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As markets remain uncertain, institutional investors are confident in real estate investments and turning to local private equity firms for maximum returns - by Joe Berko

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Institutional investors, such as insurance companies and pension funds, are weighing their options in the real estate market when making key decisions about allocating investments. In today's climate of uncertainty around economic recovery rates, inflation levels, and interest rates—real assets offer an attractive potential for these large portfolios to reduce risk while at the same time improving returns.

Despite economic concerns and a decline in investor sentiment, real estate assets have maintained their reputation as an inflation hedge. During the first three-quarters of 2022 investors raised $107 billion; while this represents the slowest fundraising pace since 2013 it is still higher than other alternative asset classes such as private equity. This was reflected by 173 institutional investors with a combined total investment value of over 1 trillion dollars from public and private pension plans, endowments, and foundations surveyed for insight into current trends in real estate investment activity.

As institutional investors are increasingly turning to private real estate investments as a means of portfolio diversification, the influx of capital has driven down yields by creating more competition for available deals. REITs now face pressure from Wall Street that motivates their pursuit of aggressive property bids; however, such endeavors often come with costly management-related requirements and overhead. However, unlike the average consumer, large pension funds rarely take a hands-on role when investing in the industry. Rather, investors choose from a menu of real estate investment vehicles, companies, and strategies available that allow them passive participation. Institutional investors are increasingly recognizing the importance of investing with local real estate private equity firms to achieve maximum returns on investments in institutional capital. By having active, hands-on management of their portfolio and broader diversification across a real estate allocation, institutional investors can maximize their commitments to lucrative projects while still managing risk.

Why Private Real Estate is a Good Choice

The case for investing in private real estate is strong as not only has it historically outperformed the S&P 500, but there are also fewer risks due to lower volatility and more control in your hands when partnering with a private equity firm and then taking on a greater active role in managing assets such as tenant leases, marketing strategies, and maintenance duties.

As a result of this dedicated supervision, returns from private real estate can range between 15% and 20%, three to five points above those earned in public markets. Unsurprisingly, private equity now constitutes over 25% of the average institutional investor's portfolio.

Current Investment Strategies

Looking ahead to 2023, investors are seeking risk-adjusted returns that favor opportunistic and value add strategies to hit their desired returns.

In addition, investors are on the hunt for distressed opportunities or special situations where they can capitalize on an opportunity, adds Connolly. “Right now we’re in the early stages of seeing these distressed opportunities, so investors are getting creative with opportunistic capital to deploy in these special situations,” she says.

Over the long term, real estate can be considered a hedge against inflation, since property values and rental income typically increase during periods of inflation. Multi-family assets are a particularly useful inflation hedge given shorter lease times, allowing management to adjust pricing more frequently.

Confidence In Private Equity

As markets remain uncertain, institutional investors are confident in real estate investments and turning to local private equity firms for maximum returns. Low-cost debt combined with rising rents has contributed to an attractive investment landscape, making it the prime option for pension funds and other large-scale capital holders seeking reliable profits.

By having active, hands-on management of their portfolio and broader diversification across a real estate allocation, institutional investors can maximize their commitments to lucrative projects while still managing risk. These partnerships can provide institutional investors with access to assets that they would not otherwise have access to due to their size and geographic limitations. With careful consideration put into the selection process, institutional investors can make sure they receive a solid return from the project, build strong relationships with their local partners and reduce the volatility of their overall portfolio by spreading out investments into different asset classes.

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