



## TGM Associates

Recently, **Geoffrey Dohrmann**, publisher and editor-in-chief of *The Institutional Real Estate Letter – Americas*, spoke with **Tom Gochberg**, **Michael Frazzetta** and **John Gochberg** of TGM Associates. The following is an excerpt of that conversation.

*Tell us a little bit about TGM Associates and what you do.*

**Michael Frazzetta:** TGM is an SEC-registered investment advisory firm. We are focused solely on investing and operating rental apartment communities in the continental United States. We work exclusively with institutional clients. We've done one discretionary fund, but we like the separate account format better because of the interpersonal relationships that we can build with our clients. We have about \$1.4 billion of assets under management as of the end of 2013.

*When did TGM start?*

**Tom Gochberg:** TGM was founded in the summer of 1991. At that time, there was no liquidity available in the marketplace, and there was a very high rate of foreclosure. In consequence, 26 of the first 50 properties TGM acquired were purchased out of foreclosure.

*What makes your approach to buying apartments different from other folks?*

**John Gochberg:** We're a vertically integrated operating company. Our niche is purchasing properties that other institutional investors are not chasing. This limits the competition, which in turn lowers the acquisition price. TGM's operating capabilities allow us to pursue the acquisition intelligently. We have successfully used this approach since TGM's inception, changing target characteristics as market conditions evolve.



**Thomas Gochberg** is co-founder, a managing principal and CEO of TGM Associates. He is responsible for the final decision on property transactions and chairs the firm's Investment Committee and is a member of the Operating Committee. As such he is also responsible for the overall management of the firm. Previously he was president and CEO of Smith Barney Real Estate Corp. and president and CEO of Security Capital, which acquired Smith Barney Real Estate in 1984.

**Michael Frazzetta** is a managing principal and CFO of TGM Associates. Frazzetta joined TGM in May 2002. He is responsible for TGM's treasury, accounting and control functions. He is a member of the Investment and Operating committees. He was previously chief financial and chief administrative officer of Barnard & Co., a venture capital fund of funds that managed over \$2 billion in venture capital investments. He also was employed as a senior manager in the New York office of Arthur Andersen LLP performing due diligence for private equity and venture capitalists.



**John Gochberg** is a managing principal and COO of TGM Associates. He joined TGM in 2000 as an acquisitions analyst, was an acquisitions officer from 2001 to 2003, and was director of property operations from 2003 to 2008 when he became COO. He manages TGM's day-to-day operating groups: acquisitions, property management and construction. He is a member of the Investment Committee and chairs the Operating Committee.

*Oftentimes I see you moving forward and making acquisitions when other firms are out of the market. And while others are going into the market, you seem to be sitting on your hands.*

**John Gochberg:** We tend to be countercyclical. When other investors are buying en masse, we like to sell into that frenzy. When other investors are selling en masse, we like to buy as the prices become lower. We're disciplined investors. When we believe it's the right time to buy, we buy. When we believe it's the right time to sell, we sell. We think it is unwise to constantly be buying if it is a seller's market.

*You mentioned the intimacy of the relationship on a separate account basis. How do you deal with times when the client disagrees with you about the right time to buy or sell?*

**Tom Gochberg:** In very late 2005, it was obvious to us that a bubble was

well under way. There was a condo conversion frenzy going on, and at the time we owned about a dozen properties in Northern Virginia and Florida that were possible condo conversions. It became clear that all of those could be sold at cap rates that were much lower than they would have achieved when/if sold on an apartment basis. We made recommendations to sell these properties to our separate account clients, who were initially hesitant due to under-allocation concerns. There were a couple of moments where we explicitly highlighted the implications of not selling into this bubble, and ultimately it worked out very well. In retrospect our clients were very pleased that they sold into the bubble.

**Frazzetta:** If you look at our history, we've been an active buyer and seller rather than an aggregator of properties. We're not an assets under management shop. We make

money at TGM when our clients make money. So, it is in our own best interest to be in alignment with our client and make the best buy/sell decision at any given point in the cycle. We buy what we feel is the best value at a particular point in an investment cycle, create value and then sell at the right point in time.

