Alpha Investing – An Introduction

*[Editor’s Note: Enrollment is closed for PIMD’s online course about real estate syndications, but I have partnered with two other online real estate courses you might be interested in. The first is **Zero to Freedom Through Cash-Flowing Rentals** by two doctors who have found financial freedom through direct real estate investing, one of whom will be speaking at WCICON20. The course will get you started buying, managing, and profiting from rental properties. It is expensive, but there is a 100% money back guarantee for the first 3 weeks of the course and if you enroll through my link I’ll personally send you a signed copy of The White Coat Investor’s Financial Boot Camp book. Enrollment is episodic and only open through August 5th, so don’t delay.*

*The second course is **How To Become A Top Performing Airbnb™ Host,** which is run by James Svetec and primarily marketed through Rich Dad Education. The initial unit/webinar is free, so you know what you’re getting into before plunking down $497 for the rest of the course. Short-term rentals can be up to ten times as profitable as long-term rentals, so if you or your partner are interested in doing this on the side in either a small way or a big way, take the course first. You* *can check out our [other online courses] too. Now, on to today's post.]*

Many financial bloggers and investors are feeling once bitten, twice shy about online "crowdfunding" real estate platforms. The sudden, unexpected dissolution of the big kid on the block, RealtyShares, last year made everyone look around and wonder how sustainable this model, enabled by the JOBS Act of 2012, was really going to be. As more and more firms entered the space, it became difficult for an investor to decide which firms to invest through. The seemingly cozy (but usually not very profitable) relationship between bloggers with affiliate deals (like me) and the companies also made it difficult to find reliable, unbiased information you could use to make a decision.

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Some investors, like me, had the means to either go directly to syndicators they trusted or hire a fund manager to select the deals and still have a diversified portfolio. Other investors retreated to the relative security of a REIT index mutual fund. But there are still people out there who want to invest in syndicated real estate that don't have the $50-100K per deal to invest. What should they do?

The truth of the matter is that true due diligence can be almost impossible, especially for deals with low minimums as doing a background check on every single person involved in the deal would consume the entire investment! I'm not sure I have enough data to recommend any platform. I certainly cannot vet them in the same way I can vet an insurance agent used by hundreds of my readers a year. A typical company has only done a dozen deals and most of them haven't gone round trip. It takes years for an equity deal to go round trip. The best I can do as a blogger is tell you about my experience, point out what I like and don't like about a given platform, syndicator, or deal, make an introduction, and clearly disclose my conflicts of interest. There's a lot of risk involved in investing in these investments. Only you can decide if you think the risk of doing so is worth the potential returns. The usual portfolio construction caveats apply – don't put too much of your portfolio into a given asset class and diversify within that class between platforms, deals, and types of real estate.

What is a Crowdfunding Platform?

Before we get too far into this, let me explain what I mean by a real estate crowdfunding company. I mean a company that brings together developers in need of investing dollars and investors in need of decent returns. The role of the company is to do some due diligence, make the introduction, enable low minimum investments, and facilitate the formation and management of the LLC. In exchange for that, the company gets paid a fee for being the middle man.

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Today I want to introduce you to a company that I think is doing crowdfunding the right way, Alpha Investing. Let's make the disclosures up front. I get paid if you sign-up to invest with this company through the links on this page and my WCI

Network partner Peter Kim, MD (Passive Income MD) has a small equity stake in the company. Would I be writing about this company if I did not have those two business relationships? No way. Is this a paid/sponsored post? Also no. I get to write whatever I want about them and they didn't get any sort of editorial control over the post (do you think it would have started the way it did if they had?)

What do I mean by doing things the right way? Perhaps it is easiest to explain by pointing out the wrong ways to do things.

Consider RealtyShares. Why did they implode? Well, they simply spent way more money than they were bringing in. Their growth at all costs philosophy became their demise. Despite that, I still got every dime I ever invested with them across 7 deals back, along with the promised interest for debt deals and the expected return on the equity deals. But it's still bad form to go out of business when you're managing the money people have saved for retirement.

Alpha Investing, on the other hand, has taken a more frugal, careful approach to their company. That means a lot fewer deals and a whole lot less advertising. It means slower growth and more attention paid to the sponsors and the investors.

Alpha Investing spends a lot of time cultivating relationships with both sponsors and investors. You're not going to get to invest without spending some significant time on the phone with them. It's not just making sure you're an accredited investor, but also that you understand what you're getting into, that you're a long-term investor, and that you are a good partner for them. And it's the same on the other side of the deal. If you look at the deal flow all the way back to the first one on the site in February 2016, (although the group was investing together starting in 2014) you can see that they are only on their 27th deal. That's like 6 or 7 a year. One deal every couple of months. The downside with that slow of deal flow is that you may have money to invest and they have no deal waiting for you. The upside is that there is no need to rush to get a deal to market, allowing plenty of time for them to do due diligence. They want to bring solid deals from the same sponsors to the same investors over and over again. Not only does this make their lives easier down the road, but it provides a great experience (and great returns) for both sponsors and investors.

