

ASB Real Estate Investments



Robert Bellinger, president and CEO, is responsible for all functions of ASB's Real Estate Division. He has more than 29 years of real estate investment experience, and has completed over \$10 billion in real estate capital transactions during his career. Prior to joining ASB Capital Management, Bellinger worked with Lend Lease Real Estate Investments as an executive vice president and principal, heading the private client group; senior vice president directing the national asset sales group; and vice president leading the acquisition of equity and debt investments in the Washington, D.C., region. Prior to joining Lend Lease in 1990, he worked as development project manager with Trammell Crow Co.

David Quigley, managing director and chief investment officer, is responsible for real estate acquisitions in the Western Region of the United States. He is based in the San Francisco office. Prior to joining ASB Capital Management, Quigley was a partner and senior vice president in the Los Angeles office of ING Realty Partners, where he was primarily responsible for investment activity, including identifying, evaluating and closing transactions; negotiating joint venture documentation with capital and operating partners; and obtaining third-party debt to facilitate closings. Prior to joining ING Realty Partners, he was director of project finance for Essex Property Corp.



Jim Darcey, managing director, is responsible for ASB's Eastern Region real estate portfolio, including new investment, asset management and property dispositions activities. Darcey also serves as portfolio manager for the Meridian Funds, ASB's series of value-add closed-end funds, and is a member of ASB's management committee. Prior to joining ASB Capital Management, he was senior vice president, asset management and acquisitions, at Lowe Enterprises Real Estate Group in Washington, D.C., where he had primary responsibility for all asset and property management activities in the Eastern Region, including the management of asset management and property management personnel.

Recently, **Geoffrey Dohrmann**, publisher and editor-in-chief of *The Institutional Real Estate Letter – Americas*, spoke with **Robert Bellinger, Jim Darcey and David Quigley** of *ASB Real Estate Investments*, a division of *ASB Capital Management (ASB)*. The following is an excerpt of that conversation.

Tell us a little about ASB Real Estate Investments.

Robert Bellinger: ASB has been in business for more than 25 years as a real estate investment management company and a pension fund fiduciary. ASB was founded in 1983 by American Security Bank, the largest financial institution in the greater

Washington, D.C., metropolitan area. ASB Capital was the bank's institutional investment advisory group, managing stocks, bonds and private real estate investments on behalf of tax-exempt institutional investors. American Security Bank through a series of mergers became part of Bank of America, and Bank of America sold the ASB advisory business 15 years ago to the Saul Family Trust, who are a major family office with national reach and tremendous financial resources. We have had the benefit of a consistent period of ownership now for 15 years, and a lot of consistency in our management team, which has been together for most of the time that I have been here.

How is the company structured?

Bellinger: Accountability, responsibility and conflict of interest are critical in our business, and so the Saul family has set up the advisory business as an independent subsidiary with our own board of directors. We are fully integrated as a company, so everything we do for our clients is done within the subsidiary.

Traditionally, we have had two primary real estate businesses, a development-only separate account with a large national pension plan and a commingled, open-end national core fund, the Allegiance Fund. We have since added a third line of business, which is a value-add fund series called Meridian. We are very focused on just those three strategies. That is a key differentiator for us and really a driver of performance because it allows us to focus on what we do and not get diluted across multiple products. The separate account exclusively does ground-up development, and we are committed to not taking on any other separate account mandates.

Jim Darcey: As a small company, we are able to leverage our expertise with that of our local operating partners. Our platform is built on joint venture partnerships with local operating partners that have product and market specialties, and then matching their specialized knowledge with our expertise and our capital in order to really optimize value at the asset level. It is not enough just to make a great buy; you have to work the asset every day in order to generate returns over time.

How have the firm and the funds changed over time?

Bellinger: When I joined ASB 10 years ago, we took the investment strategy of the core fund in a different direction. We shifted to a focus on urban opportunities in dynamic,

truly 24-hour major markets and a real focus on mixed-use assets and synergies between the uses in office, retail and residential.

Three other significant events have had a big impact in terms of changing and growing our firm. The first was the downturn, which really shook up the core property business. Prior to the downturn, investment performance dispersions from the mean were not very wide in the core space, at least for the bull market from 2002 to 2007. With the downturn, there was wide dispersion from the mean in terms of performance among core managers. As measured by the ODCE Index, we were the second-best-performing core fund from peak to trough in 2008 and 2009, and investors started looking at us and the other top core managers a little differently. The second important event was being admitted to the ODCE, which happened two years ago. That made a difference in terms of our visibility. The third significant event was restructuring the core fund into a private REIT and modernizing our limited partnership operating document to make our fund much more transparent, understandable and accountable. Those key events were big changes for us along the way, and we have grown from a \$150 million fund to a \$2.5 billion fund.

