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REALPOINT INVESTMENT ADVISORS

Real estate & the family office

A primer for real estate investors

pmrealpointinvestment.com

A nighttime cityscape featuring tall skyscrapers and a multi-level highway. Long-exposure light trails from vehicles create vibrant streaks of red, white, and blue across the right side of the image. The scene is reflected on a wet pavement in the foreground.

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Real estate & the family office

Real estate is a complex and time-consuming asset class that requires constant attention to a wide variety of details and ever-changing variables. Positioning every square foot of your portfolio to meet its intended goal requires the expertise of a trusted and objective advisor.

The successful management of a family office investment portfolio requires a carefully guided strategy focused on asset diversification, risk mitigation, experience, and transparent oversight. Part of this strategy should include a thoughtful allocation to alternative asset classes that can serve to mitigate portfolio risk. Diversification allows the portfolio to thrive over a market cycle subject to varying macroeconomic conditions that may impact returns across various asset classes.

One strategy that many family offices have historically embraced is an allocation to tangible real estate assets, which should be differentiated from pooled fund investments and real estate securities such as REITs. This strategy involves the direct ownership and management of investment real estate, as opposed to simply purchasing shares of a third-party managed pool of assets traded on the public markets. The ownership of tangible real estate assets allows for greater control over investment performance and returns. This strategy also requires much more active oversight than investment in more passive asset classes. According to the 2019 FOX Investment Survey, the average family office allocates 14% of its assets to real estate — a meaningful number when one considers that the mean investable assets were reported to be \$586 million in the same study. Based on these figures, the average family office holds approximately \$82 million in real estate investments.

Active real estate portfolio oversight, or asset management, requires the attention of a dedicated team of real estate professionals who understand real estate dynamics, finance, capital markets, and market trends. Equally important, that team must be able to develop strategies to ensure that the real estate portfolio is aligned with the overall objectives of the family office investment portfolio. Key to the successful implementation of this strategy is strong collaboration with internal stakeholders and other third-party advisors to the family office.

The intent of this white paper is to discuss the role of tangible real estate in a family office investment portfolio and the processes for maximizing its value within the confines of the risk tolerance and overall investment strategy of the family office.

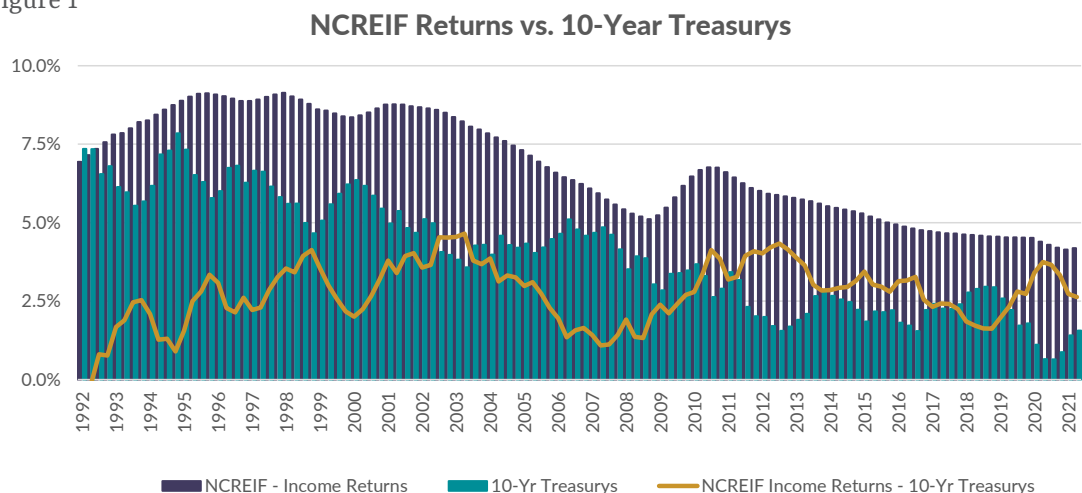
Real estate's role in the investment portfolio

While real estate is often considered an alternative asset class relative to stocks and bonds, many investors consistently recognize the importance of a real estate allocation strategy for the following key reasons:

