



# Cornerstone Real Estate Advisers

Recently, Geoffrey Dobrman, publisher and editor-in-chief of *The Institutional Real Estate Letter – North America*, spoke with **David Reilly, Thomas Dudeck and Graham Bond** of Cornerstone Real Estate Advisers. The following is an excerpt of that conversation.

*The past 10 years have seen a lot of changes in the institutional real estate space. How has Cornerstone changed in that time?*

**Reilly:** Ten years ago, Cornerstone had about \$3 billion of assets under management — all in equity investments in the U.S. real estate market. Today, we are a global manager with more than \$32 billion in assets under management, and now have both equity and debt platforms, as well as a significant securities operation.

*Where did that growth come from?*

**Reilly:** There was no single growth stream. Some of it was organic as we spent a lot of time developing client relationships, growing our investment management business and creating very successful commingled funds. As a result of those efforts, our equity operation grew to \$10 billion\*. Some of it was through osmosis as in 2009 we made the decision to add debt to our product offerings. To accomplish that, we absorbed the real estate finance arm of Babson Capital Management, an affiliated firm through our parent company, MassMutual. That represents roughly \$21 billion in AUM\*. And finally, some of the growth has been through acquisition. In 2010, we acquired Protego, a London-based company with approximately \$2 billion under management. So the combination of all of those efforts resulted in today's Cornerstone Real Estate Advisers.

*How has your product line changed during that growth period?*



**David J. Reilly**, president and CEO is responsible for all facets of Cornerstone's operations. His career in real estate spans more than 30 years with extensive experience in asset and portfolio management, acquisitions and dispositions, and operations. His experience includes all institutional property types, including hotels, office, industrial, residential and retail.



**Thomas G. Dudeck**, chief of investment strategy, is responsible for overseeing Cornerstone's portfolio management and reporting, research, product development, business development and client service, valuation and U.S. and global real estate securities management operations. In this capacity, he plays a key role in creating and implementing investment strategies on behalf of clients.



**Graham J. Bond**, managing director, business development, is responsible for business development, client relations and marketing efforts to expand Cornerstone's relationships with real estate consultants, plan sponsors and international investors.

**Dudeck:** Ten years ago, Cornerstone was a private real estate equity manager with a limited menu of products. Since that time, we have expanded to include competencies in the private and public equity space and the private and public debt space. So we now have a firm that has competencies in real estate securities, CMBS, RMBS, core mortgage loans and higher-yielding mortgage products. In addition, we have a series of private equity core and value-added funds, as well as a number of individually managed accounts with large institutional investors in the United States and in Europe. We also have a series of niche products, such as an affordable housing tax credit program and an infrastructure program.

*Where do real estate securities fit in at Cornerstone?*

**Reilly:** The real estate equity security side of the business is a global operation with offices in Stamford, Connecticut, Amsterdam and Hong Kong. It is a sub-adviser to two mutual funds, one a global fund and one a U.S. fund. In addition, it is a manager of individually managed accounts. All in all, the group has about \$1 billion AUM\*.

*What drove the changes?*

**Bond:** We have tried to position Cornerstone to take advantage of where we see the market going, which is global. In addition, our clients are expanding their portfolios to encompass all four investment quadrants, and we want to be

able to serve them. We now have depth and breadth across the entire real estate spectrum, and we can provide real estate products up and down the capital stack.

*With all of these changes, is there anything that you've kept since the beginning?*

**Reilly:** Our culture. Culture is critical for Cornerstone. We are people-focused — meaning both a focus on the people within the firm and our clients. We like to say that we “hug” our clients. Our primary responsibility in this business is to provide our clients with the best service and solutions to fit their investment needs. This is a relationship business, and we value those relationships in our role as fiduciaries.

Everyone always says that the most important thing about real estate is location, location, location. I believe it is location, people and capital. We have research expertise to select the right locations, we have the right people to execute the investment strategies, and we deploy our clients' capital in a very thoughtful manner.

**Dudeck:** We are not a company that attacks the market with teeth bared, fighting for deals and delv-

ing deep into financial engineering. We don't even attempt to compete with that. We are who we are — a thoughtful, prudent and reflective company that really thinks about how any particular fund or product meets the needs of our investors.

**Bond:** Our people-centered culture is one that encourages long-term stability. Our senior people have been at Cornerstone for some time. So we have a lot of consistency in terms of staffing, a lot of talent and a lot of depth and breadth of experience.

*What do you think would surprise investors about Cornerstone?*

**Reilly:** A lot of investors don't realize how much Cornerstone has grown. They still think of us as a domestic equity operation instead of the \$32 billion global debt and equity platform that we have today. That growth has been relatively seamless. We were able to merge three discrete investment strategies and companies, and still satisfy our client needs while maintaining our corporate culture.

