

# CONTRARIAN REAL ESTATE INVESTING

## ***STRATEGIES FOR IDENTIFYING VALUE IN A MARKET THAT SEEMS FULLY PRICED AND FAIRLY CROWDED***

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# ABOUT RCLCO



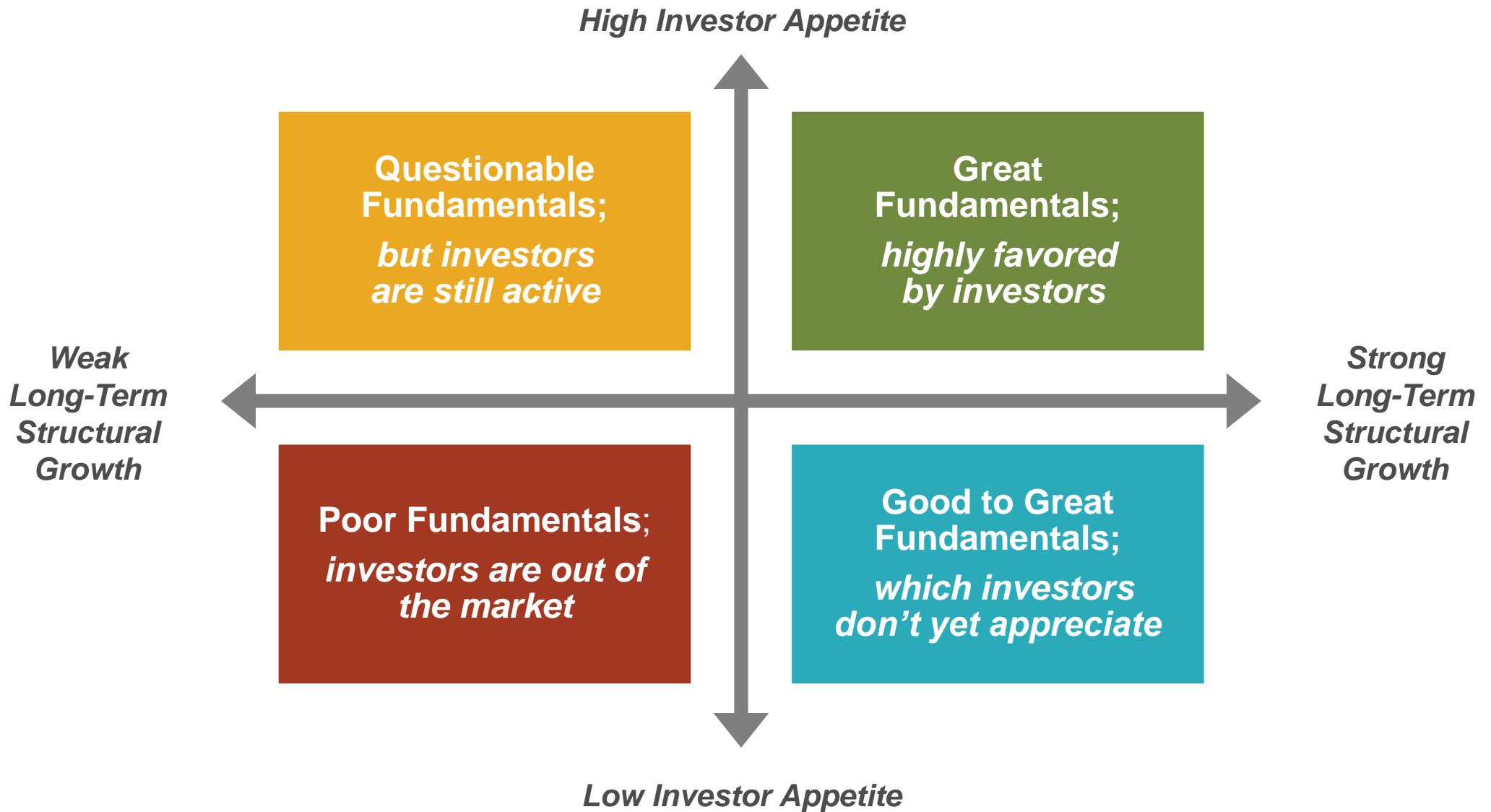
RCLCO is the leading knowledge solutions provider to the real estate industry

- “First call” for those seeking strategic and tactical advice regarding property investment, planning, and development
- We provide end-to-end advisory and implementation solutions at an entity, portfolio, or project level

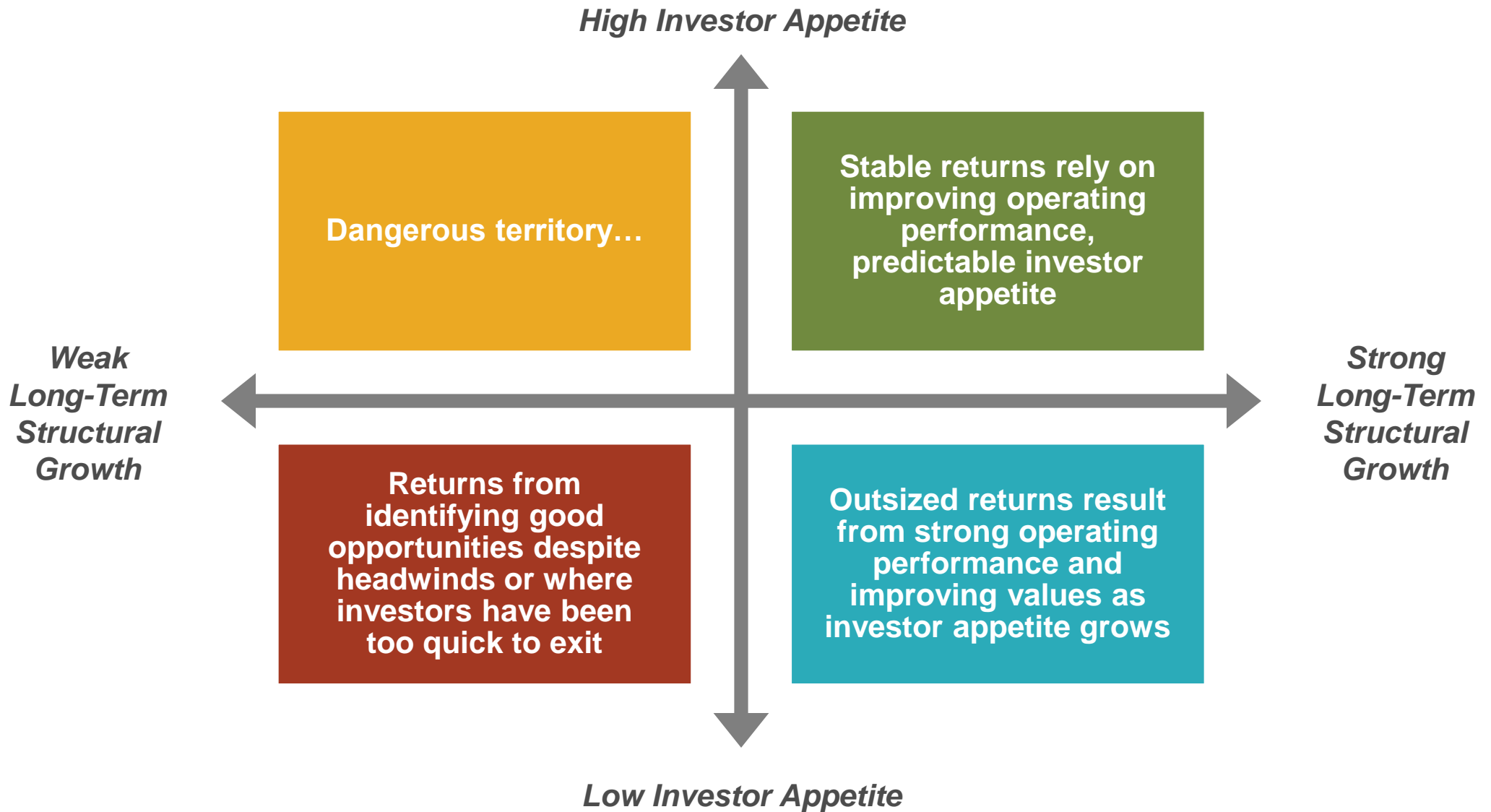
- Engaged on ~500 projects annually touching more than \$5B in real estate
- Affiliated with more than 25 leading industry associations, including ULI, PREA, NMHC, etc.
- **Office Locations:** Los Angeles, CA; Austin, TX; Orlando, FL; Washington, DC,
- **Mission:** *To help our clients make strategic, effective, and enduring decisions about real estate.*
- **Advisory Groups:** Institutional, Urban Real Estate, Public Strategies, Community & Resort, Strategic Planning & Litigation Support



