

# Kondaur: A Countercyclical Investment



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Total U.S. mortgage debt has grown over five times faster than the growth in the number of U.S. households since 1979. With over \$90 billion worth of deeply delinquent workout opportunities already existing before the pandemic, we identified an attractive investment to take advantage of dislocations in the non-performing loan market.

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## Overview

In our private equity strategy, we invested alongside a top sponsor in the equity of Kondaur Capital Corporation, a non-performing loan (“NPL”) purchaser and servicer. Kondaur buys deeply discounted U.S. residential NPLs at typically 50-60% of appraised collateral value and restructures them over 12 months to achieve mid-teens unlevered returns on equity. After operating as an independent asset manager for over a decade, Kondaur raised permanent capital to allow the company to better scale and utilize leverage efficiently.

## Countercyclical Asset Class with Returns Uncorrelated to Equity and Fixed Income

Kondaur was established within Pequot Capital Management in 2008 as an NPL investment strategy and subsequently spun out as an independent asset management company. Kondaur’s investments generate returns uncorrelated with traditional asset classes.

For more than a decade of running the strategy, Kondaur's returns have had very low correlations to the S&P 500, Barclays U.S. Bond Aggregate Index and even the performance of mortgage-backed securities. The strategy is inherently countercyclical—as the economy slows, the supply of delinquent mortgages rises, offering an excellent opportunity to purchase pools at compelling prices. In addition, Kondaur looks to restructure and sell these loans within 12 months, which greatly increases the generation of cash flow and reduces any J-Curve impact seen in typical private equity deals.

## Declining Competition that is Confined to a Handful of Investors

As the former CIO of Pequot Capital Management, one of the most successful hedge funds of the early 2000s, Kondaur's CEO Mike Corasaniti has cultivated relationships with many counterparties, including banks and government agencies that actively sell NPLs. Competition for loan pools has declined substantially over time, as multi-strategy and private equity funds with less direct domain expertise and appreciation of the operational complexity of working out delinquent loans have exited the business. At various times over the past ten years, these investors moved in and out of the market, often viewing NPLs solely as a bet on home price appreciation. They typically bid on pools based on aggregate statistics of the underlying loans and hired third-party servicers, many of which were unsuited to work with deeply delinquent borrowers. Unlike these competitors, Kondaur owns its servicer, works with borrowers directly to restructure their debts, and underwrites each loan in a pool to ascertain the value of entire pools it purchases, ensuring return hurdles can be met. This strategic differentiation has resulted in management's strong track record over 12 years since the inception of its first fund. Barriers to entry in this business remain very high as a servicer needs to be licensed in every state in which loans are purchased and with each government housing agency.

## The Market for NPLs Remains Deep

The growth in mortgage debt has outpaced the growth in the number of U.S. households by over five times since 1979, and mortgage debt greater than 90 days delinquent, the type of loans that Kondaur looks to purchase, has grown nearly 50% faster than total mortgage debt. Prior to the pandemic, there were greater than \$90 billion of deeply delinquent workout opportunities, and the number continues to grow. With permanent capital and a balance sheet following this equity raise, Kondaur will now be able to operate more efficiently and better capitalize on these opportunities.

## Portfolio Construction

Kondaur is an equity investment made through our Capital Growth offering. Petiole's financials team remained in contact with Kondaur management over two years as they developed a permanent capital solution and was invited to participate in this capital raise.

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