5 Deal Structures That Close Today

Proven Strategies for High-Rate, Choosy-LP Real Estate Markets

www.covercy.com

covercy

What's Inside:

1. **Sale-Leasebacks + Triple-Net Leases**
   Lock in long-term, lease-backed income with credit-adjacent tenants.

2. **Preferred Equity & Mezzanine Layers**
   Inject flexible, higher-yield capital into your stack.

3. **Waterfall Distribution Models**
   Design performance hurdles and GP/LP incentive tiers.

4. **Co-GP + Revenue-Sharing Structures**
   Give early investors a slice of sponsor economics.

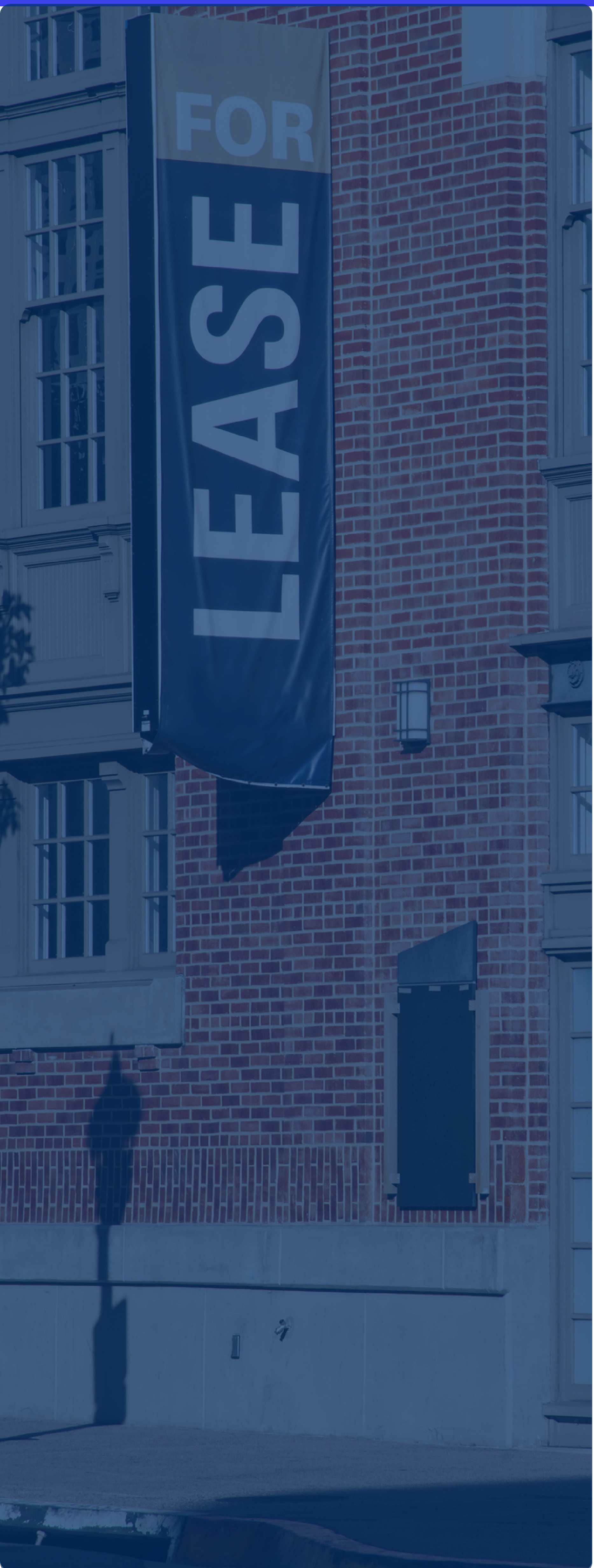
5. **Creative Syndications & Anchor-Investor Incentives**
   Use milestones, side-letters, or MFNs to secure capital.

STRUCTURE 1

Sale-Leasebacks with "Credit-ish" Tenants

Market Context

- **High borrowing costs:** 10-yr UST up from 1.5% → 4.5% in 18 months
- **LP caution:** Investors are pulling back on new commitments—GPs report a 20–30% increase in due-diligence timelines
- **Search for yield:** Core cap rates compressing near 4–5% means sponsors must push risk-adjusted returns north of 8%
- **Risk aversion:** Commitments are contingent on de-risked structures and long-term income visibility



What is a sale-leaseback?

A **sale-leaseback** lets an owner-occupant monetize their real estate while retaining operational control.

- **Transaction Flow:** Owner sells to sponsor → Sponsor leases back on a long-term NNN.
- **Immediate Liquidity:** Seller frees up capital without losing their facility.
- **Stable Income:** Sponsor secures contract-driven rent with annual/CPI escalators.
- **Lease Profile:** Typically 10–15 yr triple-net leases with renewal options.

Who are “credit-ish” tenants?

Tenants with strong fundamentals but without an investment-grade rating—unrated “sweet spot” credits.

- **Financial strength:** 5+ years of EBITDA growth and positive debt service coverage (>1.5×).
- **Operational resilience:** Niche logistics, healthcare services, essential retail—sectors less tied to broad economic swings.
- **Yield advantage:** Investors accept 8–9% caps (versus 5–6% for rated credits) in exchange for near-credit stability.