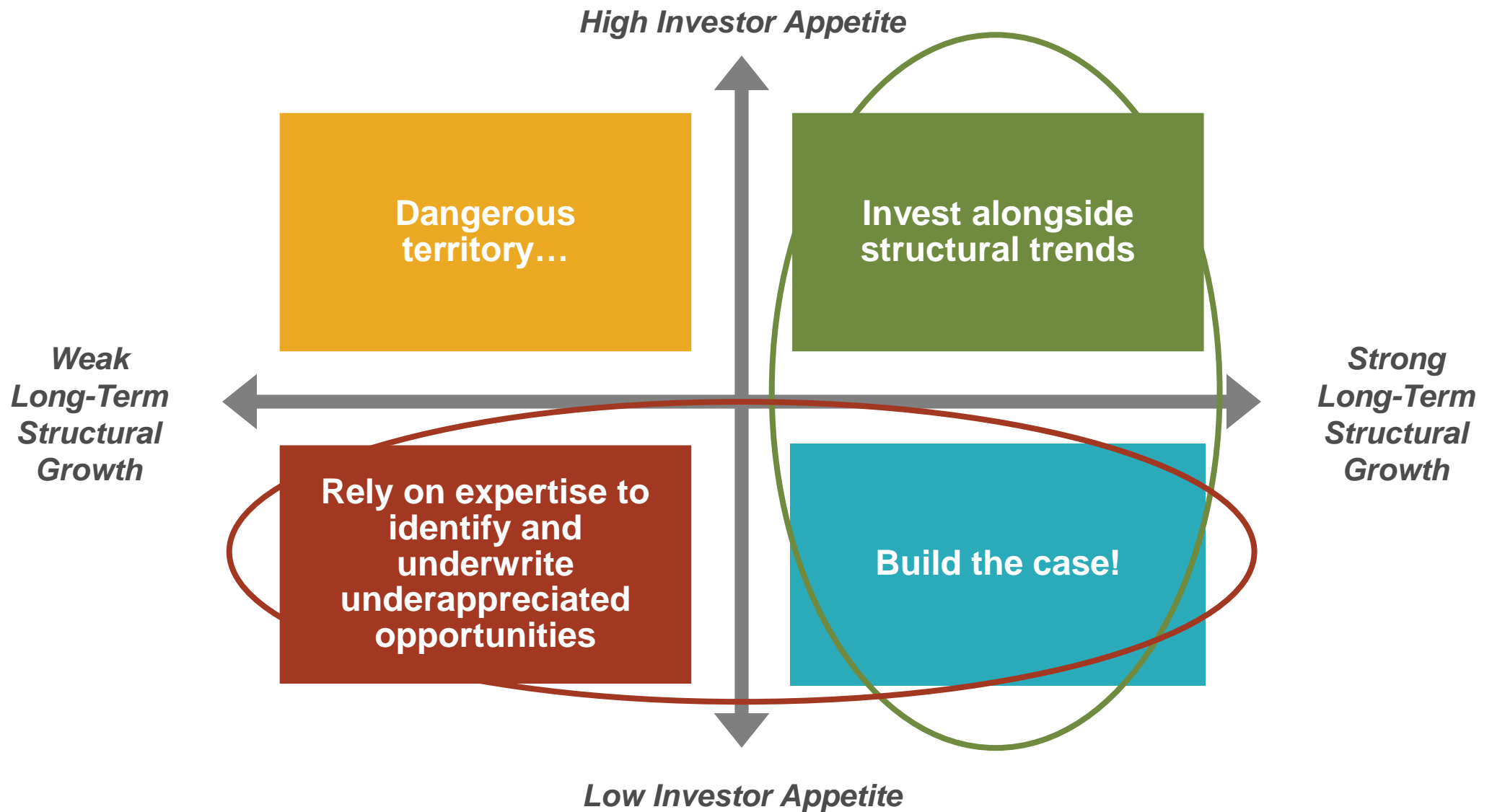
# “CONTRARIAN” = IDENTIFYING UNDERAPPRECIATED OPPORTUNITIES



# INVESTMENT OPPORTUNITIES PRESENT THEMSELVES IN EACH QUADRANT



# IDENTIFYING VALUE OF GEOGRAPHY / PRODUCT TYPE DYNAMICS WITHIN THE FRAMEWORK



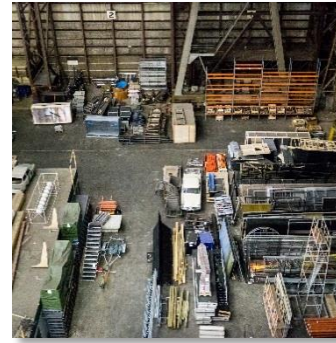
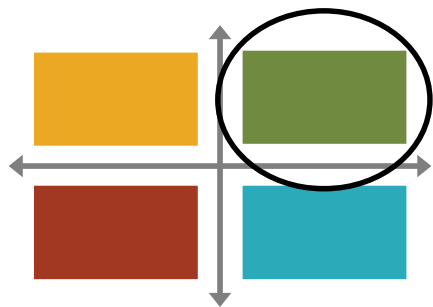
# INVESTING ALONGSIDE LONG-TERM STRUCTURAL TRENDS

- **Critical to identify:**

- What hasn't yet peaked (or maybe isn't proven) in terms of demand
- What isn't or isn't likely to be oversupplied

- **Opportunities:**

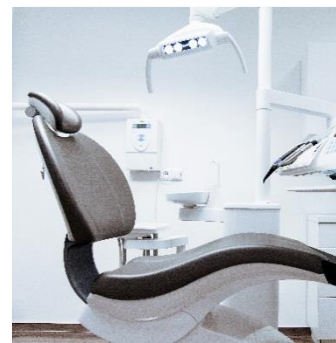
- Seniors housing
- Industrial/logistics
- Medical office
- Housing (in general)



**Great Fundamentals;**  
*highly favored  
by investors*



**Stable returns rely on  
improving operating  
performance, continued  
investor appetite**

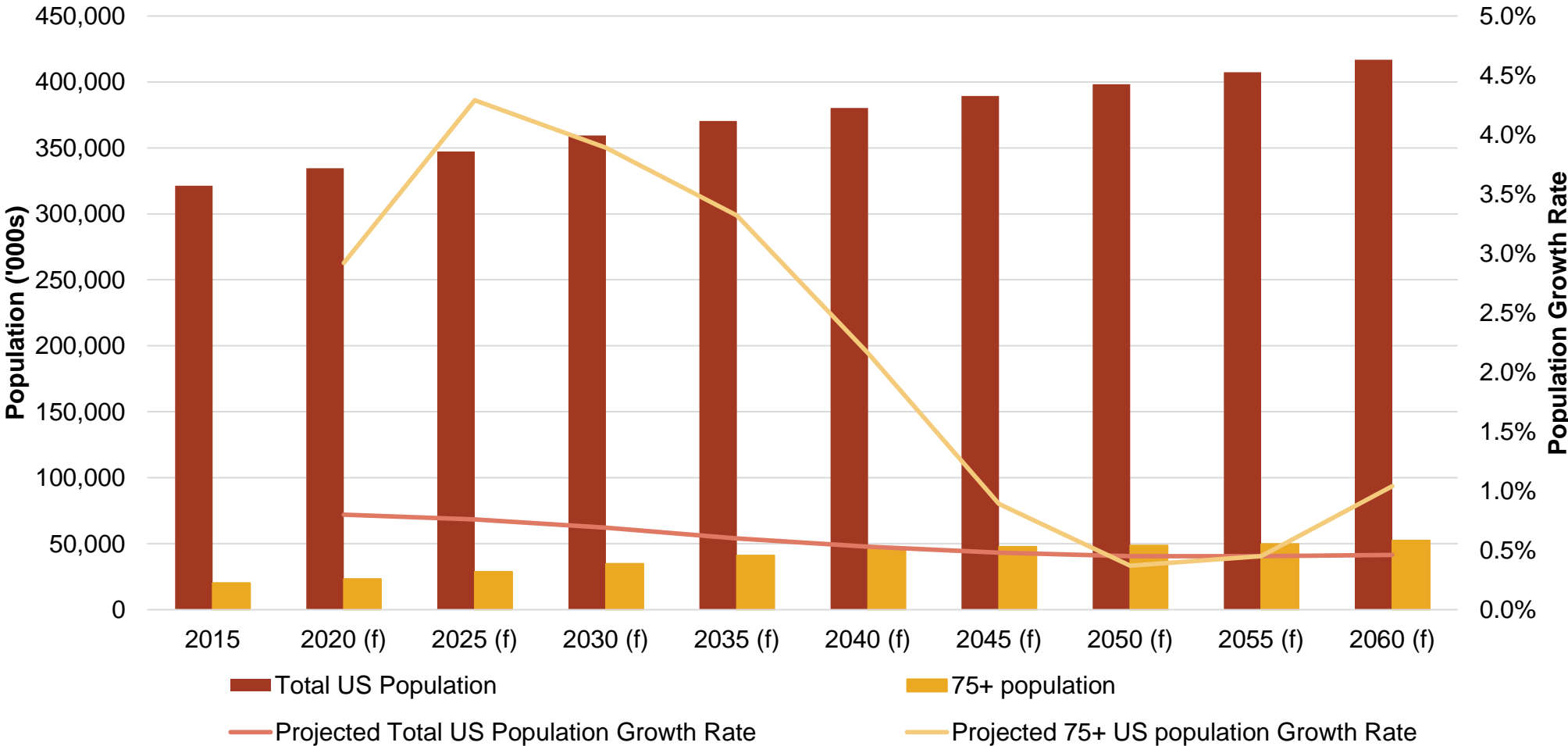


**Invest alongside  
structural trends**

# LONG-TERM STRUCTURAL TRENDS

## Aging Population Requires More (and New Types of) Seniors Housing and Other Services

*Projected Population and Growth Rate, Total Population and Age 75+; United States of America*



