an illustration. In this shopping center, there are many tenants rated AAA by Dun and Bradstreet. To name a few, Willow Lawn has Miller & Rhoads, J. C. Penney, G. C. Murphy, Woolworth's, Giant Foods, and Peoples Drug Store. The balance of the shopping center is made up of desirable local tenants. The obtaining of these desirable leases from AAA tenants made this center a success from the mortgage viewpoint.

Instead of going to a mortgage banker for a loan, a syndicator may go to a direct lender. A direct lender will examine the project and give a "yes" or "no" answer. If the answer is "no", the syndicator must go elsewhere. The mortgage banker is the best place for a small syndicator to go for mortgage assistance, because the mortgage banker is familiar with the requirements and idiosyncrasies of many investors. Institutional investors are not usually staffed to provide the counseling services that mortgage bankers can provide.[7]

Some mortgages are self-liquidating. A self-liquidating mortgage is one that is so arranged that after a number of years, the mortgage debt is completely paid off. This type of mortgage is ideal, since the syndicate does not have to be concerned about renewal or refinancing at higher interest rates. Many mortgage lenders on investment properties do not desire to have their funds tied up for a long period of time, and so, as a rule, they make self-liquidating loans for a short period of time, say ten years, and then at the end of the ten years, the remaining balance must be paid off in a lump sum. This type of mortgage may be called a self-liquidating mortgage with a "balloon payoff".[8]

Mortgages which are due in a few years are usually less desirable than long-term financing. In a long-term mortgage, due in twenty or twenty-five years, the syndicator will have ample time to choose a good time to refinance on favorable terms.

<u>Assuming a mortgage</u>. Many investors prefer to assume

existing mortgages rather than to obtain a new mortgage. The main reasons for this procedure are that there are usually extra legal and closing costs involved when obtaining a new mortgage, while a mortgage that has been in existence for a while usually carries a better interest rate than the current rate, assuming that the interest rate has been rising. The syndicate will take over the existing mortgage and pay cash for the difference between the mortgage balance and the selling price of the property.

Purchase money mortgage. In financing of this type, very often the seller of the property will take back a purchase money (P. M.) mortgage above a certain amount of cash. The P. M. mortgage may be a second, or even a third, mortgage. In some cases, if the property is clear, the seller may take a P. M. mortgage for seventy-five, eighty, or ninety percent of the value of the property.[9]

This type of mortgage financing can often improve the return on investment picture, but it can also "thin" the equity. The syndicator can compare the stability of the income with the fixed debt charges to determine when to stop leverage. The syndicator must recognize under-mortgaged properties, and also those that are too heavily mortgaged. The syndicator must achieve a realistic combination of yield and safety.[10]

Second mortgage. In the financing of investment real estate, very often the seller of the property does not want to take back a P. M. mortgage as part of his equity. It may therefore become necessary for the syndicator to seek second mortgage money in the open market. This type of financing is rather costly, as this type of lender will want a premium for the money. In some instances, however, in order to increase leverage, this type of financing is feasible.[11]

II. REFINANCING THE PROPERTY

Mortgage recast. The term mortgage recast is used to describe a refinancing procedure. In this type of refinancing, the amount of the mortgage note is not increased, but the terms, interest and length of the loan are changed. Here is an example: assume that a building was purchased in 1955, with a six percent interest rate, self-liquidating, fifteen-year, $100,000 mortgage. The payments on this loan would be approximately $10,000 per year, including interest and principle payments. Assume that in 1964, the unpaid balance has been amortized to $60,000. If this mortgage were to be recast, the new mortgage would be for $60,000. If the terms were the same, six percent for fifteen years, the annual payments are decreased $4,000 per year. If there had been a $50,000 equity in the building, the extra $4,000 would add eight percent to the return. If deemed necessary in the opinion of management, this $4,000 might be used for improvement of the building rather than for distribution to the investors.[12]

Refinancing. The term "refinance" is employed when the purpose of the change is to end up with a substantially larger unpaid balance on a mortgage.[13]

There is no doubt that this type of financing can raise yields. Financing like this can be useful because when a syndicate is using accelerated depreciation, and the amortization begins to approach or exceed the depreciation, unless the amortization rate is lowered, the tax sheltered income advantage of real estate property investment is gone. If this depreciation-amortization ratio cannot be restored, the syndicator will probably sell the property rather than have taxable income exceed cash distribution.[14]

III. THE SYNDICATE MANAGER

Skilled management is one of the most outstanding assets of any business. Practically every truly successful business enterprise is characterized by good efficient management. By the same token, many weak and ailing businesses can trace their failures to inefficient management.

Characteristics of the syndicate manager. The syndicate manager must be a man of many talents. These talents should have been acquired by study, training and experience. He must be well-informed on matters surrounding the purchase, the ownership, and the successful operation of real estate. He must be able to analyze data and situations, and have the ability and courage to make decisions. His attitude must be flexible, and his mind open to new methods and changing situations. He should be able to delegate authority and responsibility so that the syndicate is conducted in an orderly and efficient manner. He should be able to get along well with people, inspire confidence, trust, loyalty, and he must possess integrity. Finally, he should be adept at public- and human-relations, which will attract and hold the investors in the syndicate.[15]

<u>Centralized management</u>. Strong, centralized management control is essential to a syndicate's health. The manager spends many hours consulting with his staff and associates, and discussing problems. It is important to have investors who want professional management, and are willing to leave management to the professionals, because the syndicate manager cannot spend his time chatting with investors just because they are part of the project. One of the most important functions of the manager is to build an organization with depth as well as quality, so that in the case of the death or disability of the syndicate manager, the man-

agement team may be able to continue.[16]

IV. MANAGEMENT OF THE SYNDICATE

A syndicators job is not finished when he has found a property and has made a successful offering. On the contrary, his work has just begun, and the follow-up, by intelligent, effective management, is a vital part of his responsibility. Remember that a syndicator's reputation and career depend upon his ability to keep the distributions flowing to the investors as promised in the prospectus. This takes good management.

