



Durable Growth Begins with Strong Foundations

Commercial Real Estate Investing 101

A Beginner's Guide to
Private Real Estate Investing



INTRODUCTION —

Commercial real estate has long been an important component of investment portfolios for institutions, family offices, and high-net-worth individuals. While many investors are familiar with owning a home or purchasing publicly traded real estate investment trusts (REITs), investing directly in private commercial real estate can be less familiar.

Private real estate investments provide an opportunity to participate in the ownership of income-producing properties without taking on the day-to-day responsibilities of operating them.

However, understanding how these investments are structured, how returns are generated, and who is responsible for managing the investment is essential.

This guide introduces the fundamentals of investing in commercial real estate as a limited partner (LP), including the role of the sponsor, common investment structures, fees, projected returns, and the risks investors should consider.

WHAT DOES IT MEAN TO INVEST AS A LIMITED PARTNER?

In a typical private real estate investment, investors contribute capital to an entity that owns the property. The sponsor manages the investment, while limited partners participate in the financial results without assuming day-to-day operational responsibilities.

THE KEY DISTINCTION

LP investors provide capital and participate in the potential financial returns. The sponsor is responsible for executing the investment strategy, managing the asset, and making major investment decisions under the governing agreements.

A SIMPLIFIED INVESTMENT STRUCTURE

A simplified view of how a private real estate investment is structured.



How Commercial Real Estate Investments Generate Returns



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Commercial real estate investments can generate attractive, risk-adjusted returns through three primary sources: current income, value-add improvements, and property appreciation.

These return drivers often work together, and their relative contribution can vary based on the property type, market, business plan, and investment strategy.

THREE SOURCES OF RETURNS

Real estate investments can generate returns through a combination of current income, value-add improvements, and property appreciation. Each component plays a role in total investment performance.

1

CURRENT INCOME
CASH FLOW

Rental income from tenants provides regular cash distributions, which can generate a meaningful portion of total returns, especially in the early years.



2

VALUE-ADD IMPROVEMENTS
INCREASED INCOME

Strategic renovations, operational efficiencies, and improved management can increase net operating income (NOI) by driving higher rents, reducing expenses, and improving occupancy.



3

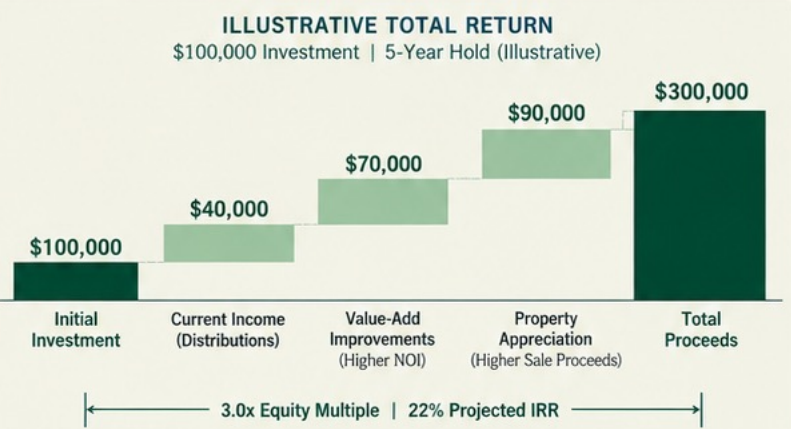
PROPERTY APPRECIATION
INCREASED VALUE

Over time, the property's value may increase due to stronger fundamentals, higher market rents, limited new supply, and changes in capitalization rates.



ILLUSTRATIVE EXAMPLE

The chart below shows how the three sources of returns can contribute to the total return of a hypothetical value-add investment.



KEY TAKEAWAYS

- Multiple Return Drivers**
Current income, value-add improvements, and property appreciation can all contribute to total returns.
- Varying Contribution**
The mix of returns depends on the property type, market, and business plan. Some investments may be more income focused, while others may have greater upside from value-add or appreciation.
- Compounding Effect**
Increasing NOI through operational improvements can drive both higher cash flow and increased property value.
- Sponsor Execution Matters**
Realizing these returns requires a sponsor with the expertise and resources to execute the business plan effectively.



