

■ The SHB interview

Michael Gordon

shares Harrison Street's real estate private equity strategy



In March 2013, Harrison Street Real Estate Capital's core property fund acquired seven Class A seniors housing properties located throughout Nassau and Suffolk counties on Long Island in New York for \$380 million. The Bristol Assisted Living at East Meadow was among the seven assets acquired. The Engel Burman Group, which developed all of the properties, continues to manage the assets. Harrison's core fund acquired the assets with a combination of equity and the assumption of existing debt from Freddie Mac.

By aligning itself with best-in-breed operators, the firm is delivering healthy returns for investors.

By Matt Valley

Michael Gordon has been instrumental in shaping the brand of Harrison Street Real Estate Capital, a Chicago-based real estate private equity firm. Gordon, who oversees Harrison Street's transactions group, is a key member of the professional team that runs the company today.

Harrison Street was launched in 2005 in partnership with Chris and Mike Galvin of the founding family of Motorola. (The name of the firm stems from Motorola's roots. Motorola began as the Galvin Manufacturing Co., which was located on Harrison Street in the Windy City.)

From the beginning, the firm's strategy has been to deploy capital in three niche property sectors: education, healthcare and storage. "We wanted to invest in recession-resistant, operationally intensive segments where the true value of our investment, and frankly the return profile, was largely predicated on the strength of our operating partners' platforms versus just commodity investing in office or retail or

industrial," says Gordon.

Harrison Street identifies best-in-breed operators with a proven track record and a philosophy similar to its own. In short, Harrison Street seeks to align itself with operators "laser-focused on their people, their customers, their brand and on partnering with an equity source that allows both of us to benefit from a long-term strategic partnership," says Gordon.

In the seniors housing arena, Harrison Street has aligned itself with about 15 operating partners, such as Maryland-based Brightview Senior Living and New York-based Engel Burman Group to name a few.

From its first deal in 2005 — the acquisition of an off-campus student housing property in the Carolinas — to today, Harrison Street has invested in roughly 430 properties nationwide with a gross real estate cost of \$8.7 billion.

In the seniors housing arena, Harrison focuses on private-pay rental properties that serve independent living, assisted living and memory care residents. "Approximately 50 percent

of the firm's capital has been deployed in the healthcare sector, which includes seniors housing and other healthcare related assets such as medical office buildings," says Gordon, a principal at the firm that now employs more than 60 people.

Through a series of closed-end, commingled opportunity funds as well as an open-end core fund, Harrison Street and its partners over the past decade have invested in approximately 115 seniors housing properties representing more than 12,800 units in 28 states. The gross real estate cost of those seniors housing properties is approximately \$2.75 billion.

Harrison Street's opportunity funds account for \$1.75 billion of that \$2.75 billion total investment. The remaining \$1 billion of investment is in the core fund. About 70 percent of Harrison Street's investments in the seniors housing sector have been in the form of acquisitions and 30 percent in the form of development.

In August, Harrison Street and Brightview Senior Living recapitalized 11 seniors housing properties in the Northeast for \$520 million. The properties are located in metro Boston; metro Baltimore; Philadelphia; Newport, R.I., and Staunton, Va.

Harrison Street acquired the portfolio from a large insurance company on behalf of Harrison Street Core Property Partners LP, its open-end fund, and Harrison Street Real Estate Partners IV LP, a \$750 million discretionary, closed-end fund. About half of the 1,600 units acquired are independent living, with the balance dedicated to assisted living and memory care.

Seniors Housing Business spoke with Gordon to gain more insight into the firm's investment vehicles and the relationships it has cultivated with operators. What follows is an edited transcript:

Seniors Housing Business: What do you want our readers to know about Harrison Street that they might not be aware of?

Michael Gordon: First and foremost, we are very research driven. We focus on what we consider to be the important metrics. We're focused on evaluating opportunities based on the merits of market, the competitive landscape, the economics behind what is being offered.

