WESTWORTH
CAPITAL PARTNERS

THE SIMPLEST GUIDE TO PASSIVE MULTIFAMILY INVESTING

Dami Fadipe
Managing Partner, Westworth Capital

Table of Contents

INTRODUCTION

The First Thing to Know

This is the simplest guide you will ever read. The first thing you need to know is this:

Real estate is not overly complicated.

When you're just starting out, it may not feel like that, but it's because you're still overwhelmed by countless possibilities.

To simplify your real estate journey, the initial step is to narrow down your focus.

In this guide, you will learn about passive investing in value-add apartment syndications, which will equip you with the necessary tools and knowledge to evaluate successful Operators (A.K.A, General Partners or Sponsors), identify lucrative deals, build an exceptional team, invest in the deals with confidence, and begin building your wealth.

To us, value-add apartment syndications represent the easiest, most reliable, and most profitable investment approach.

Are you prepared to begin?

Excellent, let's start by addressing the question:

CHAPTER II

Why Apartments?

Here are the top five reasons why apartment investing is highly appealing to us:

1 Stability

Stability means two things when it comes to apartments: Consistent Valuations and Consistent Demand.

First, we don't want assets whose value fluctuates wildly like the stock market.

We want steady, predictable returns which apartments deliver. For example, a 100-unit building doesn't experience a dramatic dip in revenue when one or two tenants move out. That's because there are enough other "customers" to smooth out the ups-and-downs of occasional vacancies.

Second, apartments are stable because they provide a fundamental necessity: housing. Unlike stocks, or gold, or bitcoin, people need a place to live, meaning they're always in demand.

2 High Risk-Adjusted Returns

If you want big returns, you have to suffer big risks... right?

Wrong.

In fact, research done by the Federal Reserve Bank of San Francisco shows that the housing market and stock market haven't followed the same patterns since before World War II. And while both real estate and stocks provide about the same returns (around 7%), housing returns are significantly more stable even in the face of market volatility. This makes real estate one of the rare assets that provides higher rewards without higher risk, with a risk profile on par with government bonds (low).

That is awesome, but the interesting thing is that real estate provides many more advantages, e.g., tax benefits, which we LOVE!

3 Control

During global uncertainties which impacts the stock market, seeing your life-savings rapidly drop can leave you feeling helpless.

With apartments, on the other hand, when market fluctuations occur, we have the ability to make operational changes that immediately reduce expenses, limit vacancies, and ensure our assets continue performing.

In short, **we are in control.**

4 Cashflow

Cashflow is the profit remaining after expenses have been deducted from top-line revenue. This profit is then returned to investors in the form of a monthly or quarterly distribution. Cashflow is powerful because it provides an ongoing stream of income to be used for any number of reasons (living expenses, a vacation, or reinvestment!).

5 Tax Benefits

The US government provides multiple tax benefits to real estate investors.

One of these tax breaks is realized through the magic of depreciation. Simply put, depreciation is the theoretical loss of value a building experiences over time as it ages and breaks down. The government allows investors to write off this loss.

I say theoretical, because the reality is real estate actually tends to appreciate in value over time. So we get the double benefit of an asset that is simultaneously appreciating and depreciating.

This means more money in your pocket now, rather than later, which is a powerful driver of wealth.

CHAPTER III

How Value Add-Multifamily Works

In the world of multifamily, three levers dictate a property’s value: **Revenue, Expenses, Cap Rate.**

Of these three levers, we control two of them:

Revenue and **expenses** play a pivotal role in any business. Increasing revenue and decreasing expenses lead to larger profits.

After subtracting Operational Expenses (ie: repairs, maintenance, taxes, insurance, payroll, lender's reserve requirement, etc…) from Gross Revenue, we are left with the Net Operating Income (NOI).

A commercial property’s value is derived by the following formula:

NOI/CAP RATE = VALUE

The capitalization rate is the rate of return the market currently demands for a particular asset class in a particular area.

Cap rates are tricky, but the important thing to know is they are dictated by the market, which means this is the lever we don’t control.

CHAPTER III CONTINUED

To execute a value-add deal, successful operators work hard to increase revenue and decrease expenses.

The most obvious way to increase revenue is charging more rent. But we can't just go demand ever-increasing amounts of rent for no reason, otherwise our tenants will leave.

