SUGARHOUSE
INVESTMENTS

STOCKS VS REAL ESTATE

What's the Best Investment and Why Every Investment Portfolio Needs Private Real Estate

If you are concerned about the future of the stock market, you are not alone. Especially with the incredible volatility we experienced due to the COVID-19 pandemic. What a ride!

A lot of people, perhaps most, are left unsure how they can possibly plan for their financial future with that type of uncertainty going on in their 401ks. And most are left wondering, if not the stock market, then what, because they're not aware of better alternatives.

In this report, we're going to explore the pros and cons of investing in the stock market and suggest an alternative for you to consider.

STOCK MARKET RETURNS WILL SURPRISE YOU

Over the last 15 years the average stock market return was 7% (from 2004 to 2018). Look back over the last 30 years and it was 9% (from 1989 to 2018).

As an example, if you invested $100,000 in 2004 it would be worth $277,454 in 2018. That's nothing to sneeze at, but that's just the top line. There's more....

Because of the volatility of the stock market from year to year, that $100,000 isn't actually worth $277,454 fifteen years later. In fact it was actually worth $225,425, which is only a 5.6% return compounded every year.

ACTUAL RETURN 5.6%		
BEGIN VALUE	GAIN/LOSS	END VALUE
$240,428	-6.24%	$225,425
$201,329	19.42%	$240,428
$183,795	9.54%	$201,329
$185,147	-0.73%	$183,795
$166,215	11.39%	$185,147
$128,252	29.60%	$166,215
$113,087	13.41%	$128,252
$113,087	0.00%	$113,087
$100,272	12.78%	$113,087
$81,225	23.45%	$100,272
$132,052	-38.49%	$81,225
$127,549	3.53%	$132,052
$112,260	13.62%	$127,549
$108,990	3.00%	$112,260
$100,000	8.99%	$108,990

Still, that's not horrible, just not as good as you first thought. But then come the fees.

Actively managed mutual funds generally have an expense ratio between 0.5% and 1.0%. Some go as high as 2.5%. Passive funds like ETFs cost less, generally around 0.2%. Because most investors have a blended portfolio, and for simple math, let's assume an average fee of 1.0%.

After paying the 1% fee each year, now your $100,00 invested fifteen years ago is worth only $193,879, not $225,425. Now you're talking about just a 4.5% return!

And now for those investing outside of a tax advantaged vehicle, here comes Uncle Sam wanting his share.

For those filing jointly and making a decent income, your long-term capital gains tax rate is 15%. If you sold this imaginary portfolio, the tax consequence lowers your average annual return from 4.5% to 4.0%. (Appendix A)

And finally, we have to talk about inflation because 15 years is a long time.

The Federal Reserve has set the annual inflation target at 2%. They've done a good job of it because the actual inflation rate over the past ten years has been 1.6% over the past ten years.

An inflation rate of 1.6% compounded over 15 years reduces your after-tax return from 4.0% to 2.5%. (Appendix B).

Ouch!

In practical terms, this means that if you invested $100,000 in 2004, your actual return, meaning the dollars you can use to actually buy something with in 2018 is just $44,382 in net gains. After fifteen years!!!

Massive ouch.

The broker got his cut, the government got theirs, inflation chipped away all along, and at the end of it all you've made very little money.

If this doesn't make you angry, it should. And I hope it makes you want to choose a different path, because it should.

So now let's talk about a viable alternative to the stock market with much less volatility, higher returns, lower taxes, and inflation resistance. Private real estate syndications.

WHAT IS A REAL ESTATE SYNDICATION?

Syndication is just a fancy word for a group investment. It's where a group of people combine their resources to purchase a large asset which would otherwise be difficult or impossible to achieve on their own. This is also sometimes called private real estate equity investing.

This approach involves direct ownership of physical real estate – land, office buildings, rental homes, apartments, shopping centers, hotels, self-storage facilities, mobile home parks and so on — with the intent of making a profit. We generally focus on apartments, mobile home parks, and self-storage properties so that will be the main focus of this discussion, but the principles apply to the other asset classes as well.

This arrangement typically involves the general partners who organize the syndication, including finding the property, securing financing, and managing the property. The general partners are sometimes referred to as the "sponsors" or "operators." These terms all mean the same thing and are used interchangeably. They acquire the properties, execute the business plans and report to investors.

