Alternative Investing Through Debt Funds?

Today's investment landscape offers a plethora of investment opportunities. Investors are presented a dizzying array of investment products, some of which are difficult to understand. One of the investment choices presented to investors is *Alternative Investments*. Just exactly what is an *Alternative Investment*?

An *Alternative Investment* is a financial investment that falls outside the conventional investment vehicles, such as stocks and bonds. *Alternative Investment* vehicles include private equity, hedge funds, venture capital, syndications, and real estate investments (debt or equity). Astute investors are quickly discovering this asset class. In fact, many investment advisors are now recommending that their clients have as much as twenty percent (20%) of their portfolio capital in *Alternative Investments*. One type of *Alternative Investment* quickly becoming popular with investors are Real Estate Debt Funds. There are numerous reasons for considering Real Estate Debt Funds, but here are some of the more salient financial benefits derived from these types of investments:

Collateralization: Real Estate Debt Funds (Debt Funds) collateralize their loans with commercial real estate property. Typically, a Debt Fund will only loan up to a 65%-70% (loan-to-value, or LTV) of a property's market value. For example, if a Debt Fund made a loan to an owner of a commercial property whose property is valued at $1m dollars, the Debt Fund would only lend the owner $650,000 -$700,000. Thus, there is an *equity cushion* ($350,000 - $300,000) to protect against any possible loan default. This attribute is especially popular with investors – their investment is collateralized much the same as a Bond! This investment feature provides a significant amount of capital protection.

Cash Flow: Real estate loans provide interest dividends, i.e. cash flow. These interest dividends are received from the borrower's monthly payments. In most instances these dividends range from 10%-15% depending on the type of loan. Debt Funds will pass these dividends through to investors in the form of *preferred returns*. Most Debt Funds make dividend distributions on a quarterly basis.

Fee Income: Most Debt Funds charge fees to borrowers who want to access Fund capital. Fees typically range from 3%-5% of the total loan amount. For example, on a loan amount of $1m dollars, a Fund would charge a fee of $30,000-$50,000. Debt Fund's will share these fees with investors – boosting overall investor return. Debt Funds can also charge additional fees depending on the type of loan and particular circumstances.

Capital Appreciation: One of the most overlooked aspects of a Debt Fund investment is the possibility of capital appreciation. Some Debt Funds will purchase other loans collateralized by commercial real estate. These loans can be purchased from banking institutions, other debt funds, or even governmental agencies. Often these loans are purchased at some type of discount. These discounts are passed on to the investors in the form of capital or share appreciation. Capital appreciation can also occur in the event of loan defaults, where the Fund realizes default interest and fees, even possible capital transactions.

Tax Advantages: Debt Fund investments can offer significant tax benefits. Frequently, investment returns, in the form of capital appreciation, can receive beneficial capital gains tax treatment. When Fund Managers purchase loans at a discount, the discount received can often be treated a long-term capital gain. Many Debt Funds structure capital distributions so that investors can receive beneficial tax treatment.

Diversification: Many investment advisors are now recommending that up to twenty percent (20%) of portfolio capital be place in Alternative Investments. Why? Diversification. As most investors are aware, traditional investments (stocks & bonds) are cyclical. In any given year traditional investments might enjoy significant gains, only to give those gains back in subsequent years. Alternative Investments can "smooth out" investment returns over the investment cycle. In many instances, Alternative Investments have out-performed traditional investments - adding to overall portfolio return.

Liquidity: Most Debt Fund investments are mid-term investments. That is, investment capital must remain in the investment for a term up to 2-3 years. After the term expires, most Debt Funds become self-liquidating, returning invested capital, together with capital appreciation, to investors (remember, dividends are typically distributed quarterly).

Professional Management: Debt Funds are managed by real estate and finance professionals. The emergence of this Alternative Investment class has given investors the opportunity to invest in strategic real estate investment strategies not before provided to investors. In the past, investors would have to personally purchase and manage real estate property in order to reap its significant benefits. No longer. Today, investor can benefit not only from professional management, but also from a particular Fund Manager's unique real estate investment skill set. Manager's also provide investors with timely financial reporting, tax assistance, investment counseling, and legal assistance.

More and more investors, and investment advisors, are becoming aware of Alternative Investment platforms. These platforms provide exciting opportunities for investors to increase portfolio returns and to invest in areas not before available to the average retail investor. Real Estate Debt Funds offer just such a type of investment. Investors should, however, closely consider any Alternative Investment Fund thesis and offering documents. Investors want to be sure that their invested capital is respected by Management so to achieve the greatest risk adjusted returns possible.

For more questions regarding Real Estate Debt Investments, please call WINPRO at 720.344.1174.