Resmark Impact Ventures

This point in the cycle: yield with added impact

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Recently, **Jonathan A. Schein,** senior vice president, managing director of global business development at Institutional Real Estate, Inc. spoke with **Patty Bartlett** of Resmark Impact Ventures. The following is an excerpt of that conversation.

Given we are late in the real estate cycle, is this the right time to invest in an emerging manager (EM) strategy?

An EM fund provides a risk-adjusted non-core strategy that we believe is key late in the real estate cycle as investors search for yield. As we get later into the real estate cycle, diversification is important to investors, who are increasingly positioning their portfolios into "defense" mode. After the GFC, many investors invested with large funds that look and behave the same way and are chasing the same deals. This has made the market very competitive and "over-brokered," which has pushed yields down. Smaller real estate firms tend to invest in the mid-market space, which is less competitive, and source many of their deals off-market. There are great opportunities in that market segment that many institutional investors are not capitalizing on. These emerging real estate firms are typically sharpshooters with highly focused investment strategies. They are especially talented at capitalizing on niche strategies and market inefficiencies, distress and illiquidity in the mid-market space. As we get later in the cycle, these are the firms that are going to find compelling, risk-adjusted, niche opportunities for their investment partners.

Can EMs provide the yield investors need — but is difficult to get — at this point in the cycle?

Yield is more critical than ever, and it is harder to hit yield requirements late cycle, when underwriting assumptions have been stretched and competition has dropped cap rates to prerecession lows. The middle market is the domain of smaller, local players with knowledge on the ground. They are well connected, focused, creative, nimble, and incentivized to execute, with less corporate bureaucracy to navigate in their decision making. These firms tend to have high employee ownership, which strongly aligns internal interests. Due to their size and capital constraints, they can only focus on the best investment theses. Their executives also have greater ownership in their decision making, and direct accountability for their results. Last but not least, newer firms oftentimes implement the latest technologies, and value efficiency and best practices in their operations. All of this leads to higher, risk-adjusted returns or alpha for their investors. However, there is a lack of institutional investor representation in this space, which creates the opportunity for the investors that do enter the space to generate outsized returns.

How does Resmark define an emerging manager?

The technical answer in California is a firm having fewer than three institutional funds with less than $1 billion AUM, although the definition does vary in other states. The practical answer is that we are looking for proven real estate professionals, who have spun out of older, more well-established firms that have never or rarely utilized institutional capital. Resmark has relationships with many exceptional EMs that invest across all real estate asset types. Some of these firms have used high-net-worth individuals to finance many years of successful operations and are now ready to transition to institutional capital. Others are young start-ups with seasoned professionals born from a disillusion with previous firm cultures or a desire to profit directly from their own talent and enterprise. Many are diverse firms. I think it is important to note that many of these firms do not want to become fund managers themselves, and prefer to remain owners and operators of real estate. Rather, as smaller firms, they are looking for a consistent source of equity capital that they can rely on, as they spend too much of their executive time and internal resources seeking out and managing capital relationships.

What risks should an investor be aware of?

Emerging real estate firms have the skill sets to execute opportunistically and generate outsized returns; however, they can be harder for institutional investors to underwrite and manage versus larger managers. There are two main areas of concern when investing with EMs, which can be overcome by structuring the right EM program. The first area is operational risk. EMs are smaller businesses, so their firms may lack corporate infrastructure or a strong back office to handle the necessary accounting, reporting and compliance that institutional investors require. They also have smaller teams, which equates to less bench strength if someone leaves the firm or project challenges arise. And they may not have sufficient financial resources to sustain their operations in challenging market conditions.

And the second area of concern?

Investment risk. Some lack the appropriate fiduciary mindset required by institutional investors, as they are more entrepreneurial in nature. Others may feel pressure to invest to generate fee revenues to keep their doors open and their lights on.

How can investors mitigate these risks?

By investing as a manager of managers on a project-by-project basis in a joint-venture structure, Resmark can mitigate both the operational and investment risks investors face when investing with EMs. Resmark's experienced and dedicated team can provide the knowledge and resources to overcome any EM operational deficiencies. And by investing in a JV on a project basis rather than through an allocation or fund, Resmark can manage investment exposure to any particular EM in an appropriate fashion and control all major operational and investment decisions. Also, Resmark is an experienced investment manager with a strong fiduciary mindset and proven track record. We are there to ensure that our investors' capital is well protected at all times and to bring a strong fiduciary mindset to bear on our JV partnerships.

Why has Resmark chosen to pursue an emerging manager strategy?