The group of people who provide the cash investment are known as passive investors or limited partners. In return for their investment, the limited partners receive an equity share in the syndication along with cash flow distribution and profits. "Limited" means they do not control the daily operations of the investment, and also have limited liability. The extent of their potential loss and liability is capped at the amount of equity invested. In this case, individuals are still direct owners in the underlying properties and receive all of the benefits.

Private real estate offers many benefits for investors, which is why institutional investors have long relied on it in their portfolios to balance market uncertainty. But individual investors have only begun catching onto this strategy in the last few years.

Let's talk about those benefits...

Benefits of Multifamily Syndications

There are six main advantages of passively investing in private syndications over any other investment.

#1 BELOW-AVERAGE RISK

The greatest advantage of investing in apartment buildings, mobile home parks, and self-storage properties may be their extremely low risk profile. For decades, these markets have proven much less volatile than residential real estate, the stock market, and cryptocurrency.

When the housing bubble popped in 2008, the delinquency rates on Freddie Mac single-family loans soared hit 4% in 2010. By contrast, delinquency on multifamily loans peaked at 0.4%. That steadiness leads to more predictable returns.

#2 PRIVATE REAL ESTATE GENERATES HIGH ABSOLUTE RETURNS

As we talked about earlier, the average stock market return over the last 15 years was 7%, but after fees, inflation, and taxes that return is reduced to a weak 2.5%.

On the other hand, private real estate offers investors the ability to generate high absolute returns. An absolute return considers appreciation and depreciation to measure the amount of money an investment earns over time. Looking at data from Preqin, a research company that tracks the performance of alternative investments, a $100,000 investment in private real estate beginning in 2001, would have been worth about $380,000 in 2017.

#3 PRIVATE REAL ESTATE HAS LOW CORRELATION TO OTHER ASSET CLASSES

Every investor is trying to balance high returns with low volatility. The average investor is comfortable with a mix of stocks and bonds in their investment portfolios…until the market's wild swings start making them nervous. Private real estate helps investors temper the volatility in their portfolios because it's immune to the daily shocks of trading.

The value of a private real estate investment is based on the actual value of the property owned. In a public REIT, however, the value is determined by daily market forces, which means the share price may not reflect the actual value of the underlying real estate. In some cases, the share price can value the REIT 30% higher or lower than the actual value of the underlying real estate.

Private real estate values, on the other hand, don't move much on a daily basis. They generally appreciate slowly over time, which is why private investments are less volatile than their public counterparts.

Both vehicles have pros and cons. Public markets offer liquidity, but that comes at the expense of volatility. Private investments offer investors low volatility, but with that comes illiquidity.

Private real estate has minimal correlation to stocks, bonds and even public REITs, as measured by the National Council of Real Estate Investment Fiduciaries (NCREIF) property index (NPI), which looks at the returns of private institutional grade commercial properties. An investment portfolio benefits greatly when it includes asset classes that are not correlated to each other.

#4 PASSIVE INCOME

Unlike stocks and bonds, the real estate syndications we offer generate cashflow for its investors from the income generated by the property. Because we're purchasing performing assets, that cash flow starts on day one of ownership.

This is the kind of passive income that leads to financial freedom. The brilliant part is that the asset itself is appreciating in value over time and can usually be sold for a significant profit. The combination of passive income and appreciation creates the type of generational wealth most investors are looking to create.

#5 PRIVATE REAL ESTATE IS TAX EFFICIENT

Real estate has tax advantages over nearly every other investment. The IRS allows real estate investors to deduct 3.6% of the value of the building each year as an expense through something called "depreciation." This is a phantom expense since it doesn't actually cost you anything or reduce your cashflow, but it does reduce your taxable income.

Let's look at this example of how this works.

You invest $100K in a multifamily syndication which generates a 10% cash-on-cash return (or $10,000) in a given year.

PURCHASE PRICE	$500,000
Down Payment (20%)	$100,000
Debt	$400,000
Cash on Cash Return %	10.0%
Cash on Cash Return $	$10,000
Tax Depreciation %	3.6%
Tax Depreciation $	($18,000)
Taxable Loss	($8,000)

You've pocketed a true $10,000 in cash, but your taxable amount is much different with the magic of depreciation:

The $10,000 you put into your pocket is entirely tax free. Instead of showing a taxable income, your tax return shows a taxable loss.

You can even carry forward your loss to future years or you can use it to offset gains from other passive income – further reducing (or even eliminating) taxes in the future, too.

Amazing, isn't it?