A lot of companies are all about volume of deals. Maybe they get paid a percentage of what the investors get paid for instance, but none of their money is invested in the deals. That produces an incentive to put together as many deals as possible, no matter what happens with them. Now, that is tempered by the fact that investors will eventually figure out they suck at due diligence and leave, but a good marketing department can overcome that problem for a long, long time. Maybe indefinitely. And even without good marketing, it may take investors a few years due to the length of these deals.

Aligning Incentives

If you read the Alpha Investing website, they say all the right things about having experts pour over the deal to make sure it is good. But the reality is that a big part of this is about aligning incentives. You want them to have some skin in the game to incentivize them to only bring you good deals.

I asked their CEO, Fark Tari, the following question:

> *How do you align your interests with investors? Do you invest in each of your deals? How is Alpha Investing's pay determined?*

This was his response:

> *Because we started our journey into real estate as investors first, we believe it is critically important for our interests to be aligned with those of our investors'. In turn, our fee structure is heavily performance based. In our investment entities, investors are first entitled to a full return of their investment capital plus a 10% preferred return each year before Alpha Investing participates in any performance fees (above which investors receive 80% and Alpha 20%). This results in Alpha taking real ownership over deal performance (monitoring each project on a monthly basis and looking to add value as each project progresses through its life cycle).*
>
> *Regarding whether we invest in our deals, all of the firm's principals have invested capital in our offerings. Through our first 20 or so transactions, at least one of the firm's principals and/or family members were invested in each. But in full transparency, it's not something that has been sustainable for us to consistently maintain in the immediate term. As our existing investments are realized, we will of course invest more capital into deals. The company itself*

does not invest, but as we grow, we fully expect to set up a co-investment fund at the company level. The decision not to do so at this juncture is based on our focus on building the platform in a capital efficient manner in the present. In short, we are extremely disciplined with the way we manage our cash position to ensure our longevity.

Now, that might not be very impressive to you, because you haven't asked that question to dozens of these companies before. But I have, and this is the sort of response you expect from a good syndicator or a fund, NOT a platform. Platforms are usually all about volume and certainly aren't investing in any significant portion of the investments on the platform themselves. In fact, because of this unique fee structure, Alpha Investing doesn't even like to be called a crowdfunding platform (they prefer "private capital network"), even if I think that's still the best way to describe the business model.

Sponsor Vetting

The reason their fee structure helps is that it provides them much more incentive than usual to vet the sponsors and the deals they are bringing. If the investors aren't making money, they aren't making money either. They describe it this way:

> *The experience and track record of our sponsor partners is at the very top of our deal evaluation hierarchy. As a result, every sponsor partner we work with fits our definition of "institutional". At a minimum, this means our sponsor partners have at least a few hundred million dollars of acquisition track record. In most cases, that number is in the billions. In short – we leverage our relationships to invest with sponsors that don't need our capital, but are willing to provide us with allocations into their projects because they value Alpha as a long-term, recurring capital partner.*
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> *We spend a lot of time and effort to comprehensively underwrite every potential investment opportunity. Understanding that in many asset classes we are at or near the peak of the current market cycle, our internal evaluation always includes constructing detailed scenario and sensitivity analysis that allow us to understand the impact of changing assumptions, market conditions, etc.. We look for strong cash on cash returns, strategic business plans that sponsors have successfully implemented on past transactions and deals that present favorable risk-adjusted returns.*

Clarity and Organization

One of the things I particularly appreciate about the company is a clear, straightforward website with clear, organized descriptions of each deal. Having seen LOTS of these, I can assure you that it is often much more difficult to get the details you seek (or should be seeking!) Let me give you an example. This is from a recently closed deal, a townhome complex in Washington State:

Property Highlights

- 81 Units
- 90,861 SF
- Currently 93.8% Occupied

Investment Highlights

- $18,000,000 Acqusition Price
- 5 Year Projected Hold
- Security Type: Equity
- $10,000 Minimum Investment

Investor Return Structure

- 14.4% IRR
- 10% Preferred Return
- 1.83x Equity Multiple
- 83% Return on Investment

Investment Materials

- Executive Summary
- Investment Summary
- Sponsor Call
- Diligence Room

It’s all right there, organized, and ready for you to make a decision. You have the summaries, which are short but packed with all the useful info. You have a quick link to the webinar with the sponsor (if you missed the original call), and you can even go to what they call the “diligence room,” which includes the nitty-gritty details if you’re interested:

Name
Majestic Bay Offering Memorandum.pdf
406725 - PCA Des Moines, WA.pdf
Purchase Agreement.pdf
Majestic Bay T12 (05.2019).xlsx
Application_EXP 6.25.19_Majestic Bay - VN.pdf
Majestic Bay Rent Roll - 07.10.2019.xlsx
Rental and Occupancy Forecast Trends-4.pdf

