Real Estate Syndication

Barbara Hendrickson

BAX SECURITIES LAW

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Background

- A real estate syndication involves the pooling of money by a sponsor from numerous investors and investing these funds in real estate projects.
- The profits (or losses) are then distributed to the investors and the sponsors.
- This is often supplemented by debt for example a commercial loan secured by a mortgage which actually funds the balance of the purchase of the property or the development or redevelopment of the project.

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Background

- Investing in a real estate syndication is similar to investing in a real estate project.
- Common examples would be the purchase of land to develop a condo or a residential townhouse complex; the purchase of bare land for development purposes; or the purchase of commercial property for revenue purposes such as a commercial mall.

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Background

- Investors are passive investors and do not participate in locating and evaluating the property, the construction or redevelopment of the property, property management or the day-to-day operation of the project.
- Investor potential for profits include cash distributions and upside potential paid at disposition of the real estate asset or the resale or redemption of their securities.

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Sponsors

- The sponsor will use the investor’s funds to
  - to acquire commercial or residential property;
  - finance development and / or redevelopment costs;
  - to satisfy the lender’s equity requirements
- Used by sponsors in addition to traditional secured financing sources.
- Sometimes sponsors will raise 100% of the funds from investors necessary to complete a real estate project / investment.

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Sponsors

- Some sponsors invest directly in the syndication vehicle and some do not.
- Sponsor who invest will also receive a share of the cash flow and profits.
- Sponsors usually receive compensation for locating the property to be purchased, doing the due diligence for its acquisition and intended development, and closing the purchase of the property.
- The sponsor usually also receives a management fee, typically based upon a percentage of gross revenue on a yearly basis but sometimes on capital raised or the net asset value of the real estate owned.

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Sponsors

- Fees paid to the sponsor may include administration fees, capital raising fees, property acquisition fees, sales or assignment fees, loan origination fees, leasing fees, renovation fees, property management fees, loan guarantee fees, development and construction fees and performance fees.
- Often fees are also paid to affiliates of the sponsor including management, development, and construction companies as well as mortgage and real estate brokers and exempt market dealers.

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Application of Securities Laws

- Sponsors are required to comply with securities laws in the syndication process.
- Sponsors also required to provide the investors with all material information necessary to allow the investor to make an informed decision concerning the investment, which normally includes an offering memorandum (OM).
- The OM must not omit material facts or make untrue statements of material facts in connection with the offering.

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Types of Structures

- The business structure for a real estate syndication typically involves one of the following entities:
    - Limited partnership
    - Trust (REITS)
    - Corporation
- Often a sponsor will use a combination of the above.

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Limited Partnerships

- Real estate syndications for development or redevelopment purposes are often formed as limited partnerships (LPs).
- The rights and duties of the sponsors and the investors are set out in the limited partnership agreement.
- A LP provides investors with flow through tax treatment and limited liability providing that certain *Income Tax Act*.
- A LP consists of at least one general partner and one or more limited partners
- A LP is created by filing a Form 3 under the *Limited Partnerships Act* (Ontario)

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Limited Partnerships

- Limited partners have liability up to the amount that they contribute to the partnership as long as they do not violate the prohibition from taking control of the LP's business.
- The LP carries on business through the general partner and the GP's mandate and the LP are governed by the terms of the limited partnership agreement.
- Title to property acquired by the LP is generally held in the name of the GP or a title nominee on behalf of the LP and not the LP itself. The LP holds the beneficial ownership of the property and the GP or nominee owns the legal title.

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Limited Partnerships

- The limited partnership agreement contains safeguards and restrictions which provide additional protections for the limited partners including:
  - voting rights,
  - restrictions on the activities of the general partner,
  - related party transactions involving the GP,
  - rights to financial information regarding the activities of the LP, and
  - notifications requirements,
  - rights similar to oppression rights for investors in corporations

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REITS

- Real estate investment trusts (REITs) are based on a trust structure
- REITs are created through a declaration of trust
- A trust is a relationship between a trustee and beneficiaries with the trustee acting as an agent with respect to trust assets.
- The trustees powers and obligations are limited by the declaration of trust

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REITS

- Special rules under the *Income Tax Act* applies to REITs that are mutual fund trusts and allow for some flow through tax treatment.
- Unit holders of an Ontario REIT does not have limited liability protection unless the REIT is also reporting issuer under the *Securities Act*.
- Special exemptions from the payment by investors of land transfer tax and the non-resident speculation tax are available for certain types of REITs.

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REITS

- Units in a REIT that is a mutual fund trust may be qualified investments for registered investment purposes.
- A mutual fund trust must satisfy certain qualifying conditions under the Income Tax Act including certain redemption features and restrictions on activities of the trust; the types and location of the property owned; Canadian residency requirements and source of income for the trust

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REITS

- A "mutual fund trust" must satisfy other among qualifying conditions under the Income Tax Act including that:
    - there has been a lawful distribution of units to the public and
    - one class of units satisfy the following test: there are no fewer than 150 beneficiaries each of whom hold at least one "block" of units with a FMV of $500

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Corporations

- Sponsors of real estate projects may choose a corporate structure in certain circumstances.
- Corporations do not have the flow through characteristics of a LP or a REIT.
- The securities of corporations listed on an exchange are eligible for registered accounts.

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Corporations

- Private corporations that meet the requirements of a "public corporation" under the *Income Tax Act* are eligible for investment in a registered account
- The requirements for a public corporation are similar to those for a REIT: 150 shareholders holding "blocks" of shares worth $500 each and the filing of a disclosure document with a securities commission.

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Other Strategies

- Some sponsors will use a combination of syndicated mortgages, mortgage investment corporations and other corporate structures to raise money from retail investors.
- These investment vehicles are regulated by the Ontario Securities Commission and the Financial Services Commission of Ontario (FSCO)

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Disclaimer

- These materials have been prepared for informational purposes only.
- These materials do not constitute legal advice and cannot be relied upon.

BAX Contact Information

- Barbara Hendrickson
- BAX Securities Law
- Suite 300 155 University Avenue
  Toronto Ontario M5H 3B7
- Tel: 416.601.1004
- Cell: 647.403.4606
- bhendrickson@baxsecuritieslaw.com
- www.baxsecuritieslaw.com

www.linkedin.com/in/barbara-hendrickson/#

https://twitter.com/BAXhendrickson