Prompt distribution of income. One of the most important functions of the manager is to be certain that the distribution checks are mailed to the investors at the time specified in the prospectus. An interesting characteristic of real estate syndication is the widespread use of monthly distributions. The fact that an investor receives his check regularly on the first day of each month ties the investor securely into the syndicate, and gives him the feeling that he can depend on these earnings and that they constitute genuine earnings.[17] A delay in the distribution of the checks, for whatever reason, will bring a storm of protests from the investors.[18]

Progress reports. Investors should be given progress reports at stated intervals, at least once a year. A profit and loss statement and a balance sheet should be included in each report. A complete report should be given concerning occupancy, major repairs and maintenance problems, personnel changes, neighborhood conditions, and general plans for the improvement of the property.[19]

Transfer and resale of interests. An important function of the manager is to act as transfer and resale agent. Because investors may die, make gifts of their interests, or sell their interests, the manager must know the mechanics of transferring these interests. The manager should also have a ready and able list of buyers, in the event that an investor wants to sell his shares.[20]

Maintain adequate reserves. It is risky to pay out 100% of net income to the investors. If everything is paid out, there is no contingent for emergencies which may occur. The brochure should spell this out completely, and any surplus accumulated during the first few years should be put into a fund to take care of sudden expenditures that are bound to arise.[21]

Escalator clause. Because of the current trend for constantly increasing taxes, insurance, and other expenses, the manager should include escalator clauses in all the leases in order to maintain the initial yield. When these clauses are in the leases, mortgage lenders will consider financing higher mortgages, because these clauses will tend to stabilize the earnings. Obtaining a higher mortgage on the property will, of course, increase the leverage.[22]

<u>Create working capital</u>. In the early syndicates, distribution of checks to the investors was usually made on the first day of the month following closing. This meant payment within thirty days or less. Consequently, the syndicates would have no opportunity to accumulate working capital. The usual procedure now is to start distribution to the investors forty-five days, or even sixty days, after closing. This procedure accumulates working capital because two or three months rent has already been collected. To eliminate borrowing money, a good business practice is to be sure that the mortgage payments and tax payments are staggered.[23]

<u>When to liquidate the syndicate</u>. Normally there is little reason to anticipate selling a syndication property for many years; however, the syndicate manager must be aware of the proper time to consider liquidation. Here are some circumstances where liquidation may be advisable:

1. <u>Inability to make distributions</u>. If the rental market falls off, or the occupancy rate declines, and

management cannot make necessary corrections, it may be best to sell and invest the money elsewhere. Some loss may be incurred, but this is a management decision.

2. <u>To sell at a great profit</u>. The property may be so desirable and profitable that a price is offered which is "too good to refuse."

3. <u>Loss of tax shelter</u>. As mentioned before, as the accelerated depreciation declines, more of the cash distribution becomes exposed to income taxes, and the decision to sell can be made, dependent upon the tax brackets of the various investors.[24]

Depending upon the syndicate agreement, the manager or general partner can make the decision to sell. However, many general partners agree in advance to sell when two-thirds of the investors agree.

The main reasons for selling a syndicated property are listed above, but there are other factors to consider before a decision to sell the property is made. When a real estate syndicate sells its property, the sale is a taxable transaction. The gain or loss on the sale is treated as a capital gain or loss. If the property has been held for less than six months, the capital gain will be taxed at ordinary income rates. If the property has been held for more than six months, the gain will be considered a long-term capital gain.[25]

Capital gains treatment permits the taxpayer two choices in computing the tax. (1) The taxpayer can elect to tax half of the gain at ordinary income tax rates, or (2) he can have the entire gain taxed at the 25% rate. It is obvious that the choice made by the taxpayer will depend upon the taxpayer's income bracket. A taxpayer in a bracket over 50% will elect the straight 25% capital gain rate, while the taxpayer under the 50% bracket will elect half the gain at normal rates.[26]

Another consideration is the installment sale. If the sellers of a syndicated property receive less than 30% of the sales price in cash, they may elect to take installment treatment on the gain. If installment treatment is available, the tax is payable when the gain is received. Thus, the gain may be taxed at lower rates over a period of time rather than being taxed all in one year.[27]

The sale of a syndicated property is just like the sale of any other property. The market has to be searched to find a buyer or buyers willing and able to purchase the property. Because syndicated property is usually larger, and requires considerable cash, there may be a time lag in the actual sale of the property. This lack of quick liquidity in real estate may be particularly harmful to a syndicate group whose reason for selling is the inability to make distributions or meet current expenses. It is best, in a situation like this, to take a loss as quickly as possible rather than be forced into foreclosure at some future date.

Selling a large investment property is not a simple situation, and therefore management's decision as to when and how to sell must be backed by knowledge and experience. This is definitely a job for the professional real estate man.

CHAPTER VI FOOTNOTES

[1]Bertram Lewis, Profits in Real Estate Syndication, (New York: Harper and Brothers, 1962), p. 168.

[2]Real Estate Salesman's Handbook, (Chicago: National Institute of Real Estate Brokers of the National Association of Real Estate Boards, 1956), p. 152.

[3]Lewis, op. cit., p. 169.

[4]Lewis, op. cit., pp. 57-58.

[5]Irving Rose, "See Your Mortgage Banker First," The National Real Estate Investor, (June, 1960), p. 16.

[6]Ibid.

[7]Ibid., p. 32.

[8]Hugo Rothschild, How to Invest and Protect Your Profits in Real Estate Syndicates, (New York: Doubleday & Company, Inc., 1964), pp. 66-67.

[9]Lewis, op. cit., p. 70.

[10]Lewis, op. cit., p. 71.

[11]William J. Casey, Real Estate Investments and How to Make Them, (New York: Institute for Business Planning, Inc., 1962), p. 210.

[12]Leonard D. Richman, "The Future and Mechanics of Real Estate Syndicates, Part II," Journal of Property Management, (Summer, 1963), pp. 229-230.

[13]Ibid.

[14]Lewis, op. cit., pp. 80-81.

[15]Lloyd D. Hanford, Sr., Development and Management of Investment Property, Institute of Real Estate Management of the National Association of Real Estate Boards, (Chicago, Illinois), 1964, p. 131.

[16]Richman, op. cit., p. 228.

[17]Richman, op. cit., p. 230.

[18]"How to Manage a Syndicate," _Real Estate Investment Letter_, Institute for Business Planning, Inc., (April 23, 1963), p. 49.

[19]Richman, _op. cit._, p. 232.

[20]"How to Manage a Syndicate," _op. cit._, p. 50.

[21]_Ibid._

[22]_Ibid._

[23]_Ibid._

[24]_Ibid._, p. 51.

[25]Lewis, _op. cit._, p. 81.

[26]_Ibid._, p. 82.

[27]_Ibid._, pp. 84-85.

CHAPTER VII

COSTS AND REWARDS OF SYNDICATION

The syndicate manager is rightfully entitled to a fee, or a profit, for putting together a successful project. The amount of his compensation should depend upon the amount of work, knowledge, technique, desirability of the offering, and the incidental expenses involved in the development of the project.

I. COSTS OF SYNDICATING

There are many costs involved in putting together a syndicate. The amount of these expenses will usually vary in proportion to the size of the project.

Interest on earnest money.[1] In many cases, a syndicator will purchase a property, and naturally he will be required to place "earnest money" in escrow. Most syndicators provide for an escape clause in the sales contract, which states that in the event title is not transferred on a specified date, the syndicator's only liability will be the forfeiture of the earnest money. Very often the "earnest money" is borrowed from a local bank, and the interest thereon is a cost of syndication. A simple illustration is:

1.	Purchase price of property	$1,000,000
	Deposit on sales contract (earnest money)	50,000
	Balance to be paid when title is transferred	$ 950,000

2. Assume that the syndicator borrows the $50,000 from a local bank and that title is to be transferred in six months. The interest on $50,000 @ 6% for six months is $1,500.

