

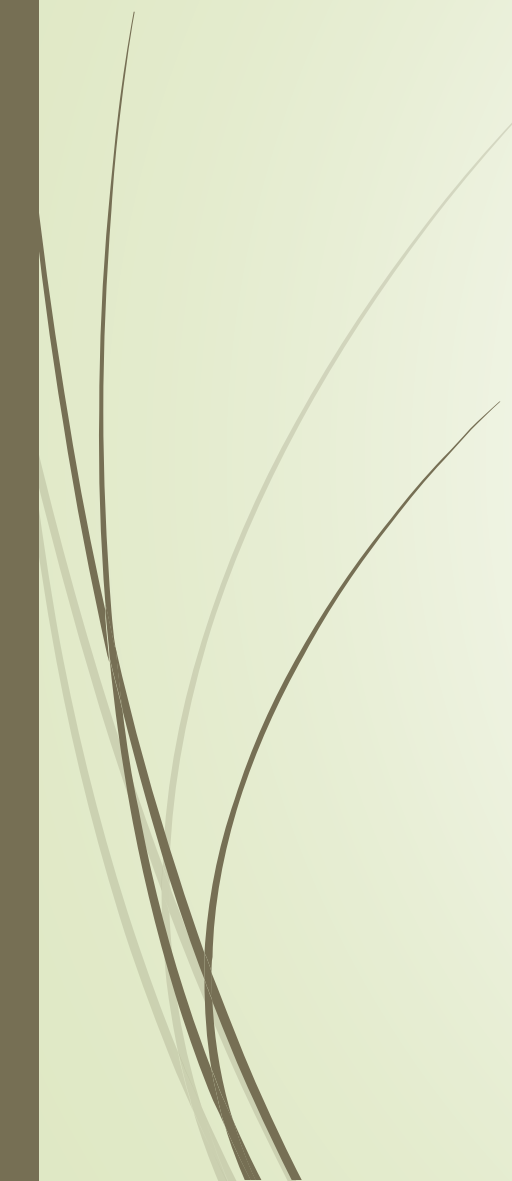
# **Benefits of Alternative Investments**



AAll Houston Chapter SIG – June, 2021



# Alternative Investments - Investopedia

- An alternative investment is a financial asset that does not fall into one of the conventional equity, income, or cash categories
  - Private equity or venture capital, hedge funds, real property, commodities, and tangible assets are all examples
  - Most alternative investments are unregulated by the SEC & tend to be somewhat illiquid
  - While traditionally for institutional & accredited investors, alt investments have become feasible to retail investors via alt funds, ETFs & mutual funds
- 



# A better “Working Definition”

comes from differentiating by Liquidity trade off

- Any private market alternative to a public market security
  - Stocks, bonds, commodities, options, managed futures, forex, etc
- Also Hedge funds
  - Relative value, typically Long/Short positions
  - Diversified as in macro strategies
  - Hedged or arbitrated positions
- Examples
  - Private equity, private debt, annuities, structured settlements, litigation financing, medical royalties, special situations e.g. cloud, etc



# Array of Alternatives - Wells Fargo Advisors

- Relative value/arbitrage\*
- Long/short credit & equities
- Structured credit/asset backed
- Macro - systematic or discretionary\*
- Event driven – distress credit or merger arbitrage\*
- Hedge Funds – directional or market neutral
- Private equity/debt
- All with terms sufficiently attractive to trade off liquidity

*\*Items asterisked have a Liquid Alternative but does it have a liquidity premium? For this presentation we will define an Alt as one without liquidity*



# What's different about Alternatives?

- Generally, alternatives provide a better risk/reward profile as a tradeoff for tying up your liquidity
- There is no daily “mark to market” on private vehicles
- However, giving up liquidity forces more confident liquidity planning
- Yale led the trade-off to LT Alternative Investments for the Endowment world
  - Averaged 11.8% vs 6.8% peer growth for more than a decade
  - Almost all their peers have followed suit



# My Background

- Have been investing in Alternatives ~6 years
  - Have become very comfortable with them
  - They avoid being overallocated to Public Markets
  - This greatly reduces the angst of big market-decline periods
  - Sleep better at night!
- Plan to review three opportunities today:
  - Asset backed Notes
  - Hines Income Trust
  - Secondary Annuities






