

The Investor's Almanac: Opportunities in Real Estate

Disruptive Forces in Investing

September 8, 2020

Matt Malloy: As it has been with so many asset classes in the current environment, real estate investing in particular has been presented with many unknowns. With a large percentage of non-essential workers still working from home, many of us wonder what lies ahead for real estate investors. Among the many questions on our minds perhaps the biggest is, is now too risky to invest in real estate? Or perhaps because of the COVID-19 crisis there are even more opportunities in front of us? I'm your guest host, Matt Malloy, and I'm here with Matt Kaplan, Managing Director and Head of Almanac Realty Investors here at Neuberger Berman, to discuss real estate investing today and where we go from here. Matt, thanks for joining me today.

Matt Kaplan: Thanks, Matt, great to be here.

Matt Malloy: So just to get us started and to give the listeners a little bit more context of what Almanac does, how do you invest in real estate and can you give a little more detail around what platform investing means?

Matt Kaplan: Thanks Matt, in short what Almanac does, and has been doing for the past 25 or so years, is to invest primarily in North American real estate, not on a building by building basis but through what we call corporate finance structures or platform investments, which allow us to invest, not only into the real estate but to gain greater transparency into an alignment of interest with the management teams that we back. So what does this mean? You know, the general approach to real estate investing is you buy a building, you put into a single purpose entity, you have a joint venture, it's operated by some external management team on the property and asset management level.

That's not something that we find attractive. What we like to do is put everything into one structure, so we have a company that owns real estate and owns hopefully all the real estate that the management team that's also employed by that company operates. That management team works for the company, that there's a Board of Directors that governs the company, it has a strategy, things are thought of in terms of shareholder value, and these are traditional corporate finance techniques taken from other sectors of the economies that have been proven quite effective. And so what you have is a company or a platform that is operating in a certain sector, that has a strategy that has good governance, that has a collection of assets, owned and operated by an aligned group of individuals who are making thousands of decisions every day. And what they're thinking about is not the manager value or the manager operations or what that building is doing versus this building. They're thinking about the company in whole. And so that, that alignment of interest has proven to be very, very powerful in terms of operating real estate over time, and also has been – you know, provided us an investor, good transparency into the operations of the real estate and the buildings and the management team and what's going on, on that side of the business as well. So, you know, that's in short what we do and why we like to do it that way.

Matt Malloy: So turning to the current environment what has been going on in real estate investing as a result of the pandemic, or amidst the pandemic, and what have you and the Almanac team been doing in terms of your approach to the market?

Matt Kaplan: Well, obviously since March there was a tremendous shock to the economy, which started then and is ongoing. And so what we've been up to, first and foremost, is making sure that we are working with our portfolio companies to understand, you know, what has, you know changed for them in their operations and their real estate and the supply and demand for their properties, for their people and their teams. You know, we're heavily involved in the governance of the companies. We referenced the board before and that's how we participate in that governance. So we have ongoing dialogues, discussion and decisions being made, at the board level, and we get involved with, you know, working with the management teams to optimize the current situations. And that could be from an operating point of view or from a leasing point of view or from a capital point of view, lenders, etc. And also the, you know, the personnel point of view – how are the teams doing, how are the people who are operating the property doing? So we've been spending a tremendous amount of time to make sure that our companies are in a good position and that good decisions are being made at the board level. And all along the way making sure that our own investors have a very good idea of what's going on and providing them with operating and other information, including fair market values and things that go into that as well. There's a lot going on relative to evaluating new opportunities for companies. They still have capital to invest and have growth plans and are taking advantage of some of the things that are going on in the market, and you know, furthermore we are looking at new opportunities.

Matt Malloy: So in this uncertain environment how would you say that the investing landscape in today's market has changed, and is there a better way to access opportunities in this environment?

