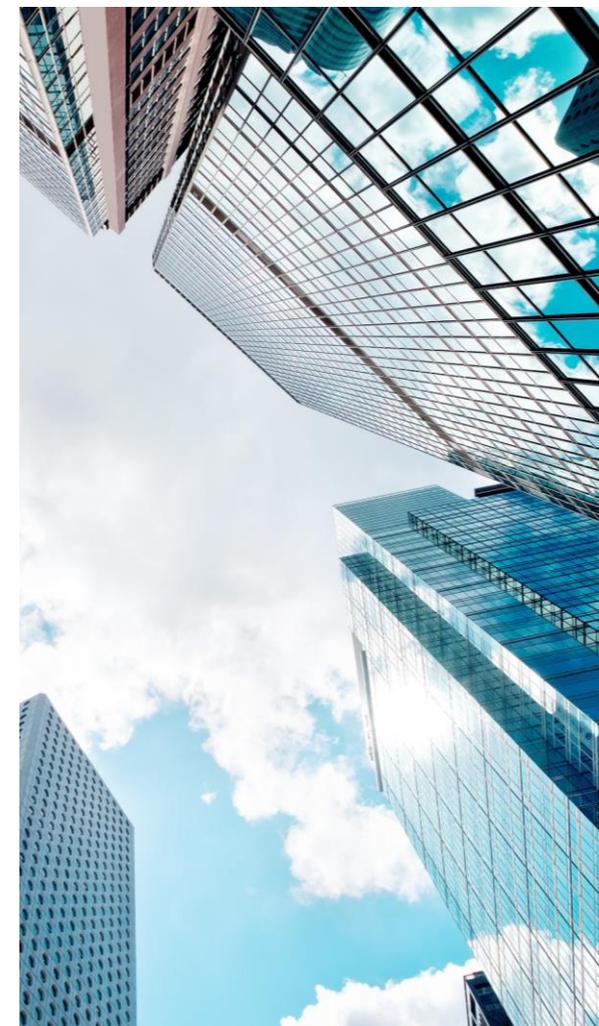




# Using Preferred Equity to Increase Real Estate Investors' Leverage and Enhance Returns

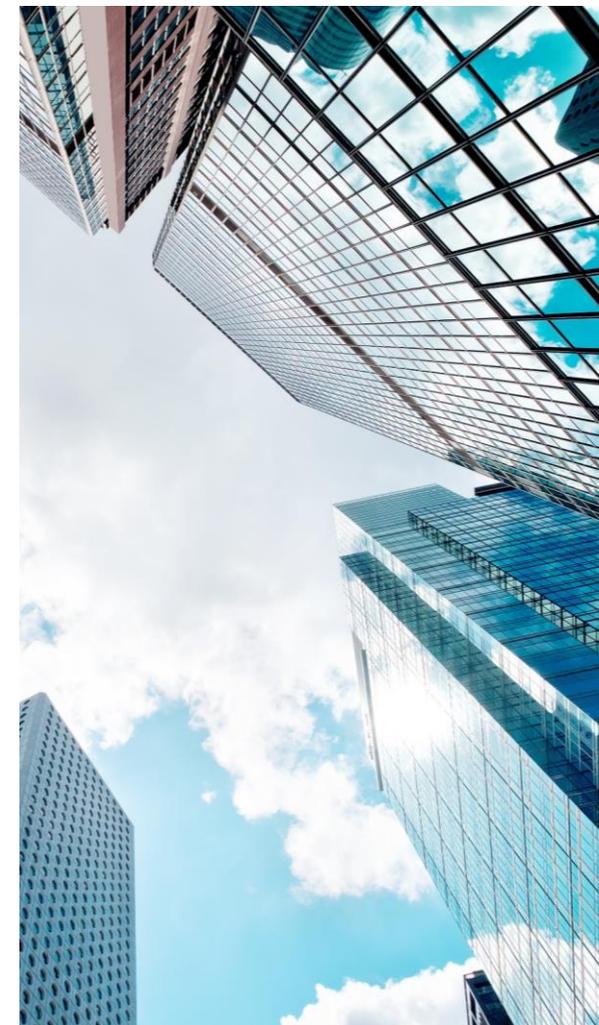
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# Introduction



**Using preferred equity helps real estate investors and developers (collectively, “Sponsors”) increase project leverage and close more deals.**

Ron Zimmerman, president of NetLeaseX Capital LLC (“**NetLeaseX**”) knows the “ins and outs” of raising preferred equity and has written about it in a featured article he wrote for the *Scotsman Guide* (for which a link is provided to the right).

In this presentation, we discuss how NetLeaseX works with Sponsors to structure investment relationships with “below the radar” high net worth investors, family offices, registered investment advisors, equity funds, and institutional investors (collectively, “**NetLeaseX Investors**”) to help Sponsors, including non-institutional sponsors and even new sponsors who lack financial resources, to raise preferred equity so that they can close more deals and earn more fees.

Many of NetLeaseX Investors are seasoned and successful real estate investors and developers who know real estate and are interested in passively “riding on the coattails” of profitable real estate investments and empowering Sponsors to handle the day to day management and operation of their projects.



## “Strategize with Preferred Equity”

*Scotsman Guide Commercial Edition*  
December 2018

Reprint can be downloaded at [NetLeaseX.com/articles](https://www.netlease.com/articles)

The *Scotsman Guide* is a leading industry publication for commercial real estate lenders and loan brokers.

# NetLeaseX’s Approach is the Opposite of Crowdfunding



NetLeaseX’s hands-on and structured investment approach facilitates higher returns with a lower level of risk than typical alternative commercial real estate investments.

