ISLAND VIEW
PRIVATE LOAN FUND

Asset Class Diversification Through Private Mortgage Funds

If you asked most investors to summarize their investment aims, it would probably all come down to two goals: a high rate of return, obtained with low risk to their principal. Ask any expert, and they will agree that the best way to achieve both of these sometimes conflicting goals is through portfolio diversification, the foundation of sound long-term investing. At its simplest, diversification can be summed up by the old adage, "don't put all your eggs in one basket." In today's terms, experts call each "basket" an asset class.

ASSET CLASSES

Asset classes are comprised of assets that share fundamentals and can be expected to have similar performance. Each class offers unique risks and rewards to the extent that their performance is influenced by different factors, commonly referred to as non-correlating. The major assets classes—stocks, bonds, commodities, real estate—historically have different degrees of volatility and returns, and together they form the building blocks of modern-day diversification strategies. By including several different asset classes in a portfolio, investors can compartmentalize risk and multiply opportunities for reward.

Experience has shown that including all the major asset classes in a portfolio gives investors the best chance at high returns with the least risk. In a recent study, economists tracked the performance of 15 model portfolios using 40 years of historical data. Predictably, portfolios combining each major asset class outperformed those containing only the worst performing asset; in fact, three of the four worst returns occurred in single-asset class portfolios. Surprisingly, however, evenly-mixed portfolios also outperformed portfolios containing only the best-performing asset class.

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This is because even high-performing asset classes are subject to some volatility—sudden, often unforeseen shifts in performance—which rob investors of some of their gains. Since it's impossible for even the best investors to accurately predict the performance of an individual asset class beyond the short-term, the best way to hedge against volatility among investments is to hold several non-correlating asset classes in a portfolio so that when top-performers face downside, other classes take up the slack. This allowed the well-diversified portfolios in the study—and in reality—to retain all the gains of the best single-asset portfolios, and more, without same degree of downside risk.

Outside the common securities markets, you'll find advisors differing on which non-correlating investments provide the best security of principal and opportunity for solid returns. One that is widely agreed to be a solid investment, however, is real estate. Real estate investments have consistently been top-performing long-term investments with less volatility than other asset classes. Let's take a closer look.

THE ROLE OF REAL ESTATE WITHIN A PORTFOLIO

The allocation of assets within a portfolio depends upon the objectives of the portfolio. Each asset class has a different role to play that takes advantage of its strengths. For instance, stocks can appreciate at amazing speed over a short time, but they may also lose their value without warning. Therefore, the role of stocks in a portfolio is to give investors exposure to potentially high short-term upside, but a portfolio composed only of stocks could also drastically lose value under adverse circumstances and would not provide much security of principal beyond stop-loss orders.

Conversely, the role of real estate within a portfolio is to significantly reduce investors' exposure to downside risk while offering predictable rates of return. While unable to multiply their wealth at rapid speeds, it is all but sure to build wealth over the long term. One of the least volatile, high-return real estate investments is the professionally managed private mortgage fund. It offers investors a way to preserve their capital from market fluctuations while they gain exposure to the interest gains of private mortgage loans. In addition, many private family offices and high net worth individuals utilize private loans to shelter generational wealth—demonstrating this investment strategy as also one of the best methods for wealth preservation.

One of the least volatile, high-return real estate investments is the professionally managed private mortgage fund.

WHAT ARE PRIVATE MORTGAGE LOANS?

Put simply, a private mortgage loan is a first lien position mortgage on residential or commercial investment properties, including: apartments, mixed-use office space, warehouse space, and 1- to 4-unit investment properties. These mortgage loans do NOT cover owner-occupied homes or consumer-type loans, which are subject to different mortgage laws. Rather, they are solely intended for commercial or business purposes.

In addition, a private mortgage loan is a type of collateralized debt, often referred to as a secured debt obligation. Thus, they provide the lender or investor not only the benefit of regular income in the form of loan payments, they also have all the security, protections and recourse typically associated with a real estate lien.

Due to the nature of these loans being shorter-term, they're not meant to provide appreciation on the capital invested. Rather, their purpose is to provide a fixed stream of income which often exceeds other fixed-income investments like bonds or annuities.

WHY INVESTORS FAVOR THIS TYPE OF INVESTMENT

The biggest draw of private mortgage loans is the safety they offer compared to publically-traded investments sold on open markets. This is because each mortgage loan is founded on a tangible real estate asset, which serves as collateral to secure the debt.

