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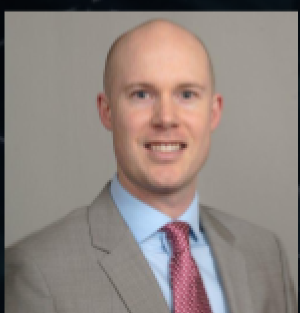
Virtual Event Series

Alternative Lending Across Asset Classes

Guest Speakers:

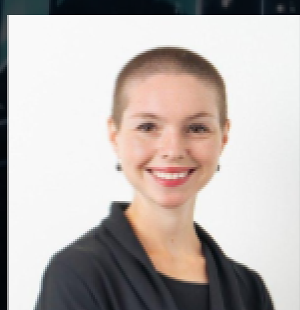


Matthew Sandretto
Managing Director
Prairie Hill Holdings

Alisa Kolodizner
Co-Owner
Prairie Hill Holdings

Hosts:

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Alternative Lending Across Asset Classes

Last time on DiffuseTap, Matthew Sandretto and Alisa Kolodizner of Prairie Hill Holdings talked to us about the many opportunities in alternative lending, risks to consider when starting a lending business, and what the yield looks like right now in commercial real estate.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

Meet the Speakers

As Managing Director of Prairie Hill Holdings, MATTHEW SANDRETTO leads all aspects of investment and real estate operations for Prairie Hill, a private REIT. He has led and participated in over $68mn in commercial real estate transactions, and $53mn in private equity transactions.

Linkedin: @matthewsandretto

ALISA KOLODIZNER is Co-owner of Prairie Hill Holdings, where she leads all aspects of business development, investor relations, and client success and experience. She brings more than a decade of experience in sales, operations, and private equity.

Linkedin: @alisa-m-kolodizner-cfp

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: Matt, maybe I'll start with you. Do you want to tell us a little bit about your background and what you're up to? And then Lisa, we'll go to you.

MATTHEW SANDRETTO: Good morning, everyone. Matt Sandretto. I run Prairie Hill Holdings, which is a private real estate investment manager. Before my focus on real estate, I was a private equity investor. I acquired companies in the printing and packaging industry as a principal GP. I was doing it for myself. And then as a business owner, I learned a lot about lending and entrepreneurship through acquisition.

When we were trying to grow a platform through acquisition, it was all about creative ways to get deals done without consuming lots of cash. So if the credit is out there, you have to go after it. I hate saying it, but if you can borrow it, it's possible to borrow, and I've probably tried to do it at some point. I sold those companies to larger strategic firms. And then recently, I focused on real estate investing, which is another area where non-bank players and private credit funds are. I'll pause there.

KENNY: Great. Alisa, maybe you could tell us about your background and what you're up to.

ALISA KOLODIZNER: Absolutely. Thank you for having us, by the way. My name is Alisa Kolodizner. I am the co-owner of Prairie Hill Holdings. Prior to that, I have a background in financial services. I started as a financial advisor. I spoke to a lot of lending, more so on marginability, and I coached financial advisors. I also helped build a lending platform for small and medium-sized business owners from the brokerage firm that I represented.

Also I worked with institutional and independent advisory firms that focus on personal finances. And then, I went into private equity. I also acquired a company separately from Prairie Holdings. I had to do a lot of work on lending in order to purchase a larger asset and what that could look like, which will be exciting to discuss with all of you today.

AYLA KREMB: Awesome. I'll dig into some of the fundamentals. We've talked a lot about crypto alternative learning around here, but what are the other types of alternative lending that exist? How should we be thinking about this whole space?

MATTHEW: Yeah. I think getting clarity on what we mean by the term is always important, and I think alternative lending to me is anything non-bank because the distinction there is that banks can create money and can create credit. Non-banks can't. They have to have their own capital source. And then, there is some overlap there, where you have banks operating as well as private credit funds or individuals. But then, there are areas where they are completely segregated, where you just have banks or you just have private funds.

I would say they're different from equity investing. With equity, you're taking the risk of losing your investment. While there's certainly unsecured lending, in lending we typically want to see a rate of return and some recourse to collateral, or some asset that could be seized in the event of a default to recoup the original investment. I think anytime there's an asset involved, whether it's a brokerage account, whether it's crypto property, or physical property, with alternative lending and real estate, you can have lending strategies.

Those are my thoughts on the different types of lending. We can get into more practical topics, like what does it look like to lend against accounts receivable, what does it look like to lend against equipment or real property, or purchasing notes to mortgage notes, and things like that. With a lot of the private credit funds that have those, the returns almost look like short volatility, where you're getting a great rate of return with almost no volatility and really high sharpe ratios. Usually, those are private credit strategies, and they usually involve purchasing notes against real estate. We could talk more about those, but those are some of the basic areas.