*How would you characterize the people at Cornerstone? Are you cultivating stars or are you trying to accomplish something else?*

**Reilly:** I would say we are as remote from a star-type process as you will find. We are a very team oriented, interactive and straightforward group of real estate professionals that are very forthright in

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what we do. Cornerstone emphasizes the people side of the equation — integrity, honesty and the fact that we do what we say we're going to do. We don't need stars to succeed, as stars often become misaligned. We think that if we have everybody pulling the oars at the same speed, then this company will be very successful.

*How has Cornerstone fared during the past couple of years of economic upheaval?*

**Dudeck:** It was as severe a downturn as many of us have ever experienced in our careers, and pretty much all real estate investment managers were significantly impacted. However, there are a couple of things that differentiated us and helped us minimize some of those negative impacts. One is that our organization is driven by our research, which alerted us to the need to ramp down our acquisition activities early on. Second, we kept our human resources intact, despite the severity of the downturn. In fact, we expanded our staff in a couple of strategic areas so that we were able to give our clients a sure sense that we had the management resources to allocate to any portfolio problems that might arise. Keeping our team intact also allowed us to be in a position to take advantage of opportunities as they arose in the recovering market — the acquisition of the operation in London, for example.

#### ABOUT CORNERSTONE REAL ESTATE ADVISERS

Cornerstone is one of the world's largest investment managers dedicated exclusively to real estate debt and equity in public and private markets across a global platform. Assets managed or serviced exceed \$32 billion as of June 30, 2011. Offices in the United States, Europe and Asia provide Cornerstone with a global reach executed through a local market presence. Cornerstone is equipped to offer creative, tailored investment solutions to an international clientele.

Founded in 1994, Cornerstone has grown to become one of the world's largest real estate advisers. Including the operations of its global network of subsidiary companies, Cornerstone offers its investment services through open- and closed-end private funds, separate accounts, co-investment programs, joint ventures, and mutual funds. An indirect subsidiary of the Massachusetts Mutual Life Insurance Company (MassMutual), Cornerstone is registered with the United States Securities and Exchange Commission as an investment adviser.

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**Bond:** Our hotel funds faced some of the greatest challenges, but we were confident about the quality of the properties and what we deemed to be their ability to stand the test of time. We were able to detect the onset of the downturn early enough to halt investment in our second fund when only one-tenth of it was invested. Now, we are actually in a sweet spot to complete investment of our mandate, with the prospect of enhancing returns on the initial acquisitions as well as the balance of the portfolio. Our investors are very comfortable with that strategy.

**Dudeck:** Our performance in the value-add fund series has consistently been in the top quartile. During the depth of the recession, our hotel funds dropped below median, but we're now making our way to the top quartile in those funds as well.

**Reilly:** We're not a traditional private equity company, but our value-add returns are competitive with those of most opportunity funds. I think a lot of it has to do with the thought that goes into those targeted strategies.

*It's still a pretty tumultuous market environment, and there's a tremendous amount of competition out there. What sets Cornerstone apart?*

**Reilly:** First of all, we have a tested group of people who are reliable, talented, dedicated and fiduciary oriented. The clients always come first — that's critical. We also have an extremely strong research capability. We integrate all of our top-down research with bottom-up information generated by our regional offices. The research group doesn't just analyze data that nobody really cares about. They get actively involved in looking at all of the investments that we make. If we don't get research's endorsement on an investment, then we don't do it. A third aspect of our operation that sets us apart is that we are a top 15 — and by some rankings a top 10 — global real estate manager\*\*, which gives us the ability to offer more to our clients. Finally, we have an extremely stable management team. We're in it for the long haul. We don't have people here swinging for the home run every time and then exiting stage

left if they're successful. Virtually the entire senior staff has been here for a long, long time. We live and we breathe Cornerstone.

*Where are you focusing in the markets today, both here and abroad and why?*

**Dudeck:** Our research indicates that the real estate market is cyclical and that there are opportunities to take advantage of these rotational dynamics in a variety of different ways. We

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see a couple of places where there are rotational opportunities today, and we have products that are designed to take advantage of them. One is on the private real estate side, targeting markets in this stage of recovery that we believe will be the fastest-growing markets over the course of the next several years; the goal is to ride occupancy and rental rate gains in those markets to create both income returns and appreciation. The second is taking advantage of what we see as a scarcity of debt capital for transitional real estate. If you can do first mortgage loans up to 75 to 80 percent, then you can control your destiny because you control the whole capital stack. You can negotiate participations for other opportunities to create higher yield as your borrowers execute their business plans. Finally, we believe there is a significant opportunity over the course of the next several years to create value in the apartment space through an apartment development program. As you are probably aware, we have executed three apartment development funds in our value-added fund series. Two

have been liquidated and were very, very successful, and the third fund just finished its investment period in the downturn and is recovering quite nicely. Those are the places that we see opportunities in the United States. There also are opportunities to create value for our investors in Europe, and we still like the public security side, both globally and in the United States, to cover the income and growth potential in those vehicles.