Private mortgages are also granted legal protections such as lender's title insurance and other various remedies to enforce the mortgage lien, though these vary by state. The investor's potential downside risk, namely the loss of principal, is also limited by underwriting criteria limiting loans to 65% of a property's total value, as established by a third-party appraisal. In fact, it is possible to structure a loan in such a way that an investor actually generates more profit from a loan default than interest paid by the borrower, however most lenders don't desire the loan to default.

Additionally, many private mortgage loans include a personal guarantee of liability from the borrower, which gives the lender the right to sue the borrower in the event of a loan default where the lender took a financial loss upon foreclosing and liquidating the property. This gives the investor another layer of added protection.

In response to how our investors rate private mortgages among their other investments:

> *"Each of my investments serves a different purpose but I would say that I am very happy with the performance of my Island View investments and that they perform very well compared to other lower risk, high yield investments."*
>
> – RYAN DULL, FORTUNE 500 EXECUTIVE, MADISON WI

> *"Island View is at the top of the list in terms of their yield at 8% per year. My other investments include annuities which are currently paying 5% per year."*
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TYPICAL YIELDS FOR INVESTORS IN PRIVATE MORTGAGE FUNDS

The yield that a private mortgage fund pays its investors is largely based on the terms of the loans in its portfolio, specifically the origination fee and the interest rate. Most private mortgage loans require the borrower to pay an origination fee of between 3-7 percent of the total loan amount, paid at closing. The interest rate is determined by the following factors:

> term or duration of the loan
> collateral type
> amount of leverage requested on the property—the loan-to-value (LTV) ratio
> repayment strategy
> value of the personal guarantee, based on the borrower's net worth
> experience level of the borrower
> quality of the tenant(s) leasing the property, if leasing will be involved

Most interest rates for private mortgages are fixed for the duration of the loan's term. If a floating rate is offered, then the lender generally sets the initial rate as the floor or lowest rate over the term of the loan. Investors who participate in a professionally-managed private mortgage fund can expect to earn mid to high single-digit returns, while enjoying the security of principal that comes from holding the collateral of a hard asset and personal guarantees of the borrower.

TYPES OF BORROWERS IN PRIVATE MORTGAGE LOANS

While no one plans to borrow money at high interest rates over the long term, it makes sense in many cases to enter such a mortgage for a one- or two-year period and then refinance into a low-interest bank loan.

The typical borrower in a private mortgage loan is looking to acquire property with less requirements and faster closing times than a bank can offer. Common examples would be real estate investors, property managers or commercial entities—generally any party who values the certainty of securing a purchase over finding the best rate.

These types of borrowers usually shop for a lower-interest bank loan to refinance the private mortgage loan once they own the property and no longer risk losing it because of financing delays. While no one plans to borrow money at high interest rates over the long term, it makes sense in many cases to enter such a mortgage for a one- or two-year period and then refinance into a low-interest bank loan.

An example on the residential side is a borrower our firm worked with from Chicago, IL who is a full-time real estate investor. He finds suitable homes, obtains financing for purchase and rehab work, manages contract labor, and ultimately sells them for a profit. Island View has provided private mortgage financing for 11 of his recent projects. Such loans—which offer convenient and expedient delivery of funds to real estate investors—account for a significant portion of a private mortgage funds' portfolio.

ADDITIONAL DEMAND FOR PRIVATE MORTGAGES

When the Dodd-Frank Act passed in 2010, it imposed stricter regulations and increased oversight of banks' overall lending practices. The act was intended to ensure that banks make only quality loans and not risky loans that could default in large numbers and cause systemic financial stress to the overall economy, such as happened between 2007-2009.

An unintended consequence of this act is that it restricted banks' ability and willingness to make mortgage loans even to well-qualified borrowers. In addition to this, it increased regulatory requirements, resulting in longer processing times to evaluate and approve loans.

The added difficulty of obtaining loans from traditional banks in the post-Dodd-Frank climate has caused many borrowers to turn to private mortgage loans as an alternative source of funding. However, even prior to the passing of the act, demand for private mortgage loans has been steady due to those looking to acquire property with faster closing times than a traditional bank can offer.

POTENTIAL RISKS AND RISK MITIGATION WITHIN A MORTGAGE FUND

MANAGEMENT TEAM

As with any investment, the experience, competence and culture of the management team greatly impacts the outcome. But with private mortgage funds, management plays an even more important role than usual because their lending guidelines determine the ultimate risk placed upon the capital. As long as management is scrupulous about avoiding risky loans, the fund is likely to prosper and provide a good return on investment. Thus, the largest risk for this type of investment is poor loan underwriting and risk assessment of loan opportunities by an unproven, inept, or unethical mortgage fund manager, resulting in a higher loan default rate and potential for loss.

