

Private real estate

Private markets education

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This primer provides an overview of private real estate and covers the strategy basics, manager value-add, performance, and benefits in an investor's portfolio.



Private real estate strategies represent over USD 1.8 trillion in assets under management (AUM), or 11% of global private markets AUM.



Real estate investing consists of receiving rental income and capital gains from the purchase and ownership of a piece of land or building.



Success in sourcing, developing, and exiting real estate projects can drive return premiums above public markets over a long time horizon.

Summary

- Real estate investing consists of receiving rental income and capital gains from the purchase and ownership of a piece of land or building.
 - Three main private real estate strategies include core/core-plus, value-add, and opportunistic.
 - Core/core-plus real estate funds aim to generate recurring rental income from high-quality properties in primary locations.
 - Value-add real estate investing focuses on properties that require some level of lease-up, refurbishment, repositioning.
 - At the higher end of the risk spectrum, "opportunistic investing" targets properties with high (re)development potential.
 - When compared to publicly traded REITs, private real estate is generally less liquid, has lower correlation to public markets, has lower volatility, and incur additional fees.
 - Using Cambridge Associates data, private real estate strategies (Opportunistic/Value-add) delivered a median 9.9% vintage year internal rate of return (IRR) and 1.41x total value to paid-in (TVPI) over 1999-2019.
 - Private real estate strategies outperformed public markets in 13 of 21 vintage years between 1999 and 2019 when observing FTSE NAREIT All Equity REITs modified public market equivalent (PME) returns by about 640bps.
 - Private real estate funds can add attractive and differentiated sources of return as they expand investors' universe to real assets that have historically low correlation with traditional investments.
 - With leases and rental income often adjusting with inflation, real estate investments may add an element of inflation protection.
 - With significant differences in manager performance, key risks to private real estate include leverage, development execution, and exit timing.
 - Other, more general private market risks also apply, including significant illiquidity of fund vehicles, limited control, and additional fees.
- This report is part of a series of short primers on specific private market strategies. For a deeper understanding of private markets, please read our [Introduction to Private Markets](#). Find more information on the client portal or contact your advisor for assistance.



1.4x

Median pooled TVPI (total value to paid in) multiple*



9.9%

Median pooled IRR*



14.7%

Upper quartile IRR*



4.3%

Lower quartile IRR*



~640 bps

Median annualized IRR outperformance vs. public REITs*



0.62

Correlation to public REITs*

Note: *Median, upper quartile and lower quartile IRR and TVPI based on Cambridge Associates data for funds with vintage years 1999 – 2019. Comparison against public REITs based on the modified public market equivalent of the FTSE NAREIT all equity REITs index. Source: Cambridge Associates, UBS November 2024.

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What is private real estate investing?

Real estate investing consists of receiving rental income and capital gains from the purchase and ownership of a piece of land or building, spanning from residential and multi-family units to office, industrial, logistics, or retail space. Three main private real estate strategies include core/core-plus, value-add, and opportunistic.

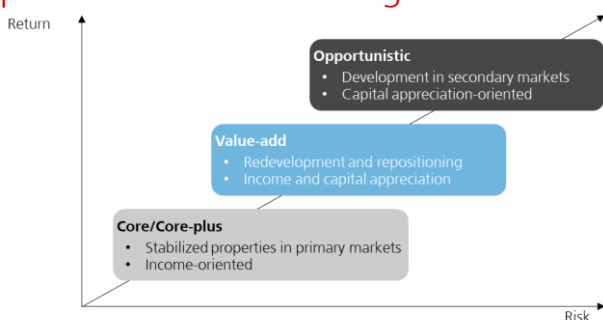
Core/core-plus real estate

- The core strategy is likely the best-known private real estate strategy. It aims to generate recurring rental income from high-quality properties in primary locations.
- Assets are typically fully or close to fully leased for the long term and benefit from a stable and high-grade tenant base.
- Most of the annualized total returns of core investing come from rental income (90-100%), which is a function of the capability of tenants to pay rents and varies with occupancy rates. Gains from capital appreciation are typically limited (0-10%).
- Holding periods tend to be long, in the order of 10 years or more.
- Leverage applied by the fund typically falls in the 15-30% range.
- A variant of this strategy is “core-plus,” which has a slightly higher risk-return profile, based on re-leasing upside and the use of higher leverage than the core strategy.
- Core-plus returns are also primarily driven by rental income (80–90%) with relatively limited potential for capital gains (10–20%).
- Holding periods are also long, in the order of seven or more years. Leverage is typically around 50%.
- A core/core-plus real estate strategy is usually implemented through limited redemption fund structures, and generally generate more stable returns over the cycle.