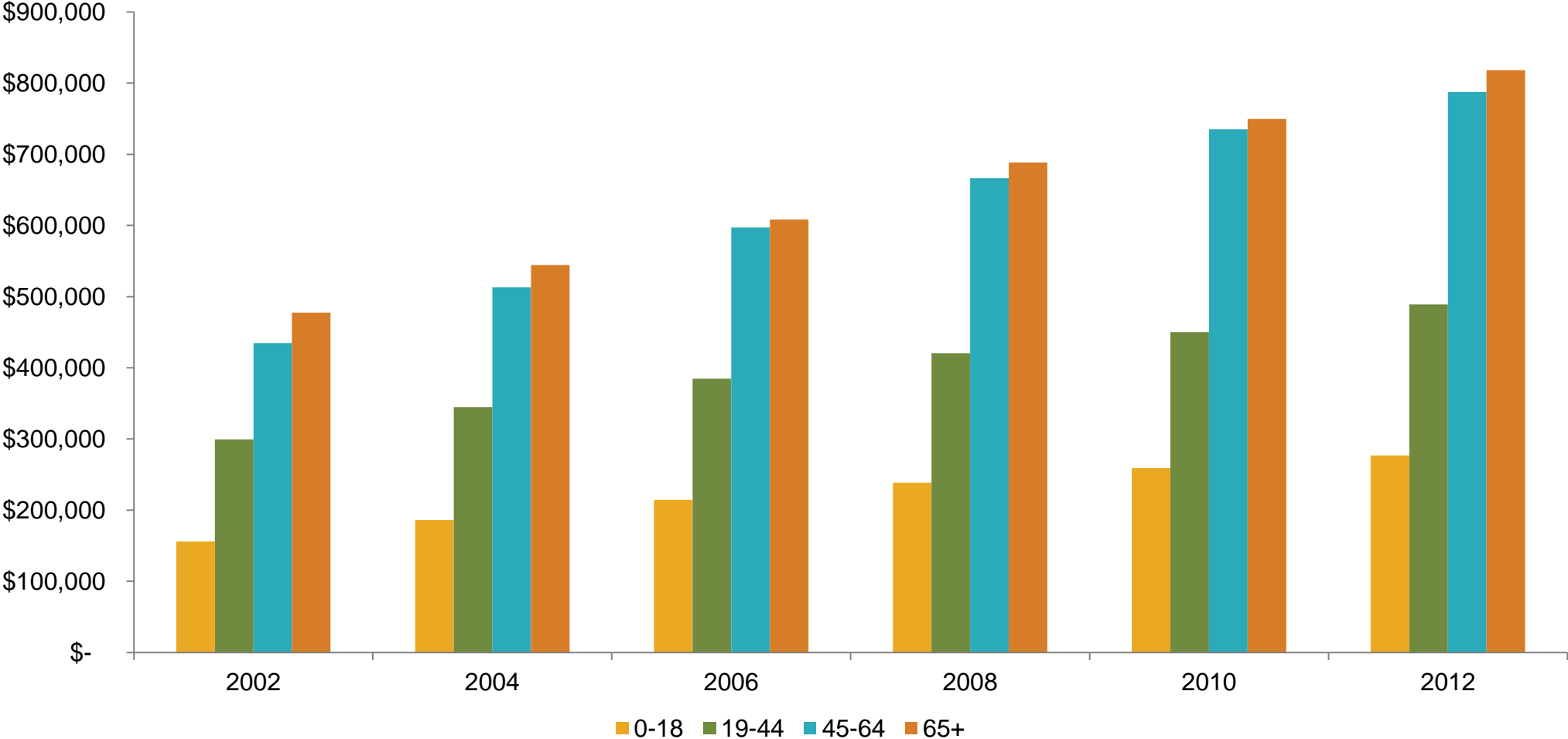
Source: US Census Bureau



# LONG-TERM STRUCTURAL TRENDS

## No Matter What Happens to the ACA (“Obamacare”), We’ll Need More Healthcare Facilities

*Healthcare Spending by Age Group; United States of America*



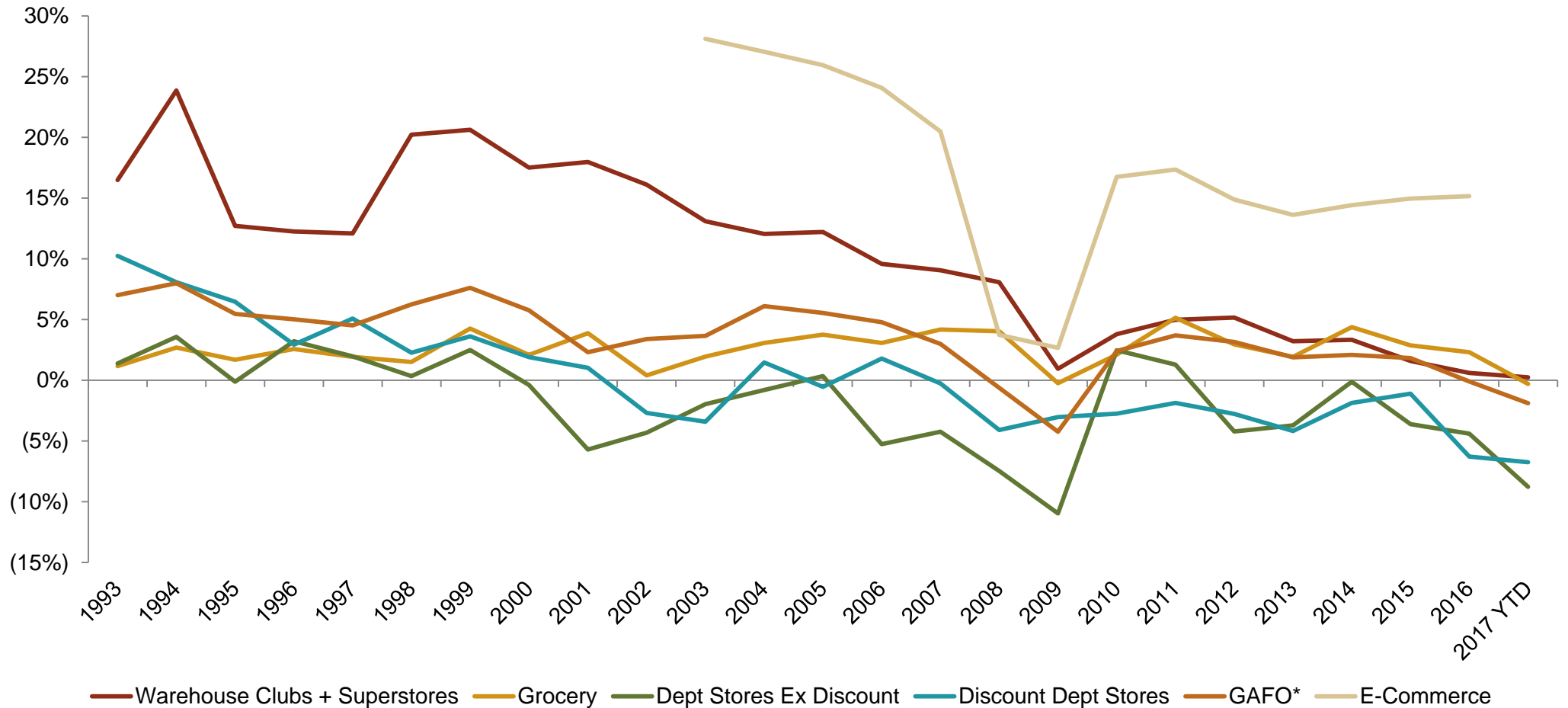
*Source: Centers for Medicare & Medicaid Services*