The main objective of an EM program always has to be to deliver strong, risk-adjusted returns to its investors. We have chosen to pursue an EM strategy because we truly believe in the investment thesis that these strategies generate outsized returns or alpha for investors. Since 1995, Resmark has delivered strong risk-adjusted returns through five current and former separate account funds, and we plan to continue to do so. At its core, the EM platform is the next step in this strong history of returns. In addition, we want to share the knowledge that Resmark has gained over the years, as Resmark was once an EM ourself. We also consider an EM program our way to give back to the real estate community. We have 21 years of experience investing institutional capital through joint-venture partnerships. We truly understand how a joint-venture partnership works, and how to be a trusted partner and fiduciary. This is something we consider to be unique and a key differentiator in our EM platform and of strong value to our investors and EM partners.

You talk about the 21 years of JV experience being a key factor. How do you believe that has positioned Resmark to take on an EM strategy?

A successful investment manager always goes above and beyond to protect their investors' capital. Our experience with JV partnerships gives us a deep knowledge base of how to successfully manage these partnerships to ensure our investors' capital is always protected. We believe that successful EM programs are founded in the partnerships; this principle is a core part of Resmark's DNA. We always ascribe to "partner first, deal second," which is our cornerstone for managing risk for our institutional investors. We protect our investors' capital by sourcing and investing with best-in-class partners who are able to successfully execute their business plans and live up to their contractual obligations. Since 1995, Resmark has initiated more than 200 joint-venture investments; approximately 115 of these investments were with 45 small developers and operators that qualify as EMs, which is more than 50 percent of all our investments. We understand how to invest with the best partners, and how to manage those investments for success.

What about your strategy differentiates you from other competing EM funds?

Early EM funds adopted a fund-of-funds structure, which was not successful. We never liked that strategy, as it does not best protect our investors' capital. We prefer the manager-of-managers structure, as it better protects investors' capital by providing robust operational and investment controls. In addition, we provide JV equity capital on a project-by-project basis, versus other funds that have an allocation model. This gives us the flexibility to invest capital more quickly if we see the appropriate deal flow, and better aligns with the needs of our EM partners. In addition, this allows us to maintain more control in investment decisions, monitor our capital exposure to our EM partners, and balance our portfolio appropriately, all of which serves to protect our investors' capital. Also, we are targeting value-add and opportunistic deals, versus other EM strategies that tend to be core-plus strategies. We believe this strategy is more in line with the core competencies and investment strategies of most emerging real estate firms.

What excites you about the EM space?

Given where we are in the current real estate cycle, we see an inefficiency in the capital markets in providing consistent, timely equity capital to EMs investing in the mid-market space, which creates a meaningful opportunity to achieve outsized returns in this area. We are excited to provide a product that is needed in the market right now. There is such a depth of talent in emerging real estate firms, and yet these firms struggle to find consistent sources of capital and spend too much of their time and energy capital sourcing. And we are also eager to provide our investors with access to mid-market investments that yield strong risk-adjusted returns with very high-quality partners that they may not otherwise invest in directly, providing alpha to our investors in a time when yields are being compressed. We are also excited to share the knowledge that Resmark has gained over our 21 years in the business with our partners, and are passionate about seeing emerging real estate firms mature and thrive. We want to be a valuable mentor to those firms that desire it, and it's fulfilling to us to be able to work with smaller, younger firms to create strong returns. It is also exciting to see the diversity of thought in the EM space, and we believe there is a strong impact investing in this space — the status quo can be disrupted without increasing risk or sacrificing returns.

Do you have any insights to share with investors who might be considering making their first investment in an EM fund?

All joint ventures, especially those with smaller firms, take more staff time and effort — so having a proactive approach is necessary. Investors should look to a proven fiduciary, like Resmark, that has a long-standing executive team, reputation for best-in-class due diligence and asset management, and well-established back office and reporting procedures, as an investment manager for their EM strategy. In addition, the manager-of-managers structure provides an important protection for investors. The manager-of-managers structure allows investors to invest in a portfolio of best-in-class EMs through a single investment manager, streamlining investor point of contact while diversifying the EM partner base and balancing the asset classes in the EM portfolio. The manager-of-managers can maintain strong operational and investment control of EM investments, which better protects investor capital, and can provide many services to investors by conducting due diligence on and directly managing EM partners. Choosing the right investment manager is critical to the success of any EM program, and investors should ensure their EM manager of managers has strong experience managing investments with small real estate firms, so their investment manager understands the risks in the space and how to properly select excellent EM partners. We also believe it is extremely important for real estate to be a component of an overall EM strategy.

CORPORATE OVERVIEW

Resmark Impact Ventures is the emerging manager platform of The Resmark Companies, a full-service private equity real estate firm founded in 1995. Resmark invests on behalf of the nation's two largest pension funds. Its emerging manager (EM) program was established in 2014 to joint venture partner with small- and mid-size real estate emerging managers to generate compelling returns for institutional investors. In a "manager of managers" role, Resmark partners with EMs through various structures, including one-off JVs, a series of JVs or a programmatic JV covering multiple investments. In addition to development projects, Resmark Impact Ventures invests in opportunistic and value-add strategies across asset classes ranging from for-sale residential, multifamily and mixed-use to office, retail and industrial.

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