CHICAGO BOOTH
The University of Chicago Booth School of Business

MEMORANDUM

Real Estate Initiative

January 19, 2018

Alumni & Friends

This memorandum is intended to inform and update you on the progress of the real estate initiative at the University of Chicago Booth School of Business.[1] Your suggestions and criticisms are encouraged.

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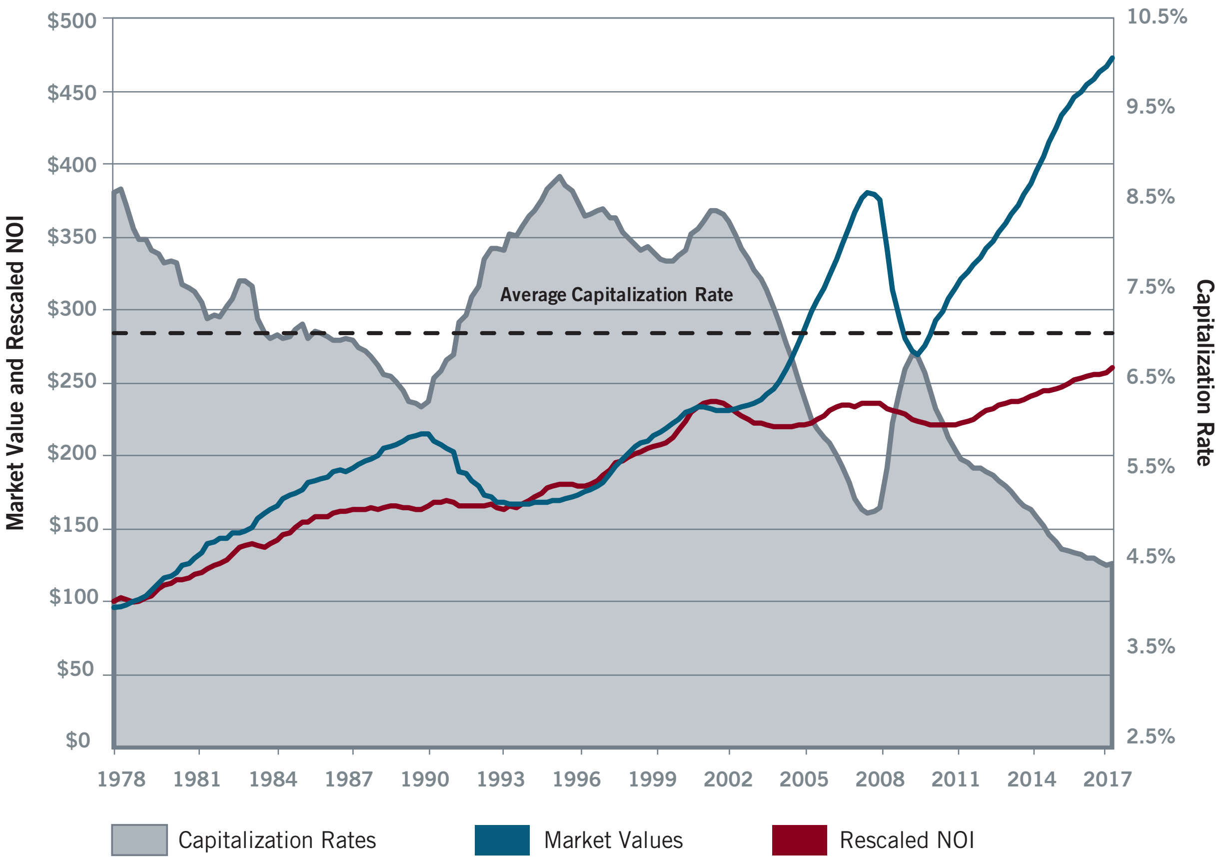
[1] For earlier memos, please see 2016 Real Estate Initiative and 2015 Real Estate Initiative.