# LONG-TERM STRUCTURAL TRENDS

## eCommerce is the Only Type of Retail Experiencing Sales Growth in 2017 (Good for Industrial)

*Retail Sales Growth; 1993 to February 2017*

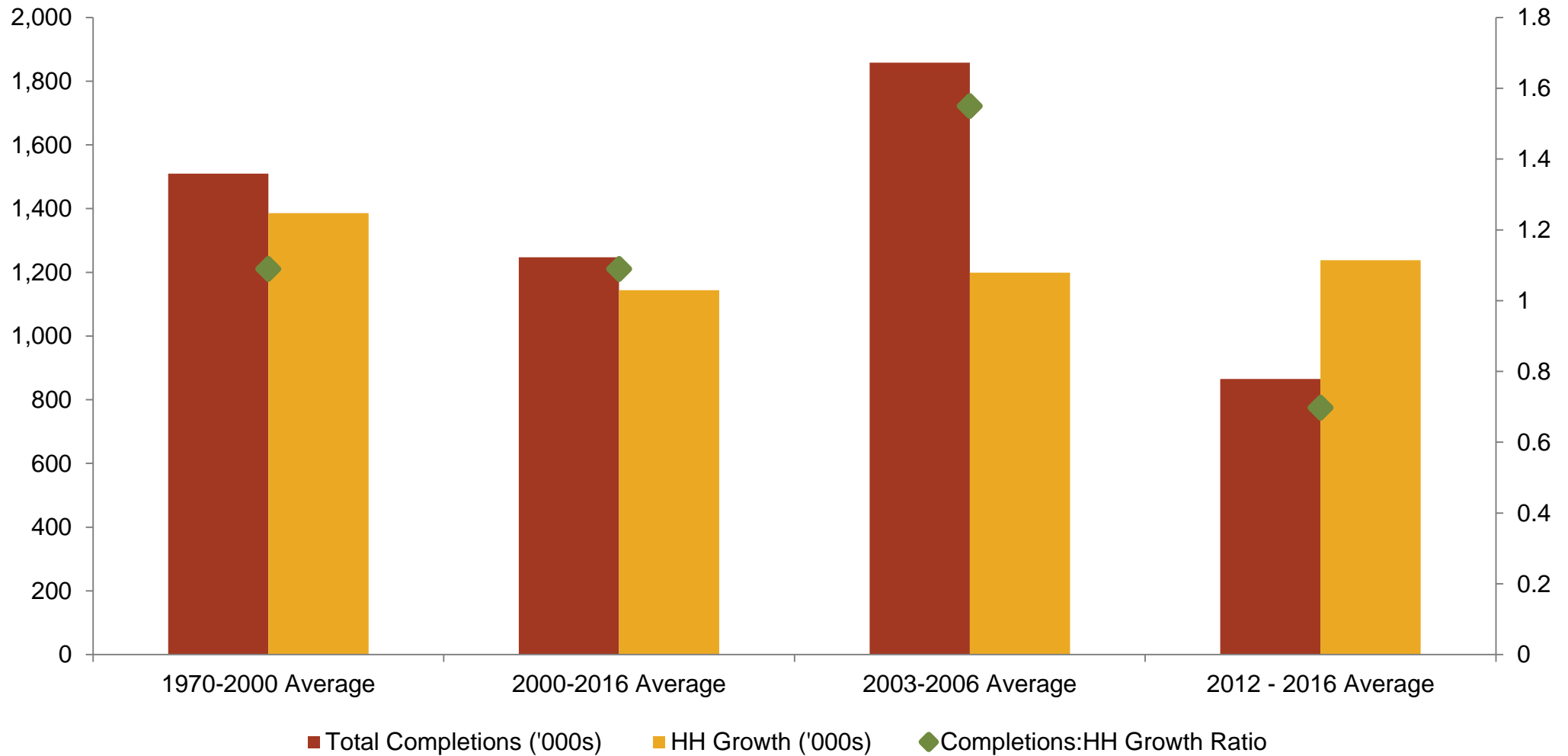


Source: Centers for Medicare & Medicaid Services

# LONG-TERM STRUCTURAL TRENDS

## Housing in the U.S. is Only Just Recovering

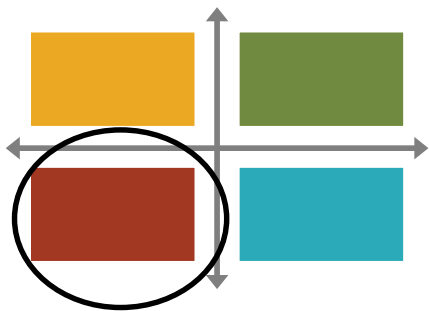
*Housing Completions Relative to Household Formation*



Source: US Census; RCLCO

# USING EXPERTISE TO IDENTIFY & UNDERWRITE UNDERAPPRECIATED OPPORTUNITIES

- Real estate is supremely inefficient (every parcel is different, many of them still great)
- Strong operators really do create value; characteristics of organizations that do this type of investing well:
  - Ability to ask tough questions of themselves & evolve
  - Creative capitalization
  - Discipline in underwriting
  - Actual asset management
  - Fine-tuned market observers



- **Examples:**

- Suburban office
- Retail
- (Upscale/Luxury) Hotels

Poor Fundamentals;  
*investors are out of  
the market*

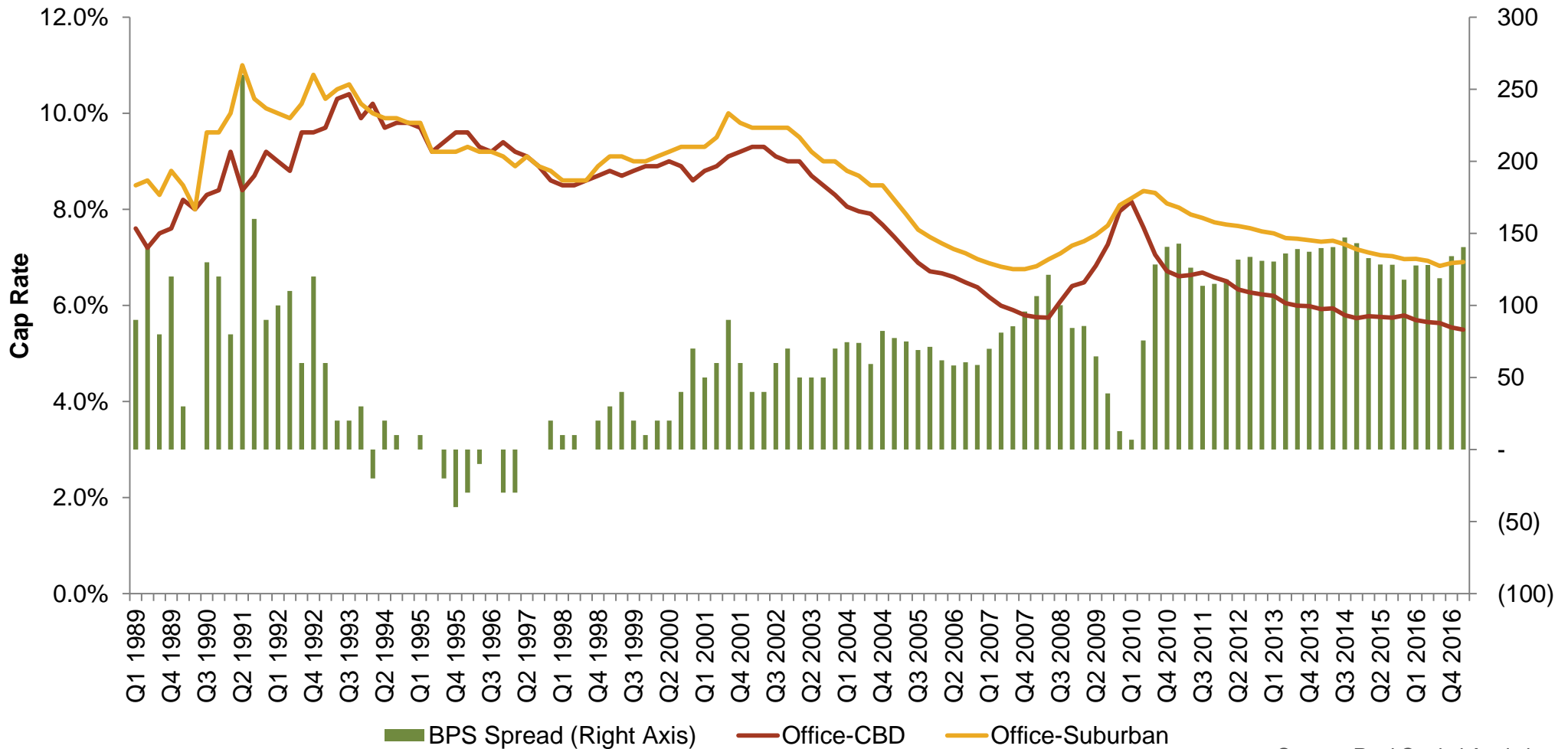
Returns from  
identifying good  
opportunities despite  
headwinds or where  
investors have been  
too quick to exit

