



Welcome to this very special edition DCREC Podcast series, sponsored by the Define Contribution Real Estate Council. An organization passionate about providing American workers a financially secure retirement by investing in commercial real estate. And now, here's today's host Todd Schnick.

Todd: Good morning and welcome back to this special edition DCREC Briefing. I'm your host, Todd Schnick, thank you for joining us on Todd (00:38) for today the benefits of investing in private commercial real estate, joining me is Jennifer Perkins a Portfolio Manager with Principal Real Estate Investors. Jennifer good to be with you.

Jennifer: Hey, thanks Todd. Great to be with you.

Todd: Good to be with you, thanks for making time to join me. Before we discuss these benefits let's start with this, what is private commercial real estate?

Jennifer: Sure. Private commercial real estate is also called direct owned real estate because really it's just that as an investor you're investing in units of ownership of office building, industrial building, apartment building, retail centers and sometimes even hotels. They are private transactions between a willing buyer and seller and specific individual property.

Todd: Okay, so why is it a good idea to include commercial real estate in the savings plan for the future?

Jennifer: Well really there's 4 main reasons private commercial real estate is attracted to long term investors. First, private commercial real estate provides diversification into a major asset class, this actually the 3rd largest in the U.S economy. It helps dampen the volatility of public stock and bond market, private commercial real estate also offers a steady stream of income or what's referred to as yield and it acts as a potential hedge against unexpected inflation.

Todd: Okay interesting, so let's start with number 1 – diversification.

Jennifer: Sure. As investors saving for the future it's always great to have different types of investment in your portfolio that don't perform the same way at the same time. So investment professionals refer to this as uncorrelated return. Real estate is not highly correlated with the traditional asset classes, meaning stocks and bonds, and historically has proven to be a true diversifier as commercial real estate is often driven by different economic factors than stocks and bonds. Demand for commercial real estate is said to return employment and generally employment lag in economic cycle. So reason number 2 has to do with volatility including commercial real estate in an investment strategy, can also help reduce the volatility or variability of return we see particularly in the stock market. Adding some exposure to commercial real estate can provide more stability to the return, thereby improving the total returns of a portfolio adjusted for risk.

Todd: Could you explain that a bit more?



Jennifer: Sure. You might remember all of the news coverage earlier this year about the volatility that was occurring in the equity market, returns were dramatic up 1 day and down the next.

Todd: I certainly do remember that.

Jennifer: Investing in commercial real estate can help dampen or mitigate that volatility and create a smoother return pattern to help investors weather the storm per se, so there's not a desire to throw on the towel and cash out at a wrong time.

Todd: Okay so why is it that a private commercial real estate has less volatile returns?

Jennifer: There's really several reasons, the most obvious being its private nature meaning the private transactions that occur between a buyer and seller for specific property versus being offered on a public exchange. Also values of private commercial real estate are supported by in place contractual leases generally referred to as rent. Surrounding safe fundamentals, meaning tenet demand and available supply as well as investor return requirements, all of which do not dramatically change each and every day, with lower volatility including private commercial real estate can help decrease overall risk and improve the stability of a portfolios return.

Todd: Alright so we've covered increased diversification and lower volatility, so tell me how private commercial real estate can provide the steady income?

Jennifer: So Todd have you ever rented an apartment or office based maybe even a storage unit?

Todd: I'm currently living in an apartment and I've rented office space and storage unit.

Jennifer: Wow you've done it all. Okay, so the rent you paid goes to the property owner obviously so now if you split tables and you've think about it as an owner of the real estate, the rent that you're paying increase that steady and fairly predictable stream of income because your rent payment has an associated term risk with it. So owners can actually anticipate receiving this rent over a certain period of time. For example, if your, let's take your office lease as an example, has a term of 5 years the owner of that office building anticipates receiving your monthly rent payments over 5 year period. Does that make sense?

Todd: Yes, sure it does. So once I've think like an owner versus a tenant yeah it does make a lot of sense.

Jennifer: So finally reason number 4, investing in private commercial real estate can help protect your future purchasing power as a hedge against unanticipated inflation.

Todd: So commercial real estate can help protect your future purchasing power? Meaning?

Jennifer: Inflation chews away at your invested savings and you want your investment to keep pace with or hopefully exceed that inflation. So general inflation is already underwritten into commercial real



estate property values but unanticipated inflation may materialize in quickly rising expenses or material cost to build commercial buildings, like the cost of steel or the cost concrete or glass even. So private commercial real estate values are generally able to respond favourably if this unanticipated inflation occurs for a couple of different reasons. Commercial leases generally allow for cost sharing of expenses with tenants and or, they may include inflation escalators that increase the rent on a periodic basis. Further, appraised values of existing buildings are benchmarked against the cost to build new buildings.

Todd: Okay so let me recap here so an investment in private commercial real estate is attractor because it provides diversification, it can lower portfolio volatility, it provide that steady and fairly predictable income stream that, and you can potentially protect future purchasing power a hedge against inflation.

Jennifer: Exactly, you've got all 4 reasons down Todd.

Todd: Alright okay. Thanks. So this is all interesting Jennifer but what is it actually mean to me is it is it actually possible for a guy like me to become an owner of multi-million dollar commercial properties and experience these benefits?

Jennifer: You can. Many employer sponsored pension plan have invested in private commercial real estate for years as part of their long term investment strategy as they look to grow assets to pay benefit to future retirees however, recently plan (07:27) sponsored of corporate and public defined contribution plan have also include private commercial real estate in their investment funds that they offer to their plan participants.

Todd: Well I have a 401K should I should I look for a private commercial real estate within my investment selections?

Jennifer: Well typically private commercial real estate is not included as a standalone investment that you would be in your investment line-up, it's usually included in what we call multi-asset funds such as target date or target risk or real asset funds. So if private commercial real estate is already included in these funds, you more than likely already owned shares of unit or units of large diversified commercial real estate funds that own many properties in many locations across the United States, so your investment which although it may seem small to you it's actually pooled with money from other investors like you to buy and hold a portfolio of commercial real estate. So once you have ownership you'll start to experience the benefits but expect the benefits to occur over longer time per annum (08:41) that's what makes private commercial real estate a great fit for retirement investors (08:47) where there is a 23 year time line. Professional managers of target date, target risk and real asset funds take a longer terms to see this (08:56) view when they look to add private commercial real estate in their investment portfolio. So Todd to sum it up think of it as the slow and steady return produced by private commercial real estate can help you in winning your savings rate. (09:11)

Todd: Good stuff, well Jennifer thank you for sharing these benefits of investing in private commercial real estate. That's all the time we have for today, on behalf on my guest I am Todd Schnick we'll see you next time on the DCREC Briefing.