



## **Pooled investment vehicles - Time to get together for some net-lease investing**

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Owning a net-lease (NNN) property can be one of the easiest, wisest, and most practical long-term investments. However, due to the high price of many of these properties, most people do not have the financial resources to own one directly or by themselves. In an effort to gain access to these types of investments, investors have traditionally looked to REITs or Tenant-in-Common programs. These types of investments, while providing exposure to net-lease properties, have significant drawbacks compared to direct ownership. In contrast to these types of ownership, investors are increasingly looking to invest in special purpose LLCs.

For the small investor, pooling funds into a newly formed and privately held LLC can offer the best returns and control of investment properties. Since most people looking to invest in real estate do not want to be full-time landlords with all the inherent responsibilities, net-lease properties, in which the tenant pays for and takes care of all taxes, insurance, and maintenance, are a perfect fit. These properties can provide a long-term lease, minimum landlord responsibilities, and a consistent and reliable return.

In order to create a special purpose LLC, a group of investors will need to outline their desired investment returns and comfort level with leverage, and have an investment timeline. When deciding on net-lease properties, investors must consider the credit rating of their prospective tenant as well as the total lease term. In order to avoid the problems associated with TIC investing, the LLC investors will not own real estate directly, but rather own interest in an LLC, which owns the real estate. Similarly, any mortgage placed on the property will be non-recourse to the investors, and instead underwritten to the LLC.

An example of a pooled net-lease purchase:

A group of four investors recently decided that they would pool some resources to gain direct exposure to real estate. No one amongst them had enough money to own a commercial property individually, but had decided that going the route of purchasing a single-tenant medical facility would be an interesting alternative investment from their standard equity investing. Each of the four pooled \$250,000 and contributed to a new LLC for the purchase of a property. After forming the LLC, the group put in an offer, or Letter of Intent, to purchase a dialysis facility that was run by and tenanted by an investment-grade medical group. The property was purchased for \$1.8 million and was encumbered by an \$800,000 non-recourse mortgage. The group also decided to have the LLC managed by a real estate group with an expertise in dealing with all financial matters as well as real estate nuances of net-lease purchases. After paying mortgage expenses and management fees, the LLC is now able to pay out a nearly 8% annual return to their group of four investors, with payments made monthly to each for an ongoing flow of income. In addition, by using a special form of depreciation known as cost segregation and mortgage interest, the LLC is able to defer over 90% of

the annual income, leaving the investors with little to no current income tax consequences. By using the depreciation, the investors will incur long-term capital gains tax only when they either sell the property or their own interest in the LLC. With current tax rates, they will have cut their total taxes in half.

For investors looking to gain direct access to real estate, a closely held LLC may be the best form of ownership. By utilizing a management firm with expertise in net-lease investments, investors can have passive and direct access to real estate and generate returns that are above or on par with most traditional investments. To compound that return, the use of depreciation, which is diluted in REIT ownership, will generate a larger after-tax return of the same asset. To take the risk even further down a notch, many net-lease properties have a corporate guarantee by the tenant on the lease, adding even further to the reliability and dependability of this investment vehicle.

Iridium Capital Partners is a manager of closely-held LLCs which invests in net-lease properties.

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