Stocks don't do this for you.

Depreciation is a benefit of all real estate investments, but multifamily gives you an additional tax bonus, not-so-creatively called "bonus depreciation." Bonus depreciation allows us to deduct the entire value of the investment from our taxable income in the first year.

This produces a giant tax loss that we can carry forward and/or apply to other passive income, reducing or even eliminating taxes paid on any gain.

Investors who focus solely on an investment's underlying returns and ignore its after-tax yields don't recognize a big benefit of real estate investing. The cash flow generated by real estate provides investors with the long-term benefits of substantial cash flow and very little tax burden.

In full disclosure we need to note that the depreciated portion of the property is subject to a recapture rate of 25% upon sale. Here's how it is applied: if a property were acquired for $10 million and depreciated by $2 million, for tax purposes the cost basis is now only $8 million.

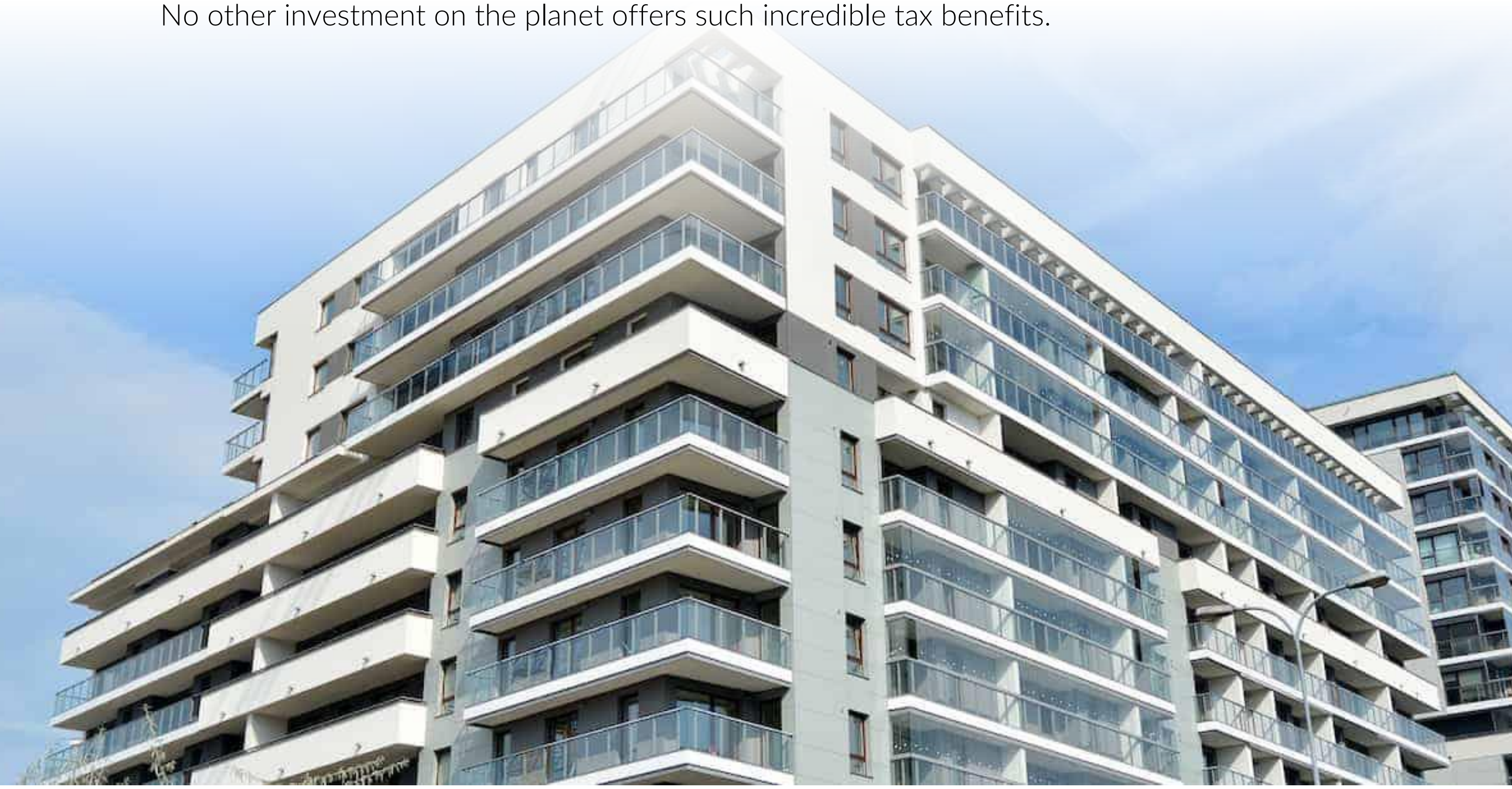
The difference between the cost basis ($8 million) and the original purchase price ($10 million) is taxed at the recapture rate (25%, or $500,000) upon sale.

