

WHY ALTERNATIVE DIRECT INVESTMENTS BELONG IN MODERN WEALTH PORTFOLIOS

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This paper is designed to support advisor education and client communication. It is not an offer to sell or a solicitation to buy any security.

Executive Summary

Wealth outcomes are increasingly determined by after-tax, after-fee, risk-adjusted results, not just headline returns. Clients also want durable income, diversification that holds up in drawdowns, and planning tools that integrate with tax and estate strategy.

Alternative direct investments, particularly DSTs, Qualified Opportunity Zone (QOZ) strategies, private credit, and development real estate can improve portfolio functionality when used intentionally and governed properly.

Income	Asset-backed and contractual cash-flow streams can supplement public-market yield and reduce forced selling during volatility.
Growth	Value creation may come from rent growth, amortization, development spread, cap-rate normalization, and operational execution; drivers that can differ from public equities and duration-heavy bonds.
Diversification	Alternatives can introduce distinct economic exposures (rents, creditspreads, occupancy, construction timelines), potentially reducing single-factor dependence on public market beta.
Strategy	Depreciation/cost recovery (deal-dependent), deferral frameworks, and gain-management tools can improve after-tax outcomes for clients with high ordinary income and/or large capital gains.
Implementation Discipline	Success depends on suitability, position sizing, manager selection, leverage control, and clear liquidity planning.

Bottom line: Alternatives are not a replacement for planning fundamentals. They are a portfolio and tax-planning tool. When paired with repeatable due diligence, conservative sizing, and CPA coordination, they can help advisors deliver better client outcomes.

1. The Modern Portfolio Problem

Many traditional portfolios face a familiar set of client-facing pressures: higher cross-asset correlations during stress periods, greater sensitivity to rate regimes, and increased demand for reliable income. Meanwhile, the most relevant benchmark for many high-net-worth households is not pre-tax return, it is net spendable wealth over time.

Common planning frictions advisors are trying to solve:

- Meeting spending needs without selling equities at the wrong time (sequence-of-returns risk).
- Reducing concentration in a single return engine (public equity beta) or a single macro factor (duration).
- Improving after-tax results for clients with high ordinary income, capital gains, or both.
- Providing diversification that is understandable to clients and defensible under a fiduciary process.

Alternative direct investments can help address these frictions because they often link returns to identifiable cash flows and asset values (rents, interest, collateral coverage, project margins) rather than solely to market sentiment.

2. Why Alternative Direct Investments Can Improve Portfolio Efficiency

2.1 Diversification through different return drivers

In practice, diversification works best when the underlying drivers of return are different. Alternatives can introduce drivers such as occupancy and rent escalations (real estate), credit spreads and underwriting quality (private credit), and project execution timelines and development spreads (development real estate). These drivers do not always move in lockstep with public markets.

Asset Type	Primary Return Drivers	Common Client Outcomes Sought
DST / Stabilized RealEstate	Lease terms, occupancy, rent escalators, cap rates, debt structure	Current income, diversification, potential inflation-resilience, tax attributes (deal-dependent)
Private Credit	Borrower quality, covenants, collateral, floating vs fixed rates, default cycle	Contractual income, potential lower volatility than equities, diversification from public
Development RealEstate	Project execution, supply/demand, construction costs, exit liquidity, cap rates	Growth potential, diversification, opportunistic returns (higher risk)
Qualified Opportunity Zone Strategies	Underlying business/real asset execution plus statutory tax framework	Long-horizon growth with potential tax benefits (requires strict compliance)

2.2 Income as a planning tool, not just a yield target

For many households, income is a behavioral stabilizer and a risk-management lever. Predictable distributions can reduce pressure to sell growth assets during drawdowns and can support required spending, gifting, and insurance or tax payments. The goal is not yield at all costs; it is building a portfolio that can fund the plan across market regimes.

2.3 Sequence-of-returns risk and cash-flow buffers

Clients who are withdrawing from a portfolio face sequence-of-returns risk: weak market early in the distribution phase can permanently damage outcomes. A thoughtfully designed alternatives sleeve may provide a partial cash-flow buffer, potentially improving plan durability when public markets are temporarily impaired.

