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US Roundtable 2019

ROUNDTABLE

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Strong in the face of rising risks

Despite political turmoil, trade wars and rising costs, confidence remains for US real estate investors thanks to steady fundamentals. By Kyle Campbell

US real estate could appear to be a market on the edge if certain headlines are to be believed. Earlier this year, interest rates hit an 11-year high and seemed poised to keep rising; the country's trade war with China roils on with no end in sight and political infighting has Washington mired in a debate over impeachment.

However, the scene on the ground is much less foreboding. The Federal Reserve cut interest rates twice during the summer and the economy remains unmoved by political uncertainty, with GDP growth continuing at 2-3 percent annually and unemployment steadily below 4 percent. The commercial property market, meanwhile, has enjoyed high occupancy rates, steady rent growth and return prospects that – while tempered compared with recent years – remain strong relative to other markets.

Coming into 2019, Gijs Plantinga, head of North American investment at Bouwinvest, the Dutch pension investor, says there were "serious concerns in our office about the US economy: where it will go, where interest rates seemed to be going, what would happen with the trade war," but his first-hand experience has left him feeling more optimistic. "People at home in the market feel less insecure and I look at fundamentals in supply and demand in each of their markets and they seem healthy," Plantinga says. "It depends on what segment, and in which market, but overall it doesn't look all too bad."

Plantinga is one of six participants at *PERE*'s annual US roundtable, taking place in New York. He is the lone investor in the conversation, but the five manager executives with whom he shares the boardroom at Sydney-based bank Macquarie Group's West 55th Street regional headquarters conveyed a similar sentiment: the US economy and investable real estate market is showing no signs of slowing down.

"Talk to tenants, talk to businesses. They can't find enough people to hire," says Eric Wurtzebach, senior managing director at Macquarie. "This is in the context of some really significant risk around the globe – geopolitical risk and the current US political system disruption, for example. But take a step back and, in light of all these issues, it feels really positive."

377,000
US multifamily unit starts last year

+2.49m
Texas job growth since January 2010

+1.98m
Florida job growth since January 2010

Multifamily mandates

For-rent housing is an increasingly attractive sector in the US. Between 2004 and 2016, homeownership in the country fell from an all-time high of 69.2 percent to 62.9 percent, a 50-year low, according to the Federal Reserve Bank of St. Louis. During that same period, the number of renter-occupied housing units climbed from 33 million to 44 million. Even with a slight uptick in the ownership rate in recent years, the renter population has not seen a corre-

PHOTOGRAPHY: **BRIAN SHUMWAY**

Carly Tripp
Managing director, chief investment officer, Americas, Nuveen Real Estate

Tripp oversees real estate investment in the Americas for TIAA's asset management arm. At $90 billion, the US is the largest real estate market for Nuveen, which manages $130 billion of real estate globally. The company has 550 employees and 26 offices around the world, including a staff of 250 spread across 11 US offices.

Nick Colonna
President, commercial investments and fund management, Kennedy Wilson

Based in Beverly Hills, Kennedy Wilson manages $16 billion of assets globally, of which $10 billion is in the US. It is a manager active in the office and multifamily markets. The firm has 10 offices throughout the US and six others in Europe and Asia, including London, Dublin and Tokyo.

Dodge Carter
Managing director, multifamily, Crow Holdings Capital

Carter oversees multifamily and student housing investment for Crow Holdings Capital, the investment management arm of Crow Holdings, a 70-year-old real estate firm. Crow Holdings Capital manages $10 billion of assets in the US through value-add funds across property types and special vehicles for retail, self-storage and multifamily.

Nishant Bakaya
Chief investment officer, CA Ventures

CA Ventures is an owner, operator and developer of primarily alternative multifamily assets. It manages $10 billion of real estate assets, including $3.5 billion of student housing, $2 billion of senior housing and $2 billion of multifamily. The rest of its portfolio consists of office and residential. It also has a presence in Europe and Latin America.

Gijs Plantinga
Director, North American investments, Bouwinvest Real Estate Investors

Plantinga oversees North American real estate investment for the Dutch construction industry's pension fund. The North American portfolio includes roughly €1.5 billion of primarily private real estate assets. Bouwinvest has an international investment team of 15, including four executives focused on North America.

