



Commercial Real Estate Investment

This presentation explores the foundations of commercial real estate investment, examining its unique characteristics as an asset class and how it compares to other investment options.



What is Commercial Real Estate?

Definition

Land and all things permanently attached to it, including buildings and structures.

Property Rights

Rights to control, occupy, develop, improve, exploit, pledge, lease, and sell.

Investment Focus

Investable property with the purpose of creating cash flow, unlike owner-occupied housing.



Commercial Real Estate Market Size

\$18T

Market Value

Total value of investable commercial
real estate in the US (2020)

97B

Square Feet

Total amount of investable commercial
real estate space

33%

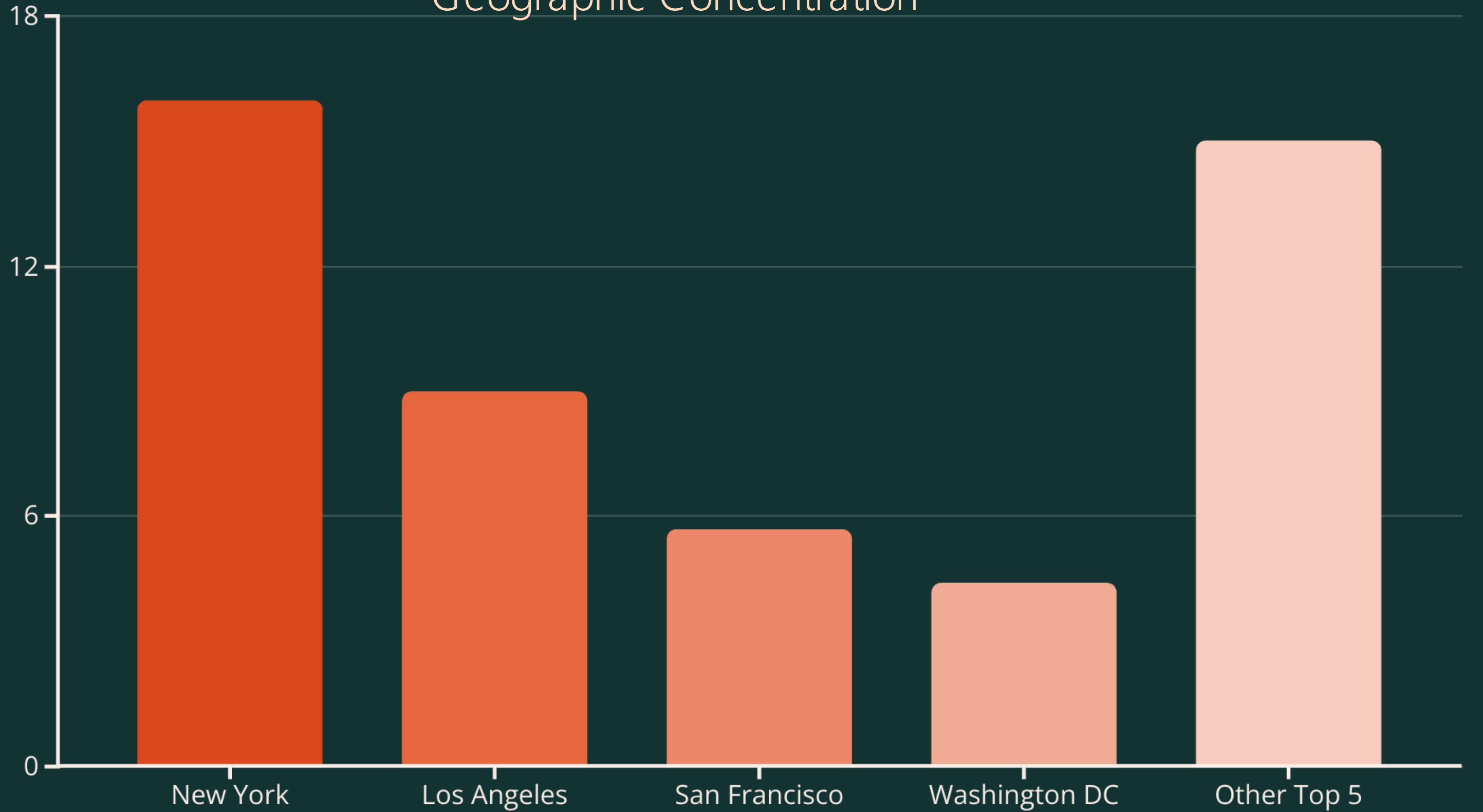
Asset Share

Combined real estate debt and equity
as percentage of all US assets

Major Property Types



Geographic Concentration



Why Invest in Real Estate?

Advantages

- Long-lived assets with perpetual land value