Why the change in real estate investment strategy? Why did you focus on 24/7 cities?

David Quigley: A decade ago, it was a small fund at a small company, and focused primarily on the mid-Atlantic and upper Midwest. We wanted to expand to a national platform and opened up a West Coast office. We took a look at the assets in the portfolio, which were highly suburban and tilted toward office. We realized we wanted to diversify out of office and we just weren't believers in suburban. Our long-term view continues to be that real estate assets in urban locations are going to provide superior investment performance through long-term NOI growth.

Is there something in particular that drew you to the mixed-use concept?

Quigley: When you get into dense urban locations, you are often buying an office building with ground-floor retail, and sometimes the retail is a significant component of value because rents for street-level retail in urban locations tend to be pretty high.

Bellinger: And, for us, mixed-use doesn't necessarily mean the specific asset has to be a mix of residential, office and retail, but the neighborhood and the market have to be mixed. If we are buying an office building, we want the office-users to be able to walk home or not have to get in a car to go buy lunch. We feel the investment performance of these assets is stronger in the markets where we are focused simply because that is where people want to be, where they want to live, where they want to shop, where they want to work.

Quigley: And where they want to play.

Bellinger: The consistency with which we have focused on truly urban, transit-oriented real estate really differentiates our portfolio. It has been years since we bought a suburban, grocery-anchored shopping center. We buy urban retail in SoHo in New York City, Union Square in San Francisco, The Promenade on Third Street in Santa Monica, Michigan Avenue in

Chicago. Our retail portfolio looks very different from other core funds that own a lot of well-located but grocery-anchored retail, and we think our retail has performed better during the downturn. Even in industrial, we have built a portfolio of properties that have unique advantages, and we focus on industrial buildings with great access to power and/or fiber, which helps to differentiate those buildings, particularly for technology-oriented tenants who are looking for industrial space. For urban residential, we think being able to walk easily to the train and take the train to work is critical.

We made a fundamental bet that urban, mixed-use markets are where people want to be, where they were moving, where demand would be increasing over a long period of time. We think this is a long-term, dynamic, important trend with an impact on all the markets where we invest across the country. Fundamentally, it is about knowing your tenants and buying assets where your tenants want to be.

How do you manage the potential conflict when a deal comes up between the accounts?

Bellinger: We have one core fund and one value-add fund. There are no core deals in our value-add fund, and no core deals in the development separate account, so



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every great core idea goes into Allegiance, and there is no conflict for core investments. The Allegiance Fund has a 10 percent noncore allocation, which includes investments that may also be appropriate for the value-add or development funds. However, even these transactions for Allegiance tend to be different as they are focused on creating high-quality core long-term hold investments. We have a transparent and disciplined pipeline process to handle those conflicts. The pipeline committee meets every two weeks, and every new investment is presented to that committee. The first question asked is: "Which fund is this investment suitable for?" To the extent that there is an overlap, then there is a rotational system. That rarely happens — less than a handful of times in a year.

How is your approach to investing different compared to other managers?

Bellinger: First, focus is tremendously important — minimizing your conflicts and focusing your best people. It is very tough, as a firm, to generate consistent alpha if you have a wide variety of mandates and masters. Second, as long as real estate is an industry where people can generate alpha, there will be inefficiencies in the market and information will not flow freely. Your ability to be nimble in that kind of environment is critical. Third, our firm has a real culture of debate. We have a diversity of thought and experience within our company, and having folks who have different points of view and different ideas will help you to make much better decisions.

Darcey: Unlike some firms where there are acquisition specialists and asset management specialists, we structured our capital investment team to be focused on the practice of real estate investment, so our investment professionals work on transactions from the acquisition all the way through the potential disposition, so the folks who are underwriting a potential opportunity stick with that investment program all the



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way through its implementation. We think that the team continuity and accountability for investment results has a real impact on performance.

What do you offer clients that is unique and special?

Bellinger: Going back 10 years, on a one-year, three-year, five-year and 10-year basis, our investment returns for our core Allegiance Fund rank in the top quartile of the ODCE index for every one of those time periods. For the three-, five- and 10-year numbers, we are either number one or number two in the index. So we have consistently, through good markets and bad, generated exceptional alpha for investors with moderate risk.

Quigley: During the past 10 years, we have had a philosophy and a thought process about where we want to invest, and we have tried to not stray from that. We have been good at sticking to our strategy and not purchasing assets that do not fit our philosophy.

Bellinger: Ultimately, people invest with us today because we put performance first in everything we do. Performance is not just about high returns; it is about managing risk to an appropriate level, as well as achieving as much alpha as you can within your risk parameters. And we have consistently

generated exceptional investment performance through good times and bad. Everything else flows from that. Our main thing is generating not just good investment performance, but exceptional investment performance.