**Tom Gochberg:** In 2008 I was at a PREA conference as was the head of real estate at one of our major clients. She pulled me over into the corner, saying, “Tom, there is really something I would like to say to you.” She then went on to say, “Thank you very much! You were the only one of our advisers who told us we should be selling everything into the bubble.” Consequently, we received incremental funds from this client.

*What motivated your purchases and sales and your response to it?*

**John Gochberg:** Our business model means we get the majority of our fees from incentives, not assets under management. We believe our fee structure gives us the greatest alignment of interest with our clients. As our clients realize returns, we realize incentive compensation. We charge only three fees at TGM: an asset management fee, a property management fee and an incentive fee. There are no purchase or sales fees or markups of any kind for any services we provide. Our asset management and property management fees are set at cost. The incentive compensation is the reward we receive when our clients realize returns above their predetermined threshold. Again, we’re trying to keep everything in alignment. With that as a prelude, it is easy to see the importance of being a disciplined buyer and seller of properties. As exceptional and innovative as our property management team is, it can never make up for overpaying for a property. And unless we realize gains for our clients, we will never get paid incentive compensation.

*How many properties have you acquired and sold over the years?*

**John Gochberg:** We’ve acquired 123 properties and sold 93 of them.

The purchases totaled about \$2.2 billion in cumulative purchase price.

**Frazzetta:** If you look at when we sold, almost half of what we’ve sold was in run-ups to peaks in pricing — the 2005 to 2007 run-up in pricing and what we think is a run-up of

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pricing from 2010 until today. Almost half of our sales were during those two short windows, and we purchased less than 15 percent of our assets during those same periods of time. So it gets back to being disciplined and being countercyclical.

*You’re looking at today’s market conditions as being a little dicey, a little heated up?*

**Tom Gochberg:** I can’t speak to dicey, but when it’s fully priced, you don’t deny the buyer what he wants!

*How did you guys deal with the housing bubble?*

**Tom Gochberg:** We first concluded that a bubble was building in late September 2005. Our initial expectation was it would be like the early 1990s; therefore, we stopped buying and instead became net sellers. We realized profits, built cash reserves and waited for buying conditions to improve. In 2005 and 2006, we sold all the properties in varying portfolios that could be deemed to be convertible by condo converters, who were then frenetically trying to acquire inventory. We ceased buying during that same year and a half before we began buying in size in mid-2007 to mid-2008. Interestingly, it wasn’t like the early 1990s, as this time around the Fed flooded the market with liquidity, and there was no governmental pressure applied to force banks and other lenders to clean up their balance sheets. In consequence,

very few institutional multifamily properties went into foreclosure. Instead, we primarily acquired failed condo properties — that is an entire property that was planned to be sold as individual units, but we purchased at apartment pricing. In consequence, the quality was very high, and the pricing did not include the potential for future condo conversion. This allowed us to build a high-quality portfolio at very good relative pricing. We made it through the entire period without any of the properties in our portfolio being under financial pressure and at the same time made very material profits for our clients.

*You’ve chosen to be a vertically integrated firm. What advantage does that bring to you?*

**Tom Gochberg:** I have been in this business for a reasonably long period of time. The first downturn of my business career was the REIT debacle of 1973 to 1977. I was then at Smith Barney Real Estate, and the firm used third-party developers and property managers. I found by 1974 or 1975 that the only way to protect the money we had invested on behalf of our clients was to kick out the third-party operating partners and run it ourselves.

*From your perspective, what is the problem using a third-party operating partner model?*

**John Gochberg:** When there are problems and everybody is under financial pressure, the operating partner in charge of the property will worry about their own problems first and not your problems. That means your assets or your capital is not preserved; they don’t really care because they’re focused on their own survival. Thus, there is a material conflict of interest. Over 23 years in business, we’ve never lost a property to foreclosure or ever had a problem property where we had a negative carry.

