June 23, 2021

Generations Summer 2021 - Day Pitney's Real Estate Fund Investment Opportunities Roundtable

On May 27, Day Pitney hosted a virtual roundtable with several sponsors of private real estate funds. The panel was moderated by Eliza Sporn Fromberg, a partner in our Investment Management and Private Funds practice group, and Peter Wolfson, a partner in our Real Estate and Land Use practice group. The panelists had a lively conversation on topics ranging from pandemic-generated trends in the real estate market to the impact of cryptocurrencies in real estate investing to the challenges of working with joint venture partners.

The panelists were Peter Brosens, co-founder of Stolar Capital LLC; Jake Geleerd, president and CEO of Tortoise Properties, LLC; Edward Gormbley, founder of Workforce Partners, LLC; Mark Landau, co-founder of Vert Peak Partners; William "Billy" Senné, founder of The Senné Company, Inc.; Omar Slowe, founder of Harpia Asset Management; and Sri Vankayala, director of capital markets at Saxum Real Estate.

Below is an excerpt from the conversation, edited for length and clarity.

Peter Wolfson (PW): Let's talk about the trends in the real estate markets during and coming out of the pandemic, particularly in brick-and-mortar retail, hospitality and office uses. What is your investing philosophy, and how can one take advantage of these sorts of market disruptions?

Peter Brosens (PB): COVID-19 has accelerated trends across the board, and we have seen more people moving into growth markets. We are focused predominantly on the multifamily space, so we have not seen as much disruption as others have, but we have also focused on investing in the path of this growth.

Jake Geleerd (JG): We have experienced success in the office space because a number of our tenants are private equity-backed. We also work hard to get to know tenants and find opportunities to place them in such spaces and work with their needs after such spaces are filled. Currently, we are very bullish on the office and multifamily realm and looking to expand in this market.

Edward Gormbley (EG): Capitalization rates are crazy right now, and that's how we know we are in unprecedented times. The times have forced us to change how we think about real estate investing. Workforce housing in particular has proved resilient throughout the recession from over a decade ago, as well as in the last 18 months. We plan on focusing more on this, and also on properties that are local to our firm so we can offset cap rates by executing on scale and removing larger operational costs.

Sri Vankayala (SV): While Saxum's roots started with development of transit-orientated office buildings, we made a decision early on to go into multifamily and industrial development, and that's done quite well. We also have a "special opportunities bucket" at our firm that focuses on value-add student housing and boutique office deals. With regard to opportunities, we're seeing more within this "special opportunities" space, which has been overlooked recently or been hit with a broad brush by institutional investors. In student housing particularly, we recently acquired assets with 70-85 percent occupancy at high-single-digit cap rates, and we are already seeing strong returns as things start to recover to normal in this sector.

Mark Landau (ML): COVID has accelerated a lot of trends, but particularly in retail. A lot of people are afraid of retail in the real estate space—I think for good reason—but we've focused on growth markets in *essential* retail like quick-service restaurants, car washes or anything that can be considered "Amazon proof." As there is currently not a lot of capital flowing into this space, we have had to adjust our risk, but it's been an interesting play. I also think there was not as much distress from the pandemic as we were predicting, and certainly nothing compared to 2008 or 2009 – the trends have been more episodic.

Billy Senné (BS): In Boston, we have seen that the multifamily market has been compressed, and it's tough to get cash flow out of it at the moment. The opportunity in multifamily is not quite here yet, unless you're doing a value addition for a development project.

Omar Slowe (OS): Over the last 12 months, we have seen more and better opportunities to acquire properties as a result of increased post-COVID-19 distress. This has accelerated investing opportunities for us, especially in terms of small to midsize residential in the outer boroughs of New York City.

Eliza Sporn Fromberg (ESF): We have been hearing from the media that both the office space and residential markets have been fundamentally transformed, as people are less focused on having good commutes or living in hot residential communities. What do you think?

EG: We have seen recent signings for huge deals in New York, and transactions have continued. I think the pandemic's effects vary geographically, and there is still a lot of demand for these things in cities and places where there are people who want to work, versus crickets in other places— it's really a tale of two cities.

JG: There are markets where you saw a sort of knee-jerk reaction and people vacating cities. Similarly, I think company owners are now realizing that technology and remote work make it very possible to not gather 300 people in an office. However, we are still seeing a lot of growth in major cities, as they still continue to be where people want to live and go to work.

SV: We have definitely been a beneficiary of this trend, which we think will be there for a bit longer. The office deals in our portfolio, by design, are all in boutique, transit-oriented, high-income demographic neighborhoods with great schools. While we didn't foresee a once-in-a-lifetime pandemic, we did believe that each of these boutique buildings would stand the test of time and didn't want to be another commodity office building. That thesis was doing pretty well before COVID, but now we've seen a ton of activity given the demand for these highly sought-after neighborhoods.