- **Diversification:** Spreading investment risk across various asset classes softens the impact of market variations. Real estate, in particular, has shown an inverse relationship with major indices such as the S&P 500. [Learn more in this related article.](#)
- **Inflation hedge:** The ownership of real estate assets offers investors the opportunity to hedge against inflation. For example, in a deflationary environment, as bond yields are compressed, the cost of capital is also decreased, allowing for financial structuring to increase cash flow and returns on real estate assets. Conversely, during periods of inflation, investors are able to benefit from rental rate increases that may outpace the fixed cost of capital associated with debt on a property. [Learn more in this related article.](#)
- **Relatively low volatility:** Over time, real estate assets provide consistent returns with comparatively lower volatility than other asset classes.
- **Cash flow:** When managed effectively, real estate assets provide consistent and predictable cash flow based on known lease terms and rental rates. [Learn more in this related article.](#)
- **Control:** The ownership of real estate assets allows an investor a greater deal of control over investment performance and returns as compared to other asset classes.

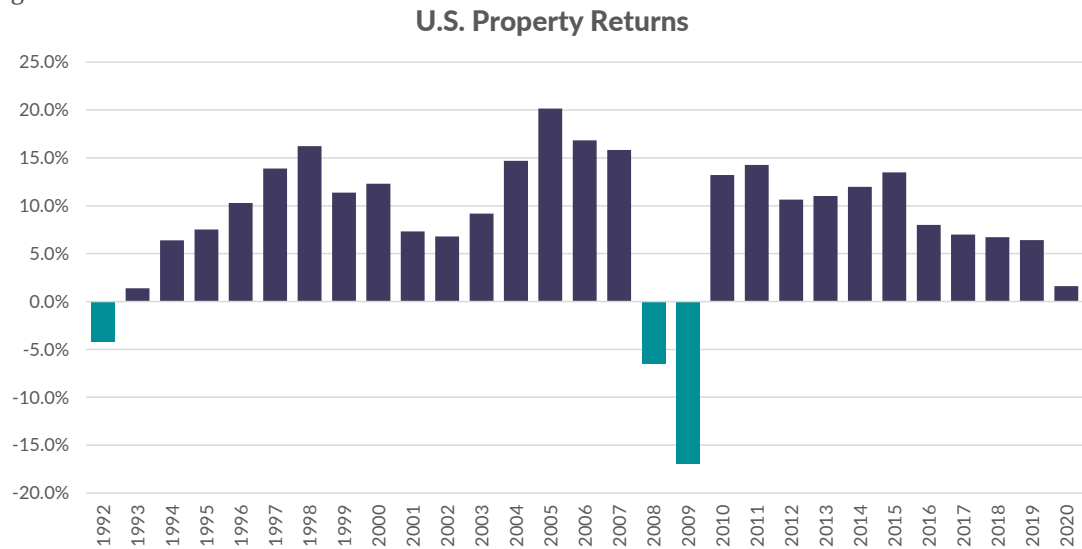
These factors are often embraced by sophisticated family offices through the inclusion of real estate within an investment portfolio. The diversification of risk and ability for greater control are further demonstrated by the data in Figures 1 and 2, which depict the relationship between NCREIF (National Council of Real Estate Investment Fiduciaries) income returns and 10-year Treasuries, as well as historic U.S. property returns.

Figure 1



Source: NCREIF, Federal Reserve, Thomson/Reuters Datastream. NCREIF returns annualized. 10-year Treasuries quarterly rates are based on 3-month averages.

Figure 2



Source: NCREIF; reflects the Q4 annual returns data.

Generally, real estate investment returns show an inverse relationship with variable-income securities; this allows investors to hedge against market fluctuations and mitigate risk in the portfolio. Additionally, real estate historically outperforms other investment asset classes, largely due to its management-intensive nature and upside potential.

Historically, a diversified investment strategy that includes real estate and other alternative asset classes has been associated with larger institutional portfolios such as pension funds and life insurance companies. However, as the trend toward the “institutionalization” of the family office continues, more and more families have been embracing this strategy as well.