Value-add real estate

- Value-add real estate investing focuses on properties that require some level of lease-up, refurbishment, repositioning or other actions to enhance the value of the property and move toward core-type attributes. As a result, “value-add” real estate investing focuses more than “core” strategies on future potential capital appreciation.
- Underlying property types include the same assets as in core, with the addition of other specialty types including hospitality assets, healthcare-related property, student housing, self-storage, and other niches.
- Value-add real estate investing requires careful planning of entry and exit points, active management of vacancies, and close management of properties needing renovation, redevelopment and/or possible repositioning.
- Fund managers have to identify attractive assets, implement relevant property improvements and tenant identification or upgrade strategy, and provide ongoing asset management.
- Returns from value-add real estate strategies are driven by a combination of income (30-50%) and capital gains (50-70%).
- Property holding periods tend to range between five and seven years, and funds tend to be closed-ended with 10-year terms.
- Leverage is typically in the range of 40-70%.
- Value-add real estate seeks to generate higher returns than core strategies due to the greater risks involved.

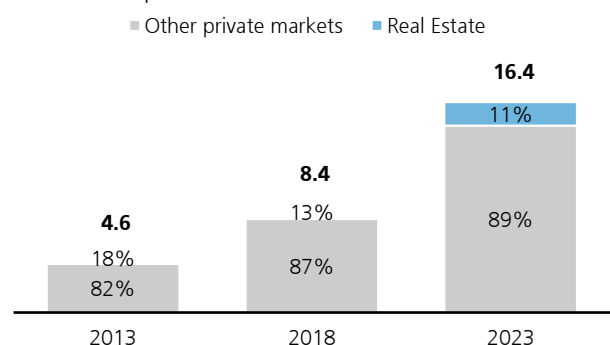
Fig. 1: Potential risk-return across private real estate strategies



Source: UBS November 2024.

Fig. 2: Private real estate has grown by 2.2x in the last decade

With over USD 1.8tr, private real estate represents about 11% of total private markets AUM



Source: Preqin, UBS October 2024.

Opportunistic real estate

- At the higher end of the risk spectrum, "opportunistic investing" targets properties with high (re)development potential.
- These properties range from ground-up development (greenfield and brownfield); complex turnaround and redevelopment situations; and distressed situations including debt, real estate operating companies, land speculation, and even non-performing loan portfolios.
- Investors expect a substantial part of their return to be derived from capital appreciation. Besides traditional risks associated with market fundamentals, the fund manager needs to manage significant financial risks like leverage.
- Returns from opportunistic real estate strategies are driven very little by rental income (0-10%) and primarily focused on capital appreciation (90-100%).
- Commonly operated through closed-end fund structures, opportunistic real estate holds assets for five years or more, potentially longer in the case of ground-up development and potentially shorter in the case of debt or other securities.
- Leverage tends to be in the 60-80% range.
- Opportunistic real estate seeks to generate high returns with relatively high risk related to execution.

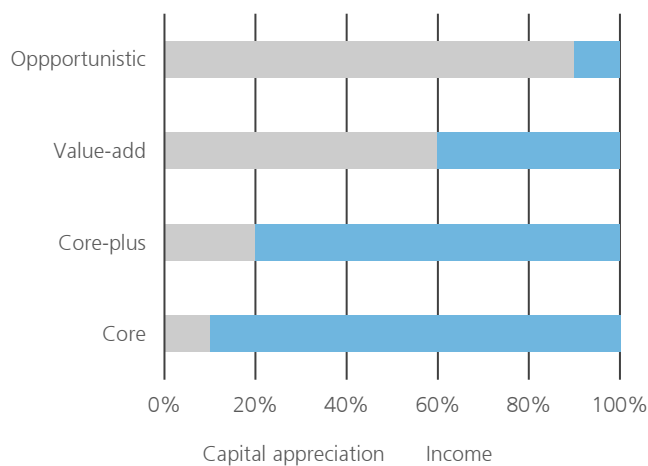
Sources of value-add

Real estate assets have various characteristics that differentiate themselves from other traditional assets. Given information asymmetry and local segmentation, properties often require significant managerial attention, specialized knowledge, and expertise.

