

Alternative Investments: Home Runs or Strike Outs?

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Perhaps the hottest trend in foundation investments in recent years is the use of alternative investments. The term *alternative investment* covers a wide array of investment products, including: hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore funds and fund of funds. These funds may be structured as limited partnerships, limited liability corporations, regular corporations or trusts.

Take Care

As with any investment, take great care before committing funds to these vehicles. A lack of regulatory oversight for such funds has brought about both benefits and challenges. Investment managers with more freedom to invest as they see fit to maximize returns, and for this reason the funds are often successful, but there is no protection to an investor who participates in a fund that fails. Additionally, alternative investments can require commitments of significant amounts of money and can have long “lock up” periods for funds – limiting your liquidity.

Before committing funds to alternative investments, we suggest that you perform significant due diligence on the fund and its managers.

- “Kick the tires!” at an on-site, face-to-face meeting with the investment firm’s management team;
- Have legal counsel review all offering information, including the fund’s historical performance and valuation process;
- Evaluate how this investment fits within the foundation’s overall investment strategy; and
- Look for information from third parties on the fund and its managers. Consider background and reference checks, as well as input from other investment consultants and managers.

After the investment has been made, continue

your due diligence of the fund by using the following techniques, or use an investment consultant to do so:

- Conduct regular, in-person meetings and calls with the management team, or participate in conference calls regarding the fund’s strategy and performance;
- Conduct regular on-site visits to check if all appears to be in order;
- Carefully review all communications produced by the fund, with particular attention to valuation of fund assets and capital changes; and
- Review a copy of the fund’s annual audit report, performed by a reputable firm and including an unqualified opinion. Consult your accountant with any questions about audit firm’s reputation.

As the result of increased activity in alternative investments, the American Institute of Certified Public Accountants recently issued new audit guidelines for auditors and investors with regard to such investments. The primary purpose of these guidelines is to ensure that investors have sufficient information to support the valuations of these investments on their financial statements.

Take Note at Tax Time

Occasionally, alternative investments generate unrelated business income, and in some instances, such unrelated business income triggers filing obligations in multiple states. Foundations that have unrelated business income greater than \$1,000 will have to file another federal tax return, the Form 990-T, and pay taxes at regular corporation rates. Be aware of the additional tax and administrative expenses that may be incurred with alternative investment and consult fund managers about this topic upfront.

In closing, alternative investments are a popular investment vehicle and have a place in many foundation’s portfolios, but appropriate care should be taken prior and subsequent to investing in them.