

Harrison Street Real Estate Capital

Recently, **Geoffrey Dohrmann**, publisher and editor-in-chief of The Institutional Real Estate Letter – Americas, spoke with **Christopher Merrill** and **Dean Egerter** of Harrison Street Real Estate Capital. The following is an excerpt of that conversation.

Since you started Harrison Street in 2005, have you seen any changes in institutional investors' perception of the student housing, medical office, senior housing and self-storage sectors?

Dean Egerter: These asset classes are more accepted today than when we started raising our first fund in 2006, and that is primarily due to the strong performance they had during the recent downturn. Investors understand they are needs-based real estate driven by long-term demographic trends, which have cycled differently than traditional property types. It is also better understood that these asset classes provide diversification from the traditional property types. Investors have now moved from the question of whether these sectors fit in their portfolio to the question of how to best access exposure to these sectors.

What is the outlook for how these property types are going to perform over the next three to five years?

Christopher Merrill: These properties have shown the ability to preserve capital in a down market, but they can still capture very positive returns in an up market. They can be a better hedge against inflation due to their generally short-term leases — student housing and senior housing have annual leases, and self-storage has month-to-month leases.

How have you handled the growth of the firm?

Merrill: Our growth has come out of the investment strategy that we set up from the beginning. As we have invested in these segments, we have had to invest in our platform while at the same time we have had to grow our staff. Even though we have had some very solid growth in assets under management, we have also disposed of a large amount of assets. We have realized on over \$2.0 billion in gross real estate over the past two years. Having this level of full-circle transactions has been a terrific aspect of our business.

Is there anything specific that you had to do because of the nature of the assets in which you invest?

Merrill: Research is one area. For instance, you cannot get an off-the-shelf student housing report



Christopher Merrill is the Co-founder, President and CEO of Harrison Street Real Estate Capital, as well as a member of the board of directors and chairman of the investment and management committees of the company. During his career, Merrill has acquired and/or developed more than \$12 billion of real estate in both the U.S. and Europe on behalf of some of the world's largest investors in all segments of the property markets.



Dean Egerter is a Principal of Harrison Street Real Estate Capital and serves on its management and investment committees. He has responsibility for portfolio oversight of the firm's Opportunistic Fund series, which has raised over \$2.1 billion of discretionary capital including co-investment capital for investment in education, healthcare and storage properties. These funds have invested in over \$6 billion of gross cost real estate and to date have realized on over \$2.0 billion of that real estate. He also acts as the firm's Chief Capital Markets Officer, managing lender relationships and all interest rate derivatives and works on the development of new product/sector initiatives.

on Ann Arbor, where the University of Michigan is located, as you can the Chicago office market. We had to create a boots-on-the-ground process of doing research on the markets in which we invest. Another area is efficiency. Our asset classes involve smaller equity investments. As we all know, closing on a \$5 million investment takes the same amount of work and due diligence as a \$100 million investment. As such, it takes a robust and efficient closing process. We have invested a large amount in our Harrison Street University, which comes out of our Motorola roots, and we have a team of people continuously looking at how we can enhance our policies and procedures.

When somebody goes through Harrison Street University, how does it work?

Merrill: Every employee goes through what we call white belt training, which is a cursory overview of certain processes such as Six Sigma, with which many people are very familiar. About 25 percent to 30 percent of our employees take it further and go through green belt training, which is a more detailed process of taking project or a process and really revamping it. And we may

have two or three processes revamped in a given year. Our Harrison Street University team also spends time with our operating partners in a similar fashion as a consulting business in a private equity firm. We do not own the property management companies that work with us, but if we can enhance the way they operate their companies, then that in turn will generate better real estate performance and better returns for our LPs.

Egarter: It engenders continuous improvement. When you have a focus on Six Sigma, and you bring people in who see how it is being used to enhance processes and to deliver benefits for our investors as well as our operating partners, then they buy in and continue to see if there are better ways of improving what we already have.

And the Galvin family has been your partners in this business since the beginning. What legacy has that given Harrison Street?

Merrill: Chris Galvin is our chairman, his brother Mike Galvin is our vice chairman, and they remain very active in the creation of our business culture. The Galvins' focus has been if you can really differentiate your business and go where others aren't, while it may seem more risky, it actually is a less risky place to be. And if you are not inventing something new — whether an investment strategy, a process, etc. — it is not innovation.

Egarter: If you can be unique and if you can be differentiated, then investors do listen to what you have to say. They may not want what you offer, but they know it is something different that they need to spend some time trying to figure out.

Where does your funding come from?

Merrill: We now have two main sources of capital. We started our firm with traditional closed-end opportunistic funds. We have launched four funds since 2006; the first was a \$200 million fund, then a \$430 million fund, then a \$600 million fund and then most recently a \$750 million fund. And while we were doing that a number of things happened. One, we saw how well our asset classes preserved capital during the downturn. We also heard from many investors who were looking for income and lower leverage. They did not want development exposure. And we realized our asset classes would be very interesting in a core structure. At the end of 2011, we launched an open-end core fund.

How does having two sources of capital help you with development partners and investment sourcing?

Merrill: Within our sectors of student housing, senior housing, medical office and self-storage, we now have the full cost of capital to transact a new asset. Because we have both core and opportunistic money,

it is enhancing the brand within these segments. We recently purchased a large portfolio of medical office buildings in the Washington, D.C., market. We would not have been able to do it without two capital buckets. Some assets went into our opportunistic fund, and some went into our core fund.

You acquired what is now known as Harrison Street Securities in 2011. Has the acquisition changed their approach?

Merrill: Harrison Street Securities invests in the REIT market in a differentiated way, with a focus on North America only and a sector-neutral strategy, which allows us to focus on the best companies rather than trying to pick which sector is going to outperform. There are a number of things we have done to supplement the unit's business model. By being part of our platform, we have added new software and we have added to the team. And, finally, we see the results. Since the firm joined us, Harrison Street Securities has grown more than three times in AUM.

What do you see as the growth areas for Harrison Street moving forward?

Merrill: We see great growth ahead in our target sectors over the next 10 to 15 years. We see the growth in the education and healthcare sectors as very positive. We will continue to grow our opportunistic strategy, and we will continue to grow our core fund. Additionally, we are excited about the prospects of our Harrison Street Securities platform.

Egarter: We are going to continue to focus on trying to bring unique and differentiated products to the market. Some of that may be similar to what we did with Harrison Street Securities in terms of bringing an existing team onto the platform, or some of it may be as we did with the core fund in terms of introducing a new product to the market. ❖

CORPORATE OVERVIEW

Harrison Street is a real estate private equity firm founded in 2005 that directly and through its affiliates, has approximately \$6.0 billion in assets under management through commingled funds and public securities products. The commingled funds focus exclusively on the education, healthcare and storage segments of the U.S. real estate market. Harrison Street Securities LLC currently manages more than \$850 million in REIT securities through three, distinct long-only investment vehicles.

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