A Growing Appetite

Exclusive survey results predict rising commercial real estate allocations, with wealthy individuals investing in both public and private real estate vehicles.

By **Beth Mattson-Teig**

The global pandemic did not put a dent in the wealth held by global high-net-worth individuals (HNWIs) or their interest in commercial real estate investing.

The volume of wealth held by HNWIs surged by some 8 percent or $6.4 trillion worldwide last year, while the HNWI population expanded by 1.7 million new entrants–half of whom reside in North America, according to the *World Wealth Report 2022* published by Capgemini. The growing cohort of HNWIs and accredited investors represents an attractive source of capital for both public and private real estate investment firms raising capital across a variety of platforms, ranging from REITs and DSTs to private equity funds and syndications.

The latest iteration of *WMRE*'s High Net-Worth Investor Survey (this year, brought to you by AppFolio) polled both financial advisors and commercial real estate professionals to get their perspectives on HNWI and accredited investor strategies and trends related to CRE investing. Survey results con-

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tinue to show a steady trendline of expectations for increasing allocations to CRE, but also illustrate how perspectives differ between commercial real estate pros and wealth management professionals when it comes to gauging HNWI activity.

Across the board, real estate pros are more bullish on gauging demand from HNWIs and accredited investors for real etate investments. And their perceptions on what property types HNWIs prefer and what factors drive investment decisions differ from those of wealth advisors.

For example, 67 percent of CRE professionals believe HNWI allocations are rising and another 21 percent say allocations are holding steady. In comparison, only about half of financial advisors (47 percent) say allocations are going up, while 48 percent believe allocations are flat.

Wealth advisor respondents to the survey estimate the current real estate average allocation at 13.9 percent. However, client portfolio allocations vary widely from those that have no capital in real estate to those individuals who have concentrations in the asset class upwards of 40 percent. Overall, a majority of financial advisor respondents (65 percent) said that they have clients who have invested in real estate and another 14 percent said clients are interested in real estate but have not yet invested.

"I think the stock market has scared people enough where they are running more towards hard assets," says Toby Mathis, founding partner of Anderson Business Advisors, a consulting firm specializing in asset protection, tax and estate planning. A majority of the clients that Mathis works with are active real estate investors who tend to carry higher allocations to that asset class. In many cases, real estate represents half or more of an individual's total investment portfolio.

"Investors are continuing to increase allocations to real estate, because they believe in the long-term performance of their real assets and real estate portfolios," says Heather Fernstrom Border, co-founder and managing partner of Alliance Global Advisors, a consulting firm that serves real asset investment managers. According to Fernstrom Border, HNWI and family offices typically try to maintain between an 8 percent and 11 percent return for their real estate portfolios. "That investment group is also taking a strong look at their current portfolios to determine whether any rebalancing efforts need to occur prior to selecting any new managers or making new real estate allocations," she says.

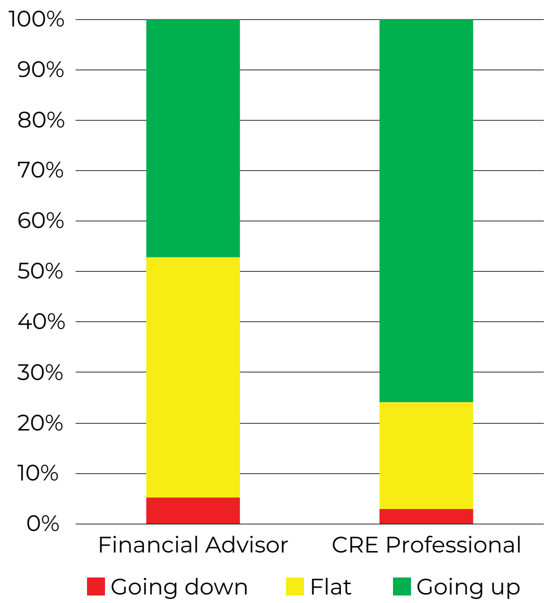
Preserving and building wealth

A variety of factors are fueling interest in commercial real estate investments. Diversification, a hedge against inflation and tax advantages are some of the top reasons financial advisor respondents cited for HNWI's interest in real estate. "Alternatives and CRE as non-correlated investments are a great portfolio compliment for growth and inflation hedge," wrote one respondent. However, advisors are also wary of the downside risks. "You have to understand the risks, liquidity and overall type of investment," noted another respondent.