3. This $1,500 usually will be considered a cost of syndication.

4. In the event that the project is dropped, the syndicator will, of course, be responsible to the bank for $50,000.

Legal costs in taking title.[2] There are legal expenses involved whenever real estate is purchased. These expenses will vary from state to state. In Virginia, the expenses involved would be: cost for searching the title to the property, fee for the insurance, and the cost of recording the deed and deed of trust. Other legal fees might be paid for consultation during the preparation of the prospectus, and development and writing of the partnership agreement. In the event that the Securities and Exchange Commission is involved, there will be additional legal fees for a filing.

<u>Miscellaneous</u> <u>costs</u>. Some of the miscellaneous expenses involved will be: cost of printing brochures, postage and telephone. There will be commissions payable if an outside sales organization is hired to sell the units of participation.[3] In many cases, there will be expenses for photographs, drawings, and special typing.[4] A tax accountant is often employed by the syndicator, and his fee is also an expense in syndicating.

II. THE SYNDICATOR'S REWARDS

There is always a question as to what is the proper compensation for the realtor involved in a real estate syndication.

> In the creation of a syndicate, the Realtor plays a key role and proper rewards are justified. It is his responsibility to bring the group together, to work with legal counsel for the group organization, to consult with accountants on administrative procedures, to seek suitable investment properties commensurate with the group objectives, to manage acquired properties, to administer the affairs of the organization, and to keep the group together for maximum effectiveness.[5]

There are many ways that a Realtor-Syndicator may receive compensation for his efforts. It is important to include the method or means of compensation chosen for the particular project in the written brochure or prospectus. When this is done, there can never be any question concerning the syndicator's just compensation. The syndicator's compensation can be one, or any combination, of the following:

Sales commission on the property. Because the realtor-syndicator has actually brought about a sale of property, he is within his rights to expect a sales commission. The commission rate will vary in different localities. In Richmond, Virginia, the recommended sales commission is 6% of the first $100,000, and 3% on any amount over $100,000.

Many syndicators waive the sales commission and pass this saving on to the syndicate, or exchange the sales commission for shares of participation in the venture. Many syndicators waive this immediate cash profit because they prefer to take their compensation in other ways.

Management fee. The realtor-promotor is entitled to collect regular commissions for real estate services, and in most ventures, the promotor is given the exclusive management of the properties for a fee.[6] In Richmond, Virginia, the recommended fee is 6% of the rent paid by the tenants. This fee may be less than 6%, however, depending upon the services rendered. Along with the management fee, the realtor will write the necessary insurance for the syndicate if he has an insurance license.

Sell property at a profit to the syndicate. It is perfectly legal for the syndicator to purchase the property and then sell it to the syndicate at a profit. This compensation procedure must be disclosed to the investors, and it is usually included in the prospectus, showing the amount of profit realized by the syndicator.[7]

A simple illustration of these points is as follows:

1. A realtor purchases a property under the following conditions:

Purchase price of property	$100,000
Cash outlay by realtor	25,000
Balance by first mortgage	$ 75,000

2.

Realtor's cash outlay on property	25,000
Syndication costs	2,000
Total cash outlay by realtor	$ 27,000

3. Realtor sells property to syndicate under the following conditions:

Purchase price	$110,000
Cash required by investors	35,000
Balance subject to mortgage	$ 75,000

4.

Cash outlay by investors	35,000
Less: Cash outlay by realtor	27,000
Difference: Profit for realtor	$ 8,000

In this illustration, the realtor would receive $8,000, which is taxable at regular income tax rates. The realtor may prefer to take his compensation as follows:

Rental income of property per year	$ 18,000
6% management fee	x 6%
Compensation per year	$ 1,080
Assuming a 15-year lease	x 15
Total compensation	$ 16,200

By taking the compensation over a period of years, the realtor has stabilized his income and doubled the amount of compensation.

Net lease. In many cases, the syndicator receives his compensation by using the net lease. Normal leases are usually made between the landlord (lessor) and the tenant (lessee), where the lessee agrees to pay rent to the lessor for use of the property, and the lessee actually occupies the property. Occupancy of the property is not necessary to establish a lessor-lessee relationship, and this type of relationship is fairly common in certain types of real estate. A net lease provides that the lessee will assume the obligation of all of the expenses of the property, in addition to paying the "net rental" to the landlord. The lessor's rent is "net", or free of all expenses, and need only be applied to mortgage payments and profit. In a situation like this, the promotor, or a corporation controlled by the promotor, gives a net lease to the syndicate. The promotor then sub-leases the building to other tenants at a higher rental than he is paying the syndicate, thereby making a profit.[8] A simple example is as follows:

Income of building	$100,000
Expenses of building	60,000
Net	$ 40,000
Rent to syndicate	25,000
Profit to promotor	$ 15,000

A promotor is able to enter into an agreement of this kind when the syndicate group is satisfied with a 10% or 11% distribution, and the property may be yielding 14% or 15%. In many cases, the promotor may take a net lease for the same yield that the property is currently producing. Then, by proper management and by increasing rents as the sub-leases expire, or by making improvements, the economic return of the building is increased, thereby throwing off a profit to the promotor. The use of the net lease as described above is perfectly legal as long as it is explained in the prospectus.

In some circumstances, a "net-net lease" is written, whereby the promotor assumes all obligations, including the mortgage payments.[9]

<u>Sales</u> <u>leaseback</u>. In the "sales-leaseback" technique, the syndicator contracts to purchase a property, and then provides that the syndicate will lease the property back to

the syndicator, or to a corporation, at a net rental. This type of transaction involves both a sale and a lease. Upon completion of the transaction, the syndicator is the major tenant, usually as an operator, and his profit is realized through successful management of the property. This technique serves a dual purpose; it permits the syndicator an opportunity for prolonged compensation, and relieves the syndicate of all operating responsibility.