Rely on expertise to  
identify and  
underwrite  
underappreciated  
opportunities

# UNDERAPPRECIATED OPPORTUNITIES

## Investors Uniformly Assuming Significant Risk In Suburban Office — Certainly Mispriced in Places

**CBD and Suburban Office Cap Rates; 1989-Q1 2017**

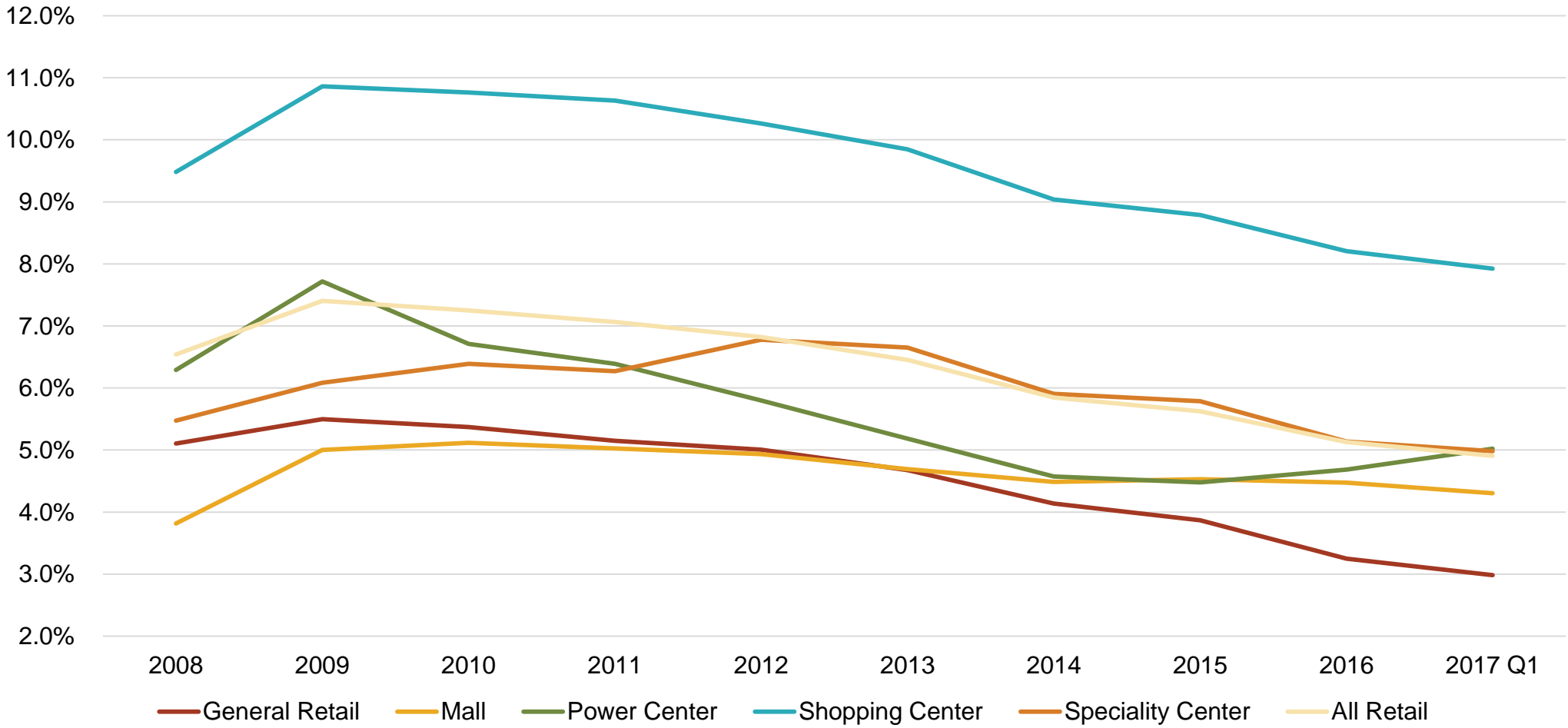


Source: Real Capital Analytics

# UNDERAPPRECIATED OPPORTUNITIES

## Retail is Under Threat and Not Favored, but Opportunities Clearly Exist

*Vacancy by Retail Center Type*



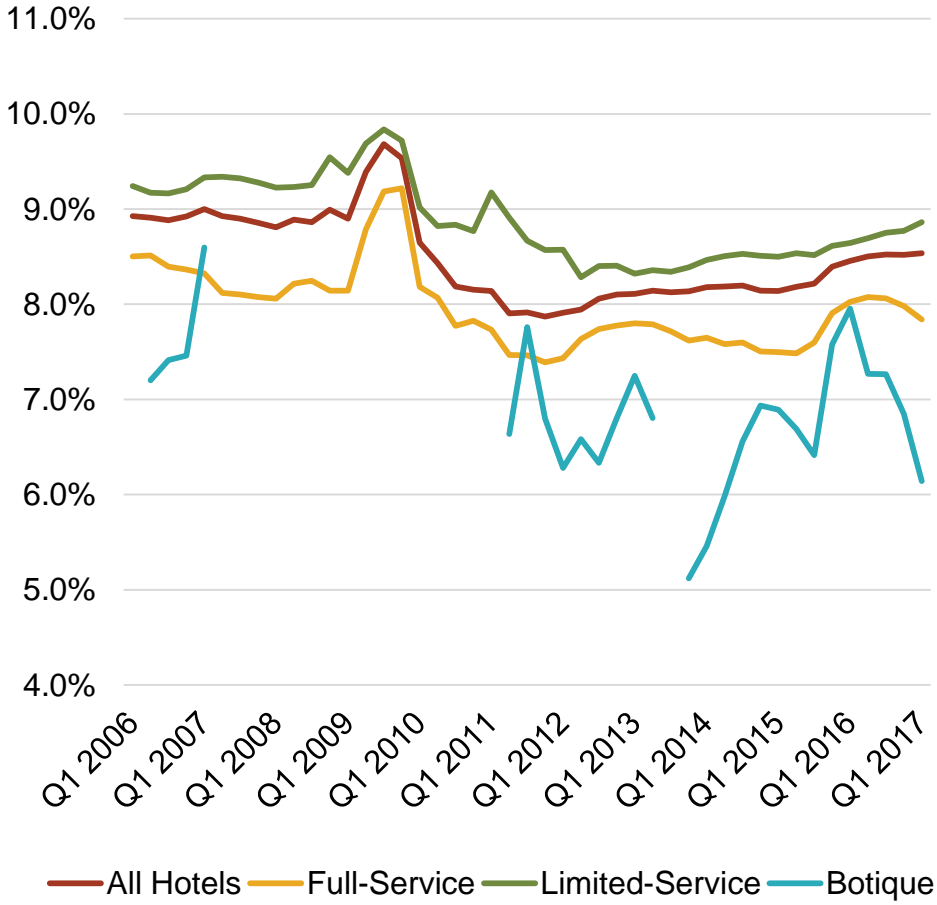
Source: CoStar



# UNDERAPPRECIATED OPPORTUNITIES

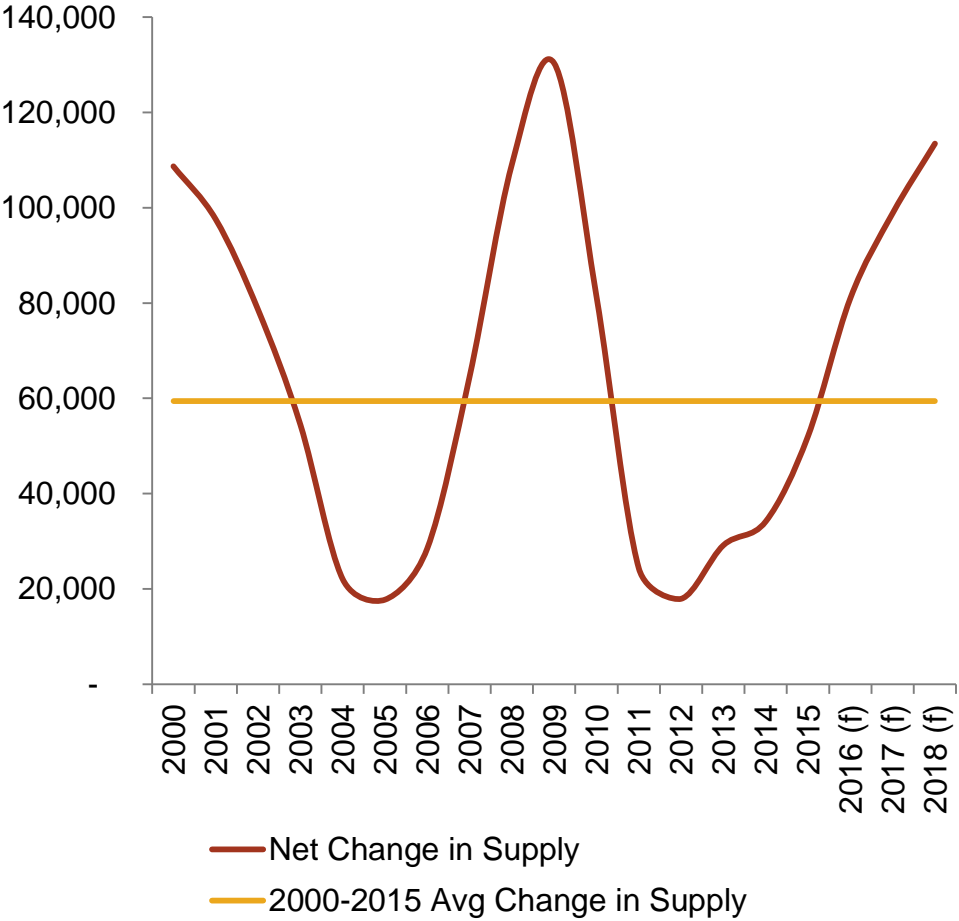
## Supply Concerns Leading Investors Away From Hotels, But Likely Create Opportunity Around the Corner

**Cap Rates by Property Type**



Source: Real Capital Analytics

**Net Change in Hotel Keys**

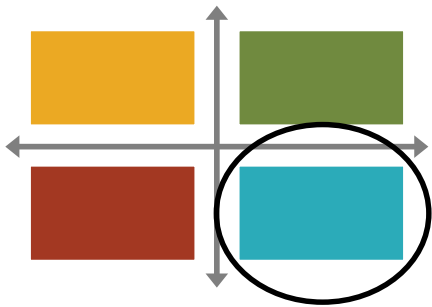