3. Alternatives as Tax Strategy: After-Tax Alpha

For high earners and clients with liquidity events, the primary performance question is often: How much of the return does the client keep? Alternative direct investments can sometimes improve outcomes through tax timing, tax character, and gain management. These benefits are deal-specific and investor-specific and should be coordinated with the client's CPA.

3.1 Ordinary income strategies (deal- and investor-dependent)

Real estate partnerships and DST structures may generate depreciation and other deductions that can offset a portion of distributed cash flow, potentially resulting in tax-deferred distributions (often reported on a K-1). The extent and usability of these attributes depends on the asset, financing, cost segregation (if any), the investor's passive activity profile, and applicable limitations.

Advisor framing: Treat tax benefits as a potential enhancer, not the sole reason to invest. Underwrite the asset and cash flow first; then evaluate the tax impact as part of the total return and planning profile.

3.2 Capital gains planning: deferral and controlled recognition

For clients with large capital gains exposure (sale of real estate, concentrated stock diversification, business exits), alternative strategies may support deferral or controlled recognition frameworks where appropriate and compliant. Examples include real estate exchange structures, and long-horizon strategies designed to align gain recognition with future planning needs.

3.3 Qualified Opportunity Zone strategies: planning profile

QOZ strategies are distinct because the tax framework is statutory and requires strict compliance. Properly structured QOZ investments are typically long-horizon, execution-dependent, and best suited for clients who can commit to illiquidity and who have meaningful capital gains to deploy. The role in a portfolio is often growth-oriented, with tax benefits as a meaningful planning dimension rather than a guarantee of superior returns.

3.4 The value of deferral: the tax timing premium

Even when taxes are not eliminated, deferral can increase long-term wealth by keeping more capital invested for longer. This 'tax timing premium' can be especially valuable for clients who anticipate lower brackets later, who can harvest losses in future years, or who want flexibility to coordinate recognition with charitable or estate strategies.

4. Core Allocations Used in Wealth Portfolios

4.1 DSTs: stabilized real estate exposure with planning utility

Delaware Statutory Trust structures are commonly used to access institutional-quality real estate with professional management. For many clients, the DST value proposition centers on: (1) access to stabilized assets, (2) potential income, (3) diversification across property types and geographies, and (4) planning and tax attributes that may be relevant in eligible scenarios.

- Best-fit use cases: clients seeking passive real estate exposure, diversification from equities, and potential cash flow.
- Key diligence items: sponsor track record, lease quality, tenant concentration, debt terms, reserves, and exit assumptions.
- Key risks: illiquidity, leverage, cap-rate expansion, tenant rollover, and sponsor execution.

4.2 Private credit: contractual income and underwriting dispersion

Private credit is often used to target contractual income with underwriting-driven returns. In many portfolios it is positioned as a complement to traditional fixed income, with the potential to reduce volatility relative to equities while still producing meaningful yield. However, manager dispersion is real: underwriting quality matters more than macro narratives.

- Best-fit use cases: income-focused clients, clients seeking floating-rate exposure, or those reducing reliance on public high-yield markets.
- Key diligence items: credit policy, collateral and covenant protections, diversification, workout history, and valuation/reporting rigor.
- Key risks: defaults in downturns, liquidity constraints, manager concentration, and leverage at the fund or borrower level.

4.3 Development real estate: higher risk, potentially higher reward

Development can add a differentiated growth engine, but it is inherently execution- and cycle-sensitive. Advisors should treat development exposure as opportunistic and size it accordingly. The underwriting conversation must focus on capital stack safety, sponsor capability, construction risk controls, and realistic exit liquidity assumptions.

- Best-fit use cases: clients with higher risk tolerance, longer horizons, and a portfolio that can absorb illiquidity and volatility.
- Key diligence items: budget contingencies, contracting approach, permitting status, absorption assumptions, and sponsor capitalization.
- Key risks: cost overruns, delays, financing risk, demand shocks, and forced sales into weak markets.

4.4 Qualified Opportunity Zone strategies: long-horizon growth with strict rules

QOZ strategies are typically appropriate only when the client has: (1) meaningful capital gains, (2) the ability to commit for a long holding period, and (3) the patience to tolerate project execution risk. Because QOZ outcomes depend both on the statutory framework and the underlying asset/business performance, advisor due diligence should be stricter, not looser.

