2013 Fall Members' Meeting Summary

The 2013 Fall Members' Meeting of the Samuel Zell and Robert Lurie Real Estate Center at The Wharton School, held at The Inn at Penn, welcomed more than 400 members, guests and students. At Thursday evening's dinner for Research Sponsors and special guests, Mark Pauly, Bendheim Professor of Health Care Management and Business Economics & Public Policy, The Wharton School, spoke on "Health Care Reform: What to Expect Going Forward."

Friday's meeting opened with greetings from Roy Hilton March, CEO, Eastdil Secured and Chairman of the Zell/Lurie Real Estate Center. Center Director Joseph Gyourko briefly reviewed the State of the Center. Membership is strong, he noted, and then spoke about the Center's professional and academic missions. "We want to be thought leaders to the real estate industry, and to that end, we continue to provide great faculty who do cutting-edge research in the markets in which you operate; facilitate partnerships between our students and faculty and industry; and provide innovative inquiries."

The State of Design

Richard F. Tomlinson II, Partner, Skidmore, Owings & Merrill, moderated the first panel, "The State of Design," with Philip Enquist, Partner at Skidmore, Owings & Merrill; Helmut Jahn, Jahn Architects, Chicago; James Crispino, President, Francis Cauffman; and Todd DeGarmo, CEO, Studios Architecture.

Following a short video on the evolution of architectural design into the modern age, Tomlinson reminded the audience that design is simply another part of the real estate industry and opened a discussion on worldwide urbanization. "There has been a rapid expansion of world markets, with global population centered in cities," he said.

"What role does design play in this context? Where do entrepreneurism, sustainability, city design and architecture work, and what are the greatest challenges? How do cities compete for talent and are the factors universal?" he asked the panel. Enquist said, “The 21st century is a century of cities. A serious challenge we’re all facing is that the world is growing at about 75 million people annually. By 2050 we’ll be 10 billion—estimates are that 70 percent will live in cities, putting 7 billion people in cities.”

These mega cities create a demand for new infrastructure, new buildings and new approaches to energy, water and waste. “Earth doesn’t have limitless resources. Designing within our limits will change cities for the better,” he said. In Enquist’s view, the biggest challenge for designers is the need to be creative within the limits of the Earth’s environmental resources, in the context of an unprecedented and rapid growth in the population.

Jahn said he and his peers just wanted to reinvent the modern design idiom when he started out. In the 1990s, the goal was to create sustainable performance and now there is the challenge of scale. “We created sustainable buildings through design before the word sustainability even existed. Now massive projects have proliferated with a certain uniformity, and patrons aren’t as plentiful. Even corporate clients favor leasing over building.” He agreed with Enquist’s assessment that an agenda needs to be developed to guide the use of available resources to pave the way for the future of design and architecture.

Crispino works with institutional clients such as global corporations and health services providers who look for total design solutions. “They look at increased urbanization and how that impacts their new facilities and distribution of services, in order to attract researchers, students, faculty, and other employees or clients,” Crispino said. Hybridization of programs is more common today, driving the creation of facilities unlike those of 20 years ago. “The notion of single-use facilities doesn’t support the types of communities we want to create and there is just a different way of working today—one that supports a certain behavior and activity rather than a type.” He agreed with Jahn, that projects work best stylistically when everyone has an open exchange of ideas and work together to create the greatest value for patrons, developers and clients. There is no precedent for what is being designed today—complex, multi-dimensional projects that require a balance between actuality and desire.

DeGarmo primarily does interior design, mostly for clients in the legal field. Tomlinson asked if today’s projects are addressing today’s needs. “Over the last few years, the demand for employees in this field hasn’t grown,” DeGarmo said, “and in general, corporations are building where the best talent can be found, and they want to be in interesting urban locations in interesting mixed-use environments." These projects require community engagement because of the impact building there has on that community. "Simplifying the process through collaboration is the way we grow our businesses," he said.

Enquist cited Barcelona as an example of a vibrant city that knows how to leverage its cultural assets and educational programs. Barcelona has come together around tourism, culture and education—creating an enterprise that enlivens the city—and solves urban problems.

The intersection between client, architect, engineers, builders and the people who fabricate them is the critical point. Jahn said, "If everyone pushes together and in the right way, real progress can be made."

Farash Distinguished Speaker: Meredith Whitney

This year's Farash Distinguished Speaker was Meredith Whitney, CEO of Meredith Whitney Advisory Group, who spoke with Robert C. Lieber, Executive Managing Director, Island Capital Group. "You've been called one of the most influential people in the marketplace," said Lieber, "and have been listed as one of Fortune's top 50 most powerful women and the oracle of the bear market."

Whitney explained that she began her career in the early 1990s and has seen it all. "When you cover financials, you cover everything," she said. She was exposed to the credit crisis early and worked to figure out what would happen next. "Clearing foreclosures was critical. It became clear it would be a state-driven issue, in terms of how U.S. markets would recover. I see things in a state-by-state, region-by-region basis. In the United States, you effectively have 50 different countries—it's not a one-size-fits-all environment."

