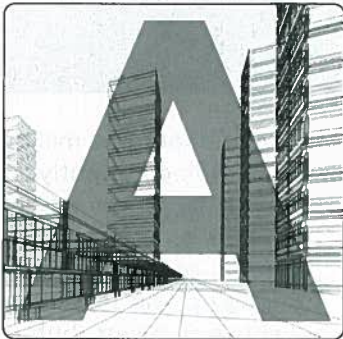


When the market is in turmoil, putting money in mortgage income funds and REITS can help preserve your wealth



As the financial crisis and market crash of 2008 illustrated all-too painfully, stocks and other “safe investments” do not always go up. Sometimes they fall spectacularly. Few saw the implosion coming or warned of it, so what’s a prudent investor to do?

With bonds ending a 25-year bull run and many experts predicting poor future returns for equities, interest is growing in the alternative property investments category, which encompasses mortgage funds and real estate equity.

When people hear alternative, they immediately think exotic and risky, says David Kaufman, president of Westcourt Capital Corp., a Toronto-based investment fund specializing in income-generating funds tied to real estate and equity investments not correlated to the ups and downs of the stock market. Kaufman, who has hosted a series on alternative investing for the Business News Network and is a regu-

lar contributor to CBC’s *Lang & O’Leary Exchange*, says clients have a simple mandate: “The number one goal is capital preservation.”

### Managing risk

Firms such as Westcourt allow high-net-worth clients, typically business owners, to get away from the inevitable ups and downs of stock and bond markets in favour of investments that steadily and conservatively create a revenue stream. Westcourt’s products include mortgage investment corporations that invest in residential mortgages, real estate investment trusts (REITs), and more unusual investments such as Canadian farmland.

While many business owners often buy their places of business and then look to purchase other commercial properties as a source of income, Kaufman says this one-off approach is fraught with risk. Besides the lack of diversification, “There is a total lack of liquidity, lack of expertise, they pay too much on the way in, and receive too little on the way out.”

The lesson that not all property investments are created equal has certainly been the experience of Chris Biasutti, a Vancouver-based exempt market represen-

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WRITTEN BY

# “You go where the returns are and it’s in real estate right now.”

tative who established his own business four years ago to advise clients on the various investment options available in the exempt market and their suitability. In the past seven years, he’s put money into everything from mortgage income corporations, single mortgages, private REITs, and raw land syndications.

Biasutti’s success investing in the alternative space has led him to teach investors about alternative real es-

tate and provide research on alternative investment products. “The government, with its regulations, really lumps this whole marketplace into what they call high-risk investment but the reality is that there is a whole spectrum of risk,” running from large, stable mortgage investment funds to speculative land syndication.

“Raw land is very illiquid,” he adds. “If you pay too much—and have some debt on it—and your intention is to develop it, there is a very high probability that you won’t be able to complete the project if you don’t have deep pockets.”

That unfortunate scenario played out in 2008 when Biasutti put approximately \$50,000 into a land development project just outside of Calgary with a projected annual return after five years of 15% to 20%. Following the recession, the developers struggled to service debt on the land. They are now restructuring and attempting to proceed with mixed-use development.



## Investor Experience

**RANDY SMITH,\*** an accountant who is in the process of selling his Toronto-area firm, has been largely successful investing in mortgage funds, individual single-family mortgages, and purchasing large apartment buildings, as well as REITs for more than 30 years.

He relies on a trusted circle of brokers to present opportunities. “I don’t have the resources to do all the due diligence myself, so I rely on the mortgage brokers to produce that,” Smith says. “But I still make my own evaluation of which deals I like.”

Smith’s picks are based on a number of rules he’s developed over the years: He rarely invests in second mortgages, preferring

a first position among creditors; he won’t invest more than 70% of the value of the property; and he needs to get the story behind the investment. “I need to understand what the person is doing and what their exit strategy is for paying me back.”

**PETER WILSON,\*** a company turnaround expert who has invested in property for nearly 40 years, likes these types of investments because they typically produce more predictable returns than equities.

“I’m in public and private REITs, mortgage pools, and direct mortgages where there are usually three or four of us in an individual mortgage,” Wilson says. He also invests with his son

in single-family bungalows suitable for second-storey additions.

Over the past decade, Wilson has invested in about 25 private mortgages—best described as bridge financing to individuals or businesses that cannot access bank lending—for a period of between one and three years, and earning an average of 9% annually. The reasons why people come to Wilson for their financing range from a borrower who suffered a bankruptcy to a business owner who needed a loan to build a new wing on a motel. Over the past decade, only one loan has gone bad and Wilson eventually recouped his cash.

Currently, though, Wilson is going less into private mortgages,

having about one million outstanding currently in mortgages loaned out to lenders. “A large number of them are drying up,” he says, a situation he attributes to heightened lending competition and the current ultra-low interest rate environment.

The Toronto-area investor recently pulled \$150,000 out of one mortgage fund because of poor results but his other mortgage fund investments are still posting steady returns.