- **Deal sourcing:** Successful private real estate managers uncover opportunities where others do not. Access to a pipeline of high-quality and hard-to-find deals is key. To gain an advantage against other bidders, managers rely on a strong network of property brokers, consultants, developers, as well as other preferred global and local partners.
- **Profitability assessment:** Assessing the return potential of a property is not easy, especially when value needs to be created. Industry expertise—especially when underwriting retail, hospitality, or healthcare transactions—is also required to forge a clear deal thesis. While for core assets, managers aim for attractive entry values, non-core assets typically require a detailed cost analysis on how to improve value, revenues, and operating profitability.
- **Repositioning assets:** For managers following a more opportunistic strategy, successful repositioning and developing new capabilities are the key factors to unlocking value to underlying assets.
- **Transaction structuring:** Property transactions, for large projects, can require complex financing. Ownership of an asset can be obtained through a variety of instruments including loan pools, joint ventures, listed securities, as well as other real estate assets. Tax considerations and planning are also required pre- and post-acquisition.
- **Property management:** Good property management is the key to securing high stable cash flows. Real estate requires significant management attention, including finding new tenants, extending new leases, optimizing rents, maximizing incremental revenues (parking/public spaces), planning maintenance, conducting operational or structural improvements, and minimizing expenses.
- **Exit process:** Property managers need to be adept at assessing the timing and exit method to maximize realized gains. Planning multiple exit strategies in case something goes wrong is key.

Fig. 3: Illustration of private real estate return drivers

Core strategies are typically more income oriented, while Opportunistic are more capital appreciation oriented



Source: UBS November 2024.

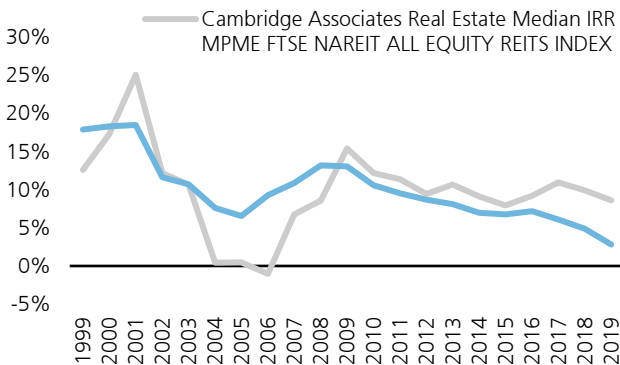
Public REIT vs. private real estate

With investors likely familiar with public REITs (real estate investment trusts), we compare and contrast key factors between REITs and private real estate funds.

- REITs are pools of properties (equity REIT) or mortgages (mortgage REIT) that are bundled in the form of a security.
- Similar to a private real estate fund, an equity REIT owns and operates real estate. However, unlike private real estate funds, REITs generally have lower fees, are more transparent and are more liquid as shares are publicly traded.
- However, in exchange for higher liquidity, REIT shares can trade at a premium or discount to net asset value (NAV), depending on market dynamics. Additionally, REIT returns typically exhibit higher volatility (Fig. 4) and correlation to public markets versus that of private real estate.
- Given higher leverage usage, yields for private real estate are typically higher than for public REITs, assuming similar strategies.
- Given the reliance on income to generate returns, REITs tend to focus more on core and value-add strategies, while private real estate funds invest across core, value-add, and opportunistic strategies.
- Public REITs tend to be sector-specific (malls, wireless towers, logistics, data centers, multi-family, health care, etc.). From a performance point of view, the market will price in the most important sector exposure, or investors will discount the least or most preferred subsector depending on momentum.
- Private real estate funds tend to be diversified across sectors, while they focus on a value-add or opportunistic investment style. To better position themselves, a large number of smaller funds prefer to be focused on niches or geographies.
- Private real estate managers can invest in niche strategies or drive value through more transformational projects than is possible for public REITs.

Fig. 4: Private real estate IRR vs FTSE NAREIT all equity REITs PME index

Private real estate has outperformed public markets in 13 out of 21 vintage years between 1999 and 2019

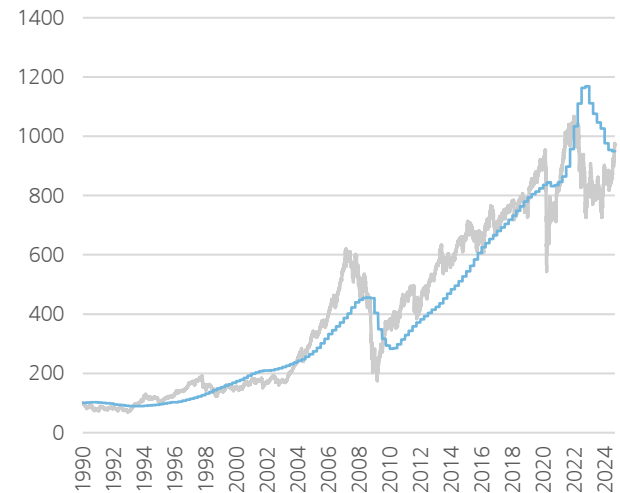


Source: Cambridge Associates, UBS November 2024.

