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CAPITAL

Transcript

Where do my returns come from?

Where are your returns come from? Is a great question that not a lot of people take the time to ask. When you're investing in private equity real estate you need to understand the waterfall.

So what is a waterfall? A waterfall is very simply how cash that is under via return of capital or profit is distributed out.

And to whom and at what level? And so a lot of times that's to investors and as well as the sponsor or developer. So let me give you an example. It's very common for the first dollars that are made to be in what's called a preferred return. Preferred return could be 6%, 8%, 10%. It could be somewhere usually at single digits. And what that means is there's no split with the sponsor. 100% of that money goes to investors. And that has to happen per the document. Next, you typically will have a full return of capital.

So let's say you were in a project and it was sold. The order of payout would be you get your full preferred return, which let's just assume for this conversation it's 8% okay. 8% of your return would come back. So if you invested 100 grand, you get eight grand. And then the next piece of cash flow that would come from the sale would go to return your, your capital return of equity.

Okay. And so that would be an additional 100 grand if you invested 100. So you got the eight plus the 100. Now you're at 108, which means you've gotten your full preferred return and your full return of capital. Then you are in a piece of the waterfall we call the splits. So what does that mean? What that means is we're splitting profits between the sponsor or developer and investors. And those splits could be all over the board.

The reason they call it a waterfall is if you can visualize a waterfall and water comes down, it hits a landing and then it goes down, it hits a landing and it goes down and hits a landing is the idea. And so what happens is there's an event and and cash is paid a certain way.

Then another event happens and cash may be paid a different way. And then another event happens in cash may be paid a different way

So it may start out at say 80/20 up until you get maybe a 14% return. And then it may shift to 70/30 or 60/40 until maybe you get an 18 or 20% return, and then it may go to 60/40 or 50/50 above that. So why do that? Because it incentivizes the sponsor and the developer to push the return as high as possible because they get a higher payout, which is in the investors best interest.

And so there's all kinds of different versions of this that we can see on the market. What we will do is help you understand that. We will explain that and tell you why we think it's in your best interest, or why there might be something to look at. Their or why we may or may not like that.