BACKGROUND

This is my 11th year at Chicago Booth. Over this period of time, we not only have witnessed significant swings in commercial real estate values but also now find ourselves in an era in which prices have never been this expensive: values are approximately 25% higher than before the financial crisis, and capitalization rates are at their all-time recorded low. The chart below shows, among other things, the path of (unlevered) commercial real estate values and capitalization rates over the past 40 years:

NCREIF INDEX—MARKET VALUES, RESCALED NOI, AND CAPITALIZATION RATES BASED ON A $100 INVESTMENT FOR THE PERIOD 1978 THROUGH 2017



The surge in pricing has also continued to bring about some consternation regarding yet another "bubble." (These pricing concerns extend beyond just real estate; both the stock and bond markets can be characterized by similar concerns.) Much of the justification for these high prices is based on the low level of interest rates. In a recent paper ("Some Thoughts on Real Estate Pricing," published last fall in the Pension Real Estate Association–sponsored Special Real Estate Issue of the *Journal of Portfolio Management*—see the Appendix), I suggest that—provided the real estate space markets are operating at or near equilibrium—real estate investors ought to pay attention to future movements in the real rate of return (e.g., the Treasury Inflation-Protected Securities, or TIPS, market), rather than the nominal interest rate. Increases in the required real rates of return are likely to adversely affect real estate valuations. (Fortunately, a recent review of the "forward" curve for such real rates suggests that future rate increases will be modest. Of course, the forward market is an imperfect predictor of future realized rates.)

REAL ESTATE LAB

The essence of this (quarter-long) class[2] has the students tackle a real-world transaction or portfolio, concluding with a presentation to one or more senior managers from the participating firm(s), at which point, the team receives feedback on the merits of its work. In 2017, the project asked the students to (hypothetically) deploy $1 billion of equity capital in the US industrial market.[3] Several industry practitioners—Michael Caprile (CBRE), Andy Ebbott, '80 (ex-Cabot Properties), Phil Hawkins, '80 (DCT), Matt Mullarkey, '01 (CenterPoint), John Pagliari (Panattoni), and Bill Stein, '94 (Blackstone)—graciously helped guide the students' formulations and ultimately judged their final presentation.[4] In essence, the students advocated a strategy that shuns high-priced (largely) coastal markets and, instead, emphasizes fast-growing secondary markets, where initial cash-flow yields tend to be substantively higher. In the students' view, this strategy is likely to be abetted by future advances in the technology revolution (e.g., autonomous vehicles, drones, 3-D printing, etc.) with an emergence of "onshoring" (i.e., a reversal of the offshoring phenomenon occurring for decades in the manufacturing sector), which is likely to place less emphasis on international shipping/deliveries (and, conversely, more emphasis on noncoastal markets). While not all of the industry veterans agreed with the students' conclusions, they were all impressed with the thoroughness and quality of their presentation.

REAL ESTATE CHALLENGES

The Real Estate Lab is a variation of the "challenges" now offered by a number of academic institutions, including the universities of North Carolina, Northwestern, Texas, and the Massachusetts Institute of Technology—with two recent additions, Maryland and Miami (Florida)—as well as others offered by industry participants: Altus (see below), ARGUS, and CoreNet. The general format of these challenges is as follows: The institution circulates a case study to the participating teams, each of which is given a week or so to prepare its solution, and then the teams fly to the host school to present their solutions to a panel of third-party judges. (Some schools devote significant resources to participating in such events.) As noted last year, another recent challenge is the Real Confidence University Challenge (RCUC), which is jointly sponsored by Altus, NAREIT, and NCREIF.[5] It asks student teams to invest a notional $1 million across a broad variety of private and public (debt and equity) real estate sectors; the winner is the team producing the highest return over the 12-month period. The inaugural RCUC concluded in June 2016; the Booth team finished second among 15 schools, with a total return of 30.9% (the team invested in publicly traded retail and self-storage). For the most recent (completed) challenge (ended June 2017), the Booth team finished first among 32 schools, with a total return of 23.6% (the team invested in publicly listed mortgage REITs)—the five students split the $30,000 first prize. While we will try to keep such sterling performance alive in the future, market efficiency suggests that this is a high bar.

[2] Admission to this class is restricted to those students who have previously taken Real Estate Investments I and Real Estate Investments II.

[3] Given the "disruptions" found in the retail market, the industrial sector is often viewed as "the other side of the trade" and as such, it made for an interesting counterpoint to the 2016 Real Estate Lab project: an asset-repositioning strategy for Washington Prime Group (WPG), a New York Stock Exchange–traded, retail-oriented real estate investment trust (REIT). Please see the 2016 Real Estate Lab findings.