The table below describes how NetLeaseX’s direct investment approach is different than the group investment approach used by “retail” crowdfunding websites like Realty Mogul, CrowdStreet or EquityMultiple.

Description	Crowdfunding Platforms	NetLeaseX Platform
<p><b>Number of Investors per Transaction</b></p>	<p><b>Many.</b> Crowdfunding websites aggregate capital from many investors, many of whom are inexperienced and are making small dollar investments.</p>	<p><b>One.</b> Using NetLeaseX’s direct investment approach, NetLeaseX finds one investor per Sponsor transaction. NetLeaseX investors’ profiles include, among others:</p> <ol style="list-style-type: none"> <li>1. “Below the radar” investors who built their wealth investing in real estate,</li> <li>2. Investors with substantial real estate experience and familiarity with structured investments, and</li> <li>3. Older investors who are no longer interested in managing and operating real estate investments.</li> </ol> <p>In general, NetLeaseX’s investors prefer to “ride on the coattails” of profitable real estate investments managed by operating partners</p>
<p><b>Due Diligence and Project Underwriting</b></p>	<p><b>Centralized.</b> Crowdfunding platforms underwrite proposed projects in house and only list projects on their websites that have been approved by their investment committees.</p>	<p><b>Decentralized.</b> NetLeaseX’s investors:</p> <ol style="list-style-type: none"> <li>1. Perform their own due diligence,</li> <li>2. Have considerable capital to deploy,</li> <li>3. Have a wide range of risk and return criteria, and</li> <li>4. Have flexibility in how they invest their capital.</li> </ol>

# NetLeaseX's Approach is the Opposite of Crowdfunding (Continued)



The table below describes how NetLeaseX's direct investment approach is different than the group investment approach used by "retail" crowdfunding websites like Realty Mogul, CrowdStreet or EquityMultiple.

Description	Crowdfunding Platforms	NetLeaseX Platform
<p><b>Project approval rates to list projects on crowdfunding aggregators' and NetLeaseX's platforms</b></p>	<p>Top crowdfunding websites only list approximately 1 to 2% of submitted projects on their websites.</p>	<p>NetLeaseX expects to list approximately 15 to 20% of submitted projects on its platform. NetLeaseX believes that, since Sponsors expend substantial resources to plan and execute their projects, they deserve to be reviewed by the substantial number and range of NetLeaseX investors.</p> <p>In other words, NetLeaseX believes the market should decide whether or not a project should be funded, rather than allowing an investment decision to be made by a crowdfunding aggregator's internal investment committee.</p> <p>NetLeaseX works with and relies on its investors' experience and creativity to figure out how to fund listed projects, provided that the Sponsor's projections indicate that NetLeaseX's investors can generate a minimally acceptable IRR. Many of NetLeaseX's investors have a particular property type expertise and/or are familiar with a particular location, which may enable them to offer a Sponsor a customized funding solution. This approach is the opposite of that of crowdfunders, which turn down 98-99% of the investments offered to them.</p>
<p><b>Sponsor's relationship with project investors</b></p>	<p>The crowdfunding aggregator (as opposed to the Sponsor) has the direct relationship with its investors.</p>	<p>With only one investor investing in a Sponsor's project, Sponsors develop close working relationships with NetLeaseX's investors. In doing so, Sponsors have the opportunity to develop "programmatic" relationships with NetLeaseX's investors that lead to repeat investments in future projects on the same or more attractive terms and conditions.</p>

# Why Preferred Equity?



Preferred equity is raised through a newly-formed entity (like an LLC), which is owned by the Sponsor and which takes title to real estate. The Sponsor's interest in the entity can be structured in several alternative ways that have in common the benefit of equity-like returns with a risk profile that is usually only available to debt investors.

## How do we do it?

- ✓ All Sponsors and/or their co-GP investors must have an investment in the LLC that is subordinate to and is in a first loss position. If the project underperforms, the Sponsor's and/or their co-GP's capital investments bear all of the losses before the NetLeaseX Investors' capital and preferred return are at risk. In return for agreeing to be subordinate to the NetLeaseX Investors' capital, the Sponsors will receive a promote of approximately 30% of project profits.
- ✓ NetLeaseX Investors like making preferred equity investments because:
  - They invest in an asset class they know and understand
  - Receive higher preferred returns than the returns that are available to owners of common interests.
  - Invest higher in the capital stack; thus, reducing risk if the project fails to perform as expected

## Preferred equity and co-GP capital are equity, not debt

No debt service requirements or funding interest reserves are necessary. Distributions will only be made to NetLeaseX Investors if and when there is available cash flow after (a) payment of the senior loan, (b) operating expenses of the project, and (c) any amounts set aside by agreement of the managers as reserves.

## No standard forms or terms and conditions for preferred equity investments

NetLeaseX 's will have documents drafted custom-tailored to meet the needs and requirements of Sponsors' specific transactions.

# Overview of Gap Financing



Mezzanine loans, preferred equity and co-GP capital all “fill the gap” between the senior debt and sponsor’s equity.

NetLeaseX Investors’ funds act as subordinate or gap financing to “fill the gap” between the Sponsor’s senior debt and equity and, therefore, increase project leverage.

- ✓ Each level of capital invested in a Sponsor’s project (the “capital stack”) carries different risks and returns. The senior debt has with the highest priority of repayment with the lowest expected return followed by the mezzanine loan and then the project equity.
- ✓ All distributable cash flow will be paid first to the preferred equity investor and then the Sponsor. If a Sponsor seeks to raise co-GP capital as a way to further reduce his/her investment, the co-GP investor would be paid after the preferred equity investor and typically before the Sponsor.

