EPISODE 30: COMMERCIAL REAL ESTATE INVESTMENTS

Male Voice

Welcome to Careers in Finance, presented by the Boehly Center for Excellence in Finance at William & Mary's Raymond A. Mason School of Business. This podcast will explore various areas of the financial services industry, career paths in finance, and other practical insights that will help students better understand and prepare for professional success in the field of finance. Be sure to subscribe to the podcast and catch future episodes as we explore the field of finance. And now your host, Morgan Hutter.

Morgan Hutter

Today we're going to be talking about commercial real estate investments. You might have heard our prior podcast on real estate. We most recently did one on commercial real estate development. So there'll be some overlap that you'll likely hear today. But really, sitting with three experts. We have Fred Henritzi, Roger Pratt, and David Klepser. So in a second, I'm going to have them introduce themselves, but they're all fellow Tribe folks. And we have Fred out of Atlanta. He'll talk about his investment company, focused mostly on office properties in the Southwest. David with Ram Realty for the past several years and focused mostly on retail and multifamily. And Roger joins us with his most prominent experience at Prudential real estate, kind of overseeing all property types and targeting top endowments, which will also overlap with some that we'll talk about with Fred. So I'm really excited to kind of hear the conversation today. Welcome. So glad you're here. So why don't we start with just some introduction? So, Roger, do you mind just introducing yourself and saying hello?

Roger Pratt

Hello, I'm Roger Pratt. I'm a class of '74 BA. I was one of the first people to be able to do an interdisciplinary program, and I created an urban studies program. I've always enjoyed sort of the built environment and, you know, writ large. And I went from there and I got two degrees from UNC Chapel Hill, first in City and Regional Planning, a master's degree. Turns out graduating in 74 was not a great time. It was hard to find jobs. I decided just to stay in school. And I worked in city and regional planning in the state of North Carolina for five years. It was interesting exciting at times, but I soon learned that the politics and, the bureaucracy, and the lack of career path that one could control frustrated me. I had children at that point, so I decided to go back and get my MBA in a related field in real estate. So from there, I ended up going to work for Prudential, and I had met them through a research project that one of my professors was involved with, and I ended up starting their Atlanta office. I ended up having a 32-year career. It seems like that's a long time to stay at one place. But at Crew, because of both the industry changing and evolving, and then the nature of my roles changing and involvement, I really had multiple careers, if you will, within the same company. I ended up running several of their larger investment funds platforms. I think at my peak, I had about 15 billion of assets under my management and supervision, focusing primarily on raising capital from the large pension funds and endowments, and then also responsible for trying to invest that money in an intelligent fashion to get the returns required. Towards the end of my career, I was the chief risk and Investment Manager Officer globally. So I have to learn about various experiences around the world and how you deal with the fallout of the global financial crisis. So, interesting times. I'm currently still involved. I'm a consultant with the Chinese real estate investment fund that had been doing deals in US. The pause button has been sort of hit on that activity. I'm also a member of the board of a Sealer Realty Trust, which is a healthcare-oriented, non-traded REIT based out of Florida. So that's probably enough of an overview for me.

Morgan Hutter
No, I love it. Welcome. We're glad you're here, and the wealth of knowledge of today's podcast is really thrilling. So I can't wait to hear everything. So, Fred, do you mind introducing yourself?

Fred Henritze
Oh, yeah. I'm Fred Henritze, and I'm with a company in Atlanta called the Brookdale Group. I started my career with a company out of Canada, Trizack, and they were based in Montreal and then in Calgary. I was there for several years, then went to work for an Atlanta-based real estate brokerage firm called Colliers, which was another company at that time. And then I worked there for a while and started working directly for Cheryl Hines till about 2000, really 1994. And then, my partner and I decided to start a real estate investment fund. We originally were going to start it with the Hines family. They weren't particularly interested in suburban office space at the time, and they had not done so well in it. And we were coming off the savings and loan crisis, which we saw some opportunities at the time, and we looked for money with them, but then eventually ran into a large investor, Yale, who really wanted to do business with us personally. And we raised a very small fund then, not like the billions, like Prudential, and we invested that money in 94 and then subsequently raised several other funds. And we've now got eight different funds operating. One we are harvesting now, which is fund Seven, and fund Eight, which we are still investing and have about two thirds of capital there. We generally raise relatively small funds, probably 400, $500 million. We do not get a traditional asset management fee, and therefore we're not encouraged to raise large funds at a time. So that's generally where we are. The geography again is the Southeast and Southwest. We go to Northern Virginia, Maryland suburbs, south of Florida, west of Texas. If we're going to do any foreign investing, we invest in New Orleans. And so other than that. That's it.

