

## The Private Investment Pool

Commercial real estate pros help today's investors dive into this growing market.

By Gretchen Pienta

Last year, national and local private investors purchased more than \$60 billion of commercial real estate through November, accounting for more than half of all commercial real estate investment, according to Real Capital Analytics. This makes working with private investors a lucrative choice for commercial real estate professionals.

Private investment in commercial real estate is not a new phenomenon, but the number of first-time investors and the amount of capital they bring to the market are increasing dramatically. Why? Recent economic conditions have made real estate an attractive investment.

"Following the collapse of the stock market in the recent past, [private investors] are looking at real estate as a safe-harbor investment," says H. Dean Weitenhagen, CCIM, of Grubb & Ellis Mid-America Pacific in West Des Moines, Iowa. "Some who had real estate in their investment portfolio in the past were reawakened to its benefits after the market debacle."

Wariness about the stock market isn't the only lure. "The low interest rate environment has brought real estate to the attention of more private investors," says Todd A. Kamps, CCIM, vice president of brokerage at Colburn Hundley in Grand Rapids, Mich.

Not surprisingly, a majority of today's private investors are new to the industry. "Private investment used to be owner/operators or industry money, but now it's not necessarily those with real estate backgrounds sponsoring investments," says Tim Strange, CCIM, SIOR, a senior adviser with Sperry Van Ness in Oklahoma City .

Jeffrey Ackerman, CCIM, SIOR, executive vice president of CB Richard Ellis in Pittsburgh, agrees. "What is unique about private investors is that they are not necessarily in real estate full time and, in many instances, have day jobs that are totally unrelated to real estate," he says.

With so many private investors crowding the market, gaining them as clients seems like it should be easy. But, as with other commercial real estate transactions, brokers should do their homework before wading into this sector. Successfully working with private investors requires knowing who they are, what they want, and how to overcome their unique challenges.

### The Economy Enigma

Relatively cheap loans continue to attract private investors to commercial real estate assets, but what will happen if interest rates rise or the economy improves?

Although such scenarios may tempt investors to put money back into the stock market, few commercial real estate professionals predict this happening to any great extent. "In the short term, higher interest rates may slow the flow of capital into real estate, but long term they should not have any major impact since real estate has performed well over the long term. In fact, for private investors, real estate has become the mainstream asset class in their portfolios compared to stocks and bonds," Ackerman says.

Brokers cite other ways, both positive and negative, that changing economic conditions might affect the private real estate investment market.

On the positive side, an improving economy may draw institutions back to primary cities, leaving more properties for private investors in secondary markets, says Jonathan M. Hardy, CCIM, a vice president at Coldwell Banker Commercial in Indianapolis . Institutions currently are diversifying into strong secondary markets such as his, "running up pricing and thereby eroding returns that private investors would receive

if they paid the same price," he says.

In addition, rising interest rates will bring the price/value balance back to equilibrium. Due to inexpensive loans and scarce quality investment properties, many investors are overpaying for buildings. Higher interest rates should correct this problem. However, this benefit has a downside. "On the one hand, investors will be happy that prices will come down as a result of higher interest rates. But on the other hand, people who purchased real estate one or two years ago with a low interest rate locked for one to three years will find that their returns have eroded, and perhaps some may be upside down," says A. Nicholas Coppola, CCIM, president of Coppola Properties in Needham, Mass. Investors with balloon payments or variable-rate loans are most at risk of losing money.

Yet measures can be taken to combat potential loan problems. For instance, Coppola insists that his clients secure long-term financing with a 10-year fixed note at a minimum. "Most of my investors understand that with interest rates at or near historic lows there is only one direction they will go from here. Better to be locked in for a longer period than to be faced with a rate increase after three or five years and risk losing precious cash flow to a higher debt payment," he says.

To prevent future mortgage defaults, some Southern California lenders are requiring high debt coverage ratios. As a result, investors are required to make down payments in the 35 percent to 45 percent range, says Robert V. Vallera, CCIM, a senior vice president with GVA IPC Commercial in La Jolla, Calif. "This should provide some margin of protection against widespread mortgage defaults if interest rates rise a few hundred basis points," he says.

An improving economy benefits multifamily property owners in a unique way: Rising rates may halt the home-buying surge, says Jackson Cooper, CCIM, a Sperry Van Ness adviser in Boise, Idaho. Thus, multifamily occupancy rates will rise, allowing owners to increase rents.

