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Real estate clients are deeply misunderstood by wealth managers - by Liz Darling

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Real estate clients need a different brand of wealth services, one that provides solutions to support their unique needs. The traditional model of wealth management is incentivized by gathering assets under management (AUM) and short-term results. It also puts a premium on diversification and tilts toward liquidity. This model has a tough time handling concentrated real estate exposure and seeing the value in patient capital.

Commercial real estate clients know this asset class can not only provide growth and cash flow but also a hedge against inflation. In order to support real estate concentrations, the wealth service model needs to look different – a flat fee so that advisors are not rewarded by encouraging investors to sell real estate or invest cash on hand to increase AUM. More focus on cash management and administrative coordination because these enable the deal-making that is part of the industry. Wealth advisors should have an in-depth understanding of the underlying real estate assets by property type and risk profile. Beyond just investment returns, though, we find a sense of purpose in real estate clients through the tangible nature of the investment. As the highly regarded author John Maxwell wrote, “We all want to find our purpose – our individual way of making the world a better place.”

Purpose and a high-level of expertise need to be a part of how the wealth services industry considers appropriate asset allocation for those whose passion lies in real estate. “Purpose, passion and expertise matter, they have value and they also impact risk tolerance,” said Susan Dahl, CEO of LEVATUS Wealth Services.

While risk tolerance is a typical question that most financial advisors ask their clients, there is little thought on how to interpret those results. Ironically, last month, an article in The Wall Street Journal’s report on Wealth Management pointed out that the actual questions advisers ask their clients to determine risk, combine too many disparate concepts. It is impossible to begin to build a risk-appropriate portfolio based on a client’s response to imprecise questions. This is critically important because clients’ answers to these questions have historically formed the foundation of how and where risk is taken in their portfolio.

We are beginning to see signs of a change in perspective in the broader market. Real estate is beginning to rise in the ranks of main stream growth allocations. As parts of the “alternatives” marketplace struggle, real estate is gaining increasing attention.

With a 9.7% 20-year annualized return as of second quarter 2017 (based on data from the NCREIF Property Index, or NPI), real estate stacks up very well against other asset classes that are growth engines in the portfolio. It provides growth, cash flow and a hedge against inflation. For wealthy clients, who often have fewer limitations regarding liquidity, this is a compelling mixture.

The approach to concentrated allocations to real estate need to be considered with a broader perspective in the wealth services industry. One that puts value on the impact of expertise on risk tolerance and acknowledges the purpose of the investment beyond just returns. This combined with a long-term investment strategy and a focus on specific solutions that better support the asset class create a good foundation from which to begin.

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