Retail and High-Net-Worth Investors: The Next Big Opportunity in Real Estate Capital

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Pursuit of retail/high-net-worth ("HNW") capital is one of the most prominent strategic trends in the real estate investment management industry today. The 2019 NAREIM-FPL Associates Global Management Survey ("GMS"), which polled 61 REIMs and private equity firms, found that approximately 90% of participants reported retail capital as being important to their business going forward, compared to 85% and 78% in the 2018 and 2017 GMS, respectively. Demonstrating this importance, many managers are dedicating significant time and resources to considering how to best access these non-institutional capital sources in order to diversify their investor base, tap into a new (and significant) pool of capital and help ensure long-term platform stability.

CHANNELS FOR TAPPING INTO RETAIL/HNW CAPITAL

Despite the near-universal acknowledgement of its importance, there is no single formula for how to best approach the retail/HNW investor base. Instead, three general approaches are most often cited:

1. Defined contribution-focused products
2. Interval funds
3. Non-traded REITs

Defined contribution-focused products

Given the magnitude of capital held in the space, defined contribution plans are often viewed as the "Holy Grail" of retail capital. Historically, however, there have been two primary challenges to accessing this channel: i) adapting illiquid real estate investments into a format suitable for DC plans, and ii) gaining acceptance from DC plan sponsors. To address the liquidity challenge, managers with DC-focused products utilize a mix of private real estate investments and a liquidity sleeve of managed real estate securities. As a result, there has been a growing acceptance among DC plan sponsors in recent years. The increased acceptance is illustrated in the 2019 GMS, which found that 13% of participants now have a DC-focused product compared to 5% a year ago, and aggregate capital raised from these products increased from $1 billion to $1.8 billion year-over-year between 2017 and 2018.

Interval funds

Interval funds are another burgeoning channel that real estate managers are utilizing to access retail/HNW capital. These funds allow managers to access capital from individual investors with limited administrative effort and no direct fees borne by the manager. Interval funds are established as perpetual life vehicles and are typically priced at net asset value with liquidity windows offered at set periods, or "intervals," throughout the year (often quarterly). Like DC products, interval funds invest in a combination of private real estate vehicles (typically core ODCE funds) and public REIT securities. These products have seen significant growth over the past several years. In 2014, the three largest real estate interval funds had nearly $300 million in net assets; today, assets have grown to approximately $8 billion.

Non-traded REITs

While the prior two approaches allow managers to access retail/HNW capital using existing products, non-traded REITs (“NTRs”) represent an alternative option that involves structuring a new product to attract this type of capital. The use of such products by institutional players like Blackstone, Starwood Capital Group, Hines, and JLL, and recent capital raising success seen by NTRs, has boosted the interest in the space. Robert A. Stanger & Company reported that, through the first five months of 2019, fundraising by NTRs more than doubled compared to the same period in 2018.

However, for all the capital and potential associated with NTRs, there are high barriers to entry that are worth considering. Entering the NTR space requires significant investment that can be costly and time-consuming. The registration process for public vehicles, along with the infrastructure required to build a network of financial advisors and independent broker dealers, makes entry into the space extremely difficult for many managers. As such, managers do not have the option to test the waters in NTRs; they must make a substantial commitment just to get a product off the ground.

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The growth across these channels highlights the significant demand for private real estate investments among the retail/HNW investor base.

“The influx of capital flowing into real estate-focused products demonstrates that there is a strong appetite for the asset class among retail investors,” said Erin Green, Senior Director at FPL Associates. “Real estate provides a compelling avenue for portfolio diversification and its returns, relative to other asset classes, have been strong in recent years. The capital raising success of these funds validates the view that if real estate investment managers can find ways to make their products accessible to non-institutional investors, the demand for such products exists in spades.”

NEW MARKET ENTRANTS TAILORING THEIR PLATFORMS TO RETAIL/HNW INVESTORS

In response to the demonstrated demand in the marketplace, new entrants are springing up to offer approachable, user-friendly platforms to funnel retail capital into real estate investments. Linda Isaacson, Managing Director and Global Head of Innovation & Technology at Ferguson Partners, said her practice has already seen several “disrupter” companies explicitly launched to focus on building real estate investment platforms for the everyday investor.

“This new area of growth is an innovative opportunity for real estate investment managers who once frequently targeted more significant dollar amounts from professional investors or investment firms, such as pensions or insurance companies," Isaacson said. "The enormous scale of retail capital will further foster the development of machine-learning technologies and PropTech/FinTech startups that focus on this area of capital raising."

Two relatively new and well-funded entrants into the real estate universe demonstrate the opportunities that exist in targeting retail capital. Fundrise and Cadre are two platforms that have oriented their entire brands toward this category of investor by democratizing the real estate investment process and allowing investors to infuse money into real estate projects through a "crowdsourcing" structure. These startups are acting as proof-of-concept for the rest of the real estate industry to understand the demand and viability of this relatively untapped capital sourcing model.