- Best-fit use cases: clients with significant gains, long time horizons, and a desire for growth-oriented exposure in a tax-aware framework.
- Key diligence items: compliance infrastructure, project feasibility, sponsor reporting, and downside-case capital preservation.
- Key risks: regulatory/compliance risk, execution risk, illiquidity, and concentration.

5. A Repeatable Due Diligence Framework for Advisors

Advisors do not need to be full-time underwriters, but they do need a defensible process.

Below is a practical diligence framework used by many wealth platforms to evaluate alternative direct investments.

5.1 Sponsor and manager quality

- Track record through multiple cycles; realized outcomes vs. marketing pro formas.
- Team stability, key-person risk, and alignment (GP co-invest).
- Operational infrastructure: reporting, audits, valuation policy, investor communications.
- Conflicts of interest and related-party arrangements disclosed and controlled.

5.2 Deal structure and investor protections

- Fee layers and total cost: acquisition, asset management, disposition, financing, and incentive promote.
- Reasonable waterfall structure and hurdles; clarity on catch-up provisions.
- Leverage policy and covenant protections; refinancing assumptions stress-tested.
- Liquidity terms: redemption (if any), gates, and secondary market realism.

5.3 Risk underwriting: focus on the downside case

- What breaks first? (occupancy drop, cap-rate expansion, defaults, cost overruns).
- Sensitivity analysis: interest rates, rent growth, NOI margin, exit cap rate, construction timeline.
- Concentration: tenants/borrowers, geography, industry, and counterparties.
- Exit plan: time horizon, buyer universe, and realistic pricing in a down market.

5.4 Tax and reporting practicalities

- K-1 timing and quality; history of amended K-1s.
- State filing exposure and expected complexity for the client.
- Depreciation assumptions and potential recapture awareness (where applicable).
- Clear guidance for CPA coordination and client record keeping.

6. Portfolio Construction and Allocation Discipline

Alternatives should be sized based on the client's plan, liquidity needs, and risk tolerance -
not based on headlines or recent performance. A clean approach is to define the 'job' of the allocation, match liquidity to liabilities, diversify managers and strategies, and monitor with a clear review cadence.

6.1 Define the job of the allocation

- Income sleeve: private credit and stabilized real estate oriented toward distributions.
- Growth sleeve: development and select QOZ strategies oriented toward long-horizon appreciation.
- Tax-aware sleeve: strategies where tax timing/character is a meaningful planning component, coordinated with the CPA.

6.2 Liquidity planning is non-negotiable

Illiquidity is a feature and a risk. Advisors should model liquidity needs (tax payments, lifestyle withdrawals, capital calls, emergency reserves) and cap alternative exposure accordingly. A common failure mode is over-allocating to illiquid strategies and then becoming a forced seller.

6.3 Monitoring and governance

- Establish a review cadence for reporting and risk flags (occupancy, DSCR, delinquency, construction milestones).
- Track distribution coverage and reserve adequacy, not just distributions paid.
- Document rationale for position sizing and any re-allocation decisions.
- Maintain a client communication playbook for periods of stress (delays, valuation marks, distribution changes).

7. How to Communicate Alternatives to Clients Without Hype

Most client dissatisfaction with alternatives comes from mismatched expectations. Advisors can reduce this risk by positioning alternatives as a planning tool with explicit constraints: illiquidity, complexity, manager dispersion, and time horizon.

Client-ready language (examples):

- “This sleeve is designed to help fund your plan with contractual or asset-backed cash flow, so we are less dependent on selling equities at the wrong time.”
- “We are underwriting the asset and the manager first. Any tax benefit is a potential enhancer, not the sole reason we invest.”
- “Because these are illiquid, we are sizing them so you still have ample liquid reserves for taxes, lifestyle needs, and flexibility.”

Advisors should also clearly explain that valuations may be less frequent, exits may occur on a sponsor timeline, and distributions can change based on performance and reserve policy.

Conclusion

Alternative direct investments can improve wealth portfolios by adding income-oriented cash-flow sources, diversifying return drivers, and expanding tax-planning flexibility. For many high-net-worth households, this can translate into improved plan durability and better after-tax outcomes - provided the strategies are implemented with discipline: suitability screening, conservative sizing, strong manager selection, and CPA coordination.

To watch the accompanying Webinar, please click [HERE](#).

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