# Different Types of Gap Financing

Gap financing includes several time-tested financing techniques that increase financial leverage and enhance returns.

1

## Mezzanine Loan

In lieu of loaning money to the Sponsor, which is secured by a mortgage or deed of trust, a Sponsor can pledge his/her membership interest in the borrowing entity to secure repayment of a mezzanine loan.

2

## Preferred Equity

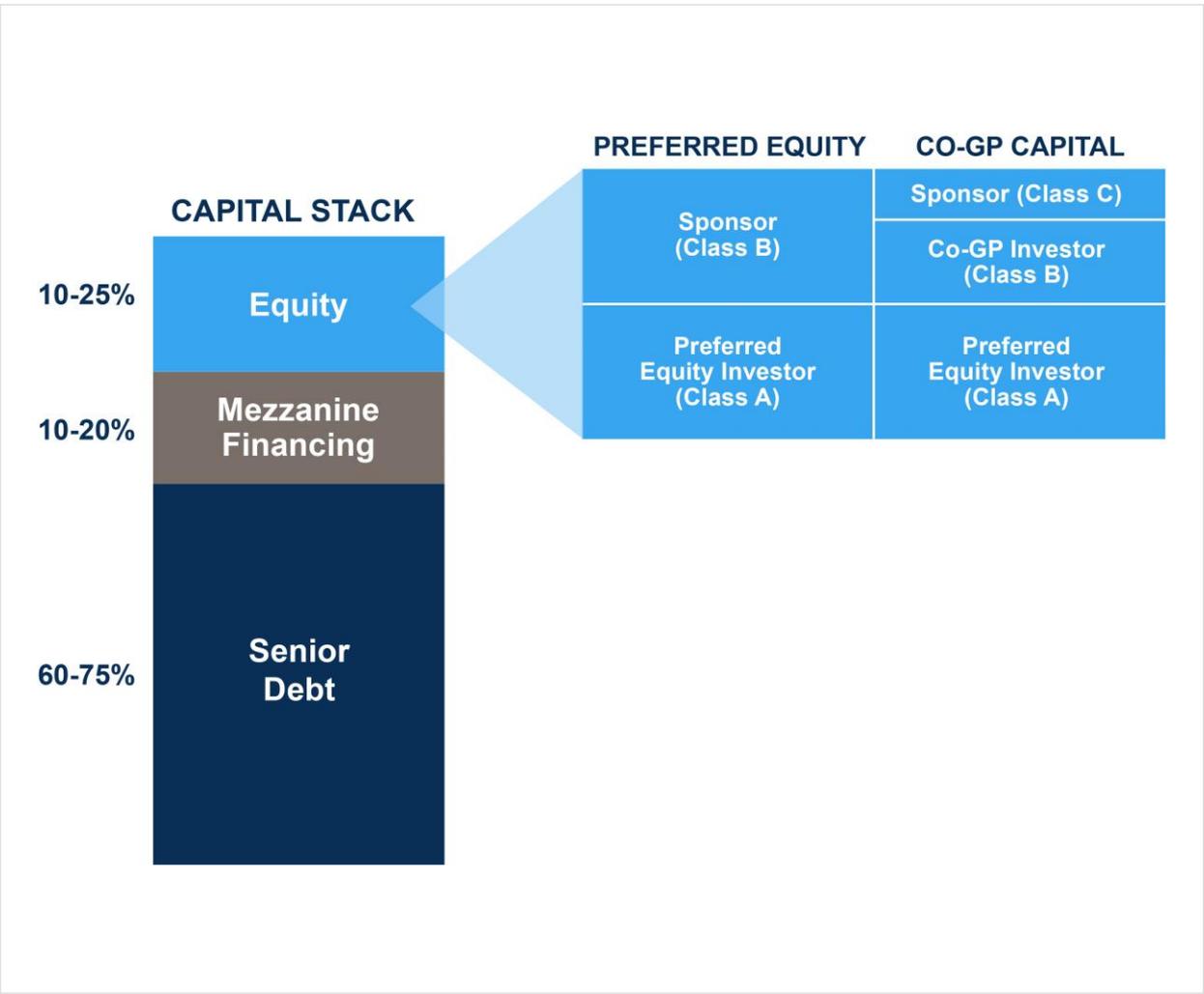
Often, senior lenders prohibit the use of subordinate debt – such as mezzanine financing. In such a case, the Sponsor will need to raise preferred equity through the Sponsor's entity. By implementing an A/B waterfall structure, the Sponsor's entity can issue senior Class A preferred to a NetLeaseX Investor and subordinate Class B preferred to the Sponsor.

3

## Co-GP Capital

If a Sponsor wants to maximize project leverage, the Sponsor can raise co-GP capital by having the Sponsor's entity issue one or more additional classes of preferred. In this case, the preferred equity investor would receive the Class A preferred, the co-GP investor would receive Class B preferred, and the Sponsor would receive the first-loss Class C preferred.

# Capital Stack Illustration of Different Types of Gap Financing



If a Sponsor has less than 20% of the required equity contribution, in certain situations, NetLeaseX may work with the Sponsor to raise co-GP capital. If a Sponsor raises co-GP capital, a co-GP investor will receive:

- ✓ Proportional percentage of the Sponsor's promote.
- ✓ Portion of any fees and payments authorized to be paid to the Sponsor.

# Obtaining a Convertible Loan Instead of Raising Preferred Equity

A convertible loan is a high leverage loan that includes provisions that provide NetLeaseX Investors with options to convert all or part of the loan amount into preferred equity. Convertible loans are typically secured by first mortgages on the Sponsors' projects, but can also be secured by second mortgages or with UCC-1 financing statements on the Sponsors' membership interests in the LLCs in the same way as mezzanine loans are secured.

