

The great REIM disruption?

Covid-19 has been the great accelerator of trends. While the real estate industry should finally become more efficient, local knowledge and experience still trumps technology in producing outsized returns and best-in-class real estate investment managers.

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Most of us have been through several severe economic and real estate market cycles. This time around, one phenomenon that has been consistent across geographies and industries is that Covid-19 has been “the great accelerator” of the evolution of social and business behaviors, whether the acceptance and efficiency of work from home or remote learning, or accelerating the Internet-based retail/delivery impact on bricks-and-mortar retail sites and last-mile distribution in opposite directions, or the technology additions required for businesses to adapt to the “new normal” business environment post Covid-19.

Prior to Covid-19, “disruptions” were taking place in most industries. In those “good old days” there were four primary technology-driven trends that disrupted industries:

1. Manufacturing and other tech-levered human productivity (e.g. robotics replacing assembly workers on the line).
2. Delivery of products and services that improve productivity (e.g. Zoom

replacing in-person meetings and Uber replacing taxis).

3. Communicating with one another and large groups “flatly” (e.g. Internet).
4. And big data, the aggregation of data and manipulation of information to better understand trends of social and business behavior.

We have observed, and participated occasionally, in the real estate industry’s multiple attempts to create new technologies that improve the incredibly interdisciplinary and complex set of decision-making processes in managing large real estate portfolios optimally. To make a respectful and friendly adaption of a Churchill-ism, *Once we run out of ideas that don’t work the real estate industry always does the right thing.* We believe that the real estate investment management business is finally becoming more efficient by leveraging technology and doing so faster and faster, whether by utilizing a complex set of existing software/services such as Yardi, Salesforce, Workday, Appfolio, Anaplan, MRI or by a custom build.

Local knowledge trumps technology

Natural selection has contributed to great return-generating REIMs becoming larger and larger AUM leaders. In fact, over the past decade it is estimated that the top 10% or so REIMs have raised more capital than the remaining 90% of firms. Should we conclude therefore that there will be five super REIMs in the post “Covid-19 accelerated” future state? We do not reach this conclusion. We believe that Moore’s Law has real natural limits to its geometry in the real estate business. These limits are due to the very multidisciplinary, multilayered, multisector, multi-structure, multimarket, and otherwise just complex decision-tree optionality that exists in real estate investing.

The technological advantages required for the largest REIMs to continue to grow at the same speed, never mind faster, and produce better-than-average returns are not available or cost-effectively implementable in the real estate business. Put simply, real estate still requires local knowledge and experience that trumps technology and technology-levered processes when it comes to producing outsized real estate returns and operating REIMs.

We do believe that the largest REIMs will continue to leverage technology to their advantage. However, we expect the path of least resistance and optimal near-term outcomes will lead to continued specialization and operational productivity within property sector silos. This could eventually make each property-sector-focused division/company most efficient as publicly traded companies or REITs.

Of course, REIMs that have consistently average to below average

returns will most likely be acquired, at least the assets and funds, by larger more profitable and technologically efficient REIMs. Further, other REIMs’ performance and growth will likely continue to be limited by the lack of autonomy in decision-making. For some this lack of autonomy is due to being one alternative asset class within a very large multi-asset class firm where real estate complexities are simply not understood or appreciated. For others, optimization of the internal REIM business may not be the primary consideration in optimizing outcomes for the overall company. For other REIMs, the retiring founding partners buyout still exists as a hurdle. These REIMs could become controlled by non-real estate investors through the founding partner buyout process. The REIM business is hard enough to excel in without spending critical time and attention convincing your own team to act for optimal growth of the REIM, tenants and investors.

Opportunities ahead

With these potential REIM market trends and a couple of continuing demographic trends:

1. Retirement, wealth and sovereign wealth portfolios continue to grow (after a serious Covid-19 adjustment) globally. Real estate allocations continue to grow globally from the benefits of real estate in a multi-asset class portfolio.
2. Growing populations have the desire and ability to pay for better and safer working, living and playing conditions.
3. More and more real estate continues to be transitioned (e.g. value-add and development) into the institutionally acceptable/securitizable assets.

4. Balancing profitability with community, diversity, environmental and common sense respectful communications considerations are growing more and more important every day.

Therefore, rather than the Covid acceleration being the dominance of super large REIMs eating up other average or below average REIMs, we believe that today’s conditions present an opportunity for the most prepared emerging REIMs to take advantage of the real estate technology that can be cost-effectively leveraged.

We can efficiently create a well-placed portfolio of levered equity development direct/co-investments in select cities where we have local advantages to deliver unbeatable real estate returns. Executing this approach while specializing in one property type adds critical operational excellence. This approach often provides outsized benefits to tenants, communities and cities, as well as outsized returns to investors.

Further, this new generation of REIMs can be exceptionally successful with a much smaller and specialized team, with much thinner overall fee levels to investors. Finally, the smaller team can mitigate specific project risks, and still offer risk mitigation through multi-city economic diversification. Therefore, we believe that the Covid-19 based acceleration in the REIM business will be the decade of the emerging REIM companies that are stakeholder-oriented, technologically efficient and have outstanding local insights. ♦

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