Commentary

Creating Value in CRE Investment Firms

Investment firms need the appropriate entities and organization structures.

By **Joseph J. Ori** | October 22, 2024 at 05:13 AM

Thousands of real estate investment companies are located in the U.S. from behemoths like Blackstone to the local investor that owns 200 apartment units or a small strip shopping center. The key investment objectives of these firms are to earn various fees for management, asset management and brokerage services and a return on the invested equity capital in the real estate properties. If the real estate firm has multiple entities or raises capital in a fund structure, there are four pockets of value in the organization. These are as follows:

- The ownership interest or carried interest of the general partner in each property
- The property management fee of 3%-6% of effective gross income earned, if the properties are self-managed
- The asset management fee of 1% to 2% of the equity capital raised or net asset value paid to run the fund or portfolio of properties
- Other fees include brokerage, advisory, financing, construction, and sales commissions which typically range from 1.0% to 6.0%

It is critical that real estate investment firms have the appropriate entities and organizational structures to earn these fees and maximize their corporate enterprise value. In most local and regional CRE firms these fees are scattered throughout each entity limited partnership (LP) or limited liability company(LLC) and do not flow up to a top-tier holding company entity where the full equity and enterprise value can be realized. In many cases, they are not even charged or paid. Even larger national firms do not have a holding company structure to maximize these four pockets of value.

The corporate structure should include a holding company formed as an LLC or LP and subsidiary LLCs or LPs that operate the property management firm, general partner, asset management entity, and an entity to collect brokerage, advisory and other fees. Some firms may combine these four value entities into two or three separate units, but I advise maintaining them as four separate entities to maximize their internal and external sales value.

The value of the holding company will be enhanced greatly if it has these three or four subsidiaries, all of which have different value drivers, and that value is consolidated into the parent holding company. If the CRE sector is in a "Bear Market" as during the last few years since the Fed began raising interest rates in March 2022, the four value pockets can be used to provide additional capital to the holding company through sales and financings.

Once all the entities are consolidated into the holding company, the value of the holding company will increase significantly. This structure also provides the holding company optionality in creating and realizing value in these subsidiary entities. For example, it can sell the property management company at a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA), it can sell all a portion of the general partner based on its carried interest value and it can sell the brokerage and asset management entities based upon a percentage of assets managed.

The owners of the holding company can also take the entire entity public or sell it to a third party. This ownership structure for private CRE organizations will maximize the four pockets of value and create enterprise value in the holding company that is typically not realized in most private real estate investment firms.

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