Mitigating the Risks of Management Teams

That is why prospective investors should seek to gain insight into how their capital will be managed and protected before they invest in a private mortgage fund. The investor who carefully reviews a fund's management team before electing to invest in the fund can avoid most of the risks associated with private mortgage funds altogether. Investors should consider the following questions:

- is due diligence performed on all loans originated?
- what is the maximum amount of leverage they allow on a given property?
- how do they assess the value of the collateral?
- does the management team have a track record of quality investments?
- what percentage of their loans have defaulted?

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Other points to consider are the kind and number of assets under management and their history of compliance with the local regulatory body. These questions will give investors critical insight into how effectively the fund's management team manages risk and will provide a strong indicator of the fund's future performance. Since private mortgage funds really come into their own as safe, long-term investments, even the risk-tolerant investor is encouraged to avoid funds whose management does not score well on these points.

MORTGAGE DEFAULT

The second risk involved in private mortgage funds is default. Even the best fund management teams will likely face a mortgage default at some point, so it is important to invest with a fund whose management has contingency plans in place to resolve this challenge, should it arise. Any fund you consider should have a thorough understanding of the foreclosure process. Fund managers should be able to clearly demonstrate that they have both the resources available to reclaim a property and good legal counsel at hand should litigation become necessary to complete the foreclosure.

Mitigating the Risk of Default

Fund managers do all they can to avoid a default within their fund, first and foremost by verifying the liquidity of each borrower's position and their ability to make sustained payments on the loan. This includes estimating longer holding times before the borrower sells or refinances the private loan. Good fund managers ensure the ability of a borrower to make interest payments, regardless of how much equity is in the property that serves as collateral. Furthermore, a fund's risk of systemic default can be significantly reduced by diversifying loans among a variety of borrowers, geographic areas, loan terms, property types, and purpose of each loan.

Equity contained within the property is primary factor which makes investing in private mortgages appealing because it acts as a buffer to limit downside risk.

In the event that a borrower does default, fund managers still have the chance to reduce or even eliminate financial losses. First, it's critical that fund managers stress-test their loan underwriting by always documenting the value of a property via a legitimate third-party professional. If a new private loan proposal has been screened correctly with thorough underwriting and a documented valuation of the collateral, then even in the worst case scenario—a default followed by foreclosure—the net financial outcome would likely still be profitable for the lender. Equity contained within the property is primary factor that makes investing in private mortgages appealing because it acts as a buffer to limit downside risk.

LACK OF ALIGNMENT BETWEEN MANAGEMENT COMPENSATION AND PERFORMANCE

Finally, investors should ask whether a fund management team's compensation is aligned with their fund's performance. If a private mortgage fund solely charges an asset under management (AUM) fee, they're not necessarily incentivized to seek new loan opportunities and strive for higher fund performance.

Mitigating the Risk of Compensation-Performance Misalignment

The best way to avoid a bad compensation-performance alignment is for investors to gain a good understanding of the fees and expenses of any private mortgage fund they consider. The ideal structure for a fund that underwrites, originates and services a private loan portfolio is one in which fund managers are compensated based upon success of the fund's overall portfolio performance. Investors can rest more easily when they know that management shares their interest in good, safe returns.

THE BEST WAYS TO GAIN EXPOSURE TO PRIVATE MORTGAGES

There are three options for investors who wish to open a position in private mortgages.

OPTION 1:
Direct investment into a professionally-managed private mortgage fund

This is the safest option for new investors, since all the responsibilities of underwriting, originating and servicing private loans, remedying defaults, and managing the portfolio are assumed by professional fund managers. The investor's only concern is to choose the fund that best meets their investment goals.

OPTION 2:
Purchase a loan assignment or new loan from a professional mortgage fund

With this option, an investor actually owns the mortgage lien and collects the monthly payments from the borrower via a loan servicing company. This option is for the more active investor who is willing to take on the responsibility of vetting each new mortgage investment opportunity with due diligence and is prepared to personally remedy a loan default, should one occur.

OPTION 3:
Underwrite private mortgages on your own

Not to be undertaken lightly, investors who choose this option assume total responsibility for finding and vetting each new private mortgage loan opportunity, and also perform their own due diligence such as: drafting the underwriting and loan documents; obtaining and analyzing environmental reports, credit reports and an appraisal; handling title work, insurance and loan servicing; processing payoff and generating a satisfaction of mortgage. Finally they are responsible for remedying a loan default if one should occur.