## Today's Private Investors

The number of private investors continues to increase as stock market instability persists and more people become familiar with real estate as an investment. "Investors desire to create stability in cash flow both long term and short term, so they are dumping their money in real estate," Cooper says.

Today's typical private investors fall into two categories: experienced real estate investors and young investors entering the market for the first time. Veteran investors have learned from past experiences in volatile real estate markets and are savvier and more informed than they've ever been. Many have been successful and are pumping even more money into their real estate investment portfolios. "Private investors have become less risk averse and have actually become less leveraged because they have built up so much equity in their portfolios," Ackerman says.

For example, San Diego County, Calif., apartment values have tripled during the past eight years, "which means that a 25 percent down payment in 1996 has appreciated 12 times in value, not even considering the cash flow," Vallera says. "My clients used to scramble to put together down payments of a few hundred thousand dollars. Now some of them are writing earnest money checks of that size."

On the other side, novice investors also are flooding the market. Raised in the Internet era, these first-time real estate investors are tech savvy, willing to diversify beyond their markets, and aggressive in pricing. "These new investors present a challenge for the seasoned private investors," Coppola says.

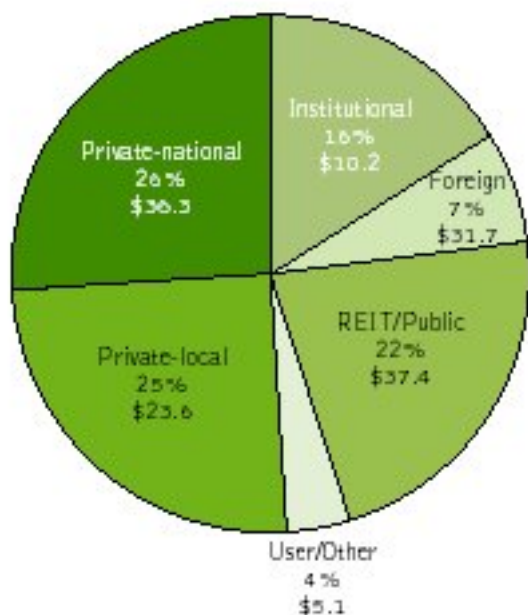
Most of today's private investors form small syndicates (typically limited liability companies to avoid personal liability in the event of a lawsuit) to purchase real estate properties. Family trusts are another large percentage of the private real estate investment market. "The accumulation of wealth has increased dramatically and is filtering into the private sector," says Daniel S. Martin, CCIM, CPM, a senior investment adviser with Sperry Van Ness in Arlington Heights, Ill., who is seeing more clients invest inheritance money in real estate.

Retirement plans are a relatively new source of investment capital. People who previously invested in

securities now are looking at real estate, says William Hugron, CCIM, managing director of the Charles Dunn Co. in Huntington Beach, Calif. "Many people are taking their [investment retirement accounts] and putting the capital into self directed companies and investing in real estate. This will be a great source of business for the real estate broker," he says.

## 2004 Investor Composition

Includes all commercial property types  
Total investment listed in billions



## What Do They Want?

Investors' portfolio size, their familiarity with real estate investment, and their investment goals determine what property types they seek.

Most private investors are not looking for fast cash; they prefer investments offering long-term, stable cash flow and equity. "One factor that distinguishes private investors from institutional investors is that private investors are investing their own money where every dollar in increased sale price actually goes into their own pocket. For this reason two motivations emerge: maximizing the price and protecting their investment," Ackerman says. "Many of them are looking to build an investment portfolio for their retirement."

Multifamily buildings are many private investors' first choice because of the comfort factor: Most people have rented an apartment at some time in their lives, so they are familiar with the property type, Martin explains.

Single-tenant, triple-net retail is another top pick. With such properties, private investors prefer trophy tenants, not trophy buildings. However, "Reliance upon a single tenant contains an element of risk that can be balanced within a sizable portfolio," Vallera says. "Few young investors have large enough portfolios to balance this risk or accept the lower capitalization rates normally associated with single-tenant triple-net or trophy properties."

Yet multitenant triple-net properties require little, if any, hands-on management, which many private investors prefer. "The less that someone has been involved in real estate before the more likely they will want an easy-to-manage, triple-net-type property," says Karl N. Innanen, CCIM, a vice president with Colliers International in Kitchener, Ontario.

This desire for less management is prompting many older investors to trade their multifamily buildings for triple-net retail or office, "which, depending on where you buy, can generate good cash flow without the significant management issues of owning apartment properties," says David J. Burma, CCIM, vice president of BT Commercial Real Estate NAI in Napa, Calif.