You've got the offering memorandum, the property appraisal, the purchase agreement, and all the info about the property I'd ever want. Heck, I've got access to the names of every single resident, the rent they're paying, and the move-in date. Super-easy, super-simple. This isn't amateur hour. They say they expect an IRR of 14.4% on this one. I believe them. They really do expect that. The investment summary was almost a pleasure to read. Not only do they assume they'll be selling it at a higher cap rate (a more conservative assumption than many use) than they bought it at, but they show you how dependent their expected returns are on each of their assumptions. Here's an example:

		Organic Rent Growth Rate			
		2.0%	3.0%	**4.0%**	5.0%
Vacancy (reno / remainder of hold)	**7.0% / 5.0%**	11.3% / 1.6x	14.1% / 1.8x	16.4% / 2.0x	18.6% / 2.2x
	9.0% / 5.5%	11.0% / 1.6x	13.8% / 1.8x	16.2% / 2.0x	18.4% / 2.1x
	11.0% / 6.0%	10.7% / 1.6x	13.5% / 1.8x	16.0% / 2.0x	18.1% / 2.1x
	13.0% / 6.5%	10.5% / 1.6x	13.2% / 1.8x	15.7% / 2.0x	17.9% / 2.1x

For example, they're assuming their vacancy during the renovation period will be 7% and then 5% afterward. Seems reasonable, given the current vacancy is 6.2%. And they're assuming the organic rent growth rate will be 4%/year, which also seems reasonable given that a quick Google search shows that rents in the region went up by 4.7% over the last year. But what if they're wrong about both? What if the vacancy rate during the renovation is 13% and then remains at 6.5% afterward? AND, what if rents only grow by 2% instead of 4%? What will your IRR be then? Well, 10.5%. They do this sort of analysis for each assumption in the pro-forma in a methodical, straightforward way.

The Fees

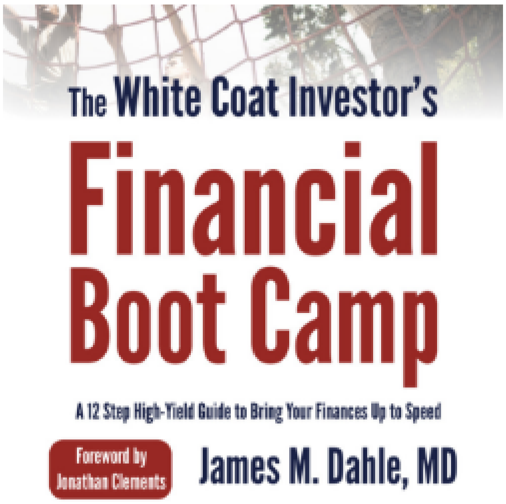
Fees matter. Every fee paid to someone in the deal is money that cannot go toward your return. Alpha Investing makes it easy to see the fee structure. In this particular deal, the fees work like this:

The sponsor puts up 2.6% of the value of the project (buying and renovating the buildings), the investors put up 23.4% of the value of the project, and 74% of the value of the project is borrowed. The sponsor gets $180K (1% of the purchase price), 4% of gross income as a management fee, and 5% of the cost of upgrades as a construction management fee. It then gets the preferred return on its portion of the equity as the investors receive theirs. After the investors get their 8% preferred return (and all their capital back), the remaining return goes 80% to investors and 20% to the sponsor. Once the investor return hits 15%, that changes to 70/30 for any additional return above that.

Alpha Investing has two set fees, a 2% origination fee on the capital and a 0.5%/year fee. In addition, there is a promote fee. As far as that goes, Alpha Investin gets nothing until the investor return hits 10%. Above that, they get 20% of the investor return. So if the investment returns 15%, the sponsor gets 20%* 7% = 1.4% and Alpha Investing gets 20% * 5% = 1%, leaving the investor with 12.6%. If the investment makes 8%, the investor gets 8%. If the investment makes 4%, the investor gets 4%.

While those fees are obviously higher than what you would see on a typical mutual fund I would recommend, I like seeing a sponsor and a crowdfunder with skin in the game. I also like to see a sponsor who really only gets paid if I make a decent return on the project and thus, has all the incentive in the world to make sure I get an excellent return.

All with a $10K minimum, instead of the $50-250K minimum you might need to come up with if you were going directly to a syndicator.



Now I didn't invest in this particular deal. It's not that I think it is a bad deal, but simply that I'm saving up for a major home remodel. I'm not investing in anything right now, so the timing isn't right for me. As usual, there are no called strikes in investing. This deal and all real estate deals are completely optional. This deal may not be right for you, either with its terms, its assumptions, or its timing. But if you're interested in getting into syndicated multi-family real estate with low minimums, Alpha Investing is a platform worth a careful look.

[Get started with Alpha Investing today!]

What do you think? Do you have any experience with Alpha Investing? What did you like or dislike? Have you had a good or bad experience investing in using online platforms to invest in syndicated deals? If bad, do you think the methods/structure used by Alpha Investing would have prevented your bad experience? Why or why not? Comment below!