**Frazzetta:** I expect that we know about onsite problems much earlier than managers who utilize third-party property management. This allows us to take constructive action earlier than they can. We can give orders to make things happen or

make the decision that it is time to get out. Our vertical integration gives us the ability to see things earlier, and then once we decide to act, the vertical integration gives us the ability to implement our plans much more seamlessly and quickly.

*What are the main components of TGM's success?*

**John Gochberg:** TGM is a specialist in multifamily properties. We have never strayed. We do it intensively, inclusive of operations and onsite management. The onsite staff are employees and part of the TGM family. Obviously, we do our own property management to fully control and implement a property's business plan. We do not provide third-party property management services to anyone else. This specialization is supported by a staff that has been remarkably stable over the years and extremely specialized. Our organization is quite similar to the classic military line and staff structure, for we are constantly training and operating based upon experience and lessons learned at various properties. Additionally, we believe strongly in promoting from within, and many of our national leaders started as onsite staff.

*When you're hiring somebody, is there a particular skill set, experience set or mindset that you're looking for?*

**John Gochberg:** We have a very unusual corporate culture. We are an intense operating group. We have an incredible amount of training, structure and range of things that we expect from an onsite manager. Probably only 10 percent of our managers today are hired from outside TGM. The majority of them are promoted from within, and we spend an incredible amount of time training our army. We regularly move people around the

country in order to retain talent rather than lose them due to the sale of a property at which they work. Every job that is vacant at TGM is posted at every single property across the country. Anybody in any position can apply for any job anywhere in the United States.

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*I hate to be cynical, but it sounds like what you're doing is a lot more expensive than just hiring third parties.*

**John Gochberg:** You have no idea how loyal our people are. How much they care. How much they manifest their pride in ownership. They feel like they belong to more than just a single property. They feel they have a job that is part of a future, and they can see upward mobility. It brings an incredible amount of value to our organization. Thus, in our opinion, our methodology is less expensive and the cash returns greater to our clients. As an example, our cash returns have exceeded the NCREIF Property Index for many years.

**Frazzetta:** I've been here for 12 years. On two occasions, we have sold a third of our assets under management. Clearly, we are going to be in situations where we either have to cut heads or be prepared for TGM to take losses for a number of years while we

wait to rebuild assets under management. Consequently, we warehouse a lot of our staff. When we believe it's the right time to sell, we're prepared to use TGM's own working capital to support the in-place, high-quality staff that we don't want to lose. Because once you build the army, it is very inefficient and difficult to rebuild and retrain these human assets if you choose to dismantle it every time it's appropriate to be a net seller in your portfolio.

**Tom Gochberg:** There's nothing more important than having strong people who you trust and who know what their responsibilities are. It's irreplaceable. Thus, our people are immensely valuable to us.

*What have your returns been?*

**Frazzetta:** If you look at our NCREIF returns, we have exceeded both the Property Index and the Apartment Subindex since TGM's inception. We consistently exceed those indices on a cash basis, and there are lots of investors out there who would like to see consistently high levels of cash flow. We usually beat NCREIF's income return by 100 basis points or more, and then we're also beating it fairly consistently on the appreciation side. So you're getting both sides of the equation.

*What do you mean when you use the term "operator"?*

**John Gochberg:** At TGM, we are an operator of properties. We own the property management process from end to end. We manage everything directly in-house. We run all our own leasing, we run all our own construction, we run all our own maintenance. Do we have a construction team capable of developing? Absolutely, but we rebuild, we remodel, we rehab. We don't build properties. We have probably done more interior renovation than anyone else in the country. For other firms, operations are what happens at the properties and the management of the properties is done by third parties. Some of our counterparts have an operations group, an acquisitions group, a money-raising group — and the different groups don't even talk to one