Eric Wurtzebach
Head of the Americas, senior managing director, MIRA Real Estate

Wurtzebach leads the Americas real estate division of the Macquarie Group, a Sydney-based investment bank with $20 billion of real estate globally, of which $5.5 billion are in the US. His team focuses on separately managed accounts, club deals and joint ventures with foreign investors, as well as platform investments.

"Almost everyone in New York, every corporation, is talking about moving people to low-cost states like Florida, Tennessee and Texas and it is happening in huge waves. I don't think the market fully appreciates the long-term impact of so many people and jobs moving"

ERIC WURTZEBACH
MIRA Real Estate

sponding drop – in fact, it is up 600,000 year on year.

Construction began on roughly 377,000 multifamily units in the US last year and, according to projections from the National Multifamily Council, a development advocacy group, the industry will have to add roughly that many units a year through 2030 to keep pace with rising demand and offset losses.

US apartments delivered a 1.42 percent return for fund investors during the second quarter of 2019, according to NCREIF, and a one-year return of 5.8 percent. While multifamily was the second weakest performing property type during that time period – ahead of only retail – performance tends to vary widely by location. Through 2018, Las Vegas, Phoenix and three California markets – Sacramento, Santa Rosa and Riverside – all produced double-digit returns, while the broader market saw a total return of just over 6 percent.

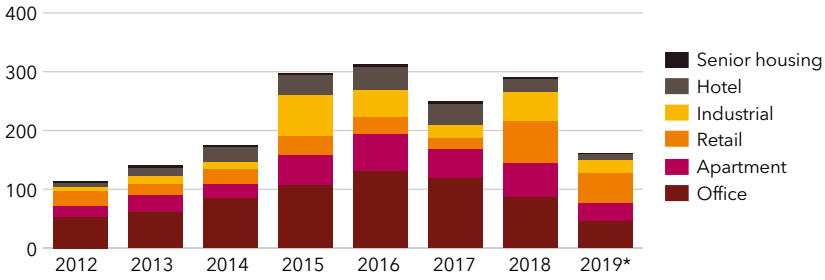
"Given what's happened with the disruption in retail and the disruption in office, capital has been flowing into multifamily because it has a long-term, secular growth story," says Nishant Bakaya, chief investment officer of manager CA Ventures. "Home ownership is on the decline and job mobility is at an all-time high."

Chicago-based CA Ventures invests primarily in multifamily, student housing and senior living, with smaller operations targeting the office and industrial sectors. Bakaya says the firm takes a similar approach to all three housing sectors, which is to focus on class A, highly-amenitized properties that command premium rents from high-earning tenants. This strategy elicits varying responses from the roundtable.

Nick Colonna, president of commercial investment and fund management at California-based manager Kennedy Wilson, says renters in the San Francisco Bay Area are already spending upward of 60 percent of their take-home pay on rent. "The large employment base firms in that region are more knowledgeable of rents, development trends and where things are going than most developers are, so they will pay people just enough to keep them there."

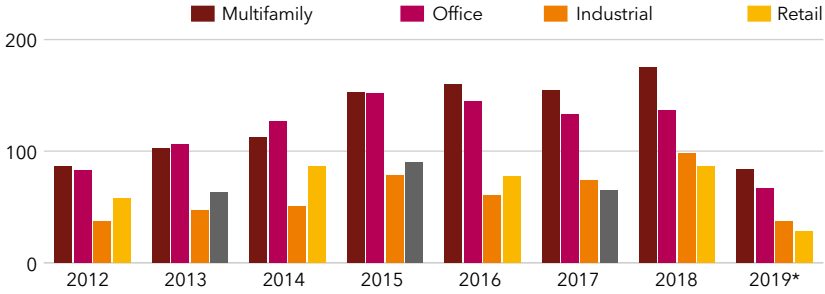
Carly Tripp, Nuveen Real Estate's chief investment officer for the Americas, says high-end housing investors have tended to "overestimate the depth of the market

Cross-border investment into the US has been strong since 2015 ($bn)



*Through two quarters
Source: Real Capital Analytics

Multifamily has dominated real estate investment since 2015 as well ($bn)



*Through two quarters
Source: Real Capital Analytics

associated growth." Dodge Carter, managing director of multifamily and student housing at Dallas-based Crow Holdings Capital, is concerned about students being able to afford market rents when they are already being squeezed by the rising cost of education: "With $1.5 trillion dollars of student debt, the obligation to service that debt impairs the ability to purchase a home."

