Effective Strategies for Maximizing Return on Real Estate Investments

The volatility in the stock and bond markets has turned investor attention to risk-minimized returns and the importance of stable income streams. How can an investor achieve these goals, mitigate risks and plan for the future?

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Diversification. Real estate as an asset class has low to negative correlation to stocks and bonds and has positive performance in weak financial markets. These factors mean that investors can benefit from a strategic real estate allocation in their investment portfolios. Diversification and predictability of returns are amongst the key characteristics of investing in real estate to mitigate risks and plan for the future.

Income Generation. Real estate's relatively low volatility is not surprising due to the contractual nature of the underlying income streams. These committed revenues, together with fixed or reimbursable costs, provide stable earnings extending over long-term leases. Investors in today's market are looking for preservation of capital with absolute returns. The solid income performance of real estate achieves investor goals and assures liquidity for the asset class. Quality income streams overcome the negative effects of an extended cyclical downturn.

Capital Appreciation. Real estate is a well-known hedge against inflation. An owner of bricks and mortar with fixed debt and a steady cash flow is impacted less by changes in inflation, interest rates and the business cycle. The supply side of the real estate equation can have a major impact on returns. For example, constraints on new construction may be imposed by governmental regulations and by changes in the economics of cost to build versus rent. Key local economic factors like dominant industry and employment growth patterns must also be evaluated to identify the right market in which to maximize capital appreciation. More diversified market economies can weather a downturn when key industries reduce activity.

Control and Reporting. Privately held real estate provides effective control and reporting over the investment. The interests of the property manager can be aligned with the interests of the owner, and an immediacy of supervision on the property manager that is unparalleled in the stock and bond market can be achieved.

These key characteristics of real estate as an asset class as well as the ability to participate in real estate investment through a variety of structures make it a wise choice for investors.

Canada and the United States. These countries offer the most compelling opportunities for real estate investment. They are stable and have high-quality properties, active trading, accurate investment and market information and property laws that are well established, understandable and provide equal protection for both domestic and foreign investors. Real estate in Canada and the United States is relatively inexpensive and offers higher yields when compared, for example, to European investment property. North America has the largest and most diverse investment property market in the world. The purchase of high-quality properties at attractive prices is possible for all investors in this market.

Liquidity in the real estate market is at its best in Canada and the United States. Institutional investors in those countries are often required to invest in real estate as part of their portfolio. This adds to the liquidity in those markets.

For investors outside Canada and the United States, adding real estate on another continent to a portfolio provides diversification benefits of improved performance and reduced risk.

Investment Strategies. The role of real estate should always be considered in the creation of an investment strategy to achieve the investor's particular objectives. Studies have shown that real estate can sustain returns that outperform both stocks and bonds. For this reason, risk sensitive investors concerned with capital preservation might allocate up to 20% of their portfolio to real estate.

Strategies to obtain the highest returns with low to moderate risk must be developed and implemented in the context of the particular market. Our recommendations for effective strategies for maximizing return on real estate investments are:

Strategy 1: Focus on existing cash flow and accept a return that does not jeopardize capital. Invest in markets that are stable with a professional real estate industry. For example, invest in apartment buildings in selected locations of Toronto, Canada, on the basis that 24-hour cities will converge in terms of valuation, Toronto currently being undervalued in comparison with other major metropolitan markets.

Strategy 2: Focus on future cash flow and invest in property that is in need of redevelopment and/or remarketing with a property manager that can do the upgrading and re-leasing. For example, invest in office buildings where barriers to new supply exist in a market with a diversified local economy.

Implementing the Strategy. An investor should engage an advisor who can follow the agreed strategy. Among advisors, find one who is hands-on with local knowledge, close to the market, who can identify trends and who understands the property's relationship to the local economy. The real estate advisor should remain with you throughout your ownership of the property and be able to identify and implement a redevelopment, disposition or replacement strategy. Deal with advisors who have professional relationships with all current and potential parties: tenants, owners, property managers, governments and lenders.

The advisor should select the property, create and implement the right investment package, including ownership structuring and property management, and identify the key factors relevant for the intended strategy to produce the desired result. Buy on the underlying fundamentals that create the cash flow, rather than on the cash flow.

Quality properties, quality tenants, quality leases and quality property management are available in the real estate markets of Canada and the United States. These markets are ideal to implement the recommendations of many seasoned and successful portfolio managers who advocate real estate for its cash flow, transparency of financial and market information and for its proven performance. Real estate is poised for the future to continue its position of bringing investors stable earnings streams with portfolio diversification benefits. ■

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