Whitney predicted jobs and manufacturing will return to the United States because of cheap energy, which will also bring strong real estate development to these business-friendly areas of low-tax jurisdictions, although California is struggling.

Lieber asked how California could turn things around.

"The problem in California is its legislative structure," Whitney said. "People want social services but don't want to pay for them, so the state pushes it down to the municipal level and [services are] dying on the vine. The cost of tuition in California has doubled in past eight years, for example."

Whitney has seen this breakdown across the country, in Detroit, in Bethlehem, and in Harrisburg, cities that were once rich in industry and decades later are devoid of that industry. “When the rich people leave, the poor stay because they have to, and social services are needed more than ever. You can’t retrain (the former industrial workers) because people can’t pay their taxes and you don’t have money for education and retraining.” She then offered a way to solve these issues: “Vote.”

There has never been a more important time to vote in local politics, Whitney stressed, because everything is affected locally. “Your finances are impacted on the local level… everything, home, taxes and value of business. It’s important to get involved now and have a voice.”

The Growing and Changing Role of Foreign Investors in U.S. Real Estate

Joe Gyourko moderated the second panel, “The Growing and Changing Role of Foreign Investors in U.S. Real Estate,” with panelists Anthony Frammartino, Partner, The Townsend Group; William Tresham, President, Global Investments, Ivanhoe Cambridge; and Adam Gallistel, Senior Vice President, GIC Real Estate.

Gyourko opened by noting that there has been a trend of capital flow-in from foreign investors lately, with activity centered in New York City, San Francisco and Washington, D.C. “According to a Bloomberg Report in August, there has been a very quick influx of tens of billions of dollars to real estate. Who is doing this? Is it really that big and how does that affect you?” he asked.

Frammartino disputed the claim. “This has been going on a long time,” he said. “Some of the deal sizes recently are bringing this to light. But U.S. markets are deep, and sovereigns are a disparate group and have broad ranges.” Newer investors are focused on headline-grabbing assets and trophies, which helps focus more attention on them. The big names attached to some of these deals are more visible and make news, he added.

Tresham spoke about the success of his business and what has worked over time: leverage in transactions in areas in which he could collaborate. Much of that success lies in finding good partners. “We reach out to those who look like they’re doing a great job and ask ourselves how we can be a great partner to them and how we can have this be a win-win. Once we leave our shores, that’s the essential message.”

Gallistel agreed with Tresham, although he hadn't always felt the same. "In the beginning, we said, 'We don't want any partners, we'll do it ourselves.'" Ten years later, GIC needed to reinvent its business model. "We now rely on partners and we put money into funds, and we will continue to do that, but the bar is much higher now. Although we still need operating partners, we believe we add value and have pursued ventures that prove that."

Frammartino said experienced organizations use their partners intelligently, knowing that sovereigns invest in relationships anticipating that investing in a fund is part of a larger relationship. He also agreed that a lot of money has found its way into gateway markets. "Office and major markets—tech, energy and life sciences—have seen a significant amount of capital invested," he said.

The partnership theme continued as Tresham stressed that he believes it is important to diversify, basing that diversification on partnerships, as well as asset class, geography and risk. He advised, "Partner with the smartest people you can find, those who know all parts of the market." Gallistel, on the other hand, looks for things that "are a little bit broken—a partnership or capital structure—something we can work through."

Gyourko wondered what Gallistel looks for as GIC invests around the world. "We started as a blank sheet, approaching the world," Gallistel answered. "We score each deal on various metrics and we use the answers as a tool."

None of the panelists felt their sovereign investors would stay away from U.S. markets. "Our clients have long-term plans, and they have a real western perspective," said Frammartino. "Our clients are trying to figure out how to get more capital into the country," Gallistel agreed.

Niches in Real Estate Investing

Asuka Nakahara moderated the panel "Niches in Real Estate Investing," with panelists David Adelman, President and CEO of Campus Apartments; David Roth, Managing Director, Real Estate, The Blackstone Group; Gordon J. Whiting, Managing Director, Angelo, Gordon, Inc.; and Kavindi N. Wickremage, Senior Vice President, Harvard Management Company.

Nakahara opened the panel by mentioning that each of these niche sectors are misunderstood in some way, and he would like to clear up some of the misunderstandings. He began by asking David Adelman to explain the biggest misunderstanding in his sector—student housing.

"Everyone thinks that student housing must be like Animal House," Adelman said. "But students today live in a much different manner, with higher amenities." He described the pluses of owning student housing the way Campus Apartments manages them. "We inspect each unit quarterly and have very proactive management. Our units are furnished and have fast Internet—what the students really care about."

Roth said The Blackstone Group has found a way to knock down every bit of skepticism around the single-family rental sector. "The last historical concern is how to maintain the properties if you're geographically dispersed," he said. "Our approach is to be concentrated. We're in only 14 markets with 2,000 homes in each—some have up to 6,000. But that concentration allows us to be more efficient."

Angelo, Gordon's Whiting stressed that the most important part of his business is to monitor the tenants' adherence to the lease and not to defer any maintenance. "There always is a chance you'll get the building back with our tenants, but you want to ensure you don't get back a building that needs lots of renovation."