Because of the specialized, complex, and time-consuming demands of underwriting, investors generally prefer to invest in private mortgage funds where professionals perform these functions for them, freeing the investor to enjoy a return on their investments without the time and labor commitments.

IN SUMMARY

Experts agree: the single best way an investor can maximize gains and minimize risk over the long term is to adopt a diversified portfolio that combines multiple asset classes that have low or negative correlation. It is also well established that real estate is one of the best-performing, non-correlating asset classes an investor can combine with stocks, bonds and commodities. Among real estate investments, private mortgage funds stand out as the best option for three main reasons.

First, private mortgage funds offer some of the best security of principal of any real estate investment because fund managers control their exposure to risk through due diligence, hedge against default by holding property as collateral at low leverage, and can even assure likely profit in the case of a default through comprehensive underwriting that transfers all risk to the borrower.

They also offer some of the highest rates of return of any real estate investment because they attract borrowers who are willing to pay higher interest rates in return for a more expedient availability of funds than traditional banks can offer. For this reason, they typically provide a return on investment in the mid to high single-digit range. This is a better rate of return than even many stocks offer, but with far less downside risk.

Finally, private mortgage funds round out a diversified portfolio very well because they possess low correlation with more traditional asset classes, such as stocks, bonds and commodities. Stock market fluctuations typically have little or no effect on the profitability of these funds. Indeed, the number of borrowers seeking private mortgage loans during economic downturns may increase as competition for real estate bargains intensifies, which can only be good for investors.

In short, investors who have not yet considered diversifying their portfolio with private mortgage funds are missing out on an opportunity to further their investment goals with one of the market’s best-performing, most complementary assets.

FREQUENTLY ASKED QUESTIONS

Is my retirement account eligible to participate in private mortgage investments?

Yes, it is done through a self-directed IRA/401(k) retirement account. Many retirement account custodians handle the setup for this type of investing. Setup of a self-directed IRA is the most streamlined option for someone starting from scratch. However, 401(k) accounts from previous employers are typically eligible to be rolled over into a self-directed IRA. If you have an existing 401(k) with your current employer, check with your retirement account plan administrator to see if they allow what is referred to as an In Service Distribution. This allows a portion of your 401(k) to be rolled over into a self-directed account.

For a deeper look at alternative investment options open to investors with self-directed retirement accounts, please click here.

How often are payments dispersed to investors in private mortgage funds?

It varies by fund, but most distributions are made on either a quarterly or annual basis.

Can the profits generated from private mortgage investments be reinvested instead of distributed?

Generally yes, but requirements vary so prospective investors interested in this option should inquire beforehand. Investors with self-directed retirement accounts may benefit greatly by reinvesting gains until they retire, since all gains that remain within an IRA are tax-deferred, or in the case of a Roth IRA, tax-free. If the capital investment is made from a non-qualified retirement account plan, investors may not derive the same advantage from reinvesting earnings, because with such plans the profits are generally treated as taxable income.

Do private mortgage funds require a minimum investment amount?

For most funds, the minimum investment is $100,000, but it varies at the discretion of the fund managers.

Is it possible to make additional investments after the first?

It varies by fund, but private mortgage funds generally allow additional capital contributions and have established minimums.

Is my investment liquid? How long am I committing my funds to this type of investment?

Because the underlying mortgage investments are often multi-year in duration, limitations are placed on the redemption of capital invested within a fund.

Similar to annuities, Island View Private Loan Fund regulates its flow of capital via a surrender schedule. We require a 7-year commitment—timeframes vary by fund—for a return of 100% of the principal and 100% interest earned. Investors agree to retroactively surrender any profit earned if the entire account is liquidated within the first three years. Investors agree to retroactively surrender half of all interest earned as part of the redemption request if the account is liquidated between year three and year seven. Island View Private Loan Fund permits investors to withdraw up to 10% of their invested principal each year without being subject to a surrender charge up to 50% of their total amount invested.

In short, private mortgage funds function best as a safe, long-term, fixed-income investment.

Who typically considers investing in private mortgage funds?

By and large, investors in private mortgage funds are high-net-worth individuals who are looking to hedge against stock market fluctuation and preserve their capital. Because private mortgages aren't pegged to a publicly-traded security, they are often referred to as a non-correlated asset class.

It should be noted that under securities laws only accredited investors are permitted to invest in a private mortgage fund. The Securities and Exchange Commission's (SEC) definition of an accredited investor may be summarized as: an individual with a net worth of at least $1 million, or with an individual income exceeding $200,000 in each of the two most recent years, or with a joint income exceeding $300,000 in each of the two most recent years. For more details or to determine if you are eligible to invest in private mortgage funds, please click here to visit the Securities and Exchange Commission's website.