Plantinga says for new investments, Bouwinvest is staying away from the luxury housing market, which it views as oversaturated. Instead, the pension is prioritizing workforce housing, which it regards as underserved. "That's where the long-term challenge sits. Not just in the US, but also in European cities," he says. "It's very hard to tackle, but the room to grow on the class A side is limited."

Red state, blue state

Historically, US real estate markets have been stratified by their proximity to saltwater, with large coastal cities taking center stage for investment capital. More recently, however, the dividing lines have been drawn by electoral outcomes, with Republican-controlled, so-called red states proving

"There is going to be an undercurrent of unpredictability due to the election and the rhetoric will cause everyone to have some level of uncertainty, but I think everything is going to remain status quo"

CARLY TRIPP
Nuveen Real Estate

more attractive to tenants than their Democratic, blue state counterparts.

Florida and Texas, which boast pro-business policies and no state income taxes, have been the biggest victors in this particular chess game, adding roughly 2 million and 2.5 million jobs, respectively, during the past nine years and outpacing the national employment rate. Other metros with relatively low costs of living have also become hubs for investment, including Phoenix, Arizona; Nashville, Tennessee; and Charlotte, North Carolina. A federal tax law passed in 2017 removed the income tax deduction homeowners could claim to offset their state and local taxes, a move that further tilted the scale in favor of low-cost states.

"Almost everyone in New York, every corporation, is talking about moving people to low-cost states like Florida, Tennessee and Texas and it is happening in huge waves," Wurtzebach says. "I don't think the market fully appreciates the long-term impact of so many people and jobs moving."

Traditional hubs such as New York and Los Angeles, and tech innovation centers such as San Francisco and Seattle still have appeal, but are more difficult to operate in

US retail down but not out

Why some managers feel the asset class still contains some diamonds in the rough

Investors have been skittish around US retail for the past several years, and for good reason. The share of goods bought online has increased every year for the past two decades, resulting in a shift in appetite toward industrial assets, particularly those that facilitate consumer home deliveries.

However, not all managers are steering clear of brick-and-mortar shopping sites. Carly Tripp, Nuveen Real Estate's chief investment officer of the Americas, has a contrarian view toward the retail space: "You can find really good value in retail right now and it's defensible retail," she says.

The London-based firm is among the largest retail property owners worldwide, with a portfolio of almost 400 assets valued at $42 billion. Tripp says her team has remained committed to the space with an eye toward so-called experiential properties. "Everyone likes to go out and experience something and you typically do that in some sort of retail environment," she says. "It's just about identifying what's going to be future proof."

Retail properties have delivered a 1.7 percent return for fund investors over the past year, according to NCREIF, the worst among any of the five property type sub-indexes tracked by the group. While income-based returns remain moderate at 4.7 percent, the properties tracked depreciated by 2.8 percent. Industrial assets, meanwhile, delivered a 13.9 percent one-year return through the first half of 2019, with appreciation accounting for 8.8 percent of that. The migration toward e-commerce has been underway for years, but it has only recently been reflected in investment themes. US retail transactions peaked at $90 billion in 2015, according to Real Capital Analytics. Industrial transactions outpaced retail by $9 billion in 2017, $11 billion last year and $8.5 billion through the first two quarters of this year.

Part of that dollar-level decline can be attributed to a shift away from certain large, pricey retail assets, such as underperforming malls and shopping centers. Dodge Carter, managing director of Dallas-based Crow Holdings Capital, says his firm has amassed $1.4 billion of food and service focused retail centers with an average equity value of $4 million each. "They are located next to office parks, hospitals and universities, in dense and affluent areas," he says of the typical assets. "Your tenants are the Chipotles, the Starbucks and the AT&Ts, all of those places people go on their way home. It is the convenience and necessity-driven retail that is actually expanding amidst the trends in retailer bankruptcy."

