Q&A with Harrison Street's CEO

By: Bob Craig March 16, 2012

(Crain's) ð Christopher Merrill's firm represents continuity in a commercial real estate market that has seen big changes in recent years.

While other investors made and lost fortunes by investing in office, retail and other traditional property types, Harrison Street Real Estate Capital LLC, which Mr. Merrill co-founded in 2005, managed to avoid the volatility by buying student housing, self-storage and health care properties ð sectors less vulnerable to economic swings.

The ñthemes haven't changed,ò says Mr. Merrill, president and CEO of the Chicago-based firm. ñWe've just continued to refine how we invest in those asset classes.ò

Harrison Street owns or is developing about $3.1 billion in properties in 38 states, including more than 20,000 student housing beds, nearly 6,000 senior housing units, 1.1 million square feet of medical office space and 66,000 self-storage units.

Harrison Street has raised more than $2 billion from investors, focusing on developments and on so-called value-add investments ð properties that are undervalued or need some work but have appreciation potential.

In a shift, the firm launched a fund last year to buy stable properties for investors that favor income over appreciation. So far, Harrison Street has raised $300 million for its Core Property Fund.

Mr. Merrill, 40, co-founded Harrison Street with Christopher Galvin, the former chairman and CEO of Motorola Inc. started Harrison Street after a long career at Heitman, the Chicago-based investment firm. The Winnetka native is a graduate of Roanoke College in Salem, Va., and has an MBA from City University in London.

In a conversation with Crain's, Mr. Merrill discussed his latest fund and the current real estate market. Here are edited excerpts from that interview:

Crain's: How is the core fund different from your previous funds?

Mr. Merrill: At the end of last summer we finished the raising of our third opportunistic fund. That's a fund that focuses its return on 70 percent of the return coming from appreciation, so it's a lot of value-add, a lot of development, it's rehab and repositioning. It uses leverage. It uses 65 percent to 75 percent financing and it's a higher-return-type fund. That last fund we raised was about $600 million.

What we did, in order to complement that strategy, we created an income fund. A fund that uses lower leverage but 70 percent of the return comes from income. Where we go out and buy stabilized, fully leased student housing properties or medical properties. It allows us to provide investors very good, solid income returns. It's a nice complement for our business. We launched that at the end of November and we have about $300 million in that fund now.

Are you still drawing from the same investor pool?

We probably have about 100 different limited partners. A lot of very large pension funds, corporate funds, endowments, foundations and we've raised close to $2 billion of outside equity since we founded the business.

What are the challenges you see in continuing to grow your business over the next 12 months or so?

Given how these asset classes have performed there has been additional competition to these segments, so that always offers some challenges. We see the platform that we've built and the relationships that we have as allowing us to continue to invest in our segments. Given the size of the markets ð the markets are probably about $1 trillion in size, and they're highly fragmented ð there is room for additional competition.

We're fortunate that we've been able to raise some capital, so for us we're focusing on really how we continue to deploy in the right real estate at the right risk and return attributes. Then what we want to do is just to continue to focus on our segments within education, health care and storage. Are there other ways to invest in those asset classes to continue to meet our goals?

If you bought a property in 2007 did the real estate downturn impact your plans for selling it?

The markets in our segments, the net operating incomes (NOI) have really held up so we didn't see the volatility or the dips of occupancy and revenues that you've seen in office, retail and residential.

For instance, in medical office ð people are still going to the doctor. In senior housing people still needed an assisted-living facility. People are still going to school and people still stored goods. So, even in the downturn our properties held and you haven't seen wide fluctuations in capitalization rates. In a lot of cases we're actually exiting from some 2007 investments that people are very interested in given the market fundamentals.

It depends on the specific asset but we've seen very solid resilience in our asset classes, even stuff we bought in 2006, 2007 and 2008.