NetLeaseX Investors have the right to convert their loans into preferred equity at a negotiated conversion rate so that the Sponsor can earn a promote just as if the Sponsor raised capital with preferred equity.

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## When to Use a Convertible Loan

- ✓ Sponsors should consider a convertible loan instead of incurring a high cost of capital by raising senior debt financing from a hard money lender. For example:
  - When a Sponsor needs to close on the acquisition of land associated with a development project, especially when the Sponsor is facing a “drop dead” closing date,
  - Where a Sponsor is unable or unwilling to sign with recourse on a conventional bank loan,
  - When a Sponsor needs to raise financing to fund the completion of a project midway through construction, or
  - When a Sponsor needs to reduce the carrying costs by paying a pay rate of 3 to 4% instead of prefunding an interest reserve at a much higher interest rate on a hard money loan.



# Sponsor Benefits in Obtaining a Convertible Loan



Convertible loans are like a senior stretch loans where the Sponsors receive higher loan to cost loans compared to the loan amounts that a hard money lender would advance.



Lower pay rate relative to hard money or land loans

- In order to help Sponsors reduce carrying costs during the predevelopment phase, the “pay rate” on convertible loans can be as low as 3% to 4% per annum, with the unpaid interest accruing and payable to NetLeaseX Investors when the Sponsors pay back the convertible loans



Sponsor may be able to negotiate the right to pay off the convertible loan; thereby, not having to dilute its equity ownership in a project



Interest paid on a convertible loan is tax deductible



# General Terms and Conditions for Mezzanine Financing



The terms sought by mezzanine lenders in today's market vary depending on the financial strength and experience of the borrower and the type of property financed.

1	<b>Structure:</b>	Pledge of 100% of the partnership, membership interest or common stock in the borrower, or the entities which own the borrower
2	<b>Product Types:</b>	All major commercial uses including multifamily, office, retail and industrial and possibly other product types like self-storage, senior housing and hospitality based on a particular lender's loan criteria
3	<b>Loan Size:</b>	\$1 million minimum; no maximum loan amount
4	<b>Loan Term:</b>	Up to 3 years, with options for additional 1-year extensions
5	<b>Maximum LTV:</b>	Up to 85% of the "as-is" appraised value or purchase price, whichever is less
6	<b>Interest Rate:</b>	Approximately 7% – 12% per annum, depending on project leverage, debt service coverage, evaluation of the underlying real estate and strength and experience of the sponsorship
7	<b>Debt Service Coverage:</b>	1.0x to 1.3x depending on property type and circumstances
8	<b>Amortization:</b>	Interest only
9	<b>Prepayment:</b>	Negotiable lockout period, typically no less than 6 months

# General Terms and Conditions for Mezzanine Financing (Continued)



The terms sought by mezzanine lenders in today's market vary depending on the financial strength and experience of the borrower and the type of property financed.

<b>10</b>	<b>Organization Fees:</b>	Typically, 1 to 2% of the loan amount
<b>11</b>	<b>Exit Fees:</b>	Negotiable
<b>12</b>	<b>Reserves:</b>	Real estate taxes, hazard insurance, replacement reserves, redevelopments costs (if any) and mortgage interest
<b>13</b>	<b>Ownership:</b>	Single asset, bankruptcy-remote entity
<b>14</b>	<b>Recourse:</b>	Depends on the lender. If the loan is non-recourse, the lender will typically require the borrower to provide limited recourse for "bad boy" or standard carve-outs, including fraud, misapplication of funds, waste, property taxes, and environmental issues.
<b>15</b>	<b>Deposit:</b>	Depends on the lender. The amount deposited with the lender upon acceptance of their term sheet covers site inspection, third party posts, legal and closings costs. The deposit will vary depending on the lender and/or the property or project to be financed.
<b>16</b>	<b>Closing:</b>	1 to 4 weeks from the date after loan approval and lender's receipt of deposit
<b>17</b>	<b>Third Party Reports:</b>	MAI appraisal, Phase 1 environmental, feasibility and any other reports as required by the lender

# General Terms and Conditions for Preferred Equity Financing



The information below provides a general outline of NetLeaseX's preferred equity financing.

1	<b>Investment Amount</b>	\$500,000 minimum, no maximum
2	<b>Investment Structure:</b>	Preferred membership interest in the ownership entity
3	<b>Preferred Return:</b>	10% per annum, cumulative from investment date
4	<b>Common Interests:</b>	NetLeaseX's Investor receives a 40-50% common membership interest in the development entity for a nominal amount, in consideration for the NetLeaseX's Investor investing in your project.
5	<b>Sponsor Contribution:</b>	Approximately 15% to 20% of the total equity investment for which the Sponsor receives the same 10% preferred return as the NetLeaseX Investor but subordinate to the NetLeaseX Investor's interest. If the Sponsor is unable to invest 15% to 20% of the required equity, NetLeaseX will work with the Sponsor to raise additional equity via a co-GP investment.
6	<b>Leverage:</b>	Low cost first mortgage debt from a third-party lender is needed. Ideal leverage is 65 to 75%. NetLeaseX can arrange the senior debt at a very competitive rate and terms if you need help in doing so. Low cost first mortgage debt from a third-party lender is needed. Ideal leverage is 65 to 75%. NetLeaseX can arrange the senior debt at a very competitive rate and terms if you need help in doing so.
7	<b>Development Entity Distributions:</b>	Net cash flow from the operation and resale of the project will be applied in the following manner: <ul style="list-style-type: none"><li>• Pay debt service on any project-related loans;</li><li>• Pay 10% per annum cumulative preferred return on the NetLeaseX Investor's Class A preferred membership interest;</li><li>• Redeem the NetLeaseX Investor's Class A preferred membership interest;</li><li>• Pay 10% per annum cumulative preferred return on the Sponsor's Class B preferred membership interest;</li><li>• Redeem the Sponsor's Class B preferred membership interest, and</li><li>• After all of the preferred membership interests have been redeemed (and all cumulative preferred return have been paid), all remaining cash flow from the operation and resale of the project will be distributed to the NetLeaseX Investor and the Sponsor as the holders of the common membership interests.</li></ul>

# General Terms and Conditions for Preferred Equity Financing (Continued)



The information below provides a general outline of NetLeaseX’s preferred equity financing.