Doug Coursen, a principal with Plante Moran Wealth Management, who serves on the firm’s internal Alternative Investments Committee, notes, “Real estate exposure across client portfolios is vastly differentiated, but the rationale for allocations tends to be more congruent: diversification from traditional public market securities and reliable streams of income for the portfolio. With this in mind, the breakout of COVID-19 in early 2020, and the rapid shift to a digital workplace, laid bare some of the risks that real estate investors previously may not have given enough forethought to, such as liquidity provisions and concentration of property types or geographic footprint. With interest rates still near historical lows, and the prospects of inflation and rising rates lurking, real estate may be an opportunistic investment; however, investors can and should evaluate their overall allocations to the space, giving full consideration to the risk/return trade-offs of the asset class.”

While the direct ownership of investment real estate offers investors tremendous opportunity, it is imperative to develop, maintain, and monitor a clearly defined investment strategy. The oversight of the process is commonly referred to as “asset management,” and involves both development of a high-level strategy and day-to-day oversight of the real estate investment portfolio and its individual properties.

About real estate asset management

At its core, asset management is about understanding and making decisions attendant to the investment life cycle of an asset or a portfolio of properties. Initially, this involves the development of a real estate investment strategy. Is the investor seeking larger returns with corresponding higher risk and management time? Is the investor simply seeking to diversify a portfolio of securities to include net-leased assets with moderate returns but lower overall investment risk? Does the investor wish to employ a mixture of investment strategies to spread risk? Asset management is also about acquiring assets to meet the desired criteria and reviewing existing real estate assets to align the type of assets and their investment performance with the investor's stated objectives.

Another key component of the asset management process is aimed at determining when to sell, renovate, reposition, or recapitalize assets. Asset managers take responsibility for advising on metrics such as long-term value and ongoing bottom-line performance in an investor's real estate portfolio. In this capacity, asset managers may be charged with supervising activities of consultants, brokers, and management firms to investigate, analyze, and implement the repositioning or selling of assets, or classes of assets, as well as overseeing property managers for each client's properties. Asset managers also focus on the capital risk of the investor's entire

real estate portfolio in an effort to obtain the highest possible return on long-term real estate investments.

The asset management of a family office real estate portfolio may be handled by internal resources or outsourced to a third-party real estate investment advisor. Regardless of the chosen strategy, it is crucial to utilize an asset manager that has a commitment to clients extending beyond a written fiduciary obligation. That means a commitment to leveraging all resources and knowledge within each asset class to seek the highest possible return on investment of each real estate asset. In addition to being able to manage a quality building in a good market, an asset manager must have in-depth knowledge of operations and relevant market forces in order to position the asset to reach its maximum potential.

"What is the difference between an asset manager and a property manager?"

Asset Manager	Property Manager
<ul style="list-style-type: none">• Create & manage asset-level business plans• Assess financial health of the asset• Maximize yields & cash flow of the investment	<ul style="list-style-type: none">• Manage daily operations & tenant interaction• Maintain the building & site• Ensure smooth operation of the business

Real estate asset managers play an important role for real estate investors, one that is sometimes confused with the role of a property manager. A property manager handles the tenant interactions, daily operations, and maintenance of a real estate asset. Property managers there to run the shop, with the goal of keeping business operations running smoothly.

An asset manager, in contrast, manages the activities necessary to improve the residual value or capital appreciation on the asset and maximize the cash flow it generates. In order to maximize yields and cash flow at the individual asset level, asset managers tailor solutions based on the specific dynamics and driving forces impacting each property.