Wilson currently has about 40% of his investment portfolio in real estate in one form or another, an uncomfortably high figure for him but “you go where the returns are and it’s in real estate right now.”

\* Names have been changed

"It was supposed to pay out in five years," he says. "If it doesn't go completely sideways, it now probably won't pay out for seven to 10 years."

Biasutti's lessons from that deal? Experience and a clear understanding of the business are key. You should understand the risks and how to mitigate them. "Obviously the market played a factor. Compounding that was the inexperience of the management group. They hadn't done one of these deals before, and they misallocated their funds by continuing to proceed with the development instead of paying down the debt."

Perhaps the most famous example of a land development deal done wrong was the Reichmann family's Canary Wharf project in London. The world's largest property development, wound up, in the end, too big and ambitious a project, and remained half empty when the worldwide economy slipped into recession during the early '90s. This turned out to be a major gamble that ultimately sunk the Toronto-based real estate development giant, Olympia & York.

### Ensuring predictable returns

On the spectrum of risk, one of the safest and most steady investment harbours for high-net-worth investors is a mortgage investment fund, which manages pools of non-bank mortgage loans for pension funds, foundations, and wealthy individuals. **Mark Hilson, managing general partner of mortgage fund giant Romspen, says the advantage of investing in mortgage funds over many other alternative investments is stability.**

"You are one step up from the equity, so your risk is meaningfully reduced, and your returns are much more predictable." Further, returns from an investment in such funds can either be sheltered from tax in an RRSP or held outside a registered plan.

**In the case of Romspen, investors need a minimum of \$150,000 to invest in the firm's pool of 125 commercial and industrial first mortgages across Canada. Typically, these are short-term bridge loans the banks can't make. "Our return is range-bound somewhere between 8% and 10%, but it is consistent and the developer has to lose a bunch of money before anything happens to us," says Hilson. "An 8% to 10% regular recurring return paid out every month is kind of a nice thing to have."**

The added attraction of investing in a mortgage fund such as Romspen is the rigor and discipline behind the



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# “The number one goal is capital preservation.”

building and managing of its lending portfolio. Over the past 10 years, Romspen has invested more than \$1 billion in 600-plus mortgages and its mortgage portfolio is currently worth more than \$700 million. It would be impossible for an individual to try and recreate such a portfolio on his or her own—and trying to go it alone would leave an investor heavily exposed to the fate of one or, at best, a handful of mortgages.

Investing in mortgage funds, or REITs have another clear advantage over investing directly in real estate.

They are highly liquid. In the case of public REITs, units can be sold just like shares. Likewise, most funds let investors easily sell at regular intervals, often monthly. Owning and selling hard real estate assets, like a strip mall, is a much longer-term proposition, typically taking six months, during which time property prices can fall dramatically.

## Getting good advice

Many business owners often say they don't have the time or interest to master the field of alternative investing, but at the very least they should select one or two advisors who can identify investment opportunities. ●

*Paul Brent is a business journalist based in Toronto.*



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## Primer: Types of Alternative Real Estate Investing

### Direct Mortgage Lending

A single investor, or group of investors (syndicated), lend capital to a borrower under a mortgage agreement (the loan). The investment is secured against the borrower's property through the registration of the mortgage agreement and names of the investors appear on the title. There is increased risk compared to Mortgage Income Funds as there is only one mortgage rather than a diversified portfolio of mortgages.

### Land Banking: Individual

A single investor acquires a parcel of land, often on the outskirts of a growing municipality, and holds it until inflation and urban sprawl increases its value. Land banking is one of the least liquid forms of real estate investing and very few banks will finance raw land, so the leveraging advantage of real estate can be lost in this strategy.

### Land Banking: Group/Undivided Interest

Investors who do not have the desire to purchase a parcel of land individually may choose to participate alongside a group of investors by buying an undivided interest in a parcel. None of the investors have direct control of the land, so their capital is committed until the entire group chooses to sell.

### Limited Partnerships for Land/Building Development

Often used for projects involving the development of

raw land, the construction of new buildings, and the ownership of real estate or other assets.

### Mortgage Income Fund (MIF)

A managed pool of capital used to make multiple mortgage investments secured against real property. Interest income earned on the fund's portfolio is distributed to shareholders through monthly, quarterly or annual dividends.

### Real Estate Investment Trust (REIT): Private

A managed pool of capital used to purchase income producing real estate. Investors participate in private REITs by purchasing shares directly from the trust. Liquidity of private REIT shares are often dependant upon the REIT buying shares back from investors at set times throughout the year. On the plus side, share prices are not influenced by stock market volatility and do not carry the high operating overhead of public REITs.

### REIT: Public

Shares are purchased through the public market and the REIT is required to file financial statements for publication. Investors purchase shares in public REITs because of the liquidity (they're easy to exit), but they carry the risk of market volatility. Public REITs often trade at prices well above or well below the true value of the shares based on the combined value of the portfolio.