Economic Consulting

Walton Land Fund 3, LP:
Laundering Fees and Fleecing Investors

By Craig McCann and Regina Meng

Introduction

We recently published an extensive study of the unregistered Reg D securities markets:

- "*Regulation D Offerings: Issuers, Investors and Intermediaries*", Craig McCann, Chuan Qin and Mike Yan, 2023 working paper, available at www.slcg.com/files/research-papers/Reg_D_Offering.pdf.

It is hard to assess investor returns in the Reg D marketplace because there are no publicly available secondary market transactions in Reg D securities. There is also no information on the financial performance of Reg D issuers except for a vanishingly small proportion of issuers who are also issuers of registered securities. It is not even possible to catalogue the worst practices in the Reg D marketplace because offering documents including Private Placement Memoranda ("PPMs") are not generally available.

We have reviewed many PPMs and posted two notes highlighting Reg D abuse:

- *HJ Sims Reg D Offerings: Heads, HJ Sims Wins - Tails, Their Investors Lose*, Craig McCann, Susan Song, Chuan Qin and Mike Yan available at www.slcg.com/resources/blog/691
- "*First National Realty Partners Reg D Offerings: Muppets Do Commercial Real Estate"* Craig McCann, Susan Song, Chuan Qin and Mike Yan available at www.slcg.com/resources/blog/693.

In this note, we provide a further example of Reg D abuse – this time with the benefit of a complete set of *ex poste* financial statements covering 11 years for a Reg D offering from Walton Group USA ("Walton").[1]

Walton has set up at least 24 special purpose entities to issue Reg D securities. Table 1 contains a listing of Walton's Reg D issuers. Please let us know if you, or someone you know, invested in one of these issues and have/has financial statements.

[1] A 2019 Bloomberg article reported on Walton's activities: "Investors Pumped Billions Into Suburbs That Never Got Built", *Bloomberg* Michael Sasso, June 13, 2019, www.bloomberg.com/news/articles/2019-06-13/-3-8-billion-bet-on-north-american-urban-sprawl-runs-aground

Table 1 Walton Group Reg D Issuers

Issuer	Filing Date	Offering Amount
Walton Bluff Springs Land, LP	10/30/2008	$5,628,910
Walton West Palmilla, LP	12/8/2008	$8,800,000
Walton Arcade Meadows, LLC	4/3/2009	$14,400,000
Walton Caldwell Ranch, LP	8/5/2009	$14,255,000
Walton Sunshine Industrial, LP	10/6/2009	$23,250,000
Walton Elm Creek Ranch, LP	12/9/2009	$28,650,000
Walton Pecan Woods, LP	4/27/2010	$20,100,000
Walton Barrow Landing, LP	6/25/2010	$21,000,000
Walton Kimberlin Heights, LP	7/6/2010	$24,375,000
Walton Land Opportunity Fund, LP	11/2/2010	$50,000,000
Walton Sherwood Acres, LP	11/17/2010	$27,425,000
Walton Heritage Woods, LP	3/21/2011	$24,450,000
Walton U.S. Land Fund 1, LP	3/21/2011	$50,000,000
Walton U.S. Land Fund 2, LP	1/25/2012	$50,000,000
Walton Canter Creek 1, LLC	4/4/2012	$12,200,000
Walton U.S. Land Fund 3, LP	3/27/2013	$100,000,000
Walton U.S. Land Fund 4, LP	4/11/2014	$100,000,000
Walton U.S. Land Fund 6, LP	2/19/2015	$100,000,000
Walton U.S. Land Fund 7, LP	2/19/2015	$100,000,000
Walton U. S. Land Fund 5, LP	3/9/2015	$100,000,000
Walton U.S. Development Fund, LP	7/27/2016	$100,000,000
BOLD Fund 1, LLC	7/24/2020	$300,000,000
U.S. Residential Growth Fund, LLC	8/9/2022	$50,000,000
U.S. Builder Identified Land Target Fund, LLC	8/9/2022	$50,000,000

Walton's website touts a superficially impressive breath of experience and claims decades of profitable real estate management on behalf of its clients.[2] Actual investor experience with Walton's Reg D offerings seems dramatically at odds with Walton's representations. In fact, based on our review of Walton Land Fund 3, LP ("WLF3") financials and other Walton Reg D offerings, it is clear that the primary purpose of Walton's Reg D offerings is to aggressively fleece uninformed investors.

