

The Investors Guide to Private Equity Investments in Real Estate

A Guide for New
Investors In Private
Real Estate
Investments

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Introduction

Private equity multifamily real estate investments can be very lucrative and exciting. They can allow investors to invest in high-quality real estate they could not buy on their own, and provide solid passive income and diversification on their investment capital. They can also allow an individual to partner with a very experienced Managing Member or Sponsor who will find the opportunities, manage the operations, put the financing in place, and even fix those pesky "leaky toilets." There is a reason that some financial advisors refer to them as the "investments of the rich" and why over 90% of the Fortune 400 retain at least some of their wealth through real estate.

Many Insurance companies, large private equity firms, and individual high-net-worth investors use multifamily real estate as an investment option to add diversity to their investment portfolio. Why? These types of investments earn consistent, passive income unaffected by the constant fluctuations seen in traditional "Market" type investments such as Stocks or Bonds. Interestingly, most individual investors do not realize that these types of private investments ARE available to them as well; private investment in real estate is much easier to begin than most investors understand. Investing in multifamily real estate is a great way to add diversity to your investment portfolio while providing an additional income stream and growing your equity.

Below is a summary of why we feel multifamily real estate investing is just one of many "alternative" investment tools an investor can use to add diversification and passive income to their investment toolbox, as well as critical points to help you better understand private equity investments in multifamily real estate.



SECTION 1

What Makes Multifamily Apartments a Great Alternative Investment Choice?

Every investor aims to maximize return while minimizing risk when considering an investment opportunity. Right? However, many individual investors' portfolios do not include personal real estate investments because many private investors believe these opportunities are only available to the ultra-wealthy.

Traditionally, substantial multifamily apartment assets are owned by large institutional investors such as mutual funds, insurance companies, or large pension plans for diversification and consistent cash flow. Why? Because they recognize that real estate is a hard asset and these types of investments earn consistent, passive income that is not affected by the constant fluctuations seen in traditional "Market" type investments such as Stocks or Bonds and direct real estate investment offers many benefits, including, but not limited to, stability, portfolio diversity, cash flow, appreciation, and tax shelter.

Individual private equity real estate investments like those offered by us allow the qualified investor the same opportunity to buy a passive ownership stake in real estate for revenue-generating investments like institutional investors. Private Equity syndications or "group investments" allow the individual investor to experience the same buying power, leverage, and additional benefits the large institutional investors enjoy while investing alongside other like-minded accredited and sophisticated investor partners.

One of the main reasons institutional AND private investors are pursuing real estate investments right now is that they are chasing yields. The near-record volume of individual and institutional capital flowing into the U.S. commercial and multifamily real estate market is a testament to the appeal of the asset class. In the 2018 mid-year summary from Deloitte, *"In the first half of 2018, global CRE transaction volume increased 13 percent year over year (YOY) to \$341 billion....The United States led the Americas' growth with a volume of \$122 billion (+11 percent*

YOY). "Current micro- and macro-level dynamics are fueling investors' appetite for real estate. Chief among them is a concern about slowing growth in China, Brexit, and the negative impact both might have on the global economy. Interestingly, this inflow trend continued through the pandemic and global inflationary concerns.

Below is a closer look at some of the top reasons that commercial real estate, overall, and multifamily apartment investing is attracting a broader pool of private investments to the sector.

As a partial owner, the private equity investment allows the investor to participate in all the benefits of owning apartment communities without day-to-day management obligations. These benefits include projected monthly cash flow, potential income sheltering through depreciation, tax benefits, leverage, principal pay-down, and appreciation, which I have summarized below.

Attractive Returns

One benchmark for measuring investment performance for a large pool of individual commercial real estate properties in the private market is the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index, which measures the performance of an immense pool of individual commercial real estate properties on an *unleveraged* (no debt) basis. For example, The NCREIF Index reported an annual return of 12.7% in 2015, which bested other vital indexes such as the S&P 500, Dow 30, and Russell 2000 in the same period. In the longer term, the NCREIF Index has reported an average annual return of 8.8% over the past 15 years, which is 200 basis points above the average performance of the S&P 500 for the same period.

Forced Appreciation

Equity investors can boost their overall return by investing in a property requiring updating (value-add) once the asset is sold or refinanced. By improving the property by updating the units and exterior, the NOI (net operating income) is increased through improved rent collections (revenue) and reduced

expenses through improved operations. Updating an apartment complex back to a market rate complex and maximizing the increase in NOI is called "repositioning" and adds significant value to the investment. The rise in appreciation through repositioning is what we call forced appreciation. It can be realized much shorter than another form of appreciation through principal paydown.

Long-term Appreciation

For assets purchased with a fully amortized loan (in most cases for 30 years) and fixed term (typically 5-7 years), the property's outstanding debt is reduced with each month's payment. Think of it as a monthly savings program - the rents paid by a property's tenants reduce the asset's leverage, which, in turn, increases equity and, hence, investor returns at the point of exit while also reducing risk. In a world of investment uncertainty, principal paydown infuses an element of month-over-month certainty of returns like owning a home.

