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Bentall Kennedy

*Recently, **Jonathan A. Schein,** managing director business development at Institutional Real Estate, Inc., spoke with **David Antonelli** of Bentall Kennedy. The following is an excerpt of that conversation.*

David Antonelli is an executive vice president at Bentall Kennedy U.S. and portfolio manager of the Multi-Employer Property Trust (MEPT), the firm's open-end commingled private equity real estate fund. It is one of the largest real estate equity funds in the United States. David also serves on the firm's investment and management committees. David has worked in real estate investment management for over 25 years. His experience includes portfolio management, investor relations, acquisitions, dispositions, financings, investment structuring and restructuring, and asset management.

Let's start with an overview of MEPT. What is MEPT, and how does it fit in Bentall Kennedy's product line?

MEPT is a $7 billion, open-end, U.S real estate fund that Bentall Kennedy co-founded in 1982. The fund's primary goal is to provide competitive, risk-adjusted core returns, including a strong income component. The strategy focuses on maintaining stable income; building a diversified, modern portfolio; and providing superior liquidity. MEPT also has a strong commitment to the principles of responsible property investing. This strategy seems to resonate with investors, as evidenced by the fact that we have over 320 institutional investors in the fund, making it one of the largest private equity real estate funds in the United States.

What differentiates MEPT from other open-end commingled funds?

Several aspects of the MEPT strategy differentiate the fund, including the strong stable income generated by the portfolio, the build-to-core development approach, its liquidity track record and its leadership in responsible property investing. MEPT has also achieved strong long-term performance — 7.95 percent annual return, before fees — since inception, which was 33 years ago. That exceeds most pension funds' actuarial requirements as well as the NFI-ODCE benchmark. We have first quartile performance in the NFI-ODCE for the 12-month period ending December 2014, and we have outperformed the peer group since inception.

How do you achieve those returns?

Performance starts on the buy. At Bentall Kennedy we have an industry-leading research and strategy team led by Doug Poutasse and his group of economists. This team has been a guiding force driving our strategy and helping us find the right markets and sectors for investment. In addition to asset selection, income from property operations is the key performance driver in a core portfolio. Our asset management team takes a hands-on approach to managing the MEPT portfolio, and we maintain tight controls and quality processes aimed at effectively managing tenant relationships, revenue and expenses. The fund features a development component, which helps us maintain a modern portfolio while enhancing returns.

How does development fit into a core risk profile?

It's actually a build-to-core strategy, which is structured to add alpha to the portfolio. With pricing and competition for prime, institutional core assets rising quickly in the past few years — assets are often selling at or above replacement cost — we've found that developing our own core assets makes a lot of sense. MEPT has always had a substantial development component and since mid-2010, MEPT has committed over $900 million in equity to develop in excess of $1.5 billion in new construction. Once properties are built and stabilized, they become cash-flowing core assets in our target markets. This strategy replenishes the portfolio with modern, class A properties while allowing the investors in the fund to share in the development profits. Development should not be a large component of a core portfolio, but the 10 percent of NAV that we allocate for development has proven very beneficial to the overall portfolio returns.

What besides strong performance differentiates MEPT?

With a history of more than 30 years, MEPT is one of the longest running open-end, core real estate funds in the market, as well as one of the largest. We now have a gross asset value of $7 billion, with 242 buildings in 25 markets, and we continue to see both increasing assets and expanding investor relationships. MEPT is large enough to provide broad diversification, while nimble enough to make the investments and adjustments to strategies that drive our returns and performance. With an operating portfolio of 30 million square feet that is over 90 percent leased, MEPT's ability to deliver stable income is also a key differentiator.

One of the factors on investors' minds is liquidity. How does MEPT handle redemptions?

Providing liquidity for our investors is one of our primary objectives, and our management team is proud of our outstanding track record of providing liquidity over the fund's 30-plus year history. While other funds have queues to invest, MEPT is open for investment.

Where is your investment focus at the moment?

The portfolio currently holds assets in 25 markets, but over 60 percent of our investment is concentrated in major markets including Boston, Los Angeles, New York, San Francisco, Seattle and Washington, D.C. These six markets are high barrier-to-entry, primary markets that are hubs for innovation with highly educated workforces. We have selective exposure in some smaller markets, but our primary focus is the larger, vibrant markets of the east and west coasts.

These are highly competitive markets. How have you been able to deploy capital in this environment?

Deploying capital is the largest challenge we have right now. We are able to do it, however, because we have strong on-the-ground transaction teams that have developed deep relationships with the local market participants. We also have a reputation of doing what we say we are going to do. That reputation puts us at a competitive advantage and enables us to compete for assets both on and off market. But there is no question that the market is very competitive so we've increased our efforts in order to get our share of acquisition and development transactions that satisfy our return requirements.

What opportunities are you finding most attractive?

We are a diversified fund, so we are investing in all four property types, but all property types aren't equal. Each will all be affected to varying degrees by the key future drivers of real estate — demographics and job creation. These drivers will be most compelling in markets that have well-educated populations, as well as innovative economies. Demographics are driving a re-urbanization trend, as the key demographic groups define their live/work/play environments with a focus on amenities, transit access and walkability. Delivering appropriate product for the evolving needs of the two big demographic cohorts — aging baby boomers and the coming-of-age millenials — in select primary markets is going to be essential. That means build-to-core development is going to be an increasingly compelling opportunity. The property focus for us in these innovation-driven markets will be CBD office, as well as urban high-rise apartments. In the industrial and retail sectors, we want to capture the growth of e-commerce and will be looking at high-volume warehouse distribution product near major population centers. Conversely, we see the growth of e-commerce as a threat to traditional retail, so we are being selective with a focus on necessity goods providers such as grocery-anchored centers and on urban, walkable, experiential retail. Although primary markets will remain our focus, there are a few secondary markets such as Denver, Austin, Raleigh, Charlotte and Portland, Ore., that also feature strong job-creation industries, such as technology, healthcare, education and energy. These cities have a growing millenial demographic that is looking for the livability and vibrant lifestyle these markets offer.

Earlier, you touched on the importance of sustainability and ESG practices in your strategy. Can you expand on that a bit?

Sustainability is at the core of all that drives excellence in our real estate management practice, and this core value aligns very well with the demand for sustainable properties by corporate, government and individual tenants. The investor community is also driving increased environmental consciousness. The Global Real Estate Sustainability Benchmark — GRESB — was founded with the support of the institutional investors we serve. So we take particular pride in the fact that MEPT is ranked as the number one U.S. diversified fund in the 2014 GRESB survey.

You sometimes hear managers claim that sustainability practices reduce returns. How do you respond?

We believe that reduced operating costs, such as those relating to energy enhancements, can improve returns. But the positive effects of ESG measures are more apparent from a risk mitigation standpoint. We may see nominally higher costs at the outset, but over the long term, sustainable practices will result in higher tenant retention and, potentially, a lower cap rate or higher multiple on exit. These investments will hold up better over a longer cycle, generating a more durable income stream that will ultimately result in higher risk-adjusted total returns. So not only is it the right thing to do, but it is good business that results in better performance.

Where do you see the fund going in the future?

Our goal with MEPT is consistent delivery on returns and on our investment objectives. Our portfolio is in line with our strategic plan and target allocation, so our team can be very selective in seeking new investments. Bentall Kennedy intends to continue to dedicate significant resources to the MEPT strategy to find new and innovative ways to position MEPT for the future, to ensure that we continue to implement best-in-class practices, meet the needs of our investors and position the fund for strong performance. ❖