Why It Works Now

Sponsors can hit that **"sweet spot"** between stability and yield.

- **Higher cap rates:** "Credit-ish" deals trade at 8–9% caps versus 5–6% for investment-grade tenants.
- **Long-term visibility:** 10–15 year NNN leases deliver predictable cash flows and clear exit optionality.
- **Off-market edge:** Direct outreach to owner-occupants reduces competition and improves pricing leverage.

A representative **industrial sale-leaseback** to show how the numbers play out.

- **Asset & Tenant:** 150,000 SF light-industrial facility sold by a family-owned manufacturer and leased back on a NNN basis.
- **NOI:** $1.0 M/year
- **Purchase @ 8.5% cap:** $11.8 M
- **Financing:** 65% LTC floating-rate debt with interest-only first 2 years
- **Lease term:** 10 years with 2–3% annual rent escalators
- **Projected Sponsor IRR:** ~12% net over the hold period
- **Exit recap:** Refinance at a 7% cap after 5 years → gross proceeds ~$14.3 M

How **top sponsors** are executing these deals:

- **Identify resilient sectors:** Focus on light industrial, medical clinics, self-storage— in other words, off-market owner-occupants with strong cash flows.

- **Underwrite tenant credit:** Analyze P&L, debt service coverage, guarantor strength; aim for 1.5×+ coverage without formal ratings.

- **Negotiate NNN lease:** Secure 10–15 yr term, annual/CPI escalators, renewal options, and tenant credit enhancements (letter of credit or guarantee).

- **Align financing:** Match lease term to loan maturities; build in interest-only windows or LIBOR floors to de-risk refinancing.

No structure is **free of risk**—here's how to mitigate:

- **Tenant concentration:** Covenants requiring reserves or partial prepayments.
- **Lease-debt mismatch:** Use shorter-term bridge debt with refinance plan or mezzanine backstop.
- **Market liquidity:** Pre-arranged junior debt facility or anchor LP commitment to secure exit.

Sale-leasebacks with “credit-ish” tenants **work best** for:

- **Net-Lease & Single-Tenant Specialists:** Sponsors focused on NNN assets (light industrial, self-storage, healthcare) who need stable 8–9% cap-rate deals.
- **Regional & Mid-Size Sponsors:** Firms with local market relationships that can source off-market owner-occupants and negotiate bespoke leases.
- **Opportunistic / Value-Add Funds:** Managers who add value through lease structuring (escalators, renewal options) rather than through heavy rehab.
- **Sponsors Targeting Yield-Hungry LPs:** Those raising from family offices, insurer captives, and smaller institutions that demand 8%+ returns on de-risked income streams.

Not Ideal For...

This structure is ***not* a great fit** for:

- **Pure Core / Core-Plus Funds:** Programmatic buyers who require fully rated, investment-grade tenants at 4–6% cap rates.
- **Large Institutional Players:** Institutions running scale pipelines around S&P-rated credits and broader fund mandates.
- **Ground-Up Developers:** Sponsors focused on pre-construction financing and stabilization, rather than stabilized sale-leasebacks.

covercy

STRUCTURE 2

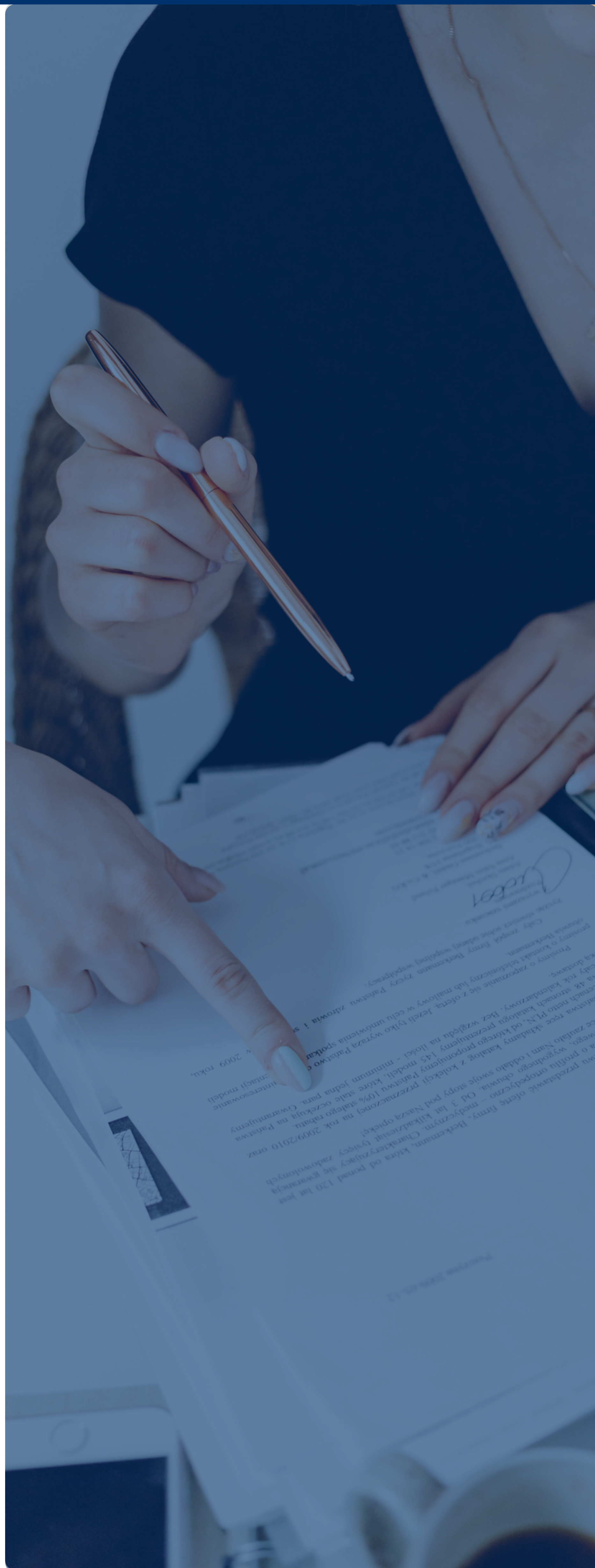
Hybrid Pref Equity with an Upside Kicker