<b>8</b> <b>Term of Investment</b>	Maximum 5 years
<b>9</b> <b>Product Types:</b>	All real estate types, including land
<b>10</b> <b>Design Making:</b>	Major decisions (e.g., termination of manager, sale, or refinancing) will require the NetLeaseX Investor’s approval
<b>11</b> <b>Senior Loan Recourse:</b>	The Sponsor will be solely responsible for submitting financial statements and any necessary loan recourse and personal guaranties to the senior lender.
<b>12</b> <b>Preferred Investment Recourse:</b>	Non-recourse, except for standard carve-outs. A completion guaranty may be required on development or rehab projects.
<b>13</b> <b>Closing:</b>	Typically, 4 weeks. However, as fast as 10 days from the date of receipt of all requested due diligence items.

# General Terms and Conditions for Co-GP Investment Financing



The information below provides a general outline of NetLeaseX's Co-GP investment financing.

1	<b>Investment Amount</b>	\$500,000 minimum, no maximum
2	<b>Investment Structure:</b>	Preferred membership interest in the ownership entity
3	<b>Preferred Return:</b>	10% per annum, cumulative from investment date
4	<b>GP Contribution:</b>	Approximately 15% to 20% of the total equity investment for which the Sponsor receives the same 10% preferred return as the other members in the LLC and Sponsor will be subordinate to and in a first loss position relative to the preferred equity and co-GP's interests.
5	<b>Common Interests:</b>	The co-GP investor will receive a proportional percentage of the Sponsor's common membership interest in the development entity for a nominal amount, as consideration for their co-GP investment in the Sponsor's project. For example, if the Sponsor would own a 50% of the common membership interest and the co-GP investor invests 50% of the Sponsor's required investment, the co-GP investor will own 25% of the common membership interest in the project. In addition, the co-GP investor will receive a proportional amount of any fees and costs authorized to be paid to the Sponsor in the project.
6	<b>Leverage:</b>	Low cost first mortgage debt from a third-party lender is needed. Ideal leverage is 65 to 75%. NetLeaseX can arrange the senior debt at a very competitive rate and terms if you need help in doing so.
7	<b>Development Entity Distributions:</b>	<p>Net cash flow from the operation and resale of the project will be applied in the following manner:</p> <ul style="list-style-type: none"><li>• Pay debt service on any project-related loans;</li><li>• Pay 10% per annum cumulative preferred return on the NetLeaseX Investor's Class A preferred membership interest;</li><li>• Redeem the NetLeaseX Investor's Class A preferred membership interest;</li><li>• Pay 10% per annum cumulative preferred return on the Sponsor's Class B preferred membership interest;</li><li>• Redeem the Sponsor's Class B preferred membership interest, and</li><li>• After all of the preferred membership interests have been redeemed (and all cumulative preferred return have been paid), all remaining cash flow from the operation and resale of the project will be distributed to the NetLeaseX Investor and the Sponsor as the holders of the common membership interests.</li></ul>

# General Terms and Conditions for Co-GP Investment Financing (Continued)



The information below provides a general outline of NetLeaseX’s preferred equity financing.

8	<b>Term of Investment</b>	Maximum 5 years
9	<b>Product Types:</b>	All real estate types, including land
10	<b>Design Making:</b>	Major decisions (e.g., termination of manager, sale, or refinance) require the preferred equity investor’s approval
11	<b>Senior Loan Recourse:</b>	The Sponsor will be solely responsible for submitting financial statements and any necessary loan recourse and personal guaranties to the senior lender.
12	<b>Preferred Investment Recourse:</b>	Non-recourse, except for standard carve-outs. A completion guaranty may be required on development or rehab projects.
13	<b>Closing:</b>	Typically, 4 weeks. However, as fast as 10 days from the date of receipt of all requested due diligence items.

# General Terms and Conditions for Convertible Loan Financing



The terms sought by NetLeaseX's private lenders in today's market vary depending on the financial strength and experience of the borrower, the situation of the borrower and the type of property financed.

1	<b>Structure:</b>	First or second mortgage, and pledge of 100% of the partnership or membership interest or common stock in the borrower (or the entities that own the borrower)
2	<b>Product Types:</b>	All major commercial uses, and special situations including land acquisition and/or development and construction completion financing
3	<b>Loan Size:</b>	\$1 million minimum; no maximum loan amount
4	<b>Loan Term:</b>	Up to 3 years, with options for additional 1-year extensions
5	<b>Maximum LTV:</b>	Up to 90% of the borrower's development or project cost
6	<b>Interest Rate:</b>	Approximately 11% to 13% per annum, depending on project leverage, evaluation of the underlying real estate and strength and experience of the sponsorship and borrower's situation
7	<b>Pay Rate:</b>	As low as 3 to 4% per annum, depending on project leverage, evaluation of the underlying real estate and strength and experience of the sponsorship and borrower's situation
8	<b>Amortization:</b>	Interest only with any accrued and unpaid interest due and payable upon pay off of the loan amount
9	<b>Conversion Terms:</b>	Negotiable, based on evaluation of the underlying real estate and strength and experience of the sponsorship and borrower's situation and whether if the borrower has the right to pay off the loan negating the lender's conversion right
10	<b>Prepayment:</b>	Negotiable lockout period, typically no less than 6 months

# NetLeaseX's Focus to Raise Capital for Non-Institutional Investors and Developers



Although NetLeaseX works with institutional investors and developers, NetLeaseX's Investors also invest in non-institutional and even first-time sponsor projects.

