MONTHLY
CANADIAN
realestate
canadianrealestatemagazine.ca

JOINT VENTURES: ARE THEY RIGHT FOR YOU?

Renovating · Buying · Investing · Borrowing

PLUS mortgage guide

TARGETING THE BEST TENANTS

Where and how to market your property to get long-term, secure renters

GETTING FINANCE IN TOUGH TIMES:

The private lenders helping investors

Using leverage to bolster your property portfolio

Moncton, NB:

Investment hotspots in a booming city

We show YOU how

How Mike Holmes has used lease-to-own options to buy 9 properties in 18 months

Display until July 20, 2009

July 09 $7.99

07

0 55113 70148 1

KMI

Publications Mail Agreement 41261516

Partnering for profit

With economic uncertainty sapping some investors' confidence, joint venture deals – where investors partner to buy property – are beginning to attract more attention. *Suzanne Sharma* outlines what you need to factor in if you're considering this approach

The days of zero down payment mortgages are gone for investors. Given the current state of the economy, lenders today have tightened their lending requirements. In order for rental property applicants to be approved for financing, they must declare their income and have a minimum 10 per cent down payment.

"Banks are much more cautious now with their money and want to reduce the risk of default as much as possible," says Walter Koziej, broker at Mercury Mortgages Inc., Mississauga, Ont. "Someone who is not putting any money into a rental property is not very motivated to keep it. It is easy to walk away from it and let the bank take a loss."

While interest rates are at historic lows, some investors might still find it hard to obtain financing or they may not have the necessary capital already available to fund an investment opportunity. Meanwhile, others might be new to the game and may not have the time or knowledge to make an educated investment decision.

This is where joint venture (JV) partnerships come into play because it can help an investor raise enough capital to back their investment.

JV deals are comparable to marriage in that both parties must be able to rely on each other, a contract is signed and everyone expects to live happily ever after. But like marriage, JV deals aren't always so smooth and unless both parties understand their responsibilities, they may wind up in over their head.

By assuring that due diligence is carried out, including researching the potential partner, understanding what each party is responsible for and signing a contract that has been looked over by a professional, JV deals might be the perfect solution on how to get into the market when credit is harder to attain.

The roles

Each partner plays an important function within a JV deal. It's vital to know who you're partnering with, so don't be afraid to ask questions, check referrals and get a professional to read through all the fine print.

The finder

You are essentially the brains behind the operation. The deal is based on your research and findings. As the finder, you put together the proposal and outline the potential ROI.

"The finder deals with everything pertaining to the property from locating and negotiating the deal, getting the property ready to rent, maintaining the property and managing tenant issues," says Brian Pulis, business coach at Growth Strategies, Brampton, Ont.

Finders are defined as real estate experts who already known to have a solid personal property portfolio and large network, adds Pulis. "You don't need to sell yourself; people will come to you so long as you've done your due diligence and really made yourself an expert."

Generally, the finder must build a reputable base, educate themselves on how to invest in a property and JV deals, and gain experience in the market. It may take time to acquire this type of standing, but many will not trust or partner with someone who doesn't have a successful track record.

The investor

You are the money man and benefit from the experience and network of the finder. You're offered a return for

"Banks are much more cautious now with their money and want to reduce the risk of default as much as possible"

Attracting 'the investor'

Coming into a JV deal as 'the finder' takes a lot of work. Researching the area, scouting a property and analysing the potential ROI is all on your head – as is locating 'the investor.' While the first three efforts depend on your ultimate real estate goals, the latter can be made easier by following these steps.

1. To become the finder in any JV deal, first educate yourself. Build a solid track record with a successful property portfolio and a large network. Ask yourself, how would you benefit the investor?
2. Have a meeting with the prospective investor and determine compatibility. Choose your partner wisely.
3. Have the investor check your references and perhaps drive by other properties that you own.
4. Prepare a Letter of Intent and ask the investor to obtain independent legal advice before signing. Also, assure the investor meets with a mortgage broker to establish financing ability.
5. Sign the Letter of Intent and collect the deposit.
6. Proceed with locating a suitable deal that meets all criteria as agreed upon by both parties.

Source: Brian Pulis, business coach, Growth Strategies, Brampton, Ont

Attention investors!

Before handing over your money, be sure you know who you're dealing with. By asking a few questions and getting answers in writing, you may be able to better protect yourself in the long run.