Cash Flow

One of the most significant advantages of real estate investments is that they can generate steady, reliable, partly tax-sheltered cash flow and provide regular distributions depending on how the offering (syndication) is structured. With the other advantages real estate offers, real estate investments can provide projected cash flow return combined with the asset's appreciation over time.

Real estate investments are often structured to deliver cash flow, with monthly, quarterly, or annual dividends distributed to investors. The two main options for investors are an equity or debt investment.

Equity investments involve buying a passive, minority (Limited Partner) ownership interest in the entity (typically an LLC) purchasing a hard asset, such as an apartment or office building where high occupancies and rising rents generally deliver what most

owners/investors strive for – steady or increasing cash flow over time.

Debt investments refer to investing in a real estate loan. An underlying asset backs these loans as collateral, such as land or a building, and one of the advantages of debt investments is that they are generally structured to deliver a fixed return.

Tax Efficiency

Distributions to Investor Partners are treated more favorably than other investments from a tax perspective because a significant portion of distributions is not considered income. The tax benefit is due to the flow-through of expenses and depreciation. While realizing appreciation and capital gains are definite incentives for real estate ownership, depreciation is another benefit.

Depreciation decreases the accounting value of the physical structure of a real estate asset, as most assets decline in value over time but do not affect the market value of a property. In its most basic form, the physical improvements of a property may be depreciated over 27.5 years in an accounting method referred to as "straight-line depreciation." However, specific enhancements (e.g., appliances and flooring) may be depreciated over a period as short as five years through cost segregation. Real estate operators utilize depreciation as a tax benefit tool, which allows an investor to use a passive "loss" from depreciating improvements to offset other passive income. The net result of higher after-tax yield depends upon an individual's or entity's taxable income. Investors are strongly encouraged to consult a tax advisor before investing.

Total Return

A property's combination of stable revenue (from rents), capital gains (resulting from increased property values), principal pay down (from renters paying down loans), and tax savings (thanks to the investment's unique flow-through structure) all help to provide consistent, passive income unaffected by

the constant fluctuations seen in traditional "Market" type investments.

Hedge Against Inflation

Notwithstanding cyclical variations due to supply and demand imbalances, in the long run, rents, values, and the replacement cost of real estate improvements rise in line with inflation. Multifamily assets tend to have shorter-term leases (typically one year) that can adjust (read: raising rents) to current market conditions (demand) much faster than other investments. The ability to increase revenue to meet local demand more frequently makes real estate investing a particularly effective hedge against inflation and should be a key component in any well-diversified investment portfolio.

Real Estate Ownership

Investors desiring passive income with an optimal balance between risk and reward generally prefer real estate consisting of land, buildings, and fixed equipment. Moreover, the land supply is limited and reasonably stable (though generally increasing) value. Real estate, therefore, is widely considered the best ultimate security and a solid basis for building lasting, even generational, wealth.

Diversification

The significant advantage of group investments is that they allow investors to join with others in acquiring a substantial and high-quality revenue-generating investment. The combined strength of the properties in the pool provides a permanent stream of steady income that is virtually unaffected by variances in individual property vacancy rates or individual market fluctuations.

Operating Capital

It is well known that an investment's staying power is the most critical factor in building wealth. The capital infusion provided through a group investment will ensure sufficient capital is available to allow the

investors to withstand economic downturns or temporary shortfalls.

Independently Assessed

Real estate ownership through a private group investment does more than bring stability to an investor's portfolio. Because real estate investment value is based on the properties' actual revenues rather than the speculative markets' ups and downs, private syndication members don't have to check their computers or the daily paper to see how their investments are doing.

Registered Retirement Savings Plan Eligibility

"Self-directed" means that you choose the investments. A self-directed IRA is no different from any other IRA. They will provide you with more choices and flexibility for your retirement savings. Private equity investments in real estate are 100% eligible as an investment option for your self-directed IRA. They will allow you to put the stabilizing, revenue-generating, and appreciating benefits of real estate ownership to work for you while taking advantage of the tax savings an SD-IRA provides.

Tangible Assets

Another key advantage of investing in real estate is that hard assets back the investment. Real estate is not the same as buying shares in a company that may be here today and gone tomorrow. Indeed, cases such as Enron and Lehman Brothers have proved that even stalwart corporations are not infallible. Real estate is an asset class that investors can touch and feel. Yes, some building occupants may come and go,



and there may be ups and downs in building valuations, but the property itself will stay, and the land it sits on will hold some value.

Summary:

As highlighted above, many great reasons exist to invest in commercial real estate. Unfortunately - CRE investment opportunities have historically been limited to a minimum of \$250,000 investments - putting the asset class out of reach to all but the most deep-pocketed investors...until now.

The passing of proactive legislation, including the 2012 JOBS Act, has helped launch a new class of private online real estate marketplaces that are democratizing access to commercial real estate deal flow. Firms such as [Solara Holdings](#) make direct commercial real estate easily accessible to accredited investors. Our platform gives investors transparent information on our current real estate investment opportunities nationwide. It provides tools to help investors track performance and manage their growing real estate investment portfolios.

