Real Estate Investment Syndicates – an Overview

Prepared For: Legal Education Society of Alberta

Commercial Real Estate in Distress

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For Presentation In:
Edmonton – October 14, 2009
Calgary - October 16, 2009

REAL ESTATE INVESTMENT SYNDICATIONS – AN OVERVIEW

The purpose of this paper is to provide a broad overview of various real estate investment syndicates including a discussion on typical structures, how such syndicates work and issues that can arise with respect to financial difficulties and corporate governance related issues. The paper will provide a background to the real estate investment syndicates followed by examples of certain real estate investment syndicates that have ended in distressed financial positions and insolvency proceeding. Lastly, the paper will address various illustrations of the problems in addressing the financial issues of real estate syndicates given their unique structures.

I. STRUCTURE AND BACKGROUND OF REAL ESTATE INVESTMENT SYNDICATES

Mortgage investment syndicates essentially started as a result of a niche market where traditional mortgage lenders such as banks were hesitant to lend. Such markets often entailed higher risk real estate programs where the owners were unable to obtain traditional financing. Canada's alternative mortgage market is one of the fastest growing mortgage markets with an estimated value of up to $100 billion.

With the increasing desire for alternative lending structures, various structures were developed including Mortgage Investment Corporations ("MICs") or mortgage brokers who arranged for various individuals to participate in a mortgage syndicate. In these examples, individual investors would often receive security by way of a portion of a mortgage registered against title of the property. As the syndicated investment structure evolved, certain creativity in the structures also evolved such that investors could invest in a special purpose entity who was to receive funds from investors under an offering memorandum and the company was to purchase and/or develop certain real estate. In this example, the investors could receive equity or debt of the entity but would not have a mortgage registered on title.

Mortgage Investment Syndicates

Mortgage investment syndicates generally result in a mortgage broker who brings together a borrower and a lender. With respect to syndicates, the mortgage broker would arrange for a series of individual investors who would participate in a mortgage (or other type of investment) with the funds raised being advanced or loaned to the borrower. The mortgage broker would receive a commission for arranging the funding and generally a fee for on-going administration of the loan.

For mortgage investment syndicates, often the mortgage broker would arrange for a 'bare trustee' to be established who basically acts as a middle man between the individual mortgage syndicate members and the borrower. For example, the bare trustee would raise the money from the individual lenders and enter into agreements with the investors as to the rate of interest to be paid and what security the bare trustee is to hold on behalf of the investors. The bare trustee would also hold the mortgage or loan documents with the ultimate borrower. In theory, the funds received by the bare trustee from the investors should be advanced to the borrower less any commissions owing to the mortgage broker who arranged for the financing.

As monthly principal or interest payments are paid by the borrower to the bare trustee, the bare trustee would then pay these interest receipts to individual investors based on the prorated share of the syndicate. The bare trustee's assets would comprise the loan to the borrower and its liabilities would be the amounts owed to the syndicate which should balance.

Depending on the structure the bare trustee may register each individual on a declaration of trust and the mortgage documentation which would set out how much each individual mortgage investor funded with respect to the particular mortgage.

Other Real Estate Syndicates

The example above provides a bare trust illustration where the syndicate participated in a mortgage or other loan arrangement such that they were a creditor to an intermediary who in turn had an arrangement with the ultimate borrower.

Other illustrations where real estate syndicates evolved include single purpose companies who have no assets and liabilities (basically a shell company) who issue an offering memorandum to raise funds from investors which are to be used to acquire and/or develop real estate. In these structures, investors would advance funds directly to the company who would then undertake to acquire the real estate and proceed with the development as set out in the offering memorandum.

Often a marketing agency would be involved to coordinate the raising of the funds and would receive a commission for doing so.

Other structures include raising of funds through limited and general partnership structures.

The Lure of Investment Syndicates

Investment syndicates often are an attractive form of investment as they allow individual investors to participate in loan structures that they could not otherwise participate in. For example, an individual investor could participate in a mortgage syndicate on a $10 million development with an initial investment of $10,000 to $100,000. Often the rate of return on such investments is attractive and the investor can receive security which is registered on title.