



Institutional Capital Refocused on Real Estate



George Pandaleon
President, Inland Institutional Capital Partners

Q: After slowing demand, is institutional capital focused on commercial real estate again?

A: We are certainly seeing increased institutional demand for U.S. commercial real estate assets – particularly from large pension funds and life insurance companies. Foreign pension investors were a bit ahead of this trend, but domestic investors are starting to increase their allocations as well. Over the past two years, the rebound in the stock market has left them with a smaller percentage of their portfolios in real estate than they would like to have. This, combined with the relative stability of high quality commercial real estate, is generating significant interest again. The issue has been the dearth of property coming to market for sale. This demand/supply imbalance is driving prices up and income returns (cap rates) down. Despite increasing prices, overall property values remain significantly lower than they were a few years ago. Inland’s proven ability to assemble large portfolios by acquiring a significant number of relatively small properties makes us an attractive partner for institutional investors.

Q: What types of assets are generating the most interest?

A: The pendulum is now swinging back toward more rational investment performance expectations. Today’s institutions are focused on the predictable returns provided by stable, high quality real estate assets. There is probably no better example of that than necessity-based shopping centers in densely populated urban and suburban metropolitan areas. Gone are the days when over-leveraged development projects were the most attractive assets, from a yield perspective. Ultimately, many of those investments proved to be too risky when the economic slowdown stopped new development in its tracks.

Q: It sounds like institutions want to be more active partners in their real estate ventures. Is that a departure from the past?

A: Today we’re seeing a much different model than we saw in the mid 2000’s. At that time, most institutions simply wanted to invest very large amounts of capital quickly. They achieved this by making major equity commitments to institutional real estate fund managers. These managers kept the institutions at arm’s length and provided minimal property-level information. In hindsight, that model proved to be inadequate when the trouble came. Major misalignments of interest became apparent, and critical investor information was often not made available. Flash forward to 2010, and institutions want proven partners who have financial ‘skin in the game,’ in addition to having solid hands-on operating capability.

Q: Can you talk about the next 12 to 24 month horizon?

A: The smart money is positioning for brighter days ahead as the economy slowly rebounds. A significant amount of capital is waiting on the sidelines to acquire well-managed shopping centers, because investors sense the opportunity to grow future rents. In terms of property fundamentals, it feels like we’ve reached the bottom. Cap rates have compressed back down to the 7.0% to 7.5% range, and sometimes lower. But it must be kept in mind that those returns are based on depressed income from the properties. Once all the ‘involuntary owners’ like banks and insurance companies decide it’s time to remove some of these assets from their balance sheets, they will find plenty of willing buyers.

Inland Institutional Capital Partners specializes in identifying large scale investment opportunities with institutional investors for the real estate companies and REITs that are part of The Inland Real Estate Group of Companies, Inc. Since 2005, Inland Institutional Capital Partners has sourced transactions with a value in excess of \$7.5 billion.