Source: PKF Hotel Horizons Report



# OUTSIZED RETURNS RESULT FROM LEVERAGING BOTH APPROACHES

- **Difficult to identify:** markets may be inefficient, but they're not stupid
- **Difficult to underwrite:** how do you know you're right, and everyone else is wrong?
- **Difficult to finance:** where are the comps?
- **Examples we're seeing right now:**
  - For-sale residential
  - Suburban apartments
  - "Missing Middle" residential products
  - Multitenant industrial
  - Hybridized product types



**Great Fundamentals;**  
*which investors  
don't yet appreciate*

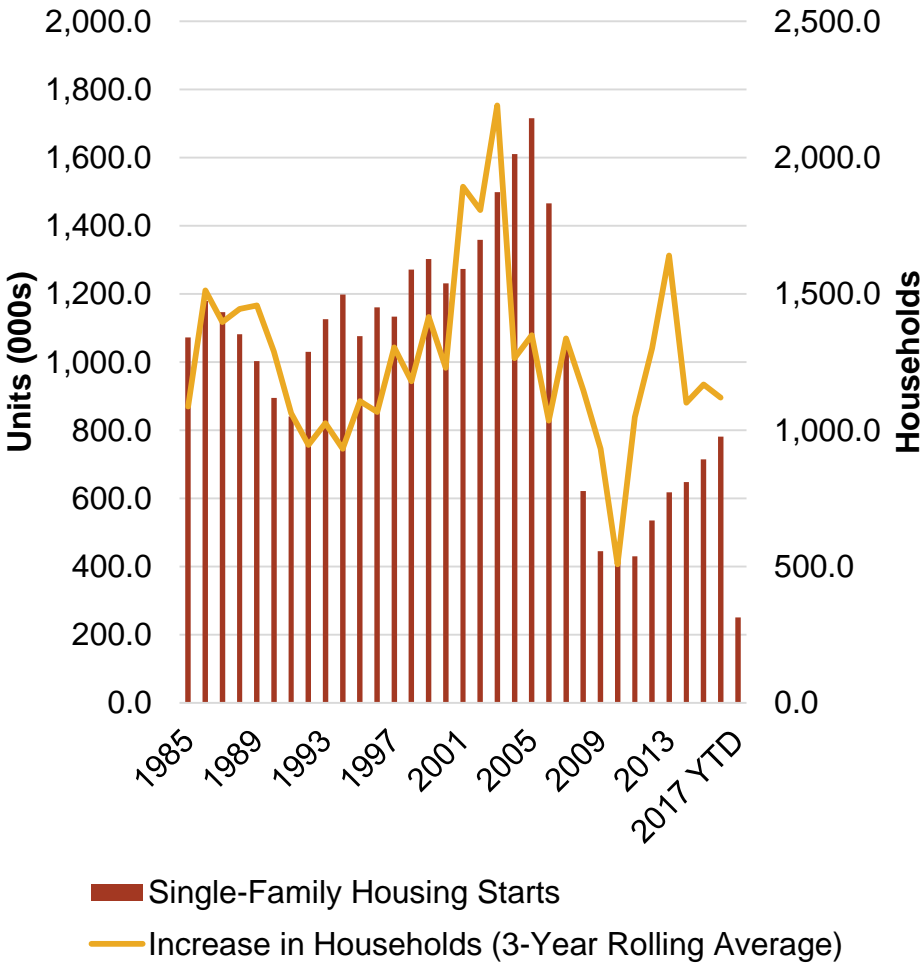
**Outsized returns result  
from strong operating  
performance and  
improving values as  
investor appetite grows**

**Build the case!**

# UNDERAPPRECIATED TRENDS

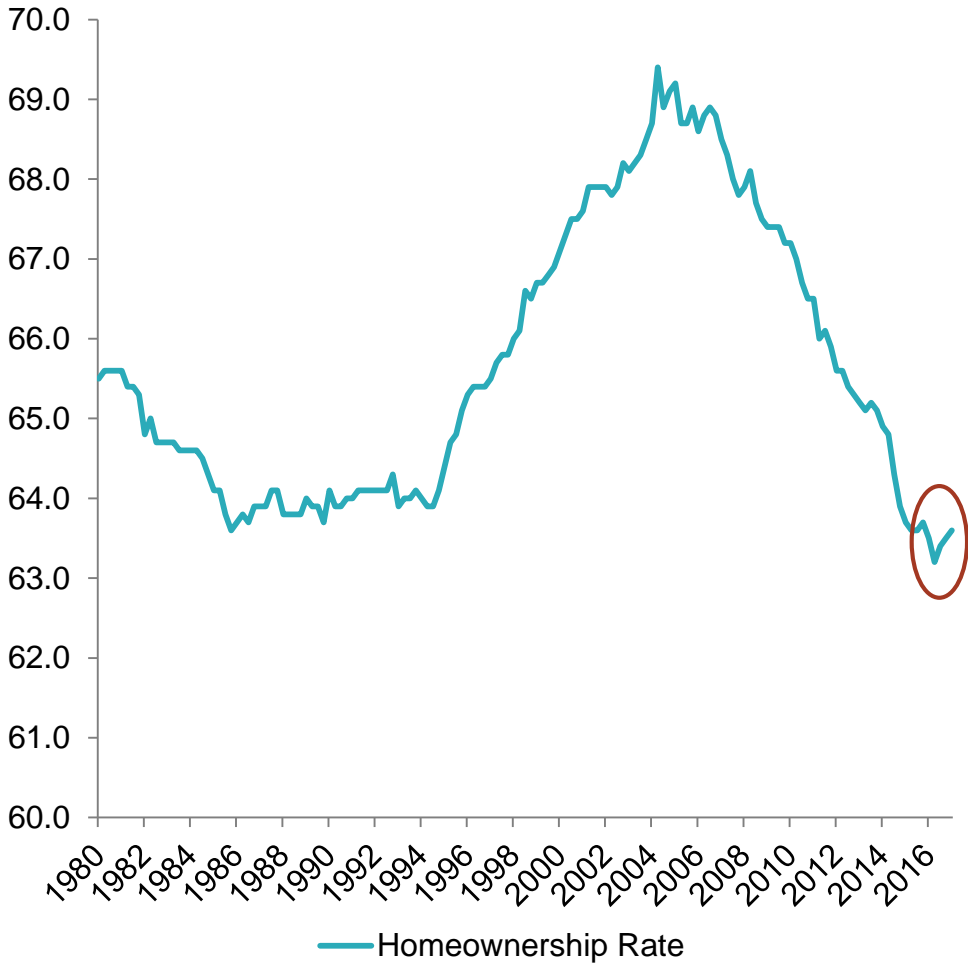
## For-Sale Residential Potentially Coming Out of the Wilderness

