INVESTMENT MANAGEMENT
MANDATE PIPELINE

Bob Gray, TerraCap Partners

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***Bob Gray** is managing partner at **TerraCap Partners**, a real estate investment and research firm. He is the newest participant to take part in IMMP's "5 Questions."*

IMMP: With most pension funds reporting dismal or negative 2012 performance numbers, why does TerraCap Partners think real estate was able to brave through the storm over the past annual period?

Gray: The climate for real estate investing is the best we have seen in a generation, especially commercial real estate in the Southeast and Florida. While stocks have been volatile over the past year and bonds are at dangerously high prices with very low yields, commercial real estate is just beginning to recover. Banks in the Southeast and elsewhere are being forced to sell commercial properties, including condo developments, hotels, office buildings and light industrial properties, at attractive prices. If you know the market and can get access to these deals, you are looking at very attractive rates of return. Florida, especially, is an area of increasing population growth and limited supply of housing – good demographic trends for real estate investment.

While signs of the residential turnaround are just starting to show up in the national numbers, we think commercial real estate, which typically lags residential recoveries, is the place to be right now. TerraCap's previous private equity real estate fund, raised in 2009, focused primarily on residential development. We are beginning to harvest those investments now and are realizing 30% or more internal rates of return (IRRs) on those deals. We are currently raising a commercial fund, TerraCap Partners II, dedicated to commercial investments in the Southeast.

IMMP: Acquisition of real estate assets may be one of the older strategies succeeding right now for pension funds and other large institutional investors. How would you characterize the longevity of such investments in today's volatile market?

Gray: After the recent down turn in this past real estate cycle it has become clear that a long only position can compromise returns especially if leverage is applied. At TerraCap we use limited to no leverage and have been buying as levels equal to 25%-50% of replacement costs. Our low basis replaces the need for leverage in order to attain returns in excess of 20%. This creates a strong defensive capital structure. Due to our low basis we are able to be more competitive with lease rates and will always be able to offer attractive rates against existing or new product. Self-liquidating funds that buy when the markets are soft and are active sellers during the up-cycle are best positioned for higher returns. Liquidation strategies of five to seven years such as TerraCap's tend to maximize returns and minimize long term market risk and exposure.

IMMP: Recent attraction to infrastructure can be seen by larger pension funds such as the **California State Teachers' Retirement System**. Do you think this is a right move for long-term investors?

Gray: I think what you are seeing with some institutional investors is a shift from stocks and bonds into more private equity, hard asset classes in order to meet their return requirements. Infrastructure is a good example of this. As the commercial real estate market begins to come back, new businesses and growing cities and towns will demand improved infrastructure and state and local governments will partner with the private sector to get these done. The trend towards infrastructure investing is another sign that institutional investors, after having been hit hard when the housing bubble burst, are stepping back into real estate investing.

IMMP: What trends is TerraCap seeing from its institutional and private clients? Why do you think this happening right now?

Gray: As mentioned before, we see institutional clients taking a very hard look at real estate investing; especially distressed real estate opportunities that help them meet their return objectives. Recent history and investment options are guiding institutions to evaluate alternative investments. Hard assets such as real estate in a recovering environment can act as a hedge against anticipated inflation while presenting strong returns to help groups offset realized or perceived losses or flat years. Institutions, especially pension funds are being very selective about which managers they choose and the risk profiles of the real estate funds they invest in. Many institutions are still very risk averse and do not want managers to use a lot of leverage.

IMMP: With Election Day just around the corner, which candidate do you think will have the most impact on the institutional investment world as we know it today?

Gray: Whoever the next president is must recognize the value of the private sector and the role it plays in job creation. Motivating small business and entrepreneurs is critical – this would include protecting lower taxes for those who invest in our economy (Capital Gains) and employer related taxes for those who are leaders and job creators. A broader net will have a much more positive impact than taxing the few. If motivated effectively, job creators can and will create millions of jobs in America, which will in return fuel economic growth.

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