Some real estate participants credit better access to different real estate investment vehicles as helping to expand interest and raise allocations. "The appetite was always there, but the hurdle was accessibility," says Ben Harris, senior vice president of investor relations for CRG, a Chicago-based national real estate investment and development firm. "For a very long time, and still in some corners of the market today, investment managers prefer to have institutional capital, but that narrative continues to change," says Harris. CRG currently works with about 500 private investors, both individually and through their investment advisors for the firm's private equity investment funds.

A Difference of Opinion

Are accredited investor allocations to CRE going up, down or flat?



Financial advisors and CRE professionals have different views on what factors are most important for accredited investors opting for real estate. Commercial real estate pros identified wealth preservation as the top factor (4.2 out of 5.0), followed by asset value growth (3.8). Wealth advisors, however, ranked tax considerations as the top factor (3.8), followed by portfolio diversification and asset value growth (both at 3.7).

However, the reality is that there is a fairly tight band in the rating of all of the different factors among both financial advisors and CRE pros. "I would say that it is absolutely all of the above, and then you have the J curve effect of their remaining portfolio," says Fernstrom Border.

The market cap on most real estate portfolios has increased over the past year due to increased returns for real estate, while the rest of the portfolio has decreased, which creates that J curve, she explains. "So, while investors have increased their target allocations to real estate, at times, they've got to a point where they can't put out additional capital, because the J curve on the portfolio is maxing out that target allocation without making new investments," she says.

Advisors see challenges & opportunities

The obvious opportunity in working with HNWI and accredited investors is access to fresh capital and new business. For example, financial advisors assist their clients in a variety of areas related to real estate opportunities, most notably portfolio advice (64 percent), market analysis/opportunities (44 percent) and networking with real estate professionals (37 percent). Respondents said that offering advice on CRE has helped their business in a variety of ways, the top responses cited being client satisfaction at 62 percent, growing AUM and client involvement each at 44 percent and client retention at 43 percent.

Some of the common challenges survey respondents reported in working with HNWIs and accredited investors is finding them, as well as managing smaller dollar amounts. It can also be more challenging to educate investors beyond the "flashy media stories" so they look more closely at market fundamentals and better understand what they're investing in, wrote one respondent. "These investors can be high maintenance for those that don't fully understand the investment process," said another. Additionally, some respondents see a significant challenge in finding opportunities to invest the abundance of capital coming from wealthy individuals and making sure return expectations are realistic.

"Overall, we're seeing that investors are optimistic and opportunistic about their real estate investments, and many do plan to increase their real estate holdings over the next few years," says Nat Kunes, senior vice president, AppFolio Investment Management. "At the same time, investors' expectations of their investment managers are rapidly changing and there is work to be done to meet these needs, particularly with younger investors entering the market," he says. Investors are more tech-savvy and eager for information than they have ever been, and there is great opportunity for investment managers to leverage technology to impress investors and exceed their expectations, he adds.

When financial advisors were asked what information would be helpful for them in growing the real estate side of their business and better serving clients, 61 percent said they wanted information on new deal opportunities, which was followed by local real estate connections and portfolio advice for investing in real estate, each at 46 percent. Additional write-in comments ran the gamut from a desire for more detailed, real-time information on market rents, cap rates and property performance to investment analysis and insight into how technology solutions such as AI can enhance deal flow. "I need to learn who is launching projects in various geographic locations and as much as possible about their track records of success. I also need to learn which lenders and investment groups are most open to new collaborators," wrote one respondent.

Public vs private investment vehicles

Financial advisors and CRE professionals also disagree on what CRE investment vehicles are most popular with accredited investors. Nearly half of financial advisors see real estate ETFs as the most popular choice, while 45 percent said PERE funds and 43 percent public REITs. In contrast, more than half of CRE professionals (58 percent) said wealthy individuals favor direct investment in multi-tenant commercial and multifamily properties, 50 percent PERE and 50 percent direct investment in single tenant net lease assets.

Those results do indicate a shift from past *WMRE* surveys, in which CRE pros have consistently rated private equity real estate funds as the top choice. Both groups of respondents agreed that two sectors that garner the least amount of attention from wealthy individuals these days are crowdfunding and club deals.

The vast menu of real estate investment vehicles available today has different pros and cons, and percep-

Views on Investment Structures

What types of investment vehicles are accredited investors most interested in? (Select all that apply.)