While NetLeaseX's Investors are interested in all profitable real estate investments, they are particularly interested in financially backing non-institutional investors who can generate above market returns.



- ✓ The deal terms that NetLeaseX negotiates with the Sponsors may vary, in part, based on the following:
- Projected profitability of the underlying project
  - Percentage of Sponsor contribution relative to total equity to be raised
  - Sponsor's experience and track record
  - Sponsor's financial net worth
  - Sponsor's cash liquidity



# Class A Preferred with Equity Kicker

At or before closing, the Sponsor and the NetLeaseX Investor will receive common membership interests by nominally capitalizing the LLC to which the property has been transferred. In addition, the Sponsor and the NetLeaseX Investor will receive preferred membership interests for their respective investments in the LLC.

## The Investment Process – Forming a Joint Venture:

1. NetLeaseX's Investor and Sponsor each purchase 50% of the common interests in a newly-formed joint venture LLC.
2. NetLeaseX's Investor contributes 80% of the required project equity and receives Class A preferred interest.
3. The Sponsor contributes the remaining 20% of the project equity and receives the first-loss Class B preferred interest.
4. The Sponsor will receive credit for any funds previously invested in the project and any additional cash that, taken together, equates to 20% of the project's total equity.
5. The Sponsor is responsible for providing a personal financial statement and obtaining the senior debt financing and will need to sign any required recourse, indemnities, "bad-boy" carveouts, and/or completion guaranties.
6. Based on a 50/50 split of future profits, the Sponsor effectively receives a 30% promoted interest in the project. Alternatively, the Sponsor and NetLeaseX may agree to a multi-tiered waterfall in which the Sponsor earns a higher, stair-stepped percentage of profits when hitting certain project-level internal rates of return.



**NetLeaseX**  
Investors can invest in one or more different classes of preferred, including the senior/subordinated co-GP preferred class.

# Waterfall Distribution at Sale of Project



Distribution of net proceeds from the operation and sale of the project will be as follows:

1

**First,**

Pay a **10.0%** cumulative annual return to the NetLeaseX Investor,

2

**Second,**

Return the NetLeaseX Investor's Class A preferred investment,

3

**Third,**

Pay a **10.0%** cumulative annual return to the Sponsor,

4

**Fourth,**

Return Sponsor's Class B preferred investment, and

5

**Fifth,**

The balance, **50%** to the NetLeaseX Investor and **50%** to the Sponsor, based upon the members' respective ownership of the common interests in the LLC.

# Opportunities to Flip Project or Co-Sponsor with NetLeaseX Investors

If a Sponsor is unable to procure senior debt financing on his own and/or does not have the financial resources to invest a minimally required amount in the project, Sponsors may be able to “flip” their projects to a NetLeaseX Investor. If a Sponsor decides to take advantage of an opportunity to sell the Sponsor’s project, the Sponsor would:

- ✓ Receive a fee from the NetLeaseX Investor in consideration for the Sponsor’s assignment of its rights to all pre-development work, including:
  - The Sponsor’s financial projections, analysis and other work,
  - The work product performed by others, including, but not limited to architects, engineers, general contractors and land-use counsel,
  - All entitlements and/or approvals received from governmental authorities, and
  - All third party reports.
- ✓ Alternatively, the NetLeaseX Investor and Sponsor may enter into an agreement that provides for the Sponsor to stay involved in the project in a more limited role and to receive from a NetLeaseX Investor (a) a promoted interest, and/or (b) fees for services as a developer or as a co-sponsor.



# Mutual Benefits to the Sponsor and the NetLeaseX Investor Upon the Sponsor's Assignment of the Project

## Sponsor

- ✓ Sponsor receives a payment for work already performed and/or ongoing fees in a supporting role to the NetLeaseX Investor.
- ✓ If Sponsor stays involved in the project, the Sponsor would be able to develop a track-record for a successful and profitable exit.
- ✓ Develops a business relationship with the NetLeaseX Investor.

## NetLeaseX Investor

- ✓ Source profitable opportunities in projects where a Sponsor has performed most or all of the initial work.
- ✓ Further mitigate risks by taking over a project rather than passively investing with an untested Sponsor who is unable to procure senior debt financing and/or is unable to make a minimally required financial investment in the project.

# What Can Preferred Equity Be Used For?

Sponsors can use preferred equity in a myriad of ways, including coupling it with senior debt financing.