1. If I purchase a property through your company, will you deal with all transactions, such as purchasing of home, all legal fees and Realtor fees associated with the home?
2. Will you also be responsible for tenants and maintenance issues? What are the costs?
3. In the event the tenant sues, will I also be held responsible, or just your company?
4. Where will my name show? Property title, insurance?
5. You issue reports for tax purposes. What exactly will be included in the report?
6. What kind of policy do you have when it comes to me seeing a statement of activities?
7. Worst case scenario: how do I know you are not taking the repairs and maintenance funds and withdrawing them for personal use?
8. What are the conditions if I decide this is not working for me?

Source: David Sandbrand, VP of business development, Cobblestone Investments, Calgary

Sample Letter of Intent

Finders (your name)
(your address)

Date

Investors
At their address
City, Province, Postal Code

Dear Investors:

RE: Joint Venture Agreement between __Finders__ (Finder) and __Investors__ (Investor)

We're excited that you are interested in working with us. We'll be searching diligently for good properties.

This Letter of Intent is not a contract, it's a working document to agree in principal until we sign the Joint Venture (JV) Agreement. This letter tells us you are committed to investing with us and providing all or most of the cash required. As Finders, we make a commitment to you to conduct and oversee all business relating to the finding, acquisition, administrative detail, and final closing on our JV property.

1. Property Specifications

a) Property will be purchased before _________

b) Price range will be between $___________ and $____________

c) Single family home / duplex / home with suite / condo / other

d) _________ sq.ft. or larger

e) _________ bedrooms or more and ______ bathrooms or more

f) located in ____________________________

2. Estimated Financial Contribution (EFC)

a) You agree to have funds available for your EFC.

b) You make a commitment to contribute between $_________________ and $_______________.

c) Your EFC will depend on selling price, closing costs and initial repairs needed on property – all of these costs are considered as your Capital Investment.

3. Mortgage Funding

a) __Finders__ / __Investors__ / __Finders and Investors__ will be qualifying and applying for mortgage jointly unless mortgage is assumable without qualifying.

4. Targeted Closing Date:

a) On or before ____________________________________.

5. Title on Property

a) Title can be held in a number of ways. The classic way is for title to be held in both parties names, either personal or corporate. We can be Joint Tenants or Tenants in Common. We have other choices that may depend on our financing. We will hold title the way that suits our JV best once we know who is better placed to get financing.

6. Length of Hold

a) Both parties agree that this is a long-term investment and agree to hold the property for a minimum of ______ years unless both parties agree to change this time period.

7. Property Ownership

a) Finders will own a __________% share of the property.

b) Investors will own a __________% share of the property.

8. Cash Flow

a) Will be split _____/______ between Finders and Investors.

b) It is recommended that any positive cash flow in the first year be banked to create an operating reserve fund.

9. Upon Sale or Refinance

a) After _______ years or upon sale or on refinance of property, Investors will receive their Capital Investment first and then the remaining funds will be shared as per 7. and 8. above.

10. The Next Step:

We will search for an appropriate property and secure it under contract with an appropriate deposit.

We agree to the content of this Letter of Intent:

Please sign and return.

Source: Barry McGuire, lawyer and JV specialist, Edmonton your capital without having to put forth the time and effort required in real estate investing.

Though it may sound simple, this is still a huge undertaking. If the investment flounders, you risk losing everything you've put into it.

In order to protect yourself, experts advise you should partner with those that have honest business models and a solid background. Be sure to analyse the figures of the investment and check the references of any potential partners. Look for deals which clearly state in the agreement that the finder makes money after the investor gets his or her cut.

Overall, each partner needs to perform their due diligence on the other, says Todd Millar, president at Glenn Simon Inc., Edmonton. "This may include the investor checking the credit of the finder. The money partner should ask the tough questions about his potential JV partner. Look at the team behind the finder, their skill and expertise."