KEY TAKEAWAY

Commercial real estate can generate attractive returns through a combination of current income, value-add improvements, and property appreciation.

Understanding Investment Returns



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Real estate investments can generate attractive, risk-adjusted returns through a combination of current income, value-add improvements, and property appreciation. There are several key metrics used to evaluate these returns, and each provides a different perspective on performance.

Understanding these metrics can help you set realistic expectations, compare opportunities, and assess whether an investment aligns with your goals.

KEY RETURN METRICS

The following metrics are commonly used to evaluate real estate investments:



CASH-ON-CASH RETURN

Measures the annual cash distributions an investor receives relative to their initial investment. This reflects the income component of the return.



INTERNAL RATE OF RETURN (IRR)

The annualized rate of return that accounts for all cash flows, including distributions and the final sale or refinance. IRR captures both the timing and magnitude of returns.



EQUITY MULTIPLE

Total cash returned to investors (distributions plus sale proceeds) divided by the initial investment. For example, a 1.8x multiple means \$1.80 returned for every \$1.00 invested.

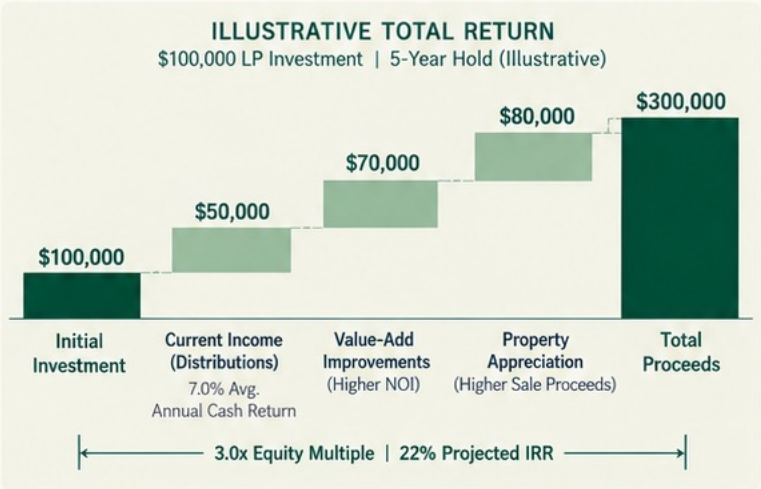


HOLD PERIOD

The expected length of time an investment is held. Returns can vary significantly based on hold period, market conditions, and the execution of the business plan.

ILLUSTRATIVE EXAMPLE

The chart below shows how the three components of return can contribute to the total return of a hypothetical value-add investment.



HOW EACH COMPONENT CONTRIBUTES

Each component plays an important role in driving total returns, and the mix can vary based on the property, market, and investment strategy.

1

CURRENT INCOME

Provides steady cash distributions, which can represent a meaningful portion of total returns, especially in the early years.

2

VALUE-ADD IMPROVEMENTS

Increasing net operating income (NOI) through renovations, operational efficiencies, or higher rents can drive higher cash flow and increase the property's value.

3

PROPERTY APPRECIATION

Over time, the property's value may increase due to stronger fundamentals, higher market rents, limited new supply, and changes in capitalization rates. This value is typically realized when the property is sold or refinanced.



KEY TAKEAWAY

Real estate returns are driven by current income, value-add improvements, and property appreciation. Evaluating multiple return metrics provides a more complete view of potential performance.

Understanding Investment Risk



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Every real estate investment involves risk. While private real estate can offer attractive, risk-adjusted returns, outcomes are not guaranteed. Understanding the key risks — and how an experienced sponsor seeks to mitigate them — is essential for making informed investment decisions.