Subordination. Another way for a syndicator to receive compensation for his efforts is to subordinate his earnings and/or equity. Very often, a promotor will obtain a number of free shares of the venture as his compensation. These shares may range in amount from 5% to 30% of the total shares in the venture. As an incentive for the investors to agree to this form of compensation, the agreement will state that the syndicator's shares be subordinated to the investors' shares. In other words, if the offering specified that the property would yield 10%, the investors would get their 10% first, and then the syndicator would get his share, if there were remaining income. In the event that the agreement also specified equity subordination, the syndicator would participate in the profits from a sale of the property after the investors had received the amounts of their initial investments.[10]

Delayed distribution of profits. Very often a syndicator will take his compensation or profit within thirty to sixty days after the property has been transferred. Syndicate brochures usually call for a commencement of distributions from thirty to sixty days after the closing of title. This means that two or three months rent has been paid by the lessees of the property before distribution is made to the investors. The syndicator can take his fee from this source. This procedure is perfectly legal provided the syndicate prospectus contains this clause.[11]

Sale of property. Frequently, the syndicator shares in the profit from the sale of the property. The partnership agreement generally indicates the division-of-profits formula. Usually the investors get their initial investment back first, and then the syndicator shares in the profit. Ratios of 50:50 and up are common for sharing the profit on a sale, although 60:40 or 80:20 is the more usual range for profit sharing. Usually the cash investors get the greater percentage of profits.[12]

Mortgage refinancing. Very often the syndicator will receive a profit when and if the property is refinanced. Again, this depends upon the agreement made between the investors and the syndicator.[13] If a property was purchased subject to a $100,000 mortgage, and three years later refinanced with a mortgage for $150,000, there is obviously a return of capital of $50,000. Most agreements will specify how this capital will be divided. Usually the syndicator will participate in this return of capital.

Profit sharing. Often syndicators receive compensation through profit sharing. In the event that a 12% return has been promised the investors in the brochure, provision may be made for the syndicator to share in additional income received over the 12% income promised to the investors. Very often this additional income is shared equally between investors and syndicator; however, this should be specified in the agreement.[14]

Free shares. Most syndicators will stipulate in the agreement that they will receive free shares. Under this method, the syndicate manager acquires the property and distributed units among investors in such a way as to have extra units left for himself. Let us assume that the syndicate purchases a property with $100,000 cash and has 120 units. One hundred of the units will be sold for $1,000 each, and the syndicate manager will receive the 20 units free as his compensation.[15]

Fixed retainer. Another method of compensation is for the syndicate manager to be on a fixed monthly or yearly retainer.[16]

Summary. The costs of syndication will normally vary with the size and complexity of the project. If the syndicator has borrowed the "earnest money", the interest on this money is a cost of syndication. Various legal fees for consultation, searching and recording the deed and deed of trust are expenses. Miscellaneous costs may include printing, postage, telephone, secretary, drawings and photographs.

The syndicator may receive his compensation in many ways. Sometimes he receives a sales commission on the actual sale of the property to the syndicate. Most syndicators waive this commission because they prefer to receive their compensation over an extended period of time. In most cases, there is a management fee for the actual management of the property. Some syndicators prefer to purchase the property in their own names and then sell the property to the syndicate at a profit. Many of the larger syndicators prefer the net lease or sales leaseback method of receiving compensation, as their initiative can be used to increase their compensation. A recent trend in syndication has been for the promotor to subordinate his earnings and/or equity and receive compensation after the investors have received theirs. After a property has been recorded, there is usually a delay of sixty to ninety days before cash distribution is made to the investors. During this period, the promoter will accumulate income and take his compensation from this income. In the sale and refinancing of property, the syndicator may receive additional compensation from these proceeds. A system of compensation can be arranged where the promoter receives compensation out of the profits. Most syndicators prefer to receive free shares of the offering as partial payment for their services. Perhaps the least used method of compensation for the syndicator is for him to be on a fixed monthly or yearly retainer. This method, of course, destroys initiative, and most syndicators prefer to receive compensation in proportion to their productiveness.

Any one, or a combination of the above methods of compensation may be used. However, it is most important for the method of compensation to be clearly stated in the brochure or prospectus.

CHAPTER VII FOOTNOTES

[1]Leonard D. Richman, "The Future and Mechanics of Real Estate Syndication, Part II," Journal of Property Management, (Summer, 1963), p. 229.

[2]Daniel S. Berman, How to Reap Profits in Local Real Estate Syndicates, (Englewood Cliffs, N. J., Prentice Hall, Inc., 1964), p. 102.

[3]Ibid.

[4]Richman, op. cit., p. 229.

[5]Lloyd D. Hanford, Sr., Development and Management of Investment Property, Institute of Real Estate Management of the National Association of Real Estate Boards, (Chicago, Illinois), 1964, p. 114.

[6]Ibid., p. 115.

[7]Hugo Rothschild, How to Invest and Protect Your Profits in Real Estate Syndicates, (New York: Doubleday & Company, Inc., 1964), p. 43.

[8]Ibid., pp. 53-54.

[9]Bertram Lewis, Profits in Real Estate Syndication, (New York: Harper and Brothers, 1962), p. 46.

[10]Berman, op. cit., pp. 32-33.

[11]Rothschild, op. cit., pp. 42-43.

[12]Lewis, op. cit., p. 37.

[13]Berman, op. cit., p. 26.

[14]Ibid., p. 27.

[15]William J. Casey, Real Estate Investments and How to Make Them, (New York: Institute for Business Planning, Inc., 1962), p. 44.

[16]Hanford, op. cit., p. 115.

CHAPTER VIII

SUMMARY AND CONCLUSIONS

In this final chapter, under the heading of Summary, the writer will restate the findings or main points of the previous chapters.

Under the headings Purpose and Conclusions, the writer will restate the purposes of the report, and discuss the conclusions drawn from this investigation.

I. SUMMARY

Background of syndication. Real estate syndication actually came into being after World War II. The backlog of construction, caused by the war, created a latent demand for new construction that practically exploded all at once, and this country entered into one of its greatest building booms of all times.

During this period, great amounts of money became available for investment, and consequently, more and more money was invested in real estate. Real estate syndication went through an evolution that started with private syndicates requiring high units of participation and group management, and went on to small units of participation and professional management. Finally, with the modern techniques of sales promotion and sales organizations selling units of participation, real estate syndication came into prominence, and became an accepted medium of investment.

The majority of people who invest in syndicates are either retired, or are seeking a second income, and are usually in the lower income brackets. This indicates that a successful syndicate, involving lower income investors, must show a good return on investment. Because of the lack of quick liquidity of real estate, a good return must be available for this class of investor; otherwise, he may prefer more liquid forms of investment. A yield of 10% to 13% is usually considered adequate for this type of investor.

There are many reasons for people to invest in real estate. Most people, of course, are interested in the high rate of return that a good real estate investment will bring. In addition to the high rate of return, thinking investors will be concerned with the hedge against inflation, leverage, diversification, tax shelter from depreciation, and the additional return that the reduction of the mortgage debt will bring.

Finding and securing the property. The location of the property is perhaps one of the most important reasons for the success or failure of any real estate venture. This is particularly true today because of the construction of the many new roads. As one example, new highway construction is most important, because these new roads can create new values or destroy old ones.

A complete appraisal and analysis of the property should be made. A property should not be selected unless it has intrinsic or real and genuine value. Property for syndication may consist of old buildings, new buildings, raw land, motels, parking lots, garages, shopping centers, bowling alleys, hotels, business offices, amusement centers, marinas, and any other property or idea that shows good investment potential. The syndicator must be sure that, in addition to showing good investment potential, the capital invested in the project is secure. The investor must be protected at all times.