[2] www.walton.com

A stylized sketch of the Walton issuers based on our review of documentation for WLF3, LP is as follows.

- Walton establishes a special purpose entity to issue Reg D securities.
- Only 48% of the capital raised is used to buy undeveloped land.
- The other 52% vanishes in payments to Walton and to third-tier brokers:
    - 11% of investors' capital is paid to securities brokerage firms,
    - 3% is taken by Walton "for making the opportunity available",
    - 17% of investors' capital is taken by Walton as markups on land purchases ostensibly to cover expenses incurred by Walton,
    - 21% of the capital is set aside for Walton to withdraw over-time as management fees and expenses for virtually nonexistent services.

Not only do we identify red flags in the WLF3 PPM, we document how Walton launders extraordinary fees through property transactions and reports inflated fair values for property holdings to shareholders in WLF3.

Walton Land Fund 3, LP Private Placement Memorandum

The WLF3 PPM describes the offering and selectively summarizes results of past Walton Group offerings.[3] The initial PPM's Use of Proceeds table is reproduced below as Table 2. Walton planned to charge WLF3 investors substantial markups for undeveloped land Walton was simultaneously buying and so much less than 56% of investors' capital was going to be used to buy land. 11% was going to be paid to brokers as selling commissions and expense reimbursements and over 40% of investors' capital was to be taken by Walton.

[3] The WLF3 Private Placement Memorandum can be downloaded at www.slcg.com/files/US_Land_Fund_3-PPM_and_Supplements.pdf.

Table 2 Use of Proceeds, WLF3 PPM, Page 23.

	Assuming 300,000 Units		Assuming 5,000,000 Units		Assuming 10,000,000 Units	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Gross proceeds	$3,000,000	100.0%	$50,000,000	100.0%	$100,000,000	100.0%
Organizational and Issue Costs:						
Selling commissions (1)(3)	$210,000	7.0%	$3,500,000	7.0%	$7,000,000	7.0%
Selling Group members' fee (2)(3)	$90,000	3.0%	$1,500,000	3.0%	$3,000,000	3.0%
Offering Expenses (4)	$27,142	0.9%	$452,359	0.9%	$904,719	0.9%
Net proceeds (5)	$2,672,858	89.1%	$44,547,641	89.1%	$89,095,281	89.1%
Use of Net proceeds:						
Land and Reserves						
Land and third-party Reserves.............	$1,684,509	56.1%	$28,075,148	56.1%	$56,150,296	56.1%
Management Fee (6)...............................	$368,670	12.3%	$6,144,502	12.3%	$12,289,004	12.3%
Operating Expenses of Walton USA	$529,679	17.7%	$8,827,991	17.7%	$17,655,981	17.7%
Sponsor Fee of Walton USA	$90,000	3.0%	$1,500,000	3.0%	$3,000,000	3.0%
Net proceeds	2,672,858	89.1%	$44,547,641	89.1%	$89,095,281	89.1%

In addition to the upfront fees and expenses and fully reserved ongoing management fees, in the event properties are sold at a profit, Walton intended to take 40% of any proceeds beyond what was necessary to provide investors with a return of capital and a 10.5% noncumulative return (preferred amount) on a *per property* basis.[4] Thus, even if WLF3 investors never received any distributions and lost most of their money, if one property sold at a substantial profit, Walton could take additional fees as *carried interest*.

Shockingly, Walton took carried interest in 2014 and 2015 despite the fact there were no distributions to WLF3 investors and Walton's own calculation of investors' IRR from inception to December 31, 2014 was -6.91% and to December 31, 2015 was -4.77%.

At page 25, the PPM describes the Sponsor Fee Walton will charge WLF3 investors.

> **Sponsor Fee to Walton USA**
>
> $1,500,000 of the Purchase Price in the event of the Maximum Offering, or 3.0% of the Gross Proceeds, will be used to pay a sponsor fee to Walton USA for making the opportunity represented by this Offering available to investors. Regardless of how many Units are sold in this Offering, 3.0% of the Gross Proceeds will be used for this purpose.

With the First Supplement Dated to the WLF3 PPM, Walton listed this 3% as an Acquisition Fee in the Use of Proceeds table. Acquisition Fee is undefined in the

[4] WLF3 PPM, Page 6.