- Moderate returns with lower volatility than stocks
- Good inflation protection
- Portfolio diversification benefits
- Direct control over investment decisions

Challenges

- Low liquidity compared to stocks and bonds
- High transaction costs (2-10% of purchase price)
- Significant management burden
- Large capital requirements for direct investment
- Complex valuation due to heterogeneity

Investment Approaches



Direct Investment

Owning physical property directly, with full control but high management burden



Listed REITs

Publicly traded companies that own and operate income-producing real estate



Real Estate Debt

Investing in mortgages or mortgage-backed securities

Direct Property
Ownership

REIT Stock Trading
Documents



Direct Real Estate Investment

Full Control

Direct decision-making authority over property management, improvements, and tenant selection.

Management Burden

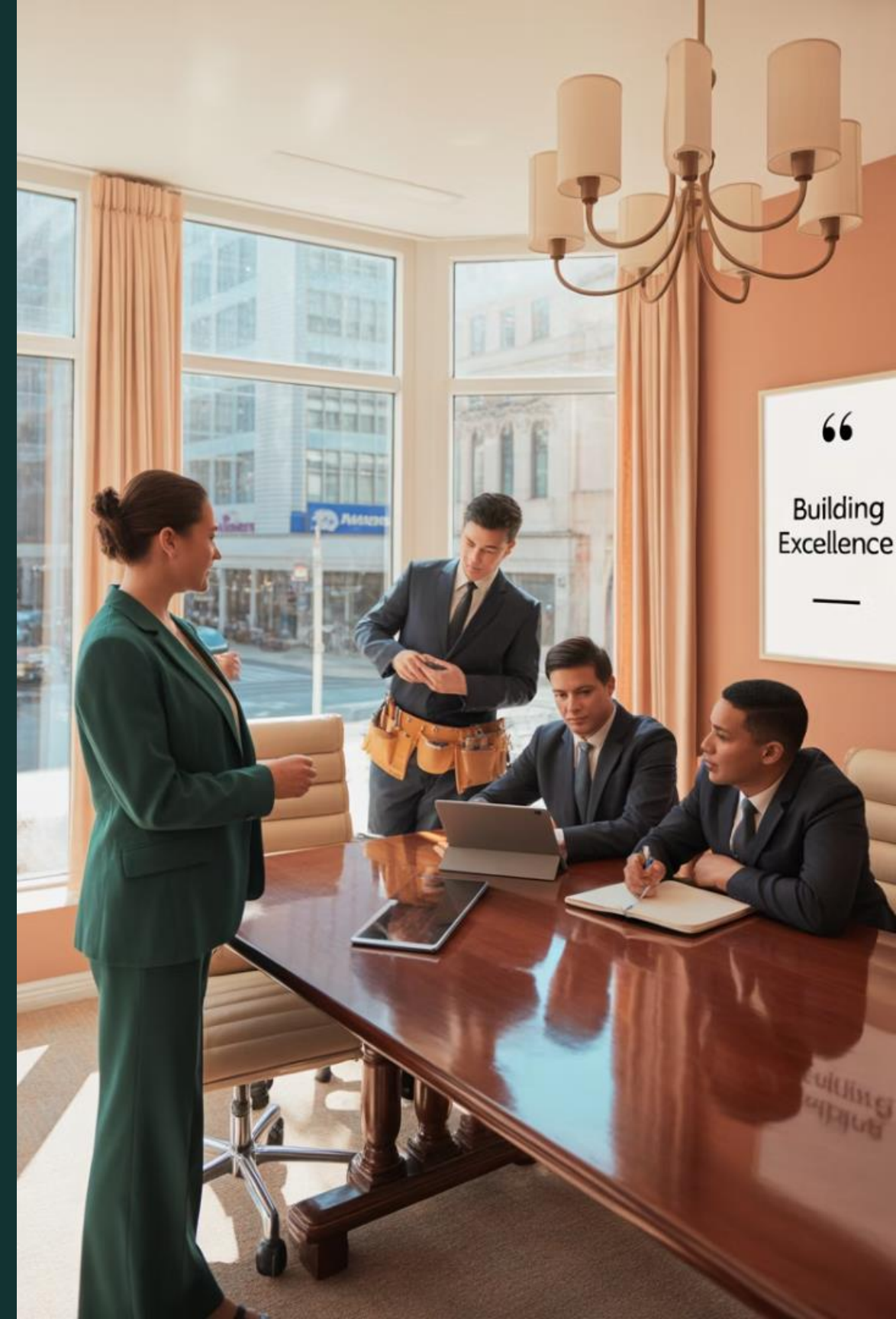
Responsibility for hiring brokers, making repairs, paying taxes, and maintaining the property.