Many large syndicators maintain that the syndicator must enter into a sales contract for the property with his own money. This may be true in sophisticated investment markets like Chicago, New York and Miami, but it is not necessarily true on the local scenes. Local properties can also be secured by options and exclusive listings.

Selecting the form of ownership. The selection of the best vehicle for ownership is not a simple matter. Legal specialists should be consulted, and each syndication should be analyzed to determine the best form of ownership. All of the forms of ownership discussed in Chapter IV have been used, and probably will be used in the future, depending upon the requirements of the investing group. The limited partnership seems to have been the most popular form of ownership for real estate syndicates of the past; however, as tax laws and other legislation change, the limited partnership may be replaced by some other form of ownership.

The ideal characteristics for a real estate syndication are the major characteristics of a corporation. These are: (1) associates, (2) an objective to carry on a business and divide the profits, (3) continuity of life, (4) centralization of management, (5) limited liability, and (6) free transferability of interests. However, if a syndicate possessed all of these characteristics, the syndicate would certainly be treated as a corporation taxwise, and would thereby forfeit two of the major attractions for the investing public interested in real estate investment. The syndicate and the investors would be subject to taxation, and the depreciation expense would be charged to the syndication instead of being passed on to the individual investors.

Prepare the brochure. The brochure or prospectus should contain full information about the offering. Full disclosure is mandatory, and a complete and well-prepared brochure will eliminate complications, misunderstandings, and possible legal actions.

Find the investors. The first syndications of a promotor are usually sold to members of his family, friends, business associates and acquaintances. As the syndicator becomes more experienced and proficient in the profession, large scale promotion and sales techniques will be used. In selling investors, the approach must be honest and straightforward, and stress should be placed on the safety of principle, rate of return, marketability, and the tax return of the offering. New investors must first be sold on syndication itself, and then on the specific syndication being offered.

Financing the property. Mortgages play an important part in the growth of real estate equity. By the use of mortgages, there is leverage, and a dollar is able to do the work of several dollars. If the value of the building increases, there is equity growth, and as the mortgage is paid off, there is also growth. Consequently, real estate investments have a dual source of growth not usually found in other types of investment.

The syndicate manager and management of the syndicate. As in any business, skilled management is necessary to the success of a syndicate. The syndicate manager must be a man of many talents. Strong, centralized management and control is essential to a syndicate's health. Prompt distribution of checks to the investors, as specified in the prospectus, is recommended, and is most important to keep the investors completely satisfied.

The syndicate manager must recognize the proper time to liquidate the property. Liquidation may be advisable when the syndicate is unable to make distributions, losing the tax-shelter benefits, or when it is able to sell at a great profit.

Costs of syndication. There are many costs involved in putting together a syndicate, and the total costs will vary with the type of project and the size of the venture. Many syndicators feel that the interest on earnest money is a legitimate cost of syndication. Then, too, there are legal costs in taking title to the property, consultation fees for the preparation of the prospectus, fees for developing the partnership agreement, and various other legal fees. Other expenses for printing, postage, telephones, photographs, drawings, typing, and possible selling commissions may be involved.

The syndicator's rewards. The realtor plays a key role in the creation of a syndicate, and he therefore is entitled to just compensation. First-time investors very often are disturbed because the syndicate manager receives various fees for putting the project together. Many investors are of the opinion that the syndicate manager should receive the same compensation they do, in proportion to the amount of money invested. Upon reflection, however, after the responsibilities, duties, planning, and professional know-how necessary are explained to them, they are usually satisfied that the promotor is entitled to additional compensation.

The syndicator may receive compensation in many different ways. Compensation may be realized by sales commission on the property, management fees, selling the property at a profit to the syndicate, the use of the net lease or sales leaseback, subordination, delayed distribution of profits, sale of the property, mortgage refinancing, profit sharing, free shares, or by being on a fixed retainer.

II. PURPOSE

Purpose. The purpose of this paper was to present a relatively complete, simple and concise report on the techniques and tools of real estate syndication, so that the small local realtor will realize that: (1) putting together a syndicate is not beyond his comprehension, (2) it is not necessary to depend on large syndicators, promotors and attorneys to perform the real estate functions and promotions necessary for the formation of a real estate syndicate, (3) it is not necessary to absorb hundreds of complicated articles, briefs and legal reports to become expert in the know-how of syndication, and (4) it is advisable for him to pursue a course of study in the fundamentals of real estate syndication.

It is felt that the purposes set forth above have been accomplished in the preceeding chapters.

The previous chapters have shown that the putting together of a syndicate is a simple operation, and is within the realm of the local realtor. The local realtor must simply find the property, arrange for the financing, sell the investors, and then finally manage the property. These are functions that the average realtor accomplishes from day to day in many properties; however, not all of these functions are usually accomplished in an individual property transaction unless the realtor is involved in syndication.

Throughout this report, emphasis has been placed on the fact that it is not necessary for the local realtor to call in promotors, attorneys, or syndicators from the large cities to perform the real estate and promotion functions of a real estate syndication. The simple truth is, all that is involved in a syndication is the finding of a suitable investment property and then finding investors who are willing and able to invest in the project. Locally, this certainly does not warrant the calling in of experts from Washington, New York or Chicago.

It is felt by the writer that a realtor desiring to learn about syndication can read and study this investigation, and have the basic tools to put a profitable local syndicate together. It is acknowledged that all the answers to real estate syndication are not contained here, but enough of the answers are here to enable a realtor to get started in local syndication. The local realtor, being basically a salesman, will normally not have or take the time necessary to accumulate, absorb and organize the hundreds of articles written about syndication, and it is felt that this report can be of great benefit to him.

A continuing study of real estate syndication is necessary for the realtor if his intentions are to remain in this field. The changing of tax laws and interpretations will undoubtedly effect the general principles of real estate syndication, and this reason alone should make the syndicate-minded realtor continue his study. For continuing study in this field, it is recommended that the realtor subscribe to the National Real Estate Investor and the Journal of Property Management periodicals. For a good all-around reference, it is recommended that "Profits in Real Estate Syndication", by Bertram Lewis, be obtained.

III. CONCLUSIONS

This investigation into real estate syndication has enabled the writer to form four conclusions. They are:

1. Real estate "know-how" is the key to a successful real estate syndicate. (Selecting the property.)

2. Real estate is a better investment than most other investments.

3. The syndicator benefits from maximum leverage.

4. Real estate syndication is not the complete answer to investment.

Selecting the property. The right selection of a property for investment purposes is perhaps the most important way to insure success in the venture. Not many lawyers, accountants or investors are qualified to judge the physical condition or location of a property. This is definitely a function for the experienced real estate man. Yet many lawyers and accountants have been drawn to syndication. An accountant may examine a balance sheet and the profit and loss statement of a property, and decide that the investment is good, and that prospects for the future look great. An experienced realtor, however, examining the same property, may turn it down because his knowledge and experience tells him that the area is on the way down, and that new highway construction scheduled five years from now is probably going to destroy the value of this property. In this situation, the accountant would say "go" and the realtor would say "no".