We make all due diligence, monthly and yearly financial statements, and other documents available to our investors during the investment, as well as provide investor conference calls, 24/7 investor website access, management updates, site visit reports, financial updates, and an annual report (K1) for tax purposes to keep our investors informed of what is happening with their investment dollars. Try getting granular access from your Stock or Mutual Fund investments!

Private investments in multifamily real estate are a practical and obtainable option for the individual investor. We will now discuss some key concepts in real estate equity structures and how they pertain to you, the investor.

In Section 2, we will cover the key points of how real estate investments are structured, how debt and equity fill the "capital stack", and how the general and limited partner investors work together to form a syndication.

SECTION 2

The Capital Stack and Private Equity

The equity portion in a real estate syndication generally entails the highest attendant risk and potential return of any real estate capital stack position. As we will see, numerous legal and payment structures within equity real estate investments can impact the return potential and risk for any given investor. Further, the investment strategy, property class, and market all significantly affect the risk/return profile of any real estate equity investment.

This section looks at different ways real estate equity investments are structured and some critical considerations for individual real estate investors considering private equity multifamily investing. Please remember that each investment has a different structure and it's critical to understand how each is structured.

Real Estate Equity Investments – The Basics

Real estate developers and investors typically refer to the total financing of a real estate project as the “capital stack.” Note that this financing, or capitalization, may go beyond purchasing the real estate alone. Beyond the property acquisition, capital raised for a given investment may include ongoing value-added construction, marketing expenses, and other lease-up costs. It should be noted that common equity positions are usually more prolonged: debt, mezzanine debt, or preferred equity positions are more easily replaced or refinanced from an investment.

In the real estate capital stack metaphor illustrated above, the total financing of the project is similar to an apartment building (pun intended!) with the equity position (you) as the top floor (or floors, depending on the size of our building metaphor). Below the top floor sit the lower-upside, lower-risk portions of the total capitalization, including senior debt (which we may consider the foundation of the



Building), subordinate debt (including the aptly named mezzanine debt piece), and, **possibly** preferred equity. The lower the position in the capital stack, the more protections investors typically have. Senior debt is so called because it is “senior” to all other places in the capital stack, i.e., senior debt lenders are entitled to be repaid before any other investor in a given real estate investment. Subordinate debt and preferred equity investors hold payment priority over at least one different position in the capital stack and some recourse if the Sponsor (i.e., borrower) defaults. Equity investors typically have no recourse and are the last to be repaid. In exchange for assuming this risk, equity investors enjoy a higher potential upside.

Equity investors in a real estate investment are typically thought of as a partnership, with the sponsor acting as GP (“General Partner”) and passive investors – e.g., individuals investing with us – as LP (“Limited Partner”).

Distribution of Waterfalls and Promotion of Equity Investments

Once debt and, if any, preferred equity positions are paid, the payment arrangement within the equity structure kicks in. This “distribution waterfall” dictates the order and proportions of profits among GP and LP investors.

This arrangement is covered within the company operating agreement and is vital for any passive investor to understand as they evaluate a potential investment.

In a typical arrangement of profit distribution, a Sponsor will contribute their equity to the project's financing into the same property-owning entity as the LP investors. The Sponsor may or may not earn the same (*pari passu*) share of profits with LP investors until a certain income hurdle (threshold) is met with an inevitably higher threshold return for all equity investors. In our example below, 'all members' are defined as the Sponsor's GP position and LP investors.

Once this return threshold has been met – and all principal has been returned to equity investors, pro rata (in proportion related to the percentage invested)– the "sponsor promote" kicks in, and the Sponsor earns an outsized share of profits afterward. To complicate matters, multiple "tiers" of sponsor promotion may exist within a distribution waterfall.

To drive this home, let us consider an example distribution waterfall from an actual investment we recently offered to our investors; this information in a syndication can be found prominently in an investment's Operating Agreement and should be included in every PPM:

1. First, 100% pro rata to all members until all members have received their respective accrued and unpaid 7% return on capital (the 'preferred return');
2. Second, 100% pro rata to all members (equity investors) until all capital contributions (principal) have been returned.
3. Third, 70% pro rata to members and 30% to the Sponsor until all members have received a 20% IRR (the 'first tier' of the distribution waterfall) and;
4. After that, 60% will go to LP members and 40% to the Sponsor (the 'second tier' of the distribution waterfall).

Why Sponsor ("GP" or General Partner) Promotes Exist

At first glance, it may appear that such a structure unfairly compensates a sponsor in the event of a successful investment. However, consider that passive ("LP" or Limited Partner) investors rely on the Sponsor to execute on many fronts, including:

- Sourcing and underwriting assets
- Leveraging local knowledge and a boots-on-the-ground presence to unlock hidden value and enter investments at a favorable going-in basis, often acquiring property at below-market value
- Assuming debt liability
- Formulating and executing a solid business plan.
- Manage tenants – including lease-up, turnover, evictions, and lease renewal.
- Securing ongoing financing (where necessary) and negotiating the favorable sale of assets to maximize returns.