# Today's Case Studies

- Secondary Annuities
- Hines Income Trust
- Hall Real Estate Notes

## **Previous Meetings:**

- CAZ Investments (Chapter 10/2019)
  - Diversified private equity
  - Hi-Reward/Lo-Risk funds
- Laureola Life Settlements (SIG 08/2020)
  - Zero correlation Med-Reward/Lo Risk funds
- Kaplan MultiFamily Funds (SIG 09/2020)
  - Low correlation Real Estate private equity
  - Hi-Reward/Lo-Risk funds



# Hall Asset Holdings – Asset backed 8% Notes

- HAH is the vehicle for financing Craig Hall's real estate empire
  - National real estate firm based in Dallas
  - 40+ years of experience
  - 100% domestic projects
- \$50mm Bond Issue with coupon of 8% paid quarterly
- Term 5 years, 8 months
- Secured with \$510mm in Net Assets (10 to 1 coverage)
- First Lien secured on Dallas assets downtown & Frisco, TX





# HAH 8% Notes - Pros and Cons

## ➤ PROs

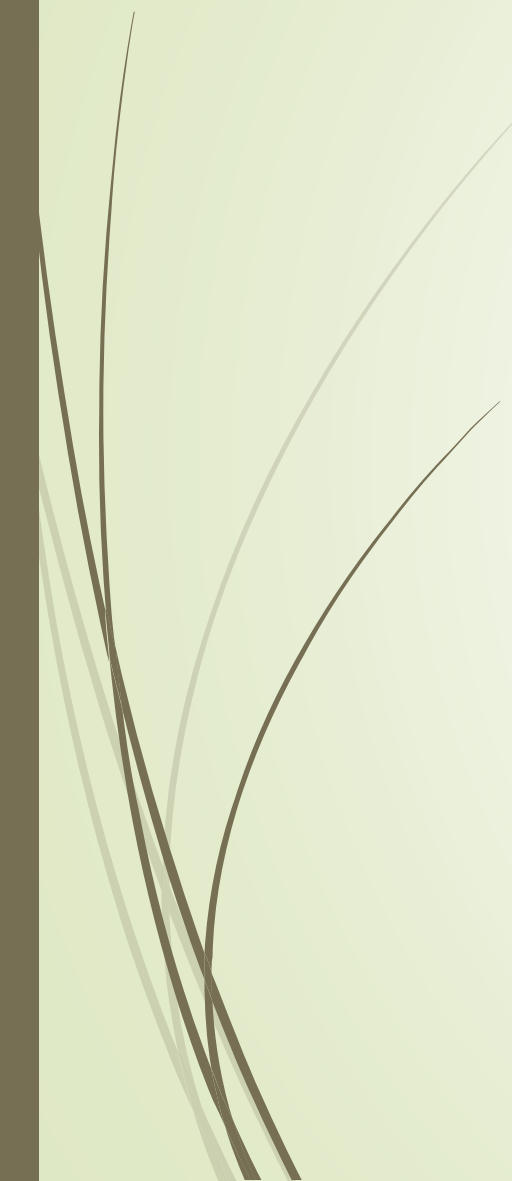
- Excellent risk/reward balance
  - Highly attractive returns for the very low risk level
- Accomplished & experienced developer
- Good financing & project management skills
  - Frisco fastest growing town in US
- Good collateral security & asset diversification
- Covenant to maintain minimum 20% liquid assets

## ➤ CONs

- Lack of liquidity but there are costly surrender conditions
- Inflation is an issue today & can erode the bond value
- Minimum size \$50k



# HAH Conclusion

- These are highly attractive fixed income vehicles
  - They will compete with LT equity returns at greater safety levels
  - 8% returns fit very well with tax-deferred retirement portfolios where dividends of 3-4% are standard & bonds are barely positive
  - Contact:
    - Andrew Murdoch, broker
    - Based in Portland OR
    - Somerset Wealth Strategies
    - [amurdoch@somersetws.com](mailto:amurdoch@somersetws.com)
    - 800-813-4000
  - Additional materials available
- 



# Secondary Annuities

- Better returns than traditional annuities
- None of the obscene sales commissions of annuities
- Returns in the mid single-digit range
- Tax free by using Roth IRAs
- Top Tier Insurance Company holds & administers the payment stream
- Security is backed by the Ins Co with a formal Court Order & legal opinion
- Each case is an individual transaction
  - Function of \$ amounts & timing



# How these Transactions are Sourced

- An individual suffers a loss & is awarded damages under a legally documented settlement
- Typically, Hedge Funds buys the settlement from the individual for a fixed \$ amount
- By law, the transaction must be approved by a Court in the individual's Home State
- Payment stream is placed in the hands of a top tier Insurance Company to administer
- The Hedge Fund then sells the wrapped transaction into the Secondary Annuity or "Structured Assets" market
- Brokers will offer these opportunities to individual investors seeking cash yields &/or longevity insurance