Morgan Hutter
That's great. Well, I know we had mentioned that we did an endowment podcast as well, so it'll be fun to have the listeners that tuned into that kind of hear what it sounds like. Fred and Roger will share today a little bit too. All right, David, that brings us to you. So welcome.

David Klepser
Great, thanks. Morgan. Glad to be here. David Klepser, class of 1997, business school, had a finance degree, started in investment banking, and then transitioned over to real estate after getting my MBA in Chapel Hill. I've been with Ram Realty Advisors now for about seven years, and I manage the company's North Carolina operations. We are primarily an apartment and retail mixed-use acquisition and development company. Similar to Fred, we do raise private equity funds that we then invest. We're currently in our 6th fund right now. Our North Carolina

team is focused on Charlotte in the Raleigh-Durham market. Ram, as a company, focuses on the Southeast primarily beyond those two areas in North Carolina. Also, South Florida. Kind of Palm Beach on down in Miami, Central Florida, in Orlando, and Tampa. And then we also have a new office in Nashville and some investments there. So we're focused primarily on development and acquisition of those properties, apartments, retail, and mixed-use. That's the background for me.

Morgan Hutter

Perfect. And you also were a Tribe gymnast, right, when you were here?

David Klepser

I was a gymnast, William Mary, for four years. It was great experience, great place to be athlete.

Morgan Hutter

That's great. And Fred, I know you have ties to some athletic as well. Are you the godson of Fred Powalski, the number one tennis player at one point in the world? Right.

Fred Henritze

He was my godfather, and he was a great tennis player at William & Mary right at the turn of the war. And then, subsequently, he traveled around the world playing tennis. And believe it or not, he was involved in the CIA and had a pretty illustrious career in that.

Morgan Hutter

Very fun. Well, welcome, Roger, Fred, and David. We're glad you're here. So, Fred, why don't I start with you, and can you maybe just share? Because we did a podcast before on commercial real estate development. We're talking a little bit more about investments today. What's the difference between the two?

Fred Henritze

Well, I saw that question, and the development business can be an investment for anyone that wants to get involved in real estate, although the pure investment business is somewhat different than that. It can be multiple asset classes, as some people have talked about. We happen to concentrate in office, and like I said, we did provide equity to office developments at a point in time. It was probably several years ago when buildings were a little less complex than they were today. And there a difference between the replacement cost and what you could build them for was much cheaper at that time. Things are a little more complex now. And of course, the office business has changed totally. As many of you know, people are using office space quite differently than they have in a long time. And it really, really makes it a challenge to invest and to own real estate for the moment coming off of COVID, And I think some of that is going to be relatively long-term as to the way they use their office space. So from the investment standpoint, we have a discretionary fund. We can control what we invest in without the influence of our investors, even though they're hypercritical and we are very good at transparency and reporting to them, we don't let them drive our decisions on what we purchase around. The size of our deals has become a little bit bigger than it used to be. We generally try to acquire the top three buildings in a particular submarket. And as you know, submarkets are made up of many different places. Atlanta probably has 14 different submarkets. Northern

Virginia has quite a few. Charlotte has several. And so it's not specific to the city so much as it is the specific submarket where we do invest our time and resources.

Morgan Hutter

That's great. Roger and David, anything to kind of add?