We reinforce to our investors the importance of understanding that true success within this business is much more predicated on your operating partner, on the programming that they offer, on their philosophy of care, on their brand, than it is on having an asset in a great location in a great submarket. If you don't have the right operating partner, you're not going to be successful.

While focusing on penetration rates, occupancy, location, market dynamics and a pro forma that shows a 12 percent stabilized yield is all well and good, it's paramount that you align yourself with an operating partner that really understands the importance of catering to its employees and residents. With that comes continuity of operations, low employee turnover and the ability to drive rental rates.

SHB: Since the company's inception, you've launched four closed-end opportunistic funds. How much did you raise in each fund?

Gordon: We launched our first fund in 2006. It was a \$208 million product. The second fund was a \$430 million product. Fund III was \$595 million. Fund IV is a \$750 million product. All of the capital we raise is discretionary and given our strong limited partnership base we have the ability to bring co-investment capital into

any investment opportunity. This gives us a lot of flexibility and affords us the ability to move very quickly on any size transaction.

SHB: What kind of return can an investor in your funds expect to receive?

Gordon: We reinforce to our investors that they should expect the appropriate return for the risk profile of a particular investment. Our goal is to build a well-diversified portfolio, so we tend to stay away from quoting individual property level returns. We have sold over \$2 billion in real estate in our segments, so we believe our investor base has been quite pleased with our performance.

SHB: Could you walk us through the lifespan of an opportunistic, close-end fund to give us some insight into how it works?

Gordon: Slice the fund into three different time periods: one time period being the investment period; the second being the value-add/asset management period; and the third being the liquidation or the disposition period. Our goal is to identify opportunities to invest in, to add value during the hold period.

The opportunities can range from building a property from the ground up and leasing and stabilizing the asset; buying an existing asset and rehabbing it; buying an existing asset and repositioning it; or buying an asset that works relatively well and experiences great oversized cash flow during the hold period.

Once we feel as though we have fully added value and stabilized a property or portfolio, we will create a disposition plan. There have been investments where we have expediently added value and stabilized and sold a property or portfolio within two or three years.

We've had other investments that we've held for the past eight years that we continue to benefit from great cash flow. So, a lot of it involves portfolio or fund management.

SHB: What is the objective of the Harrison Street Core Property Fund?

Gordon: On the opportunity fund side, we're really targeting a five- to seven-year hold, where a larger share of the return comes from appreciation. The core fund is an open-end, evergreen fund that is highly focused on consistent

income. We're looking for great assets with great partners in great locations, primarily in submarkets that have tremendous barriers to entry to ensure that our portfolio will continue to perform for a long period of time.

In the senior sector, we focus on assets that are more oriented toward an upper-middle-class or affluent resident with a higher acuity. With that comes high barriers to entry.

SHB: Who are the investors in the opportunistic funds?

Gordon: Our investor base consists of U.S. and foreign pension funds, corporate plans, insurance companies, endowments, foundations and large family offices. As a firm we have raised over \$4 billion in discretionary capital from over 160 different groups coming from seven countries. This diverse investor base gives us great flexibility when working with our partners.

We have a number of foreign pension funds that are investing in our platform. Frankly, a lot of them look at us as a great diversification tool. We are exposing them to [real estate sectors] that a lot of their current fund managers have a limited exposure to: education, healthcare and storage.

SHB: In the last few years, we've seen a number of REIT-to-REIT mergers and the consolidation of public companies such as Brookdale Senior Living and Emeritus Corp. in a \$2.8 billion deal. What impact are these publicly traded giants having on private equity firms such as Harrison Street?

Gordon: What's nice about our business is that we are focused on local and regional operating partners. To the extent that we can provide them with capital required to do what it is that they do best, they are happy. There are certain operating partners out there that prefer being one of many operating partners within a REIT's infrastructure. There are a lot of groups out there that don't.

Quite frankly, a number of our operating partners have been through REIT-driven deals and have elected to not participate in those anymore. They were either with us, left and came back or they would just rather align themselves with private equity.

