The GUIDE to Alternative Investing in Real Estate

CONNECT INVEST

Overview

In this e-book, you will learn the benefits of diversifying your portfolio with alternative investments. It is intended for investors who are experienced with the basic concepts of financial planning and investment strategy. It explains the difference between traditional and alternative asset classes and gives a summary of the most common types of alternative investment. In addition, it provides a more detailed guide to real estate as an alternative asset, and helps you understand what it takes to become a confident alternative investor using Connect Invest.

Introduction

Smart investors like you devote a lot of time and energy to thinking about portfolio strategy. Whether you work with an adviser or manage your financial plans entirely on your own, you know that diversification is an essential component to managing risk in your overall investment portfolio. The old adage holds true: don't put all your eggs in one basket. Connect Invests exists in order to help you carry out that strategy.

Many times, experienced investors reach a limit in just how much they can diversify. They have come up with the right mix of stocks and bonds for their goals. They have a healthy mix of individual equities, mutual funds, ETFs, muni and corporate bonds, interest-bearing cash accounts, and perhaps some global equity exposures. If you have come this far in your diversification journey, you are further ahead than most investors. At the same time, you are likely asking how to take your strategy to the next level. That is where alternative investment comes in.

Alternative investments give you another set of investment markets to consider. As the name suggests, they fall outside traditional stock and bond markets. There is an enormous range of alternative assets that can be invested in: real estate, venture capital, hedge funds, private equity, commodities, derivatives, collectibles and fine art, and more. Basically, anything that can appreciate in value can become an investment and become part of your overall portfolio.

However, most alternative assets are out of reach to the typical individual investor. Generally speaking, alternative investments represent unfamiliar territory even to experienced individuals. They have an entirely valid reputation as complex, unregulated, and higher-risk investments.

In some cases, they require specialized knowledge of the assets (such as real estate or collectibles). In other cases, they are normally the province of institutional investors (such as hedge funds, private equity, and derivatives) and individuals simply do not have ready access to them. In still other cases, they have typically had high financial barriers to entry, with investment minimums of six or seven figures.

Finally, alternative assets themselves are unregulated, but the SEC limits purchase of many asset types to accredited investors or qualified purchasers. For example, Connect Invest offers fractionalized Note investments in real estate. Rather than investing directly in real estate, we offer indirect investments into loans taken by bankable

borrowers for land acquisition, property development, building construction, or renovations. We are proud to help people enter the alternative investments space or expand their alternative strategies even further by offering access to these Notes.

Note: Only accredited investors may open an account and purchase notes on Connect Invest. To learn more, read our "Guide to Accredited and Qualified Investor Status. "

Knowing the Alternatives

As we said above, the world of alternatives offers you many possibilities. Because Connect Invest is a real estate platform, we will focus on that asset class later in this document, but before getting into those details, here is an overview of some of the more common types of alternative investments out there.

Alternatives fall into two main umbrella categories, financial assets, and real assets. Financial assets are based on the notional value of an asset. They do not have any inherent worth and may not have a physical form at all. As the name suggests, real assets are physical assets that are tangible, such as commodities and natural resources, man-made items such as works of art, coins, or other collectibles, infrastructure, and real estate. It is a real asset if you can actually touch it.

To illustrate the concept, if you purchase a painting by Monet, even if the art market collapses, you still own a painting that you can hang on your wall. If you invest in a hedge fund with a strategy that goes off the rails, you lose your entire investment. This may sound dire, but in fact, if you are a traditional investor, most if not all of your investment assets are also financial (i.e., stocks and bonds) and therefore also intangible.

To make matters just a bit more complicated, in some situations, such as futures markets, financial assets have been built on top of real assets. The corn may exist, but its potential future price is an intangible financial asset. Connect Invest's real estate loan Notes fall into this category.

Understanding the distinction between financial and real assets matters because it can help you decide how and where to invest. It helps you understand the current and future value of an investment asset and plot out the potential returns versus risk. It can also give you strong clues on how to carry out your diligence and decide what is right for you.

Financial Assets

Hedge Funds: Hedge Funds pool together the funds collected from a group of investors (who must be accredited to participate) and then manage the investment of those funds into a wide range of opportunities. As unregistered investments, hedge funds can invest in anything that the hedge fund manager imagines as part of the hedge fund strategy. Investment periods can be several quarters or years, so investors do not have liquidity. Hedge funds also often borrow money (i.e., use leverage) to amplify returns even further, at the risk of also amplifying losses. Some can take a fairly conservative

approach, but many of them intentionally take high risks in order to realize significantly higher return than traditional markets.

Because hedge funds have a manager who monitors the fund, choosing the right investment strategies, they have a "2 and 20" fee structure, charging 2% off the top on assets managed and taking 20% of any investment gains. Highest performing hedge funds can deliver triple-digit returns, but on average, they have been underperforming the S&P by a factor of more than 2x in recent years.

Private Equity: Similar to a Hedge Fund, Private Equity (PE) collects funds from a pool of accredited individual and institutional investors, and then invests it on their behalf. PE investments are directed to privately held companies or used to take publicly held companies private (i.e., a buyout). Most investors in PE are considered limited partners. The PE firm, or general partners, makes investments on their behalf, and plays an active role in ensuring the financial success of the company they invest in. Investment periods are typically several years as the company is cultivated to ensure a turnaround, an IPO, or an acquisition. Venture Capital (VC) is a specific form of private equity focused on startups. During the investment period, PE firms charge investors both management and performance fees.