Open-ended private funds

- Relative to the finite terms attributed to the closed-ended private funds described above, open-ended private funds aim to maintain a perpetual structure.
- Open-ended private funds typically offer softer lock-ups versus closed-ended funds. While periodic liquidity exists for investors in open-ended private funds, they may be subject to risk of large scale redemptions from other investors. Investor and fund level gates can help alleviate this risk.
- Open-ended private funds incur less blind pool risk given that underlying investments are known at time of fund investment.
- Given the evergreen nature of open-ended private funds, there is higher emphasis on buy and hold versus private fund structures, which have defined exit periods
- Private closed-ended funds tend to have a higher risk/return profile versus that of open-ended private funds given exposure to more value-added/opportunistic strategies, whereas open-ended private funds often focus on core/core-plus strategies.

Fig. 5: Private open-ended global real estate fund vs. listed real estate total return

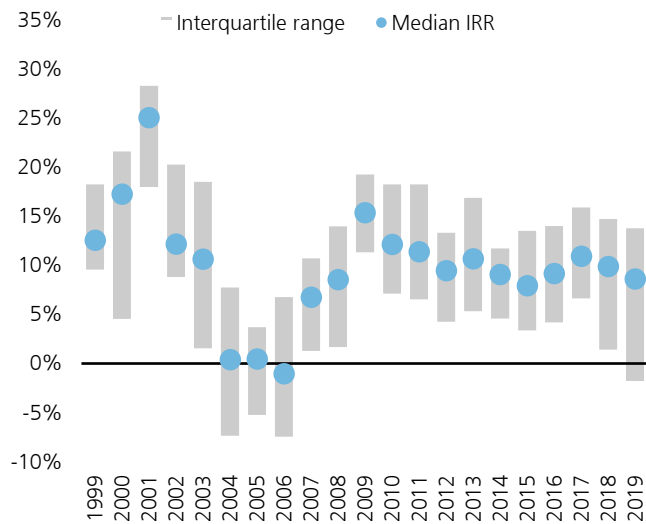


Source: FTSE EPRA NAREIT Developed Total Return Index for listed, NCREIF Fund Index for Open-end Diversified Core Equities provides quarterly and annual total returns for 28 institutional open-end commingled real estate funds. Bloomberg, UBS November 2024.

Performance analysis

- Vintage year IRR is the standard measure for private market performance and reflects net cash flows from funds inception in the reference year.
- According to Cambridge Associates (a leading data provider in the private market industry), real estate funds delivered a median vintage year IRR of 9.91% over 1999-2019.
- We observe a wide range of IRRs for each vintage year (Fig. 6), highlighting the importance of manager selection when considering distressed debt strategies.

Fig. 6: Private real estate return dispersion per vintage year



Source: Cambridge Associates, UBS November 2024.

Real estate and the business cycle

- Real estate returns are generally linked to economic cycles, with GDP growth, low unemployment, consumer spending, and low interest rates supporting real estate dynamics.
- However, dynamics can vary by geography and asset type (office, apartment, industrial, retail, etc.), with vacancy rates, rental growth, and new construction also influencing the real estate market.
- Private real estate returns were highest soon after the dot-com bubble (2001 vintage) and the global financial crisis (2009 vintage). This period exhibited depressed property prices and lower cost of capital.
- Private real estate returns were lowest a few years before the global financial crisis (2004-06 vintages). These investment periods exhibited higher purchase prices, rising cost of capital, and liquidity pressure leading up to the global financial crisis.

Real estate in your portfolio

- Private real estate funds can add attractive and differentiated sources of return as they expand investors' universe to real assets that have historically low correlation with traditional equity and fixed income investments.
- Private real estate funds can earn a premium above public market equivalent returns for providing long-term capital, enabling this active approach to sourcing assets, executing on repositioning projects, and optimizing property operations.
- For core or value-add focused strategies, private real estate investments can provide a sizable yield component to returns with potentially lower volatility.
- With leases and rental income often adjusting with inflation, real estate investments may add an element of inflation protection.

