LEVERAGED BREAKDOWNS
CONQUER YOUR REAL ESTATE PRIVATE EQUITY CAREER

Real Estate Private Equity Introductory Guide

by Leveraged Breakdowns

Introduction

I work in acquisitions for a Manhattan real estate private equity ("REPE") megafund. A REPE megafund is a large pool of money set up by a private equity firm for the purpose of investing in real estate companies, portfolios, or single assets. In the couple years I have spent with my investments team, I have invested over $4B of our own equity straight into various real estate opportunities representing over $14B of GAV across more than 150 individual assets.

As an investor, it has been my job to know each one of these assets inside and out. But this only represents the assets that we have closed on. I couldn't begin to count the number of assets for which I have diligenced and built full acquisitions models. I've been fortunate to learn a lot about real estate in a relatively short amount of time with the best investors in the world.

Before I landed my dream job at a REPE megafund, I worked in real estate investment banking ("REIB") at a bulge bracket bank in Manhattan. Despite the prestige of a bulge bracket, transitioning into REPE was a monumental challenge because the REIB skill set exists in an entirely different universe from the REPE skill set. In REIB, my job was to pitch and help execute deals. To highlight the disconnect between the REIB and the REPE skill sets, our most granular REIB models never dove beyond NOI. Analyzing real estate no further than NOI is not a very diligent or detailed approach to real estate investing.

In sharp contrast, any half-decent REPE investments model should individually forecast at least sixteen sub-NOI line items such as:

Income	Controllable OpEx	Non-Controllable OpEx
• Gross Potential Rent	• Repairs & Maintenance	• Management Fee
• Concessions	• Contract Services	• Utilities
• Vacancy	• Turnover / Make-Ready	• Utility Reimbursements
• Other operating income	• Personnel	• Insurance
	• Advertising	• Real Estate Taxes
	• Administrative	• Maintenance Capital Reserves

Suffice it to say, I had to pack in a lot of extra-curricular learning on top of my insanely demanding REIB workload to prepare for my REPE interviews.

I am uniquely positioned to help folks break into REPE given my joint experiences of first approaching the industry as a complete outsider with little insight or connections, and second having now worked a few years investing a lot of money across several industry headline transactions. I'm not the foremost expert on real estate, but I do understand your position quite well and I know enough to make you extremely dangerous both during interviews and on the desk.

What is REPE

REPE Fund Structure

REPE funds invest private money into real estate via equity ownership. Equity holders are at the bottom of the capital stack, which means they are the last to receive their money in the event of liquidation. In other words, equity holders bear the greatest risk and are thus entitled to the greatest return on investment as the residual owners. The mortgage lenders and mezzanine debt holders that are above the equity holders are entitled to nothing more than their fixed coupon and par value at exit, whereas the equity holder's potential return is uncapped.

The fund manager who raises all of the private equity is called the general partner ("GP") whereas its investors are called the limited partners ("LP"). Some GPs hold a significant stake in their own funds, whereas others may contribute closer to 5% of the total fund contributions. LPs make money when their distributions exceed their contributions, i.e. their investment was profitable.

How REPE GPs Make Money

REPE GPs make money in two ways. First, GPs participate in the same equity upside as the LPs. Second, GPs collect fees from their LPs to manage the money. GPs typically collect two types of fees: asset management fees and incentivized promotes. Asset management fees are easy enough to calculate, you multiply the fund capital that has been actually put to work times the asset management fee, which varies by firm but might hover between 1.5% to 2.0% per year.

Incentivized promote structures vary by fund, but generally establish a baseline return before which the GP collects no incentivized promote fee. This baseline return is typically referred to as the pari passu hurdle, which is a latin phrase meaning "equal footing." After the investment returns exceed the pari passu hurdle rate, the GP is promoted to collect profits at artificially inflated percentages of ownership.