# Two Examples of Secondary Annuities

- 10 year Prudential Insurance Annuity( 2017-26)
  - Pays ~\$1,200 per month w/no COLA
  - About half way through life cycle
  - Purchased for \$117k in late-2015; pays out ~\$142k
  - 4.25% tax free payout
  - Used for income generation
- 
- 8 year NY Life Insurance Annuity (2028-35)
  - Pays ~\$5k per month w/3% COLA
  - Not yet started drawdown
  - Purchased for \$116k in mid-2015;pays out ` \$298k
  - 5.8% tax free payout
  - Used for income generation & longevity risk



# Secondary Annuity Pros and Cons

## ➤ PROs

- Excellent risk/reward balance
  - Attractive returns for the low risk level
    - Balance Sheet of Insurance Company
  - Particularly if a Roth account is used to avoid taxes
- Accomplished & experienced broker (Somerset Wealth)
- Minimum participation is determined by size of CF stream

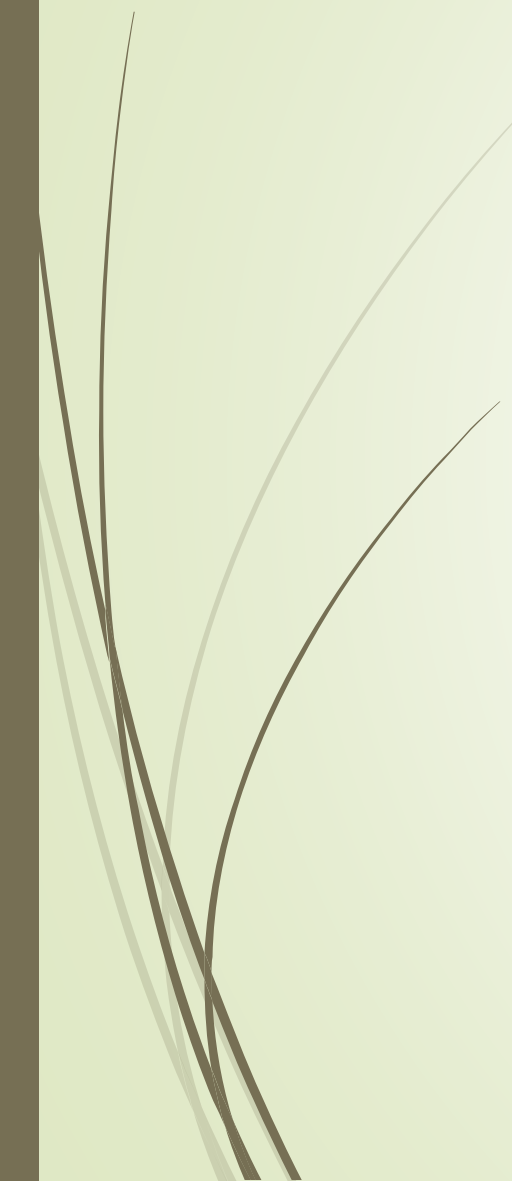
## ➤ CONs

- Lack of liquidity but can surrender for 4% fee after 1/1/19
- Inflation





# Secondary Annuity Conclusion

- These are highly attractive annuities with much lower fees
  - They will compete with LT equity returns at greater safety levels
  - Can customize the CF stream that fits your need for income security
  - Contact:
    - Andrew Murdoch, broker
    - Based in Portland OR
    - Somerset Wealth Strategies
    - [amurdoch@somersetws.com](mailto:amurdoch@somersetws.com)
    - 800-813-4000
  - Additional materials available
- 



# Hines Income Trust

- Hines started RE developing in Houston in 1950's
- Now a global Real Estate behemoth
- Remained a private family-run business
  - with employees as shareholders
  - Leverage their properties up to ~60% with low cost debt
- Also sell private interests in the Hines Income Trust under Reg. D from time to time
- Units are REITs with ~7% returns
- Also have an equity kicker ~2% from appreciation in property leasing revenue



# Hines Income Trust - Pros and Cons

## ➤ PROs

- 7-9% income is a good medium-sized reward
  - Relatively low for equity risk
- Accomplished & experienced developer
- Good financing & project management skills
- Global asset diversification
- Have demonstrated growth in returns to offset inflation
- Very low minimum investment of \$2,500