Capital Intensive

Requires substantial financial resources, typically millions of dollars for commercial properties.

Low Liquidity

Average deal takes 8 months to complete, with properties selling only once every 5-10 years.



Real Estate Investment Trusts (REITs)



Public Trading

Listed on stock exchanges with high liquidity and ease of transaction



Market Size

Over \$1 trillion in real estate holdings in the US market



Volatility

More short-term price fluctuations than direct real estate



Accessibility

Available to small investors with minimal capital requirements



Real Estate Debt Investment



Mortgage-Backed Securities (MBS)

Primarily for multi-family rental apartment properties, often with government guarantees



Commercial Mortgage-Backed Securities (CMBS)

Securities based on non-residential properties without government guarantees



Bank Balance Sheet Loans

37% of all loan originations, with local banks playing a significant role

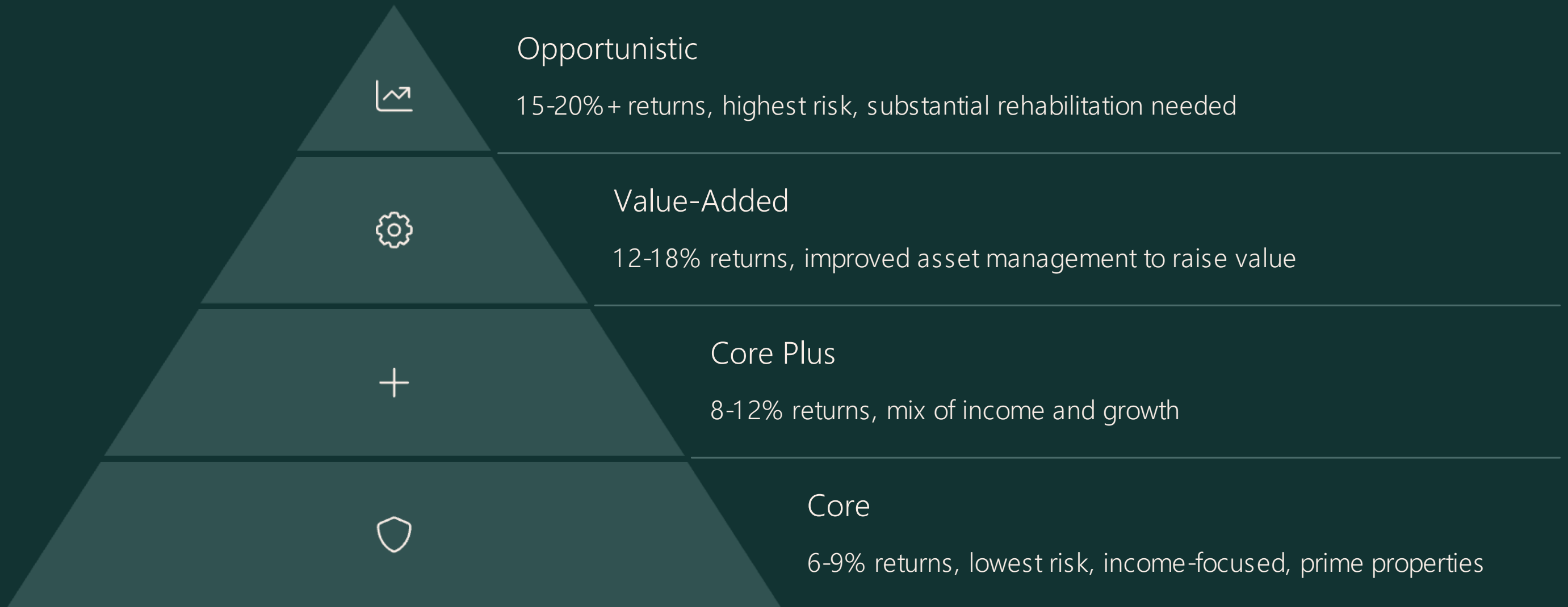


Mortgage REITs (mREITs)

