Vol. XIX, Issue 7

Emerging Manager Monthly

The Trusted Source for Emerging Managers

July 2024

Real Estate Program Aims To Broaden Opportunity Set

The recently funded emerging manager real estate program at the New Jersey Division of Investment is designed to give the plan access to managers that would normally be out of the $100.1 billion plan's reach, according to a real estate panel from the organization's June 26 virtual conference.

The pension plan launched its real estate emerging manager program with a $250 million commitment to GCM Grosvenor in 2023 and made its first investments earlier this year, NJ DOI Head of Real Estate Kevin Higgins said, during a panel with GCM Grosvenor Managing Director and Head of Real Estate Investments Peter Braffman

GCM allows NJ DOI to access emerging managers that would normally be out of reach given the division's investment limitations of being 20% of a manager's assets under management and 20% of a fund as well as its real estate check size of between $150 million and $350 million, according to Higgins.

"We really provide that kind of service to work with someone like Kevin and be able to work with managers in a way that gets around some of the restraints that large plans have in accessing smaller platforms," Braffman said. "The 20% limit is ubiquitous and the check size threshold is another problem, so we purposefully designed this program to get around those issues."

The program utilizes an open architecture model, in which GCM has the ability to invest in deals, programmatic joint ventures, seeding strategies, anchor funds, co-investments, direct funds and dynamic GP capital solutions on behalf of the division.

"Conceptually, we're trying to do full lifecycle investing. We're going to start with a team, ideally just as they're getting going, and be the capital partner. We're not going to be restrained by saying, 'Well, until you get other capital, we can't invest with you.' Then, the whole goal is for you to raise third party capital and we want to enable that formation and that could mean by helping on the GP side or seeding your funds," Braffman said. "And as your platform grows and raises new funds, then we'll support that fund business. If you want to raise new strategies, then we'll support that as well. Ultimately, it all leads to graduation, and, at that point, the concept of graduating isn't that you weren't good before; you're great and it's just about scaling. You scaled enough now that Kevin and his plan can invest with you."

While Braffman noted that an emerging manager is technically defined as a firm with less than $2 billion in total assets under management, no more than three fund offerings and a fund target size of $1 billion or less, he believes that the manager universe is expanding as firms with up to $3 billion in assets and up to four funds are now being considered emerging.

"There has been movement to enlarge these metrics a little bit. If someone has up to $3 billion in AUM, often that constitutes as still being emerging," he said. "And, for New Jersey, they've adopted that kind of broad metric. This just gives groups a long time to be in the program because often when groups scale up, they're not scaling sufficiently for Kevin to invest directly himself on behalf of New Jersey. So, it gives time for groups to get bigger and scale their practices. We're trying to find teams who want to be investment management platforms and scale them to the point where they can be truly one of New Jersey's partners and they can accommodate the check size that New Jersey is looking to invest."

Specifically, GCM is seeking emerging managers for the program that have an attributable track record within their strategy, ability to source investment opportunities, a history of working together and are experienced investment professionals.

"We need to find teams that act as good investors and are good fiduciaries," Braffman said, noting that the program primarily targets U.S. real estate but invests broadly across the capital stack and asset class, including hotel, industrial, multi-family, office, residential, retail and niche real estate.

When it comes to due diligence, GCM evaluates how an emerging manager invests and what they invest in, acts as a fund operator, works with operating partners and/or debt partners and protects capital, according to Braffman, who noted that for emerging managers that have not yet raised an inaugural fund, GCM analyzes how the firms have worked with other capital partners and how quickly they have been able to return capital.

"A lot of times, you're doing stuff nice at the deal level, you're building a nice portfolio, but are you getting money back to your LPs? And that's an essential part of being a fund manager," he said. "Obviously if you have a fund, we can see what you've done and if you haven't, we'll figure it out, but these are the types of things that we look for."

Braffman noted that GCM has seen the real estate emerging manager universe evolve and tracked 1,463 real estate emerging manager funds since 2010, an expansion of 146 funds per year.

"The plurality of [emerging managers] are diversified groups, meaning they do a number of different asset classes," he said. "But the truth is almost two-thirds of the universe are sector specialists, with multi-family being the biggest group and debt the second largest … And that's the inverse of the mature manager universe, which I would say is more about groups that are truly diversified because they're large asset managers. As the universe is growing and as these emerging managers are growing, more and more have become diversified because they're scaling."

Additionally, market dislocation has led to "extensive fund formation supporting private capital spin outs" and a new wave of emerging managers since the real estate asset class first became accessible to institu-

Continued On Next Page

REAL ESTATE: Managers Must Be Transparent With Allocators, Do Homework

Continued From Previous Page

tional capital in 1992, according to Braffman, who noted that capital disruptions, such as the savings and loan crisis in 1994, dotcom bubble in 2000, the Great Financial Crisis in 2008 and COVID in 2020, "have created stress in the market but have also created opportunity."

"When each of these disruptions happened, as real estate became cheaper because the values fell meaningfully, that also meant that it became an interesting moment for employees at other firms to evaluate whether they should stay at those firms or leave because the promotes that they were counting on were not as valuable or had no value anymore," he said. "The cost of leaving became much cheaper and we've seen that happen time and time again. Each of these events was not just a burst of real estate opportunity to acquire things, but real estate destruction and value leading to spin out teams coming out and starting new businesses."

Braffman advises prospective emerging managers to be transparent and an active investor; do their homework on NJ DOI, GCM and the landscape; have a concise pitch book that explains their uniqueness; build a thoughtful capital plan and a lasting platform; and provide correct contact information, the latter of which is "kind of silly" but often overlooked.

"One of the best meetings I ever had, the very first thing the manager said was, 'This is our strategy and we've done a couple of rounds of this, and we learned not to do these things.' Often what you won't do or what you've learned tells us more than, 'Here's another great deal we did,'" he said.

NJ DOI's Higgins even recalled a meeting where a manager opened the conversation by explaining the worst deal they had ever done and found the exchange to be refreshing as the firm highlighted the lessons acquired from their experiences.

Emerging managers should also have a team of representatives attend meetings because "you're going to be talking a lot and having someone who is just listening, watching us and our questions and the little things that we're saying is an important thing to have," according to Braffman, who noted that, overall, managers should avoid getting caught up by false expectations.

"We're going to be nice but be sure to ask for real feedback," he continued. "And don't just assume because it is a good conversation that an investment is remotely likely because it's going to be tough. There will be a lot of follow-ups, a lot of meetings; it's a long process. That's just true, generally speaking. Expect all of that going in and it will make your life better."

Additional coverage available in the July 2024 issue of Emerging Manager Monthly.
Click here to view the full issue.