Supplements which say capitalized terms not defined in the Supplements are defined in the PPM. Interestingly, the Acquisition Fee is not defined in the PPM or in any Supplement. Walton, without explanation, simply rebranded the 3% Sponsor Fee it was taking from investors as an Acquisition Fee - foreshadowing its fraudulent bundling of this Sponsor Fee into the fair value of WLF3's property holdings.

The PPM discloses that WLF3 will purchase undeveloped land from Walton USA in non-arms' length transactions which Walton may have recently purchased at lower prices.

> Acquisition of the Interests in the Properties
>
> The Offering is a blind pool offering in that we have not yet identified specific Properties in which the Issuer intends to acquire Interests with the net proceeds from the Offering. The actual dates on which any Interests in Properties will be acquired will in part depend on the timing of the funds raised in this Offering, and each such date is referred to as an "***Acquisition Date***".
>
> On the Acquisition Date for an Interest in a Property, it is expected that the Walton Acquisition Entity will acquire such Property from the seller, and the Issuer will acquire up to a 95% undivided interest in the Property from such Walton Acquisition Entity, with the size of its interest depending upon the proceeds it has raised through the Offering. The Walton Acquisition Entity will retain the remaining undivided interest in the parcel, which will be at least a 5% interest. Thereafter, from time to time the Issuer may acquire undivided interests in such Property from the Walton Acquisition Entity, to the extent that the Walton Acquisition Entity has acquired a greater than 5% interest in such Property. It is anticipated that the Issuer will acquire interests in Properties sequentially, acquiring up to a 95% interest in one Property before acquiring interests in subsequent Properties. For each Property, the Walton Acquisition Entity and the Issuer will share in the expenses of the Property in accordance with their respective proportionate interests in such Property, subject to the True-Up Payment.
>
> The Purchase Price to be paid by the Issuer for the Interests in the Properties and to fund the Reserve (pursuant to Project Budgets for each of the Properties) will reflect not only <u>the seller's sale price for each Property</u>, but will also reflect (i) <u>third-party costs and expenses incurred by Walton USA</u> and its affiliates, or amounts payable by the Issuer in connection with third-party <u>costs associated with researching and acquiring each Property, Issuer Expenses and Concept Planning Expenses</u>, (ii) <u>the Management Fee payable to Walton USA</u>, (iii) <u>certain operating expenses of Walton USA and certain of its subsidiaries and/or affiliates</u>, and (iv) <u>a sponsor fee to Walton USA for making the opportunity represented by this Offering available to investors</u>. See "Estimated Use of Proceeds – Determination of the Purchase Price." [p,36]

A reader of this disclosure could not fully appreciate the price gouging Walton intended to engage in or that these transfers from investors to Walton for worthless services would be laundered through property deeds to inflate the properties' fair value subsequently reported on audited financial statements.

The Use of Proceeds table was updated four times as WLF3 raised money and closed on land purchases. By mid-2013, WLF3 had raised $95,245,000 from investors and bought $65,516,658 in six undeveloped properties; the final Use of Proceeds table is reproduced below as Table 3.

Table 3 Use of Proceeds, Fourth Supplement, October 22, 2013 to WLF3 PPM, p.3.

Projected Use of Proceeds (assuming sufficient Units are sold)

	Harvest Grove North Property		Cumulative (6 Properties)***	
	Amount	%	Amount	%
Gross proceeds	$28,275,000	100.0%	$95,245,000	100.0%
Organizational and Issue Costs:				
Selling Commissions	$ 1,979,250	7.0%	$ 6,667,150	7.0%
Selling Group members' fee	$ 848,250	3.0%	$ 2,857,350	3.0%
Offering Expenses	$ 255,809	0.9%	$ 861,699	0.9%
Net proceeds	$25,191,691	**89.1%**	$84,858,801	**89.1%**
Land and Reserves:		**68.4%**		**68.4%**
Acquisition of Property:				
Acquisition of interest in Property *	$13,231,069	46.8%	$45,832,370	48.1%
Reserve items:				
Concept Planning expenses	$ 1,720,688	6.1%	$ 5,195,176	5.5%
Issuer expenses	$ 2,107,719	7.5%	$ 5,665,831	5.9%
Management Fee **	$ 2,290,154	8.1%	$ 8,481,137	8.9%
Operating Expenses of Walton USA	$ 4,993,811	**17.7%**	$16,826,937	**17.7%**
Acquisition fee to Walton USA	$ 848,250	**3.0%**	$ 2,857,350	**3.0%**
Net proceeds:	$25,191,691	**89.1%**	$84,858,801	**89.1%**

* includes capitalized and closing costs of $156,816 for the River Park Property, $65,738 for the Redwood Meadows Property, $965,535 for the Dobson Creek Property, $214,760 for the Vista Ranch Property, $423,826 for the Ridgewood Lakes Property and 755,032 for the Harvest Grove North Property.