## For example, preferred equity may be used to:

- Fund the ground-up development of real estate projects
- Acquire profitable real estate investments
- Acquire land, pay for entitlements and other pre-development expenses
- Fund an interest reserve with the Sponsor's senior lender
- Fund any required capital improvements and/or needed renovations
- Fund a reserve to pay for any future tenant buildouts and/or leasing commissions
- Acquire nonperforming and sub-performing senior and mezzanine debt at a discount
- Cover unfunded capital calls from limited partners
- Monetize a Sponsor's equity without giving up control of the property
- Buy out existing limited partners
- Raise capital without paying pre-payment penalties or defeasance costs

**Higher Yielding  
Returns in  
Opportunistic  
Investments**

**Lower Yielding  
Returns in  
Stabilized Properties**

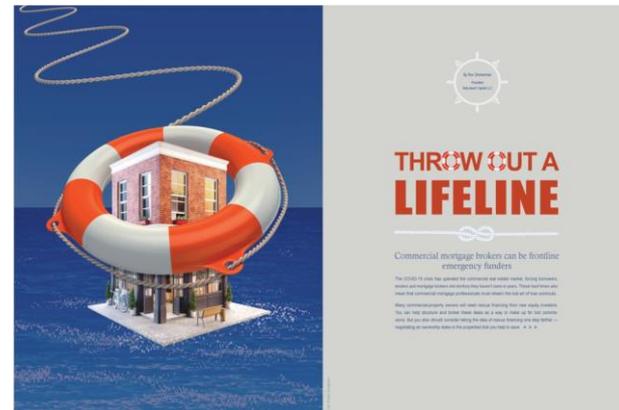
# Providing Rescue Financing to Facilitate Loan Workouts

As highlighted in Ron Zimmerman's second featured and follow-on articles in the *Scotsman Guide* (for which links are provided to the right), preferred equity can also be used to provide rescue financing to facilitate loan workouts.

Rescue financing works like bridge equity, a temporary infusion of cash up to three years. This is typically enough time for properties that haven't become permanently impaired to return to their pre-pandemic or historically higher values.

## Rescue financing can be used to:

- Cover any operating deficits due to Covid-19 and/or for any other reason,
- Gain leverage to facilitate favorable loan workouts with CMBS and other types of lenders to reduce interest rates, extend maturity dates, and/or release or otherwise reduce personal loan guaranties,
- Fund an interest reserve for the senior and/or mezzanine lender,
- Fund major capital expenditures,
- Fund tenant buildouts, and
- Pay leasing commissions.



**"Throw Out a Lifeline"**  
*Scotsman Guide Commercial Edition*  
July 2020



**"Ride to the Rescue"**  
*Scotsman Guide Commercial Edition*  
August 2020

# Acquire Real Estate in Sponsors' Self-Directed Retirement Plans with Debt-Free Preferred Equity

## Many real estate investors self-manage their retirement assets.

By using self-directed IRAs, investors are able to invest in real estate.

The problem, however, is that the retirement account's profits from properties that have debt financing are taxable.

For example, if an investor borrows 80% of a property's purchase price, 80% of the profit would be taxable in the retirement account. This tax is called Unrelated Debt-Financed Income (“UDFI”) tax.

## Benefits of “Leveraging” with preferred equity instead of debt.

- ✓ Sponsors can maximize their after-tax profit by leveraging with debt-free preferred equity financing
- ✓ Since the Sponsor purchased the property without debt financing, 100% of the Sponsor's profit will be tax-free and not subject to UDFI.
- ✓ On highly profitable transactions, Sponsors can justify “sharing the wealth” with NetLeaseX Investors since the Sponsor's tax savings would exceed the NetLeaseX Investor's marginal increase in profit. Accordingly, NetLeaseX Investors can make debt-free preferred equity investments rather than making first mortgage loans to Sponsors with the same risk profile.

# Why Work with NetLeaseX?



Establishing itself as a gatekeeper, NetLeaseX introduces Sponsors to “below the radar” investors.

Before NetLeaseX presents Sponsors’ financing requests to NetLeaseX’s Investors, NetLeaseX will work with Sponsors to:

- Better understand the Sponsor’s financing objectives,
- Review Sponsor’s project proforma,
- Calculate the capital raise based on a detailed Sources and Uses of Funds that NetLeaseX prepares with input from the Sponsor,
- Collect and review due diligence and work with the Sponsor to obtain any additional due diligence not initially provided,
- Negotiate with and obtain a “meeting of the minds” of the terms of NetLeaseX’s proposed financing,
- Draft a detailed term sheet,
- Draft an Agreement with the Sponsor (if the Sponsor signs NetLeaseX’s term sheet),
- After closing, deposit into escrow with a title company designated by the NetLeaseX Investor any unused proceeds from the NetLeaseX Investor’s preferred equity investment, and
- Submit requests to the escrow agent, as directed by the NetLeaseX Investor, to release funds to pay for authorized fees, costs, and expenses as listed on the Sources and Uses of Funds.

# Benefits to Sponsors of Raising Investment Capital from NetLeaseX Investors



## Non-institutional sponsors benefit by working with NetLeaseX Investors as follows:

- ✓ By raising investment capital and developing a track record with NetLeaseX Investors, Sponsors enhance their ability to raise additional capital on subsequent transactions with NetLeaseX Investors and/or other investors, potentially with more attractive terms for them.
- ✓ Sponsors can view NetLeaseX Investors as experienced strategic investors that may provide ongoing advice to Sponsors and make introductions that help the Sponsors in future transactions, and
- ✓ Sponsors have opportunities to develop relationships with “below the radar” high net worth investors, family offices, equity funds and other equity investors that the Sponsors would not have been able to reach on their own.

## Highest to Lowest Expected Returns



Purchasing and entitling land for sale to Sponsor or third party



Horizontal development of multifamily and housing projects



Ground-up development of multifamily and self-storage facilities



Help Sponsor monetize equity in Sponsor's and/or limited partner's interests in a stabilized, cash-flowing asset



Senior debt-free preferred equity financing to Sponsors seeking to avoid UBTI tax in self-directed retirement plan investments

# Design Features of NetLeaseX's Proposed Structured Financings



NetLeaseX will negotiate and memorialize all or most of the provisions described below into Agreements with the Sponsors seeking financing from NetLeaseX Investors.