The key is to find assets charging under-market rent and then find ways to increase value to the tenants so as to justify raising rents. This means upgrading units with new floors, cabinets, counter-tops, appliances, amenities, etc... See example of upgrades in the diagrams below.

With these improvements, these units now fetch a rent premium. For example, a unit currently renting at $800 might go for $900 after renovations. We can also decide to charge the tenants back for their water use in the case of master water meters. Another way is to implement paid preferred parking spots, internet service markup, where we contract a service provider at a $10/unit discount and then charge each unit at market rate for the internet use.

CHAPTER III CONTINUED

Sure, in the first example above, $100 doesn't seem like much, but that $100 a month equals $1,200 a year. If the apartment complex is 100 units, then that's an additional $120,000 per year in rental income.

That's fantastic, but that's not even the best part. Remember, to calculate a commercial property's value you divide NOI by cap rate (Value = NOI/Cap Rate). Assuming the current market cap rate is 7, then the asset's value has been increased by over $1.7 million ($120,000/7% = $1,714,285).

That is called Forced Appreciation and it's the reason the value-add model of investing is so powerful.

CHAPTER IV

What is a Real Estate Syndication?

Success in real estate requires purchasing an asset at the **right price**, in the **right location**, with the **right team** executing the **right business plan.**

Most people don't have the time, energy, nor desire to gain the knowledge, research the markets, find the deals, build the teams, or execute the business plan necessary to win in real estate.

That's where syndications come in.

Syndications are a way for a group of investors to pool their financial and intellectual resources to invest in large properties.

There are two types of investors in a syndication: **Passive** and **Active**.

Passive investors (aka the **Limited Partners**) supply the money to fund the deal.

On the active side are the **General Partners** (aka the **Sponsors**) who leverage their time and experience to identify viable markets, underwrite deals, secure bank financing, guarantee the loan, oversee the business plan by managing the property management company, ensuring strong investor relations, and managing the exit of the asset.

Think of a syndication like flying in a jumbo jet across the world.

CHAPTER IV CONTINUED

A group of passengers pool their money to fund the transcontinental flight. An experienced team of operators (pilots, flight attendants, maintenance crew, etc…) leverage their unique skillset to safely transport the group to the other side of the globe.

As the passenger, you pay for your ticket and enjoy the ride. That's all.

In an apartment syndication, the pilots are the General Partners and the passengers are the Limited Partners.

Every real estate deal requires three things: **Time, Knowledge, Money**.

In a syndication, the General Partners leverage their **time** and **knowledge**, while Limited Partners provide the **money**.

And that, in a nutshell, is a syndication.

TIP: If you are thinking about investing in a real estate syndication, a wise (and logical) question to ask is whether the General Partners are also investing their own money in the deal alongside the passive investors. This concept, in the real estate world, is called "having skin in the game". When sponsors also invest their own money, they are motivated to work harder than ever for the deal to be successful.

At Westworth Capital, we invest alongside our Limited Partners in 100% of our deals. Most times in the multiple of the minimum investment amount.

CHAPTER IV CONTINUED

HOW A SYNDICATION WORKS

Partnership Structure

A syndication is providing a security overseen by the Securities and Exchange Commission (SEC). Typically, securities require registering with the SEC, but syndicators are allowed to skip this registration by utilizing Regulation D Rule 506(b) or 506(c).

Rule 506(c) allows sponsors to advertise their offering to the whole wide world of Accredited Investors.

Under Rule 506(b), a sponsor can raise an unlimited amount of money as long as they do not publicly advertise or solicit investments from strangers.

506(b) vs. 506(c): At a glance

	506(b)	506(c)
Offering size	Unlimited	Unlimited
Who can invest	Accredited investors and up to 35 non-accredited investors	Accredited investors
Who certifies LP accreditation?	The LP	The GP
Can the GP advertise or publicly solicit?	No	Yes
Regulated by state blue-sky laws?	No	No

WHO IS AN ACCREDITED INVESTOR?

An accredited investor is an individual who either:

1. Makes $200,000 of annual income in the previous two years ($300,000 for a married couple)

Or

2. Has a net worth in excess of $1,000,000 (excluding the value of their primary residence)

For those not accredited, there is Rule 506(b) which allows "sophisticated" investors to participate in a syndicated deal.

