CRAVING the LIGHT

All corners of the commercial real estate industry are facing era-defining challenges. Transparency matters. Now more than ever.

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What holds promise for improving the business relationships we depend on for making better investments? All corners of the commercial real estate arena are facing era-defining challenges. Transparency matters—now more than ever. Being intentional and open in our dealings with our investors, employees, and communities will bring closeness to all our relationships—particularly those between managers and investors.

In this context, liquidity is a primary financial concern that has bubbled-up to the top of the worry list. The resulting anxiety is triggering an increase in redemption requests and unplanned capital calls. According to the May 29, 2020 IPE Real Assets report, the amount of institutional capital seeking to exit open-ended core real estate funds in the US has more than doubled since the beginning of the year to US$14.4 billion.[1]

Today's uncertain market valuation conditions exacerbate the complexity involved in balancing redemption payments with capital calls. How long it takes to clear these requests is yet to be seen. The significant question is, "How will managers, faced with today's challenges, hold their investors' trust while working through these issues?" Crisis reveals character and character is revealed through the ongoing process of transparency.

The Necessity of Transparency (It's More Than *Just* a Word)

Prior to the Great Financial Crisis (GFC), transparency in the real estate sector was "nice to have," but not always pressed as a serious issue. Fast forward to today, and the practice of transparency has grown into a necessity. In fact, the Economist Intelligence Unit (EIU) conducted a survey in February 2017 (more than seven years post-GFC) of 200 investment managers in the alternative asset class space. The result of the survey showed 63% of the respondents listed "degree of transparency" as "very important" and well ahead of all other investment considerations.[2]

Investors by nature are hyper-curious. With curiosity comes the desire to learn, which drives exploration and inquiries. An intellectually curious investor thirsts for information and data in order to make prudent and profitable decisions. One vehicle, in particular, relies on curiosity for its development: a separate account is open to implementing any given strategy birthed from investor curiosity and its investment beliefs. The investor is, by definition, an active participant in this account. This proactive role enhances transparency at each step of the investment process. The more comfortable a manager is in welcoming its investors to the decision-making table, the greater the trust.

What does transparency actually look like? How does it get delivered from the manager to the investor? Following are five examples demonstrating a manager's transparency in various situations that often occur throughout the investor/manager relationship.

Allocation of Investment Opportunities

Situation: Investment opportunities available at any one time in a manager's pipeline are dynamic. When the demand exceeds the pipeline's bandwidth, the manager typically resorts to its written allocation policy. While the steps involved in those policies differ by manager, the need for consistent and transparent application is essential to ensure equitable and non-biased outcomes.

Solution: Routine investor reports should include a schedule showing the manager's pipeline, the allocation of those opportunities being pursued, and a list of recently closed transactions. Any surprises revealed may indicate a need to strengthen investor/manager communications and investment aspirations.

Shared Beliefs

Situation: Investors want to see their managers devoting significant focus and attention—from across their respective organizations—on their particular needs. Active management of their physical assets easily becomes the go-to focal point, yet this is only one piece of what's involved in meeting an investor's needs. A premium is attributed to those managers that actively manage assets, and anticipate and participate in the specific needs of investors.

Solution: Don't assume a manager knows everything important to the investor. Managers should spend dedicated time asking questions so that they can gain a mutual understanding of investment philosophy and shared beliefs. The development of these dialogue-based relationships over time is vital as each conversation builds a framework of knowledge that allows both investor and manager to be more effective.

