

Who's Really Winning?

Critical questions to safeguard your investment

When you're presented with an investment opportunity in real estate, especially through a friend, acquaintance, chavrusah, family member, broker, or syndicator, it's crucial to pause and reflect. While these investments seem lucrative, there are many underlying factors that are often glossed over in the glossy presentations and enticing pitches. Let's break down some important points to consider before making any decisions.

Who's really living large?

Take a moment to look around. Who appears to be benefiting the most—investors or syndicators? The one giving the money or the one taking the money? Syndicators often flaunt big houses, luxury cars, and exotic vacations. While they may tell you that your investment will yield substantial returns, their wealth is often a direct result of the various fees and kickbacks they collect—not necessarily the success of the investments they manage.

Why isn't the syndicator investing their own money?

If the deal is truly as good as it sounds, why isn't the syndicator using their own money? This is a key question to ask. If a syndicator truly believes in the success of a project, you would expect them to invest their own funds. After all, if the returns are so promising, wouldn't they want to maximize their gains? The fact that they rely on other people's money may be a sign that the deal isn't as lucrative as it appears and that inflated fees are driving the deal.

Who's really investing in this deal?

If this deal is so attractive, why aren't other experienced real estate investors pursuing it? Most deals today are shared on public platforms and circulated to the entire industry. Perhaps they've already reviewed the deal and decided it wasn't worth the risk, leaving the deal for less experienced syndicators who then turn to less experienced or 'innocent' investors to fund the risky project.

Hidden fees: what you might not know

Did a friend, neighbor, or chavrusa introduce you to the investment? What you may not realize is that they likely are receiving a fee or commission for bringing you on board. Even if the investment doesn't perform well, they still get paid. Meanwhile, the syndicator often collects substantial fees—acquisition fees, markups, and kickbacks—before the project has even generated any returns for investors.

The reality of public vs. private investments

When considering real estate investments, it's worth comparing private syndications with public investment products. The S&P 500 and many mutual funds, for example, have returned over 10% per year on average over a 10-year period. Publicly traded real estate investment trusts (REITs) have historically returned similar results annually and are regulated and audited. Unlike private syndications, which don't report data and have been susceptible to Ponzi schemes and fraud, REITs operate with mandatory oversight, making them a safer option for many investors.

Lack of supervision: the risks of unregulated investments

We understand the risks of an unfiltered internet, but what about the risks of unregulated investments? When syndicators handle other people's money without proper supervision, the temptation to engage in inappropriate or unethical behavior can increase. Without proper oversight, it's easier for things to go wrong behind the scenes, often to the detriment of investors.

Underperformance of investments

It's a common misconception that every real estate investment will meet or exceed its pro forma projections. In reality, many investments don't perform as well as initially promised. Investors may experience delayed dividends or even losses of their invested principal. This can be a rude awakening for those expecting guaranteed returns from their earnings and life's savings.

The role of third-party professionals

While third-party professionals like underwriters, appraisers, and financial reviewers are often involved in evaluating a deal, it's important to remember that these professionals are paid by the syndicator. Their goal is often to make the deal look attractive to investors, which can sometimes lead to biased or overly optimistic assessments.

The dangers of cash calls

Have you heard of a cash call? This occurs when a syndicator asks investors to contribute additional funds to a project. If investors can't or choose not to come up with the money, they risk losing their equity or having their ownership share diluted. Cash calls can create unexpected financial strain and are something to be cautious about. It's solely up to the syndicator to initiate a cash call. The investors have no say in the decision. A syndicator can use any excuse to raise additional cash. Excuses include—renovations, banking requirements, loan covenants, additional staffing, increased property tax, higher operating expenses, lower rental income, higher insurance premiums, capital expenses, increased vacancy, leaks, inclement weather, roof repairs, just to name a few.

Side agreements and unequal treatment

Syndicators may enter into side agreements with larger investors, giving them preferential treatment and leaving smaller investors with less favorable terms. This can mean the difference between A shares and B shares, where larger investors get a better deal while smaller investors bear more risk or receive lower returns.

In conclusion

Investing in real estate can be a powerful way to build wealth, but it comes with risks, especially when relying on syndicators who may not have your best interests at heart. Before committing to any deal, consider the points above and do your due diligence. Understand who is really benefiting from the investment, what the risks are, and whether or not the returns justify the potential downsides. By taking a thoughtful and informed approach you can better protect yourself and your financial future.

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