Bringing in a "money partner" can help build your real estate portfolio into a winner

Joint ventures

There will come a time when most real estate investors will be looking for secondary sources of cash to build their portfolios. Some will use additional leveraged monies, such as lines of credit, or equity in the rest of their portfolio, or even private money. However, one of the most common solutions is bringing a "money partner" into the mix – someone who can provide working capital to fund the portfolio growth and who is looking to get a return on their available cash.

REAL ESTATE INVESTING

DON CAMPBELL

Although this type of relationship is commonly called a joint venture, in many cases it is not technically such. Many times it could be a shareholder relationship, where the investor and the cash provider own shares of a corporation, which they use to invest. In other cases, the money investor just wants a simple, annual percentage return on their investment – this would be a lender relationship.

A true joint venture occurs when two or more parties get together and pool their money, knowledge and leverage to build a portfolio. No shares are owned; it is just two or more parties deciding that the best course of action for both is to work together. They agree to terms on money, dividing of duties and setting of goals. From that comes a joint venture agreement (or as some wags call it, a business prenup agreement).

This agreement must be detailed and must be completed before any money passes hands because once real money enters the equation, new emotions enter, making the written agreement much more volatile to create.

When an agreement such as this is created, it becomes the basis of the relationship moving forward and deals with all potentialities (taxes, income, expenses, death, divorce, duties and disputes).

The majority of these joint venture deals are structured where one partner finds and negotiates the real estate deal to the absolute best of their ability, while the other partner or partners put up all or a good portion of the cash in return for participating in the ultimate profits or losses in the deal.

They are full partners, each with their own risks in the deal, but with different roles.

One is contributing their vast expertise, experience and contacts to maximize the profits in the deal by choosing the property wisely, arranging a good price and then managing the day-to-day operations of the property.

The other is often a silent partner providing just the initial investment capital.

Risks are shared, as are the rewards, mostly on a 50 per cent for each party basis (after the money partner is first paid back their capital).

How it works

The following is a very simplified example (that does not take taxes into the equation):

Purchase and operation

1. Property is valued at $350,000 when purchased, but real estate expert partner negotiates the deal and buys it at $300,000.
2. The money partner puts up $65,000 (for down payment and closing costs).
3. A mortgage is arranged for the remaining $235,000.
4. Property is overseen by the real estate expert partner.
5. Money partner receives monthly or quarterly updates.

Profit split

A few years later, the property is sold for $420,000.

Here's what happens:

1. The bank gets paid back the remaining mortgage of $210,000.
2. The money partner is paid back their initial $65,000.
3. Closing costs are paid (lawyer, realtor commissions) of say $5,000.
4. Leaving $140,000 pre-tax profit which is divided equally between the two partners.

This simplified math scenario is very typical where the money partner, with very little effort, receives a strong return on their initial investment. The real estate expert puts in all of the effort of maximizing the profit for the partnership, so the money partner does not need to.

Cash flow

There is one component that is missing from this equation and that is the positive cash flow that is created from the property (usually beginning in year two of ownership). This cash flow, in most cases, is split 50/50 on an annual (not quarterly) basis.

Bringing other people's money into your real estate deals can be a huge win, but it is critical that you look after the other partner's money better than you would protect even your own. In order to make this structure successful and repeatable, you must give extra attention to your due diligence, making sure you're buying into the "right deal." Never, ever put someone else's money into a deal that you wouldn't put your own (or your grandmother's) money into.

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Never tolerate risks that you or your investor wouldn't normally accept. Explain the risks to the money partner in advance and keep in close contact. If there is bad news, don't hide it. If there is great news, tell them early and often. This is critical because a successful deal is the best way to attract even more funds to your investment business.

Leverage in real estate comes in many forms including leveraging of money, leveraging of time, leveraging of knowledge, as well as leveraging of expertise. All take time to create, are equally important in a deal and all must be in balance for the deal to be profitable. That is why business relationships between people with different assets and skill sets work much better than those with matching skills. ◆

Calgary-based Don Campbell is a founding partner and senior analyst with the Real Estate Investment Network and author of the best-selling books Real Estate Investing in Canada 2.0 *and* 97 Tips For Real Estate Investing. *Visit the website at* www.reincanada.com