In a World of Transparency, Where do “Blind Funds” Fit In?

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A key buzz word in the investment industry, over the past decade, has been the word “transparency.” Transparency in our industry means the ability for investors to see through our company to the various components and processes utilized in our business and funds, including discovering how we source a property, how we do diligence on it, how we manage risk and other areas that affect the investment. A blind fund, alternatively and traditionally, offers investors a vehicle that acts like a blind wall, whereby the investor invests his/her money but leave it to the manager’s discretion to determine not only how the investments are handled, but also what types of investments they decide to make.

There are two areas that differentiate the blind funds from the transparent ones: Disclosure Characteristics and Process.

Most transparent investment funds are governed by formal Private Placement or Offering Memorandums (PPMs) that detail their investment philosophy, state the internal and external regulations and disclose a substantial set of rules such as:

• The type of investment they can invest in, e.g., multifamily housing in the secondary marketplace, Class B housing

• Whether the fund can or can’t borrow money and from whom, e.g., cannot utilize mezzanine financing

• Cash flow goals

• How and when money is disbursed

• Risk/reward characteristics

In contrast, while blind funds or pools may have documents that state that that their goal is to invest in real estate, as an example, there is nothing in their document to prevent them from switching gears and investing in technology or healthcare or whatever management perceives to be the “next new thing” that they feel will give investors the highest yield possible, without informing the investors of their decision. There may not be a stated rule as to when capital is returned. The operative issue is what ISN’T stated in the PPM; that the managers have the freedom to do whatever they want with your money, without informing you of those decisions. Blind funds remove a layer of protection for investors.

There are two key areas to focus on when considering whether an investment is a blind or transparent fund – investment rules and rights/authority of management, both of which hinge on the specifics of the PPM. This critical document lays out the ground rules not only of the investment but, equally important, the powers of the management team.

From the PPM you can answer the following questions:

- What can the fund invest in or utilize? (asset class, sub-class, financing limitations)
- What are the rules of the investment? (e.g., size of the investments in any one property, leverage)
- Most importantly, is the fund limited to certain investments? What can't it invest in or utilize?

From the PPM, you can also read the stated rules for management and managers of the investment vehicle:

- What is the investment strategy of the fund?
- What are the fees of the fund?
- What is the background of the managers?
- Do they have a risk mitigation program?

Going further, beyond the PPM, an investor should be doing diligence on the managers, themselves, to determine:

- Is there a track record for the manager? What proof is there that the numbers are real?
- Does the manager have internal processes that are utilized for various aspects of their business? If so, are they documented?
- Does the firm utilize known, independent service partners for valuation and administration?

Institutions, family offices and sophisticated investors have increasingly performed rigorous due diligence on prospective investments to ensure more transparency, rather than allocate their capital to blind funds.

Colony Hills Capital does not subscribe to the blind fund process. We advocate and practice transparency. We create documents that try to clearly specify what we can and can't do. We create processes that are verifiable and sustainable. We strive to answer any and all questions to our clients' satisfaction. We author thought leadership pieces, endeavoring to work with our clients to educate them about what we do and how and why we do it so they understand our process and so there are no surprises. We disburse gains and provide clear descriptions of our investment thesis so that investors receive their money back as we succeed. In summary, at Colony Hills Capital, blind funds just don't fit in.