The realtor is like any other businessman. He must know his product, and the right property must be selected with the proper balance between stability and growth. In the selection of a property for syndication, many properties have to be examined, perhaps as many as fifty. As the realtor is in the field constantly, analyzing properties, he is the logical person to recognize a good investment. The proper selection takes real estate "know-how" and, as this is the prime attribute of the real estate professional, his leadership entitles him to be the principle in a real estate syndication. Lawyers and accountants have their functions in the syndicate, but not in the selection of the property.

<u>Real estate is a better investment than most other investments</u>. Many great men have indicated that in their opinions, investing in good real estate is one way of becoming independent, and that real estate is the basis of wealth.

Vast numbers of people are confronted with the problem of how to invest their money and use it to the best advantage so as to produce growth and income. As discussed previously, investors who desire safety above all will probably invest in savings and loan associations and savings banks. Inflation seems to be as inevitable as death and taxes, so consequently the value of this income is reduced. Then too, income taxes will lower the yield on this type of investment so that little or no gain is realized. Let us assume that a man and wife have $100,000 invested in a savings and loan association at 4.25% interest. Their income from this investment will be $4,250 per year. After deduction for income taxes and allowances for inflation, it is apparent that this income is hardly enough for living expenses.

Stocks and bonds may pay a little more in dividends than banks and savings and loan associations do in interest, but there is an added risk here. Income from stocks and bonds is also subject to income tax, unless they are tax-exempt state or municipal bonds. Income from stocks and bonds will generate from 5% to 8%. The same $100,000 invested at 8% in stocks and bonds should yield about $8,000 per year for this man and wife. "Blue Chip" stocks, which are the safest, will generate about 5% or 6%. There is growth potential in stocks which should take care of the inflationary trend; however, there is always the possibility that stock prices will plunge and wipe out equities which have been built up over the years. Real estate values may also plunge after a prolonged recession or depression, as experienced in the early 1930's, but normally values of real estate do not fluctuate as readily as stocks, and there is a definite time lag in both downward and upward surges of the market.

Investment in real estate will maximize growth and maximize income for an investor. $100,000 invested in real estate will meet the normal income needs of this same couple and provide a steady continuous growth. Because of leverage, the putting of other peoples' money to work for an investor, 10% return or more before depreciation can be realized. Because the federal government permits heavy write-offs for depreciation, part, and in some cases all, of the income will be tax sheltered. After depreciation, the 10% return will yield 13% to 15%. There are few, if any, other investments that will yield this much income. Therefore, a good real estate investment will maximize income.

Equity growth is maximized in real estate investments because of the dual source of growth, or possible triple source of growth. First, there is growth caused by the normal appreication of properties. This appreciation of property has continued since the beginning of World War II, and there is no indication that it will stop. Even if the buildings themselves stop appreciating, because of the scarcity of land or the increased demand for land, the law of supply and demand will cause land values to increase. Second, there is growth through the increased earning power of the property. As the economic value of a building is increased, the rentals or income can be increased. Third, growth is generated because the mortgage is being amortized, usually amortizing at the rate of 4% to 5% a year. This third growth gactor may also be considered as a hidden savings, because the income from this growth is not realized until the property is sold or refinanced. Also, with the use of escalator clauses, income from real estate will not be subject to the losses incurred by inflation. Conservatively speaking, the growth potential of a good real estate investment is as follows:

Normal appreciation	2%
Increase economic value	5%
Amortization	4%
Estimated yearly growth	11%

It is therefore felt by the writer that a good real estate investment will offer an investor maximum growth.

<u>The syndicator benefits from maximum leverage</u>. With little or no equity, a promotor can control more wealth in a syndicate than in other investments. Syndicators have built up tremendous equities in properties with little or no cash outlay of their own. The function of the syndicator is not to invest himself, but to find situations in which others can invest. The syndicator is satisfied with his syndication and management fees, and his free shares of

participation. Many of the larger syndications have been consumated with as little as ½% of the syndicator's money involved. The Graybar Building in New York City was purchased for more than $4,000,000, and the syndicators invested only $20,000. 501 Fifth Avenue cost $2,145,000, and the syndicators invested only $50,000. The investors in a syndicate, in essence, are actually supplying mortgage money for the syndicator. The return to the investor is fixed, like a mortgage payment, either by the terms of the lease or by the terms specified in the prospectus. With the use of the investors' money and mortgages, the syndicator generates maximum leverage to his advantage, and can control property with no equity, or from ½% to 3% equity.

Real estate syndication is not the complete answer to investment. The recent large syndicate failures in the larger cities has made investors cautious. The projects involving the largest risks are the ones that are "falling by the wayside". The syndicate investors have realized that investing in real estate is not a "get rich quick" scheme, but that sound, conservative real estate is still a good investment because the investor can get a better than average return. The local realtor or syndicator has benefitted by their failures, because the local investors will know the syndicator personally, visually inspect the property, and not be subjected to high pressure techniques. Real estate syndication has progressed because of the rewards to the syndicator and to the investor as well.

Real estate syndication lacks the easy liquidity offered by other investments, and therefore investors should not place all of their money into real estate investment. A well-rounded portfolio should be the aim of investors, and syndication investments should be tempered with insurance, stocks and bonds, savings accounts, and other forms of investments.

BIBLIOGRAPHY

A. BOOKS

Berman, Daniel S. How to Reap Profits in Local Real Estate Syndicates. Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1964.

________. How to Put Together A Real Estate Syndicate. New York: Daniel S. Berman, 1961.

Brede, William J. Creative Thinking in Real Estate. New York: Harper & Brothers, 1959, pp. 275-285.

Casey, William J. Tax Shelter in Real Estate. New York: Institute for Better Planning, Inc., 1959.

________. Real Estate Investments and How to Make Them. New York: Institute for Business Planning, Inc., 1962.

Hanford, Lloyd D., Sr. Development and Management of Investment Property. Chicago: Institute of Real Estate Management of The National Association of Real Estate Boards, 1964.

Lasser, J. K. Successful Tax Planning for Real Estate. Larchmont, N. Y.: American Research Council, 1961.

Lewis, Bertram. Profits in Real Estate Syndication. New York: Harper & Brothers, 1962.

Real Estate Salesman's Handbook. Chicago: National Institute of Real Estate Brokers of The National Association of Real Estate Boards, 1956.

Rothschild, Hugo. How to Invest and Protect Your Profits in Real Estate Syndicates. Garden City, N. Y.: Doubleday & Company, Inc., 1964.