Across the country, commercial real estate professionals are experiencing little demand for rehabilitation deals because most private investors don't have the experience to undertake such projects. The one exception is properties that are extremely undervalued and can be flipped quickly. "Investors in the wealth-building phase of their careers are frequently more apt to pursue value-added investments such as rehabs or otherwise underperforming properties," Vallera says.

**2004 Investment by Property Type**  
As a percentage of total property investors

PROPERTY TYPE	PRIVATE-LOCAL	PRIVATE-NATIONAL
<b>Multifamily</b>		
Garden	41.6%	28.0%
Mid/High-rise	37.0%	35.7%
<b>Industrial</b>		
Flex	36.4%	25.3%
Warehouse	26.3%	18.7%
<b>Office</b>		
CBD	18.5%	31.0%
Suburban	21.6%	23.0%
<b>Retail</b>		
Mall/Other	21.3%	21.3%
Strip	28.8%	23.3%

Source: Real Capital Analytics

## Overcoming the Challenges

Private investment brokerage can be lucrative: Clients are plentiful, money still is relatively cheap, and the Internet allows brokers to cast a wide net. However, these advantages also present several challenges.

**Little Available Product.** The No. 1 problem is finding quality, well-priced product, investment pros say. "More people are hearing that their uncle or friend or neighbor has made a score buying real estate [so] they are jumping into the real estate arena," Coppola says. "These new investors are making it difficult for senior or more sophisticated individual investors to locate deals because they are not willing to take the risks or overpay just to compete with novice investors."

Lack of available land for new construction also contributes to this problem in some regions. For instance, Curtis A. Skomp, CCIM, a broker with Coldwell Banker Schmitt Real Estate in Key West, Fla., experiences this conundrum on a daily basis. "We are totally built out on our four-by-two-mile island," he says.

To find properties for clients, brokers should stay in touch with all owners, especially those who currently aren't interested in selling, rather than only focusing on for-sale properties. Innanen lives by the 80/20 rule: Of 100 probable properties, 20 are listed, "and those are the ones that are being fought over by the buyers, while the other 80 may be ripe for the picking. So I have tended to concentrate on the unlisted

properties," he says.

It helps to develop a regular prospecting model, Cooper says. "Contact owners on a consistent basis to keep in their faces when they do decide to sell," he advises. Skomp maintains relationships with the owners of prime commercial real estate in the Florida Keys; he then tries to match qualified buyers with available properties, whether for sale or not.

Also, don't forget the basics: cold-calling current property owners, networking, holding seminars, and maintaining relationships with related- industry professionals. "If you wait on good triple-net properties to show up on your doorstep, you'll be waiting a long time with resulting empty pockets," Weitenhagen says.

**Unrealistic Expectations.** Investors with unrealistic expectations are another hurdle. For example, in California Buurma has encountered many investors who want to sink earnings from their businesses into real estate "without a thorough understanding of what drives a specific market and/or product type," he says.

Qualifying investors up front is one way to combat this problem. Determine their motivations and make sure they are capable of real estate investment. Buurma won't work with clients until he has established three things: The investor is well qualified, is willing to be educated about the market and property types, and is willing to act quickly when presented with a property that meets the agreed-upon criteria. If investors don't act on your recommendations, they should drop in priority, and you should offer more-active and realistic buyers the best properties first, Innanen says.

If a prospective client refuses to be swayed from his unrealistic expectations, the best bet is to walk away, even if it means losing a potential commission. "If they're not willing to accept reality, cut them loose and save yourself a lot of grief," Weitenhagen says.

**Competing With the Internet.** Although it allows you to market your properties and services to a large audience, the Internet also competes for your business: Why should investors consult you when they can find property and market information free online?

Private real estate investment used to be a local and relationship-driven business. However, "the conventional barriers that prevented information sharing are gone, and investors can find opportunities by sitting at their computers rather than driving around their local market looking for properties to purchase," Ackerman says.

Yet this can be a bonus: "Most sales to private investors are not currently clients of our firm and are spur-of-the-moment buyers," Ackerman says. "We are finding that approximately 30 percent of our sales of investment property are to private investors from the West Coast, which was almost unheard of 10 years ago."

Also, the Internet can't compete with a broker's expertise. Brokers offer valuable insight and can add context to the numbers presented on Web sites. They can "truly balance the risk/price with the individual investor's modus operandi," Weitenhagen says. Ackerman agrees: "A professional CCIM can provide private investors much-needed underwriting expertise and local market intelligence that is not available on the Internet."