And assuming the property has been held for at least a year, which is essentially always the case with commercial real estate, appreciation above the original purchase price will be subject to the long-term capital gains rate of only 20%. Continuing with the example above, if the property were sold for $14 million, the gain from $10 million to $14, million would be taxed at the capital gains rate of 20% ($800,000). So the overall tax liability at sale would be $500,000 (depreciation recapture) + $800,000 (long-term capital gains), or $1.3 million.

One more tax benefit of direct ownership of real estate is the ability to defer taxes indefinitely through a 1031 exchange. This allows real estate owners to sell a property and buy another without incurring capital gains taxes. In theory, an investor could buy and sell properties without ever paying taxes on the gains.

And finally, private equity real estate is typically held in an LLC, which is a pass-through entity. This means 100% of income, losses, and expenses pass through to the owners. Unlike corporations, the LLC itself does not get taxed. Individual members are taxed on their share of the income, expenses, and losses reported on their year-end tax document, the K-1. They are taxed at their tax rate, which is often lower than the corporation's.

No other investment on the planet offers such incredible tax benefits.



#6 INFLATION HEDGE

Private real estate investments are a fantastic hedge against inflation. The Federal's Reserve's inflation target is 2% each year, which means everything goes up in costs, including rents, which for these assets, increased rents mean increased income. As income goes up, so does the value of the property.

Yes, expenses increase each year as well, but take a look at the following table that shows both the rents and expenses going up 2% each year. See what happens to the Net Operating Income (NOI):

	PURCHASE	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Inflation Rate		2%	2%	2%	2%	2%
Income	$10,000	$10,200	$10,404	$10,612	$10,824	$11,041
- Expenses	$7,667	$7,820	$7,976	$8,136	$8,298	$8,464
= Net Operating Income (NOI)	$2,334	$2,380	$2,428	$2,476	$2,526	$2,576

The NOI is going up! The higher the NOI, the higher the value of the property. That small 2% inflation rate results in a 10% average annual return on the cash invested in a typical real estate syndication.

	PURCHASE	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Inflation Rate		2%	2%	2%	2%	2%
Income	$10,000	$10,200	$10,404	$10,612	$10,824	$11,041
- Expenses	$7,667	$7,820	$7,976	$8,136	$8,298	$8,464
= Net Operating Income (NOI)	$2,334	$2,380	$2,428	$2,476	$2,526	$2,576
Annualized NOI	$28,002	$28,562	$29,133	$29,716	$30,310	$30,916
Cap Rate	7%	7%	7%	7%	7%	7%
Value	$400,029	$408,029	$416,190	$424,514	$433,004	$441,664
Appreciation	$0	$8,029	$16,190	$24,514	$33,004	$41,664
Return on equity		10%	20%	31%	41%	52%
Average Annual Return		10%	10%	10%	10%	10%

The more inflation increases, the more the apartment building appreciates. The perfect inflation hedge.

PRIVATE REAL ESTATE SYNDICATIONS – THE BEST INVESTMENT YOU CAN FIND!

The average individual invests their money in the stock market. It's not their fault. They simply don't know that better options exist, and their financial advisor isn't likely to tell them.

But as we've seen, after fees, taxes, and inflation, the average annual returns of the stock market aren't that great. Combined with volatility, like a market crash right before you need that money, at best it's a questionable investment class.

No other investment performed as well as private real estate in the last recession or offers above average returns (including cashflow), extraordinary tax advantages, and inflation hedge.

SO WHY DON'T YOU ALREADY HAVE PRIVATE REAL ESTATE IN YOUR PORTFOLIO?

Historically it has been difficult for individuals to access the best investments in this asset class. They were originally only available to institutional investors such as pension funds and endowments, or the ultra-wealthy.

Now that has all changed. Individual investors have far more opportunities to access private real estate than ever before. In theory, it should now be easier for individuals to assemble a portfolio of private real estate investments, presumably applying the same principles used in their stock and bond portfolios. But it doesn't always work that way. Private real estate is still a complicated and unfamiliar asset class for many.