Sherman, Arthur Brown. Selling Business Real Estate. New York: Prentice Hall, Inc., 1955.

Webster's New International Dictionary, Second Edition, Unabridged. Springfield, Massachusetts: G & C. Merriam Company, 1956.

B. PERIODICALS

Barton, Sidney M. "Tips From A Pro," The National Real Estate Investor, (January, 1960), pp. 20-21.

Berger, Nat. "Syndicators' Need Grows for Code of Ethics," The National Real Estate Investor, (November, 1961), pp. 35-36.

Berman, Daniel S. "Seven Advantages of Syndication," The National Real Estate Investor, (November, 1961), pp. 39-40.

_______. "Syndication Offers Many Advantages to Realty Man," The National Real Estate Investor, (September, 1962), p. 28.

Bernstein, Norman. "Real Estate Syndication," National Capital Area Realtor, Syndicate Handbook, (June, 1960), p. 17.

_______. "Real Estate Syndications - An Introduction," National Capital Area Realtor, Syndicate Handbook, (June, 1960), pp. 7-8

"Biggest Syndication - Empire State Building," The National Real Estate Investor, (February, 1962), pp. 64-65.

Bloch, Joel. "Buys Out-of-Town Syndicates in N. Y. C.," The National Real Estate Investor, (September, 1962), pp. 27-28.

"Bowling Center Sites in Demand," The National Real Estate Investor, (July, 1960), p. 22.

Falk, Emanuel. "Comments on Real Estate Syndication," Journal of Property Management, (Winter, 1962), pp. 102-104.

Ford, Eugene. "Tax Aspects of Real Estate Syndication," National Capital Area Realtor, Syndicate Handbook. (June, 1960), pp. 13-14.

Glickman, Louis J. "Backdrop of Syndication," The National Real Estate Investor, (November, 1961), p. 30.

_______. "Syndication," The National Real Estate Investor, (April, 1960), p. 13.

Gorlitz, Smauel J. "Syndicators Code of Ethics," National Capital Area Realtor, Syndicate Handbook, (June, 1960), pp. 15-16.

Gottlieb, Arnold. "New York State Regulation of Syndication," The National Real Estate Investor, (August, 1960), p. 28.

Heller, Lou. "Syndication Seen Competing for Investment Dollar Throughout U. S.," Baltimore Real Estate and Building News, (September, 1963), pp. 7-8.

Helmsley, Harry B. "Latest Developments in the Syndication Field," Journal of Property Management, (December, 1959), pp. 75-77.

_______. "The Nature of Syndicate Operations Today," Journal of Property Management, (March, 1956), pp. 152-154.

_______. "Syndicate Investments are Expanding the Real Estate Market," Real Estate News, New York, (October, 1958), p. 341.

"How to Manage A Syndicate," Real Estate Investment Letter, Institute for Business Planning, Inc., (April 23, 1963), p. 49.

"Inside Syndications," The National Real Estate Investor, (January, 1963), p. 34.

"Inside Syndications," The National Real Estate Investor, (March, 1963), pp. 44-45.

Krauitz, Morris A. "Syndication," The National Real Estate Investor, (April, 1960), p. 12.

Kronfeld, Edwin. "Real Estate Investment Trusts and Form S-11," Journal of Property Management, (Winter, 1961), pp. 80-84.

Leavey, James. "Real Estate Syndicates," California Real Estate Magazine, (May, 1960), p.8.

Lifton, R. K. "How to Organize A Successful Syndicate," The National Real Estate Investor, (March, 1960), p. 10.

"Liquidity in Emergency," The National Real Estate Investor, (January, 1960), p. 30.

Lund, Joseph W. "New Treasury Department Regulations for Real Estate Investment Trusts." The National Real Estate Investor, (May, 1962), pp. 38-39.

Mains, Thomas F., Jr. "Southland Ripe for Investment," The

National Real Estate Investor, (July, 1962), p. 24.

Markheim, J. William. "The Mechanics of Syndication," Journal of Property Management, (September, 1958), p. 12.

Mayer, Carl A. "Real Estate Syndicates and How They Work," Journal of Property Management, (December, 1955), pp. 79-86.

Mintzer, Albert. "Small Unit Syndications Won't Support Higher Yields," The National Real Estate Investor, (September, 1962), p. 29.

_______. "Unfreeze Realty Equity," The National Real Estate Investor, (November, 1961), pp. 36-38.

Neeriemer, Elmer L. "Syndicates Vacant Land in Arizona," The National Real Estate Investor, (September, 1962), pp. 26-27.

"New Approach to Syndication," The National Real Estate Investor, (January, 1960), p. 18.

Richman, Leonard D. "The Future and Mechanics of Real Estate Syndication, Part I," Journal of Property Management, (Spring, 1963), pp. 154-166.

_______. "The Future and Mechanics of Real Estate Syndication, Part II," Journal of Property Management, (Summer, 1962), pp. 222-233.

Rose, Irving. "See Your Mortgage Banker First," The National Real Estate Investor, (June, 1960), p. 16.

Rose, Robert M. "Realty Syndicator Needs Accurate Property Listing," The National Real Estate Investor, (September, 1962), p. 30.

Schneider, Walter V. "Advantages of Publicly-Held Realty," The National Real Estate Investor, (November, 1961), p. 31.

Schultz, Mortimer L. "A Syndicator's Yardstick for Value," The National Real Estate Investor, (November, 1961), pp. 32-33.

_______. "Must 'Sell' Concept to N. J. Investors," The National Real Estate Investor, (September, 1962), p. 29.

Shapiro, David. "Legal Vehicles of Ownership," National Capital Area Realtor, Syndicate Handbook, (June, 1960), pp. 11-12.

Silverstein, Harry. "Syndication," The National Real Estate Investor, (September, 1962), p. 26.

Swesnick, Richard H. "Making Money Via the Syndicate Route," Journal of Property Management, (Winter, 1961), pp. 85-87.

_______. "Syndications and Securities Exchange Commission Regulations," National Capital Area Realtor, Syndicate Handbook, (June, 1960), pp. 9-10.

"Syndicate Merchandising," The National Real Estate Investor, (August, 1960), p. 15.

"Syndicates and the Securities Exchange Commission," California Real Estate Magazine, (August, 1960), p. 11.

"Syndicates - Five Methods of Legal Formation," California Real Estate Magazine, (August, 1960), p. 9.

"Syndicates for Promotion Minded Realtors," California Real Estate Magazine, (August, 1960), p. 8.

"Syndicates: Tax Advantage of Different Forms," California Real Estate Magazine, (August 1960), p. 10.

"Syndication," The National Real Estate Investor, (June, 1960), p. 34.

"Syndication: Growth Potential Case History," The National Real Estate Investor, (June, 1960), p. 34.