For instance, a GP with a 5.0% equity contribution might set its promote structure to be: pari-passu until 10.0%, then a 5.0% promote until 15.0%, and a higher 10.0% promote after 15.0%. This means that, for every dollar earned until a 10.0% return, the GP receives the profits as the 5.0% equity owner per its capital contribution. Yet for every dollar between the 10.0% pari passu and the first 15.0% hurdle rate, the GP is promoted an additional 5.0% to collect each incremental dollar as if it were a 10.0% equity holder. Note, for this first hurdle, the GP only collects its 10.0% promoted ownership of profits on the incremental dollars between the 10.0% and the 15.0% return. The GP still receives the pari passu dollars between 0.0% and 10.0% at a 5.0% stakeholder. After this first hurdle, the second and final hurdle on all dollars beyond 15.0% entitles the GP to an additional 10.0% of artificial ownership on each dollar earned that pushes returns beyond a 15.0%. Again, the pari passu and first hurdle dollars are split per the original contribution and first hurdle of promoted ownership, respectively. Only the additional dollars of profit that push the deal's returns beyond a 15.0% are distributed to the GP at its promoted 20.0% ownership (original 5.0%, plus the first 5.0% promote, then plus the 10.0% promote on the final hurdle).

If this hurts your head, it will make much more sense once covered in Excel. For now, you only need to understand that the promote fees exist to incentivize the GP to manage its investments to outperform. Any outperformance of the investment will both increase the returns to the LPs while increasing the GP's fee.

REPE Career Overview

When you say you want to work in REPE, you mean you wish to work for the REPE GP. The responsibilities at a REPE GP vary by function. Although we will focus primarily on my function, investments, below is a brief overview of typical roles at a REPE to give you a taste for the overall ecosystem.

Investments

Also known as acquisitions, investments professionals decide where to allocate the fund's capital. Investors maintain active relationships with regional brokers who frequently share new investment opportunities. Brokers feed investors' pipelines with new deals. Pipelines are a list of opportunities the fund is actively considering for investment. Deals mature through the pipeline in various stages, beginning with an initial underwrite, followed by second-round due diligence, and then end with final due diligence and investment committee ("IC") approval.

The detail of the investment underwriting matures as it advances through the various stages of the pipeline. The financial analysis for an initial underwrite will be far less detailed than that of a mature opportunity. Initial underwrites help investors quickly sort worthwhile deals from the incessant flood of opportunities. If a deal matures through to the final stage of the investment pipeline, the fund's IC will pass final judgment on the suggested bid price. Multiple REPE funds compete for the same opportunities, so IC tries to pay the least amount necessary to outbid their competition.

Just as an aside, the IC hardly ever denies a transaction; I've never seen it happen. You may think, "if every transaction seems to pass investment committee, then why does it exist?" A cynical response would be that investment committee exists only for external optics. But the cynical view is too narrow; the fact of the matter is that investors are constantly sharing and scrutinizing one another's deals in a process known as shopping.

Investors shop deals amongst one another Shopping a deal is when employees will chat about a thesis while grabbing coffee, lunch, or together in break-out conference rooms. This informal shopping process weeds the unpopular deals from the plausible transactions.

Asset Management

Once the fund has closed its investment in a property, the investment team hands the management of the property to the asset management team. The asset management team sees through the execution of the business plan. Every year, the asset management team sets in place its budget for each property. This budget sets forth the fund's targets for rent increases and expense optimizations to be achieved.

Aside from managing the assets through their hold period, the asset management team also disposes of the assets. This means that the asset management teams run the sales processes. The type of model that asset management teams use to determine their disposition strategy is called a hold/sell model.

Simply put, the hold/sell model helps the asset management team determine whether they should hold or sell the asset. Most hold/sell models take an IRR approach to solving for the hold/sell decision. The key differentiator between a hold/sell model and an investments LBO model is that the beginning part of the hold/sell model reflects actuals whereas the remainder of the hold/sell model reflects projected revenues and expenses.

Investor Relations

The investor relations (IR) team serves the client-facing role of managing communications between the fund and its LPs. IR personnel manage a variety of responsibilities. Some IR personnel are more accounting and reporting oriented, keeping the LP investors up-to-date with the investment performance. Others are more focused on marketing and fundraising to grow the size of the next fund.

Overview of an Investments Career

Careers that Lead Into REPE Investments

Not all professionals break into REPE straight out of college. For instance, I was an investment banking analyst before I transitioned into REPE. Other valid career paths include working at a CRE brokerage shop like Eastdil, HFF, CBRE, etc., working at a real estate investment trust (REIT) either on the acquisitions or asset management side, or working for a research outfit such as Green Street Advisors.

On the other hand, it is a growing trend in the industry to hire analysts straight out of college. A handful of funds have begun to create undergraduate summer analysts positions similar to investment banks and consulting firms. However, such structured programs are still quite rare. The best way to break into REPE as an undergraduate is still good old fashioned networking.