## Selected Summary Operating Agreement Provisions.

**Waterfall Priority Order.** The preferred interests will be structured on a senior/ subordinated or A/B structure where the NetLeaseX Investor will receive his/her preferred returns and investment in full before the Sponsor receives theirs.

**LLC Management.** The LLC will have three managers of which two managers will be appointed by the Sponsor and one manager will be appointed by the NetLeaseX Investor. All major decisions listed in the operating agreement will require unanimous consent of the managers.

**No Capital Calls to the NetLeaseX Investor.** If there is any capital shortfall, the Sponsor will be responsible to advancing such funds to cover it.



# Design Features of NetLeaseX's Proposed Structured Financings (Continued)



**No Financial Disclosure or Recourse for the NetLeaseX Investor to the Senior Lender.** The Sponsor will be solely responsible for obtaining the senior loan without any financial assistance or support from the NetLeaseX Investor. If the senior lender is unwilling to proceed on this basis, the Sponsor will need to:

- Find another senior lender,
- Obtain a third-party loan guaranty, or
- Open discussions with NetLeaseX Investor to discuss a mutually beneficial solution.

**Sponsor's Investment Drawn Down First.** 100% of the Sponsor's investment will be drawn down first, before any funds will be used from the proceeds of the NetLeaseX Investor's Class A preferred investment.

**Specified Uses of Funds.** Working in collaboration with the Sponsor, NetLeaseX will prepare a detailed Sources and Uses of Funds and attach it to the Term Sheet and the Agreement with the Sponsor. The Sponsor's use of the NetLeaseX Investor's Class A preferred investment funds will be limited the uses listed on the Sources and Uses of Funds.

**Escrow Net Proceeds from the NetLeaseX Investor Class A Preferred.** At closing, 100% of the NetLeaseX Investor's preferred equity investment that is not used at closing will be deposited into escrow at a nationally-recognized title company designated by the NetLeaseX Investor. After closing, the Sponsor will submit an email to NetLeaseX and the NetLeaseX Investor requesting that the escrow agent release funds to pay for authorized fees, costs and expenses as listed on the Sources and Uses of Funds.

# Key Takeaways

- ✓ Gap Financing is a great way to increase leverage, close more deals and generate more fees.

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- ✓ Gain access to “below the radar” private principal investors who are interested in backing non-institutional and even first-time sponsors.

## Benefits to working with NetLeaseX:



NetLeaseX “eat what it kills.” NetLeaseX will **only** be paid if and when the Sponsor closes with a NetLeaseX Investor.



Speed and certainty of execution with NetLeaseX Investors who have the experience to quickly review and analyze due diligence assembled by Sponsor and NetLeaseX.



NetLeaseX Investors have the financial liquidity to close without syndication risk or need to obtain consent from any third parties.

# NetLeaseX's Fees and Costs



## NetLeaseX will be compensated by one or more of the following ways:

- ✓ After obtaining a “meeting of the minds” with the Sponsor, NetLeaseX will draft (or have drafted) a detailed term sheet memorializing the terms and conditions of NetLeaseX’s proposed financing.

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- ✓ If the Sponsor executes NetLeaseX’s term sheet, Sponsor will pay NetLeaseX a non-refundable fee in the amount of \$7,500 to cover NetLeaseX’s time and expense in making the Sponsor’s project available to NetLeaseX Investors and working with counsel to draft the term sheet and subsequent Agreement to Form Joint Venture.

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- ✓ At closing, NetLeaseX will receive a “guaranteed payment” (as defined in Internal Revenue Code Section 707(c)) which will be negotiated on a case by case basis based on the particular parameters of each property and project. NetLeaseX’s fees are a project cost and will be borne by the members based on their proportional ownership interest in the LLC.

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- ✓ NetLeaseX has the option to co-invest with the NetLeaseX Investor for an amount and on terms to be negotiated between NetLeaseX and NetLeaseX’s Investor.



## Ron Zimmerman

**Ron Zimmerman is president of NetLeaseX Capital LLC, an investment banking firm specializing in raising investment capital for real estate investors and developers. Mr. Zimmerman is also a real estate broker.**

- ✓ Mr. Zimmerman has more than 35 years of industry experience as a real estate and distressed debt investor, raising investment capital for real estate investors and developers, and real estate brokerage. He has significant expertise in structuring real estate financial transactions, investment analysis, real estate finance, and the restructuring and workout of commercial and consumer loans.
- ✓ Mr. Zimmerman has experience in tiered financing of acquisitions, financial restructurings, and leveraged recapitalizations and worked as a consultant to real estate investors and developers on a national basis and acting as a strategic advisor for clients in complex IRC Section 1031 tax-deferred exchange transactions, net lease financing, and sale/leasebacks.
- ✓ Mr. Zimmerman has written three articles for the *Scotsman Guide*, an industry publication for commercial real estate lenders and loan brokers. Mr. Zimmerman's first featured article on raising preferred equity, "[Strategizing with Preferred Equity](#)", was published in the December 2018 issue. The second featured article, "[Throw Out A Lifeline](#)" and follow-on article "[Ride To The Rescue](#)" were published in the July and August 2020 issues, respectively, and discuss rescue financing which many real estate investors may need to raise to cover negative cash flow during the COVID-19 crisis. You can download reprints of Mr. Zimmerman's articles by going to [www.netleasex.com/articles](http://www.netleasex.com/articles).
- ✓ Mr. Zimmerman graduated with honors from the University of Cincinnati College of Business Administration, majoring in Real Estate and Finance.

# Let's Talk



If you have any questions and/or would like to discuss your project and how NetLeaseX can help, please contact Ron Zimmerman:



## NetLeaseX Capital LLC



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