WHY DON'T I JUST DO THIS MYSELF, OR JUST BUY SINGLE FAMILY RENTALS?

Active investing is when buyers own and operate by themselves, or perhaps with family, friends or acquaintances. However, given the substantial capital and expertise required to acquire and operate investment-grade commercial real estate, there are high barriers to entry.

Acquiring property alone isn't impossible, but it comes with a lot of work and responsibility. Unfortunately, many active investors mistakenly buy assets that require more time and resources than originally expected. Or perhaps their business plan isn't appropriate for the given market, making the venture much less profitable than anticipated.

Most people who begin considering investing in real estate think of single-family rental houses. The challenge with this option is that it's not very passive. If you manage the property yourself, you're responsible for finding the tenant, taking calls when something breaks, making repairs, finding a new tenant, and dealing with all the nonsense you never imagined would occur. Even with a good property manager, because you'll still be managing the manager.

Sometimes people will then look at "turnkey rentals," where you own a house, typically in another state, that is professionally managed by a turnkey company that buys, fixes, and manages the rental.

Turnkey properties are supposed to be entirely passive, but it doesn't always work out this way. Just google "turnkey rental property reviews" and you'll find a whole list of stories where things didn't go as planned, and now the owner is trying to figure out how to manage a property from five state away.

But the biggest problem with single family rentals is that you don't control the value. It's 100% market driven. They are valued by how much your neighbors' properties sold for and there's nothing you can do about it. And look at what happened during the great recession of 2008. Tenants fled into cheaper apartments, property values plummeted, and many landlords were wiped out.

HOW MUCH OF YOUR PORTFOLIO SHOULD BE IN PRIVATE REAL ESTATE?

The old saying "don't put all your eggs in one basket" applies to real estate as well. Private real estate is cyclical in nature and goes up and down over time. Not on a daily basis like stocks and bonds, but it has its highs and lows. And it is generally an illiquid asset, which means your capital may take months or years to unlock. It's not an option if you need access to capital in the short term.

How much you allocate to real estate is a function of your time horizon as well as your net worth. Some investors may not feel comfortable having any capital in illiquid assets. Others may be perfectly fine with a large illiquid position in their retirement account, but not in their personal savings account. This illiquidity isn't necessarily a bad thing as long as you have other assets to use for emergencies.

WHO CAN INVEST IN PRIVATE REAL ESTATE?

Generally, private real estate investing is only available to accredited investors, a regulation set by the federal government. However, some managers use exemptions that allows non-accredited investors to participate as well.

Individuals meeting one of the following criteria qualify as accredited investors:

- Net worth overs $1 million (excluding the value of your primary residence);
- Individual income of $200,000, or joint with a spouse over $300,000, in each of the past two years and the expectation to reach the same level this year.

GETTING STARTED WITH PRIVATE REAL ESTATE INVESTING

If you're interested in learning more you're already in the right place. By downloading this special report, you'll be receiving a quarterly email from me and my team to help you make smart investment decisions.

Many websites offer access to individual deals. These platforms act as the middleman between the investor and the real estate operator, and offer similar properties to what we offer at Sugarhouse Investments. The big difference is the concierge treatment that our investors receive.

Sugarhouse Investments provides articles, newsletters and guides to help individual investors make smarter private real estate investing decisions. View more educational resources at sugarhouseinvestments.com/thought-leaders.

If you're interested in being notified of upcoming investment opportunities, please schedule a phone call with us so we can get to know you and your investment goals prior to showing you upcoming opportunities. We'll then be able to present you with investment opportunities that are right for you.

I hope you found this report helpful as you plan your financial future.

Brad

APPENDIX

APPENDIX A – IMPACT OF FEES AND TAXES ON YOUR STOCK PORTFOLIO

$100,000 invested in 2004 would only be worth $193,879 in 2018 after fees and taxes. That's just a 4.5% return!