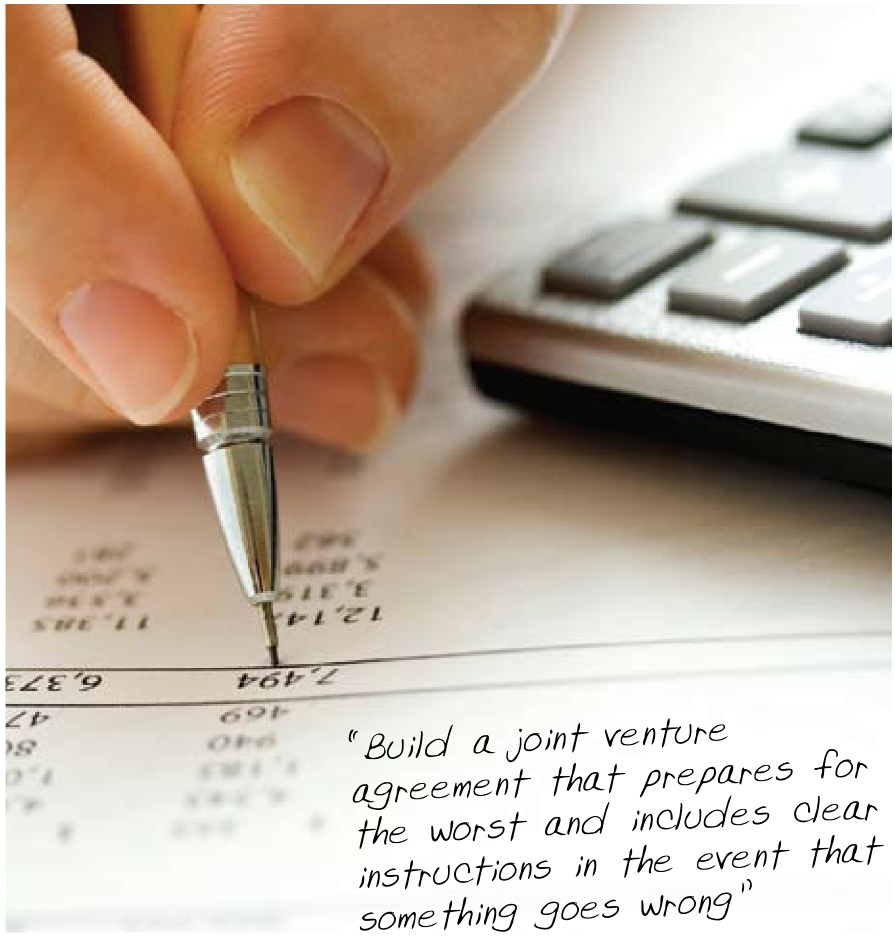
Contracts

There are two items that should be signed in every JV deal in order to protect both parties and assure the deal is followed through.

The Letter of Intent is signed in the beginning stages and includes the general responsibilities of each partner. In essence, it states all items that are discussed between the investor and the finder and puts it on paper. This is meant to prevent the investor from walking away at the last minute.

For example, the Letter of Intent may go into specifics such as the value of the potential property, as well as the agreed upon cash flow and ROI.

The Joint Venture Agreement (JVA)



"Build a joint venture agreement that prepares for the worst and includes clear instructions in the event that something goes wrong"

Tax implications

In a joint venture arrangement, each coventurer determines income by picking up their own direct expenses, plus the proportionate share of joint venture revenue and expenses.

This approach differs from both a general partnership, and a limited partnership type of structure says Craig Keller, chartered accountant in Waterloo, Ont. In a partnership, each partner reports his or her share of income or loss after all revenue and expenses of the partnership are determined.

"Borrowing cost expenses thus can be shared, or can be deducted by the one person only, depending on the investment structure," says Keller. "The investor typically should deduct the borrowing costs. The finder of the property would not normally share in this deduction (unless they paid for part of the borrowing costs)."

In short, each participant in a joint venture contributes assets, shares certain expenses and revenues but also may have other expenses that are unrelated to the other participant's position.

CASE STUDY:

PeeverConn Properties

Carson Conn, 25, and Derek Peever, 25, entered the world of real estate with little investment capital. However, their dedicated attitudes and thirst for knowledge, along with guidance from their fathers, allowed them to purchase their first joint venture (JV) property, a condo in Agassiz, B.C., in 2006 for $65,000; each partner put $5,000 down.

Now, the current market value of the property is estimated at $105,000, with about $150 per month in positive cash flow.

After their first deal, the duo decided to continue investing in joint ventures, a method they felt would allow them to participate in bigger, more profitable deals that they otherwise may not be able to pursue on their own.