The sponsor-promote structure helps ensure sponsors are incentivized to achieve the highest return possible and compensate for the effort and risk this entails.

Cash Flow, Project Plans, and Varying Risk/Return Profiles

While equity real estate investments entail a higher degree of risk and potential reward than other positions in the CRE capital stack, equity investments vary substantially in their term, target cash flow profile, risk factors, and exit strategy.

Here are some factors that may increase the potential return and lower risk of an equity real estate investment:

- **Strong, established market:** a robust local economy and diverse demand drivers may reduce the attendant risk of any CRE investment within the market. Enhanced competition from other investors may

compress cap rates and dampen return potential.

- **Stable cash flow:** Placing solid cash flow from rent rolls may help mitigate liquidity risk.
- **Limited development scope:** less complex and extensive capital improvements mean less potential for significant delays or vacancies.

Some factors that may lower the potential return and increase the risk of an equity real estate investment:

- **Less-established, burgeoning markets:** a market on the rise, with a less established but growing set of demand drivers, typically offers higher going-in cap rates and tremendous potential for significant appreciation. However, a less diverse, robust group of demand drivers means the market may be harder hit by an economic downturn, increasing potential risk.
- **Ground-up development:** projects that entail wholly new construction carry more complexity and generally offer no cash flow within the investment term. These ground-up investments can tap into growth in a market and the potential for outsized returns. These factors amount to a higher degree of risk. These factors should be considered for investments across the capital stack; they can have tremendous significance for equity investors who are afforded fewer protections but are entitled to a more significant share of the potential upside.



Section 3

Private Equity and The Multifamily Real-estate Syndication

Now that you understand how real estate equity investments are structured let's take a deeper dive into how the equity portion of the Capital Stack is raised and the roles of the investors.

What is a Real Estate Syndication?

Investing in a real estate syndication is the pooling of capital. The benefit of putting this capital together is that it might make it possible to purchase and pursue opportunities that one person may not be able to on their own.

A famous example of this was the syndication led by Helmsley & Malkin, where they formed a group of investors to buy the Empire State Building in the 1960s for \$65 million, many of whom contributed only \$10,000 each.

Syndication differs from a real estate fund because the asset is already identified in a syndication, and the money is raised for that specific "one-off" opportunity. A real estate fund is more of a "blind" investment "pool" where capital is pre-raised based on the Sponsor's vision, track record, and reputation. After raising that capital, the fund sponsors will then go out and acquire properties based on the fund mandates once capital calls are made to the investors.

Types of Properties

There are many ways to invest in real estate, and syndications are formed for nearly every type of investment property. Every class has unique strategies; therefore, operators usually stick to their knowledge. For example, the large multifamily sponsors typically stay in that lane, and those in the hospitality sector stick to their own. Occasionally, though, you'll see a group venturing out.

People need somewhere to live, and with the rates of homeownership dropping, particularly in the metro area, rentals (particularly apartments) will continue to be in high demand.

The strategy of these syndications is to improve the operational numbers of the property (increase net operating income), improve any deferred maintenance items, and ultimately sell the property down the line, for example, in 5-7 years.

At [Solara Holdings](#), we focus on multifamily syndications.

What are the Various Roles in a Syndication?

Sponsor

A person or Company, in this case, organizes this investment and is responsible for managing the whole operation on behalf of the investors. They are interchangeably known as the Sponsor, GP or General Partner, Operator, or Syndicator.

Depending on the organization's legal structure created for the investment, the Sponsor is technically known as the General Partner (GP) or Asset Manager. The GP investor refers to the managing party on an investment. "GP Investor" is typically synonymous with "the Sponsor" concerning real estate investments and the party responsible for originating the investment, sourcing debt and equity financing, and managing the project through to completion. As such, GP investors take a management role in ensuring the success of the investment (as opposed to passive LP investors). They are afforded greater potential returns in structuring the investment.

Sponsors run and operate these properties and manage income (rent and other income producers like storage space, garages, or laundry income) and expenses (such as utilities, maintenance and upkeep, landscaping, and renovations).

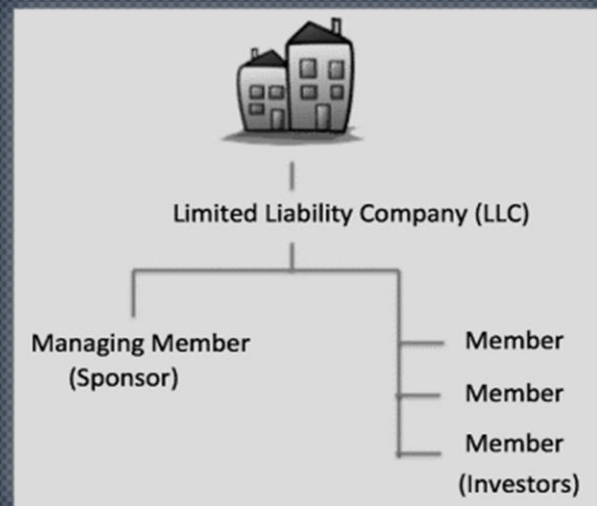
Investors

Investors are known as Limited Partners (LPs) or Members, depending on the legal structure. As you might guess, LP investors in equity investments assume a limited share of risk and, consequently, greater potential profits compared with the GP investor(s). LP investors are not liable for the debt and are exempt from much of the legal risk inherent in the real estate project.