A "sophisticated" investor is someone with sufficient knowledge and experience in financial and business matters to evaluate the risk and merits of a prospective investment. The downside of being a sophisticated investor is that you must have a pre-existing relationship with an operator before jumping into a deal.

If you're a sophisticated investor, you need to do two things before you can participate in a syndication:

1. Educate yourself

and

2. Build Relationships with Syndicators (this can be as simple as schedule a couple phone calls with us so we can learn more about you and your investing goals)

RISK

Most apartment syndications utilize bank financing.

This debt can be either recourse or non-recourse. A non-recourse loan means that the loan is secured only by the collateral of the property itself. If the borrower defaults, the bank can reclaim the property and that's it.

Recourse debt has no such limitations. If the borrower defaults, the bank can come after the loan guarantor's personal assets.

So, who is the loan guarantor?

That's the General Partners, and it's one of the roles they assume when securing the debt on the property. What this means for the Limited Partners is that they bare little risk in the case of a default.

COMPENSATION

Depending on the deal, passive investors get paid at a couple different points over the life of an investment.

Cashflow

Cashflow is the profit remaining after subtracting operational expenses from revenue. This surplus is distributed to investors in either monthly, quarterly, or annual distributions depending on the deal structure.

Exit Distributions

The biggest chunk of change comes during a refinance or ultimate sale of the property.

It's at these points you'll receive back the majority of your seed capital. If this happens due to a refinance, this reduces the amount of your own initial money in the deal, but you're STILL earning the same returns.

Not all deals utilize a cash-out refinance, but they're great when they occur. Otherwise, it's upon selling the property that you'll recapture all the forced appreciation in the form of a big payday exit.

Tax Benefits

Welcome to the wonderful world of depreciation, interest payment write offs, and expense write-offs.

In many cases, it's possible that your tax exposure will be reduced to zero (or even negative) despite benefiting from thousands of dollars of annual cashflow distributions.

These taxes can't be deferred forever, unfortunately. Uncle Sam will inevitably get his due when the property sells, but in the meantime, you'll have the benefit of cash in hand which can be reinvested and earning during that period before repayment.

The full breadth of tax benefits is beyond the scope of our purposes. Talk to your tax professional before making any decisions to see what's right for you.

The Equity Split

There are many ways to structure the equity split of a syndication, but let's keep it simple.

In the majority of deals, the equity split is around 70/30. That is, the Limited Partners are entitled to 70% of the returns and the General Partners receive 30%. These numbers vary depending on the operator, their track record, and the strength of the deal.

Many deals also offer a Preferred Return to the LPs, which means the Limited Partners are entitled to receive a percentage of the returns before the GPs receive any portion of the proceeds.

Preferred returns are great for Limited Partners because it puts their interests ahead of the GPs.

CHAPTER V

Finding the Money to Invest

A common reason people give for not investing in real estate is: I just don't have the money.

Which, to be fair, is a valid excuse.

But fear not, intrepid investor! There are hundreds of creative ways to raise funds for your first deal. Here are four of our favorites!

LIFE INSURANCE

Did you know you can borrow against the equity in your life insurance policy? Many active investors leverage their life insurance policy to buy their first investment property.

IRA

One of the most common ways to passively invest in a syndication is through a Self-Directed IRA. You do this by redirecting your current retirement savings out of the volatile stock market, and place it into stable alternative assets, like real estate.

The long-term, tax-free, compounded growth of this strategy is extraordinary.

401K

Another lesser-known source of capital comes from another retirement account most working professionals have sitting around: the 401(k).

Many people think you have to invest in the stock market with a 401(k), but that's not true.

If you have a 401(k) with a former-employer, you can roll those funds into a Self-Directed IRA (as discussed in the previous section).

HELOC

Most American's net worth exists in the from of equity in their primary residence. Unfortunately, all that equity is just sitting there... unused, Dead.

We don't like dead money. We want our money working while we sleep. When evaluating your Return on Equity (ROE), you should ask, Is this the highest and best use for this money?

In many cases, the answer is no.

A HELOC can be a great short-term capital option as the interest rates typically fluctuate between 1—2% over prime with an interest only payment structure over the term of the loan.

HELOC's might not be great for longterm debt, but it can be a great way to put some capital to work on a short-term basis (6-12 months).

