

## CHAPTER SIX



# Expand Your Horizons

## (Alternative Investments)

Traditional investing in publicly traded funds has always been the generally accepted way to invest your money. The question then arises: Is this the safest way of moving forward or even the most profitable way?

**Investing is not the easiest thing** that most people do. In fact, most people have a higher tendency to avoid their investments rather than focus on them and manage them successfully. We generally think investments are typically geared toward stocks, bonds, mutual funds, and ETF's (Exchange-Traded Funds). Even inside our company-sponsored retirement plans, there are things

like target date funds which are built for people who have too much fear and anxiety to actively manage their own money.

With all of this in mind, we wanted to add another layer for improved management in an ultra-volatile time. Traditional investing in publicly traded funds has always been the generally accepted way to invest your money. The question then arises: Is this the safest way of moving forward or even the most profitable way?

In this chapter, we attempt to explain how to “Expand Your Horizons” and look at investing in the private sector instead of just the public sector. This is not recommended for everyone since it is typically designed for the “Accredited Investor.” Nor is it recommended to invest all of your portfolios in the private sector. The objective is to find a happy medium that suits your risk tolerance, suitability, and investment objectives.

These are just a few ideas on how to work in the private sector:

### **Hospitality**

Investments in hospitality allow a client to buy a preferred share of companies that purchase high-end hotels and resort properties. If you are a preferred shareholder,

you maintain a senior position in the equity ownership of the company and a position of liquidity. In return for using your money for the development and enhancement of these properties, the company pays you a fixed rate of return that is typically more lucrative than banks and lower-performing vehicles. For example, it could start with a gross rate in the range of 8% and increase incrementally with the longevity of your holding time.

*Since many public companies don't offer preferred shares, the protections you have can be reasonable. Specifically, you will always be ahead of common stockholders to get paid back.*

### **Chain Restaurants**

Chain restaurants are an example of a Private Placement investment that is designed to provide investors access to a compelling private equity opportunity, which supports current income and attractive long-term capital gain potential. In this arrangement, the investment is used to expand the number of the company's fast-food restaurant franchises. Some examples of well-known fast-food restaurants are Burger King, Dunkin' Donuts, Kentucky Fried Chicken, etc. The advantage to the investor is that these franchises are owned by business professionals,

rather than mom-and-pop operators. This “Regulation D” offering identifies established brands within appealing locations that can be managed very effectively and, because of their size, receive better pricing on the cost of doing business. Here, the rate of return is generally a combination of a fixed rate of return and a share of the company’s profits.

*Because there is limited liquidity with Private Placements, these are ideally suited for people who know what they are buying and are unlikely to change, because these folks would be considered an Accredited Investors.*

### **Distressed Real Estate**

Distressed Real Estate Funds are opportunistic real estate investments designed by investment firms to acquire significantly undervalued real property assets. The distressed valuation may be due to market factors, bankruptcy, credit, family, or refinance issues. These properties are large holdings such as hotels, commercial and industrial space, or multi-family housing. Because there is stress to the existing financial structure, investment firms can purchase these properties at a 30-40 percent discount; sometimes even more. They then either upgrade the property

and sell it, simply manage it, or wait for it to appreciate to refinance and pay off the investors.

*While the rate of return is often unknown, due to the unpredictability of the real estate market, the return on the investment may be sizeable. The risk to the investor is also higher until the investment goals for that specific property are realized.*

### **Opportunity Zones**

We always strive to leverage highly appreciated investments and recharacterize them from being taxable to tax-free (based on current income tax rates). For example: if you've sold some stocks and wound up with a large capital gain, you will need to pay tax on that gain. An "Opportunity Zone" is a unique investment that allows you to earn a reasonable rate of return and zero out taxes on all associated capital gains. The Trump administration passed these laws to cover certain categories of lands that are underutilized and undervalued. The concept was to provide people with an opportunity to develop these kinds of properties. The resulting legislation became the Opportunity Zone.

Because land development that meets Opportunity Zone conditions is simply too much of an undertaking for

the average investor, some companies have created funds specifically for building projects in Opportunity Zones. As a result, it's similar to investing in a private fund where the company promises you a specific rate of return.