Risk is not inherently negative. It is a natural part of investing, and with the right strategy, due diligence, and sponsor expertise, risks can be managed to help protect investor capital and improve the likelihood of achieving targeted returns.

KEY RISKS IN REAL ESTATE INVESTING

While each investment is different, the following are some of the most common risks in private real estate:



MARKET RISK

Changes in the economy, interest rates, job growth, and supply and demand can impact rental rates, property values, and exit opportunities.



EXECUTION RISK

Delays, cost overruns, or operational challenges can impact the ability to complete planned improvements and achieve projected returns.



FINANCING RISK

Changes in interest rates, loan terms, or lender requirements can increase costs or limit refinancing options at exit.



TENANCY RISK

Lower-than-expected occupancy, tenant defaults, or higher turnover can reduce rental income and increase operating expenses.



REGULATORY RISK

Changes in laws, regulations, or tax policy can impact operating costs, development plans, or the overall attractiveness of the investment.

RISK MITIGATION STRATEGIES

An experienced sponsor uses a combination of strategies to help manage risk, including:

	Disciplined Underwriting	Conservative assumptions and detailed analysis to evaluate potential risks and returns.
	Active Asset Management	Hands-on management to drive occupancy, control expenses, and execute business plans.
	Prudent Capital Structure	Appropriate leverage levels and fixed-rate financing when possible to reduce exposure to rate volatility.
	Diversification	Investing across markets, property types, and sponsor relationships to reduce concentration risk.
	Experienced Team	A knowledgeable team with deep market expertise to navigate challenges and adapt to changing conditions.

RISK AND REWARD

Real estate investments involve risk, but with higher risk often comes the potential for higher returns. The goal is to generate compelling, risk-adjusted returns by carefully evaluating opportunities and actively managing the key risks throughout the investment period.



While risks cannot be eliminated, an experienced sponsor can help identify, manage, and mitigate them to improve the likelihood of a successful investment outcome.



KEY TAKEAWAY

All investments involve risk. Understanding the key risks — and how they are managed — is essential for evaluating the potential returns and determining if an investment aligns with your objectives and risk tolerance.

The Importance of the Sponsor



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In private real estate investments, the sponsor is one of the most important factors in determining success. The sponsor provides the vision, expertise, and capital to acquire, improve, operate, and ultimately sell the property. Even the best investment strategy can fall short without an experienced and well-aligned sponsor.

For first-time investors, evaluating the sponsor’s track record, execution capabilities, and alignment of interests is critical to understanding both the potential returns and the associated risks.

WHAT A SPONSOR DOES

A real estate sponsor is responsible for the full investment lifecycle, from acquisition through exit.



KEY QUALITIES TO EVALUATE

When assessing a sponsor, consider the following:

	Track Record Experience with similar investments and a history of successful execution.
	Market Expertise Deep knowledge of the target market and local operating landscape.
	Execution Capabilities Proven ability to source deals, complete value-add projects, and operate efficiently.
	Financial Discipline Conservative underwriting, disciplined capital management, and prudent use of leverage.
	Alignment of Interests Sponsor invests meaningfully alongside LP investors and is incentivized for long-term success.

ALIGNMENT OF INTERESTS

A strong sponsor structure helps align the sponsor’s incentives with those of investors.



QUESTIONS TO ASK

These questions can help you better understand a sponsor’s experience, strategy, and alignment with your goals.

- ☐ What is the sponsor’s track record with similar investments?
- ☐ How many transactions have they completed, and over what time period?
- ☐ What is their experience in the target market?
- ☐ Who will be responsible for executing the business plan?
- ☐ How much capital are they investing alongside LP investors?
- ☐ How are their incentives structured?
- ☐ What challenges have they faced, and how were they resolved?
- ☐ Can they provide references from past investors or partners?



	KEY TAKEAWAY
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A sponsor’s experience, execution capabilities, and alignment of interests are critical factors in achieving attractive risk-adjusted returns in private real estate.