**U.S. Housing Starts**



Source: U.S. Census

**U.S. Home Ownership Rate**



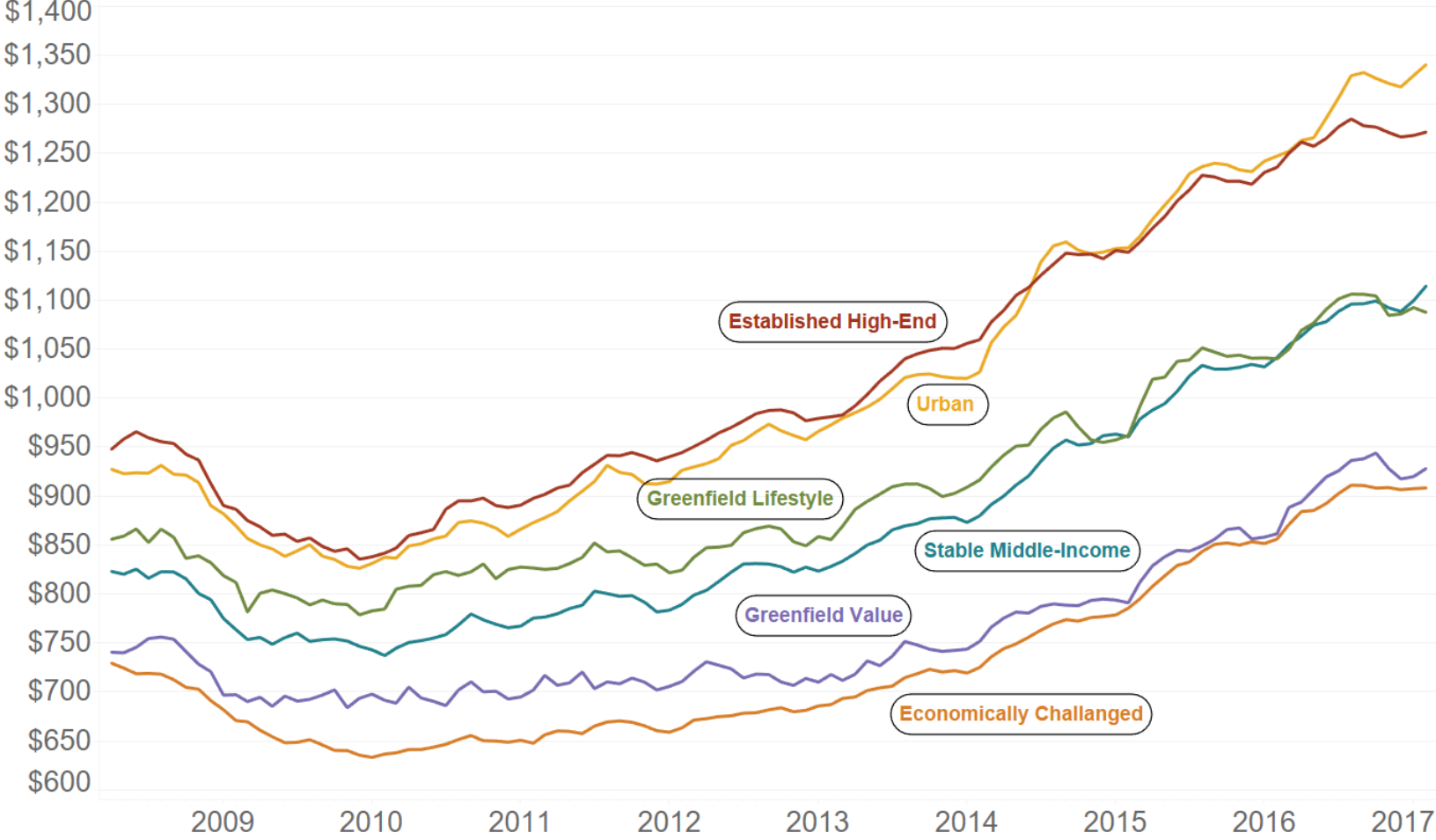
Source: U.S. Census



# UNDERAPPRECIATED TRENDS

## Investors Overly Focused on (Sexy) Urban Apartment Markets Despite Similar Performance of Other Place Types

*Average Effective Rent by Place Type, United States*

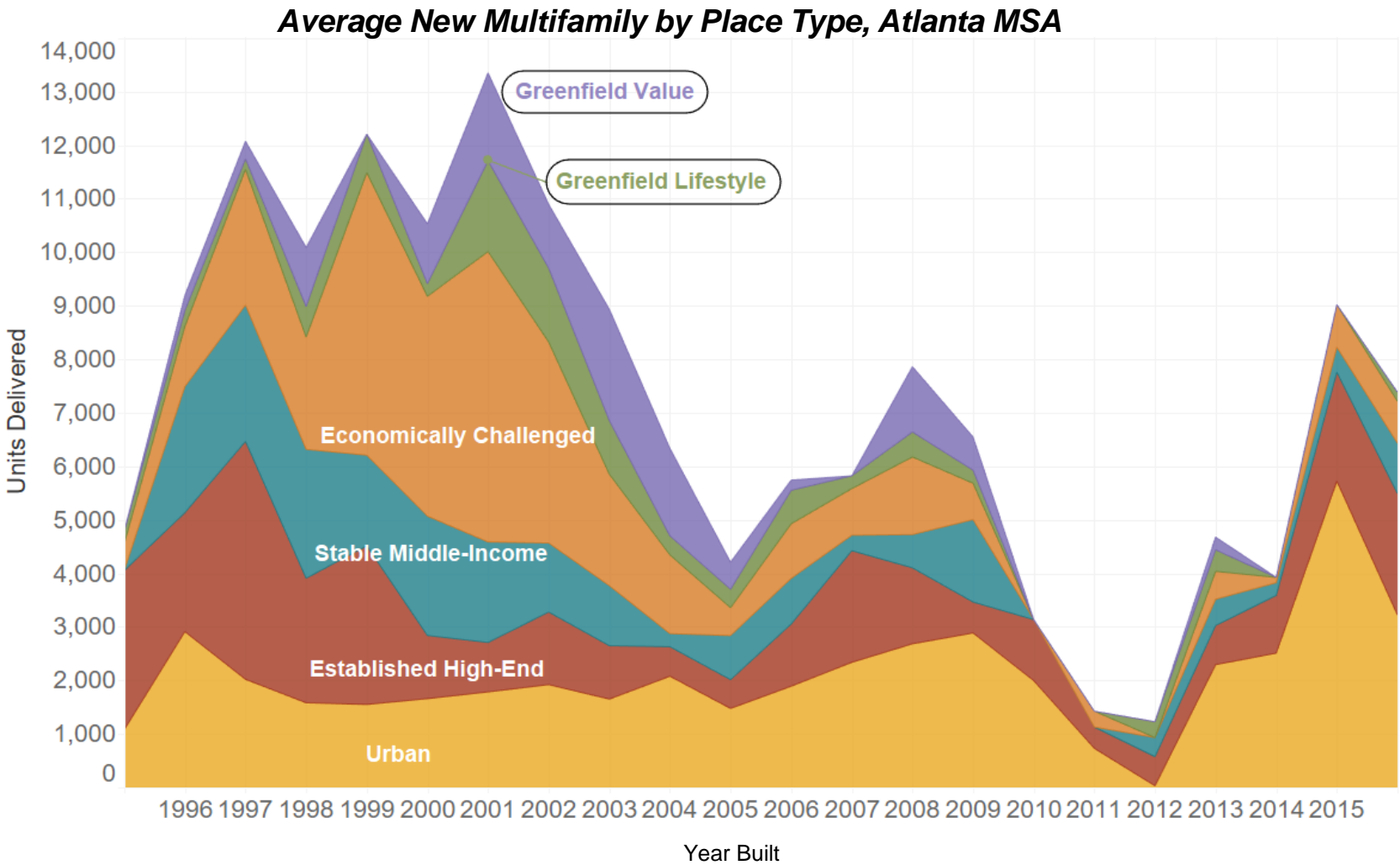


Source: Axiometrics; RCLCO Place Type Characterization System



# UNDERAPPRECIATED TRENDS

## Market Has Turned Away Without Basis from “Economic”/Place Type Missing Middle

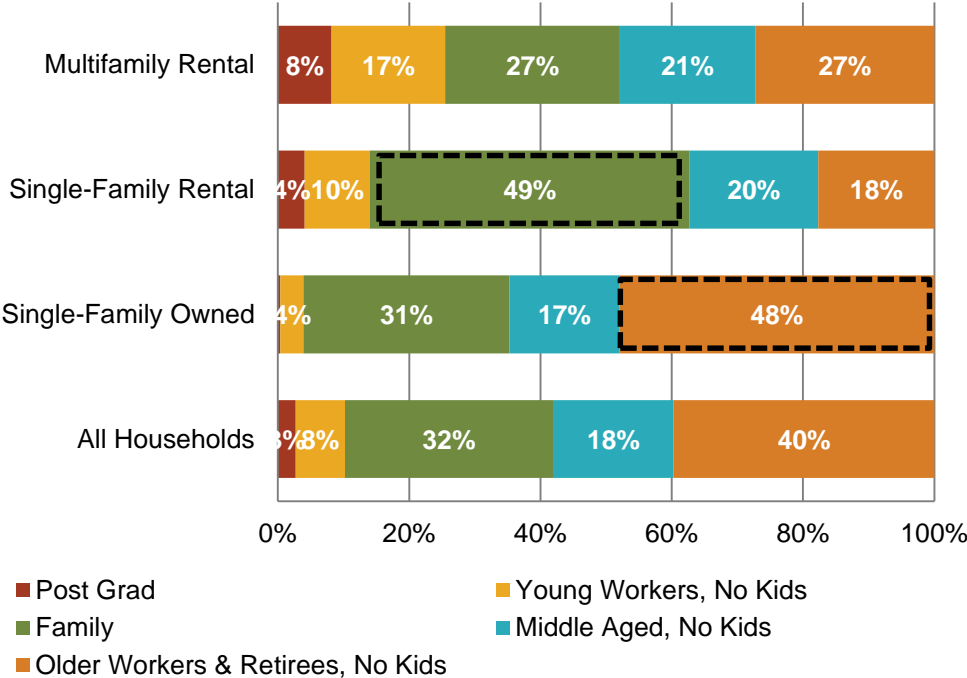


Source: Axiometrics; RCLCO Place Type Characterization System



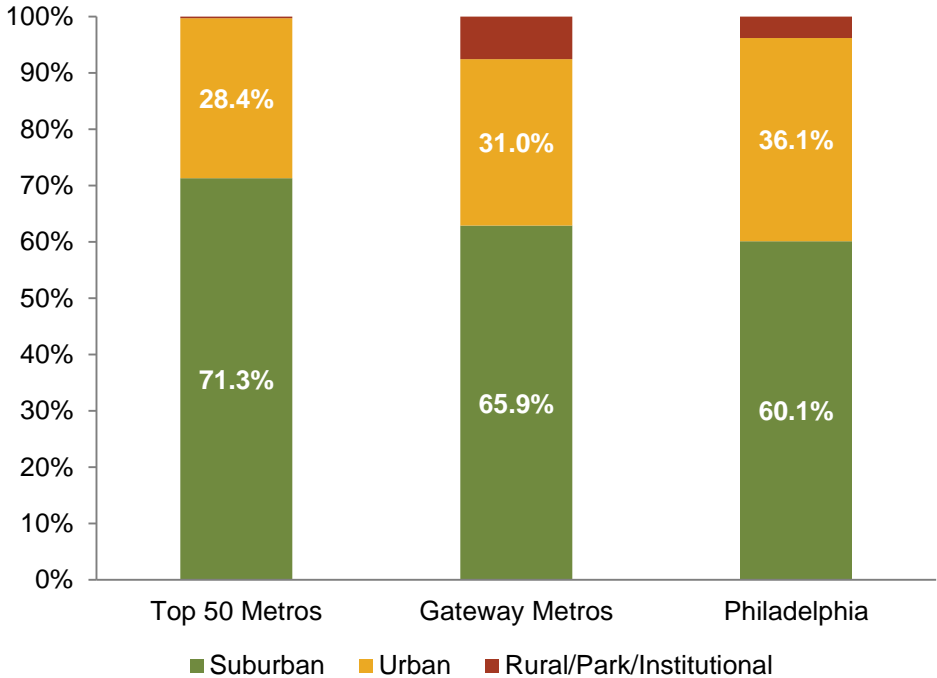
# UNDERAPPRECIATED TRENDS & PRODUCT TYPES: MISSING MIDDLE

**Family Lifestage Distribution by Housing Type; United States**



Source: U.S. Census

**Place Type of Current Residence; Millennials (25-34)**



Source: U.S. Census

Image: Opticos Design



# UNDERAPPRECIATED TRENDS

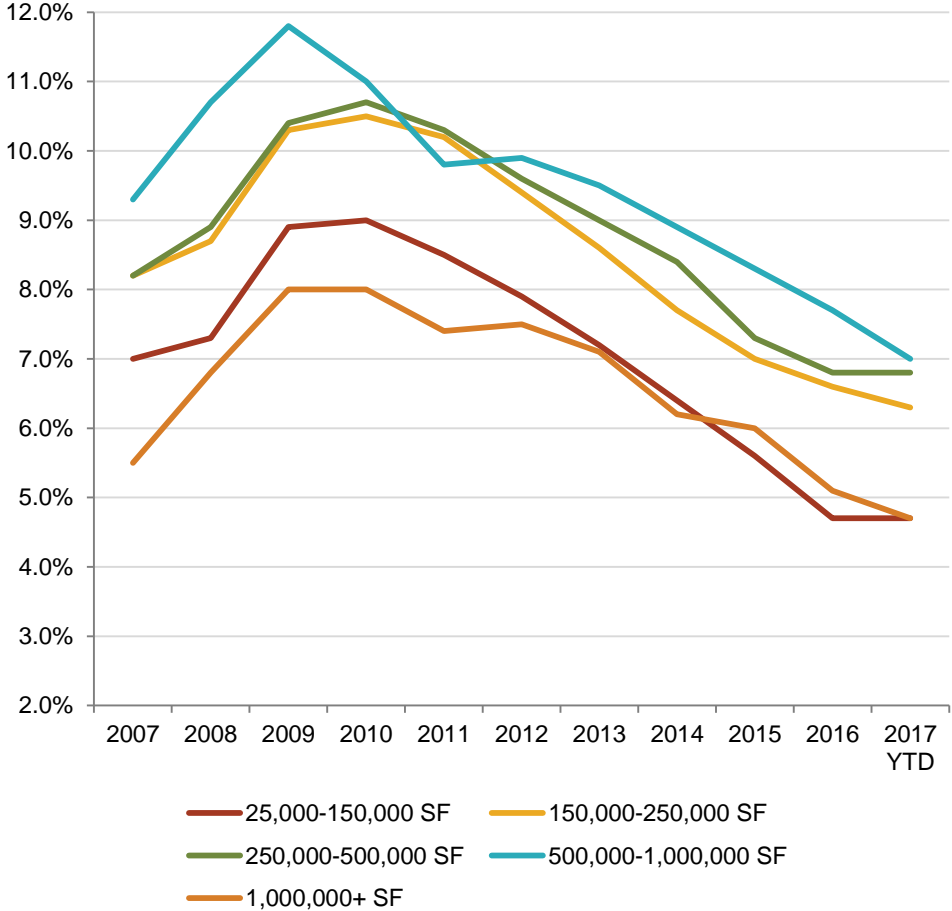
## Small-scale (Usually Multi-tenant) Industrial Exhibits Strongest Market Fundamentals

**Percentage Change in Industrial Inventory by Size Category; 2007-2017 (YTD)**



Source: Costar

**Average Industrial Vacancy by Size of Building; 2007-2017 (YTD)**



Source: Costar

# UNDERAPPRECIATED TRENDS

## Evolving Trends in American Life Driving New and Creative Product Hybridization

TREND	<i>Increasing Residential Transience</i>	<i>Rise of Work From 'Home/Sole Proprietorship'</i>	<i>Retail Box Store Obsolescence</i>