Roger Pratt

I mean, I'd comment from a fund perspective. You can think of real estate and sort of three buckets stabilized type properties that are typically income oriented. I'd be 90% plus lease. That's usually the most conservative form of investing. And a lot of the big pension funds and investments, sort of like that steady sort of income return. The funds I ran at Crew are more in the value-added box, where there's normally some repositioning, or you're doing some work where you're trying to do a lease-up, or you're trying to do some cosmetic, or maybe bigger than that, improvements to it. And then there's opportunistic. In general, I would put the development business in the more opportunistic box, and that's because you've got land and entitlement risk. You've got lease-up risk because normally you don't have a tentative hand at the beginning, although sometimes you do, and then you've got construction risk. So basically, with those extra risk, you need extra compensation. In my funds, which I said were in the value-added space, I tend to do a blend of projects. If I sponsored a development project, I would say, you know, over a 20-year period from the, say, early ninety s to the early 2010s, we sponsored some 270 apartment development projects with a number of the major apartment developers in the country. We tried to structure the deal where our partner took the construction in our risk, and then we shared in the lease up. And also we also like them to take their entitlement risk. As a result, they got to promote if the deal is expelled, where they got a larger return for themselves, and it ended up working out quite well. But anyway, by doing that risk control and by only doing a certain amount of that sort of stuff in big funds, I was able to average into a value-added sort of return objective. So that ended up working pretty well for us, particularly in the apartment sector, because it has fewer roller coaster rides than you get in the office or hotel sector, I would say.

David Klepser

Yeah, I'd just add to that thinking about kind of the spectrum of where students could play or where their roles are in the real estate field. And correct me if I'm wrong, Roger, someone like Roger Prudential really has the capital and is figuring out where to allocate it, whereas the types of companies that Fred and I are with, we're getting the capital. And more than managing kind of the day-to-day, whether it be Fred buying office buildings, my firm building apartments, buying retail, whatever it may be. So there's a lot of different places to kind of play in the real estate field. Kind of along the way. You've also got service providers like the big brokerage firms that are offering various services as well. So there's a lot of different opportunities kind of across the whole industry.

Fred Henritze

Roger, I think, is very correct and his overlay of what the investment horizon is, because we play in the value add space, and we rarely are in stabilized space, but we don't do a whole lot of opportunistic. But I think he's completely right in that development risk is in the opportunistic budget. You're taking cost basis, you're taking development risk, you're taking zoning risk. And usually, a promoter who's done that does get a carry for doing that. It's a little bit difficult for us because they get a carry and we get a carry too. So it can be a double promote.

Morgan Hutter
If you're not careful as we talk about terms. David, let me come back to you for a second. So I'm hearing double promote, upfront risk, discretionary funds, capital. What are some of these terms that listeners should maybe tune into or do some research on so they can talk the talk?

David Klepser
Yeah, that's a great question because there is a lot, and you hear us throwing these terms around, which we use every day, and they're probably spinning their heads like discretionary and promote and carry. So, yeah, I think Roger and Fred can definitely jump in here. But one key metric that you talk a lot about in the real estate industry is capitalization rate or cap rate, which is basically the yield on the investment. And that's really when you talk about the spectrum there that Roger was mentioning with the state lies the value add and Opportunistic. Those all have kind of different yields that result on the investment. Another key metric that some of the students may be familiar with is IRR internal rate of return. That's the overall investment return across the holding period of an investment from the day you put your money in to the day then when you exit it; what's your overall internal rate of return? I don't know. Fred roger, jump in. I'm sure there's a ton of ones we talk about every day that would be helpful for folks to hear.

Roger Pratt
I mean, I would chime in the word fiduciary. Prior to like 1970, when Prudential launched the first institutional real estate fund called PRISA, most investments were being done more by, not by institutions. Now the major, you know, say, the top 500 pension plans, the larger endowments, they typically put five to 15, maybe even up to 20% of their funds into real estate. And with that, the whole industry has transformed from being a mom-and-pop, sometimes having sketchy reputations in terms of whether they were accounting for their properties and so forth. Right. Donald Trump and his organization is in the news today because he's more of the old school style of real estate, both development and investment firm. But with the rise of the Virginia retirement systems of the world, CalPERS, General Motors getting into real estate, that has caused the industry to transform. It's very important. If you're going to raise institutional capital, there's a whole different discipline where you need to be transparent. You need to put the investors interest even ahead of your own investment interest, which is difficult for some of the players in the business to do because they're used to having playing the game that they like to play rather than necessarily playing up to the investors. So that's the word that's important. In particular, if you're wanting to get into business and are not in a family private sort of firm, you're going to need to understand how the rules of the games have changed quite a bit within that. In terms of a term, I would say the term property value. Once again, that's in the news today because it seems like it's a simple concept because you really do need to know what you own and what it's worth, and what you might be able to sell it for. But there's a whole many different ways of coming up with that number, whether it be appraised value, an insurance value that might have loans for a mortgage basis, and so forth. So that's one of the disciplines trying to figure out when you hear a property value, what is it, what was the purpose, and how do you go about coming up with that sort of number? So we don't have long enough in this podcast to get into all of that, but that's part of what drives us. And sort of the income cap rate is

