Commercial Real Estate Investing Fundamentals: A 2016 Outlook

Published on January 21, 2016

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As the real estate market continues to boom, many investors are looking to take advantage of building wealth through commercial real estate in 2016, and with good reason. 2015 was a landmark year for the commercial real estate industry, with seven of the 10 most active global markets for investment sales being located in the US.[1] The first half of 2015 alone saw $232 billion of investment sales across all asset class types, and many of the 2016 projections indicate that there are no signs of stopping.[2]

An initial hurdle potential investors find is how to navigate the often complicated world of commercial real estate investments. There are typically two ways to invest in real estate: "hard" real estate, meaning direct ownership—either full or partial—of commercial, residential or other properties, or "soft" real estate, such as traded shares of real estate investment trusts or other securities.

Soft Asset Ownership

For those who may need access to the funds they have invested during the next 5 years, it may make sense to invest in “soft” real estate, liquid publicly traded securities. This gives some diversity to a portfolio, though many publicly traded real estate stocks are trading below their asset value, as many people seeking higher yields have invested in the sector and the high demand has driven yields down and prices up. [3]

Investors seeking to purchase soft assets can go to an exchange and buy shares of a publicly traded real estate fund quickly. Examples of publicly traded real estate are; Monogram Residential Trust, Ventas, Vereit, Tier Reit, and Inland Real Estate Corp - as well as others. This may be a good option to provide diversity in a portfolio, although it is the most volatile option, and will move somewhat hand in hand with the overall market.

Hard Asset Ownership

When we think of hard asset ownership we predominantly think of two forms, direct ownership of real estate and investing in real estate that is managed by a private equity firm. Direct ownership often makes sense for people who have time to deal with repairs, tenant issues and leasing that need attention; while investing alongside a private equity firm may make more sense for someone who does not have the time or expertise.

In direct ownership, an investor may make a personal investment, or pool several people's funds together, and purchase one or more commercial real estate properties as a direct owner. With direct ownership investors have more control and responsibility than if they were investing in a soft asset or a hard asset via private equity firm. Direct ownership offers many advantages, such as the ability to have a sense of ownership and pride that comes from the direct involvement in something you can see and touch. In addition, real estate makes an excellent vehicle for transferring wealth, as interest in a property often can be placed in family partnerships at discounted values.

In contrast, hard asset ownership managed by a private equity firm is often involved in value-add and opportunistic real estate investments. These properties are typically sourced on a "limited-market" or "off-market" basis, meaning they can be bought before they are shopped around. Buying properties "off market" allows the firm to purchase an asset for a lower price than if everyone has a chance to make an offer on it. To see and purchase these commercial real estate assets, you have to have current relationships in the industry, which is a valuable component of a private equity investment firm.

In addition, commercial real estate assets that require development or repositioning often need an experienced team with the expertise to successfully estimate, budget and carry out the repositioning. Often the firm will target well-located and functional commercial properties currently facing occupancy and/or operational challenges, but which can be renovated, re-leased, re-branded, and then re-capitalized within a 3-year to 5-year timeframe. Typically these assets will be owned at an all-in investment basis significantly below replacement cost, thereby generating outsized risk- adjusted returns on equity invested and a great avenue for building wealth.

Deciding which investment option is best depends heavily on both the long and short term financial goals of investors, as well as their expertise and available time commitment. While the commercial real estate market is expected to continue to do well across the board, it is vital to consult a financial advisor prior to investing.

For more information on investing in commercial real estate with a private equity fund please visit www.encorewealth.bz or call Brandon Burns at 214.280.0908.

[1] http://rew-online.com/2016/01/06/solid-fundamentals-point-to-another-strong-year-for-commercial-real-estate/

[2] http://rew-online.com/2016/01/06/solid-fundamentals-point-to-another-strong-year-for-commercial-real-estate/

[3] http://www.wsj.com/articles/use-reits-to-invest-like-a-property-mogul-1434731193/