Why Sponsors & LPs Are Rethinking Preferred Equity

- Rate volatility is back: 10-yr Treasuries have doubled to ~4.5%, pushing fixed-debt costs above 7%.
- Core cap rates are stuck at 4–5%, leaving a yawning 3–4% yield gap for new equity.
- LPs want income that resets with rates—plus a slice of sponsor upside if deals outperform.
- Mezz debt boxes have tightened: lenders demand more equity, more flexibility in structuring.

Blending the **safety of preferred equity** with a **sponsor-style upside kicker.**

- **Floating-Rate Coupon:** Quarterly resets (SOFR or LIBOR + 350–450 bps) protect investors from rising rates.
- **Equity Ratchet:** Warrants or conversion rights vest when net IRR hurdles (e.g. 15%) are reached.
- **Capital-Stack Position:** Subordinate to senior debt but senior to common equity—locking in priority cash flow.
- **Flexible Term:** Typical 5-7 year hold, interest-only payments, with conversion or cash-out options at exit.

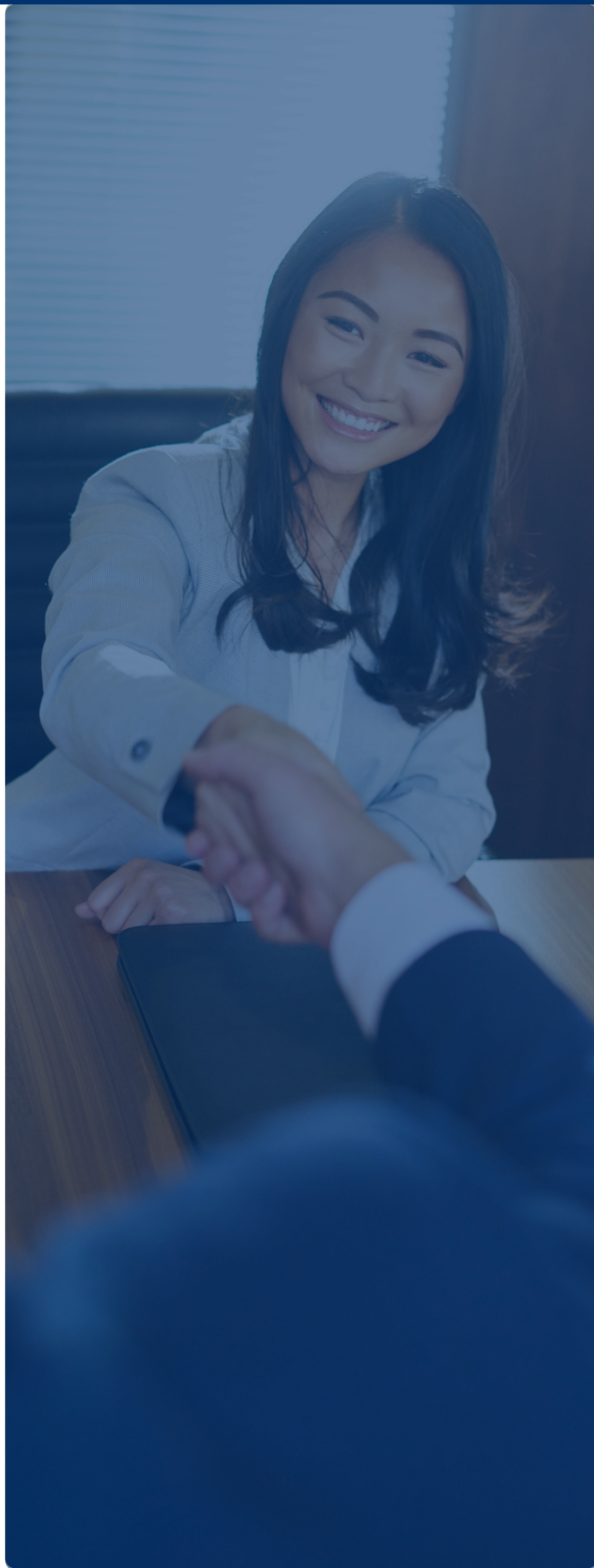


A **true hybrid** solves for both protection and participation:

- **Rate Reset Protection:** Coupons adjust quarterly, capping the coupon floor/fix to prevent steep spikes.
- **Performance Upside:** Equity ratchets trigger extra promote on net IRR above set thresholds.
- **Downside Priority:** Pref-equity sits ahead of common in cash distributions, reducing first-loss risk.
- **Sponsor Alignment:** Warrants tie sponsor economics directly to deal performance.

