DRA Advisors

David Luski, a co-founder of DRA, is President and COO of DRA. He is involved in all aspects of DRA's business, including both acquisitions and asset management of DRA's portfolio.

Paul McEvoy is Senior Managing Director of DRA responsible for portfolio management and investor services. He also serves as DRA's principal client contact.

ABOUT DRA ADVISORS

DRA Advisors is a registered investment adviser specializing in real estate investment and management services for institutional and private investors. DRA's focus is on conservative, value-added real estate investments in the office, retail, multifamily and industrial sectors in the United States. DRA's acquisitions since inception include 900 properties valued over $18 billion. The firm currently has more than $9 billion in assets under management.

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*Recently, **Geoffrey Dohrmann**, publisher and editor-in-chief of* The Institutional Real Estate Letter – North America, *spoke with **David Luski** and **Paul McEvoy** of DRA Advisors. The following is an excerpt of that conversation.*

Can you give us a snapshot of where DRA stands today?

McEvoy: After starting in 1985 as Dreyfus Realty Advisors, today DRA is a 25-year-old investment firm with $9 billion under management. Our charter is to invest in value-added assets in both primary and secondary markets across the United States, through both single-asset purchases and portfolios. We have also privatized three public REITs. We have a focused and disciplined business plan in which we invest through only one fund at a time. There are no conflicting accounts. We have 77 associates, mostly in New York, with small offices in Miami and San Francisco to help us stay closer to our joint venture partners and managed assets.

Out of all the things you could have done, why did you decide to focus on value-added investments?

Luski: Value-added gives us the most flexibility of product and strategy. It is somewhere between core, which is the plain vanilla return, and opportunistic, which is a little bit too far out on the risk spectrum. We like it because we can protect our capital, yet still get a boost in performance by adding value along the way.

What kinds of strategies do you employ?

McEvoy: We focus predominantly on acquiring existing properties with strong cash flow in place and to which we can add value by driving revenues, controlling expenses more effectively and implementing targeted capital improvements. Value can also be created in the acquisition itself, particularly when capital is dear.

Can you give an example of that?

Luski: Recently we were able to acquire an asset in New York City called Worldwide Plaza. In better times, this would be a core asset in a prime location, but the recession and the inability to refinance the debt had forced it into foreclosure. So we bought a high-quality existing asset that was about two-thirds leased. The plan was to lease the balance of the property, add value by adding capital to property operations, and then rebrand and remarket the building to a marketplace that hadn't been exposed to this asset because it had been 95 percent leased for the past 15 to 20 years. So it's a core asset with a value-added opportunity that was driven by capital and leasing.

McEvoy: This was at the end of 2008, when everyone was afraid of their own shadows. The only way that we were able to participate was to jump in when everyone else was very fearful.

Luski: We bought the asset through a 50/50 joint venture with a local partner, George Comfort and Sons. The bank took back a first mortgage on the property, and we came to the table with capital to stabilize the leasing and pay for some of the improvements that were needed at the asset level. Our all-in cost was about $375 a square foot, which was about 30 to 40 percent of replacement cost. Buying it significantly below replacement cost enabled us to competitively lease space in the marketplace at a time when Manhattan leasing was slow.

Why would a deal like that show up on your doorstep?

Luski: Our ability to move quickly and understand fairly complicated structures puts us in the forefront of a lot of deals. When we looked at this particular deal, we were trying to figure out how to buy assets from banks that have taken assets through foreclosure and help them minimize some of their tax loss or book loss position. So people come to us usually when there's a complication in structure or a need to move quickly. Our ability to provide capital in a joint-venture format also brings a lot of operating partners to us who have the skills but need the capital.

McEvoy: We also have close ties with public REITs. We've found that even when the REITs are not financially distressed, they are continuously reinventing themselves and revising their business plans. That's created constant opportunity for us because when they redefine their investment focus, they usually divest a segment of their current portfolio and frequently through a joint-venture format. These ventures are often sizable and complex, which limits the universe of real buyers to a very small group. This increases DRA's ability to acquire advantageously.

You've been involved in several large portfolio plays. What drives those kinds of deals?

Luski: Those deals are market-driven. We go back and forth between public and private arbitrage depending on what makes sense at the time. When the public markets are heating up, we are a seller of our private portfolios. When Wall Street prices real estate cheaply, we are a buyer of public companies. We took three public companies private in 2004–'05: 1) Price Legacy, a shopping center REIT; 2) CRT Properties, an office REIT in the southeast/southwest; and 3) Capital Automotive Real Estate Trust, the largest owner of triple-net-lease properties leased to auto dealers. Despite the problems of the auto manufacturers, CARS has performed very competitively through the real estate down cycle.