one of those things because it's a multiplier effect where if you've got an income stream, you usually can capitalize that and come up with some guesstimate of what the value might be, realizing that those values tend to fluctuate over time and in different cycles.

Morgan Hutter

Now, you mentioned all of you promote and carry, but we didn't define them. So can somebody kind of take the lead on our listeners on promote and carry?

Roger Pratt

Well, generally, in terms of how we structured and improved, normally, you structure a deal with an entrepreneurial developer, and if the project successful, ie. Gets you a minimum return; there might be a preferred rate, say it's 8%, just for the purposes argument. And then if you get that upon the sale of the asset and let's say you get 15% or 20% return so that you've got a spread between the 8% that was sort of your hurdle to say 15, you have 700 basis points spread. Then normally, the developer would get a disproportionate share of that extra, and that split might be anywhere from 50-50 to 80 20, whatever the amount the developer gets. Depends on the nature of the deal and other factors. But that's the general idea that they get more than their share if the return is above the hurdle rate.

Morgan Hutter

Thank you so much.

Roger Pratt

If it's below the hurdle rate, they don't get a promote.

Morgan Hutter

Sure. So Fred, why don't we come to you and kind of shift gears a little bit? How does real estate investing fit into the endowment model?

Fred Henritze

The endowment model, very similar to other large investors, has almost an infinite time frame for what they're going to invest in. So they sometimes have a longer horizon than some other investors who may want a short-term return. And we've seen people very comfortable with five to seven-year returns, in some cases a little longer. They are still very IRR driven, and so they are trying to get the highest IRR they can at the earliest period. And as we know, you can't eat IRRs, so we like to make additional capital over and above the regular IRRs. So you got to be a little cautious about that. Endowments, particularly the large endowments, are incredibly diversified in all of their investments, not just real estate. In some cases, in real estate, they'd be very interested in retail, they'd be very interested in industrial office, hotel, and hospitality. And so they have a very diverse portfolio in that regard. Some of the smaller ones quite a bit less, but so they are investing across the spectrum in real estate per se. And so, they may allocate a certain amount to office historically had been one of the largest categories in that space. Now I think industrial and multifamily may be slightly higher this year. So that's one of the differences I've seen.

Morgan Hutter

Wonderful. Very helpful. Roger, coming back to you for a second. You obviously had great experiences. How did your undergraduate educational experience prepare you for career in commercial real estate?

Roger Pratt

Well, when we were setting up this call, you'd ask for our background and wanted something personal. So I really hadn't thought about this previously, but I mentioned I had created an interdisciplinary major and the time was new, the concept was new and in some ways, it was risky because you were going outside of the silos of a normal major. So, history majors, you know what that is and you know what the pecking orders and so forth. And by creating my own major, which included history, economics, political science, and sociology, I ended up taking courses in all of them. And I did run the risk of being orphaned if you will. But I also gave me agency to create my own experience, which caused me to be more engaged and put me more responsible for my own education. And I ended up cultivating relationships with key faculty members in all four of those departments and had independent study one-on-one, I think, with three of them, one of whom I went to his house every week to talk and so forth. And I was able to do special projects. In terms of how it helped my career, I said I hadn't really thought about it, but it caused me to have a level of initiative and also a level of independence that I wouldn't have had otherwise. And actually, when I went on to graduate school, I was so much in that mindset. When I went to UNC, Chapel Hill, and City and Regional Planning, I learned that there was an environmental management program at Duke. I ended up taking two classes at Duke, which is, as we all know, was only 11 miles away from Chapel Hill. But I also took there's a landscape design program at NC State. I took a historic preservation course in their design program. And at UNC, I ended up taking a land use law course in the law school. So those collective experiences a sort of broke down barriers for me. Also made me less intimidated by people who'd gone to Duke or the law school or somebody that was an architect or whatever and just made me more comfortable. And when I ended up starting my career at Pru, I was much more even though I was assigned to the sort of asset management section of the group initially; I was more willing to wander around and interact with the mortgage guys and even the head of the office relative to my tenure. And I think those qualities make it, so you're a little more adaptive and adaptable to a career path. And I think that's fully played a big part in my ability to navigate the potential corporate bureaucracy would probably stand somebody well in whatever field they were in because you're forced to interact with different types of people with different educational backgrounds and try and put yourself in their shoes.