PE is an enormous component of the overall investment landscape, generating over $582 billion in deals in 2018. PE has also accumulated an enormous amount of uninvested capital from investors, hitting a record high of $2 trillion by the end of 2018. PE typically attracts patient investors with long time horizons for seeing returns. Over the long haul, PE tends to deliver higher returns than national or global equities markets. Analysts vary, but the typical average is about 5 percentage points higher.

Limited Partnerships: Limited Partnerships are direct investments into the ownership structure of a privately held company. They are not restricted to accredited investors or qualified purchasers. As a limited partner (note that the term has a slightly different meaning here than for PE), you have direct access to the company's income without being an employee or having direct management responsibility. You can receive quarterly or annual payouts of profits from the business. If the business is profitable, this can be a source of regular investment income.

Unlike other categories of financial asset, however, there is no formal market for investment opportunities, and no advisory or management structure. Investment opportunities typically come through friends, family, or business relationships. Your ability to withdraw returns or your original capital is determined by the legal terms of the partnership agreement.

Marketplace Lending: Marketplace lending offers borrowers a means to bypass traditional bank loans. They may be able to find more favorable loan terms or less stringent credit requirements in a private marketplace of loans. Investors in marketplace lending can choose loans and borrowers to lend to, or in some marketplaces, they can choose borrower profiles such as credit risk. They then receive payments of principal and investment gains from interest as the loan is repaid. Peer-to-peer or social lending also falls into this category.

Marketplace lending is a relatively new form of alternative investment, with many

online platforms emerging to allow borrowers and lenders to participate. Loans are typically unsecured. They may potentially be more risky than traditional bank loans, because of the potential for borrower default. Investors considering investing in marketplace lending should carefully evaluate the performance and default rates of potential platforms and pay close attention to the specific loans that they are willing to invest in.

Real Assets

Real Estate: Real estate is a familiar form of alternative investing, and a frequent choice for savvy investors looking to diversify beyond stocks, bonds, and interest-bearing cash accounts. There are three main approaches to real estate investing, as well as many options in the type of property and different phases of development to invest in.

The two main approaches are:

Directly Owned Property: For the most hands-on approach to real estate investing, many investors buy properties directly. This can include a primary residence, a secondary residence, or a pure investment property to rent as a form of passive income. Direct ownership of property has many financial and psychological benefits. However, direct investors in property must also factor in the lack of liquidity, the potentially long period of appreciation, and the additional sources of cost such as utilities, taxes, maintenance, insurance, and any interest on top of the principal. Your investment remains fully illiquid until you sell the property.

Real Estate Investment Trusts (REITs): REITs are companies that own income-producing real estate properties (commercial or residential) and allow investors to buy shares in multiple-property portfolios. This method maintains a more hands-off approach on the part of the investor, who is free to invest without the stress of property ownership. REITs have outperformed traditional direct real estate investments, with an average annual return of 11.8% over 20 years.

There are two main types of property to consider:

Commercial Real Estate: Commercial properties include office buildings and parks, retail establishments, land/plots of land, industrial warehouses, manufacturing plants, and other facilities used for business. In addition to appreciation in value as the market evolves and as investments are made into the property such as renovations, they earn income from the rents paid by commercial tenants. You can also invest in such properties by purchasing notes against loans for development or renovation.

Residential Real Estate: Residential properties include single-family and multi-family housing and land that is expected to be developed for one of those purposes in the future. It can also include property where houses and townhome communities will be built. These investments can earn income from renters or purchasers, as well as increase in value due to market appreciation and further investments in property improvements. As with residential real estate, you can invest in such properties, such as a condominium project, by purchasing notes against loans for development or renovation.

There are three main phases to be aware of. These phases are relevant because borrowers typically seek loans associated with a particular phase, and those loans have different levels of risk and Loan-to-Value thresholds required by a responsible lender. In order of the degree of speculativeness and risk, these phases are:

Land: Purchase of land on which a commercial or residential project will be built

Development: Activities that prepare a parcel of land for construction including clearing, grading, water, sewer, and electric, or other required infrastructure for a project

Construction: Elevation of one or more structures on the property or renovation or large -scale improvement to a property such as architectural changes, additional parking, and energy efficiency improvements

Indirect Real Estate Investing

As mentioned above, Connect Invest gives you access to indirect investment in real estate by purchasing fractions of loan Notes that are backed by collateral (i.e., the physical real estate). In other words, you can participate in the real estate asset class without getting involved in the ownership of a property directly or via a REIT. With Connect Invest, borrowers and developers take on the responsibility of developing, owning, and running a property. Unlike illiquid and long-term real estate ownership, these are short-term commitments that generate cash flow in the form of interest back from the borrower. With the protective cornerstones in place on our Connect Invest platform, this modern approach is convenient, self-directed, diverse, low-risk, high-yield, and does not require large initial sums.

Reach Out to Connect Invest

Does Connect Invest's approach to alternative investments sound like a fit for you? If you are excited by the opportunity to enter the alternative investment space via our self-directed platform, our Investor Services Representatives are here to help. Reach out to them to open an account or ask questions, but keep in mind that they cannot provide direction or advice about investment strategies or decisions regarding your portfolio. For more information, go online to ConnectInvest.com