ML: I think offices will experience what we saw in retail. Quality and location will matter, particularly in Manhattan and other large cities. I also think we will not see as much distress there because the major office players in these cities have the financial wherewithal to withstand the consequences of the pandemic. Additionally, I think the idea that everyone is going to work forever is a bit of a fallacy and overreaction – at the end of the day, people will always seek out quality places to live, and cities will continue to recover and reinvent.

PW: Let's talk about those dark storm clouds on the horizon regarding Section 1031 like-kind exchanges, stepped-up basis at death and capital gains tax increases. What are your thoughts on the possible effects of this?

SV: We are a very active player in the opportunity zone (OZ) space, and we've been getting more interest from high net worth or retail investors partly driven by these potential changes to 1031. As these investors continue to look for tax-efficient investment structures, the OZ space has become more interesting to them. At Saxum, as OZ sponsors, we feel we have an edge relative to our OZ competition in that we have a strong track record in this space and furthermore provide investors with asset class diversification. Most OZ funds are multifamily-focused, but we've been investing in OZ industrial deals as well as some OZ office deals in high-growth areas like Austin, Texas. Our view is also that each investor has their own individual preferences for how they wish to strategize for their tax goals, but it's worthwhile for them to at least understand the OZ space and explore it. Most of our deals are development deals with high-profit/return profiles, which when combined with the OZ tax benefits, make the projected net investor returns highly accretive.

BS: What I've seen on the advisory side of our business a lot lately is that people are willing to sell their real estate to pay for capital gains now and to get into our syndications of specific properties for long-term cash flow. They are thinking that if there is a possibility that 1031 goes away and capital gains rates increase, then they might as well just take the hit now and move into something with a more stable long-term cash flow.

OS: I think that many need to realize that investing in opportunity zones is not just for ultrahigh-net-worth investors seeking a tax shelter. Our partners include sophisticated investors that have a need for tax efficiency in the long term but are also interested in and eager to embrace our impact focus and the spirit of opportunity zone investing, which align well with our mission. For example, throughout our process on both the investment management side and the development side, we focus on seeking out women, minority and even LGBT vendors in our diversity and inclusion efforts for service providers and contractors. We also work to find opportunities to share some equity upside and/or for knowledge transfers with members of the communities where we work. This creates a virtuous cycle that benefits us and the community in several other ways.

ESF: What geographic markets are you looking to get into that you would have never considered five years ago?

ML: Because of some of the retail we are doing, it's areas like the panhandle of Florida. I think a lot of people are broadening their investments because there is institutional capital flowing to markets to which it would not have otherwise flowed.

SV: We've been doing more multifamily and industrial, and that takes you to different locations because of the drivers being so different. We've seen a lot of the Sun Belt for multifamily and the logistic/port locations for industrial. On the student housing side, we like the non-Power Five athletic conference college towns.

BS: I'm seeing some opportunities in areas where there are no direct flights. That's been interesting for us, and we have been looking in more rural communities for services and tenants that have services that are kind of internet-proof, aka not disrupted by online competitors.

ESF: What are your thoughts about real estate as an investment versus equities or versus other types of investments, and have your thoughts on RE investments changed over time?

PB: For the people I speak to in the equity market, I think the biggest factor is inflation, and I think the equity markets will probably take a pretty significant turn. I think right now the stock market is driven by liquidity that the feds are providing, right? They're buying $120 billion every month, and those government bonds and mortgages are making their way into the stock market. If we start to see inflation, the government will have to reverse course. I also think, in general, if you own hard assets and you can fix your debt, real estate is a fantastic place to be.

BS: What we have been seeing so far is that foreign capital has not been as significant as others have been saying, especially in contrast to domestic capital. I mean, it's *here*, and people have money, and they want to put it in real estate. I also think there's a lot to be said for the amount of liquidity that has been pumped into the system over the last year. However, we think real estate is a very unique thing, which has lots of different opportunities. You can only buy one bitcoin and you can only buy one type of Apple stock, but if you're a skilled real estate operator, you can hunt for the right deal, which could be available in a variety of marketplaces, and you can make your money on the buy.

SV: Real estate has also got a sort of emotional aspect to it because these are the only real assets, and people like that. They're longer-term and sometimes even generational types of deals. And frankly, some of the development deals we are taking right now have pretty attractive returns, especially if you are doing it in sectors that have got some sort of real tailwind to them, like industrial or multifamily.

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