The **execution roadmap** in four steps:

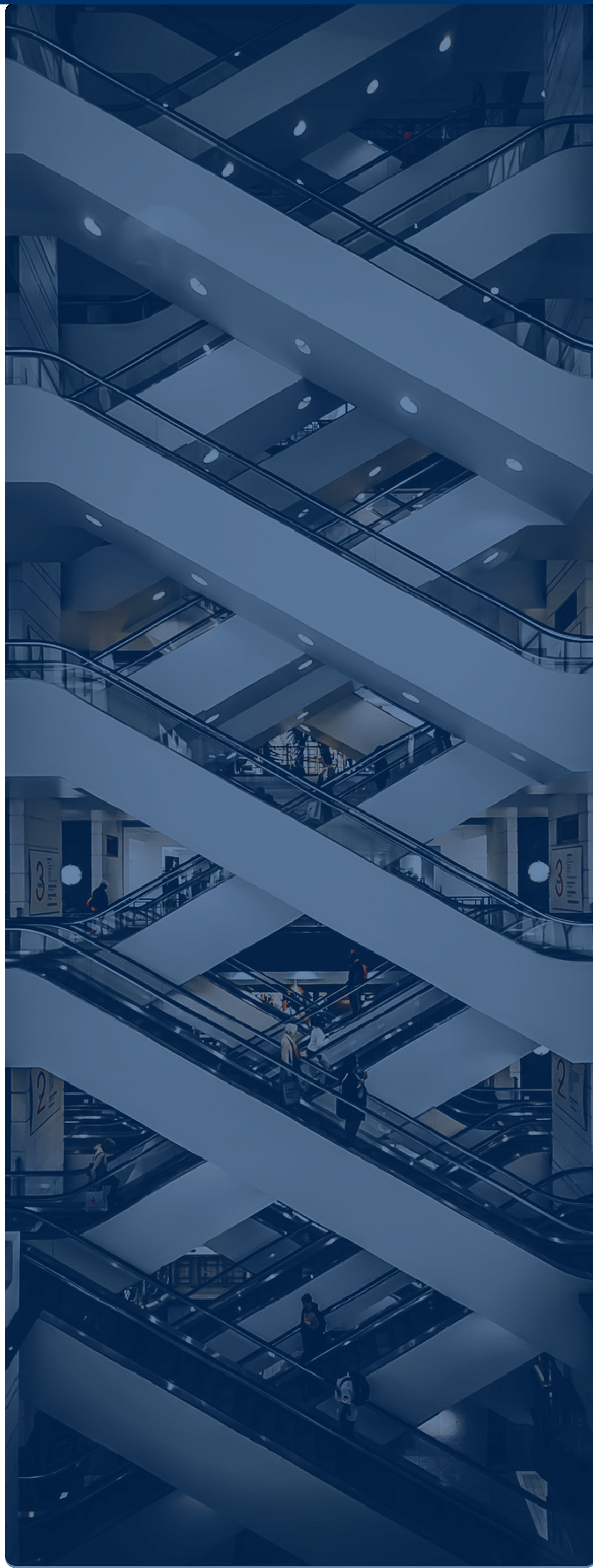
- **Commitment:** LPs subscribe to the pref/mezz tranche alongside senior lending.
- **Coupon Mechanics:** Interest-only at SOFR + 400 bps, with quarterly rate floors/floors.
- **Kicker Trigger:** At 15% net IRR, a portion of pref converts to equity or 20% of excess profit is shared.
- **Exit Options:** Upon sale or refinance, pref holders convert or collect final distributions—locking in both yield and upside.



A Real-World Example

A **real-world transaction** example:

- **Sponsor Raise:** $5 M of hybrid pref equity
- **Coupon:** SOFR + 400 bps, resets quarterly; interest-only first 3 yrs
- **Term & Escalators:** 5-year hold with 2% annual payment step-ups
- **Equity Kicker:** 20% promote on all net IRR above 15%
- **Projected Returns:**
  - LP net yield ~9–11%
  - Sponsor IRR ~18% over hold period