** reserved and paid to Walton USA in annual amounts of $49,910 in respect of the River Park Property, $46,168 in respect of the Redwood Meadows Property, $531,578 in respect of the Dobson Creek Property, $186,305 in respect of the Vista Ranch Property, $255,563 in respect of the Ridgewood Lakes Property and $458,031 in respect of the Harvest Grove North Property; unearned amounts remaining upon final exit, if any, will be distributed to the partners.

*** includes the River Park Property, the Redwood Meadows Property, the Dobson Creek Property, the Vista Ranch Property, the Ridgewood Lakes Property and the Harvest Grove North Property.

The categories in this final Use of Proceeds don't line up with the initial WLF3 PPM's Use of Proceeds excerpted in Table 2 above or with the subsequent financial statements published to investors in WLF3.

According to land deed records WLF3 bought the six properties from Walton for $65,516,658 when Walton had simultaneously paid $46,007,624, or $19,509,034 less than what it charged WLF3 investors.

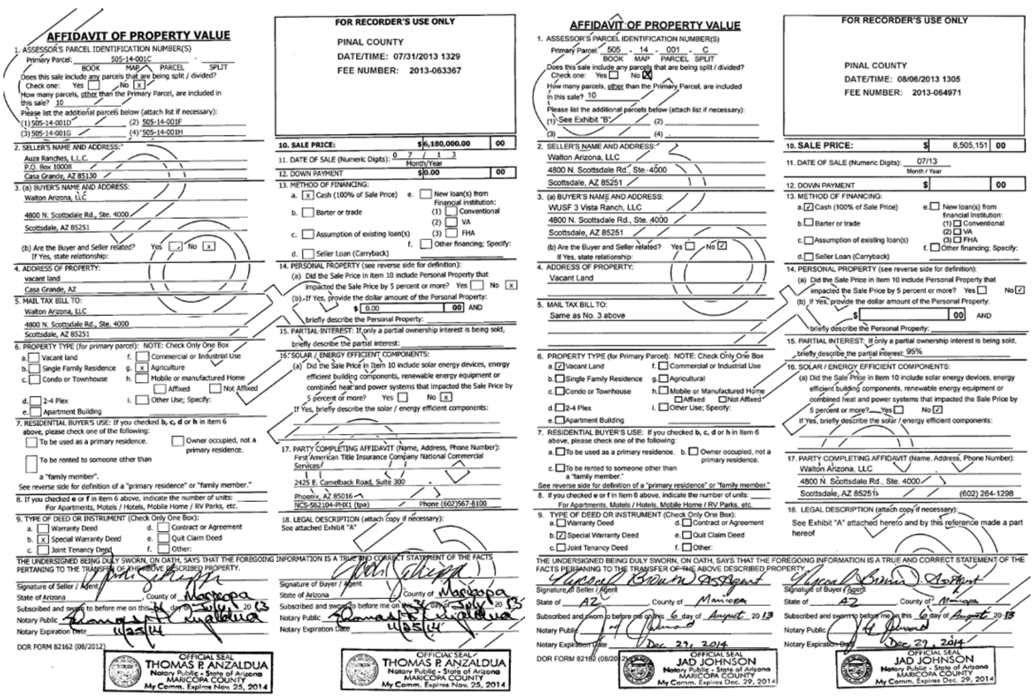
Table 4 WLF3 Property Holdings, December 31, 2013