*For example:* If I invest one hundred thousand dollars and sell it for one million dollars, I've got a six-month window from the time I received that capital gain to reinvest it and receive a dollar-for-dollar offset of my capital gain. The Opportunity Zone structure has an approximate 10-year window, which means you will still own a part of the investment after all the benefits are delivered. All of the resulting income is tax-free, and you receive a full offset of the capital gain.

*When the Opportunity Zone investment is completed, you may still own a share of that property, which could be almost any type of real estate development, including hotels, multifamily projects, office buildings, etc. It's can be a pretty spectacular deal.*

## **Oil and Gas**

Investments in Oil and Gas Limited Partnerships provide several unique tax benefits. These investments, with an

initial valuation of 100%, cover various areas from re-search and development to site preparation to actual well drilling. By the time the company is ready to drill wells, the value of the investment is depleted a great deal.

*For example:* On an initial investment of one million dollars, there may only be \$600,000 left by the time they are ready to begin drilling. Since the investment is ideally meant for retirement planning and annual valuations take place mid-year—one year following the investment—we take that valuation and convert it from an IRA to a Roth IRA. It's justifiable to use the lower valuation, which reduces tax exposure on the original investment by as much as 40% on average.

After the IRA conversion, it's just a matter of time until the oil and gas company begins to realize profits on their new wells and start returning the balance of the principal. It usually takes about five years to get your principal back and another five years to get the majority of the profits out of those wells. That's because these are not single wells; they are blocks of wells. At any given time, some of the wells in a block may under produce, while others overproduce. Usually, you may expect a two-

to-one return on your investment over ten years. Because of the trickle-down effect, your money is going to come back in the first five years with 40% of it being returned in the first two years.

*For Example:* The return of capital and profits you receive from well production can be reinvested elsewhere. So, not only could you have a two-to-one rate of return (no liquid cash to show for it in the first year), but in the fifth year you've received your million dollars back. By the tenth year, however, you've made an additional million dollars. Due to the reinvestment opportunities, there could even be a higher rate of return in the process.

These are just some of the ways to expand your horizons and achieve your goals. Remember that effective investing is different for each investor. Some of these ideas are meant to minimize your risk during the most volatile times. Some are designed with a higher risk and a higher rate of return. And some are strictly designed to be a tax hedge.

*This market is in a constant environment of change.  
So, when you look at the private sector, you should*

*know that most of these types of funds have a starting point and a predefined ending point, whereas public investing does not typically set that predefined timeline.*



## Chapter in Review

Private Sector Investment is designed for “Accredited Investors” and is not recommended to invest your entire portfolio. Find a happy medium that suits your risk tolerance, a comfortable financial fit, and optimal investment objectives.

### 1. Hospitality

Few private sector investments offer great such benefits. Investments in hospitality allow you to purchase high-end hotels and resort properties with reasonable protections in place (you will always be first in line to get paid back).

### 2. Chain Restaurants

1. This Private Placement investment provides investors with access to a compelling private equity opportunity by supporting current income and attractive long-term capital gain potential.

2. Your investment helps to expand the company's fast-food restaurant franchises, which are owned by business professionals, rather than mom-and-pop operators.
3. This "Regulation D" offering identifies established brands within appealing locations that can be managed very effectively and, because of their size, receive better pricing on the cost of doing business.
4. The rate of return is generally a combination of a fixed rate of return and a share of the company's profits.

### **3. Distressed Real Estate**

1. These Private Placement investments offer compelling equity opportunities and have appealing long-term capital gain potential.
2. Distressed Real Estate Funds are designed to acquire significantly undervalued real property assets, and the return on your investment can be sizeable.

#### **4. Opportunity Zones**

1. The “Opportunity Zone” is a unique investment that allows you to earn a reasonable rate of return and zero out taxes on all associated federal capital gains.
2. Special funds are available for building in Opportunity Zones, which make this type of investment easy for the average investor.
3. It’s similar to investing in a private fund where the company promises you a specific rate of return.

#### **5. Oil and Gas Partnerships**

1. Investments in Oil and Gas can provide unique tax benefits. Although it represents an environment subject to change, and therefore a higher risk.
2. Oil and Gas investments can offer a higher potential of return. They have a starting point and a predefined ending point.