

RECOMMENDED READING

Active Private Equity Real Estate Strategy

by David J. Lynn, Ph.D. (©2009, John Wiley & Sons, Inc., 286 pages)

REVIEWED BY SCOTT R. MULDAVIN, CRE, FRICS



THIS BOOK “IS A COLLECTION OF abridged market analyses, forecasts, and strategy papers from ING Clarion’s Research & Investment Strategy (RIS) group. . . It is not meant to be a comprehensive approach to strategy formulation for the real estate industry, but instead illustrates a cross section of private equity strategies across the various property types.”¹

Active Private Equity Real Estate Strategy effectively achieves what it intends, providing readers with an inside look at the kinds of issues, investment factors and other considerations that go into private equity real estate decision-making at one of the world’s largest real estate investment management organizations. Books on private equity real estate investment are rare, and even rarer is a book that spends less time defining terms and more time discussing the nuance and process of making private equity decisions. In this case, unlike in making sausage, the process is enjoyable to learn about.

While most of the chapters focus on describing the key investment drivers and risks for particular property sectors, and will be quite useful for those readers who want to understand how institutional property investors think about real estate, it is in chapters 11 and 12 where the book lives up to its name. Chapter 11, “Active Portfolio Management using Modern Portfolio Theory,” introduces “Hypothetical Fund Forecasts” utilizing sector, region and metropolitan area forecasts. Key issues in benchmarking, balancing and rebalancing portfolios and scenario analysis to test the impact of rebalancing are discussed. While the

treatment of these issues is not extensive, it is difficult to find books that address them at all.

Chapter 12 on derivatives is quite good. While derivatives are seen as somewhat of a “dirty” word today, this chapter demystifies some important private equity-based derivatives that can have important applications to active portfolio management through hedging, asset allocation and rebalancing, and speculation. The chapter discusses the key risks of derivatives—liquidity, basis risk, counterparty risk and interest rate risk, and provides some detailed applications of derivatives as a form of portfolio insurance and to rebalance a fund.

The book’s initial chapters start with an overview of the key markets and trends that form the basis of more sophisticated investment strategy and active portfolio management techniques, which are discussed in the second half of the book. While the initial chapters on the real estate market

About the Reviewer



Scott R. Muldavin, CRE, FRICS, is president of *The Muldavin Company* and executive director of the *Green Building Finance Consortium*, San Rafael, Calif. Muldavin is a co-founder of *Guggenheim Real Estate*, a \$4 billion private, open-end real estate fund, and has been a pension consultant for *CalPERS*, *CalSTRS*, *Alaska Permanent Fund* and other pension funds, as well as a consultant to scores of private and public real estate equity managers including *Prudential*, *RREEF*, *Merrill Lynch*, *Kilroy Realty* and others.

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and forecasting are straightforward and may be useful for those with limited background in these issues, the chapter on recession simulation is interesting and of course, quite important in today's market environment.

Chapter 4, "Subprime Fallout and the Impact on Commercial Real Estate," was written in the summer of 2007, just prior to the unanticipated (at least as to its severity) collapse of the real estate markets, and demonstrates the type of analysis produced that summer that led to forecasts of no recession and limited impact of the residential subprime crisis on commercial real estate markets. While I am not sure the authors want to advertise forecasts that failed to materialize, I applaud them for keeping the chapter in and providing students and other readers an inside look at how "event" risk and the psychology of markets can catch even the smartest of investors by surprise.

The book is also notable because it does not focus on office and retail investment, the focus of most institutional investor portfolios, but presents an excellent framework and assessment of residential land investment as well as global gateway industrial markets, senior housing and other sectors.

The book's greatest strength—the inside perspective on the process and thinking of a firm providing investment products to investors—is also a weakness. By focusing on the perspective of an investment firm, less information is

provided from the perspective of an investor. The authors do not provide their perspective on where private equity real estate fits in the broader investor portfolio, and they pay less attention to the many shades of private equity based on the relative risks and rewards of investment. Examples include core, core plus, value-added, opportunistic, mezzanine debt (equity) and related typologies that provide some classification that enables investors to actively manage their private equity real estate portfolios.

While I never like to critique a book for what it does not do—when it never intended to do it—I cannot resist. I would like to have seen a bit more on performance assessment and private equity deal structures, which have become important to the strategic development and management of private equity real estate. What are the trends in private equity deal structures and performance-based fund contracts? Are clawbacks becoming more important? How will the problems many private placement deals are experiencing change the way deals are structured?

In summary, few books on private real estate equity exist, and David Lynn and ING's contribution offers a unique glimpse at the internal research and strategy development process for one of the industry's largest real estate investors. By focusing on what the book says about the strategy process, students and practitioners will gain insights not available in standard academic textbooks. ■

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1. From Preface to the book.