IMC INSTITUTIONAL MORTGAGE CAPITAL

How family offices invest in real estate

And why the long view is essential

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In an economy that offers an ever-increasing array of complex investment options, it still makes sense for family offices to invest in real estate.

"Unlike some other types of investment, real estate is a hard asset. It can last through several generations within a family office portfolio, so if you're investing in property today, it's something you can pass on to the next generation," says Ken McKinnon, Senior Managing Director and Equity Partner at Institutional Mortgage Capital (IMC) in Toronto.

Ken McKinnon, Senior Managing Director, Head of Relationships at IMC

"This is especially so if the investment is in high-quality real estate. It's a good inflation hedge and it can hold its value not just over generations, but in some cases for centuries," he says.

The landscape for family offices

"Real estate is a popular asset class for family offices," notes Campden Wealth Ltd.'s 2024 North America Family Office Report, published online by RBC. The report surveyed 183 family offices in North America, including 26 in Canada.

"Our survey found 73 per cent of North American family offices had some direct real estate exposure. Residential is the most popular sector for family offices (81 per cent), but around half the family offices have some exposure to industrial, office or retail," the report says.

Investing in real estate is a natural fit for many family offices because it provides a steady income over a long period of time, McKinnon says.

"A lot of family offices grew out of one- or two-family businesses, which at some point grew to where the family either sells or monetizes the business and is looking for investments for the profits," he explains. "One reason that real estate is usually part of that mix is because families hear of direct opportunities from friends, families and managers especially within their local market."

Real estate is also an easy asset class for investors to understand, McKinnon adds.

"You can usually get your head around what a property is worth today fairly quickly. Also, most families have some investment history with real estate—they've either leased space or owned a building, so they've already had some business interaction. It's not like a foreign asset class where they're completely reliant on a third party's expertise to navigate the investment."

Risks on the horizon

There are risks to investing in real estate, and family offices have been living through some of them over the last few years. In particular, “U.S. commercial real estate has been described as a time bomb,” the Campden/RBC report notes.

“In the office market, the over-arching trends have been [working from home], reducing demand while new build has pushed up supply and vacancy rates,” the report says. “Overall commercial property prices are estimated to have experienced a 17 per cent decline from their 2022 peak.” Other risks for real estate generally are potential trade wars and uncertainty over whether interest rates will continue to fall.

“For starters, the strength of the American dollar should be good for investors in Canada, particularly international buyers,” he says. The Canadian dollar has declined since late September from about 74 cents US to roughly 70 cents today.

While it may be unclear whether interest rates will keep going down, the Bank of Canada’s key lending rate is 3.00 per cent, down 200 basis points since the peak and lower than the U.S. benchmark rate of 4.50 per cent. “The lower the interest rate, the better it usually is for the valuation of the real estate,” McKinnon says.

Investing directly is, of course, not the only way for a family office to be in the real estate market. Family offices can purchase real estate investment trust units, for example; some REITS are on public markets while others are available on private markets and must be purchased through a specialized dealer.

A family office can also participate in a limited partnership, which pools capital and either invests in real estate debt or equity. In either case, day-to-day management is left to the managing general partner. Investors can also get exposure to real estate debt, either by investing in a public fund, a mortgage investment corporation or lending money directly to an owner or developer.

“Lending against a property can be attractive to long-term investors for a number of reasons,” says Robert Fitzpatrick, Senior Managing Director at IMC. “It can generate a predictable rate of return, functioning much like fixed income securities in the overall portfolio with a yield pick-up.”

Real estate debt also offers diversification across asset classes. “It’s worth it for family offices considering real estate investments to look more broadly outside of their local market and at different property types,” McKinnon adds.

“It’s not just residential, office or industrial,” he says. “There are a lot of other types of properties, ranging from storage facilities to student housing and hotels. Right now, for instance, purpose-built rental housing is popular, but at different times each of these classes has done well in Canada, and this should continue as long as people around the globe want to live and work here.”

The IMC team, which McKinnon helps lead, has been together for almost 30 years and has originated more than 1,400 commercial mortgages with a total value of more than $14 billion.

IMC currently has two investment funds open for new client commitments: Real Estate Debt Fund XIV, a value-add, closed-end that invest in a diversified portfolio of Canadian commercial short-term mortgages, targeting returns of 10% to 12%; and Active Mortgage Fund (AMF), an open-ended fund that delivers a consistent and attractive income stream to investors, while controlling portfolio risk, by investing in a diversified portfolio of Core, short term Canadian commercial mortgages. The objective of the funds is to deliver a consistent and attractive income stream to investors, while controlling portfolio risk.

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