IMPLICATIONS FOR REAL ESTATE INVESTMENT MANAGERS

Taking stock of this new landscape, many established real estate investment managers across the industry are starting to think differently about the profile of capital raisers they are bringing onto their platforms to pursue this capital. Many firms are finding that relationships and knowledge of HNW and retail investors' needs matter more than real estate-specific knowledge, which can oftentimes be taught on the job. As an example, capital raisers with private equity and private credit backgrounds are familiar with the structure and terminology of real estate investment platforms and have existing relationships that can be leveraged in their new role.

When finding talented candidates, the challenge often lies in convincing them of the career opportunities in real estate.

"We have had success recruiting great candidates who demonstrate excellent leadership ability, product knowledge and robust professional networks – even if they lie outside of real estate – to head these new capital-sourcing opportunities," said Gemma Burgess, President of U.S. Search at Ferguson Partners. "Finding the pool is not where the heavy lifting sits; it is educating those individuals on [the real estate] industry and helping them to see that there is an opportunity to grow their career if they change asset classes."

While the shift in capital sourcing will be a slow burn across the industry, the first mover advantage - especially when it comes to brand positioning in the minds of retail investors - will be critical. In real estate, the most successful investment managers are often the ones who are willing and able to identify and capitalize on opportunities in the marketplace before others. The same can be said when it comes to capital sourcing.

Board Recruitment and Advisory Practice

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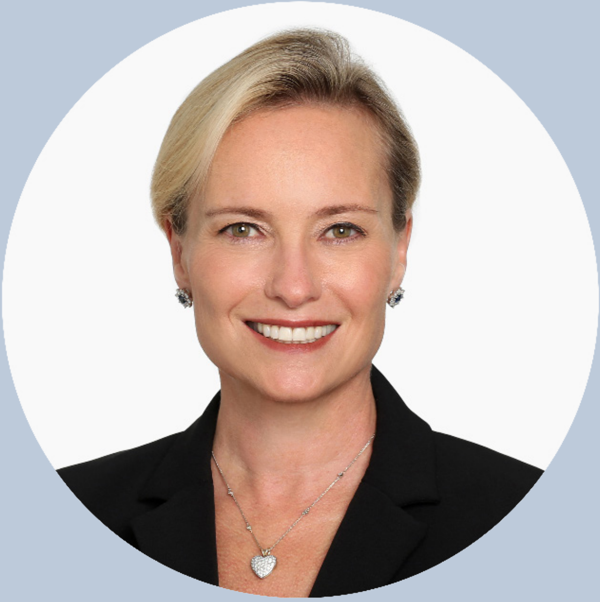

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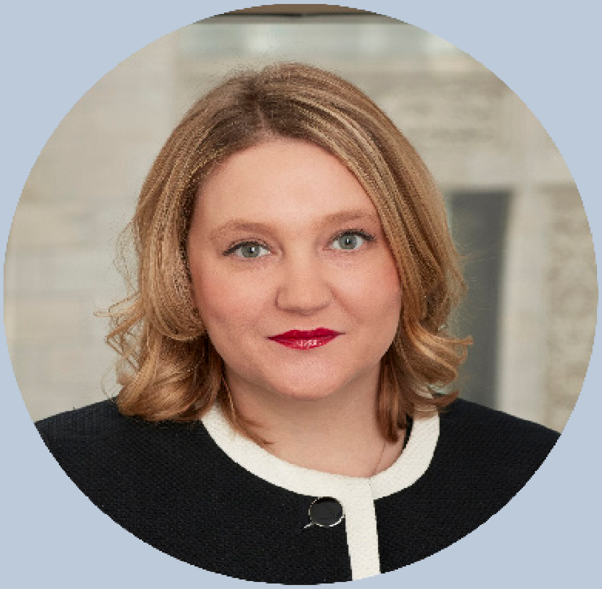

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Comprised of two businesses that work together, FPL offers solutions and services across the entire business life cycle:

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With an emphasis on the right fit, Ferguson Partners offers services in executive and Director recruitment. We also offer a full range of leadership services including CEO and senior executive succession planning, leadership assessment and coaching, and team effectiveness.

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Focusing on a wide array of business needs, FPL Associates assists with the assessment, design and implementation of compensation programs. We also provide organizational, financial & strategic consulting, bringing a wealth of industry and category-specific expertise to a broad range of projects.

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- Corporate Finance
- Specialized Research

Our Industry Practices

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Private Equity/Real Estate Investment Managers, Public (REITs) & Private Owners/Developers, Property Services (Brokerage) Firms, Commercial Mortgage Investment/Finance, Residential Mortgage Investment/Finance, Homebuilders, Corporate Real Estate

Hospitality & Leisure

Lodging (Brands/Owners), Gaming Resorts & Casinos, Restaurants, Sports & Recreation, Amusement Parks & Attractions

Healthcare

Owners/Investors/Operators/Financiers of Seniors Housing, Hospitals, Medical Office Buildings

Infrastructure, Engineering & Construction

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