## ➤ CONs

- Lack of liquidity
- There are monthly limited redemption facilities



# Hines Income Trust Conclusion

- Excellent track record
  - High achiever employees compensated partly in stock
- Operate in 225 cities in 25 countries
- 7-9% income is a good medium sized reward but relatively low for equity risk
- Interesting trade-off for Hall 8% bonds over this choice
  - ~1% higher reward for Hines
  - Hall credit is rock solid (10:1 Net Assets to Debt)
- Contact: Keen Butcher at Butcher Financial



# Butcher Financial LLC

- Another good firm in the Alternatives Business
    - Where I have invested
  - Has good deal flow where you meet the issuing Principals
  - Tailored to Income Generation needs in niche markets
  - Butcher invests alongside you & monitors developments
  - Contact:
    - Principal: Keen Butcher
    - Based: Houston
    - Phone: (713) 259-1798
    - E-mail: [keen@butcherfin.com](mailto:keen@butcherfin.com)
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# Alternative Investments - Pros and Cons

## ➤ PROs

- All the attractions of traditional investments but improved risk/rewards
- Greater diversity in Portfolio & lesser market swings
- Potential tax opportunities by investing through IRAs


## ➤ CONs

- Lack of liquidity
  - Time your investments to meet your income needs
- Need to be selective on Terms & Conditions in due diligence
- Most insist on minimum investment levels





# Why make Alternative Investments?

- Take advantage of better investment risk/reward profiles than market vehicles
    - Both ends of risk/reward spectrum
      - Med-Risk/Hi-Reward and Lo-Risk/Med-Reward
    - Enjoy the benefits of better deals in the private markets
  - Better portfolio diversity by lowering public market exposure
    - Lowers risk & improves returns
    - Lessens volatility & drawdown exposure when markets collapse
    - Avoids sequence risk early in your retirement years
- 



**Additional Questions?**



# Laureola Fund

- Private equity specialized mutual fund with \$36mm AUM
- Domiciled in Bermuda, operations in US, advisors in UK & elsewhere
- 100% focus on Life Settlement Policies
  - They only exist in the USA
- Model is to buy policies cheap, maintain them in a portfolio & cash them in as they expire
  - Fund has unique niche in sub \$1mm policies & with impaired lives
- Fund has 183% growth since inception; with 21.5% CAGR
- Highest month 7.3%; lowest month(0.3)%
  - Only one month with a loss in 5+ years!
  - Highest year 31.9%; lowest year 13.1%
- No bad debts; all highly rated US Insurance companies



# Laureola Fund – Tax Issue

- ▶ Section 408(a)3 of US Internal Revenue Code states that “no part of the trust fund will be invested in insurance contracts”
  - ▶ Cannot be held in 401(k)s or IRAs
- ▶ Three leading custodians and at least two tax attorneys have become comfortable in supporting Fund ownership:
  - ▶ Laureola is a mutual fund in which an investor subscribes so there is “no direct ownership of life insurance policies”
  - ▶ Life settlement business did not exist when S.408 was written
  - ▶ However, certain State rulings discourage investing in life insurance policies (AR, KY, OR)
- ▶ The IRS is chronically short of audit people
  - ▶ When IRS agents are assigned to jobs, they will always prioritize higher \$ potential than this small fund

**“IRS has bigger fish to fry”**



# Personal discussion with Midland IRA

- *Midland emphasized that discussion was not a legal opinion and that we should not rely upon it:*
- “They are very comfortable with Laureola & with other funds in this space
- They believe that owning shares in a mutual fund (or as a partner in a partnership) vs owning the policies/contracts directly is a key differentiator for them
  - This is why they became comfortable with being a custodian in this area
- They have been providing custodial services in this segment for a number of years & are very comfortable in adding new accounts for Laureola investors”



# Pros and Cons of Life Settlements

## ➤ PROs

- Good returns
- Low volatility
- Zero correlation to Public Markets

## ➤ CONs

- Illiquidity, tenure varies by fund
- Competition has driven down returns more recently
- Potential IRS challenge
- Minimum \$100k





# Laureola Fund Conclusion

- The Fund is a very attractive investment vehicle
  - Performance has been stellar with very low volatility
  - Not quite such a clear cut decision as the Hall Notes!
  - Contact:
    - John Swallow, Investor Relations Director
    - Laureola Fund Advisors
    - Based in UK
    - Phone +44 (0) 7473 668 439
    - [John.Swallow@LaureolaAdvisors.com](mailto:John.Swallow@LaureolaAdvisors.com)
  - Additional materials available
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