The 12 Step-by-Step Process of a Syndicated Investment

Step 1	An attractive opportunity comes across your desk and the operator announces the deal is open for funding. The clock starts ticking.
Step 2	After reviewing the investment summary deck, notify the operator with your soft reserve. The soft reserve expresses your interest in the deal and how much you intend to invest. The soft reserve does not lock you into a specific number, nor does it guarantee a spot in the deal.
Step 3	The sponsor will likely hold a webinar, in-person meeting, or 1-on-1 investor phone calls to share more information on the deal and answer questions.
Step 4	The sponsor confirms your spot in the deal and how much you intend to invest. The PPM (private placement memorandum) will typically arrive within a week of the initial presentation (or as soon as feasible).
Step 5	The signed PPM and funds are due within 3-4 weeks of receiving the PPM. Get your paperwork and funds transferred quickly as syndications are popular investments and quickly fill up.
Step 6	Wire the funds to the sponsor 1-2 weeks before closing.
Step 7	The operator will notify you when the deal has successfully closed.

After Closing

Step 8	You should receive monthly communications from the operator providing general project updates.
Step 9	Cash flow distributions will likely be distributed quarterly along with financial updates on the project's performance.
Step 10	You'll receive a K1 tax form annually detailing how much you made/lost in that calendar year. You will more than likely see depreciation reducing your taxable income on the investment.
Step 11	Most deals have a projected hold period of 3-7 years. Over that period, there may be the opportunity for a refinance. If this occurs, you will receive a significant portion of your initial investment back. If the asset is sold, you'll receive your portion of the profits per the equity split detailed in the PPM.
Step 12	Fund the next deal!

CHAPTER VII

Key Metrics

Here are 4 common attributes of a deal passive investors use to gauge the quality of a potential investment.

Cash on Cash Return

The annualized returns relative to the initial amount invested.

This is the most common measure investors consider, because it quickly identifies your annualized return against how much you've invested.

If you invested $100,000, and received an annual distribution of $10,000, then your CoC return is 10%.

Internal Rate of Return

The total time-adjusted returns of an investment.

IRR accounts for how much money you've put into a deal at time 0 (when the deal starts), distributions, any proceeds from a cash out refinance or sale, and bundles them all together into one macro-return. From here, the return is adjusted to account for the time that's passed between when you invested the money and when you received those returns.

When you receive your return is an important driver of IRR, because it accounts for the Time Value of Money. Simply put, $1,000 today is worth more than $1,000 a year from now.

Appreciation

The organic or forced increase of an asset's value over time.

Appreciation is similar conceptually to inflation. That is, over time, resources increase in value while the strength of money in circulation (typically ever-increasing) slowly weakens.

While it's important to calculate organic appreciation into your underwriting assumptions, your model shouldn't overly rely on this mostly uncontrollable factor.

The important thing to note is:

Do not bank on organic appreciation

Now, "organic appreciation" is not to be confused with "forced appreciation", which is a different strategy that we mentioned earlier and is the backbone to the value-add model of multifamily investing we execute.

Equity Multiple

The total amount of distributions received divided by the amount of initial investment.

This metric isn't terribly important, but you should know it because many operators will try to use it to prove the strength of their deal.
If you invest $100,000, and it returns $200,000, then that is a 2x equity multiple.

The reason this number isn't so important is because it's influenced to a great degree by the length of the hold.

If one deal has an EM of 2x and the other has 2.5x, but that first deal is a 5 year hold whereas the second deal is a 10 year hold, then, that second deal isn't actually all that great, despite having a higher equity multiple.

Preferred Return

The claim on profits provided to investors.

A 7% preferred return means the passive investors receive a 7% return on their investment before the General Partners take any cut of the profit. Once that 7% hurdle is achieved, then the remainder of the profits are split between GP/LP according to the equity split.

This is a great way for General Partners to put their investors first by taking a backseat until they've provided a minimum satisfactory return on your money.

CHAPTER VIII

The Private Placement Memorandum

The Private Placement Memorandum (PPM for short) is a highly technical and lengthy document filled with legal jargon and disclaimers that informs you of all the inherent risks of an investment.

You should have your personal lawyer take a read-through.

With that said, **you** should also read the PPM. The document allows you to make a well-informed decision. Don't pass off responsibility for reading it.