Matt Kaplan: Well, you know at a certain level, you know, everything has changed, but from our investing perspective I won't say nothing has changed but very little has changed. And obviously what has changed is that the economic environment for all forms of real estate has been upended. Traditional demand models for, for all real estate has been heavily impacted and rents and occupancies are adjusting accordingly, both up and down. It's a \$15 trillion sector so it's very hard to generalize, but clearly the environment is different, and therefore one has to take a different approach to that environment in terms of assumptions and perspectives. And some of these changes have run though, you know, for the worse. You know, unemployment is weighing on consumer demand, it's weighing on travel patterns. Work patterns might be changing, they might not, and, you know there has also been some changes for the better. In January and February we were asking, you know, when the credit cycle would end and when the economy – you know, the economic cycle would end, and now we know and we have a little bit more clarity on where things are going, and some property types have seen, you know, visible increased demand. Industrial, marinas of all things, tech-orientated real estate, data centers, etc., so you know that's all changing. Your underwriting has to change and there has to be some evaluation of what's clear and what's not clear. For us what's not changed is that we see a lot of evidence that capitalizing real estate platforms provides, you know, great benefits in all types of environments. The companies that we have in our portfolios today are very well positioned to at least survive in today's environment and perhaps thrive. They have strong balance sheets. They have excellent capital positions and this gives them the ability to protect and operate their properties and maintain their properties, and even perhaps play offense by taking advantage of some of the opportunities that are coming up. Furthermore the companies that we seek to invest in, and they're looking for all types of capital, are looking to be in this position with strong balance sheets and the ability to go forward.

Matt Malloy: Are there real estate sectors that you believe might not recover as fully, if at all? Could we see a meaningful restructuring of certain sectors within the real estate market and how should we think about it? What might that look like?

Matt Kaplan: Yeah, well, the way we're looking at it is that, as my earlier comments indicated that it's all changing and it's all sort of restructuring is a good way to put it and that there's more clarity in certain sectors than in others. I think there is, you know, more clarity in sectors that have, you know, sustained demand for necessities. You know, shelter, food in the groceries and supply chains, technology-orientated real estate and data centers, so that's where we're spending most of our time today looking at new investments. As things continue to clarify in other sectors we'll continue to look there, but you know, less clear of course is lodging and when demand will come back, and where and how. And we're seeing some green shoots, if you will, in some of our portfolios in limited service, in drive through locations but what's going to happen to the urban locations, etc.? I still think it's unclear. Retail, I think operations are actually pretty clear what's happening and there might be some issues regarding rents in some of the models, but what really hasn't become clear is new pricing levels. There hasn't been a lot of trades, etc., and so there's very little to, to underpin an investment decision. Other sectors are sort of in the middle. It's, you know, senior housing is – you know when will it come back? It's when seniors and their families, will they feel more or less comfortable in their homes or in a facility that is purpose built to protect them and serve their needs? You know an office -- it's still also up in the air. There are two very strong arguments of work from home prevailing and suburbs being stronger than the urban core and the new patterns that we've all adopted. Or you know, getting back to, you know, recognizing what we were talking all about in January -- that winning organizations that compete and win, focus on culture and collaboration in ways that can only be done in person. So, those will clarify but as I indicated there are certain things that we're – you know, that are more clear today and that's where we're spending our time and effort.

Matt Malloy: Thank you for that, Matt, and just to wrap up, and we've spent a lot of time in focusing on the current environment. What is your outlook over a slightly longer period of time, say the next 12 to 36 months for real estate investing and what could fundamentally change, and how do you think about preparation for unknown scenarios?

Matt Kaplan: Well, when you're making investments into real estate, they're generally illiquid. You buy a building and it's hard to get out and tomorrow or the next day, so you're always looking at, you know, where is the puck going to be I guess? And so my comments relative to clarity about multi-family is what are you going to want to own in 2023, 2024? And so, you know, what we're working on those sectors and those industries on that basis, is that we're going to hold them for a long term period of time and we have a long term mentality in our shop. And we have good management teams and, you know, if long term fundamentals seem to be OK then, you know, that's a good place to start thinking about investing. So you know, that's how we're thinking about the medium term or the long term. And along the way, you know we could be proven wrong or the market could change in unexpected ways as it often does, and has been doing since we've been investing this way.

