# OAK INVESTMENT MANAGEMENT GROUP

DECEMBER (2) 2012: The Re-investment Problem in Real Estate

*The re-investment problem in finance refers to the difficulty in re-investing a windfall. Part of the problem can be to do with the general economic cycle as if you are selling an asset at a 'good' price it is likely that there are many buyers chasing analogous assets. If this is the case then getting money back to work in the same sector will be competitive and might well mean that it was better not to sell the original asset in the first place.*

There are few asset classes that are as affected by the re-investment problem as real estate. Although this seems to be an enviable problem (as it could be argued this is the opposite of a liquidity problem) it is something that a real estate investment professional has to take seriously. At its heart to deal with the re-investment problem an investor has to examine and assess the realistic and realisable alternative investment opportunity to the position currently before a property is sold.

Why is this important in real estate particularly? First the round trip costs of investing in and coming out of real estate are significant. Professional, agency and regulatory fees are large even before tax considerations are taken into account. Secondly, (*especially* for prime) real estate assets capital value element is disproportionately more important than the income element but this same capital element is disproportionately correlated with the rest of the market or sub-market from which the asset comes. So, for example, if a prime asset is sold to buy another a prime asset, all other things being equal, many years income will have been thrown away for no benefit.

Sometimes, sales are presaged by the need to pay down a debt position, to stabilise another part of the portfolio or to keep 'dry powder' for unknown opportunities. The first two are self-evident priorities but the last can be fraught with dangers. Possessing a cash pile can seem like a deceptively safe strategy. Although liquidity has been at an exceptionally high premium over the last few years, liquidity to be worth anything still needs to be committed at some point in the cycle. Looking forward, the value of cash has an uncertain future – indeed it could be argued that the trickle, the flow and then the flood to hard assets will be the origin of the next boom.

The re-investment problem can be mitigated by having a well thought out strategy that reads the cycles of the economy correctly. Of course, it is impossible to know exactly what will happen but managing investment in real estate is like being the captain of a large ship. It is important to scan the horizon for likely and probably risk factors, it is crucial to prepare for various scenarios and it is essential to set a course far in advance. Like a large ship, real estate usually moves slowly so it is important to be on top of things for the future, sometimes years in advance. Conversely, by the time a problem is obvious it is usually the least optimal time to deal with the issue at hand.

Good strategic planning in real estate is about knowing what and when exposure to various value catalysts / risk factors is likely. Dealing with the re-investment problem is a natural part of that process – it happens to be at an important juncture between two investments / assets – but it is still about managing a smooth running commitment to real estate. Correctly managed re-investment is as much an opportunity to deliver value as risk.

---

*Nicholas Frankopan is Managing Director of Oak Investment Management Group pan-European real estate investment manager. To contact the author please email [nfrankopan@oakadvisors.co.uk](mailto:nfrankopan@oakadvisors.co.uk) or learn more about the group at [www.oakimg.com](http://www.oakimg.com).* 