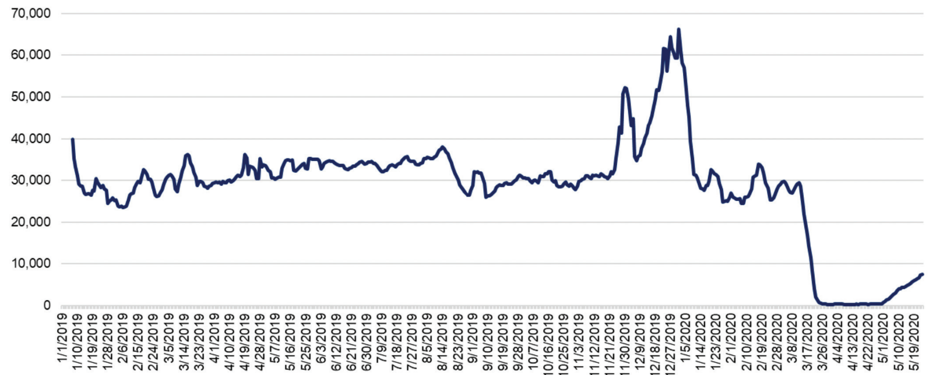
Information Flow

Situation: There are a handful of methods to earn alpha. The conventional wisdom focuses on four: information flow, operational capabilities, sourcing, and problem solving. Ideas and critical thinking applied to any of these techniques is destined to add value. The greater the transparency involved in each step, the higher the potential reward.

Solution: To better understand what it looks like building transparency into each step, take the information flow and problem-solving pieces and look at each independently and then together. Whether assessing the pros and cons of a new investment opportunity or authoring an annual investment plan, the more dialogue and exchange of information between the manager and investor, the more robust and energic the feedback loop. Leveraging off one another's knowledge will stir the imagination needed to move new investment ideas forward. The union of investor and manager working side by side unlocks creativity and drives evolution.

Exhibit 1: Estimated daily visits at Upscale Center in Texas from January 2019 to May 2020*

Sources: Placer.ai, L&B Realty Advisors
**Using a seven-day moving average*



Harnessing Big Data

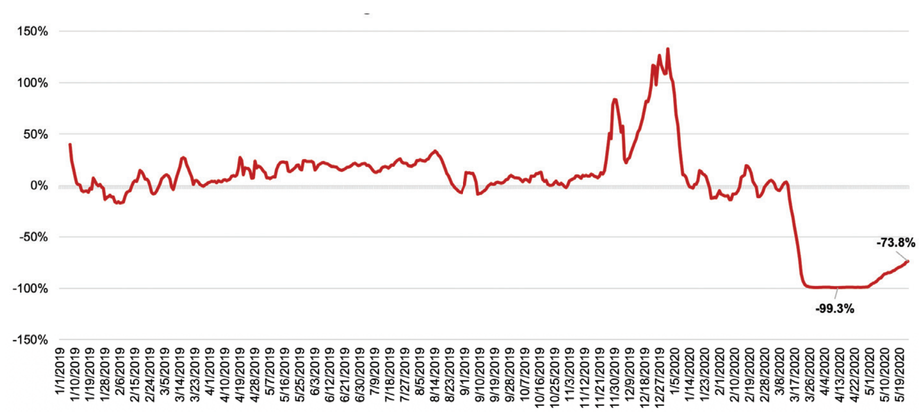
It has been said that, "if you torture the data enough, it will confess." This warning takes on new meaning in a world of big data and amid the proliferation of new property technology (proptech) tools now available to commercial real estate players. Exponential growth in computing power has made it possible to store and analyze oceans of data, but interpreting the data requires experience, integrity, and reasoned judgements.

Situation: It is well known that the retail property sector is under immense pressure as a result of the current pandemic, as well as long-term trends favoring online shopping. Using the proptech tool Placer.ai, which tracks foot traffic at shopping centers using cell phone location data, we can tell two stories about a particular upscale Center in Texas.

In Exhibit 1, one can quite clearly see the explosion in traffic associated with the holiday shopping season, as well as the steep drop-off in traffic during March 2020 associated with local "stay-at-home" orders due to the coronavirus.

Exhibit 2: Estimated customer visits at Upscale Center in Texas from January 2019 to May 2020 with baseline*

Sources: Placer.ai, L&B Realty Advisors
**Measures change in estimated visits compared to normal traffic volume for that day*