ALISA: And I'll just add one thing to what Matt said. With different lending strategies, understanding risk, how that risk is assessed and what it's tied to is really important. Coming from the financial services industry, I can speak to that depending on what your portfolio contains. And when we say portfolio, that includes both physical portfolio and alternative. But today we're talking about alternative lending.

We are more involved in real estate specifically, but understanding what is the risk, and what is the ability to lend against various types of ownership. Whether it's property, whether it's your brokerage portfolio, cryptocurrencies, or cash, everything has a different level of risk, and hence, lending opportunity. That is really important.

Coming from the brokerage industry, I also think about marginability. There are a lot of negotiations that I would have to do with firms when it came to talking about "Okay, here's what you own. What is the risk to our firm of giving you the ability to lend against it?" It all depends on the underlying asset class.

KENNY: That makes sense. We're talking about alternatives because we have had a lot of crypto events. But in Prairie Hill specifically, let's go a little bit deeper on your focus area. It sounds like real estate would be your primary focus. And so, the nuts and bolts questions would be what type of yields are you typically seeing in the current environment? How are these loans typically structured? We can go a little bit deeper on one specific asset. Alisa, maybe I'll start with you on this one.

ALISA: Sure. Prairie Hill Holdings specifically focuses on commercial real estate. Most folks assume that when you talk about real estate, you're talking about residential. We actually focus on things like grocery stores, etc. All of it. We focus on what we call COVID-proof, recession-proof real estate. What's really niche about the opportunities that we seek specifically is that we found this really nice sweet spot. We acquire properties similarly with a "P" mindset. We're looking for opportunities to acquire real estate based on the tenant.

And so, if the balance sheets of the tenant are strong, and we actually want to buy the company, which is the tenant, then we become interested in looking at how we can acquire the building that the tenant occupies. It's a really unique way of looking at how to purchase real estate, that is different from what is typically discussed in the real estate world.

We're not looking for the sexiest investment. We're not deciding on purchasing property depending on what area it's in, or what it's going to look like. We look for stability. We look at a return that is stable, so we can actually tell our investors that you can expect a cash yield. You can expect this internal rate of return. The expectation always is to under promise and over deliver.

What's also unique is the size of the opportunities that we look at. The real estate that we target typically ends up being between 5 to 20 million. That's what the purchase prices are. They're large enough where an individual isn't going to be buying that property because that may be a large amount of their portfolio. We don't have competition there. But also, it's a little small for institutional, because they tend to focus on properties or buildings that are a couple hundred million.

The reason for that is the due diligence they would do to buy a very large property is very similar to the due diligence they would do to buy one that we would acquire. And so, if they're going to spend that due diligence to buy property, they prefer that which has a larger purchase price. That's the difference.

In regards to return, we look at a cash yield of 6 to 10% net. It's a nice and healthy return in today's market space. Also, the way we've set up Prairie Hill with our investors and limited partners, you're actually getting your basis back for the first few years until exit. I'm not an accountant or attorney, but it's basically tax-free income until sale.

And then, what also is unique is our IRR is closer to 20 plus percent, with our exits potentially being in the institutional realm over time. That is a very conservative estimate of where we are. I'll pass it to Matt, if there's anything else you'd like to add.

MATTHEW: Sure. We are equity investors in the sense that we're owning the properties. However, with the way real estate is priced net lease, we have very long term leases, and the value of the property is tied to the creditworthiness of the tenant, whether the tenant is an investment grade, publicly-traded company or a private company. And then, you also have capitalization rates, which are how real estate is valued. It's a proxy for risk too.

How bonds from the government are being priced versus corporate has a big role in how the assets price. We've touched debt in everything we do. I know the topic today is alternative lending, so I'm happy to talk about the lending side as well. We're more equity investors in terms of that fund, but we definitely touch all the aspects of lending as well.

KENNY: Gotcha. You mentioned a couple of terms there, and we want to define some of them. I think most of the people will be familiar with this, but what is net lease? What is single net, double, and triple net? And then, I think you mentioned cap rates. What is the cap rate? How is that different from more traditional IRR? What is EBITA? What's a P mindset?

MATTHEW: Yeah, that's a great question. When people think of real estate, they think of the terrible Ts. Toilets, tenants, and taxes. I think that's the third T. In a triple net lease you get rid of all the Ts. I'll give you an example. If you're from Chicago, you've probably eaten at a Jimmy John's before. Jimmy John's is not going to own their real estate typically, because if you're a franchisee and you want to grow, you want to have 20 Jimmy John's locations. Not just one.