Publicly traded companies that invest in real estate debt instead of equity



Investment Risk Categories

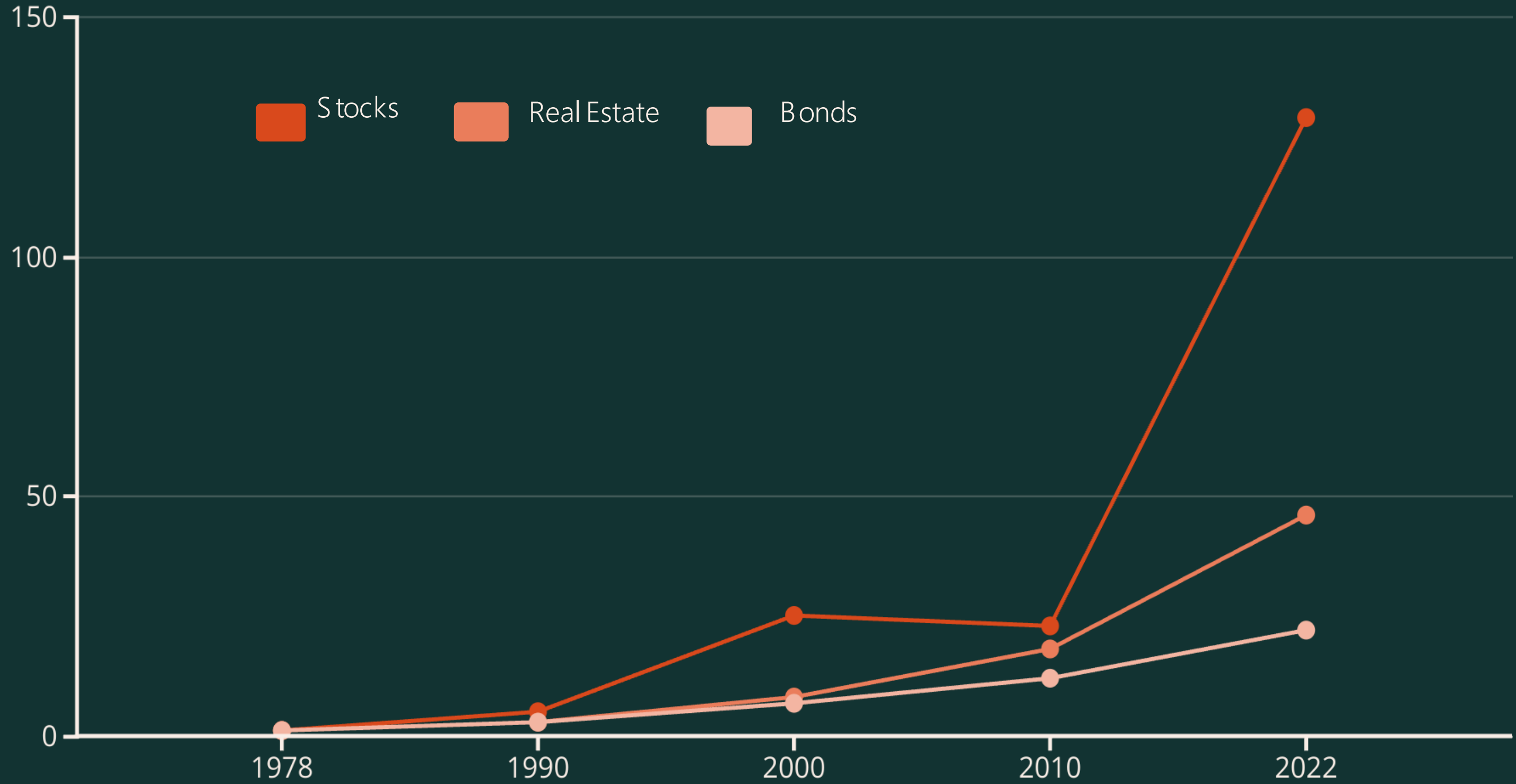


Major Investment Asset Classes

Asset Class	Return	Risk	Liquidity	Income
Stocks	High	High	High	Low
Real Estate	Moderate	Moderate	Low	Moderate
Long-Term Bonds	Moderate-Low	Moderate-Low	Moderate	High
Cash (T-bills)	Low	Low	High	None



Historical Cumulative Investment Performance



Performance Statistics (1978-2022)