Gijs Plantinga, Bouwinvest's director of North American investment, says the Dutch pension investor has reduced its

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>
> **GIJS PLANTINGA**
> **Bouwinvest**

because of rising costs and reactionary policies that hamper new development. "There's a cost of doing business versus an ease of doing business that benefits certain states and penalizes others," Carter says, comparing California to nearby Arizona.

A rash of state-level rent control measures this year in New York, California and Oregon have multifamily investors on alert. While the motivations are understandable given rising housing costs in big cities, Wurtzebach says the results are often counterintuitive, driving up construction expenses and disincentivizing new development. He points to new regulations in New York as an area of concern. "When large, politically connected private equity firms are caught off-guard by rent control in New York City, that should tell everybody something about what's happening in the world," he says.

Colonna says the entire West Coast should be approached carefully, though he notes having boots on the ground and strong local government relationships can ease the investment process.

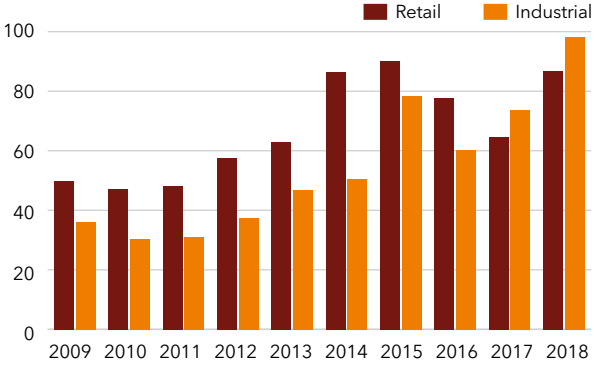
Meanwhile, changing regulations have not deterred Bouwinvest from big cities in blue states. Plantinga was in Brooklyn this summer touring a recently acquired affordable housing property with the pension's board when the new rent controls were passed. The board took the announcement in stride: "They said we're in the game long-term for what they call social returns," he says. "We like to make our returns in a socially responsible way and affordability is a theme there, so it didn't land as badly as I feared."

International influx

Bouwinvest plans to open a New York office next year for a more hands-on approach to US investment and to be "closer to an important market," Plantinga says. This is in line with a broader market trend of international investors setting up shop in the country. "It's a natural evolution," Wurtzebach reflects. "Some of these global institutional investors and sovereigns are becoming more sophisticated and want to be closer to the assets and have better oversight and understanding of these markets specifically."

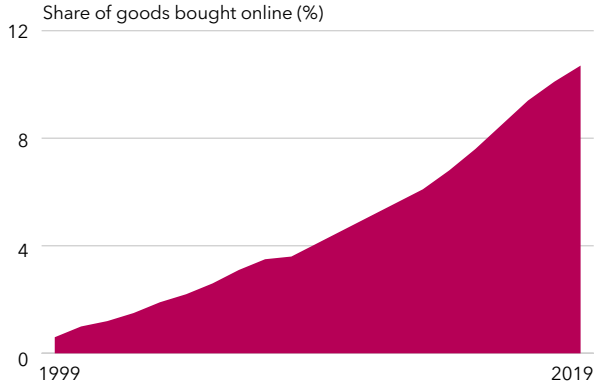
During the past three years, Colonna says Kennedy Wilson has seen its balance of investors shift from 75:25 percent domestic-foreign to an even 50:50 split.

Investors have shifted capital to industrial and away from retail to take advantage of the rise in e-commerce ($bn)



Source: US Commerce Department

E-commerce's share of sales have skyrocketed during the past decade



Source: US Commerce Department

exposure to retail in recent years. But it still commits some capital to "walkable retail in vibrant urban areas," though this approach is primarily focused on European cities. "They are not prime," he says of the assets, "they are more in smaller, desirable neighborhoods."

Not all are sold on the opportunities in the retail sector, however. Nishant Bakaya, chief investment officer of Chicago-based CA Ventures, says the property type is "not a knife I want to catch." The multifamily and alternatives specialist acknowledges that "super class A assets with experiential retail in infill locations" have performed well in the face of rising e-commerce trends, but also says "everything else has been consistently battered."

Retail demand is likely to lag that of other property types, but Tripp says the US retail landscape was due for a shakeup: "Historically, the US has been oversupplied on retail per capita. We have more retail than any other developed country, so there has to be a correction and a rebalance there. But that's going to make the good retail stand out even more than it does now."