You don't want to use your cash to buy a bunch of real estate. It's too expensive. So, you're going to put your cash into setting up operations. You want to lease. The leases of these types of restaurants, or grocery stores, or industrial, or all these other assets, are going to be structured as net leases. That means the tenant is going to pay for maintenance. The tenant is going to pay property taxes, and even pay for insurance on the asset.

Landlords are going to carry their own insurance as well. They're going to cover some of those things. If the toilet breaks at Jimmy John's, one of the terrible Ts is calling the plumber, and Jimmy John's is going to pay the plumber. From an investor perspective, it gives you a lot of advantages. However, you still are going to have some capital expenditures.

For example, rough parking lots are often going to be landlord responsibility. But a lot of the capital expenditure that's uncontrollable in multifamily and residential is completely avoided. Bathrooms and kitchens tend to look dated sometimes, and quickly, within five years even. If you have to redo bathrooms and kitchens in 1,000 units, that's a ton of money, so it can destroy investment returns. But net lease doesn't have that issue.

KENNY: Appreciate it. Alisa, anything you want to add to that?

ALISA: Yeah. I'm noticing that there are a couple of questions in the chat, and one of them is about how we work with our investors. So, the way we work with investors is we provide them the ability to invest directly into real estate. They own a portion. One example we have is a $13 million property. The way they also can own it is directly, which means it can be a 1031 exchange. We are able to work with individuals that are selling one property and going to another. There's obviously this timing that has to occur in order to still be credited as a 1031 exchange.

We also provide the opportunity for investors to purchase into the property with their retirement accounts. We actually have a direct custodial relationship with Millennium Trust. I think there was a question in the chat on how we work with brokerage firms so that individuals can invest their retirement accounts directly into it. That's one of the ways. And then, the third is direct, which is literally by wiring cash.

I noticed a couple of questions about this, but we currently do not work in the crypto realm but we're open to it. Part of this conversation is understanding the type of lending we do, but it also opens the conversation around what other lending can we do in order to get exposure into the alternative space. So I appreciate some of those questions.

AYLA: Awesome, I'll pop in another question. What are the kinds of risks that most people are not aware of when it comes to lending with a pipe? To look at it in a simplistic way, “oh, there's enough collateral. That's great. And the terminal makes sense to me, so that works for me.” What are the more nuanced bits and pieces where they only learn through a smack in the face?

MATTHEW: That's a great question. In the breakout room, we were talking a little bit about some of the legal aspects of lending. I think it’s all about understanding the process of how to actually seize the asset, or get control of the asset back, and then really thinking through what that looks like and whether you're prepared to do it. Because I think that sometimes, people think they've secured it, but they haven’t, because they've never thought about what it looks like if all of a sudden you get the keys to a company and it's like, “Okay, do you want to run this company?”

Some lenders are willing to do that, some are not. What does it look like if there was a $2 million printing press, and you own it now? Things like that. That's why a lot of the time in private credit funds, you have a lot of folks with litigation backgrounds that really know what it takes to go after guarantors and borrowers, and what legal strategy you need to do that.

And then, another thing to consider is the time it takes. There are things borrowers can do to drag things on forever, and time is money. So as a lender, you have to get clarity on whether you're going to try and take control of the property or not. Both strategies can be valid, but you have to procedurally understand what that looks like.

ALISA: I'll add a little bit more to that as well. Understanding what your lender is focused on is also important. I think that with the acquisition of a business, I have to do a covenant test every quarter. And so, understanding what is that ratio of your profits and losses that you have within your organization in this example, and what it needs to be in order to continue being viewed as a positive lending client, because there are different parameters that need to be followed.

It will also depend on the institution that you work with. It will depend on the asset class that you are having underwritten. There are a lot of things to know. Once again going back to risk understanding, you have to ask questions like “what is this asset class that I'm lending against? What tests do I need to pass? What are they doing in the background?” And honestly, knowing your worst case scenario is very important, even though no one likes to talk about it.

When I think about my experience in financial services, the things that people didn't like to talk about are death and divorce. People don't like to talk about what that worst case scenario is when it comes to lending. But truly understanding what happens and what you can do if you don't pass the covenant test or if you are unable to make that monthly payment is very important. It can really impact your steps going forward.

And then, the biggest piece that I like to focus on is diversification. Lending is a form of diversification for your own portfolio. It will react differently in different markets. For us in Prairie Hill Holdings, we assess the value of our properties by asking questions like what happens to them as interest rates go up and go down, and how that impacts the cost structure. That's because we are continuing to buy properties, and we are continuing to deliver the returns that we do.

One of the things that Matt mentioned is the importance of stability. Knowing that we have a tenant for 5 to 10 years and knowing what their rent is going to be provides more stability in a lending environment than when you are lending against, for example, an equity portfolio, because that is evaluated every second as the market is open.

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Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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