Legal Structures

As mentioned, the syndication may be created with a specific tax and legal structure. It is usually designed as a Limited Partnership (LP) or a Limited Liability Company (LLC) to own the property on behalf of investors.

This structure aims to create a separate SPE (Special Purpose Entity), such as an LLC, to manage and control the asset. It can protect individual investors from further liability beyond this one deal. Below is a simple diagram reflecting a typical SPE organizational structure.



Accredited Investors.

For the most part, syndications are typically open only to accredited investors depending on which SEC

exemption the syndicator(s) chose to form their offering (more on later).

To be considered an accredited investor by the SEC (Securities and Exchange Commission), you must either:

1. Have an income of at least \$200,000 each year for the last two years or
2. If you're married, have a combined income of at least \$300,000 each year for the previous two years, or
3. Have a net worth of at least \$1 million, excluding your primary residence, individually or jointly with your spouse.

If you qualify based on income, part of the qualification is that the expectation is that you'll continue to make that income in the coming year. Syndications will typically ask you to provide a letter from your accountant stating that you qualify, ask for two years of tax returns, or send you to a third-party site to validate your info.

This verification process is required because syndications raise capital through an exemption known as Reg D 506b (or c) created by the SEC. In short, this states that these offerings do not have to be registered with the SEC if they are not marketed to the general public, and the investors consist only of accredited investors. It's usually quite expensive and complex for them to go through the SEC, so they often go the route of Reg D. With the JOBS act, some of that marketing has been relaxed (Reg D 506C), but the need to have accredited investors remains the same.

An Example of How a Syndication Works

The following is how the process typically works, using a single property investment as noted in the example above.

A sponsor finds a property that they think would meet investment objectives, makes an offer, and gets it accepted through a PSA (Purchase and Sale Agreement). This binding contract "ties" the property up in what's known as the escrow period.

During this time, the Sponsor performs their Due Diligence (multiple inspections), acquires debt financing, creates an SPE (Special Purpose Entity to purchase the property then finally develops an investment package typically referred to as an Offering Memorandum and PPM (Private Placement Memorandum-more on this in the next section).



This PPM will include the following:

- Details of the property/deal
- Terms, sponsor contribution, equity splits, and fees
- Investment projections
- Payout and distribution details (waterfall structure)
- Comparable properties
- Risks

The Sponsor will then begin to raise money from Limited Investors (LP). The Sponsor will decide on a minimum investment amount and have a certain number of "Units" available for purchase. Once there is enough capital, and the financing is worked out, the property will be purchased, and the Sponsor will manage and operate the property until the end of the anticipated term of the project ("Hold Time").

Distributions of profits (or losses) on cash flow are outlined in the PPM (waterfall structure). Upon disposition (sale) or refinance of the property (both

called a “capital event”), the proceeds are then distributed as outlined in the PPM Operating Agreement.

Section 4

The Private Placement Memorandum-

5 Items Every Private Equity Real Estate Investor Should Review Before Investing.

1. **Business Plan/Property Offering** – The business plan or offer covers all the details of what you are investing in and will typically include information on the type of property desired, financial analysis, operations, market analysis, and investment objectives.
2. **Private Placement Memorandum (PPM)** – This document states the objectives, risks, and terms of the investment involved with a private investment and outlines the type of investment, a detailed description of the business, a financial overview, management or Sponsor biographies, sources and uses of funds, the risks, and all fees associated with the investment. An offering memorandum provides buyers with information on the offering and helps protect the sponsors from the liability of selling unregistered securities.
3. **Operating Agreement (OA)** – The operating agreement is among limited liability company "LLC" Members governing how the LLC's business will run. A group investment will cover how the venture will be operated, including but not limited to how fees, expenses, and income or losses are handled or disbursed. The OA will also describe when and how you can sell your ownership when you are paid back and how the Company will be terminated (wind up) at the end of the investment. It is essential to review this document before investing in any type of investment.

4. **Subscription Agreement (SA)**– A subscription agreement is an application by an investor to join a limited partnership. The SA helps the sponsor/manager of the investment evaluate the investors' suitability and qualifications for the placement. It is an SEC requirement that the sponsor/manager collect the SA from each investor in the opportunity before receiving any capital investment.
5. **Sponsor Background/Experience** – Knowing who handles the business's operations is essential in a group or private equity investment. It's a good idea to know who they are, and their experience. You should feel comfortable with them managing the projects as they will be a significant factor in making the investment successful.

Pros and Cons of Investing in a Syndication

Like any other investment opportunity, investing in syndications has pros and cons. You need to understand what they are and if it helps meet your financial objectives.

