REAL ESTATE WEEKLY

Planning, research key to productive investment strategy

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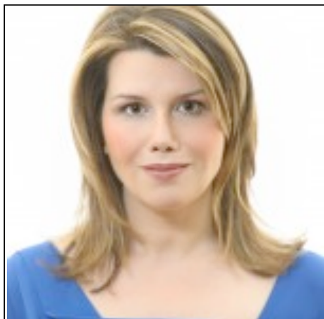

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In the current economic environment, real estate investment has risen to the fore in the minds of many investors as the safe-haven vehicle of choice. But planning and careful research, with a strict eye to objectives, is key to any investment strategy.

One reason for the sustained popularity of real estate investment is diversity. Real estate investors have at their disposal choices of such varied property types as multi-family rental and for-sale apartments, Class A or B office assets in central business districts or the suburbs, industrial, retail, hospitality and even ground-up construction.

In each case, it is essential to remember the inherent risks and rewards. These include the longer-term leases of office and retail properties, which lock up rental rates for extended periods.

At the other end of the spectrum, hospitality rates reset daily and multi-family apartment rents reset annually, allowing operators to capture changes in the prevailing market over time.

Whatever property type, there are three key areas that must be part of this groundwork planning process: cash flow requirements, risk profile and partnerships.

The first two of these criteria are tightly linked. As the risk profile rises, the initial in-place cash flow generally drops. So, core assets generally have healthy cash flows from the onset, while value-add and opportunistic projects might have limited or even negative cash flows in the early years of an investment.

Furthermore, nearly all real estate investment requires some leverage. Typically, institutional investors prefer to keep loan-to-value ratios below 65 percent, leaving ample cash flow to service the debt, even if the market softens. Of course, additional leverage enhances equity returns.

The varied risk profiles of three different asset types — core, value-add and opportunistic properties — bear closer study.

Core assets are typically low risk and low maintenance, with strong in-place cash flows and returns yielding between 4-9 percent. Class A CBD office properties in high-barrier-to-entry locations like New York and San Francisco are key examples.

As the name implies, value-add investments require more hands-on management, and cash flows can vary widely based on the investment and business plan. Those cash flows might be minimal at first, especially if additional capital is required. But there is substantial upside in that eventual returns can range up to 15 percent. A prime example of value-add might be a dated but well-located garden apartment complex, where an investor might renovate both the property and the apartments to increase rents.

Opportunistic ventures typically need dramatic improvements before they yield value, but the returns are the highest of the three food groups, typically starting at 15 percent. Think of a retail center, half-vacant, tired and in need of rebranding. The investor will have to invest the time to launch a rebranding/lease-up campaign before any returns are realized.

Finally, will the investment include an operating partner? This is the route many of the major financial players are currently following, finding a source of know-how, manpower and local knowledge. A trusted, vetted partner can help an institutional player achieve investment goals without the burden of taking on additional transaction and management personnel.

Operating partners provide the expertise in both the properties and markets they serve, and they provide an existing infrastructure, the skilled staff and the know-how to successfully execute a business plan. This local knowledge is especially helpful if you are targeting value-add and opportunistic investments. In such cases, a strong local team is critical and day-to-day responsibilities can be substantial.

Operating partners also prove their investment mettle far beyond the scope of the immediate need. They can help create an ongoing asset pipeline geared to investment criteria since they are constantly on the ground sourcing new and interesting opportunities.

In short, operating partners can ramp up investment strategy, ensuring near-term and ongoing returns.