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Mortgage Pools Offer a New Opportunity for Investing in California Real Estate

by James Perry

Following is a Q&A on mortgage pools with James Perry, president of The Alliance Portfolio, an Orange County – based private equity finance corporation. In the past couple of years, returns of 10% or more have been common in mortgage pools, compared to 4-5% for more mainstream investments. The Alliance Portfolio's newest investment fund, the TAP California Funds III, LLC, currently offers a 9.5% return generated by a security instrument backed by a diversity of Southern California real estate from luxury homes to mixed-use properties.

James Perry

WHAT IS A MORTGAGE POOL?

Mortgage pools must comply with state and federal agencies and some provide complete and full disclosure through an offering memorandum. A mortgage pool takes in money from investors and then loans that money to property owners with the property serving as collateral. The secured loans are comparable to bridge or sub prime loans in that they are made at higher interest rates.

WHAT'S THE PURPOSE OF A MORTGAGE POOL?

The purpose of a mortgage pool is to create a long term investment vehicle that provides a favorable rate of return to investors, while giving them security through diversification of risk, stability and predictability of monthly cash flow. Investors pool their money by buying shares in the fund; interest earned from the payments from the fund's mortgages become income for the fund.

HOW MUCH DO MORTGAGE POOLS EARN?

Mortgage pools offer secured investment vehicles that generate a higher return than comparable low-risk securities. Mortgage pool returns are often greater than 9-10% annually. Monthly income from mortgage pools can vary as interest rates change because mortgages can be prepaid. With the likelihood of interest rates increasing, the return from the mortgage pool would increase as well.

WHO INVESTS IN THESE POOLS?

Mortgage pools are perfect for investors who don't have real estate expertise and don't want to commit the time and energy to learn. A pool provides them the benefit of investing in real estate without having to actually purchase the real estate, or having extensive knowledge and experience in real estate investing. All income earned is distributed to shareholders according to their proportional interest. Mortgage pools are also redeemable on reasonable notice so they offer more liquidity than a direct mortgage or syndication.

WHY SHOULD I INVEST IN A MORTGAGE POOL AS OPPOSED TO INDIVIDUAL TRUST DEEDS OR MUTUAL FUNDS?

In many respects, mortgage pools are a better alternative to individual trust deeds. Mortgage pools limit the liability to individual investors and diversify risk. A $25,000 investment into a pool of 18-20 loans has more diversification that a $25,000 investment into a single loan secured by a single property with only one borrower. Unlike a mutual fund, mortgage pools funds are secured by real estate and are not subject to the volatility of the stock market. While mortgage pool securities are primarily used to provide safe income, there is also the opportunity to increase yields through interest rates hikes, making them a good investment for retirees or anybody on a fixed income. Another advantage to mortgage pools is that they are very suitable for most tax-deferred savings accounts.

WHY SHOULD INDEPENDENT BROKER/DEALERS OR FINANCIAL PLANNERS BE INTERESTED IN A MORTGAGE POOL FOR THEIR CLIENTS?

A mortgage pool such as the pools sponsored by The Alliance Portfolio offers the opportunity to add a higher yield instrument that earns about 9-10% to an investment portfolio. A mortgage pool is secured by real estate assets and thus has minimal investment risk, and generates predictable cash flow or dividends that can be reinvested in the pool for growth. A mortgage pool also provides broker/dealers and financial planners an additional source of fee revenue. From our standpoint, it's a win-win deal for everyone.

ARE THERE ANY DISADVANTAGES?

Mortgage pools are not insured by FDIC or any government agency. Some mortgage pools require that investors meet suitability standards. The minimum investment can be upwards of $25,000. Investors receive a K-1 tax form, and earnings may be taxable.

WHAT TYPES OF PROPERTY OWNERS BORROW MONEY?

Primarily owners of residential properties and apartment buildings, but also commercial property owners. The mortgage pools sponsored by The Alliance Portfolio lend money almost exclusively to owners of property in Orange County, which gives us the opportunity to see the property and know the borrower personally. We believe that provides a higher level of security for the loans. Consequently, we have had a very low default ratio during the nearly 10 years we've been in business.

HOW ARE THE INVESTORS PAID?

Some mortgage pools offer investors the option of receiving monthly cash flow, or growth through reinvestment of the earnings. Additionally, many mortgage pools are pension fund, IRA and rollover qualified, which makes them a great vehicle for tax-differed investment capital.

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WHO MANAGES THE FUND?

Mortgage companies like The Alliance Portfolio specialize in administering mortgage pools and syndicated mortgages. These companies serve as the professional investment manager and administrator of the pool on the investors' behalf. The pool is continuously managed with a primary objective of securing new mortgages to replace mortgages that mature. With many mortgage companies, an investor's income is deposited directly into his or her account and a monthly statement keeps them informed of their account balance, current yield and mortgage portfolio details.

HOW IS THE POOL MANAGER PAID?

Comparable to a mutual fund manager, the mortgage company is paid a management fee to research the proposal, make the lending decisions, and handle all the payments and administration. The fee the mortgage company earns is not paid by the investor, but rather is a percentage of the income earned on the mortgages.

With offices in Newport Beach and Aliso Viejo, The Alliance Portfolio is observing its 10th anniversary. Established in 1996, the company has generated more than $100 million in loan originations and investment opportunities. James Perry is company president and can be reached at jperry@theallianceportfolio.com.