Harvard's Wickremage explained her entrance into alternative investing as a search for yield in 2010 and 2011. "Interest rates were at an all-time low, and when you couple yield with cheap financing, it's powerful," she said. "We looked at sectors that could grow at a faster rate than overall GDP, which meant student housing, senior housing, self storage, things that are not tied to job growth. These asset classes are interesting. There are many operational layers to how you run these asset classes, and you can't necessarily translate management of one type to others."

Adelman explained that his gateway city can be anywhere, because his customers will be in place for a long time. He likes to be geographically diverse and is up to the challenges inherent in schools of different sizes and locations.

Roth said he has shifted into East Coast markets, where there is still an attractive mix of yield and price appreciation. "We hire regional managers, figure out where people want to live for renting as well as for selling, and find houses people want to live in. We've mitigated our risks by hiring those local experts."

Whiting explained that Angelo, Gordon diversifies by geography, industry and type of tenant. The company is in 31 states and Canada, with offices in London and Amsterdam as well.

“Diversification is tricky,” said Wickremage. “If you’re building a portfolio with only diversification in mind, you might not achieve what you think you will. Over the past few years, recovery has been inconsistent across the country. When we look at acquiring an asset, it’s got to make sense on a stand-alone basis or we don’t do it.”

Finally, Nakahara asked each panelist to look into the future. “If we come together again in three years, what will we be talking about in your sectors?”

While Adelman believes people will continue to want to be involved in his asset class, Roth believes that even though people are renting more now, the desire to own a house has not changed. Wickremage agreed with him, believing that people will always think of single-family as an obvious asset class. Whiting remarked that in three years, panelists will still be talking about interest rates and their impact.

Real Estate in a Rising Rate Environment

The final panel of the day, “Real Estate in a Rising Rate Environment,” featured moderator Peter Linneman, Professor Emeritus, The Wharton School, with Neil G. Bluhm, Managing Principal, Walton Street Capital; John H. Pelusi, Jr., Executive Managing Director and Managing Member, HFF; and Owen D. Thomas, CEO of Boston Properties.

The discussion began with Bluhm discussing the two most recent crashes—in 1990 and 2008—and how important it was to learn lessons from each. “In 1990, there was overbuilding and real estate was mispriced,” he said. “Commercial real estate caused the recession in ’90, just like the for-sale housing market caused the problem in ’08. In 2008, the whole world was overleveraged.”

“It took eight or nine years after ’90 to fully work out the opportunities; this time it seems to be going much faster, especially with prime assets,” said Linneman. “What do you think?”

Pelusi answered that there hadn’t been as much distress as in 2008. There were relative bargains and you didn’t see banks forced to liquidate like you did in ’08. “The Fed keeping interest rates so low for five years saved them,” he said. “When you look at all asset classes, all have benefited from the cost of cheap capital, but people who created that mess didn’t have to pay the penalty. Savers have been unduly punished.”

The men agreed with Linneman that the best asset classes are least vulnerable. Thomas said that even though jobs aren’t back, investors are enthusiastic about his assets.

Individual assets are the best opportunity, added Bluhm. “We invested almost $2 million of equity over the last two years, almost all being properties acquired by the banks or owners who had to restructure their debt. There aren’t as many opportunities today as then, but there still are some. Buy assets where you get a new owner.”

There are two categories that are talked about a lot: first, Class A apartments in top five markets—Boston, Washington, D.C., Silicon Valley, New York and San Francisco; second, the suburban office market.

“For the second, institutions no longer want to own them, lenders don’t want to lend to it, and rents are low in real terms. Is this an opportunity or the sector that doesn’t work?” asked Linneman.

The men agreed that the former market makes sense if the properties are in a good market and you plan to hold; over the long term, they can be money-makers. “Depending on your capital and your goals, this could be a good place to do it,” said Pelusi.

They didn’t completely agree about suburban office market: Bluhm doesn’t like it because of the high turnover of tenants; Thomas cautioned that it’s important not to “paint any asset class with one brush.” These office buildings, when placed in robust areas, near other attractions and mass transit, can work.

Pelusi agreed. “Wherever they are located, they depend on the economy around them. But we’re not seeing a lot of these trades because the market will pay too little, so owners don’t really want to sell.”

Then the panel discussed the misunderstood nature of the gaming sector. Bluhm insisted that it is not dead, but regional gaming is steadier but struggling because the states see casinos as a way to raise revenue, which increases competition and oversaturates markets. Also, lower-end gamblers have been hit harder by increased taxes, devouring their discretionary income.

Finally, the panelists discussed their view of the world now and what people may be underestimating as a risk or an opportunity.

They agreed the political posturing in Washington has created a lot of pessimism, but there are also positive elements in today's economy. Now is a good time to own commercial real estate because of the lack of new building.

Bluhm believes the best opportunity is to invest internationally, especially in emerging markets, which will grow over the long term. "I'm a little bullish and optimistic that we'll get through this," he said.

Roy Hilton March closed the meeting. The Spring Members' meeting is scheduled for Wednesday evening, April 30 and Thursday, May 1, 2014 at The Rittenhouse Hotel.

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