*What types of investments are clients most interested in today?*

**Dudeck:** The perspective of clients continues to evolve. In 2010, a wave of capital hit the core equity and mortgage spaces, which investors perceived as low-risk. During the past several months, we've begun to see clients who have met their allocations in the core space begin to shift their focus to value-add equity and debt strategies. That's going to continue to evolve as clients look for risk management and capital preservation, while obtaining an income stream that approximates their actuarial payouts.

*Has core become overvalued?*

**Bond:** A lot of capital has flowed to core, but there are still opportunities in the core space where investors can beat return hurdles. Buying at the bottom of the economic cycle is better than buying at the top, and we are still bouncing along at the bottom of the economic cycle.

*How does Cornerstone approach risk management?*

**Reilly:** Cornerstone has always been a conservative investor when it comes to leverage, which has a huge impact on how much risk an asset takes on. Obviously, some of our investments had potential problems, and we worked those out with lenders, but the majority of them did extraordinarily well through the downturn because of our low-leverage approach. Secondly, we really listen to our on-the-ground people in the regional offices. We listen to the drumbeats that are occurring on a local basis and react very quickly.

**Dudeck:** We've learned the importance of being observant and adapting to changes as they occur.

Interest rate, currency and capital market movements are much more rapid than they were 10 years ago, and one of the things that a good investment manager does is be very observant of those changes and create products that are adaptable.

*How are you mitigating the dual risks of slow growth and inflation?*

**Dudeck:** We are able to mitigate some of the risks associated with slower growth by focusing on rotational opportunities and strategies. Looking at investments in areas that we believe will be faster growing over the next couple of years mitigates the uncertainty about the general pace of growth. For example, we believe markets that have high concentrations of jobs in technology, energy and health care will grow faster than other areas of the country, so those are the areas we are focused on.

*How are you controlling for inflation risk?*

**Dudeck:** One of the advantages of the real estate asset class is that its income component provides a reasonable hedge against inflation over the long haul. We have always stressed the importance of going-in and on-going distributable income in our investment strategies.

*One of the reasons people are concerned about inflation is that they don't believe the Fed will continue to keep interest rates low. Are you factoring that risk into your acquisition strategies and into the management of your portfolios?*

**Reilly:** Building our portfolios encompasses a combination of factors, and being aware of the probability of rising interest rates is certainly one of those factors. As we've mentioned, we design our products to take advantage of the rotational aspect of the real estate market. If you anticipate there will be inflation, you really have to target your product type. There are certain asset types, such as apartments and hotels that will perform better in an inflationary environment than oth-

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ers. We would also want to try and lock in today's low interest rates, as well as keep our use of leverage in the moderate range. Add a focus on the better performing markets, and we can develop strategies that take advantage of inflation, rising rates — really any cyclical change — rather than be hurt by them.

*What are your priorities for 2011 and beyond?*

**Reilly:** Over a five-year perspective, there's no question we are going to move more aggressively into the

European and Asian markets, where we already have established platforms. We will continue to expand the combination of products that we bring to the marketplace, up and down the capital stack, as well as securities offerings. Longer-term, we are going to continue to grow. We have roughly 300 employees now spread around the globe, and as our AUM continues to increase, we will need more staffing to offer investment expertise for and satisfy the needs of our clients.

**Dudeck:** We have a strategic plan to continue to grow Cornerstone, but only at a pace that makes sense to us and our clients, that responds to opportunities and that can be accomplished with adequate resources in place to sustain performance. Growth for growth's sake is not our objective. Successful growth for us and our clients is the goal.

**Bond:** Ultimately, we can only grow and succeed if we meet the needs of our clients. We must continually recommit ourselves to developing a full spectrum of innovative investment strategies that meet the evolving needs of our investors, seize opportunities when they present themselves, exercise prudent judgment in all of our affairs, continue to be a strong performer and provide outstanding client service. ♦

*\*As of June 30, 2011*

*\*\*Cornerstone is ranked among the top ten largest real estate investment managers according to Pensions & Investments (Sept. 20, 2010).*

## Cornerstone's broad real estate investment capabilities

U.S. Equity Investments	Core	Value-Added	Development	UK/European Private Equity
Open-end Fund	✓			
Closed-End Fund	✓	✓	✓	✓
Separately Managed Accounts	✓	✓	✓	✓

Property Types	
Multifamily	✓
Office	✓
Retail	✓
Warehouse, R&D	✓
Hotels	✓

Debt Investments	Core Mortgage	Public CMBS	Mezzanine High-Yield Debt
Closed-End Fund	✓		✓
Separate Account	✓	✓	✓

Real Estate Securities	
U.S.	✓
Global	✓

Other Real Estate	
Affordable Housing	✓
Property Index Certificates (PICs)	✓