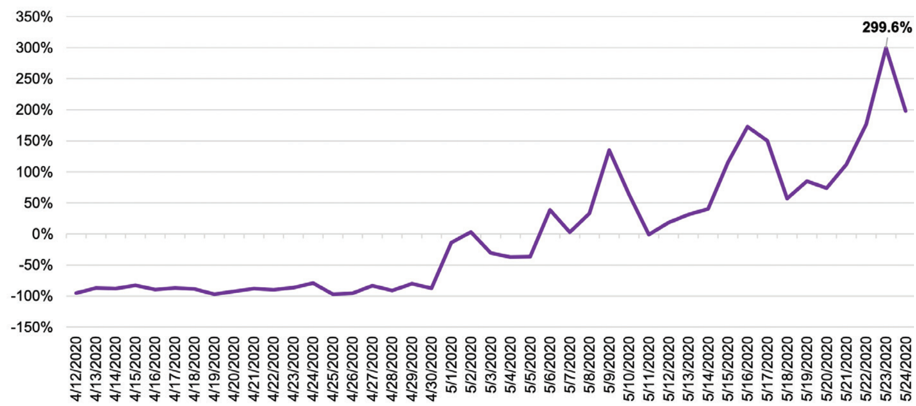
To more clearly show how the current number of visits reflects a departure from the "normal" number of visits this center typically experiences, we can compare recent visits against the "baseline" of typical visits for this time of year (Exhibit 2).

Exhibit 2 shows that during most of March and April, visits to the Center were effectively 100% below what the Center typically experiences in the spring months. However, as a result of a limited reopening, visits to the Center have increased, but remain about 74% below what is "normal."

Solution: This is as close to the "true story" for this Center as we can get using the Placer.ai data. However, given the impact of the limited reopening on the change in foot traffic at this property, a much different story could be told if we limit the time frame to capture only the period from mid-April to mid-May. Exhibit 3 shows the same change in foot traffic compared to the baseline as Exhibit 2, but with a different time period.

Exhibit 3: Customer visits at Upscale Center in Texas from April 2020 to May 2020 with constrained time frame

Sources: Placer.ai, L&B Realty Advisors



On its own, Exhibit 3 would give the impression that foot traffic at the Center has exploded in recent days, gaining nearly 300% the normal traffic expected on these days. However, by restricting the time frame used in the analysis, Exhibit 3 shows the increase in *visits compared to a period in which the center was effectively closed.* Any growth from zero visits will appear to be explosive.

Context is everything when interpreting data. Additional information and interpretation is frequently needed, if not required, to adequately explain how data has been interpreted so that the story it tells is authentic.

Telling the Complete Story

Situation: The small number of high-quality proptech firms incentivizes them to closely guard the underlying methodologies that form their value proposition. Proptech's current love affair with AI and big data analytics technology is easy to understand, because firms in this space can predict trends and boost profitability. However, investors should measure the outcomes for statistical algorithms and machine-learning technology to tell the complete story.

Solution: How do we know the technology works? Even with the curtain being only partially drawn we can see the outcome and measure the results. For example, Carbon Lighthouse is a provider of energy savings that uses big data analysis, machine learning, and AI-driven technology to reduce electricity consumption in the commercial real estate space. Their model attempts to solve for the competing needs to protect the privacy of their patented algorithm while at the same time assuring a specific outcome for investors. Carbon Lighthouse guarantees a minimum annual financial savings for the entire term, thereby demonstrating confidence in their technology until a proven track record is established to validate the efficacy of the technology.

Where Do We Go from Here?

Is the DNA of the manager's culture receptive to giving the investor authentic ownership throughout the investment process? Whether that question suggests friction or collaboration determines the level and quality of transparency. Looking closely at a manager's own workplace provides a powerful glimpse into its culture. More than likely, the degree of transparency practiced up and down the hallways will be what the investor should expect to experience.

Holding lasting trust is never easy, yet even with today's challenges, a manager whose business dealings are grounded in transparent practices will be positioned to deliver better investments. Transparency starts with opening up to those around us to reveal deeper and more authentic relationships. It empowers investors and managers alike and clears the space so that all stakeholders can focus on making better investments.

About the Author

G. Andrews Smith is CEO of L&B Realty Advisors, an employee-owned real estate investment advisor offering real estate investment management services to institutional investors.

Notes

[1] Jon Peterson, "US Core Real Estate Funds' Redemption Queues Reach $14.4bn," IPE Real Assets (May 29, 2020), realassets.ipe.com/news/us-core-real-estate-funds-redemption-queues-reach-144bn/10045900.article

[2] Economist Intelligence Unit, "The Path to Transparency in Alternatives Investing," The Economist (May 24, 2017), eiuperspectives.economist.com/financial-services/path-transparency-alternatives-investing