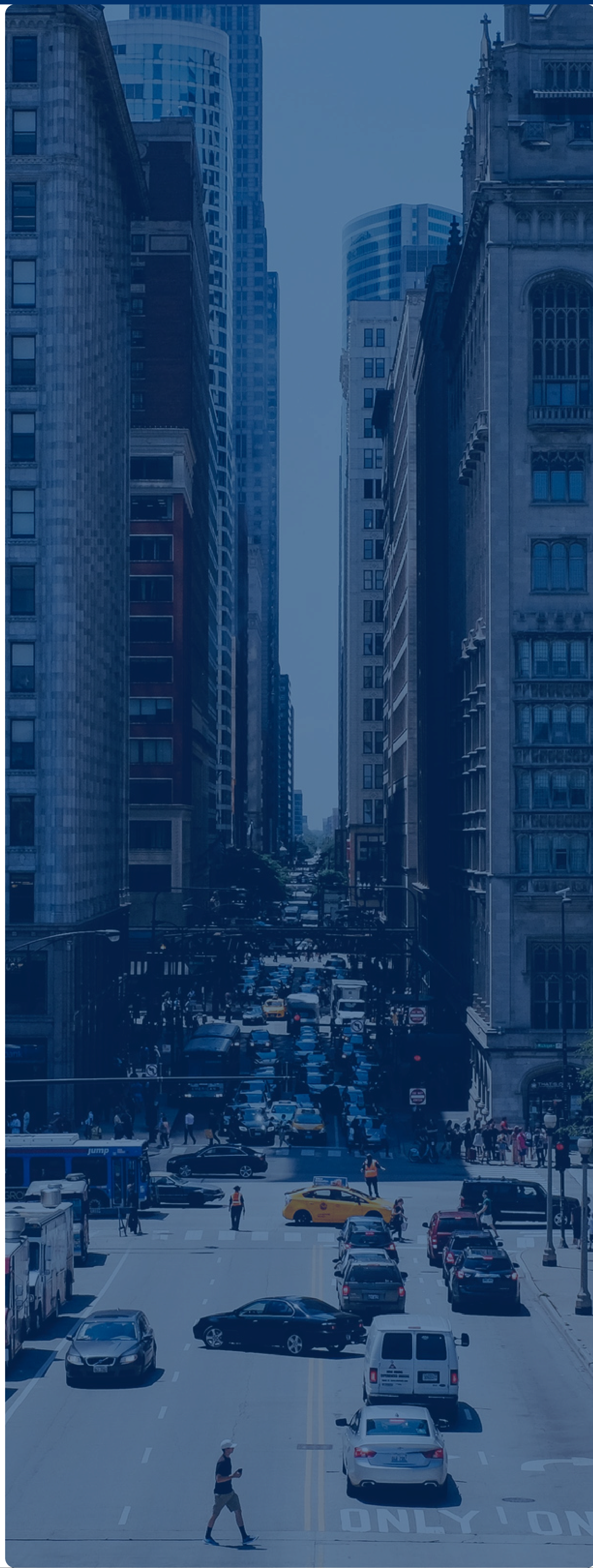


Nail the details with **disciplined execution:**

- **Model Scenarios:** Stress-test coupon resets under SOFR swings up to +2%+
- **Define Kicker Hurdles:** Set clear IRR thresholds, vesting schedules, and tax-efficient conversion mechanics
- **Document Clarity:** Ensure SPAs and term sheets have unambiguous warrant/convert provisions & default cures
- **Coordinate Financing:** Align senior debt maturities to pref term; consider mezz backstops for gaps
- **LP Communication:** Provide a one-pager summary and host education calls to ensure all investors understand the hybrid mechanics

Every hybrid carries **unique exposures**—plan accordingly:

- **Complexity Overload:** Mitigate with concise executive summaries and Q&A sessions for LPs
- **Coupon Volatility:** Cap/floor the floating spread or add a spread-adjustment collar
- **Tax & Timing:** Work closely with counsel on conversion events to avoid adverse tax treatment
- **Governance Creep:** Limit sponsor control waivers; use board-observer rights & consent thresholds



Who Benefits?

Hybrid pref equity structures with upsides **work best** for:

- **Structured-Credit & Mezz Funds:** Perfect for debt-plus-equity managers looking to package floating coupons with equity participation.
- **Liability-Driven Investors:** Pension plans and captives needing rate-reset income but unwilling to miss out on equity upside.
- **Sponsors with Refi Cliffs:** GPs whose senior debt maturities are next 24–36 months—floating pref buys them flexibility.
- **Sophisticated Family Offices:** Investors fluent in hybrid docs, seeking bespoke yield instruments, not plain-vanilla equity.

This structure is ***not* a great fit** for:

- **Pure Yield-Only LPs:** Those who want fixed returns and can't handle quarterly rate swings or equity conversion complexity.
- **Retail/Small-Ticket Sponsors:** Operators without the modeling, legal or reporting bandwidth to manage resets & ratchets.
- **Core/Core-Plus Funds:** Programs built around long-duration, fixed-rate, investment-grade cash flows at 4–6%.
- **Standardized Institutional Investors:** Large pensions or sovereigns that insist on S&P-rated credits and minimal bespoke terms.

covercy

STRUCTURE 3

Graduated Waterfalls for 15%+ IRR and LP Peace of Mind

Tiered performance hurdles closing more capital, faster

Why waterfalls are critical in today's market:

- **Preferred returns have climbed above 8%** as LPs demand yield protection.
- **LP skepticism:** extended hold periods and volatility drive calls for guardrails.
- **Sponsors need transparent, tiered waterfalls** to close deals and build trust.
- **Clear hurdle structures** have become closing tools in tighter fundraising.