Pros

- You know the exact property you're investing in, as opposed to REITs and RE Funds, that may be investing in other asset classes you do not want to invest in.
- Pass-through tax treatment depreciation and interest expense.
- Can participate in a 1031 exchange (with exceptions)
- Can allow for diversification – Because you're only buying a small share, you may have the ability to invest in other opportunities at the same time instead of having all your funds tied up in one property.
- Access to multiple investment opportunities with professional asset management firms such as Solara Holdings.

- Liability protection and protection from personal credit risk.
- Passive investment – The majority of the work is done upfront by vetting the opportunity and Sponsor. The Sponsor assumes all management roles and responsibilities for the term of the project.

Cons

- Lack of liquidity – Locked in for whatever the term might be. It may be possible to sell your interest, but it's not easy.
- Lack of control – LPs do not participate in the operating/decision-making (Asset Management) process. The Sponsor (GP) is the asset manager of the investment and has overall management rights, such as when to refinance or sell.
- Costs and fees - All syndications have expenses and fees associated with the project, which should be considered when assessing a potential investment.

Section 5

The Dollars and Cents of a Syndication

Private real estate has historically exhibited a low correlation with public markets. Many institutional investors regard private commercial real estate – with its illiquidity and inherent worth – as an opportunity to de-correlate from public markets and reduce exposure to systemic risk at the portfolio level. As with any asset class, real estate investors need uniform ways to evaluate and compare real estate investments' target and realized returns.

Professional commercial real estate investors make use of a handful of return metrics. All are useful, but more is needed on their own to determine the relative appeal of a real estate investment. This section breaks down standard return metrics in the context of private real estate investment and their

application and limits. Before diving in, note that expected return figures are based on assumptions and modeling that are NOT guaranteed; return figures are only as good as these assumptions, models, and the data used to build the proforma. Remember, past performance does not guarantee future results.

Cash-on-Cash Return

This metric (also commonly referred to as the “cash yield” of an investment) can be represented as a simple equation:

$$\text{Cash on cash return} = \frac{\text{Annual Dollar Income}}{\text{Total Dollar Investment}}$$

As such, this return metric provides a clean, quick way of assessing the magnitude of cash distributions throughout the project's lifetime. Implicit in the formula is that this return metric is an average across every year (annualized) the project encompasses. For example, a cash-flowing workforce housing multifamily apartment building offering an average annual cash return (or cash-on-cash return) of 7-8% based on projected net operating income at the property. This calculation excludes the profit earned at disposition (sale or refinance) when the principal is also typically returned- also known as a “capital event”.

As the projected annual distribution schedule indicates, distributions to investors are projected to increase over the lifetime of the term as the Sponsor makes operational improvements and increases NOI, culminating in a disposition year where investors are projected to receive a healthy cash return, along with their pro rata share of sale profits and return of principal.

Limits of Cash-on-Cash Return

The Cash-on-Cash return metric averages distributions over the ordinary period of operation of the underlying asset. For a given cash-on-cash return value, an asset's cash flow can vary wildly from month to month and year to year. NOTE- Sometimes, the business plan may result in little or no cash flow

before stabilization which means there may not be enough cash flow for investor distribution.

Be sure to evaluate the target distribution schedule across the lifetime of the investment.



Equity Multiple

Equity multiple is also one of the core metrics used in evaluating real estate investment opportunities and perhaps the simplest to employ. The metric is calculated simply by taking the total profit plus equity invested, divided by equity invested:

$$\text{Equity Multiple} = (\text{Total Profit} + \text{Max. Equity Invested}) / (\text{Max. Equity Invested})$$

Returning to our Workforce Housing Multifamily example, the equity multiple at the base case projection for the minimum investment of \$10,000 would be calculated as

$$\text{Equity Multiple} = (\$8,588 + \$10,000) / \$10,000 = 1.86x$$

This result could be "your money back (1), plus 86%."

Limits of Equity Multiple

While the equity multiple provides an excellent snapshot of the overall profitability of an investment, it does not discount to present value – in other words, it does not incorporate the time value of money and account for the duration the investor's money is tied up – nor does it say anything about the distribution of cash flow throughout the lifetime of the project.

Internal Rate of Return (IRR)

The internal rate of return (IRR for short) is the most commonly relied-on return metric in equity real estate investment. It is also the most complicated. The internal rate of return is a discount rate that makes the net present value (NPV) of all cash flows from the investment across periods equal zero.

It should be realized that IRR cannot be calculated analytically and must be computed using software (a simple Excel function can accomplish this). The higher the IRR, the more appealing the investment.

As a discount rate, IRR accounts for the time an investor's money is tied up in an investment; holding all else constant, the more periods the investment comprises, the lower the IRR. Since the "time value of money" looms large for active investors, this feature is the main reason IRR is prevalent in real estate investing. Active investors are keenly aware of liquidity and the time value of money – the "tying up" of dollars in a long-term investment is detrimental, as it precludes using that money for other investments or personal use—the internal rate of return accounts for this.