Quigley: We think about core a little differently from our competitors. To us, core isn't trophy; it revolves around a concept of long-term tenant demand. Core buildings are those where tenants want to be. We think that over time we will have above-average rental growth by focusing on those assets. When we look at investments, we really try to understand how tenants in the market use space and what they really care about. We ask ourselves why a tenant would want to live or work in this building versus the building next door or down the street. If we don't have an answer, it's probably a commodity building, and if so, we will pass. We are really passionate about this tenant-centric approach. It's a big part of how we think about real estate.

What are some of the other values that drive your decision making and strategy at ASB?

Bellinger: Having a very collaborative culture that embraces constructive debate is critical. To be effective at that you have to have an open mind, be a good listener, be willing to hear someone else's idea that might be completely different from your own. You have to give that person the benefit of the doubt, even assuming they are right and then having to prove them wrong.

Quigley: If you are primarily investing an open-end, long-term investment vehicle, which we are, you can fall into the trap of finding investments that you like because you think they will perform well right now. We think hard about how the investment will perform over the long term and whether it can generate above-average rent and NOI growth over a sustained period of time.

How do you know when you need to sell?

Bellinger: Everybody in the industry does a buy/sell analysis of the pros and cons of owning the assets in their portfolio. We take it a step further. We get our entire investment team together and rank every asset within a fund from top to bottom, number 1 to number 60. We fight over whether an asset should be ranked 12 or 13, and should this property be ranked ahead of that property. It is a great discussion that digs into the pros and cons of each asset. Then we look at the assets at the bottom and ask, “Why do we own these 10 assets, when we could own 10 that are more like the ones at the top of our list?”

Quigley: We spend a lot of time worrying about the potential exit. We were a very active seller in the two years before the downturn. We sold a lot of assets that we didn't love, and it was difficult. We had an incoming queue because we had to reinvest that money before we let new money in, but we felt it was the right thing to do for performance.

Darcey: We sell assets for a number of reasons. First, if we think that market events such as new supply might pose a challenge to an investment over time. We don't have a crystal ball, but we are thoughtful about being responsive to new threats. Second, we also have been good sellers when a buyer is willing to pay a number that just doesn't make sense to us. Finally, if a property is a chronic underperformer and our best ideas just haven't worked, it may be tough to admit, but that probably is an asset that we don't want to own.

Bellinger: This is where our culture is particularly important in making sales decisions, especially with our core fund. Core funds traditionally have not been great sellers. We have tried very hard to be an effective seller, and the key is having the humility and courage to recognize your mistakes and then do something about them.

Where do you see the markets today?

Quigley: There is a lot of capital chasing what feels like not enough deals. To me, part of that is because investors are very frustrated with the return prospects of their investment alternatives. Interest rates are so low that sitting in cash is a tough place to be, buying bonds is a tough place to be. The stock market may be at an all-time high today, but people continue to be gun-shy. Lots of investors aren't looking to part with their real estate because they don't know where to invest their money when they get cash back. Also, the recovery has been very uneven. When you look at markets across the country, some are doing better than others. Our view is that some markets will continue to outperform others, and we are trying to position ourselves in those markets and submarkets that will outperform to capitalize on that growth. The trick is to buy into those markets at prices you believe in, and that is a challenge — but hasn't it always been?

Darcey: Our theme of going where the tenants want to be is going

to continue to drive our strategy. We are looking in parts of New York City that traditionally have not been considered the driver of office demand. We saw very little absorption in the traditional Plaza Midtown office market last year. All the demand, all the absorption was occurring in Midtown South in Chelsea and Tribeca in historic loft warehouse buildings, so we are going to continue to try to put ourselves in the minds of tenants and try to understand what is driving leasing decisions.

Bellinger: The notion that the rising tide lifts all boats was much more true in the 1960s, 1970s and 1980s than it is today. I think bad ideas are punished. I think mediocre industries and companies are punished, and there is much greater dispersion between winners and losers than we have possibly ever seen. Many forces are at play globally — and technology is a big part of it — that will enable and perpetuate change going forward. In real estate, I think that has a potentially profound impact on performance. ❖

CORPORATE OVERVIEW

ASB Real Estate Investments (ASB), a division of ASB Capital Management, LLC, is a leading U.S. real estate investment management firm with more than \$3.5 billion in gross assets under management for approximately 200 institutional clients. Headquartered in Washington, D.C., ASB invests in major urban markets across the country, concentrating in office, multifamily, retail and industrial properties. Applying a disciplined strategy, ASB manages the ASB Allegiance Real Estate Fund, its sole vehicle for core investing, a value-add fund and a development separate account.

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