Okay, so let's demystify the PPM so you can navigate it as efficiently as possible.

PPMs vary by the type of issuer, the size of the offering, and the number and type of investors being solicited, but each private placement memorandum should contain at least these five sections: **Executive Summary, Investment Strategy, Management and Experience, Summary of Principal Terms, and Risk Factors.**

- **Executive Summary**

This section presents a condensed description of the investment, usually including the investment thesis, pricing, minimum subscription amount, investor qualifications, disclosures of management fees, and a brief discussion of the issuer's governing documents.

Some things to look out for are disclaimers giving management too much latitude or discretion. Also, be on the lookout for potential conflicts of interest. This section should closely follow what has previously been stated in marketing materials and represented by company representatives.

If something pops up here that you've never seen before, that's a red flag.

- **Investment Strategy**

This section describes the operator's investment strategy, process, criteria, and exit strategy. Also, you'll find a description of the issuer's key competitive advantages and resources in the specified market.

This section is important because it explains the issuer's plan for achieving the targeted results. Look for a well-reasoned investment strategy that is clearly explained. A vague strategy lacking a cohesive narrative should be avoided.

- **Management and Experience**

Here, you'll find biographical and background information about the principals and key employees.

Remember, a successful investment is dependent on the management team. They are the pilots. If they fall asleep at the stick, or lack the training and experience to handle rough air, the plane will go down.

- **Summary of Principal Terms**

This is the most important section of the private placement memorandum. Here you'll find the organization of the company, fee structures, expense responsibilities, profit splits, and a detailed summary of the business plan. A careful analysis of this section provides most of the information necessary to fully comprehend the investment.

CHAPTER VIII CONTINUED

- **Risk Factors**

This section outlines all the ways the investment is risky or speculative. It speaks to all the known potential risk factors that might lead to the deal ultimately failing.

While certain risks are present in nearly all investments (natural disasters, bankruptcy, pandemic, etc...), pay close attention to the risk factors unique to that particular asset given the business plan, current market trends, and operator expertise.

Congratulations, you've invested in an apartment syndication!

Now what?

Let's break it down from the moment a deal closes until it's sold and what you should expect in-between.

CHAPTER IX

What to Expect After Closing

Upon closing

Expect a note from the operator the moment the deal officially closes. With many operators you can expect an Investor Guide, which will give you a high level overview of what to expect moving forward and answer some frequently asked questions.

This proactive communication setting expectations is one of the tell-tale signs of a great operator.

Included in this guide should be information about the timing and logistics of your cash flow distributions, how to set up auto-deposits, tax-related questions, and more.

Monthly

You should expect a communication from your operator every month for at least the first 6-12 months of a deal. These communications can take place via email, video recording, live webinar, or just a quick phone call.

In these communications you'll receive general high level updates about the progress of the deal such as, how many units have been renovated, current occupancy rates, whether renovations are on-track with the business plan, and occasionally some photos of the latest progress. This helps keep a pulse on the project.

Quarterly

The quarterly communication delivers more detailed financial reports, including the rent roll and profit and loss statement. These updates focus on the underlying financial picture and performance of the asset to date.

Annually

Every year you'll receive a Schedule K-1 for tax purposes. This document reports your share of the income, deductions, and credits. You'll receive a separate K-1 for each syndication you've invested in.

Westworth Capital

Westworth Capital specializes in value-add multifamily apartments that return strong, risk-adjusted returns to investors by leveraging years of expertise to extract maximum value from every asset it acquires.

Want to learn more? Reach out to schedule to schedule a 1-on-1 call. We can't wait to hear about your investing goals and how we might help you achieve them!

NEXT STEPS

Ready to Partner?

PHONE CALL
- Westworth and co-sponsors introduction
- Schedule an in-person or Zoom meeting

IN-PERSON / ZOOM MEETING
- Discuss your investing goals
- Learn about our process
- Preview a sample deal

INVESTMENT OPPORTUNITY
- Review deal deck
- Join investor webinar to learn more
- Place a soft commitment

FUND AN INVESTMENT
- Review Private Placement Memorandum(PPM)
- Sign Subscription Agreement
- Wire Funds

Contact us

Westworth Capital
info@westworthcapital.com
+1 469 393 3444