			From Walton Affiliates to Land Fund 3			From 3rd Party to Walton Affiliates			
Investment Description	Property Location	Acreage	Date Acquired	Cost of 95% Undivided Interest	Cost per Acre	Date Acquired	100% Interest Purchased by Walton	Cost per Acre	Mark-up
River Park	Gaston County, NC	143.99	12/28/2012	$1,733,699	$12,674	6/4/2012	$1,600,000	$8,781	44%
Redwood Meadows	DFW Ellis, TX	104.98	1/4/2013	$2,027,143	$20,326	9/27/2012	$1,443,750	$13,753	48%
Dobson Creek	Prince George County, M	623.47	4/23/2013	$24,307,911	$41,040	3/29/2013	$17,386,966	$27,887	47%
Ridgewood Lakes	Polk County, FL	666.27	6/13/2013	$9,869,624	$15,593	4/30/2013	$6,264,508	$9,358	67%
Vista Ranch	Pinal County, AZ	318.60	7/31/2013	$8,505,151	$28,101	7/31/2013	$6,180,000	$19,398	45%
Harvest Grove North	Hillsborough County, FL	727.33	12/31/2013	$19,073,130	$27,604	10/4/2013	$13,132,400	$18,056	53%
				$65,516,658			$46,007,624		51%

The Vista Ranch transactions illustrate how Walton laundered expenses through property records into inflated financial statement values. Walton Arizona, LLC acquired 318.60 acres of vacant land located in Casa Grande, AZ from Auza Ranches, LLC in July 2013 for $6,180,000 ($19,398/ac).[5] See Figure 1a). The same day, Walton Arizona, LLC sold 95% interest in the same 318.60 acres of vacant land to Walton U.S. Land Fund 3 for $8,505,151 ($28,101/ac).[6] See Figure 1b).

Figure 1 Pinal County Records Reflect Simultaneous Transactions for $6,180,000 and $8,505,151.

a) b)



[5] acclaim.pinalcountyaz.gov/AcclaimWeb/Details/GetDocumentbyInstrumentNumber/DOC/2013-063367
[6] acclaim.pinalcountyaz.gov/AcclaimWeb/Details/GetDocumentbyInstrumentNumber/DOC/2013-064971

Walton Land Fund 3, LP Financial Statements

Financial statements covering inception in 2012 to the most recent statements as of December 31, 2022 illustrate the basic WLF3 economics which are devastating for investors.[7] Investors contributed over $94,399,744 by the end of 2013. WLF3's 2013 financial statements show $84,114,838 in assets - an immediate $10.2 investor loss mostly reflecting $10.5 million in payments to brokers and to Walton.

Table 5 Consolidated Balance Sheets

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Assets											
Investments in undivided interests in land, at fair value	$2,736,329	$66,100,000	$69,410,000	$70,972,072	$75,298,363	$65,181,000	$70,317,000	$71,110,250	$69,072,500	$65,027,221	$72,584,055
Cash	$350,323	$0				$1,585,619	$91,572	$0	$0		$1,163,887
Restricted cash	$961,433	$18,408,300	$15,545,400	$12,908,901	$10,740,825	$8,677,093	$6,830,251	$5,909,602	$5,005,916	$1,359,007	$856,040
Accounts receivable	$0	$474	$929	$24,396	$29,913	$156,587	$35,465	$0	$0	$505,875	$3,187,155
Prepaid Insurance			$4,403	$4,227	$0	$0					
Due from affiliates						$29,958	$445,692	$363,773	$826,458	$625,560	$488,659
Total assets	$4,048,085	$84,508,774	$84,960,732	$83,909,596	$86,069,101	$75,630,257	$77,719,980	$77,383,625	$74,904,874	$67,517,663	$78,279,796
Liabilities and Partners' Capital											
Accounts payable and accrued liabilities	$25,750	$85,399	$139,146	$130,900	$255,260	$51,526	$64,653	$49,515	$37,283	$46,340	$41,822
Deferred revenue									$23,801	$171,000	$194,236
Due to affiliate	$2,324	$186,207	$6,661	$0	$3,949	$56,165	$4,569	$0	$0		
Total liabilities	$28,074	$271,606	$145,807	$130,900	$259,209	$107,691	$69,222	$49,515	$61,084	$217,340	$236,058
Commitments and contingencies											
Partners' capital	$4,020,011	$84,237,168	$84,814,925	$83,778,696	$85,809,892	$75,522,566	$77,650,758	$77,334,110	$74,843,790	$67,300,323	$78,043,738
Total liabilities and partners' capital	$4,048,085	$84,508,774	$84,960,732	$83,909,596	$86,069,101	$75,630,257	$77,719,980	$77,383,625	$74,904,874	$67,517,663	$78,279,796

WLF3's true financial condition was much worse than the financial statements reflect. The land was not worth $66,100,000. It had recently been purchased for $46,000,000 and coincidental with the purchases of the six properties WLF3 paid Walton $20,000,000 in Sponsor/Acquisition Fees and for Walton Group USA' general operating expenses unrelated to the specific properties, all of it laundered through the property records.