	Financial Advisor	CRE Professional
Real estate ETFs	49%	19%
Private real estate equity funds	45%	50%
Publicly traded REIT shares	43%	29%
Real estate mutual funds	35%	15%
Private placements with real estate investment managers	33%	42%
Direct investment in multitenant commercial and multifamily real estate assets	32%	58%
Non-traded REIT shares	31%	15%
Direct investment in single-tenant net lease assets	29%	50%
Private real estate debt funds	22%	24%
CRE crowdfunding	6%	16%
Club deals	5%	12%
Other	3%	1%

tions of those opportunities also vary depending on the situation. One of the factors that attracts HNWI and accredited investors to private real estate is a general view that performance is non-correlated to the stock and bond markets. Investors also like the liquidity offered by publicly-traded vehicles such as REITs, mutual funds and ETFs versus less liquid private and direct investments.

"More of my clients still like getting their hands dirty and seeing what's going on," says Mathis. His clients are active in direct investment and private placement syndications. "There is a little distrust in the stock market right now. So, they want to have their fingers in the pie so to speak and see the actual return and how their money is being utilized," he adds.

Oftentimes, estate planning and tax planning play a role in the types of real estate investments individuals are selecting, notes Marc Scudillo, managing officer of EisnerAmper Wealth Management and Corporate Benefits LLC. "When you get to this level of wealth, it is less about purely the income stream, but how do we minimize how much taxes need to be paid while assets are transferred to the next generation or generations," he says. HNWIs also need to consider how those assets can be passed on to the next generations, and whether or not those generations are capable of managing the assets. That capability can influence whether clients choose to hold active or passive real estate investments, he adds.

One of the trends Scudillo is noticing among his baby boomer clients who own investment property is that, while they like the income aspect of real estate, they are less interested in actively managing those properties. Some are tired of dealing with tenants and worrying about rent abatements and eviction moratoriums. So, there is a shift to sell apartments or rental properties and do a 1031 exchange into a more passive vehicle, such as a DST or triple net lease property. For those that have large gains from a sale, they are also interested in the tax advantages of investing in Opportunity Zones.

Why Invest in Real Estate?

How important are each of these factors for accredited investors when investing in commercial real estate? (Scale of 1 – 5)

	Financial Advisor	CRE Professional
Tax Advantages	3.8	3.8
Portfolio Diversification	3.7	3.6
Asset Value Growth	3.7	3.9
Wealth Preservation	3.6	4.2
Income	3.6	3.7
Inflation Hedge	3.6	3.7
Estate Planning	3.3	3.5

Multifamily remains a favored sector

One of the lingering impacts from COVID-19 is that it has shifted interest away from office, retail and hotel properties, due to the challenges and uncertainty facing those sectors, and pushed capital more firmly towards high-performing sectors such as industrial and multifamily. "Fluctuating demand profiles, i.e. flight from CBDs and remote working, has created unexpected turbulence and perceived risk in selected markets and product types that were previously deemed 'safe'," wrote one respondent.

Financial advisors and CRE professionals are in agreement that the top two property types wealthy individuals prefer are multifamily and industrial. However, CRE professionals have stronger conviction in their opinions. Nearly three-fourths of CRE professionals believe accredited investors prefer multifamily (79 percent) or industrial (74 percent). Half of the financial advisors surveyed said that accredited investors prefer multifamily, followed closely by industrial at 44 percent. Both groups also rated self-storage high, at 46 percent for CRE professionals and 42 percent for financial advisors.

Historical survey results show a drop in sentiment related to both office and retail. Although one in four financial advisors said office is still a favored sector, CRE professionals were more pessimistic at only 14 percent. Both rated retail at less than 20 percent. In the 2016 survey, office and retail each rated favorably among 34 percent of respondents.

Multifamily and industrial have been attracting more attention from investors across the board over the past several years due to strong demand drivers and performance. "Within multifamily, we're seeing increased appetite for development, which was not the case a few years ago," says Fernstrom Border. In addition, HNWI and family offices are showing increased interest in alternative sectors, such as data centers, life sciences, self storage and seniors housing. "These niche sectors have very much gained the attention of the high-net-worth and family office world," she adds.

Prior to the recent interest rate hikes, income was a big focus for investors, notes Harris. Certain types of real estate really offered that income. Now that interest rates are higher, there is a pretty heavy shift towards growth and keeping up with inflation, he says. In particular, investors like those property types with shorter-term leases that can re-set rents more quickly, such as multifamily and self storage, he adds. Industrial is being viewed more favorably in large part because of the secular shifts in the market to e-commerce. According to CRG, e-commerce grew by 15 percent from 2000 to 2020, but it still made up only 20 percent of total retail sales. In addition to the growth in e-commerce, there are expectations for faster delivery of goods. All of that is driving development of more robust supply chains and greater demand for industrial and logistics space, says Harris.