Dynamic, multi-hurdle waterfalls engineered for today's sponsors & LPs

- **Micro-Hurdles at Fine Increments:** Instead of a single IRR hurdle, GPs are layering 6%, 8%, 10%, 12% IRR bands—each with its own split—to reward even modest outperformance.
- **Performance Gates Beyond IRR:** Leverage non-financial triggers (e.g. 90% stabilized occupancy, ESG score, NOI targets) to unlock promotes—giving LPs confidence in operational milestones.

- **Automatic Catch-Up Controls:** Rather than an open-ended "catch-up," we cap GP catch-up splits (e.g. 50/50 up to 110% of pref) so LPs always retain headroom for their preferred return.
- **Built-In LP Protections:** Clawback escrows, reinvestment caps and minimum cash-flow reserves ensure that if later performance dips, LPs get first claim on any excess cash.

Operationalizing Multi-Hurdle Waterfalls

Turning tiered IRR bands into real-world deal drivers:

- **Hurdles Meet Milestones:** Tie specific IRR bands to operational benchmarks—90% stabilized occupancy, 2.0× DSCR, or ESG targets—to give LPs confidence you're not just chasing returns on paper.
- **Automated Escalation Events:** Use waterfall triggers built into your SPV structure so that once a hurdle's hit, the cash-flow split shifts instantly—no manual recalcs or legal amendments.
- **Catch-Up Caps & Clawbacks:** Limit GP catch-up at 100–110% of preferred to prevent over-leverage, and hold a 5–10% reserve in escrow to claw back any over-paid promotes if later performance dips.
- **Alignment Through Transparency:** Publish monthly waterfall statements and a one-page waterfall summary in your portal so LPs see exactly where the deal sits—and feel secure at every tier.

A four-step roadmap to implement dynamic waterfalls:

1. **Define preferred return** (e.g. 8% net IRR to LP).

2. **Layer micro-hurdles** (e.g. 6%, 8%, 10%, 12% bands) with corresponding promote splits.

3. **Automate triggers** in your SPV so splits shift instantly once each hurdle hits.

4. **Finalize waterfall** at exit or refinance—distribute per the last achieved tier.

Real-world mid-market deal example:

Equity raise: $10 M pref equity

Pref hurdle: 8% IRR to LP

Tier 1: 70/30 split up to 12% IRR

Tier 2: 60/40 split 12–15% IRR

GP catch-up: 50/50 until parity

Actual returns: LP ~11.6% net IRR; GP ~4.4% net carry on excess

Ensure a smooth rollout with these best practices:

- **Model IRR sensitivity** across all hurdles under upside/downside scenarios.
- **Draft clear term-sheet extracts** showing hurdle bands, catch-up and clawbacks.
- **Negotiate governance:** set consent thresholds for major events.
- **Align senior debt maturities** with your waterfall term.
- **Provide LPs** with a one-page waterfall summary and host Q&A sessions.

Watch out for common pitfalls—and how to guard against them:

- **Complexity overload:** use one-page visuals and LP education calls.
- **Waterfall "leakage"**: cap fees/expenses above hurdles.
- **Clawback enforcement:** hold reserves in escrow for true-up.
- **Reinvestment mismatch:** tie reinvestment windows to hurdle timelines.

Who Benefits?

Tiered waterfalls are ideal for:

- **Mid-Market Sponsors** seeking differentiated fund economics.
- **Value-Add Operators** who want to align performance with LPs.
- **Structured-Credit Funds** packaging yield + upside in one tranche.
- **Sophisticated LPs** (family offices, captives) comfortable with tiered IRRs.

Not Ideal For...

Skip dynamic waterfalls if you're:

- **Pure Core Funds** needing flat, predictable distributions.
- **Early-Stage Developers** without hurdle modeling capacity.
- **Small Sponsors** lacking the bandwidth to negotiate complex docs.
- **Large Institutions** requiring standardized, rated-credit instruments.

covercy

STRUCTURE 4

Co-GP & Revenue Share Deals

Share sponsor economics to accelerate your close.

Why Co-GP deals are gaining traction now

- LPs are more cautious—**final tranches are the hardest to close.**
- Sponsors need to sweeten the tail-end of raises **without diluting common equity.**
- Revenue-share incentives can **bridge the commitment gap** and build trust.
- In a rising-rate world, fee/carry sharing drives **urgency and alignment.**

What Is a Co-GP/Revenue-Share Deal?

Treat early LPs like co-sponsors by sharing Sponsor economics on first $X M:

- **GP carry share (e.g. 20–30%)** on Tier 1 equity up to defined cap.
- **Fee splits (origination/acquisition)** pro-rated to their tranche.
- **Reverts to standard GP economics** for capital beyond the threshold.
- **Side-letters** formalize the co-GP rights and revenue-share terms.