Limits of Internal Rate of Return

The main drawback of IRR is the opposite of the equity multiple's weakness. While it does incorporate time, it is not the best gauge of an investment's overall profit potential. A concise project may show an outsized projected IRR despite low projected profit. The second drawback is akin to the equity multiple's other weakness; the IRR alone also needs to include more about cash flow distribution throughout a project.

Investments with stable cash flow are typically preferable, as they entail less risk and offer the opportunity to put capital to work elsewhere sooner. Consider two joint equity investments: one returning all principal and profit only at the end of the term upon sale and the other returning consistent cash flow throughout. These vastly different investments could have the same target hold period and an identical IRR objective.

* A Note on Using Return Metrics in Practice.

No one return metric should be used in isolation as you evaluate an investment's target or realized returns. Whether looking back at realized returns or considering target return objectives, use all three metrics to create a complete picture of investment performance. Examine how cash flow, if any, is expected throughout the investment's term, the underwriting assumptions, and all attendant risk factors.

Remember that investment return projections are only as good as those doing the projecting. As a passive investor, take a close look at the track record of the GP investor/Sponsor – this is a crucial step in evaluating an investment's return potential and risk.

Section 6

Bringing it All Together

As discussed above, the risk/return profile of any equity investment can vary substantially based on other attributes.

That said, an equity real estate investment may be worth considering if:

- You are comfortable with a lack of liquidity: your investing goals do not preclude a term of 3+ years (with no contractual entitlement to interim cash flow).
- You have sufficient time to understand the investment, including all attendant risk factors and nuances like the specific distribution waterfall of your equity position (as explained above).
- You are long on debt, or common (LP) equity, and would like to pursue the potential for greater long-term appreciation in your portfolio.

Private equity real estate investments in multifamily apartments can be very lucrative and exciting to invest in and can provide a great source of passive income and diversification that Stocks and Bonds cannot offer. Partnering with a well-respected and reputable company is critical to your investing success. We encourage you to do your due diligence,

including reviewing the information and documents mentioned above. The Sponsor should provide you with the documents you need to check **before** investing and make sure you ask plenty of questions (**see FAQ below**). Reviewing these five documents and asking plenty of questions before writing that check will set you up for investment success! Hopefully, this summary gives you the information you need to make an informed decision.

We encourage investors to consider a diversified approach, which includes diversifying across the capital stack if desired. To that end, we want to ensure that the increased nuance of equity investments is not a barrier to you and that you, as a new savvy real estate investor, have the same direct access to quality real estate investments as other successful investors.

If you are ready to learn more and want to explore the many opportunities we are currently reviewing, please schedule a call with us below.

We currently have investment opportunities available for your review.

Schedule a Call



**Solara
Holdings**

Navigating Private Real Estate Investments for the Individual Investor

Solara Holdings is a national real estate investment firm focused on providing our clients with passive investment opportunities in rental real estate. Our extensive experience in real estate investing, unique and exclusive offerings, and first-class services ensure that clients can access quality multifamily investment opportunities for passive income and portfolio diversification.

Whether you are a seasoned investor or just starting, we have the right investment solution tailored to your investment goals.

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888-822-1292

Frequently Asked Questions

➤ What are the steps I should expect after I decide to invest?

- ✓ Below is a summary of the three steps you should expect to complete once you review the offering material and decide you want to invest in our projects.

STEP 1:

- ✓ Review the Investment Summary (Offering Memorandum) and all supporting documentation, including the PPM, the Investor Verification Form, the Subscription Agreement, and the Operating Agreement.

Once reviewed, please contact Mike Butler, Principal and Asset Manager at Solara Holdings, to discuss the opportunity in more detail and answer any questions you may have.

STEP 2:

- ✓ Submit the required documentation for Accredited Investor verification through our online investor portal.

STEP 3:

- ✓ Once verification is confirmed, complete the Subscription Agreement via e-signature then and wire funds as directed.

➤ What are some advantages of investing in apartments versus single-family rental homes?

- ✓ Apartments offer advantages over single-family homes, such as economies of scale and more significant cash flow potential. Cash flow in an apartment building is usually higher per unit than in a single-family home since more rent is coming in on a rent-per-square-foot

basis, and expense costs are "shared" by multiple units.

➤ What could go wrong?

- ✓ All investments have an element of risk. Some risks to consider are tenants moving out, tenants not paying rent, interest rates increasing, poor management, and external factors such as environmental, economic, and political issues that could impact the property's operating performance.

➤ How do you finance the purchase of the complex?

- ✓ Some acquisitions combine debt (mortgage) and cash, while some deals are all cash.

➤ Can I be guaranteed that I will get my initial investment back?

- ✓ No, any form of investing has an element of risk, and there is a possibility that you may not receive your investment back. To mitigate this risk, investment opportunities are selected in a real estate market with the highest probability of generating strong cash flow, appreciation, and returns to the investor.

How long is each property held?

- ✓ Depending on an exit strategy, each property will have a different hold time, which could be 1 to 10 years. The average holding time is approximately five years.

➤ How many other investors are in the deal with me?

- ✓ Each investment opportunity will have different investors in the deal. The fewer, the better, as most investors desire a higher proportion of cash flow and equity.