Investors prefer primary markets

Survey results show that respondents believe HNWIs continue to favor the safety of primary markets, with 72 percent who said wealthy individuals have a strong or extreme preference, which is similar to the 70 percent who held that opinion in the 2021 survey. The number of investors who had a strong or extreme preference for secondary markets was 34 percent and only 15 percent for tertiary markets. However, survey results are likely skewed somewhat by the type of investment vehicle. Those HNWIs that are buying property directly are often more willing to go to secondary and tertiary markets where there is less competition from institutional buyers.

"Investors understand where people are migrating within the country. They want to invest with that growth, which is taking them to the southwest and the southeast across all different asset classes," says Harris. At the same time, recent volatility in the market has created a flight back to investing in more core markets and major cities that have been more historically stable, because these HNWIs and accredited investors are focused on preserving their wealth, he says.

Respondendents had mixed views on whether wealthy individuals prefer investing locally, regionally or nationally. Forty-three percent said accredited investors have a strong or extremely strong preference for investing nationally, which was slightly higher than regional at 41 percent and moderately higher than 36 percent who said those investors strongly prefer to invest locally.

For those investors who are actively managing real estate, they are looking to buy assets that are in their backyards. For passive investments, the focus is more on performance metrics and the best risk-adjusted return they can get versus a specific geographic market, notes Scudillo. In addition, there are a number of tertiary markets like a Tampa or Sarasota that are seeing really good growth. Investors see that growth, and so for them, they are more focused on the quality of the project than the size of the market, he says.

U.S. investors, especially HNWI and family offices, typically favor transparent local markets. However, once they've primed their portfolios, they also like to diversify, whether that is by geography, property type or strategy with a mix of core, non-core and perhaps some development, notes Fernstrom Border.

In terms of geography, the Sun Belt has generated quite a lot of interest over the past few years, and there is also expansion from primary markets into secondary and tertiary markets. "You're seeing these large institutions go into smaller markets like a Boise, Idaho, which never used to be an institutional play, and I believe the high-net worth capital will follow the institutional-led transactions," she says.

An overwhelming majority of respondents (upwards of 84 percent) said HNWIs are interested in considering a variety of strategies, including core, core-plus, value-add and opportunistic. Although there is greater hesitation around distressed investments, a surprisingly high number of respondents (70 percent of CRE professionals and 56 percent of financial advisors) said wealthy individuals are at least moderately interested in those investments.

Best in Class

Which property types do you feel accredited investors currently prefer? (Select all that apply.)

	Financial Advisor	CRE Professional
Multifamily	51%	79%
Industrial/Logistics	44%	74%
Self-Storage	42%	46%
Data Centers	39%	22%
Medical Office	36%	38%
Seniors Housing	29%	17%
Cell Towers	26%	15%
Office	25%	14%
Life Sciences/Biotech	24%	35%
Single-Family Rental	19%	30%
Retail	17%	20%
Hotel	14%	9%
Manufactured Housing	9%	8%
Student Housing	7%	8%
Other	4%	1%

Source:

Survey respondents were fairly aligned in their views of return expectations. Financial advisors estimate that wealthy individuals expect an average return of 10.9 percent from real estate investments, while CRE professionals see a slightly higher average of 11.4 percent. "With most of our clients, we've found that return expectations have revolved more around how does my total wealth meet my return expectations for accomplishing my goals whether it is in good markets or bad," says Scudillo. From there, the discussion focuses on which real estate vehicles can best meet those goals within the context of a client's risk tolerance, he adds.

Survey methodology: The WMRE High-Net-Worth Investor Survey (brought to you by AppFolio) was conducted via an online survey distributed to WMRE and Wealthmanagement.com readers in February 2022. The survey results are based on responses from 435 participants. Of the total survey respondents, 51 percent identified themselves as financial advisors, 32 percent as commercial real estate professionals and 16 percent other. More than half of the respondent base work for an independent B/D or RIA. Half described their role as an owner/partner/president/chairman/CEO or CFO-level executive. Respondents operate in all regions with 44 percent active in the East, 42 percent in the South / Southeast / Southwest; 39 percent in the Midwest / East North Central / West North Central and 37 percent in West / Mountain / Pacific. In addition, respondents are active across property segments. However, most are involved in multifamily at 58 percent, office at 54 percent, industrial at 52 percent and retail at 51 percent.