As it relates to opportunities on the investment side, we're typically focused on things that are a little bit different than the REITs. The REITs are largely responding

to big transactions. Remember that the majority of our activities are still on the opportunity fund side, where we're focused on building or buying one asset or a few assets at a time. These are deals that are largely off the REITs' radar.

The one area where we are kind of playing in the same sandbox is on the core fund side, but companies like The Engel Burman Group and Brightview Senior Living would rather align themselves with a private equity company that they know, that isn't subject to quarterly earnings, that is perhaps a little bit more flexible in structure, that is a little bit more available as it relates to asset management and decision-making.

SHB: Can you give me an example of how you work with your joint venture partners?

Gordon: Years ago we were introduced to one of our joint venture partners, Bridgewood Property Group. (The Houston-based company is a developer of senior living communities.) The president and CEO is James Gray. He approached us with a project called The Village of the Woodlands Waterway, which coincidentally we're marketing for sale currently.

During the initial stages of getting to know each other, we fully underwrote his track record. He had built up a large operating platform and great portfolio, which he sold to one of the REITs years ago and he was retooling. We were tremendously impressed by his competency as a developer. We walked through a number of the assets that he had developed subsequent to his retooling and we spent a lot of time with his firm understanding the virtues of the Woodlands market.

The Woodlands is a submarket north of Houston that remains very strong from a housing value perspective, from a housing sales perspective, from an employment perspective through the recession. We spent time with him documenting relationships, collaborating to identify the optimal lender in a difficult lending environment to find construction financing.

His company started going vertical at a time when not many private equity guys or developers were either (a) willing to stomach ground-up development, or (b) able to put together the capital required to go vertical. We delivered the project very successfully a few years ago. We stabilized the

project and we're in the market right now to sell the project.

The development is a couple hundred units and includes independent living, assisted living and memory care. It's indisputably the highest-quality property within that submarket. It's won a lot of awards. It's a very well run community. During the course of our relationship from then to now, we've built up a portfolio with Bridgewood Property Group of roughly 13 or 14 assets.

SHB: What do you particularly like about the seniors housing space? What drives you?

Gordon: It's a dynamic industry. When we're evaluating an opportunity or walking through an asset, or discussing one of our communities with a partner or investor, it's more than discussing leasing and tenancy. It's more than looking at numbers on a page. We're evaluating businesses. We're evaluating opportunities that are so complex that it almost takes us out of pure real estate analytics and allows us to creatively discuss how we can do what we're doing better.

We spend a lot of time collaborating with our operating partners and sharing with them what we're seeing across the country. To see that infused in their programming and be successful is fun. In our own business, we're constantly reinforcing the importance of collaboration, being creative and strategic.

Within seniors housing, you have the ability to do that as it relates to activities, food service, healthcare, and the socialization that takes place between the residents and our employees. For us to be investors in an environment that allows for all that to happen is rewarding.

SHB: Can you provide any examples of that collaboration?

Gordon: One initiative that we're focused on right now is sustainability. We're starting to discuss with our joint venture partners the cause and effect of some significant expense savings related to implementing certain systems, whether they be solar, motion sensors, or water usage in our communities. To be able to share palpable evidence that, from a physical perspective, we can really enhance our income and thus the value of the real estate has been a major initiative that we are rolling out.

We also have an entity within Harrison Street called Harrison Street University that we utilize with new and existing operators. It is an entity developed by Motorola in the 1980s. It seeks to improve the quality of process outputs by identifying and removing the causes of defects and minimizing variability.

To help many of our operating partners, we're sending a team into the field to spend time with

their people. The team creates tailor-made programs to allow for our partners to identify some weaknesses as it relates to both their corporate systems and their real estate systems. Harrison Street works with them to eliminate those issues.

For example, with one of our partners we rolled out a program where we helped them to identify exactly how their executive direc-

tors were spending time. It turns out that they were spending a lot more time on administrative tasks than being out in the community and working alongside their people and their residents. We came up with a system that really reduced their responsibilities from an administrative standpoint, and that has led to tremendous resident satisfaction and employee satisfaction. ■

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