"Syndication is Here to Stay," The National Real Estate Investor, (November, 1961), p. 38.

Tenney, J. M. "Success Formula for New Syndicates," The National Real Estate Investor, (November, 1961), pp. 34-35.

_______. "Syndication Complements A Public Corporation," The National Real Estate Investor, (September, 1962), p. 31.

"Tips From A Pro, Investment Formula," The National Real Estate Investor, (September, 1962), p. 21.

"Transcontinental Investing Corporation," The National Real

Estate Investor, (March, 1962), pp. 22-23.

Weekley, Larry. "Richmond, Va. Opportunities for Outsiders," The National Real Estate Investor, (May, 1962), pp. 26-28.

Williamson, John C. "The Real Estate Investment Trust Act," Journal of Property Management, (Winter, 1961), pp. 68-79.

Wolff, Lewis, "Current Practices in Real Estate Syndication," The Real Estate Analyst, Appraisal Bulletin, Ray Wenzlick Research Corp., Number 33, Vol. XXVIII, (August, 1959), pp. 347-350.

Yassky, Harold H. "Sound Syndicating Practice Calls for Professionals," The National Real Estate Investor, (November, 1961), p. 42.

C. PUBLICATIONS OF REAL ESTATE SOCIETIES AND OTHER ORGANIZATIONS

Berman, Daniel S. "Analysis of The Real Estate Investment Trust Law," National Real Estate Investor Directory, New York: 1961, pp. 116-120.

Brown, Anne L. "Syndicating Shopping Centers," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards. Chicago: 1957, pp. 34-35.

Brudno, Walter W. "Syndicates and Income Taxation," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards. Chicago: 1957, pp. 11-15.

Casey, William J. "Partnerships, Joint Ventures, Syndicates," Institute for Business Planning, Inc., New York: 1961, pp. 3200-3263.

________. "Real Estate Investments, Deals, Ideas, Forms, Vol. II," Institute for Business Planning, Inc., New York: 1961, pp. 56801-56841.

Cobert, Eugene O. "Tax Aspects of Land Deals," National Real Estate Investor Directory, New York: 1961, pp. 129-131.

Collins, Robert B. "Poorbuying A Deal - Oklahoma Style," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, p. 63.

Conway, Thomas. "A Houseful of Landlords," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of RealEstate Boards, Chicago: 1957, pp. 45-46.

Dansker, Jerome. "Leaseback Primer," National Real Estate Investor Directory, New York: 1961, pp. 132-133.

Emmer, Vivien H. "Small Real Estate Group Ownership Venture," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 38-39.

Helmsley, Harry B. "Brokering to the Upper Brackets," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 25-27.

Hickman, Robert E. (Sponsor) The Dynamics of Commercial Property, Chicago: National Institute of Real Estate Brokers of The National Association of Real Estate Boards, 1961.

"IRS Ruling on Partnership in Real Estate," National Real Estate Investor Directory, New York: 1961, pp. 150-151.

Johnstone, W. Gordon. "Syndicates for Secondary Financing," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago; 1957, pp. 32-33.

Jones, Richard L. (Sponsor) Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957.

_______. "Interest and Enlightenment," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957. p. 2.

_______. "Opportunity for Realtors," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, p. 3.

Kargman, Max R. "The Family Syndicate," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 18-20.

Land Trusts, A New Concept of Handling Real Estate in Virginia, Trust Department, The Central National Bank of Richmond, 1962.

Laronge, Louis S. "Small Dollars Can Buy Real Estate," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 58-60.

Lifton, Robert K. "How to Organize A Syndication," National Real Estate Investor Directory, New York: 1961, pp. 121-125.

Mayer, Carl A. "Real Estate Syndicates and How They Work," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 5-10.

Mendenhall, Ed "Case History - North Carolina," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, p. 47.

Morris, L. Allen "Florida Syndicates," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 48-51.

Mulholland, Clem B. "Subdivision Syndicates," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, p. 57.

Pihl, Marshall R. "Why Legal Council," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 22-24.

"The Real Estate Investment Trust Law, Reprinted from The Congressional Record, Sec. 856, 857, & 858," National Real Estate Investor Directory, New York: 1961, pp. 142-149.

Real Estate Syndication, Lecture outline by Robert P. Buford, Jr., Alvin Silverman, Richard J. Horwich, sponsored by

The Continuing Legal Education Committee of the Bar Association of the City of Richmond, September 21, 1962.

Roach, Dick B. "A Small Syndicate," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 61-62.

Robbins, Charles E. "How To Go Public," National Real Estate Investor Directory, New York: 1961, pp. 126-128.

_______. "S E C Real Estate Regulations," National Real Estate Investor Directory, New York: 1961, pp. 138-141.

Rusch, Joseph L. "Case History - New York," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 36-37.

Silverwood, Ralph J. "Case History - Chicago," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 54-55.

_______. "How Small Investment Syndicates Work," Money Making Ideas From Fellow Realtors, The National Association of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: (April, 1961), p. 1.

Snyder, Clinton B. "Syndication - New York Style," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 15-17.

"Syndicating in the Baltimore Area," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 42-44.

Wilbur, Albert A. "How They Do It In Chicago," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 52-53.

Williamson, Gordon. "How To Set Up A Trading Organization," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 28-31.

Woodbury, Wallace R. (Sponsor) Creating Commercial Deals, The National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1960.

Wymore, Jerry. "Land Development by Group Ownership," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 40-41.

Wyse, Jack J. "Syndicating The Small Dollar," Real Estate Syndicates and How They Work, National Institute of Real Estate Brokers of The National Association of Real Estate Boards, Chicago: 1957, pp. 55-56.

D. PUBLICATION OF THE GOVERNMENT: STATE AND FEDERAL

Reprint from The Code of Virginia, 1950 and 1962 Cumulative Supplement, Securities Act, Title 13-1, Corporations, Chapter 5, Charlottesville, Va., 1962.

U. S. Treasury Department, Internal Revenue Service, "Community Property," Document No. 5108 (12-63), Washington, D. C., 1963.

U. S. Treasury Department, Internal Revenue Service, "Corporations," Document No. 5180 (12-62), Washington, D. C., 1962.

U. S. Treasury Department, Internal Revenue Service, "Depreciation, Investment, Credit, Amortization, Depletion," Document No. 5050 (12-63), Washington, D. C., 1963.

U. S. Treasury Department, Internal Revenue Service, "Losses From Operating A Business," Document No. 5062 (12-63), Washington, D. C., 1963.

U. S. Treasury Department, Internal Revenue Service, "Partnerships," Document No. 5179 (12-63), Washington, D. C., 1963.

U. S. Treasury Department, Internal Revenue Service, "Rents and Royalties Income," Document No. 5060 (12-63), Washington, D. C., 1963.