➤ **Will I be involved in the day-to-day management of the property?**

- ✓ No, you will handle all day-to-day activity, and you will not have any management responsibilities.

➤ **How will I get my money back?**

- ✓ Your initial investment may be returned to you when either the property is sold or if the property is refinanced at a higher value. Investors will receive cash flow distributions, if any; generally, these payments are sent out quarterly. Some lenders like HUD only allow semi-annual or annual distributions.

➤ **What is the structure of the deal?**

- ✓ Each property is placed into a single-purpose partnership structure. A Limited Liability Company (LLC) is a standard entity selection. The LLC will own the apartment complex.

➤ **What am I buying when I invest in your deals?**

- ✓ You are buying investment units in the LLC, and the LLC owns the building.

➤ **Why must you follow the Securities and Exchange Commission (SEC) rules?**

- ✓ Securities are regulated by the SEC. ✓ Any time money is pooled together from two or more investors with the expectation of making a profit, security is created where the investors are not involved with management decisions.

➤ **What is an accredited investor?**

- ✓ SEC defines an accredited investor as someone who has a net worth that exceeds \$1 million, excluding the value of the primary residence, or anyone who has received income over \$200,000 (\$300,000 if married filing jointly) for the last two years, with the expectation of

that level of income in the current year. The SEC assumes that an accredited investor has the financial acumen to make intelligent investing decisions without its oversight.

➤ **What is the purpose of the investor qualification form?**

- ✓ Completing the investor qualification form validates that you are either an accredited or sophisticated investor. In purchasing securities through a 506(c) Offering, (CEP) is obligated to verify any participating investor's status as an accredited investor by Rule 501 of Regulation D. There are three primary methods CEP may employ to comply with the verification standards such as a broker-dealer letter, attorney letter, CPA letter, or a third party specialty services like verifyinvestor.com to obtain proper and suitable verification.

➤ **Why do you ask to see my bank or brokerage statement?**

- ✓ Your bank or brokerage statement must be provided to show you have the necessary resources to participate in these investment offerings.

➤ **What is a PPM?**

- ✓ PPM stands for a private placement memorandum. It is a document that the investor will review in detail and outlines the specific investment opportunity. The PPM presents potential risks to the investor.

➤ **How do I fund my investment?**

- ✓ You can fund your investment using money in a checking account, money market, CD, stock account, or a self-directed IRA.

➤ **Where do I send my money?**

- ✓ Wiring instructions will be provided, and your money will be wired to an escrow account.

➤ **Should I consider using a self-directed IRA account?**

- ✓ There are benefits of using a self-directed IRA to invest since the money grows tax-deferred with no immediate tax implications. Please consult your financial advisor/accountant to determine how these investments may affect your tax situation. We will work directly with your IRA custodian to facilitate the transfer.

➤ **How will I be updated about my investment?**

- ✓ When you join as an investor, you will receive direct access to our investment portal to view your investment activity. The portal is accessible 24/7 from your desktop or mobile device and will include an executive summary of the property's performance.

➤ **What is the minimum investment?**

- ✓ Typically, the minimum amount is \$50,000, but the amount will vary depending on the specifics of each offering.

➤ **What if I need to get my money back early?**

- ✓ Once you invest in the deal, you can only get your money out early once the property is sold or refinanced. The Fund member realizes that special situations arise, and the investor must contact the Fund manager to discuss. Investors will forfeit any equity in the deal if their investment is returned early.

➤ **What type of investment return will I receive on my money?**

- ✓ Every deal will have a different investment return that depends on the property's age, location, and exit strategy. The investment return is discussed in the PPM.

➤ **What is the difference between a Debt and Equity Partner?**

- ✓ Debt Partner will receive a pre-defined target return, such as a stated interest rate.
- ✓ An Equity Partner shares in the upside and downside of the project and receives both cash flow and equity appreciation.

➤ **What are some of the tax issues that should be considered?**

- ✓ Every investor's tax situation is different. You must consult with your tax professional for specific tax advice.
- ✓ Some items to consider:
 - Equity Partner will receive a Schedule K1 reporting the income or losses from the property.
 - Additional state tax returns could be required to file.

Investing involves risk, including loss of principal.

Real estate investments are not guaranteed or insured. Please ask questions and ask for more information before you consider any investment. Any historical performance data represents past performance. Past performance does not guarantee future results;

Current performance may be different from the performance data presented; The Company is not required by law to follow any standard methodology when calculating and representing performance data; The performance of the Company may not be directly comparable to the production of other private or registered funds or companies; The securities are offered in reliance on an exemption from the Securities Registration under the Federal Securities and Exchange Commission's Regulation D, Rule 506(c) registration requirements, and therefore are not required to comply with certain specific disclosure requirements; The Securities and Exchange Commission has not passed upon the merits of or approved the securities, the terms of the offering, or the accuracy of the materials.

Per rule 144 of the Securities and Exchange Commission, after the initial sale, The Securities may not be resold within one year without registration or qualification for an Exemption from registration.

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Please consult with your applicable professional for such advice