LEARN MORE

The asset management process

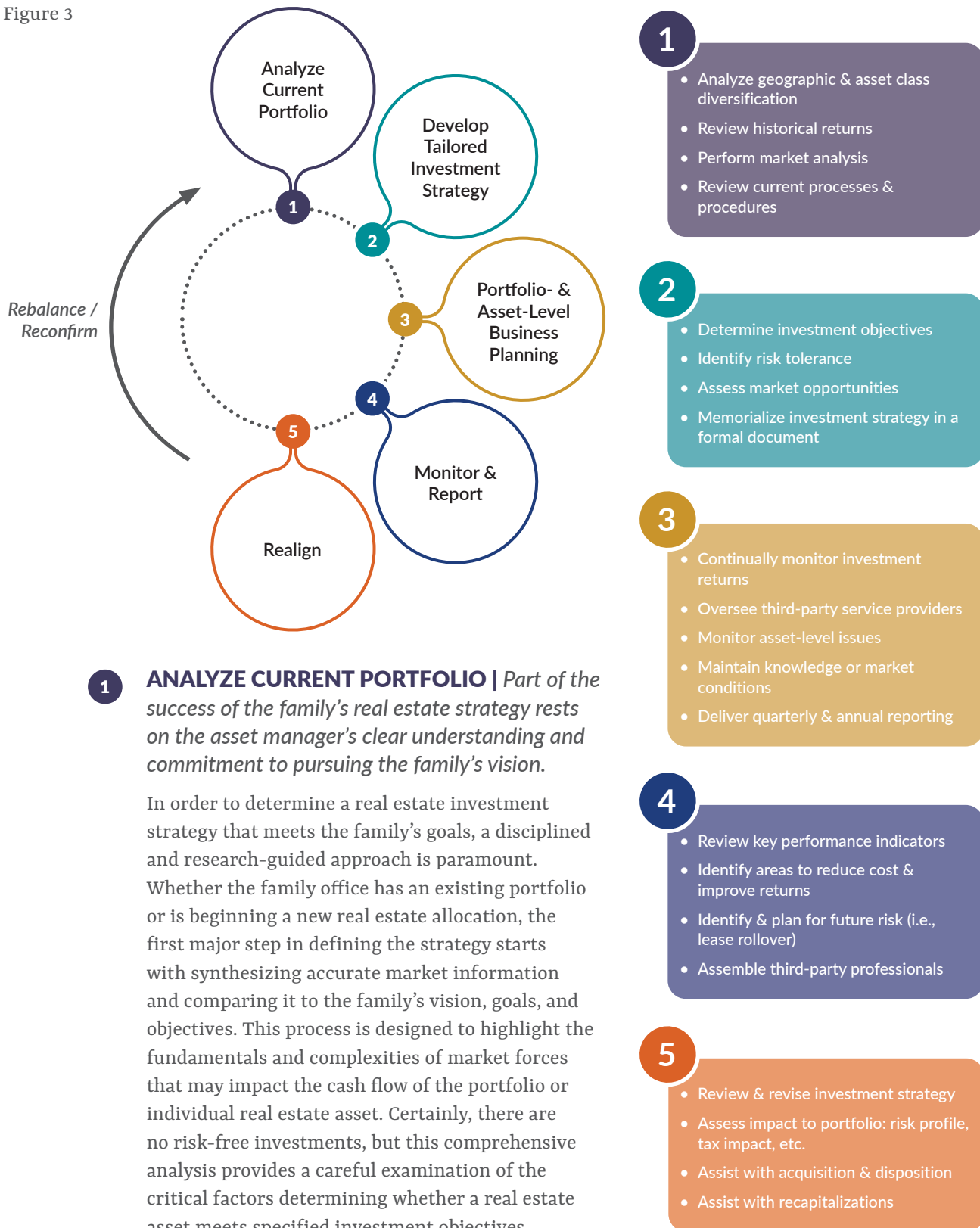
The implementation of the family office real estate investment plan by the asset manager should be guided by a plan that is transparent and clearly defined.

The process, in essence, begins with an analysis of the current real estate portfolio, if it already exists, and a comparison of the makeup and performance of the portfolio against the stated investment objectives of the family office. For example, if the family office desires to achieve greater returns and is willing to accept the corresponding risk, a portfolio of net-leased retail assets with long-term leases to credit tenants is not likely to achieve this objective. It is also important to conduct a review of existing assets, their current and future positions in the marketplace, and the overall diversification of the assets from a geographic- and asset-class perspective. A portfolio that is overly concentrated in one type of real estate asset or geography may benefit from a repositioning effort to diversity the portfolio and mitigate risk. **Learn more in this related article.**

Once the portfolio has been analyzed and a strategy defined, a detailed business plan must be developed for each specific asset. For example, an office building whose largest tenant has a lease expiration within three years may be able to be refinanced at a lower interest rate if the lease is extended. While this lease extension may require a reduction in rental rate, a thoughtful cost/benefit analysis should be conducted to determine if the cash flow derived through reduced debt service over time is greater than what is given up in an initially lower rental rate. Concurrently, a plan should be developed for a scenario whereby the anchor tenant does not renew. The asset manager should have a detailed understanding of other potential tenants in the marketplace, the likely time frame and cost associated with releasing the space, and the impact to cash flow and sustainability of the building during the vacancy period.