Other parties that frequently invest in private mortgage funds include: privately-managed funds looking to diversify their portfolio, sovereign wealth funds, family offices, high-net-worth wealth managers, and Registered Investment Advisors.

Where can I find additional information about private mortgage investments?

Contact John Michael Stevens at (414) 810-2011 or john.stevens@ivplfund.com with further questions. It may also be helpful to speak with:

(i) investors you may know who have experience or background with private mortgage investments;

(ii) other financial professionals such as Registered Investment Advisors (R.I.A.), CPAs, accountants, financial planners, lawyers, or fund managers who have experience with private mortgage investments;

(iii) and after speaking with a fund manager and reviewing their private placement offering and partnership agreement, ask for references of other investors who have worked with the fund to learn about their experiences with management. References of investors we work with are available upon request.

WHAT INVESTORS WHO WORK WITH ISLAND VIEW HAVE TO SAY

When asked to rank their investments with Island View's private mortgage program in terms of performance compared other investments in their portfolio, investors said:

> *"Each of my investments serves a different purpose but I would say that I am very happy with the performance of my Island View investments and that they perform very well compared to other lower risk, high yield investments."*
>
> – RYAN DULL, FORTUNE 500 EXECUTIVE, MADISON WI

> *"Island View is at the top of the list in terms of their yield at 8% per year. My other investments include annuities which are currently paying 5% per year."*
>
> – RON PECHMANN, RETIRED, MILWAUKEE WI

> *"The returns are on par or slightly better compared to other private lending and I feel more comfortable with the extra pair of eyes during the due diligence phase of analyzing the deal and borrower. Compared to stock and option trading, private lending is head and shoulders better returns."*
>
> – ROGER BORTNEM, REAL ESTATE INVESTOR, MINNEAPOLIS MN

When asked if they were hesitant about investing in Island View and private mortgage loans, and what led to their investment decision:

> *"My accountant recommended that I look into an opportunity with Island View. I was interested in opportunities to diversify some of my investment portfolio into a non-correlated vehicle with good yield. Initially I was skeptical because it was a non-traditional investment and I had never heard of Island View. I was also unsure of the risk. [What led to a decision was..] my accountants referral along with my experience interacting with Josh and John during my due diligence. All my questions were answered and I was able to review documents and deal structure with other trusted advisors who agreed that the investments appeared legitimate."*
>
> – RYAN DULL, FORTUNE 500 EXECUTIVE, MADISON WI

> *"No I wasn't hesitant at all. After completing my self-directed IRA/LLC through Service Financial, Island View's private loan program was recommended as an alternative investment."*
>
> – RON PECHMANN, RETIRED, MILWAUKEE WI

> *"Not at all hesitant. [From...] past experience with Josh I knew Josh to be a man of much experience and integrity."*
>
> – ROGER BORTNEM, REAL ESTATE INVESTOR, MINNEAPOLIS MN

When asked about the biggest benefit or the results they have achieved since investing with Island View's private mortgage program:

> *"The largest benefit has been the working relationship that has developed with Josh and John. I have accomplished my main goal of adding a diversified, high yielding investment that is not tied directly to the market but have also built a positive business relationship that has expanded beyond my initial investments."*
>
> – RYAN DULL, FORTUNE 500 EXECUTIVE, MADISON WI

> *"The biggest two benefits have been that I haven't lost any of my money and that I know how much money I'm going to make each month with a good consistent return."*
>
> – RON PECHMANN, RETIRED, MILWAUKEE WI

> *"High returns and well vetted borrowers."*
>
> – ROGER BORTNEM, REAL ESTATE INVESTOR, MINNEAPOLIS MN

When asked about their overall experience with Island View:

> *"My experience from a customer service perspective has been outstanding. Responsiveness and attention to detail have really exceeded my expectations. I have completed over 7 investments and plan on continuing the relationship."*
>
> – RYAN DULL, FORTUNE 500 EXECUTIVE, MADISON WI

> *"I'm completely satisfied with Island View, their customer service, and gladly recommend them."*
>
> – RON PECHMANN, RETIRED, MILWAUKEE WI

> *"I have worked with Josh as both a borrower and a lender and I have always received the highest level of service."*
>
> – ROGER BORTNEM, REAL ESTATE INVESTOR, MINNEAPOLIS MN

We would be happy to put you in touch with one of our current investors if you would like to hear more about their experiences first-hand. Please call (414) 810-2011 or email john.stevens@ivplfund.com to request details.

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