nyrej

Investments: Be nimble in real estate - Step out of the box and remove limiting blinders

July 30, 2013 - Spotlights

Over the past few years, the U.S. has experienced a long period of interest rates that were relatively flat and historically low. The result was an environment of cheap money and ample investment opportunities. Real estate benefited from these conditions, resulting in a buying surgeâ€”a real bonanza to the ready, willing and able buyer. With relatively cheap credit available, cap rates were pushed lower, with prices steadily increasing. Investors willing to invest in real estate have been able to easily achieve 10% yields, far greater than the market at large, especially when adding in favorable tax consequences. Now, however, with the recent release of the June Fed (FONC) meeting report, credit markets have been rattled with the expectation that the Fed will begin slowing down its bond buying program. The era of cheap credit is beginning to wane, and with it, many investors are no longer considering real estate. However, for investors who are versed in the value of real estate, knowing that it holds value over time as well has having growth potential, and are aware of its significant tax benefits, being nimble in real estate will pay off even with the current interest rate environment.

A common mistake in real estate investment is taking a narrow view of real estate assets. Most investors have a comfort zone in which they like to invest, such as a specific city or geographic area, an asset type (retail, commercial, residential, medical, industrial), or the longevity of the investment. While it is always beneficial to be well informed about specific areas of investment, keeping to such highly-focused and exacting investment criteria often blinds investors to other excellent opportunities. A prime example of location bias in investing occurs right here in New York City. We consistently hear from investors that they only want to invest in our metropolitan area. This tunnel vision obscures opportunities that exist all around themâ€”just not right in their own backyard. You don't hear the same argument applied to visiting the Microsoft Development facility when they buy Microsoft stock or examining the books of a company issuing bonds. Too many investors view real estate as a tangible asset that can only be looked at in terms of a physical investment close to home, rather than looking at the deal metrics, regardless of asset type or location.

As we move into a period of rising interest rates, we expect cap rates to lag as far as six months, squeezing returns in high demand markets very thin, effectively eliminating the excess return that real estate normally commands. However, real estate investment rewards are available to investors who rethink and redefine real estate as an asset class, who are nimble and expand their investment considerations to include both other locales, even nationwide, as well as asset types that have their own inherent advantages.

Individual buyers of single-family houses for rental income aren't in the market for convenience stores. However, with rising interest rates and stable prices, yields in major metros will start falling. If that individual is truly a real estate investor and believes in the asset class, he/she must look outside of their local area. Most likely it won't be a property in the same town with a "FOR SALE" sign posted, but, with the advice of a broker from a national firm, or from real estate advisory/management firms, or from funds that invest in real estate as an alternative investment, a whole new world of potential and valuable opportunities are available for investment and profit.

When Iridium Capital decided to include a drugstore in our fund's portfolio, it made no sense to find the New York City-based Walgreen's and pay an escalated price when the cap rates nationally are much higher. Since our Fund invests in properties with triple-net leases only, and are unwilling to deal with any maintenance issues, we found our best value in Grove, Oklahoma. Among the many advantages we have is the tax advantage inherent in many Oklahoma properties and being able to secure an off-market situationâ€”a rare commodity in our local metropolis.

Other opportunities abound now, including taking over notes on properties; buying properties in pre-development for a discounted sale price; looking at properties with long-term leases and long-time tenants in place with strong rent guarantees, either personal or corporate. Stepping out of the box and removing limiting blinders can open a whole new and fascinating investment world in the alternative investment arena that will continue to pay above-market premiums for the savvy investor.

Marilyn Kane is the president and Sean Shanahan is the CFO at
Iridium Capital, New York, N.Y.