Tiered Revenue-Share Dynamics

Go beyond a flat co-GP fee:

- **Graduated carry splits** (e.g. 30% on first 10%, 20% on next 10% IRR)
- **Fee-share escalators** if deal closes within 60 days
- **Equity kickers** tied to hold-period performance (e.g. extended carry on re-sale)
- **Reinvestment rights** for co-GPs at the same economics on add-on deals

Execution in four steps:

- **Define tranche size** (e.g. first $3 M of LP capital)
- **Split economics:** determine and agree on carry %, fee %, & kicker triggers
- **Document** via side-letter or LPA amendment with governance rights
- **Close & share:** track performance, distribute fees/carry per agreed tiers

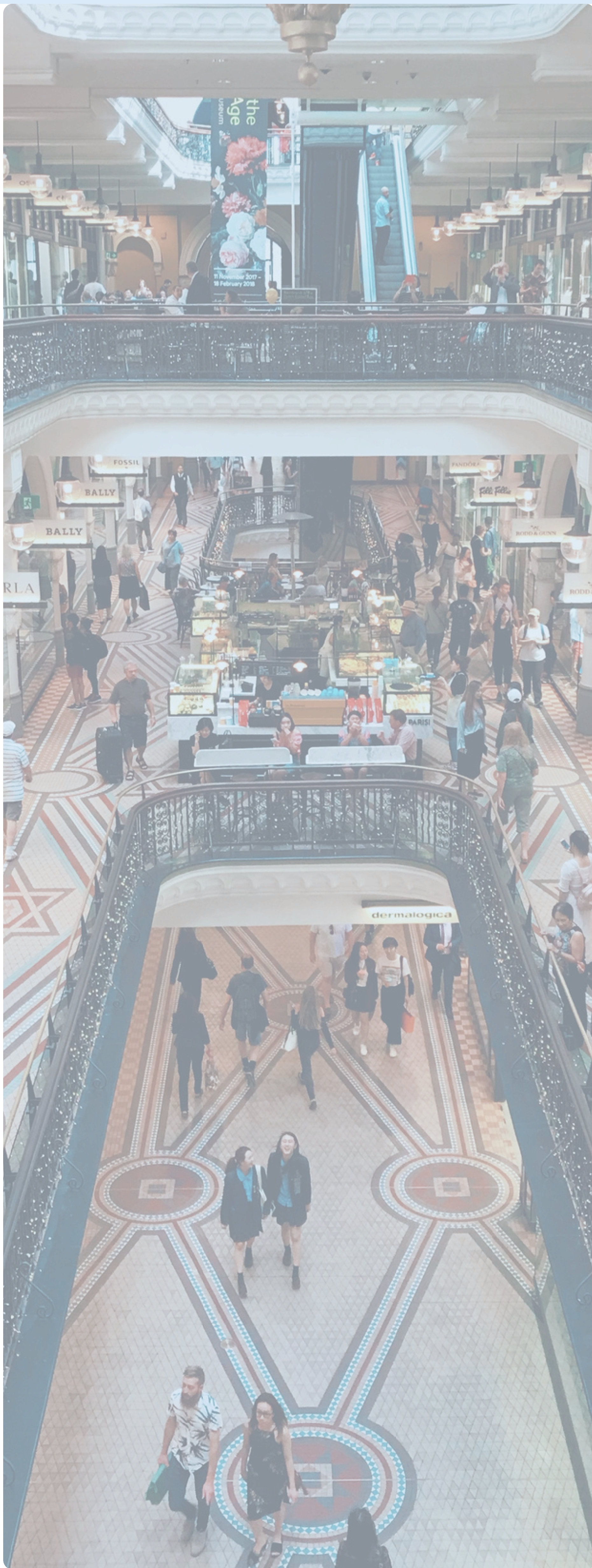
A Real-World Example

Sample deal in action:

- **Tranche:** first $2 M of LP equity as Co-GP
- **Carry split:** 30% on IRR up to 12%; 20% on IRR 12–15%
- **Fee share:** 50% of acquisition & financing fees for the co-GP tranche
- **Kicker:** additional 5% carry on net IRR > 15% for co-GPs
- **Outcome:** co-GPs earn 10–12% blended yield + 8–10% carry upside

Best practices for smooth implementation:

- **Tranche calibration:** size co-GP slot to drive urgency but preserve sponsor upside
- **Clear legal docs:** use side-letters with defined exhibits & governance seats
- **Communication:** present a one-pager showing co-GP economics & alignment
- **Performance tracking:** automate waterfall pulls in your fund accounting system
- **Hurdle tests:** include time/budget triggers to re-release unfilled tranches



Watch for these pitfalls—and guard against them:

- **Over-subscription:** cap co-GP slots to avoid cannibalizing common equity
- **Legal complexity:** keep side-letters simple; limit bespoke clauses
- **Performance drag:** tie fee-share triggers to deal-closing milestones, not just exit
- **LP confusion:** host Q&A webinars and distribute FAQ docs

Co-GP & revenue-share works best for:

- **Mid-market sponsors** with tail-end capital gaps
- **Value-add funds** needing a closing accelerator
- **Family offices** seeking deeper deal economics
- **Strategic LPs** who want a seat at the table & revenue upside

Not Ideal For...

Skip co-GP deals if you're:

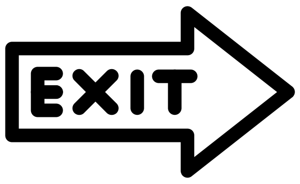
- **Pure core investors** wanting straight fixed returns
- **Small sponsors** without bandwidth to manage side-letters
- **Institutions** requiring standardized, rated-credit securities
- **Retail investors** not set up for complex sponsor economics

covercy

STRUCTURE 5

Syndication Triggers & Anchor Protections

Lock in LPs with milestone-based exits and downside safeguards.