13.02%

Stocks

Average annual return

9.32%

Real Estate

Average annual return

16.46%

Stocks

Standard deviation

6.99%

Real Estate

Standard deviation

7.30%

Bonds

Average annual return

3.16%

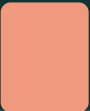
Bonds

Standard deviation

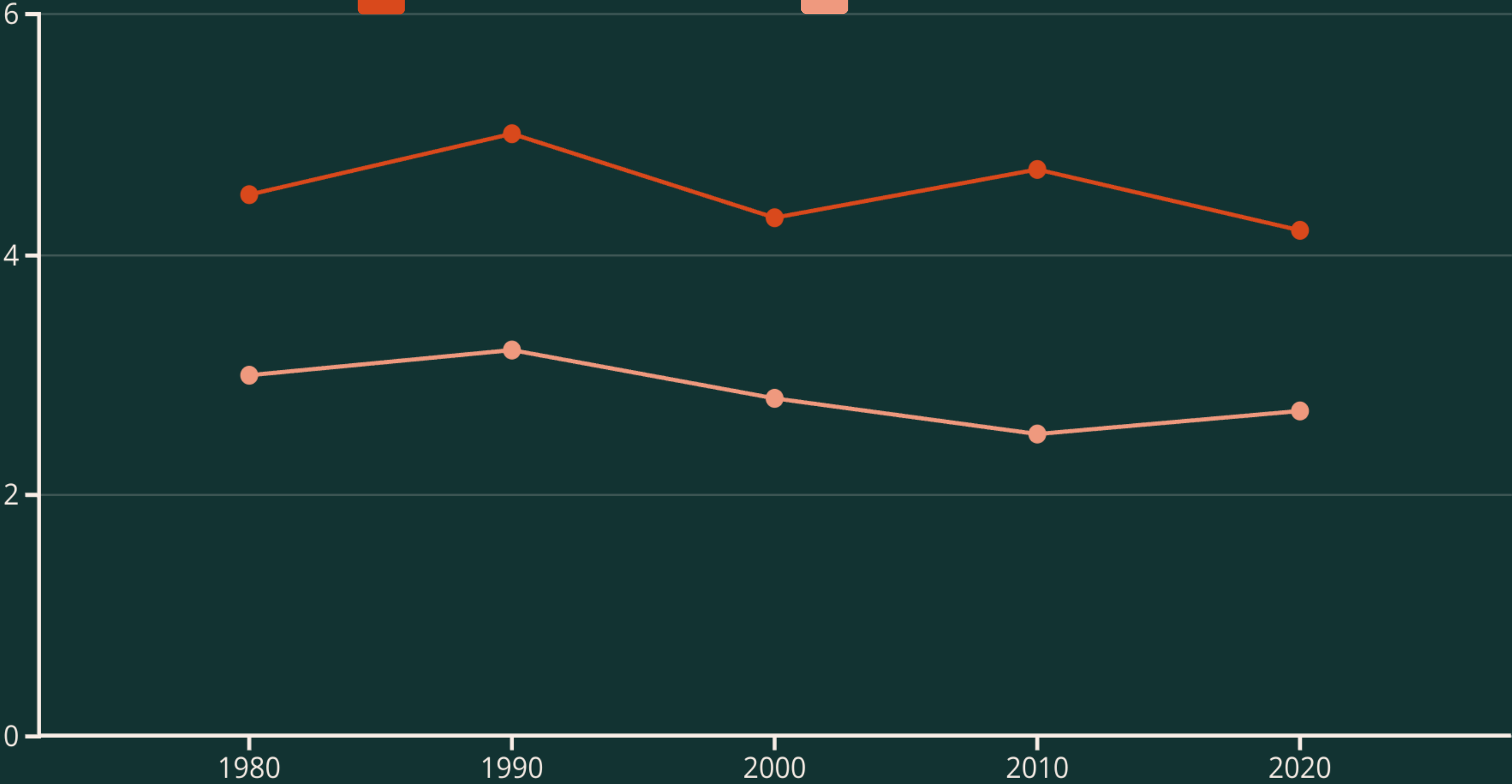
Average Income Yield % Comparison



Real Estate



Stocks



Real Estate Market Cycles

Recovery
Increasing occupancy, modest rent growth, limited new construction

Recession
High vacancy, declining rents, minimal new construction



Expansion
Low vacancy, strong rent growth, increasing new construction

Oversupply
Rising vacancy, slowing rent growth, excessive new construction

Historical Market Disruptions



1980s Building Boom

Tax incentives led to overbuilding, especially in office, retail, and hotels



1986 Tax Reform

Removed special tax incentives for real estate investment



Early 1990s Crash

Property values fell 30-50% in major markets



2007-2009 Financial Crisis

Commercial property prices dropped 35% from 2006 to 2009



COVID-19 Pandemic

Shifted demand patterns between property types and locations

Investor Objectives and Constraints



Growth Objective

Long-term horizon with no immediate need for cash. Typical of young to middle-aged individuals and growing pension funds.



Income Objective

Need for current cash flow. Typical of retired individuals and mature pension funds with more retirees than contributors.



Key Constraints

Risk tolerance, liquidity needs, time horizon, expertise level, and capital availability all influence investment decisions.



Investor Heterogeneity

Different Objectives

Investors have varying goals based on life stage, wealth level, and institutional requirements.

Varying Constraints

Risk tolerance, liquidity needs, and expertise levels differ significantly among investors.

Market Creation

This heterogeneity creates markets as different investors want to buy when others want to sell.

Product Development

Investment products are tailored to various objectives and constraints to serve diverse investor needs.

Key Takeaways



Unique Asset Class

Real estate offers distinct risk-return characteristics compared to stocks and bonds.

Historical Performance

Moderate returns with lower volatility than stocks and higher income yield.

Multiple Investment Approaches

Direct ownership, REITs, and debt instruments provide various entry points.

Market Cycles

Understanding historical patterns helps anticipate future opportunities and risks.