Understanding Sponsor Fees and Compensation



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Sponsors are compensated through a combination of fees and performance-based incentives. These fees cover the costs of sourcing, acquiring, improving, operating, and ultimately selling the property, while the performance incentive aligns the sponsor’s interests with those of investors.

Understanding the different types of fees — and what they cover — can help you evaluate whether a sponsor’s compensation structure is reasonable and aligned with the value they provide.

TYPES OF SPONSOR COMPENSATION

The following fees are commonly used in private real estate investments:

ACQUISITION FEE

Compensates the sponsor for sourcing, underwriting, and closing the investment.

TYPICAL RANGE
0.5% – 2.0%
of purchase price

EQUITY PLACEMENT FEE

Compensates the sponsor for raising equity capital from investors.

TYPICAL RANGE
3.0%
of equity raised

ASSET MANAGEMENT FEE

Ongoing fee for day-to-day property management, asset oversight, reporting, and investor communications.

TYPICAL RANGE
1.0% – 2.0%
of effective gross revenue (EGR) or net operating income (NOI)

PERFORMANCE INCENTIVE (PROMOTE)

A share of profits above a specified return threshold, which aligns the sponsor’s interests with investors.

TYPICAL RANGE
Typically 20% – 30%
of profits above the hurdle

EXAMPLE FEE STRUCTURE

The table below illustrates a common fee structure for a value-add multifamily investment. Actual terms can vary by sponsor and investment.

Fee Type	Example	Description
Acquisition Fee	1.0% of purchase price	Paid at closing for sourcing, underwriting, and acquiring the property.
Equity Placement Fee	3.0% of equity raised	Paid on raised equity capital from investors.
Asset Management Fee	2.0% of effective gross revenue (EGR)	Ongoing fee for property management, asset oversight, reporting, and investor communications.

PERFORMANCE INCENTIVE (PROMOTE)

The sponsor earns a share of profits after investors receive a preferred return, with higher splits over higher IRR hurdles.

Return Hurdle (IRR)	Investor Split	Sponsor Split
8% Preferred Return	100%	0%
8% – 15% IRR	70%	30%
15% – 20% IRR	60%	40%
> 20% IRR	50%	50%

KEY CONSIDERATIONS

When evaluating a sponsor’s fees and compensation structure, consider the following:

Market Standards

How do the fees compare to similar investments and the broader market?

Value for the Cost

Do the fees reflect the sponsor’s experience, resources, and the complexity of the investment?

Transparency

Are all fees clearly disclosed and easy to understand?

Alignment of Interests

Does the structure incentivize the sponsor to maximize long-term value for investors?



KEY TAKEAWAY

Sponsor fees and compensation are an important part of the investment structure. Understanding how they work — and how they align with your goals — can help you evaluate opportunities and choose the right partner.

Evaluating an Investment Opportunity



Evaluating a real estate investment involves more than just the projected returns. A thorough review of the property, market, business plan, and sponsor is essential to understanding the opportunity and the associated risks.

The following are key areas to assess when reviewing a potential investment.

KEY AREAS OF EVALUATION

 1	 2	 3	 4	 5
THE PROPERTY	THE MARKET	THE BUSINESS PLAN	THE SPONSOR	THE TERMS
Evaluate the property type, location, physical condition, amenities, and potential for improvement.	Assess local supply and demand dynamics, job and population growth, and competitive properties in the submarket.	Review the strategy for creating value, including operational improvements, renovations, leasing assumptions, and timeline.	Consider the sponsor's track record, experience in the target market, execution capabilities, financial strength, and alignment of interests with investors.	Understand the investment structure, fees, preferred return, promote, hold period, and key legal terms.