[4] Please see the 2017 Real Estate Lab findings.

[5] If interested in more information, please see realconfidence.com/challenge/2016.

STUDENT EMPLOYMENT

As noted in earlier years, the students' enthusiasm for our real estate class offerings waxes and wanes with the real estate cycle. With the passage of time, the real estate markets have recovered their precrash peaks and then some, and correspondingly, many of our students have enthusiastically embraced a career in commercial real estate. As also indicated previously, the number of real estate–related job opportunities for our students has been on the upswing. Over the past few years, students have taken (full-time) positions with AJ Capital, Angelo Gordon, Bentall Kennedy, CBRE Global Investors, Citibank (real estate investment banking), CIM, Colony Capital, Equity International, Green Street, Goldman Sachs (real estate investment banking), Heitman, John Buck, Jones Lang LaSalle, Mesirow Financial, Sterling Bay, Tishman Speyer, Ventas, etc. Some students have also founded (or cofounded) their own firms. And, a number of firms have also graciously hosted one or more summer interns.

Helping in these recruiting efforts have been "real estate treks" (i.e., student visits to a number of real estate companies in a given city (including Chicago) over the current and past several years. Participating firms have included: Angelo Gordon, Blackstone, Brookfield, CBRE, CPPIB, Five Mile Capital, Goldman Sachs, The Habitat Company, HFF, Kilroy Realty, KKR, Related, Silverpeak, Starwood, Sterling Bay, and Tishman Speyer.

Should your firm consider hiring one of our fine students, please visit the electronic resume book (Student.ChicagoBooth.edu/Group/RealEstate/Employers and use the password "Booth2017") of current full- and part-time students assembled as part of our most recent conference.

REAL ESTATE CONFERENCE

Last fall, we held our 11th annual Booth Real Estate Conference. These events have been well attended (averaging more than 200 people) and have been of high quality—as perhaps best exemplified by our keynote speakers and participating faculty members:

CHICAGO BOOTH REAL ESTATE CONFERENCE		
Year	**Keynote Speaker**	**Academic Speaker(s)**
2017	Sam Zell, Equity Group Investments	Eugene F. Fama
2016	Roy March, Eastdil Secured	Sanjog Misra
2015	Debra Cafaro, Ventas	Jonathan Dingel
2014	David Twardock, ex-Prudential Mortgage	Nicholas Epley & Amir Sufi
2013	John Schreiber, Blackstone	Randall S. Kroszner
2012	Tom Barrack, Colony Capital	Luigi Zingales
2011	David Simon, Simon Property Group	Scott Meadow
2010	Neil Bluhm, Walton Street Capital	Steven Neil Kaplan
2009	Sam Zell, Equity Group Investments	Kevin M. Murphy
2008	Jonathan Kessler, Empire State Realty Trust	Erik Hurst
2007	Joseph L. Pagliari Jr., Chicago Booth	

However, the 2017 conference[6] was particularly gratifying. Not only were the presentations and discussions of the highest caliber, but all of the participants (except for Sam Zell—always exceptional) were either Booth alums and/or faculty members. Whenever you have both Gene Fama and Sam Zell at the same event, you just know things are going to be good! A link to this event's topics, speakers/panelists, and conference brochure is found in the Appendix.

ALUMNI INVOLVEMENT

There are also a great number of alumni to thank for the generous giving of time, insights, and resources. First, I have to again thank Bernie Ocampo, '05, head of the Booth Real Estate Alumni Group (ChicagoBoothREAG.org), who has provided ongoing support to a variety of real estate–related initiatives, including creating a forum for alumni to share ideas and resources and helping students identify various job opportunities. Second, I have to thank and acknowledge Eteri Zaslavsky, AB '99, MBA '04; she is the leading force behind our annual real estate conference and many other Chicago-based events. Third, let me acknowledge Mike Kirby, '05, (cofounder of Green Street), who has helped me in a variety of intellectual/research pursuits, has hired Booth students to his firm, and continues to promote the deep insights he learned 30 years ago as an MBA student here. Fourth, let me also thank a number of Chicago-based alums, including Bruce Cohen, '89, Debra Cafaro, JD '82,[7] Brian Finerty, '03, Ari Glass, '06, David Helfand, '90, Ed Ryder, '92, and David Schwartz, '90, who have participated in a great number of real estate–related activities and events. Fifth, let me also thank a number of alums located outside Chicago, including Keith Breslauer, '88, Al Nickerson, '93, Tyler Rose, '86, and Bill Stein, '94, who have been guest lecturers and, more generally, been very generous with their time when approached by our students (and/or me). And sixth, any listing such as this runs the risk of significant omissions; this is the case here as well.

