

Private Real Estate Investing: An Introduction

What is Private Real Estate Investing?

Private real estate investing is the process of investing directly in real estate properties. Unlike publicly traded real estate investment trusts (REITs) or real estate-related stocks, private real estate investments involve direct ownership or participation in properties. Returns are typically generated through rental income and appreciation upon eventual sale.

Property Types in Private Real Estate Investing

Private real estate funds generally invest in four real estate property types:

1. **Multifamily:** For-rent apartment buildings
2. **Office:** Commercial buildings designed for companies that need workspace
3. **Industrial/warehouse:** Spaces for storage, logistics, manufacturing, and more
4. **Retail:** Urban and suburban shopping centers, high street stores, and regional malls

WHAT YOU SHOULD KNOW:

- ▶ Private equity real estate investing is a strategy that involves the acquisition/development, management, and eventual disposition of properties through pooled funds.
- ▶ Private real estate investments generally target four main property types: multifamily/apartments, office, industrial/warehouse, and retail.
- ▶ Private real estate can help diversify investors' portfolios, provide potentially higher risk-adjusted returns, and serve as a hedge against inflation. .

¹Hamilton Lane Cobalt data – June 30, 2023.

Main Property Types	Demand Drivers	Types
Multifamily/ Apartments	<ul style="list-style-type: none"> • Population growth • Housing deficit • For-sale residential affordability issues • High mortgage rates 	<ul style="list-style-type: none"> • High-rise, urban apartment buildings • Suburban garden-style apartment buildings • Single family home rentals • Similar property types: duplexes, multistory apartment building
Office	<ul style="list-style-type: none"> • Economic growth • Business expansion and relocations • Increasing corporate amenities/space per employee 	<ul style="list-style-type: none"> • Central business district high-rise offices • Suburban office • Creative office space • Similar property types: medical office, lab or life science space
Industrial/ Warehouse	<ul style="list-style-type: none"> • Acceleration of e-commerce • On-shoring and near-shoring trends • Infrastructure growth 	<ul style="list-style-type: none"> • Large distribution facilities • Infill, last mile warehouses • Manufacturing plants • Similar property types: industrial outdoor storage, self-storage
Retail	<ul style="list-style-type: none"> • Population growth and density • High income levels and discretionary spending • Necessity-driven, food resources 	<ul style="list-style-type: none"> • Grocery-anchored shopping centers • Essential/convenience retail centers • Big-box retail stores • Shopping malls • Urban, high-street stores

One of the distinctive features of private equity real estate investing is active property management. Fund managers take a hands-on approach, implementing strategies to enhance value, such as: renovations, rebranding, optimizing rental levels and occupancy rates, and efficiently managing costs. The goal is to increase the properties' cash flow and overall market value over time.

Exiting a private equity real estate investment typically occurs through the sale of properties once they have appreciated in value or reached the end of their investment horizon. Successful fund managers aim to strategically time these exits to capitalize on market conditions and maximize returns.

What is the due diligence process for private real estate investing?

Private real estate due diligence involves understanding many variables, including macro-economic and location-specific factors. Interest rates, demographic trends, and economic growth drivers directly impact the relative attractiveness of various real estate property types and geographies. Private equity real estate fund managers also assess potential investments based on sub-market locations, local market trends, property type supply and demand fundamentals, and growth potential.

What are the benefits of private real estate investing?

Private equity real estate investing may offer the potential for high returns and portfolio diversification through direct ownership of tangible assets.

1. **Attractive returns:** Real estate has historically offered investors attractive returns, with few periods of negative results.¹ Returns are generally consistent because tenants are contractually obligated to pay rent for a defined period of time.
2. **Diversification:** Real estate can provide portfolio diversification. Private real estate allows investors to access different property types, which may mitigate investors' risk exposure.
3. **Low volatility:** Private real estate may be more stable than the public markets and can help offset market risks, since it generally has a low correlation to other asset classes.
4. **Inflation hedge:** Private real estate can be an inflation hedge because owners have the flexibility to adjust rents in line with inflation or pass along any expense increases to the tenants, for example.

What is a publicly-traded Real Estate Investment Trust (REIT)?

REITs are formed as companies that own and often oversee the operation of income-producing real estate (e.g., commercial real estate, apartments, hotels, etc.) or real estate-related assets (e.g., mortgage lenders, mortgage servicers, etc.). Since REITs are required to distribute a majority of their earnings to investors, they are often viewed as a dividend play. In addition, REITs have tax advantages, compared to other company-level investments, since they are pass-through vehicles that are not taxed at the corporate level. REITs typically provide lower-risk, returns compared to non-core investments that are heavily weighted towards income.

How is private equity real estate investing different from owning public REITs?

Unlike public REITs, which trade on public exchanges, private real estate investments are generally less liquid, have higher investment minimums, and are mostly available only to institutional or accredited investors. Since the bulk of private real estate is held through closed-end funds, the investment hold period is typically longer, ranging from 7 to 12 years. In order to compensate for lower liquidity, private real estate investors seek higher returns than publicly-traded REIT investors. To achieve these returns, private real estate investors are more active in terms of asset management, preferring to take on more renovations or development to increase property values. In addition, since private real estate is not traded daily, the valuations are less volatile than public real estate securities.

How does private real estate fit in investors' portfolios?

Private real estate can help diversify investors' portfolios, provide potentially higher and more consistent returns, and serve as a hedge against inflation. Further, a portfolio which includes private real estate assets may reduce overall portfolio risk and enhance long-term growth potential. Still, investors should consider whether private real estate aligns with their portfolio, and look at factors such as upfront capital requirements and longer hold periods.

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