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Boost Retirement Income with BDC's

On the eve of my retirement from a 40 year career in the produce industry (yes there really is a produce industry), the job of managing an investment portfolio has now taken on a different dimension. It's now a serious business.

Now that the paycheck will no longer be arriving on the 1st and the 15th of each month, the task of creating a sustainable income stream in order to maintain some semblance of a life style has taken center stage. Without a defined pension plan as a safety net, it's now all about Social Security, accumulated savings, and the "*portfolio*."

Forget CD's and investment grade bonds. With interest rates effectively at zero, those traditional instruments of choice relied upon by retirees past have become virtually useless as income generators. Further, the principal portion of bonds, be they Treasury or otherwise, has never been at greater risk than today. Sooner or later, interest rates will rise, the effect of which, will decimate the face value of bonds. So to paraphrase a quote from The Most Interesting Man in the World, "stay *short* my friend". (If you haven't seen the commercial, you have no idea what I'm talking about)

Now back to the *"portfolio."* Prone to excess as I am, and at the risk of being labeled a closet indexer, I currently have 62 names on my list. With the exception of the Spdr Gold Trust, symbol (GLD), all pay dividends. The list can be viewed here.

The weighted yield on the entire portfolio is just over 5%. Granted, that is not exactly a "knock your socks off return." However, for the most part, I have avoided risky double digit yielders in favor of companies with sustainable payout ratios and dividend growth prospects. This portfolio of "62" is an eclectic list that includes, in descending order of value…

1. Traditional corporate equities
2. Master Limited Partnerships (MLP's)
3. Closed End Funds (CEF's)
4. Preferred Stocks
5. Exchange Traded Funds (ETF's and ETN's)
6. Business Development Companies (BDC's)
7. Real Estate Investment Trusts (REIT's)

I maintain basic qualifying criteria for each of the above investment classes, but in the interest of brevity, I will limit further discussion in this post to just one – **Business Development Companies.**

From a pure yield standpoint, BDC's blow the doors off the other investment classes, with yields of 7 to 11 percent commonplace in today's market environment. They are not, however, without risk and need to be carefully screened and monitored. But the extra juice can do wonders to boost your income stream.

BDC's are beginning to attract more attention as the first of the baby boom generation will reach full retirement age this year and they will be reaching further out on the yield curve seeking income. Created in 1980 by an act of Congress to promote investment in smaller U.S. based companies, BDC's must meet certain qualifying criteria. They are similar to REIT's in that they are not taxed at the corporate level provided that they pay out at least 90% of their taxable income to shareholders – thus the higher dividend yield is achieved by avoiding the double taxation of traditional C-Corps.

BDC's are like Private Equity Firms for the individual investor. They typically provide first and second lien mezzanine financing to companies with market capitalization's of less than $250 Million. They may also take significant equity positions as well. To retain their qualifying status, BDC's must also be significantly involved in the management of the firms that they invest in. A comprehensive article on the structure and working of Business Development Companies can be found here.

Currently, Business Development Companies represent only a small portion of my "portfolio", but I plan to increase that allocation significantly in the coming weeks and months. Unlike MLP's (Master Limited Partnerships) where distributions are structured as return of capital in order to defer income taxes, BDC distributions are immediately taxable as ordinary dividends or interest income to the investor. Therefore, it is preferable to hold them in a tax deferred account such as a traditional IRA or 401K.