Risks

- Changes in general business conditions, such as GDP, unemployment, interest rates, household formation, and household income, can affect real estate returns.
- Risks of investing in real estate projects include substantial leverage, potential inability to service debt, and deal timing.
- Risks of investing in private real estate funds include blind pool structure and the potential for unwanted or unintended sector risks or concentration.
- Tenants may delay or default on rent obligations. Additionally, higher-than-expected vacancy rates may hurt returns.
- Real estate projects may incur unforeseen damages to property, which may delay completion and/or increase costs.
- Given the long lead time for new development, exit conditions may be considerably different from the time initial investments were made.
- Private real estate funds are longer-term investments, with the typical fund life around seven to 10 years.
- Other, more general private market risks also apply, including significant illiquidity of fund vehicles, limited control, disclosure, and transparency on underlying holdings, and high fees. These risks cannot be fully eliminated, but can be reduced through extensive institutional due diligence and rigorous investment and monitoring processes.

Appendix: Select definitions

- **Blind pool:** money collected from several people which is put into a fund and invested for their profit. It is left unspecified which properties are to be acquired.
- **Cash flows:** cash flow is the net amount of cash and cash-equivalents being transferred into and out of a fund.
- **Control provisions:** designed to provide a level of influence over significant operational and business matters.
- **Correlation:** the degree to which the fluctuations of one variable are similar to those of another.
- **Dry powder:** refers to cash reserves kept on hand by a private markets firm to cover future obligations, purchase assets or make acquisitions.
- **Exit:** the time period in which an investor can convert holdings into cash to be liquidated over a designated period of time.
- **Illiquidity premia:** the premium that an investor can demand depending on how difficult it is to convert the underlying security can be converted to cash.
- **Idiosyncratic risk:** risk associated with a narrow set of factors pertaining to a particular company. Risk that has little association with overall market risk.
- **IPO:** the first sale of stock by a private company to the public. Also referred to as an "initial public offering."
- **IRR:** a return method used to evaluate private market investments and reflects the discount rate at which the present value of an investment's future cash flow equals the cost of the investment.
- **J-curve:** illustrates a period of initial negative cash flows (contributions) towards positive cash flows (distributions back to the investor) over a period of time.
- **Junior debt:** loan that ranks below other loans with regard to claims on assets or earnings. In the case of borrower default, creditors who own subordinated debt won't be paid out until after senior debt holders are paid in full.
- **Leverage:** the use of borrowed capital or instruments to increase the potential return (but also potential losses) of an investment, a simple example is a mortgage used in real estate transactions.
- **Leveraged buyout funds:** a private equity strategy using borrowed capital to gain control of a company.
- **Minority stake:** reflects a non-controlling interest that is less than 50% of a particular entity.
- **Multiple expansion:** describes the way a particular valuation metric increases to reflect a higher value assigned to an underlying investment.
- **M&A:** mergers and acquisitions is a general term that refers to the consolidation of companies or assets through various types of financial transactions. M&A can include a number of different transactions, such as mergers, acquisitions, consolidations, tender offers, purchase of assets and management acquisitions.
- **Multiples:** a term that measures some aspect of a company's financial well-being, determined by dividing one metric by another metric. The metric in the numerator is typically larger than the one in the denominator, because the top metric is usually supposed to be many times larger than the bottom metric.
- **Public Market Equivalent (PME):** a method that converts public market returns to a benchmark that can be compared to private market returns.
- **Redemption rights:** gives investors the right to force a company to repurchase their shares after a period of time.
- **Secondary buyout:** describes a sale between private market firms
- **Senior debt:** loans or debt securities that have claim prior to junior obligations and equity on a corporation's assets in the event of liquidation.
- **Spin off:** describes the separation of an independent company from a larger parent.
- **Sponsor:** the general partner in a limited partnership who organizes and signs up investors.
- **Standard deviation:** a measure of the degree to which individual values vary from the distribution mean. The higher the number, the greater the risk.
- **Tag-along provisions:** provides a minority shareholder the right to join in on a sale of a company that is initiated by a majority shareholder.
- **Trade sale/strategic sale:** describes a sale of a business to another business operating in a similar industry.
- **TVPI (Total Value to Paid In):** a return metric that describes the total capital distributed back to the investor + residual value left in the fund divided by invested capital.
- **Unit economics:** a measure of direct revenues and costs on a unit basis for a particular business model.
- **Value add:** describes the operational, business, or structural improvements private market managers seek through underlying portfolio investments.
- **Vintage year:** is the year in which the first influx of investment capital is delivered to a project or company. This marks when capital is contributed by venture capital, a private equity fund or a partnership drawing down from its investors.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- **Foreign Exchange/Currency Risk:** Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

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