Morgan Hutter

The diversified experience and relationships is fantastic. I love now this is the second time you've mentioned faculty and just the impact that they've had. I know William & Mary has these unbelievable faculty that want to always raise their hand for students this day. It's great to hear that that has been true and continues to be true. And then the same when you yeah.

Roger Pratt

They actually wanted to do it. So that was a great experience as a result because you got more excited. If they're excited, you get more excited.

Morgan Hutter
That's true. That's true. Was there a particular faculty member that you really recall that really well?

Roger Pratt
There's a history professor, Funajella was his name, and he did urban studies. And I remember I ended up taking an advanced class as a sophomore on Urban Studies, and he was from New York. And then he saw that I had not taken the well, it wasn't required, but it was highly suggested. More introductory history class. His was a 400 level. I was supposed to 200 level. I said, well, that was already filled up. And I said I had a really good history program in high school.

Morgan Hutter
Went for it.

Roger Pratt
We'll see if I can manage. He looked at me. So then I studied extra hard, and I think I got the best score on the first test that he gave. He then decided to be really hard on me after that.

Morgan Hutter
It sounds like it all was for the benefit and all worked out. So thanks for sharing. So David, as we're sharing kind of experiences, you had shared that you started investment banking, switched over to the real estate side, referral real estate. What was that transition like? Why make it? We have obviously a lot of students interested in both sectors. Is there anything you want to share?

David Klepser
Sure, yeah. Coming out of Bloomberg, I was pretty young; how for investment banking, I had a finance major for concentration rather than a business school. I got investment banking, and it was very fast-paced industry, very challenging, a lot of hours, and I learned a ton. And as I got further along into it, I was looking to move into something a little bit more tangible and had an interest in real estate. And for me, the way to do the transition was to go back and get my MBA at Carolina, and they had a real estate concentration within the MBA program there. So that was kind of how I had made my transition. But I tell you, looking back, finance, accounting, financial modeling are huge aspects of what we do in real estate every day. And really provided a great foundation for me in my future because I just understood all that, had learned the basics, that William & Mary really developed those skills further in banking and then going over to the real estate side. It was just applying things different metrics, just looking at things a little bit differently. Some of those phrases we talked about earlier, cap rates and carry and promote, and some of those things and how you look at the real estate finance slightly differently than other businesses. But really, having that foundation, that was really helpful for me. In starting real estate, of course, you had to pick up all the other knowledge about my work that I'm in on the construction and understanding some of those aspects of the business as well. But I guess the foundation of William & Mary really teaching you how to be a thinking human across a lot of different disciplines and juggling pretty busy schedule, too, because when you get out in the workplace, obviously you're juggling a lot of different tasks, a lot of different projects

simultaneously. So being able to have had that in college and learning how to juggle all those deadlines and work was helpful in preparing me.

Morgan Hutter

Yeah, I've definitely heard adaptable, independent, the multitasking deadlines organized. I mean, it sounds like definite characteristics and skill sets, plus the financial modeling. I'm glad you mentioned that, David. That's definitely something we work for our students and those that are listening to switch over to hone those skills. Fred, you mentioned something interesting. You said earlier that we're using the space differently, industrial and multifamily or maybe more prominent than office right now. Where do you see the industry going with these COVID-19 impacts?