EXECUTIVE LUNCHEON SPEAKER SERIES

A few years ago, we started the practice of hosting a series (generally, once a quarter) of luncheons with prominent real estate executives. These are informal affairs, held at Gleacher Center, with approximately 15 to 25 students in attendance. The executive makes a few remarks for approximately 20 minutes and then takes student questions for approximately another 20 minutes. This fall, Quintin Primo (Capri Capital) graciously joined us. Past speakers have included Stephen Barter, Keith Breslauer, Debra Cafaro, Bruce Cohen, Mike DeMarco, Bruce Duncan, Andy Ebbott, Steve Fifield, David Helfand, Andrew Miller, David Twardock, et al.

[6] I'd also be remiss if I were not to thank this year's sponsors: DLA Piper, BMO Harris, Draper and Kramer, Eastdil Secured, Equity Commonwealth, and the Fama-Miller Center for Research in Finance.

[7] While a graduate of the university's law school (but not its business school), she is clearly a kindred spirit.

BOOTH ALUMNI IN THE REAL ESTATE WORLD

As I have noted on several occasions, the students and I are the beneficiaries of so many Booth alumni occupying positions of executive prominence in the area of commercial real estate. I continue to marvel at the students (now alumni) who choose to come to Booth and what they are taught while here—clearly, it is a powerful combination. This impressive alumni network includes:

THE WHEEL OF GOOD FORTUNE: BOOTH ALUMNI IN KEY POSITIONS AT SELECTED REAL ESTATE FIRMS

REITS:
DCT
Equity Commonwealth
First Industrial
Green Street
Mack Cali
Ventas

Advisors/Core:
BlackRock
CBRE Global Investors
LaSalle Investment Management

Developers:
Fifield
Oxford Capital Group
Ridge Property Trust

Advisors/Value-Add:
Blue Vista
Cabot Properties
Heitman
Waterton

Mortgage Lenders:
Bank of America
Merrill Lynch
Prudential
Wrightwood Financial

Investment Banks/ Capital Markets:
Eastdil Secured
Goldman Sachs
Bank of America Merrill Lynch
Morgan Stanley

Advisors/Opportunistic:
Apollo
Blackstone
CIM
Five Mile Capital
Fortress Investment Group
Greenfield Partners
Jaguar Growth
Patron
Pearlmark Real Estate Partners
Singerman Real Estate
Silverpeak
Starwood Capital Group

As with the earlier listing of contributing alumni, this list also runs the risk of significant omissions. So, please call them out. (Ultimately, it may be worth considering creating a web-based version of this wheel, with links to the prominent Booth alums at these firms.)

Finally, and perhaps most importantly, let me (belatedly) wish you and your family happy holidays!

APPENDIX: SELECTED ACADEMIC & PROFESSIONAL ACTIVITIES

2017 Academic & Professional Presentations

BMO Capital Markets Real Estate Conference:
"Assessing Real Estate Returns by Strategy: Core v. Value-Added v. Opportunistic"

Pension Real Estate Association (PREA) | Research Affinity Group:
"High-Yield Lending: It's Good Until It's Not!"

"Some Thoughts on Real Estate Pricing"

Booth Real Estate Conferences

2017:
Agenda
Videos

2016:
Agenda
Videos

Recently Published Papers

Journal of Portfolio Management (PREA-Sponsored Special Real Estate Issue):
"Some Thoughts on Real Estate Pricing"
"High-Yield Lending: It's Good Until It's Not!"

Real Estate Economics:
"Long-Run Investment Horizons and Implications for Mixed-Asset Portfolio Allocations"

"Real Estate Returns by Strategy: Have Value-Added and Opportunistic Funds Pulled Their Weight?"