So, deeply embedded in Almanac's investment process is risk management and recognizing that our models aren't perfect and our assumptions aren't perfect, and subject to the whim of the markets and the economy. So we've built into, you know, what we do, trying to address some of those risks by, you know investing with high quality partners who know what they do; you know do in real estate and they have a lot of skin in the game and are aligned with us in our investment. We tend to invest in platforms that have lower than average leverage and therefore are safer. We tend to invest in platforms – you know, in real estate that have strong recurring cash flows and yield is a good thing through thick and thin. More often than not we get seniority in the capital structure to protect our position and, um, you know, we have good governance at our companies. We clearly have strong legal documentation surrounding them, but the board has proven itself over time to be a great and effective, you know, governance mechanic to guide a company through all sorts of unknowns that, you know, documentation can't quite address. So we're going into investments and we're making investments and we have a pretty good idea and are pretty confident about what they're going to be doing, but as always at Almanac we're protecting capital and protecting it well.

Matt Malloy: Thank you, Matt; this was extremely insightful, and thank you for taking the time and sharing your views on real estate investing with us. Best of luck to you and the Almanac team.

Matt Kaplan: Great. Thanks, Matt, it was a pleasure to be here.

Matt Malloy: And to our listeners, if you enjoyed today's podcast we encourage you to subscribe via Apple Podcast, Google Podcast or Spotify and visit www.nb.com/disruptiveforces for more information about our firm and our offerings. Thank you.

This general market summary and the opinions and beliefs expressed in this podcast are provided for general informational purposes only. Nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security, and the views and beliefs expressed are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally. This presentation is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Investment decisions and the appropriateness of this presentation should be made based on an investor's individual objectives and circumstances and in consultation with his or her advisors. Information is obtained from sources deemed reliable, but there is no representation or warranty as to its accuracy, completeness or reliability, and has not been independently verified. All information, opinions and beliefs set forth in this presentation are current as of the date of this presentation and are subject to change without notice. We do not undertake to advise you of any change in the opinions and beliefs or the information contained in this presentation. Any views or opinions expressed may not reflect those of the firm as a whole. We may issue presentations or have opinions that are inconsistent with, and reach different conclusions from, this presentation. No representation is made that any investment process, investment objectives, goals or risk management techniques discussed herein will or are likely to be achieved or successful.

Any forward-looking opinions, beliefs, estimates, assumptions, outlooks, projections, assessments, or similar statements (collectively, "Statements"), constitute only subjective views, estimations or intentions, should not be relied on, are subject to change due to many factors, including fluctuating market conditions and economic factors. Such Statements involve inherent risks, many of which cannot be predicted or quantified and are beyond our control. Future evidence and actual results could differ materially from those set forth in, contemplated by, or underlying these Statements, which are subject to change without notice. Considering the foregoing, there can be no assurance and no representation is given that these Statements are now, or will prove to be, accurate or complete. Neuberger Berman undertakes no responsibility or obligation to revise or update such Statements.

Neuberger Berman products and services may not be available in all jurisdictions or to all client types. Diversification does not guarantee profit or protect against loss in declining markets. Investing entails risks, including possible loss of principal. Indexes are unmanaged and are not available for direct investment. Investments in hedge funds, private equity and other private funds are speculative and involve more risk than more traditional investments. Investments in hedge funds, private equity and other private funds are intended for sophisticated investors only. Past performance is no guarantee of future results.

Portfolio, volatility or return targets or objectives, if any, are used solely for illustration, measurement or comparison purposes. Such targets or objectives reflect subjective determinations based on a variety of factors including, among others, strategy and prior performance (if any), volatility measures, portfolio characteristics and risk, and market conditions. Volatility and performance will fluctuate, including over short periods, and should be evaluated over the time indicated and not over shorter periods. Performance targets or objectives should not be relied upon as an indication of actual or projected future performance. Actual volatility and returns will depend on a variety of factors including overall market conditions and the ability of to implement the contemplated investment process, investment objectives and risk management. No representation is made that these targets or objectives will be achieved, in whole or in part.

The "Neuberger Berman" name and logo are registered service marks of Neuberger Berman Group LLC.

© 2020 Neuberger Berman Group LLC. All rights reserved.