A "SOPHISTICATED" APPROACH TO UNDERSTANDING THE TYPES OF INVESTORS & SEC REGULATIONS FOR INVESTING

What is the difference between an accredited and sophisticated investor...and why does it matter?

What is a passive investor?

A syndication typically has many passive investors. A passive investor's role in a real estate syndication is to supply the money needed to fund the deal. **Passive investors are also known as limited partners.** Depending on the deal, passive investors receive all of the benefits of owning real estate---*such as cash flow, forced appreciation and a tax sheltering asset.* This comes without the headache of finding the deal, getting it under contract, financing the deal through a bank, raising the extra money needed for closing/repairs, hiring a property manager, and managing everyone to make sure your vision is met.
In other words, **a passive investor supplies the money, reaps the rewards of personally owning real estate while avoiding the whole "tenants and toilets" downside of real estate investing!**

Who can invest *passively* in apartment syndications?

There are two groups of passive investors in apartment syndications:

- **Sophisticated** Investors
- **Accredited** Investors

Why does my investor status matter?

Your investor status will determine what the U.S. Securities Exchange Commission (SEC) allows you to invest in. Real estate syndicators must follow these rules to stay legal.

- Sophisticated Investors
    - Primarily limited to 506(b) offerings (which requires a pre-existing relationship with the real estate syndicator).
- Accredited Investors
    - Can invest in 506(b) with a pre-existing relationship or 506(c) offerings.

Are you an accredited or sophisticated investor?

Sophisticated Investors

- No requirement for how much you and your significant other earns a year.
- Requires the ability to evaluate the merits and risks of the investment offered.

Accredited Investors

- Income requirements
    - *If you're single (and ready to mingle!)*
        - Earn >$200,000 per year for the past 2 years and plan on making this income the following year.

          --OR--

        - Over $1,000,000 in net worth (minus your home).
    - *If you're married...*
        - Earn >$300,000 per year for the past 2 years and plan on making this income the following year.

          --OR--

        - Over $1,000,000 in net worth (minus your home).

What is a Rule 506(b) and Rule 506(c) offering?

The SEC allows syndicators to raise money so long as they follow a few rules. The two most common rules used to fund apartment syndications are **Rule 506(b)** and **Rule 506(c)**. **Rule 506(b)** offerings (90% of all real estate syndications) can have sophisticated and accredited investors in a deal, so long as there was a pre-existing relationship and no advertising was used through social media, email, or offline marketing. Any real estate syndication that hits your desk through marketing without a pre-existing relationship falls into a **Rule 506(c)** offering (7% of all real estate syndications). **Rule 506(c)** offerings only allow accredited investors in the deal.

This means that you'll never even get to see 90% of all real estate syndications because they're 506(b) offerings! In order to get involved in a real estate syndication as an sophisticated/accredited investor for these deals **you need to build a relationship** with an operator in the deal!

Here's a summary:

- **Rule 506(b)**: ***90% of transactions***
  - Eligible investors
    - **Max of 35 sophisticated investors** <u>**AND**</u> **any amount of accredited investors**
  - Can't be advertised
  - **Requires pre-existing relationship**

- **Rule 506(c)**: ***only 7% of transactions***
  - Eligible investors:
    - **Only accredited investors**
    - Advertised through social media, email and/or conferences
    - No pre-existing relationship needed

- Rule 504, Rule 505, Crowdfunding: *3% of transactions*

A Small Rant by the Author, Jesse Daconta:

Most people can invest in real estate syndications and make actual passive income. Every investor I meet invests in real estate for passive income and envisions themselves collecting "mailbox money" while they're doing what they love. ***As long as you're the one finding the deals, raising the money, gathering a team, and closing on deals--- you have a full time job even with a property management company.*** **The only investors who receive "mailbox money" are passive investors *(this could be you)* or note investors *(mostly banks)*!**

What's needed for a "pre-existing relationship?"

The SEC doesn't have a requirement or definition for what's needed to check the box for "relationship". Most real estate syndicators who have **506(b)** offerings will allow investors into their deals once they feel that they know you, your investment goals, and have spoken to you a couple times through phone or in person. So what does this mean? ***If you're interested in being a passive investor (accredited OR sophisticated) and want to unlock 90% of all real estate syndications, go forth and build relationships!***

Quote

"If you want to change the world, find someone to paddle with."

-Admiral McRaven

For those who don't understand certain vocabulary words in this article. We recommend checking out last month's article: "Real Estate Syndications: What Are They?"

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