Fred Henritze

Well, I don't think the decision has been made as to how people are going to use office space. I believe it's trending in the right direction, but there's a lot of uncertainty out there in that regard. From what I've seen from multifamily, it's growing crazy in every place in the Southeast, the least that I've seen, rents are going up and in industrial space. The interesting thing about that is that the people that are filling the space up are putting a lot more money in the space than the original building cost. And so even if they sign a five-year lease, they're really good for ten or 15 years. So that helps that although they're very low cap rates or lower returns, but when they leverage them and they do have some rent growth over time, I think that can be good on the office side. I think the rent collections has been good in almost everywhere that we've seen, and we're seeing occupancy rates ticking back up again. And I think the Southeast is a good place to be investing in the office product because I think you're seeing people moving there for cost of living and other reasons, and people choosing to be someplace where they can start a family, have a bigger place to live, and it's just easier than some of the Northeastern cities.

Fred Henritze

So one thing I was going to say is the analyst role that we were talking about earlier that David mentioned is so critical in our business. It wasn't so much for me when I started off because that was a while ago, but the people we hire now are analysts. They're sometimes from big banks. They understand that know how to work really hard. And so, in that particular role, they can really analyze things. They know the value of various components, and they can work really fast. So that's become a real important part of our business in quite some. Time.

David Klepser

Yeah, I'd just add on to that too. As I was mentioning, I've made the transition by going back to business school. But just as kind of a little side note story, we hired an analyst here recently for my office, and he had worked for a couple of years in the financial services industry and just had a desire to get into real estate. And he took some online classes himself just to kind of get the basics of some of these terminology that's out there. And he had a demonstrated strong financial background and interviewed great, had great personality, and was a hard worker, and that's how he wanted to make the transition. And so that's just kind of a little side story as to even if you didn't have a real estate concentration or real estate background and undergrad, I think, having a good basic business and financial skill set there's, there's definitely opportunities out there.

Morgan Hutter

Thank you. So we're getting close to our time here, but I want to make sure we direct our listeners maybe to places that they can learn more about the field. So I'm kind of open to all of you. Are there books, journals, articles? Where can listeners listen to learn more and just excel in the field?

Roger Pratt

So I would comment because I did think about this a little bit. There's a number of sort of trade or professional organizations that focus on this space. One is the Urban Land Institute, and they put out an annual publication called Emerging Trends, which is a great overview of all the property types and capital sort of things. It's very readable that comes out, like I said, annually. There's a group if you're interested in institutional real estate, which is what we've primarily been talking about. There's a publication center called Institutional Real Estate Inc., And you can go to their website, and they have a number of their publications and background, sort of papers and so forth are just right there, a click away that you can read about. Another big group is the Pension Real Estate Association PRIA, which is mainly the large investors as well as the large investment managers that are managing their money. They also have a big website, also have publications, and the like right on their website that are meant to be introductory on things like why real estate, that type of thing. And then the major money managers like Prudential, my former employer, now called PGM, PGIM Real Estate. You click on that, they have research. But the other big players, the competitors of the world, also have similar things. Most of them have ahead of research. Most of them put out thought pieces and the like. And maybe the last one I'd mention is the organization REIT real estate associate program. This is a group that is encouraging minorities that have not traditionally been very well represented in the field. Most of the big players in the field, whether you be a brokerage house, an institutional money manager. The larger developers, national developers particularly, are wanting to have a more diverse base, but there just hasn't been a very big pool historically in that it might somebody that might have worked a while in it, but then not have a sustained career. And organizations like REIT are trying to create educational intern assignments and so forth with the bigger players in the industry to try to help advance that there's others in addition to them. But those are just some thoughts.

David Klepser

Yeah, just to add, Roger, hit a bunch there. Just to elaborate a little bit on ULI, the Urban Land Institute they have chapters in cities all across the country. And as a student, you can get a pretty discounted rate. Or after you out of college, there's a Young Leaders rate. And a lot of those local chapters have events where you can go, and they have presentations on different area projects. You can mix and mingle with other folks in the real estate industry, ask questions. So it's really a great organization to get involved in. And they've also got online classes you can take as well. So I think that's just wanted to note that.

Morgan Hutter

Well, thank you so much with that. We're kind of wrapping up our time. But Roger, Fred, and David thank you so much for joining us on the Careers and Finance podcast at the Boehly Center for Excellence and Finance at the Raymond A. Mason School of Business at William & Mary, and we hope to see you all back in Williamsburg in the very near future.

Roger Pratt

Thanks, Morgan.

Fred Henritze

Thanks, Morgan.

Male Voice

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