RETURN BEFORE FEES				FEES			ADJUSTED RETURN AFTER FEES	
BEGIN VALUE	S&P RETURN	G/L	END VALUE	%	$	END VALUE	GAIN/LOSS	RETURN
$208,870	-6.24%	($13,034)	$195,837	1.00%	$1,958	$193,879	($14,992)	-7.18%
$176,671	19.42%	$34,309	$210,980	1.00%	$2,110	$208,870	$32,200	18.23%
$162,913	9.54%	$15,542	$178,455	1.00%	$1,785	$176,671	$13,757	8.44%
$165,769	-0.73%	($1,210)	$164,559	1.00%	$1,646	$162,913	($2,856)	-1.72%
$150,322	11.39%	$17,122	$167,443	1.00%	$1,674	$165,769	$15,447	10.28%
$117,161	29.60%	$34,680	$151,840	1.00%	$1,518	$150,322	$33,161	28.30%
$104,351	13.41%	$13,993	$118,344	1.00%	$1,183	$117,161	$12,810	12.28%
$105,405	0.00%	$0	$105,405	1.00%	$1,054	$104,351	($1,054)	-1.00%
$94,405	12.78%	$12,065	$106,469	1.00%	$1,065	$105,405	$11,000	11.65%
$77,244	23.45%	$18,114	$95,358	1.00%	$954	$94,405	$17,160	22.22%
$126,849	-38.49%	($48,824)	$78,025	1.00%	$780	$77,244	($49,604)	-39.11%
$123,761	3.53%	$4,369	$128,130	1.00%	$1,281	$126,849	$3,087	2.49%
$110,026	13.62%	$14,986	$125,011	1.00%	$1,250	$123,761	$13,735	12.48%
$107,900	3.00%	$3,237	$111,137	1.00%	$1,111	$110,026	$2,126	1.97%
$100,000	8.99%	$8,990	$108,990	1.00%	$1,090	$107,900	$7,900	7.90%

Here's a summary of the returns after fees, and then after paying long- term capital gains taxes:

Initial Investment	$100,000
Portfolio Value in 2018	$193,879
Gross Gain	$93,879
Average Annual Return	4.5%

Long Term Capital Gains Tax (%)	15%
Long Term Capital Gains Tax ($)	$14,082
Net Gain	$79,797
Average Annual Return	4.0%

APPENDIX B - IMPACT OF INFLATION

Factor in a 1.6% inflation rate with fees and taxes, and the return has been reduced from 4.0% to 2.5%.

RETURN AFTER FEES				INFLATION			ADJUSTED RETURN AFTER INFLATION	
BEGIN VALUE	S&P RETURN	GAIN / LOSS	END VALUE	%	$	END VALUE	GAIN / LOSS	RETURN
$166,651	-7.18%	($11,962)	$154,690	1.60%	$2,475	$152,215	($14,437)	-8.66%
$143,252	18.23%	$26,109	$169,361	1.60%	$2,710	$166,651	$23,399	16.33%
$134,245	8.44%	$11,336	$145,581	1.60%	$2,329	$143,252	$9,007	6.71%
$138,819	-1.72%	($2,391)	$136,428	1.60%	$2,183	$134,245	($4,574)	-3.30%
$127,930	10.28%	$13,146	$141,076	1.60%	$2,257	$138,819	$10,889	8.51%
$101,330	28.30%	$28,680	$130,010	1.60%	$2,080	$127,930	$26,600	26.25%
$91,718	12.28%	$11,259	$102,978	1.60%	$1,648	$101,330	$9,612	10.48%
$94,151	-1.00%	($942)	$93,210	1.60%	$1,491	$91,718	($2,433)	-2.58%
$85,697	11.65%	$9,986	$95,682	1.60%	$1,531	$94,151	$8,455	9.87%
$71,259	22.22%	$15,831	$87,090	1.60%	$1,393	$85,697	$14,437	20.26%
$118,923	-39.11%	($46,505)	$72,418	1.60%	$1,159	$71,259	($47,664)	-40.08%
$117,915	2.49%	$2,942	$120,857	1.60%	$1,934	$118,923	$1,008	0.85%
$106,533	12.48%	$13,299	$119,832	1.60%	$1,917	$117,915	$11,382	10.68%
$106,174	1.97%	$2,092	$108,265	1.60%	$1,732	$106,533	$359	0.34%
$100,000	7.90%	$7,900	$107,900	1.60%	$1,726	$106,174	$6,174	6.17%

Here's a summary of the returns after inflation and taxes:

Initial Investment	$100,000
Portfolio Value in 2018	$152,215
Gross Gain	$52,215
Average Annual Return	2.8%

Long Term Capital Gains Tax (%)	15%
Long Term Capital Gains Tax ($)	$7,832
Net Gain	$44,382
Average Annual Return	2.5%