Most internship opportunities you will find will likely be created on an ad-hoc basis. Thus, googling "real estate private equity internships" is going to be an extremely ineffective approach as compared to contacting alumni, friends, and family connections who work in the industry.

Junior Positions in Real Estate Private Equity

Before you become a hot-shot investor, you must pay your dues as a junior analyst and associate. During this phase of your investments career, you are a well-compensated human calculator. Top investments guys simply don't have enough time to chase down every idea and opportunity that presents itself. Thus, they hire junior employees to actually hit the pavement and perform the due diligence and build the underwriting models. Your job, essentially, is to do the thinking for them.

Of course, top investments professionals only want to hire the best thinkers. As a junior investments employee, your reputation for diligence, attention to detail, credibility, and timeliness is your only worth. In other words, your bosses will want you to be able to cut through reams of data at lightning speed without making any mistakes or missing important details. This means you need to quickly develop an eye for what's important, what you can ignore, how to organize everything for quick future retrieval, and how you can structure your models with lots of internal checks to guarantee that nothing is in error.

Sound difficult? It is. In college, 99% is a stellar mark. In investments, 99% accuracy quickly compounds into a garbage model. Even one mistake can ruin your projections, so don't make mistakes. The best way to avoid making mistakes is to build in checks for every single line as you model. Summarizing a monthly cash flow into an annual overview? Make sure each year ties for each line item. Summarizing debt assumed and debt issued? That had better tie back to your implied GAV. I've seen countless analysts burn out who get caught in their messy web of un-checkable models because they did not incorporate checks into their model from the start. If you take any piece of modeling advice from me, build checks. Once you've built in a check, you know that piece of data is correct forever.

Fresh analysts from undergrad in the higher-end funds typically earn salaries comparable to investment bankers, being about $90k base with $30k - $45k cash bonus. Junior analysts typically don't earn carry, though it isn't entirely unheard of. More experienced analysts earn a bit more in the ~$130k base range, with cash bonuses ranging between 25% to 100% of salary depending on the fund and individual achievement. Associates can expect to make at least $200k all-in, and might expect a bit of carry though it may not be guaranteed.

Mid-Level Positions in Real Estate Private Equity

Beyond the junior analyst and associate positions, REPE titles vary between firms. A senior associate at one firm might be a vice president at another, whereas a managing director at one firm may be a senior vice president at another. Regardless, these mid-level positions are typically reserved for people in their late twenties to mid-thirties. Note, these age ranges assume the professional has maintained their career track since graduating college. Typical titles for mid-level positions in REPE include senior associate, vice president, and principal.

Mid-level investments professionals vary in their areas of competency. Some are execution-focused, which means they don't source deals so much as help drive active, typically large M&A deals forward in the investments process. Other investments professionals are more outward-facing, meaning they spend plenty of energy speaking with brokers and researching markets to underwrite opportunities to bring to investment committee. Each fund has a different mix of these people, the execution type being more of a necessity at larger REPE funds than at their smaller counterparts.

Mid-level compensation is less standardized, even at a single fund. Individual achievement begins to determine a large part of each professional's compensation. As you become more senior as a mid-level professional, the fund typically increases your compensation not through your base salary, which generally remains the same, but through your performance bonus. And as the fund increases your performance bonus, more and more of that is locked away as long-term carry and less of it is paid in cash. This carry-based compensation strategy aligns the investment employees with the fund itself since a significant portion of their wealth is directly impacted by their investment decisions.

All this non-standardization aside, mid-level all-in compensation generally ranges between $400,000 per year to $750,000 per year for the more senior and higher-performing positions. Though keep in mind, a significant portion of that compensation is locked away in closed-end funds that won't liquidate for perhaps a decade or more.

Senior-Level Positions in Real Estate Private Equity

Senior investments professionals are managing directors, group heads, managing partners, and senior managing partners. Partner and senior managing partner are the highest titles achieved in real estate private equity. These individuals are the thought leaders at the REPE fund. Most sit on the investment committee and have veto power over investments they do not like. Compensation at the senior level is entirely variable, though typically above $1M per year. Again, much of this compensation is locked away in the fund as carry and thus aligns the investors' personal wealth with their investment decisions.