In 2007, they purchased another condo, a two-bedroom, two-bathroom for $150,000 in Mission, B.C. This time around, they used their investor's secured line of credit to buy the property. They renovated the property over a two-month period, costing them $12,000.

"The property was then appraised at $200,000 and we took out a new mortgage equal to 75 per cent of the new value ($150,000), cashing out the investor's line of credit," says Conn. "We were now into the property for only the cost of renovations and closing expenses. This property is currently rented for $1,146 per month, resulting in $280 per month positive cash flow."

Peever explains one of the biggest sources of capital for real estate investing, which many investors use for JV deals, is secured lines of credit for those with equity in their homes. The formula the bank uses to see how much equity you can access out of your property is the appraised value multiplied by 80 per cent less the mortgage(s) the investor owes. The line of credit is usually at prime or one over prime and if used to invest in investment property the interest is potentially tax deductable.

By the spring of 2007, the pair established their company, PeeverConn Properties, which scours the market for bargains and finds profitable properties for investors, and it is these partners that provide the capital. Returns vary deal-to-deal, but Conn and Peever use a conservative three to six per cent per year appreciation rate.

"We also cut investors $100 cash flow cheques to offset their interest payments," says Conn. "We measure our returns by calculating the cash-on-cash return (appreciation plus mortgage pay-down plus cash flow, divided by capital invested)."

Conn advises investors to screen their partners, check references and ask for testimonials. "You also want to make sure that all parties involved acquire independent legal advice and that there is a Joint Venture Agreement in place that has been prepared by a lawyer specializing in real estate law," he says.

Additionally, it is wise to pre-plan all the key aspects of the terms of the deal before meeting with the lawyer, and this can save a portion of the legal fees. Lastly, seek independent accounting advice on the particular joint venture opportunity.

"We started with approximately $15,000 each and through joint ventures we were able to leverage our limited capital allowing us to purchase our first properties," recalls Peever. "Since then, we have built a multi-million dollar portfolio generating positive cash flow."

Carson Conn and Derek Peever

is signed upon closing, and is a detailed legal document, which includes even the most miniscule details including the term of the deal.

Millar uses a JVA template that covers all the potential hiccups the partnership may encounter, as well as all the possible solutions for each.

"Build a JVA that prepares for the worst and includes clear instructions in the event that something goes wrong," he says. "Include clauses like death, bankruptcy, divorce and partnership buyouts."

Also, have a clear exit strategy outlining both partners' roles. This prevents either party from bailing without repercussions. If this isn't discussed beforehand and one party wants to break the contract in the midst of the deal, then a settlement must be negotiated or it can be taken to court.

The JVA is not an area to be frugal so it's important to get a lawyer familiar with JVs to look it over before signing. Costs vary deal-to-deal depending on the amount of work required by the professional.

Generally, a lawyer will review the clients understanding of joint ventures, then move on to conversations of risk tolerance and the JVA.

"Depending on their level of sophistication, this can take a substantial period of time and, of course, substantial legal costs," says Barry McGuire, lawyer and JV specialist, Edmonton. "If somebody wants to get a joint venture agreement drafted using this technique, and wonders how much the legal costs are, it could be easily $5,000."

McGuire adds that in a two-person joint venture, it is common for only one of the parties to be on title. "In that situation, the party not on title should have their interest recorded not as a title holder but as an interest holder. The way you do that varies widely from province to province. Some accountants recommend that there be a trust agreement in place where only one party is on title. Sometimes the party who contributes most of the cash but is not on title will require a second mortgage to be registered protecting their financial investment."

The deal

Essentially, JV partnerships allow likeminded individuals to come together

Sample JV deal

Property type	Duplex in Barrie, Ont.
Purchase date and price	2004 for $175,000
Investors total investment at closing	$12,000
Profit share	50/50
Monthly positive cash flow	$444
Current property value	$235,000
Total profit for the investor as of May 2009	$36,000

The property was refinanced in the spring of 2008 and $40,000 was reinvested towards the purchase of a Triplex for $252,000 in Orillia, Ont. If the JV deal was terminated today (May 2009) the investor would receive his initial deposit back ($12,000) plus 50 per cent of the equity for a total $36,000 return. In addition the investor would still have a 50 per cent share of the triplex.

Source: Brian Pulis, business coach, Growth Strategies, Brampton, Ont.

and invest in a venture for a set period of time. Both parties split the profits and assist the other in realizing their real estate goals.

