SyndicatedInvestments

IRISHTIMES
Wednesday, October, 13 2004

# Should I invest in a property consortium?

## Is is sensible to get involved in a syndicate? Yes – but be careful to read the small print warns property consultant **Bill Nowlan**

A question that I regularly get asked is "Should I invest in a consortium acquiring a given property. How do you know the difference between good ones and bad ones?"

The answer to these questions is not simple. I have personally invested in some syndicated property situations myself and I have set up others for my clients.

When investing in any property, be it a syndicate or a sole purchase, you must be sure you know what you want and if that property can deliver your expectations. If you are a pension fund paying no tax then the income can be as important as the capital appreciation.

Be sure that you don't put all your eggs in one basket and be prepared for surprise. The advantage of syndication is that it allows you to get a spread of investment in quality property but only if you select your syndicate wisely.

If you decide to go the syndication route, there are some fundamental features that I would recommend that you consider.

Firstly, the underlying property is of critical importance. If you don't get that right you are doomed from the start. No "syndicator" can do anything about a bum property.

Even if it is fundamentally a good property, not all properties that are sound long-term investments are suitable for syndication because generally by their nature, syndications are relatively short-term investments at say, eight or 10 years.

The second issue is to be sure why you are investing in the syndicate in the first place. Do you want income or capital appreciation? What is your age and your risk profile?

At my age I personally see syndicates as a way of securing good income whilst the underlying invested capital is protected against inflation and offering a degree of capital appreciation. If all you are looking for is spectacular capital appreciation, then syndication is probably not the way unless you are very close to somebody in the know.

In my view the days of spectacular property appreciation in Ireland or in the UK are gone and will not come pack for quite a while. Also if a property had spectacular growth prospects it will not get syndicated. In fact most properties get syndicated solely to get fees for the syndicator and not to enhance the wealth of the participating investor.

The next issue is to look at the exit mechanism from the investment or in other words, how do you get out? Do I have to wait till the property is sold? How do I ensure that the property gets sold?

Generally it is very hard to get out of a syndicate before the scheduled exit date. Getting out at the expiry date is another matter. There will probably be all sorts of words expressing good intentions about the property being sold at, say, year 10 but at the end of the day, if you only control one or two per cent of the syndicate you have little say and the syndicate manager will have all the say.

I say to my clients not to rely on their money coming back on the day set out in the letter canvassing the investment, as the property market may not be in shape to sell your property at that date.

Property investment is generally illiquid but syndicate investment is even more illiquid. Allow several years latitude for getting your money back

The next issue is that of borrowing to secure the property. The number one issue in borrowing is the liability for interest and capital on the syndicate members if things go wrong. It is not unknown for tenants to go bust or for interest rates to rise significantly. If the borrowings are not fully non recourse (and get your lawyer to check the fine print) don't touch the project with a barge pole. It's one thing to lose your investment in the syndicate, it's another to lose your house!

In particular, when your lawyer is checking the fine print make sure that any borrowings are not joint and several or that the syndicator/manager can't bind you in future dealings with the bank.

The level of borrowings is also important. The knee jerk reaction is to borrow as much as possible, i.e., 70 to 80 per cent of the property acquisition cost with the investors putting up the balance. Syndicators and bankers love this approach because the hard money for them to rise is the equity.

Of course the appeal of borrowing as much as possible secured on a property is that if the property appreciates in value, then the equity values rise significantly, i.e., by the amount of the leverage. The downside is that if the value of the property falls, the value of your equity will be wiped out.

I have advised some of my clients to go into syndication with only 50 per cent gearing especially if they are pension-focused investors because this lowers the risk significantly.

On the issue of taxation of members of syndicates and within the syndicate I could, and may, write an article solely on the subject of taxation of syndicate property.

All I will say to day is that it is complex area and before putting money into a property syndicate talk to your personal tax advisor as there are a whole range of issues ranging from CGT, income tax, succession taxes and VAT.

I now come to my favourite subject namely fees and costs involved in property syndicates. Long-term property investment is about income and securing a growing income. The cost of setting up and managing a medium-sized consortium investment is not small and can absorb a big piece of that income. In addition to the normal purchase cost there will be additional work for lawyers, tax advisors and for bankers.

The syndicator will want to secure his slice and someone will have to administer the syndicate and manage the property throughou its life. When the property is sold there wil be a fresh crop of professional fees and costs All these costs come out of the investor' pocket. Some will come out upfront, other over the period of the investment and other at the end.

Every syndicator has a different approacl to managing these costs. Some will keep then down to the minimum by negotiating th