2013 Spring Members' Meeting Summary

This year's Spring 2013 Zell/Lurie Members' Meeting at the Rittenhouse Hotel in Philadelphia welcomed more than 400 members, guests and students. At Tuesday evening's dinner, awards were presented to students and faculty. View the award winners. Center Director Joe Gyourko also announced the establishment of the Donald Siskind Fund for Real Estate Law. The award was from Edward Siskind on behalf of the Siskind Family in honor of his father, Donald H. Siskind, Esq., a 1959 graduate of The Wharton School. The Siskind Real Estate Fund will provide financial support for course and curriculum enrichment in real estate law.

The evening's speaker, Tim Buckley, Chief Investment Officer at Vanguard, gave a fascinating talk on The Allure of Growth. Following the talk, Center members adjourned to a reception in Boathouse Row Bar.

Robert C. Lieber, Chairman of the Zell/Lurie Real Estate Center, opened Wednesday's meeting. Joe Gyourko thanked Lieber for completing his two-year term as Chairman. Lieber was delighted to receive the Center signature developing mind crystal head, a captain's chair and a tribute book as sincere thanks for his terms as chairman and vice-chairman of the Center. Lieber will step down before the Fall Meeting. Roy March, CEO of Eastdil Secured and current Vice Chairman of the Center will become Chairman and Spencer Haber of H2 Capital Holdings will take over as Vice Chairman.

The first panel session, "The Economy and Policy Risks: Implications for Different Property Markets and Sectors," was moderated by Lieber, with panelists Mark Duggan, Professor and Chairman, Business Economics and Public Policy Department, and Faculty Director, Wharton Public Policy Initiative; Joe Gyourko; and Peter Linneman, Sussman Professor Emeritus of Real Estate at Wharton. Lieber asked, "What do we think the opportunities are, what will we see next, and what are the directions the economy will take?" The panelists agreed, in general, the 2008 downturn was unique and will require innovative policies to regain its footing. Duggan said, "The picture is more positive now than I would have predicted." Linneman noted that with disparate conditions around the country, "It depends on who and where you are. If you are a strip center owner in suburban Vegas, where only about 20 percent of lost jobs have been regained, it's horrible. In Fort Meyers, it's horrible, with 10 percent unemployment rates. Philadelphia has regained just one-third of all lost jobs." Gyourko reminded the audience that in this downturn, "everyone got slammed" and there is great regional differentiation now—regional and market variation that won't go away. Looking at past recoveries is not a good way to predict where change may come. But overall, markets that innovate and have a population of college graduates will recover more quickly, Gyourko said.

Duggan was concerned that the U.S. economy is vulnerable. He mentioned immigration reform, trade policy, the possible export of natural gas, and the impact of rising interest rates on debt's level of the share of the GDP as uncertainties that are important to consider. Investors move into cash, which isn't productive in the interim, said Linneman. Corporations have lots of cash on hand, which some have begun to return to shareholders, added Duggan: "It will be interesting to see if this is a sign of things to come." According to the Fed announcement, keeping rates low until sometime in 2015 is its current policy, said Gyourko. "I think the Fed keeps its foot on the pedal until sometime in mid 2014, and after that, all bets are off, and then we run into big interest rate issues."

The second panel, "What Really Is Back and What Is Not?" was moderated by Asuka Nakahara, Associate Director of the Center, with panelists Douglas T. Linde, President of Boston Properties; Jeffrey H. Schwartz, Deputy Chairman of the Board, Executive Director and Co-founder, Global Logistic Properties; and W. Edward Walter, President, Chief Executive Officer and Director, Host Hotels & Resorts.

In response to Nakahara's question, "What's really back and what did it feel like in the mid-2000s?" Walter said, "From the hotel industry standpoint, the good times shouldn't have ended." Linde said he saw rents growing up to 35 percent annually up to the end of 2008, which was consistent across his markets. Schwartz said he was focused on growing his company's international platform and saw "irrational pricing" at that time, with almost no differential between primary and secondary markets. "We sold a lot in secondary markets and redeployed that to China and Japan along with primary markets in the United States," he said.

Linde's sector saw a shutdown for about five months, he said, and pricing levels were down about 40 percent. "We basically repriced, and in areas like New York City where there were significant changes in attitude and business sense, we leased up in a year or so." Walter said product type made big differences, with luxury hotels down about 45 percent, and still below where they were in 2007; the other sectors are back. Other shifts discussed were dramatic changes in office space, consumers' continuing conservative spending habits, and "the massive shift to e-commerce."

Opportunity in China, where demand exceeds supply, concerns Schwartz, who advised to take advantage of the Asian market, the United States has to "grow and recruit and train people. There's no pool there, and we need management development and leadership programs to grow them."