TYPICAL DUE DILIGENCE PROCESS

Sponsors provide detailed information to help investors evaluate the opportunity, including:

1		INVESTMENT OVERVIEW Executive summary, investment thesis, and key terms
2		UNDERWRITING Detailed financial model with assumptions and sensitivities
3		PROPERTY INFORMATION Rent roll, operating statements, physical due diligence reports, capital improvement plan
4		MARKET RESEARCH Submarket analysis, comparable properties, supply and demand data
5		SPONSOR BACKGROUND Track record, team bios, relevant experience and prior investments
6		LEGAL DOCUMENTS Private placement memorandum (PPM), operating agreement, and subscription documents

IMPORTANT QUESTIONS TO CONSIDER

Here are some key questions to ask as you evaluate an opportunity:

- 1 What is the investment thesis and how does this property fit into it?
- 2 How is value being created, and what are the key assumptions in the underwriting?
- 3 What are the main risks, and how could they impact returns?
- 4 How does the sponsor's track record and experience compare to similar investments?
- 5 Are the fees, preferred return, and promote structure market-standard and aligned with investors?
- 6 What is the expected hold period and exit strategy?



KEY TAKEAWAY

A disciplined evaluation process — looking at the property, market, business plan, sponsor, and terms — can help you make informed investment decisions and increase the likelihood of achieving your goals.



Before You Invest

Investing in private real estate can be a highly effective way to build long-term wealth, but it's important to do your homework. Every investment is unique, and the right opportunity for one investor may not be the right fit for another.

The questions below can help you evaluate an opportunity, understand the key terms, and determine whether it aligns with your investment objectives and risk tolerance.

KEY QUESTIONS TO ASK



THE PROPERTY

- ☐ What is the property's location and submarket?
- ☐ What is the current occupancy and rent level compared to the market?
- ☐ What are the planned improvements and associated costs?
- ☐ What is the business plan and timeline for execution?
- ☐ What are the key risks specific to this property?



THE SPONSOR

- ☐ What is the sponsor's track record with similar investments?
- ☐ Do they have deep market expertise and local relationships?
- ☐ What is their experience with value-add and property operations?
- ☐ How much capital are they investing alongside LPs?
- ☐ Are their incentives aligned with investors?



THE INVESTMENT STRUCTURE

- ☐ What is the total project cost and how is it being financed?
- ☐ What are the key fees (acquisition, asset management, property management, etc.)?
- ☐ What is the preferred return and promote structure?
- ☐ What is the expected hold period and exit strategy?
- ☐ Are there any potential capital calls?



YOUR CONSIDERATIONS

- ☐ Does the investment align with your financial goals and time horizon?
- ☐ Are you comfortable with the illiquidity and inability to access capital during the hold period?
- ☐ Does the risk/return profile fit your risk tolerance?
- ☐ How does this investment fit within your overall portfolio?
- ☐ Have you reviewed the offering documents with your tax, legal, or financial advisor?

TAX CONSIDERATIONS

Private real estate investments can offer meaningful tax benefits, but it's important to understand how they work.



K-1 REPORTING

Investors typically receive an annual Schedule K-1 reporting their share of the property's income, expenses, depreciation, and other tax items.



DEPRECIATION

Real estate depreciates over time, which can help offset taxable income, even while cash distributions are received. This can result in tax-efficient returns.



CASH FLOW VS. TAXABLE INCOME

Your cash distributions may be higher than your taxable income due to depreciation and other non-cash deductions.

This information is for educational purposes only and not tax advice. Please consult your tax advisor regarding your specific situation.

OTHER IMPORTANT FACTORS

Additional items to consider before investing:



LIQUIDITY

Private real estate investments are illiquid, and there is typically no secondary market for interests.



CAPITAL CALLS

Some investments may require additional capital contributions if costs are higher than expected.



DOCUMENT REVIEW

Review the private placement memorandum (PPM), operating agreement, and subscription documents carefully and consider having them reviewed by your legal or financial advisor.



RISK OF LOSS

All real estate investments involve risk, including the potential loss of some or all of your invested capital.



KEY TAKEAWAY

A thorough review of the property, sponsor, investment structure, and key risks — along with input from your trusted advisors — can help you determine whether an investment aligns with your goals and risk tolerance.