Pitfalls to Avoid in Passive Alternative INVESTMENTS

KEGLER BROWN HILL+ RITTER

Presented by
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You have reviewed
the pitch deck
What's Next?


Ask the Sponsor for the
OFFERING DOCUMENTS

You May Receive One or All of the Following:

- Private Placement Memorandum
- Business Plan
- Subscription Agreement
- Operating Agreement

100+

pages of legalease?
Don’t be discouraged!

Money

Verifying whether the Operating Agreement is consistent with your economic expectations

Money

Cash Distributions

If you're investing for cash flow, locate the provisions governing how net profits will be shared among business partners

Money

Tax Allocations

If you're investing for passive tax losses, locate the provisions governing allocation of profits + losses among business partners

Money

Sponsor Fees

A sponsor will perform certain services to the issuer that the issuer would otherwise need to pay to a third party

Money

PRO TIP #1

If your expectation is to receive a preferred return, then make note of when the preferred return will begin to accrue. Sometimes it begins to accrue on the date that your cash is contributed, sometimes it doesn't begin to accrue until project stabilization.

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PRO TIP #2

If the sponsor is taking a promote, then verify that profits and losses are allocated in proportion to cash contributions and not percentage interests. Also ask the sponsor whether they plan to accelerate depreciation deductions via cost segregation study.

PRO TIP #3

Verify that guaranteed payments are fully disclosed (no hidden fees), paid for actual services performed, and no less favorable than would be available at arms-length from a third-party service provider.

Power

It is not uncommon for the investors to have an approval right on certain major decisions

PRO TIP #4

Operating Agreements typically contain a provision that enumerates the rights of investors to vote on major decisions, such as whether investors must satisfy additional capital calls by the sponsor if, for example, the sponsor busts the project's development and construction budget.

Power

Transfer Rights

Govern whether a partner is able to sell its ownership stake – to another partner or 3rd party

Power

PRO TIP #5

Generally, passive alternative investments are illiquid investments, meaning you are along for the ride until either (i) the sponsor refinances the project's existing indebtedness and buys you out, or (ii) the sponsor sells the project and everyone gets cashed out. Provision that govern transfer rights are the exception to that general rule.

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Responsibility

Sponsor has a responsibility to provide periodic reports that keep investors informed

PRO TIP #6

The right balance is somewhere in between these high and lower standards, typically involving annual internally-prepared financials and a quarterly summary of issuer activity.

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Once you've reviewed the Operating Agreement:

Summarize into an investment abstract

Compare your understanding of the offering with disclosures in the PPM

A reputable sponsor will be responsive to any inconsistencies

Any response that falls short of your expectations presents the opportunity to:

Walk	Assume the Risk	Request a Side Letter Agreement

A sponsor's obligation to provide full + fair disclosure doesn't end when you wire funds

Anti-fraud provisions of federal + state securities laws apply through to dissolution

Conducting this exercise up front will better align your expectations with what's enforceable


Q&A

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