Residential real estate partnerships, the most common type of JV deal, target properties ranging in size from condo units, to single-family homes, to apartment buildings. The structure is set up with partners who directly own a portion of the assets.

On the plus side, this allows entry-level investors with less capital to get involved. Cash flow is the primary yield. Keep in mind that with this option, you're putting all your eggs in one basket and with property investing, diversification is ideal.

David Sandbrand, VP of business development at Cobblestone Investments, Calgary, explains there are two basic ways to tackle this type of deal. The first is where he, as the finder, gets approached by an investor, signs a Letter of Intent and then searches for a property that meets all criteria.

The second is where he purchases a property, renovates and rents it out and then gets an investor to 'buy him out.' This frees up his and he still maintains 50 per cent ownership. Also, he has found that investors are more apt at getting involved when they see the property is already being managed and has a solid rate of return.

When asked why he gets a money partner involved and doesn't continue to invest solely based on his own, Sandbrand's answer is simple.

"The reason I invest in JVs is because I'd much rather own 50 per cent of 100 properties, instead of 100 per cent of 50," he says. "My capital would run out if I didn't partner with someone. It's just smart business sense."

On the flipside, the investor providing the funds is required to do very little and can sit back and reap the rewards. It's a win-win situation for both, he says.

At first acquisition, money partners tend to be more active in order to assure their investment is solid. After seeing solid returns they typically become less hands-on.

Sandbrand's most recent purchase, a four-plex in west Calgary for $762,000 (initially appraised at $1.03 million) is generating $5,200 per month in rental returns.

The deal was broken down with the money partner putting in $100,000, which covered the down payment, legal fees, taxes, insurance, maintenance and reserve fund for the property. Meanwhile, Sandbrand took care of qualifying for the mortgage with his name on title, and the rest of the buying process.

At the end of the five-year term, the money partner is projected to profit $157,164, based on an annual 31 per cent rate of return, on top of their original $100,000 capital for a total $257,164, while Sandbrand will make a return of $157,164. Sandbrand says he chose this area due to growth and development, including the expansion of the LRT in the west.

Josh Woodrow, personal investor in Halifax, says the one drawback of being 'the finder' is the management issues that arise. "Though I enjoy what I do, from finding the property, to working with Realtors and negotiating deals, to legalizing the deal, to marketing the property, I find locating a good property manager may take some time."

David Sandbrand

In his experience, Woodrow has dealt with property managers who haven't performed regular inspections, attended to tenant complaints or sent him monthly financial statements.

Woodrow advises others to go through referrals and do background checks before hiring a property manager. "It's really a matter of trial and error though," he says. "You have to make these mistakes, learn from them and move on."

6/30/2009

David Sandbrand
Cobblestone Investments
146 West Springs Pl SW
Calgary, AB T3H 4W2

Simon Parker, VP Editorial & Operations
Canadian Real Estate Magazine
100 Adelaide Street West, Suite 300
Toronto, ON M5H 1S3

Dear Simon,

Thank you for including me in your July 2009 issue as an expert in the 'Partnering for profit' article. I'm happy to help, and always enjoy sharing my experience with your readers. I do however want to take this opportunity to point out two errors made in the editing of my interview.

On page 50, I was quoted as saying "The reason I invest in JVs is because I'd much rather own 50 percent of 100 properties, instead of 100 per cent of 50", and "[…] partner is projected to profit $157,164, based on an annual 31 per cent rate of return […]", and both of these are not true.

First, truth be told, I'd much rather own 100 per cent of 50 properties than 50 per cent of 100 properties, since the additional work that we do when we bring JV partners in to a deal is much higher than it would be if we owned the entire property ourselves. For the same internal return, it would be far less overhead for us to not have investment partners.

My actual quote was that I would rather own 50 per cent of 100 properties, instead of 100 per cent of **10** properties.

Second, we never have and never will project a rate of return for our investors. Based on the performance of past projects, the market conditions expected over the life of that investment, and the leverage used to buy that particular property, it is our goal to achieve an above-average rate of return for our investor. No projection or guarantees are ever provided to prospective partners. Estimates and goals are always based on forward looking information, and are never guaranteed.

Thanks for your time Simon,

David Sandbrand
VP Business Development
Cobblestone Investments