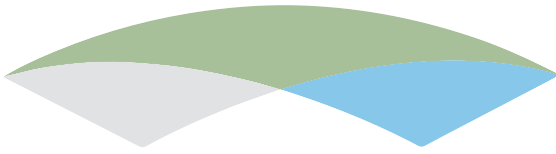

Partnerships and Syndicates Explained

For an obligation free initial consultation give us a call or send us a email.

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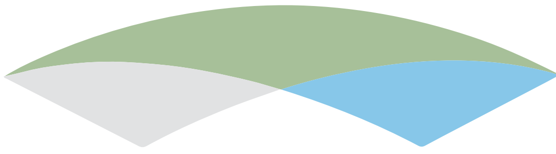
Professional guidance every step of the way

Over the past 20 years I've probably spent more time talking about, writing about and verbally explaining management rights partnership finance than just about any other single issue in the industry. The only other area that comes close in terms of general lack of understanding and prudent risk analysis is off the plan purchases of management rights. When the two collide get ready for fun and games! However, armed with a grounding in the fundamentals neither opportunity should cause alarm or present unacceptable risk to potential purchasers or investors.

The partnership (or investor syndicate) concept is not new in terms of a group of investors getting together to leverage their combined purchasing power to acquire an asset. Historically the concept has been used in the commercial property sector and to a lesser degree in the freehold hotel/motel investor sector. Acquisition of going concern businesses by investor syndicates are less common with the management rights industry being a rare exception.

Typically the management rights partnership opportunity starts with the listing of a large property. Positive attributes that might attract investors and working partners include term of agreements, real estate to going concern value ratios, return on investment, return on equity and future upside potential. I am often surprised when I meet existing partnership investors and when I ask about return on equity I get a puzzled look and a shrug of the shoulders. I am also surprised / shocked / horrified (take your pick) to learn that in many cases partnerships are formed to purchase large management rights with the working partner having no prior accommodation management or similar experience. For me the single most critical component of any partnership acquisition is to identify the right managing partner. Get that wrong and the risk profile of the transaction will rise significantly. I am also a big fan of having everyone on the same page from the outset. When I talk to disgruntled managing partners or investors the source of concern most usually stems back to the initial set up and a lack of understanding and transparency through the process. Returns not meeting expectations can also cause some angst albeit these are going concern businesses with numerous variables in terms of operating conditions. In my view no one should invest in a management rights (or indeed any business syndicate) if the return is critical to meeting debt obligations outside of the investment or the general living costs of the investor. These are discretionary investments in my view and should be treated accordingly.

So, a listed going concern or off plan management rights has been identified and the return on equity numbers look encouraging. In my mind that's a return commensurate with risk as calculated on the capital contributed by the partners. Remember, that's return after interest costs, managing partner wages, relief management, body corporate levies and incidental expenses outside those usually included in a typical management rights profit and loss for sale purposes. A suitable working partner has been found and a silent partner investor group have shown interest in the project. The group would generally engage an accountant, lawyer and finance broker to assist with the transaction, advise on appropriate structures, review risk and potential opportunities, provide finance and return scenarios and coordinate investor group meetings and the equity, offer, contract, partnership agreement and settlement process more broadly. The co-ordination of the initial assessment, negotiation of purchase price and conditions, due diligence and equity contributions is critical and in our case is undertaken by Transaction Management Consultants PL, a wholly owned Phippsfin PL and Holmans Accountants consultancy. TMC Pty Ltd liaises with select industry expert lawyers and accountants via the due diligence process and ensures that only professionals with significant expertise in partnership transactions are involved.



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Having consideration for budgeted staffing levels and the size of the business a base managing partner salary will be agreed. This would usually include a cash component plus residence within the manager's lot together with payment of utilities, body corporate fees and business outgoings. It is important for the partnership to divorce the return on equity expected by the managing partner from remuneration considerations. The two are totally separate and I have seen disputes caused by silent investors failing to recognize that the managing partner's equity investment return is a reward for capital invested, not for time and effort.

Prudent risk management would suggest that debt funding for these projects be limited to gearing levels of 65% of less and that limited guarantees be requested when putting the finance proposal together. Of course, higher gearing is available and may be appropriate on a case by case basis. I think it's also appropriate to consider interest only terms to assist in preserving the return on equity which would otherwise be eroded by the cash flow impacts of principal repayments. Loan covenants need to be reasonable and in a perfect world not give the lender too much leverage in terms of changing the rules post settlement. It's important to seek finance proposals from lenders who understand these transactions, particularly agent companies, unit trusts and increasingly self-managed superannuation fund compliance. While it is not usually possible for a SMSF to purchase a going concern we are seeing an increasing number of investors using SMSF capital via compliant purchase structures. I am not going to go into detail here except to say that under the appropriate purchase structure SMSF investment is possible and the lenders appear reasonably relaxed when dealing with these structures. Obviously investors need to seek their own advice and ensure that their investment decision complies with Superannuation Industry Supervision Act guidelines.

We have assisted a number of syndicates recently and provided potential investors with feedback in relation to likely debt finance structures, interest costs and lending guidelines. We work closely with industry lawyers and accountants to assist clients through the whole process from reviewing opportunities to executing transactions. If you would like to know more about these opportunities we are always happy to help. Simply call or email and we can provide guidance as required. If you are an experienced accommodation manager looking to take the next step we are also happy to have a chat. In closing think about this. If a bank lends a partnership 65% gearing at an interest rate of 6% and the partners contribute 35% plus costs for a return on equity of 20% who is taking the bigger risk for the lower return. Food for thought I suspect.

Disclaimer : This article does not constitute investment advice. We are not financial advisors nor do we hold an AFSL. The percentages and concepts used are for illustration purposes only and should not be relied upon in any manner. Parties contemplating the purchase of any business or any investment should consult their professional advisors.

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