On an ongoing basis, the overall strategy and status of the asset-level business plans should be reported on by the asset manager at least quarterly. This promotes transparency and allows the family office to maintain an ongoing understanding of each asset's performance and issues relative to the real estate portfolio. The overall investment strategy should be revisited annually and memorialized in an annual portfolio strategy and performance report. As part of this process, the strategy and individual assets may need to be realigned periodically. This process is described in the following pages and illustrated by Figure 3.

Figure 3



1 ANALYZE CURRENT PORTFOLIO | *Part of the success of the family's real estate strategy rests on the asset manager's clear understanding and commitment to pursuing the family's vision.*

In order to determine a real estate investment strategy that meets the family's goals, a disciplined and research-guided approach is paramount. Whether the family office has an existing portfolio or is beginning a new real estate allocation, the first major step in defining the strategy starts with synthesizing accurate market information and comparing it to the family's vision, goals, and objectives. This process is designed to highlight the fundamentals and complexities of market forces that may impact the cash flow of the portfolio or individual real estate asset. Certainly, there are no risk-free investments, but this comprehensive analysis provides a careful examination of the critical factors determining whether a real estate asset meets specified investment objectives.

2

DEVELOP TAILORED INVESTMENT STRATEGY | *The asset manager should provide a clear, thoughtful, and uncomplicated methodology for achieving the goals of the family office.*

Strategy is the asset manager's guide to achieving the family's real estate investment objectives. It captures the family's vision, highlights opportunities, and defines a clear beginning and end point. Though an opportunity to generate short-term returns through individual deals may exist from time to time, having a clear and robust strategy is designed to ensure investment decisions are made consistent with a long-term vision.

Understanding why a particular asset is aligned or misaligned with an investment strategy provides insight to alternative action plans that can mitigate risks. Within the urban framework of each metropolitan area, a series of economic, social, and political forces may influence the value of each building or parcel of land. With an emphasis on mitigating risks and meeting objectives unique to a family office real estate investment strategy, the asset manager translates these forces into risk factors that inherently influence how to properly structure agile portfolio- and property-level business plans that:

- Preserve capital
- Build in flexibility
- Facilitate estate planning and succession objectives
- Optimize tax structures
- Maintain transparency in decision-making
- Establish key benchmarks
- Enable “what-if” scenarios
- Define the opportunity
- Provide a context for strategic and tactical decisions

3

PORTFOLIO & ASSET LEVEL BUSINESS PLANNING | *Once a strategy has been established, the family office must prepare a detailed plan at both the portfolio and asset levels.*

At the portfolio level, a “business plan” includes determining what asset classes and geographical areas are likely to help achieve the goals, taking into account real estate market trends and macroeconomic factors. This may result in a determination that some current assets should be sold or recapitalized and will drive decisions relative to acquisitions and the management strategy for the portfolio.

As important as an overall portfolio strategy is, a plan for each specific asset in the portfolio is also necessary. This involves planning for impending capital expenditures, lease expirations, or debt maturities; understanding the dynamics of the local real estate market and aligning the property with those dynamics; and preparing financial forecast reports to project future returns and plan “what-if” scenarios. This proactive approach helps the family office address inevitable property-level issues well in advance of them becoming concerns.

4

MONITOR & REPORT | *Consistent and transparent reporting promotes alignment with all stakeholders and creates accountability for the portfolio's performance.*

Detailed reports on the real estate investment portfolio should be prepared on a quarterly basis and presented to key stakeholders for review and discussion. These reports should include a snapshot of aggregate financial performance of both the overall portfolio and each individual property. Good quarterly reports should also highlight important market information and property-level issues such as lease expirations, loan maturities, or necessary maintenance.