PWC audited the WLF3 financial statements from 2013-2016; EY audited the WLF3 financial statements from 2016-2022. It is unclear what work PWC did to verify the $66 million fair value assigned to properties as of December 31, 2013 which had changed hands in arms-length transactions for $45 million earlier in the year. The $66 million valuation was based on the simultaneous non arms-length transactions between entities controlled by Walton which included a $20 million markup unrelated to any improvement in the six properties bought for $45 million.

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[7] These financial statements can be downloaded at www.slcg.com/files/WLF3_Financial_Statements_2012-2022.pdf.

Truthful financial statements would have shown the December 31, 2013 property fair value to be $46,000,000 and the total assets, $64,000,000. Even this would overstate the value of investors interest in WLF3 since $18,408,300 is pledged to Walton and segregated in a non-interest bearing account to be drawn out over time. When Walton was done fleecing investors in 2013, there was really only $46,007,624 in assets available for investors who paid $94,399,744 in 2013 for their interests. That is, WLF3 investors lost 51% in the very first year.

Table 6 Consolidated Statements of Operations

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue											
Interest income								$12,947	$8,814	$0	
Land sales										$16,606,000	$3,920,175
Total Revenue										$16,606,000	$3,920,175
Cost of sales										($10,761,662)	($2,857,758)
Gross profit										$5,844,338	$1,062,417
Operating expenses											
Organizational costs	$30,926	$830,774									
Professional fees	$25,785	$58,905	$41,246	$46,298	$38,810	$60,194	$112,984	$219,782	$216,232	$250,143	$224,419
Management fees	$ 1,914	$ 846,999	$ 1,527,553	$ 1,527,553	$ 1,525,639	$ 1,527,553	$ 1,116,012	$ 407,227	$ -		
Property maintenance	$0	$21,793	$99,245	$123,190	$126,712	$9,441					
Other fees										$20,235	$111,720
Other expenses	$0	$1,038	$7,123	$8,144	$6,242	$5,608	$1,041	$30,708	$36,444	$55	$231
Total operating expenses	$58,625	$1,759,509	$1,675,167	$1,705,185	$1,697,403	$1,602,796	$1,230,037	$657,717	$252,676	$270,433	$336,370
Gain on sale of investment					$0	($527,162)	$91,060	$0	$0	$0	
Net investment loss	($58,625)	($1,759,509)	($1,675,167)	($1,705,185)	($1,697,403)	($1,075,634)	($1,321,097)	($644,770)	($243,862)	$5,573,905	$726,047
Unrealized (depreciation) appreciation on investments	$1,002,256	($667,454)	$2,252,924	$668,956	$3,728,599	($9,211,692)	$6,497,129	$328,122	($2,246,458)	$6,027,023	$10,131,158
Net (decrease) increase in partners' capital resulting from operations	$943,631	($2,426,963)	$577,757	($1,036,229)	$2,031,196	($10,287,326)	$5,176,032	($316,648)	($2,490,320)	$11,600,928	$10,857,205

Table 7 Partnership Accounts

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Beginning Balance		$3,783,215	$84,114,838	$84,774,706	$83,778,696	$85,809,892	$75,522,566	$77,650,758	$77,334,110	$74,843,790	$67,300,323
Partnership Contributions	$3,378,311	$91,021,433									
Syndication Costs	($301,931)	($8,377,313)									
Net investment loss	($58,625)	($1,759,509)	($1,675,167)	($1,705,185)	($1,697,403)	($1,075,634)	($1,321,097)	($644,770)	($243,862)	$5,573,905	$726,047
Unrealized appreciation on investments	$765,460	($552,988)	$2,252,924	$668,956	$3,728,599	($9,211,692)	$6,497,129	$328,122	($2,246,458)	$6,027,023	$10,131,158
Carried Interest			$82,111	$40,219							
Distributions							($3,047,840)			($19,144,245)	
State witholding tax										($150)	($113,790)
Ending Balance	$3,783,215	$84,114,838	$84,774,706	$83,778,696	$85,809,892	$75,522,566	$77,650,758	$77,334,110	$74,843,790	$67,300,323	$78,043,738