## CORPORATE OVERVIEW

TGM Associates is an investment advisory firm with a single focus: multifamily properties. On behalf of its investor clients, TGM acquires, manages and sells apartment properties throughout the United States. Since 1991, TGM has invested more than \$2.2 billion in 123 multifamily residential properties throughout 28 states. TGM's current portfolio contains 30 properties in 14 states with more than 9,600 units (a historically low number of units for TGM as the firm has been a net seller for the past several years).

another. They run in silos. We are a vertically integrated organization, and when our acquisitions group is looking at a property, they are communicating with TGM's operations group to get information to underwrite it, and when due diligence starts, the operations group takes over and starts confirming the underwriting of the deal and making sure they are going to be able to bring it in at the projected numbers. The greatest rule that I, as head of due diligence, use is: Once you buy a deal, you are stuck with that deal. No matter how well we run it, we can never make up for overpaying for a property. The most important thing is: If you don't believe in a property or you are unsure about it, walk away.

*Give me an example of how you guys achieve value in a way that most of your competitors might have missed or might not have done.*

**Frazzetta:** We are unaware of anybody that does interior value-add the way we do it.

*Really?*

**John Gochberg:** We are capable of rehabbing an entire apartment interior, except for painting the walls and carpet replacement, in one day, including occupied units. We can do this because our rehab methodology does not disturb the existing residents, who are out of their apartments working while the rehab is done during one business day. In consequence, we do not incur vacancy loss or re-leasing expense. Our rehab teams are capable of rehabbing three to five units per day, per team and move methodically through an entire property from start to completion, instead of rehabbing as apartments turn over as is traditionally done in the industry. As a result, we can complete the entire rehab of a 300-unit property in only three months. Additionally, doing an interior value-add across an entire property at once allows for major cost savings to occur on labor, waste disposal, materials and pricing on appliances, and we have a more powerful negotiating position when negotiating contracts because

we are doing it as a whole property and not individual units at a time. It means that as the leases roll over, we increase rents without incurring any vacancy loss.

*How have you managed to be able to do that?*

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**John Gochberg:** Let me be clear, to do it in a day, the organizational time is anywhere from two to three months. In advance, you have measured every unit, and designed, built and prepped the cabinets. Remember, you are showing up at one moment in time with all your appliances, all your lights, all your door hardware, all your new cabinets, all your new bathroom vanities, all your plumbing fixtures. Everything has to show up at once, and your workers are ripping an apartment out, putting a new apartment in, and doing this in three to five units at a time, per team, at a property. If one component doesn't show up, the whole process has to stop, so it is critical to have it all planned out well in advance.

*What is your cost differential?*

**Frazzetta:** We can rehab a property for about 60 percent less than what it costs our competitors because of this process.

**John Gochberg:** We buy properties where we truly believe that the value-add improvements will pay off. And if we believe that the value-add will pay off, then during the due diligence process we have already priced, organized and prepped for this. So we are about two or three months away from starting construction when we

take title of the property. Therefore, the value-add is completed within the first year, allowing for NOI increases to occur much earlier than if the value-add is performed when units turn at lease rollover.

**Frazzetta:** We understand the rehab process; we understand how to do it and what it costs. The risk to us is not the rehab process. The risk to us is whether we will get the rent bumps. So the key in the due diligence process is to make sure, when we buy a building with the intent to add value, we can increase the property's income to get an appropriate return on the added investment. That requires an intense understanding of comparables and whether the marketplace will allow the rent increases that will justify the cost of the rehab process.

**John Gochberg:** We can also do a smaller rent increase than most people today because we can get it done in less time and at a lower cost in the first year. So we can increase the rent charges to a lesser degree going into year two, basically as the leases roll. Whereas the average firm that takes two to three years to roll the same size property is at a disadvantage, as they have taken much longer before they start getting the increased rents, which means they will need to get much higher rent bumps to achieve the same level of return.

*What is the one thing somebody should take away from the article?*

**Frazzetta:** I think what they should take away is that TGM does only one thing, multifamily investing. We have been doing it intensely for a long time, and we do that one thing very well. ❖

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