An annual report should summarize the prior year's quarterly reports. It should also contain a discussion of the strategy for the coming year based upon a thorough analysis of the real estate market and investment prospects by geography, asset class, and investment risk profile. Key to the development and implementation of this strategy is maintaining alignment with the stated objectives of the family office and realigning where necessary.

5

REALIGN | *Realigning and rebalancing the real estate portfolio to capitalize on ever-changing market dynamics is crucial to maximizing investment returns and mitigating risk.*

Changing market fundamentals, such as those caused by COVID-19 and other market upsets, have caused many portfolio strategies to deviate from their intended course. Now is the time to revisit those strategies for both short-term restructuring and long-term sustainability.

An asset decision matrix is one of the techniques that asset managers can use to evaluate existing portfolio strategies versus return-on-investment expectations, risk profile, and capital requirements. This decision-making process allows the asset manager to verify whether the strategy is supported by current data and improves the understanding of how the asset is contributing to the portfolio. It also allows for a holistic analysis of what has succeeded, what has not, and the reasons why.

An effective strategy requires a strong knowledge of the existing marketplace, as well as demographic, political, and corporate trends. There is no certainty of outcome, but proactive analysis and strategic planning catalyzes the vision into a sound strategy and provides the direction-setting framework for implementing a real estate investment plan. The decision-making process described in the preceding section is represented graphically in Figure 4.

Figure 4

	Portfolio Yield Benchmark	Strategic Business Plan	Value Proposition
Asset/Portfolio Constraints	OPERATING COSTS	PRO FORMA ANALYSIS	ASSET DIVERSIFICATION
Capital Resources	MID-STREAM FUNDING REQUIREMENTS	LOAN RESTRUCTURING	CASH FLOW GROWTH
Local Market Position	COMPETITIVE SUPPLY & MARKET SUPPORT	LEASING & MARKETING STRATEGY	TRANSACTION COSTS

Conclusions

Family offices continue to become more sophisticated and are trending toward a more institutionalized structure and operating governance. As part of this trend, many family offices are embracing a diversified investment strategy that includes real estate and other alternative assets in addition to more traditional asset classes such as fixed-income, equities, and other securities.

While this paper discusses the opportunities and benefits for family offices and other investors in real estate, the successful implementation of a real estate strategy within an investment portfolio benefits from specialized expertise, industry knowledge, and a disciplined process of managing real estate assets to achieve long-term goals. This requires a well-conceived strategy that is continually monitored, reported on, and realigned to realize the full investment potential of an actively managed real estate portfolio.

Investors whose core business is real estate typically possess internal resources to effectively develop, implement, and oversee this strategy. However, many family offices and other investors with broader portfolios lack some or all of these resources. Family offices with direct real estate investments benefit greatly by adding a professional real estate asset manager to the investment team, whether through internal hiring or by engaging an outside firm to ensure the proper execution of a real estate strategy that will allow them to enjoy the benefits of the asset class.

Opinions expressed in this paper are current as of the date of this article, and are subject to change at any time.

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About Plante Moran Real Estate Investment Advisors

Plante Moran Realpoint Investment Advisors (PMRIA) delivers the insights and experience needed to help private, family office, and institutional clients achieve their investment real estate objectives.

Through PMRIA and related affiliates, we have been involved in over \$1 billion worth of acquisitions, dispositions, and financing in more than 30 states. The team now has approximately \$1 billion in assets under advisement (as of Dec. 31, 2024), representing every asset type. Learn more at pmrealpointinvestment.com.

Our comprehensive asset management services

PORTFOLIO STRATEGY

- Define real estate objectives
- Assess risk tolerance
- Define geographic & asset class diversification
- Establish & track investment return hurdles
- Oversee periodic rebalancing

REAL ESTATE TRANSACTIONS

- Source acquisition opportunities
- Manage building disposition strategy
- Assist in deal structuring
- Debt procurement
- Conduct underwriting & due diligence

ASSET OVERSIGHT

- Establish business plan for property
- Strategize for recapitalization
- Oversee operations & third-party service providers
- Monitor KPIs vs. market
- Provide investment reporting
- Manage risk

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