"There's a cost of doing business versus an ease of doing business that benefits certain states and penalizes others"

DODGE CARTER
Crow Holdings Capital

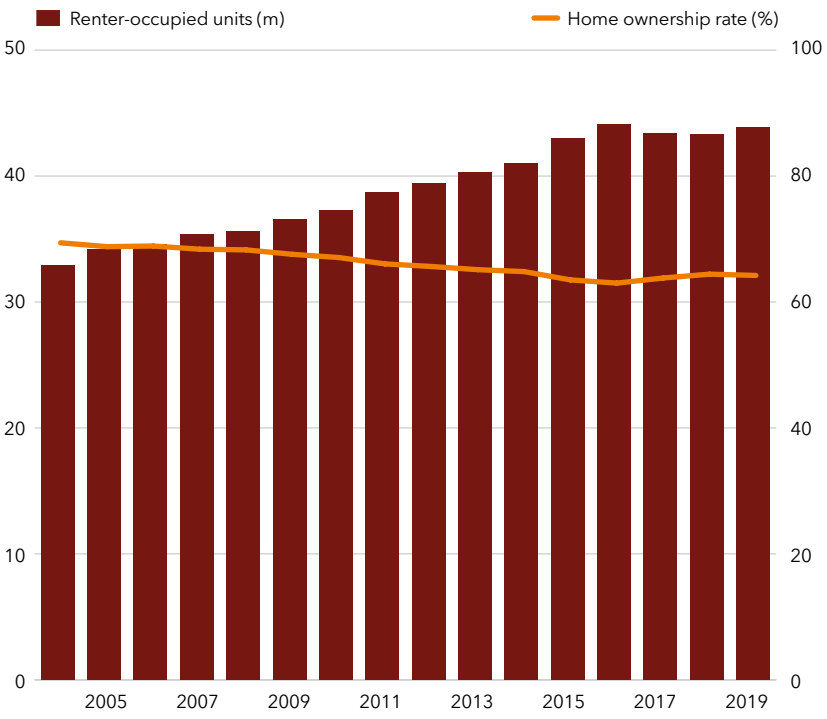
Wurtzebach says many of the larger non-US institutions have a higher risk tolerance and prefer separately managed accounts and joint ventures targeting build-to-core strategies. Tripp, on the other hand, has seen strong international interest in her firm's new suite of sector-specific open-ended core funds: "A lot of international investors that are trying to dial up their US portfolios are going for beta," she says.

Cross-border investment in the US has risen steadily since the global financial crisis, peaking at $460 billion in 2016, according to Real Capital Analytics. Foreign investment fell off in 2017, tumbling to $375 billion, but picked up speed again last year, totaling $384 billion. And, despite a strong dollar, non-US investors have accounted for $211 billion of transactions during the first two quarters of 2019.

Office property has remained a consistent favorite for international buyers, followed by apartments. While industrial assets – particularly those focused on last-mile logistics – have grown in popularity since 2015, recent years have seen an uptick in retail investment, too.

International capital brings with it a

More Americans are renting instead of owning their homes

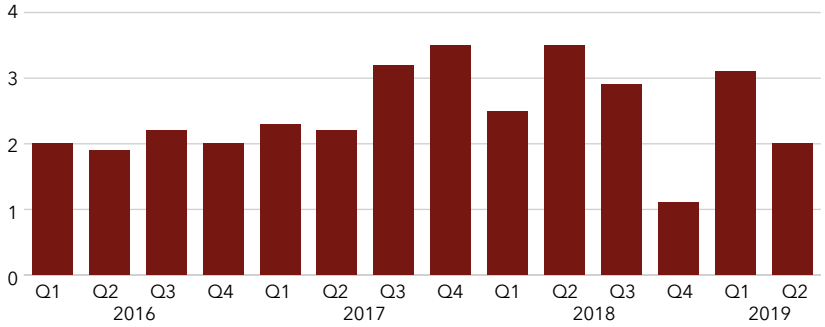


Source: US Federal Reserve Bank of St. Louis

"Given what's happened with the disruption in retail and the disruption in office, capital has been flowing into multifamily because it has a long-term, secular growth story"