We look to buy in areas that others might be avoiding. That was true with the auto dealership leases, and now it's true with retail. People are getting negative on retail because consumer spending has declined. So this is a time when we want to be looking for quality property that will rebound as the economy recovers. In the past quarter, we have either bought or contracted to buy $400 million to $500 million worth of retail properties while others are shying away from the space.

McEvoy: A lot of institutional investors, whether they're value-added or core-plus, are focused on the largest markets. We invest in primary markets when everyone else is afraid to invest, but it's more likely that you'll find us investing in a lot of secondary markets with good growth prospects, established institutional footing and diversified economies. For example, our most recent deals are in suburban Denver and North Charleston, S.C. We believe those offer better risk-adjusted returns than the hotly contested core markets today.

Are there areas in the value-added space that you just don't like?

Luski: We tend to stick to the four major food groups of office, retail, residential and industrial. We have looked at other areas, such as hospitality, single-family developments and condo developments, but those sectors move quickly with the cycle, and we just don't have the in-house expertise to take advantage of that on a competitive basis. So we do look at some opportunities on the edges from time to time, but the majority of our effort is really on the four major areas.

What else differentiates your firm?

McEvoy: Concerning DRA itself, I believe we are unique in that the ownership of the company is quite broad and stable. We have 13 owner-partners, with an average 15-year tenure at DRA. We have a very collegial group of associates and over half the company has been at DRA for eight years or longer. The fact that people want to stay here a long time suggests that they're challenged and happy with their career progression.

As you would also expect with a firm of our size, client relationships are deep, with some going back almost 20 years. In a typical Growth and Income Fund offering, about 80 percent of capital is raised from our existing investors. We co-invest on a pro rata basis, and all of our promotes are totally back-ended, so we have an effective alignment of interests with our investors. That said, we take our fiduciary obligation seriously and that really transcends our investor friendly terms and co-invested capital.

Another thing that differentiates us is that we are a one-product shop with three decades of experience in that product. During that time, we have sold more than $6 billion of assets with an average realized rate of return of 20 percent.

Now that we're through the worse of the recession, are there any changes in your business plan or investment strategy contemplated in 2011?

McEvoy: When our Fund VI acquisition period expires in March, Fund VII will continue our value-added investing program. The objectives will be the same but the deal flow is evolving.

Luski: A big wave of bank foreclosures and servicers who have to work through their portfolios is building, as is the number of assets needing an infusion of capital. This will be a major source of deal flow for us. Some of these deals are already evident. For example, of the last four deals that we closed, one was a bank syndicate foreclosure on a shopping center; another was a servicer take-back; the third was a corporate seller in need of capital for its own repositioning; and the fourth was a major public REIT that wanted to refocus its business plan.

How has your portfolio held up through the down cycle?

McEvoy: The down cycle separated the people who knew how to operate real estate from those that succeeded on the upside, but were unable to manage their businesses when the market collapsed. Our greatest exposure is the 2005–'08 period, when DRA Growth and Income Fund V and VI were investing. Based on our results so far and what we believe are conservative projections, we expect Fund V to generate a positive IRR with a full return of capital. Fund VI currently has double-digit cash flows and, by the time we finish investing, we expect it be close to generating the original investment return objective. None of our funds have had to seek any kind of rescue capital; we've been able to manage the funds and the capital needs of each fund internally.

Luski: The underwriting discipline and the culture that we've had of buying transactions that have a strong component of cash flow to support the underwriting, as well as capital appreciation, has given us the downside protection in this tough time. We're not saying we haven't had a couple of issues with some investments, but we've been able to be selective and protect the majority of the assets with the cash flow and the capital that we've been able to garner from our existing portfolio. Given where we are after just going through a historic downturn, we feel really good about the returns that should come out on the upside of this recovering market.

How has your client base responded to all of this?

McEvoy: Our clientele is very diversified. Pension funds make up 40 percent of the group, university endowments account for another 40 percent, and other kinds of financial institutions comprise the remaining 20 percent. This diverse group is still very confident in real estate as an asset class. Based on their plans to continue to invest with us, they are also confident in DRA.

Luski: There are still going to be some tough times ahead. This is going to take a couple of years, if not longer, to work its way through some of the different product types and situations. You are going to have to be really smart and prudent about where you put your money. We're grateful that our investors believe we have the team to continue to succeed. ❖