## Looking Ahead

Most investment brokers agree on the continued strength of the private investment market. "People are having good experiences," Strange says.

Real estate's tangibility is an important aspect of its attraction. "Investors who don't like the low returns of bonds or the volatility of the stock market or lack confidence in Wall Street can buy real estate, which they can touch and feel as well as effect change to add value," Innanen says.

However, as always the economy is the wild card. Although investment brokers don't expect rising rates to negatively affect private real estate investment, a changing economy could have repercussions. "The big unknown that is lurking in the shadows of our current economy is that so many investors have been willing to pay a premium for properties over the past several years because financing has been so available and rates so low," Buurma says. "With so many people purchasing highly leveraged investments with low variable rate loans, it remains to be seen what impact higher interest rates will have on the financial viability of these properties. It could get interesting."

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More-experienced investors find triple-net retail and restaurant product fits their criteria for a stable return and few management responsibilities.

*photo: Dunkin' Brands*

## What Private Investors Want in ...

... California : "Apartment properties, since housing is so costly."

— David J. Buurma, CCIM

... Key West , Fla. : "Motels, bed and breakfasts, strip centers, apartment buildings, and condominium redevelopment opportunities."

— Curtis A. Skomp, CCIM

... Ontario : "Multifamily followed closely by industrial properties."

— Karl N. Innanen, CCIM

... Indianapolis : "Low management, mid-level returns in office, retail, and a little industrial."

— Jonathan M. Hardy, CCIM

... Cleveland : "Net-leased deals, multifamily, and shopping centers."

— Vicki Maeder, CCIM

... Boston : "Retail, either store blocks, community shopping centers, mixed-use, or single-tenant, triple-net deals [that are] retail or medical oriented."

— A. Nicholas Coppola, CCIM

... Pittsburgh : "Multifamily, retail, and office."

— Jeffrey Ackerman, CCIM

## Testing the Water

Although their numbers are rising, private investors can be hard to find. Experienced investment brokers

offer the following tips for getting your feet wet.

**Build Trust.** “The best way to have a successful career in investment real estate brokerage is to build trusted and lasting relationships with the key decision makers,” says Robert V. Vallera, CCIM, a senior vice president with GVA IPC Commercial in La Jolla , Calif.

Understanding clients' needs and wants is one way to do this. Robert A. Liebeck, CCIM, a broker with MJ Peterson Commercial in Buffalo , N.Y. , always conducts face-to-face interviews with clients before working with them. The personal experience he has had owning real estate helps him connect and relate to their concerns, he says.

**Offer Integrity.** Don't allow clients to make bad investments just to make a commission. Position yourself as a consultant, not an advocate for a sale, says Tim Strange, CCIM, SIOR, a senior adviser with Sperry Van Ness in Oklahoma City .

“Strong relationships are built by applying superior market and product knowledge with integrity, consistently representing your client's best interest,” Vallera says. “Many of my clients have seen me dissuade them from pursuing marginal acquisitions or ill-timed property sales, costing myself commission dollars in the short run.”

Also, such relationships help build referral business. “The trust that my clients have in me is effectively transferred when an existing client raves about the caliber of representation that I provide,” Vallera says.

**Believe in the Deal.** If you have a successful track record, clients likely will respect your opinion. Therefore, only recommend investments that you would consider for your own portfolio. “You must strongly believe in the deal to convince investors,” Strange says. “Your credibility as an investor helps a lot.”

**Educate Novice Investors.** Investors tend to be very loyal, and one way to build long-term relationships is by sharing your expertise with first-time investors. “CCIMs are often the preferred service provider for private investors since they are searching for commercial brokers who can provide sound real estate advice,” says Jeffrey Ackerman, CCIM, SIOR, executive vice president of CB Richard Ellis in Pittsburgh . “I have found that private investors look for brokers with specialized training and who have a network to draw upon for expertise.”

**Stay Visible.** Being recognized as the real estate investment expert in your market is another way to keep clients coming through the door. “Word of mouth and your reputation are very important,” says Daniel S. Martin, CCIM, CPM, a senior investment adviser with Sperry Van Ness in Arlington Heights, Ill.

Marketing helps: “I dominate the commercial listing market and have a lot of signs on buildings,” says Curtis Skomp, CCIM, a broker with Coldwell Banker Schmitt Real Estate in Key West , Fla. “I also do extensive local advertising in the Key West paper.”

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