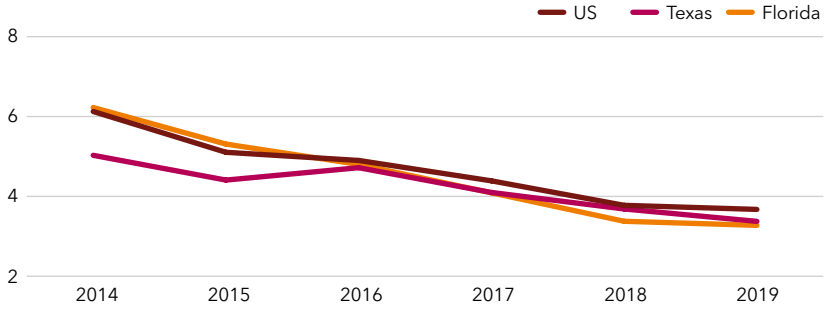
NISHANT BAKAYA
CA Ventures

US GDP growth has been fairly stable since 2016 (%)



Source: US Bureau of Economic Analysis

Unemployment has fallen faster in Texas and Florida than the rest of the US



Source: US Bureau of Labor Statistics

greater focus on environmental, social and governance issues, specifically sustainability. Much of the foreign capital Crow Holdings Capital interacts with has a focus on ESG issues, Carter says.

Plantinga says Bouwinvest requires 90 percent of its investments to have some type of green certification, be it LEED Silver, Gold, Platinum or some other standard, by 2021. It also wants 75 percent of its international managers to participate in the GRESB benchmark with an eye toward eventually hitting 100 percent.

London-based Nuveen has similar aspirations, hoping to reduce its carbon footprint by 30 percent by 2030 and, ultimately, be carbon neutral. While US firms pay less attention to such issues, the consensus is the market is moving in the same direction. Kennedy Wilson issued its first global corporate responsibility report this year in response to growing demand from investors on both sides of the Atlantic and it recently expanded its European sustainability program to the States. To remain competitive in the market, developers must, therefore, factor in sustainability, Carter says.

However, the economic benefits of

"The large employment base firms in [the San Francisco Bay] region are more knowledgeable of rents, development trends and where things are going than most developers are, so they will pay people just enough to keep them there"

NICK COLONNA
Kennedy Wilson

building to green standards remains unclear. Doing so can secure development bonuses from local municipalities and result in some operational cost savings. But does it boost actual returns? "From a rent perspective, in certain locations it may impact rents and occupancy, but not often," Carter says. "Can you get a little bit of return when you go to sell? Possibly. But today it is not consistently available. Still, ESG is something we are factoring into our recent investment considerations."

2020 vision

There are reasons to be skeptical of the US economy heading into 2020. An impeachment inquiry has begun on president Donald Trump, the public equities market appears shaky and once shining startups – Lyft, Uber and WeWork, to name a few – have lost their luster. With a slowing global economy and a potentially bombastic presidential election on the horizon, extending the longest growth period on record will be no easy feat. Yet, despite the broader market uncertainties, US real estate remains on stable ground, Bakaya says: "I'm bearish on the economy, bullish on real estate." Aside from a few microeconomic concerns – shortages of some skilled labor sets, rising material costs, construction obstacles in certain cities – the overall market shows few signs of weakness. Average cap rates have held steady, transaction volumes are strong and there is an unprecedented amount of dry powder in the space. "There is going to be an undercurrent of unpredictability due to the election and the rhetoric will cause everyone to have some level of uncertainty, but I think everything is going to remain status quo," Tripp says.

Bakaya says the political rhetoric might cause investors to get nervous and pull back, leading to a "self-inflicted" recession, but one that could be beneficial to real estate as capital moves to safety. "Real estate did really well during the last down cycle," he says. "It's not the worst thing for us."

Plantinga has a similar outlook, though he is less certain of how an "investment pause" would play out: "Fundamentally, I feel confident about our sector. But I'm wondering by how far there might be little cramp in capital flows. It's up to the markets to decide how panicky they want to get." For now at least, panic is yet to set in, and these six private real estate practitioners can get on with their day jobs largely undisturbed by events beyond their control. ■