Why sponsors need syndication triggers today

- LPs resist "all-or-nothing" equity calls **when market volatility spikes**
- Anchors want **clear, milestone-based exit paths** before committing final tranches
- Sponsors face **longer hold periods**
- LPs seek **downside guardrails** in exchange for capital
- Syndication triggers and anchor protections **build trust—and speed up closings**

Syndication triggers are predefined milestones that unlock next funding tranches:

- **Project-Level Triggers:** Stabilization (85% lease-up); construction completion; NOI targets
- **Time-Based Triggers:** Refinance eligibility after X months or upon senior debt extension

- **Market-Indexed Triggers:** When cap rates compress to <X% or DSCR reaches 1.75×
- **Exit-Path Clarity:** Each trigger automatically initiates a valuation or refinance process before LP calls
- **Financing Milestones:** Securing senior debt financing or anchor LP commitments triggers the next tranche

Anchor LPs require built-in protections before releasing capital:

- **Minimum Equity Lockup:** Sponsor retains ≥10% equity until Anchor exit
- **Clawback Reserves:** Hold 5–10% of distributions in escrow to rebalance if performance dips

- **Co-Sale Rights:** Anchor has pro rata right to sell into future rounds or exit events
- **Redemption Provisions:** Anchor can force a sale or refinance if key metrics lag (e.g., <6% yield)

Hybrid Milestones + Protections

Go beyond simple triggers by combining:

- **Tiered Milestone Releases:** Release 30% of funds at 60% stabilization; 40% at 85%; 30% at refinance
- **Performance-Linked Escrows:** Allocate 5% of cash flows to reserve if NOI falls <80% of pro forma
- **Anchor-Funded Guarantees:** Anchor commits partial equity to guarantee shortfall coverage up to X%
- **"Soft Call" Windows:** Allow Sponsor to call funds early if market conditions exceed trigger thresholds (e.g., cap rate compression)

Putting syndication triggers and protections into practice:

- **Define Anchor Role:** Select Anchor LP(s), determine their tranche size and required protections
- **Set Trigger Milestones:** Establish clear, quantifiable metrics (e.g., 85% leased, 1.5× DSCR, 12-month vacancy <5%)
- **Document in LPA/Side-Letter:** Embed triggers, reserves, co-sale and redemption rights in fund docs
- **Fund & Monitor:** Sponsor draws down initial 50% of capital; monitor milestones quarterly
- **Unlock & Release:** When each trigger hits, release next tranche—adjust reserves if breaches occur

Illustrative multifamily syndication:

- **Total equity raise:** $12 M (Anchor = $4 M)
- **Initial Funding:** 50% of total ($6 M) at close
- **Trigger 1 (60% leased, month 6):** Release 25% ($3 M)
- **Trigger 2 (85% leased OR 1.25× DSCR, month 12):** Release 15% ($1.8 M)
- **Final Trigger (Refinance @ <5% cap, month 24):** Release 10% ($1.2 M)
- **Anchor Protections:** 5% of cash flows to clawback if monthly NOI < $120 K; co-sale rights up to 50% of Anchor tranche

Best practices for a seamless sponsor-anchor relationship:

- **Anchor Selection:** Choose LP with track record and comfort with milestone metrics
- **Clear Metrics:** Use hard data (leases signed, NOI, occupancy) not soft forecasts
- **Reserve Sizing:** Set 5–10% reserve based on downside stress tests—tie to NOI or DSCR
- **Legal Precision:** Draft side-letters with explicit trigger definitions, co-sale & redemption mechanics
- **Communication Cadence:** Provide monthly lender reports, quarterly LP dashboards and mid-trigger update calls

Watch for pitfalls—and safeguard accordingly:

- **Trigger "Gaming":** Sponsors delaying lease-up to hit higher milestones—mitigate with time caps (e.g., month 18 max)
- **Reserve Shortfalls:** Under-estimated cash-flow volatility—mitigate by stress-testing cash flows at 75% occupancy
- **Anchor Overexposure:** Anchor locked in too large a tranche—mitigate by capping Anchor at 25–33% of total
- **Documentation Gaps:** Vague definitions of "refinance" or "stabilization"—mitigate by using clear, measurable thresholds

Syndication triggers & anchors are ideal for:

- Sponsors with **multi-phase developments** needing phased raises
- **Value-Add GPs** in rent-up or repositioning sectors (multifamily, office conversion)
- LPs seeking **milestone assurance** before releasing final capital tranches
- Pension plans or insurers requiring **built-in downside reserves** & co-sale rights

Skip this structure if you're:

- **Pure Core Investors** wanting fully stabilized, fully funded deals at close
- **Sponsors without clear performance metrics** or data sources for triggers
- **Retail LPs** not set up for milestone-based funding
- Institutions requiring **standardized, programmatic equity calls** without side-letters

Ready to raise capital?

Have questions about implementing any of these strategies? Want to see how other GPs are putting them into action in today's market?

Let's talk. Connect with our team today for a capital stack consultation.

Book a Meeting