

COMMERCIAL REAL ESTATE WATERFALL DISTRIBUTION

6 Things Every Investor Must Know

1 WHAT IS A WATERFALL?



A waterfall defines the **order in which profits flow** from a deal — LPs (investors) receive priority tiers before the GP (sponsor) participates in profits.

Money flows **top to bottom** — each tier must be filled before profits cascade to the next. LPs drink first.

2 THE 4 TIERS

1	Return of Capital	LPs only
2	Preferred Return	LPs only
3	GP Catch-Up	GP priority
4	Profit Split (Promote)	LP + GP

3 TIERS 1 & 2 — LP FIRST

Before the GP earns any profit share, LPs receive:

TIER 1 — RETURN OF CAPITAL
Full initial investment returned.
\$250,000 → **back to LPs**

TIER 2 — PREFERRED RETURN
8% annually on invested capital. \$250K
× 8% × 5 yrs = **\$100,000**

LPs receive \$350,000 before GP profit sharing begins

4 THE GP CATCH-UP



After the pref, the GP receives a **disproportionate share** of next profits until they reach their target percentage of total distributions.

EXAMPLE

GP catch-up at 50/50 until GP has earned **20%** of all distributions. Aligns GP to perform — they only profit after investors are whole.

5 THE PROFIT SPLIT

After catch-up, remaining profits split per the operating agreement. The GP's share above their co-invest is the "**promote**."

EXAMPLE — \$300K REMAINING PROFIT

LP 80% GP 20%

LPs receive
\$240K

GP receives
\$60K

6 WHY IT MATTERS

Read the PPM carefully. The waterfall determines exactly when and how much you get paid.

- ✓ Is the pref cumulative or non-cumulative?
- ✓ What is the catch-up rate and structure?
- ✓ What's the LP/GP profit split?

RED FLAGS

- ✗ No preferred return to LPs
- ✗ Aggressive GP catch-up terms
- ✗ Compounding pref that hurts LP returns



Always read the waterfall before you invest — it determines how you get paid.



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