The Family Office Club is the #1 largest family office association globally with Over 1,000 registered family offices. We have the #1 most attended U.S. family office conference series, and the bestselling book in the industry.

Our platform business model approach allows us to provide family office training, conference, investor data, executive search, and single family office creation and management services all through the Family Office Club brand and relationships.

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Today’s Webinar

- Private Debt Financing
- Who Lends to Private Companies and Projects?
- What Factors Drive the Lending Decision
- What is Driving Private Debt Financing
- Different Forms of Debt
- Peer Lending
- How Family Offices Fit In
Private Debt Financing

Private debt financing occurs when a firm or individual raises money from private sources to fund operations, make an acquisition, or finance a project. The private investor(s) will lend the money in exchange for bonds, bills, or notes issued by the borrower.

Many small and medium-sized businesses rely on private debt to fuel their continued growth and eliminate the need to surrender equity to outside investors.
Why Borrow?

- **Tax Deduction of Interest**
- **Non-Dilutive & Shareholders Keep Equity Gains**
- **Consolidates Control with Corporate Equity-Holders**
- **Windows of Low Borrowing Costs & Cheap Financing**
- **Financial Certainty** (Set Rate, Payment Dates, Etc.)
- **Lack of Alternative Funding Sources**
Why Lend?

Search for Yield: Investors are Turning to Alternative Debt Investments in a Low-Yield Environment

Diversification of Portfolio

Seniority in Capital Deck

Recover Assets if Borrower Fails to Meet Payments

Ability to De-risk with Low LTV & High Collateral
Forms of Collateral

- Aviation, Marine, Transportation Assets
- Art, Jewelry, Collectibles
- Personal Real Estate
- Equity Stake in a Private Company
- Public Shares
- LP Interests (Hedge Funds, Private Equity, etc)
- Commercial Real Estate
- Multifamily Real Estate (Apartment Buildings)
- Land Banks
- Credit Rating (Line of Credit)
- Equipment or Facilities
Types of Debt: Debentures

No asset backing up the bond

Used for short-term capital raise

Investors only issue to highly rated issuers with attractive guaranteed fixed rate.
Types of Debt: Corporate Bonds

Most institutional investors and family offices have some fixed income investments, if not an entire unit dedicated to bonds.

Issuers range from corporations to municipalities.

Coupon (interest rate) depends on credit rating (AAA to junk), duration, market supply/demand.

Some investors with extensive expertise will buy more exotic CDOs, derivatives and other more complex debt securities.
Types of Debt: Mezzanine

Combination of debt and equity financing

Lender typically has option to convert to equity stake in the company if loan payments are late or default.

Short-term, minimal/no collateral, and subordinate to more senior debtholders. Thus, investors charge high interest rates in 15-30% range making this an expensive form of capital.
Types of Debt: Bridge

Short-term, bridges the gap between initial need and longer-term, cheaper financing.

Provides borrower with immediate funding source to cover current obligations and secure long-term debt agreement. May be used to finance operations until the close of a round of funding.

Duration: As short as a couple of months, typically a year or less.

Used to bridge the gap in a private equity buyout until the acquisition is completed.
Types of Debt: Convertible

A convertible note is structured as a short-term loan with ability to convert into equity.

Common among early-stage start-ups looking to secure initial funding. Investors will buy the notes with the convertible feature, often converting into preferred shares in lieu of repayment and interest.

Advantage for investors buying convertible notes in start-up is the ability to secure preferred shares.

Advantage for company is delaying valuation, securing early financing, and tax/expense savings.
Common Considerations

LTV: Loan-to-Value Ratio determines the ratio of the loan to the value of the asset being acquired. Investors seek a low LTV ratio.

Collateral: the assets being pledged by the borrower in the event of a default.

Liquidity: what is the market for the loan or underlying assets, were the investor to need to offload the investment to another buyer.

Duration: What is the duration of the loan, when do the bonds mature.

Rating: If applicable, what are the bonds rated, does the corporation have a rating from an agency like Moody’s, S&P, Fitch?

Borrower Risk: What is the borrower’s risk profile? How likely is the borrower to make payments and on time? Is there risk of default?
Investment Process

Initial Due Diligence: what is the appraised value of collateral? Does diligence team/analysis confirm assessment? Are there risks that the borrower will default or have trouble making the payments? What is the risk profile of the borrower?

Structuring/Underwriting: What is the duration and length of the loan? How does the debt fit within the capital stack? Does the investor have covenants on the loan? Priority of payments vs other capital providers? Secured vs. unsecured? Recourse vs. non-recourse?

Investment Characteristics: Does this fit within the investor’s objectives? How does this fit within the macro environment? Are there better opportunities out there?
Note: Recourse vs. Non-Recourse

Non-Recourse Loan: Preferred by borrowers because the lender can only seize the assets posted as collateral. Because this feature is advantageous to the borrower, the lender may charge a higher interest rate to compensate for the greater risk to his capital.

Recourse Loan: Preferred by lenders because, in the event of a default, the lender is able to seize not only the collateral but he can also pursue other means to be made whole.

So, if a borrower defaults, the lender will recover the collateral and then go after the borrower’s other assets and even sue to recover other funds such as future wages.
Peer-to-Peer Lending

Traditional lenders have exited the market for various reasons, especially post-financial crisis.

Alternative lenders including family offices, institutional investors, and peer lenders have stepped in to fill the vacuum. Platforms like Lending Club and Prosper have opened the door to more investors and streamlined the underwriting process.
Banks Stepping Back

Traditional source of capital for businesses

Banks have scaled back from lending post-crisis

High credit requirements may be prohibitive

Many banks uninterested in resuming large-scale credit business
Family Office Wealth Creation Using Debt

Used seller-financed debt to acquire and expand a portfolio of 300 retail locations. Sold the portfolio for $500m total, netting $300m in liquidity.

The family then used debt again to create a NOL of $12M a year to off-set its 19 assets remaining after the sale which produce a $5M a year NOI.
Live Case Studies #1-3

1. **Will Fail**: Offering a preferred return to family offices of 8-12% in order to keep the equity portion.

2. **Did Just Fail**: Seller Financing, no skin in the game approach

3. **In Negotiation**: Take over of debt, leave owner with 10% upside for the future
Gross Revenue Royalty Opportunities

1. **Example 1**: Manufacturing family invests in its own space exclusively and requires a 2% gross revenue royalty on each investment for strategic involvement.

2. **Example 2**: We closed a 33% equity stake deal in a consumer products business, 12.5% gross revenue royalty.

3. **Example 3**: Investor invested for 20% equity stake, gross revenue royalty of 5% until money returned and then royalty reduced to 2.5% permanently.
Why Royalties?

1. Perpetual
2. Operation Partner Scenarios
3. Venture Debt
4. De-Risks Early Equity Investments
5. Ignored by 99% of investors
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