	↓	↓	↓
SOLUTION	<i>Short-Term Furnished Rental</i>	<i>Residential/Office Hybrid Conversions</i>	<i>Mall Anchor Medical Office</i>



*Saul Urban  
Unban Suites; Washington, D.C.*



*Novus Residences  
eLofts; Alexandria, Virginia*



# UNDERWRITING “CONTRARIAN” STRATEGIES

- **Contrarian investment strategies bear a higher burden of proof:**
  - “What we’re observing really is a structural change.”
  - “I know about the threats, but this asset is different.”
- **Contrarian returns should earn higher returns (for the same level of risk):**
  - Clearly delineate and understand the risks
  - Quantify and evaluate the risks
  - Answer whether the market pricing makes sense
- **Contrarian investor characteristics:**
  - Inquisitive culture
  - Research-driven approach
  - Appreciation for “the cycle”
  - Patient and flexible capital
- **Investment vehicle/approach matters:**
  - Fundraising, lifecycle, and approach make it difficult for commingled funds to be contrarian

# CONCLUDING THOUGHTS/QUESTIONS

- **So, how might you think of constructing a portfolio “staking” investments in these categories?**
- **How do we overlay thinking about market cycle and this approach?**
- **How do we use debt or creative capital stack formation with each?**
- **How do you underwrite a manager’s contrarian strategy?**