John Grayken, Chairman and Chief Executive Officer of Lone Star Funds, spoke on "What's different about this cycle? Is the past a good guide?" In accordance with the day's theme of not using past economic recoveries to gauge this one, Grayken began by announcing that he didn't know any more about the economic recovery (but looked at it through a different lens) than most investors—that of a global distressed investor.

He called real estate a "great business and one in which great fortunes are made and lost." His business model, he said, "has always been the same. You don't need to predict where the next crisis is going to be, you can read about it in the Wall Street Journal, and take your time in showing up."

Grayken acknowledged that the country is still in a serious crisis, and the exit would be slow and painful; that we're in the midst of a debt deflation that is being attacked by the central banks around the world with unconventional monetary policy. "There is lots of uncertainty about how this plays out. …The U.S. will lead the recovery, but it will take time. We have the ability to regenerate; our demographics are superior here to Europe and Japan. But we have a serious fiscal issue and political fragmentation, which is hurting growth, and monetary policy is way out there," he added, and continued on to analyze the situations in Japan and Europe.

Session three, "State of the Real Estate Market: What are the Risks and Where is the Opportunity?" was moderated by Roy March, CEO, Eastdil Secured and Vice Chair of the Center, with panelists Mark L. Myers, Executive VP and Group Head, Commercial Real Estate for Wells Fargo and Ric Clark, CEO of Brookfield Property Group. The session opened with a discussion about the return of debt capital business and the excess liquidity carried by banks. As consumers deleverage, liquidity tends to go toward real estate, a trend that should continue, according to Myers.

"The good news is our cost of capital is low, but we have regulation and its impacts and spreads will continue to get tighter," he said. "Well structured, safe, well-underwritten, priced inside 150 basis points is accretive and attractive." Myers said

Wells Fargo will cross over from conventional to merchant banking to take advantage of cheap source of capital. "We will buy loans and will price them fairly tight. We're trying to be the counter party to some of these foreign banks as they liquidate their portfolios," he said. "They're good opportunities for us."

March asked the two men how they underwrite capital markets. "We're conservative on underwriting," said Clark. "We think rates will stay low, near term. If we're refinancing something four or five years down the road, we'd expect cap rates to go 100 to 150 basis points on stabilized cap rate. It's an historic time to borrow money."

The final panel of the day was an informal conversation led by Peter Linneman with Michael Fascitelli, former Chief Executive Officer and President of Vornado Realty Trust, and Barry Sternlicht, Chairman and Chief Executive Officer of Starwood Capital Group.

The men began by talking about low interest rates and speculating about how long they can remain low. Fascitelli commented that he is on three investment committees with "some of the smartest people in the world" who don't have an answer to the question they have all been pondering for two and a half years. The men had heard Ben Bernanke, Chairman of the Federal Reserve, speak on the topic, and "he thinks the world is soft, and will keep rates low for a long time," said Sternlicht. "He also said that overall there's no inflation." Concerning mortgage rates and 10-year debt today vs. a few years ago, Sternlicht advised it's important to have an exit strategy as a borrower because when real inflation comes, it happens fast. "It will be too late when it becomes obvious." "There is no precedent for the environment we are in now," said Linneman. "No one has seen this before. There is no delivered wisdom."

Fascitelli agreed. "The Fed doesn't even know. They can control only the short-term rate, but are also manipulating the long-term rate. By buying and saying we're holding short-term down forever, they're trying to get you to invest. Build what you want and invest short." As the men talked, it was obvious that very little is a given right now. Fascitelli called the investment market the "most difficult" he's seen, and "hard to figure out." Use caution and be choosy about where you go was Sternlicht's advice. "What used to take four or five years doesn't any more," said Fascitelli. "Everything flows faster, and capital can flow out as quickly as it flowed in."

Linneman brought up the topic of one truly out-of-favor sector: anything run-of-the-mill in suburbia, except apartments. "It was pro forma that rents would grow at 3 percent, retail, office, homes, but it's been declining in real terms. Sternlicht said oldfashioned real estate needs to be brought back. “Financial engineering is done. A generation thought leverage was the answer to real estate. What it takes is finding great real estate in an area you believe in—go back to the old ways of doing it. We look for expertise in each vertical and have the ability to add value to what we buy.” “The message is, there is opportunity everywhere,” counseled Fascitelli. “Just know what you don’t know. Even when you protect yourself, realize what you don’t know.”

Lieber ended the meeting at 4:10 p.m. The Fall 2013 Members’ Meeting is scheduled for Friday, October 25 at The Inn at Penn.
MEMBERS: To listen to audio clips of the meeting and to view the meeting photo album, please contact Ron Smith.

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