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DEALS & DEALMAKERS

L&L, R.A. Cohen and Acadia execs talk current projects and business strategies

James Nelson of Cushman & Wakefield sat down with Ralph Della Cava from R.A. Cohen & Associates Inc., Joshua Carson from L&L Holding Company, Jessica Zaski from Acadia Realty Trust, and Can Tavsanoglu from XIN Development International Inc. to discuss their current projects and their business strategy in today's market.

James Nelson: Please tell us about your company and your current portfolios.

Ralph Della Cava: I am a principal at R.A. Cohen & Associates, a residential multi-family real estate company located in Manhattan with real estate investments in the greater New York area with a portfolio of more than 40 buildings located in Westchester and Manhattan, and areas of the Bronx and Brooklyn.

Joshua Carson: L&L Holding Company is an owner, operator and developer of New York City office buildings with a current portfolio exceeding six million square feet. Our bread and butter is large scale redevelopment and repositioning of existing buildings and selective ground-up projects.

Jessica Zaski: Acadia Realty Trust is a retail REIT, traded on the New York Stock Exchange. Additionally, we have a series of opportunity funds. These dual platforms allow us to play across the risk spectrum from fully stabilized trophy properties to ground-up development. In addition to our New York holdings, we also have a sizable portfolio in Chicago, the Northeast, the Mid-Atlantic-DC area and San Francisco.

Can Tavsanoglu: I am the director of acquisitions at XIN Development. We are the U.S. investment arm of a US publicly traded Chinese company called XINYUAN Real Estate Co, headquartered in Beijing. XIN is the first Chinese developer to build a large scale ground up development in New York without local partners.

James Nelson: What are your recent acquisitions, and business plans? What does your typical investment look like?

Ralph Della Cava: Traditionally, we invest with our own equity in neighborhoods that we expect to see real rental growth. Our business plan is to reposition these assets through redevelopment. In the past few years, we have made substantial investments south of 14th Street and evolving neighborhoods in Brooklyn.

Joshua Carson: A large focus for us now is our ground-up project at 425 Park Avenue, which is a new office development. We recently signed an anchor lease with Citadel, a great tenant to kick-off the office leasing. It is a complicated project to build, but there has not been a new block-front office building on Park Avenue in over 50 years. Most of our business though is renovating existing office buildings and doing what we call modern interventions. We see opportunity in properties where the owners do not have the credibility, the expertise, or the capital to bring their buildings into the modern era.

Jessica Zaski: We entered the San Francisco market last year with the purchase of City Center and subsequently bought four other properties there. We got onto Madison Avenue at 801 Madison. It has been more challenging to buy because pricing is extremely aggressive and we are starting to feel push back from our retailers who are saying there is not an endless opportunity for rent growth in every corridor. We have ambitious buying goals in 2016, both on the core and fund side so it will take some creativity.

Can Tavsanoglu: We are finishing up a 500,000 s/f development in Williamsburg that has done very well. We also just closed on development land in Midtown West to build a 135,000 s/f mixed use development with a large retail component and mid-market residential condos.

James Nelson: You have been able to buy these assets at a low price per foot, is that still possible today? Where do you see pricing levels headed?

Ralph Della Cava: I believe the main issue is trying to understand the price per square foot versus the gross potential of the asset. We want to understand if we are buying this property at a price of $10 million or $20 million, where do we think it will grow in value in the next five to ten years. I am more interested in understanding the overall value in time versus the annualized return in a given year.

Joshua Carson: There has been a huge escalation in price from the trough in 2010 to 2012. We have seen a real run up, but I think it has largely been driven by underlying fundamentals. Regardless of the market environment, our business plan is to see things that maybe others do not, no matter where we are in the cycle.

James Nelson: Retail is a major driver to achieve top pricing. How do you look at the retail component when underwriting?

Joshua Carson: Historically, the ground floor retail component of our office acquisitions has been secondary to our analysis. But with retail being a significant driver of valuation, we have become more sophisticated in understanding ground floor space, and we have looked to partner with retail experts as well.

Jessica Zaski: Retail is our focus. On the fund side, we are returns driven. The going in cap rate is somewhat irrelevant and we are looking a lot more at where we stabilize once we have executed our business plan for the property. For the REIT, we look to add high quality assets with contractual growth that will enhance the portfolio.

Can Tavsanoglu: There are not that many deals these days that make financial sense. Therefore, we tend to invest in up and coming neighborhoods such as South Williamsburg back in the day, and now Hells Kitchen. In terms of retail investment, I agree with Josh, it is definitely becoming more mainstream. Even for a traditional residential developer like us, retail was a big component of our underwriting for our new deal on 10th Avenue. I believe we may be over supplied on the residential side, but under-supplied in quality retail space.

James Nelson: How do you look at the construction costs when buying land?

Can Tavsanoglu: Construction costs are prohibitively high right now and you can't find contractors to build your building. Everyone is in the execution mode for the next two years. But after two years, they may not have anything new to work on, and I think that will impact construction costs positively. Land pricing is going to go down as well as new land comes online and sellers get realistic again. Additionally, financing market is very tough, too. So overall, it's a challenging market that is waiting to be unlocked somehow.

James Nelson: Ralph, Can you tell us about the new rent guidelines and how you are navigating them?

Ralph Della Cava: The De Blasio administration has really pushed more towards a regulatory rental system. For the first time in 23 years, you must re-rent an apartment as rent stabilized to the first new tenant even when the apartment is vacated and your legal rent reaches the $2,700 threshold. It is shifting our housing stock back to a much slower decontrol process over time.

James Nelson: Additionally, you have a rent freeze from last year on stabilized rents and operating expenses that go up. How does that affect the way you underwrite?

Ralph Della Cava: For the first time in rent stabilized history, there was a zero percent increase on rent stabilized leases. Concurrently, there is pushback in the market from fair market tenants on lease renewals, as this is largely due to stagnating salaries in the workplace. Rents are declining 10 to 15 percent right now, and we will see more of a transition this year. There is always a peak in May, June, and July of the rental season, so it will be interesting to see how that trend continues. We are currently underwriting with the understanding that rental growth may slow.

James Nelson: Absolutely. I also think it is important for investors to really look at the effect of rents, because as you mentioned, you are seeing some decline in rents, but sometimes that decline is hidden because you see a higher rent, and maybe there was a couple of free months' rent given to get to that level.

James Nelson: Joshua, who is buying office assets today? Where is the equity coming from?

Joshua Carson: Sophisticated U.S. and New York City investors are competing with investors from all over the world. We have done two deals recently with Japanese equity partners and we think there is more of that to come. Last year, we did a deal with a German insurance company. At the same time, you still have a tremendous amount of pension fund and sovereign wealth fund money that has a New York City allocation. And we are obviously up against the major New York City REITS, although with declining stock prices, it may mean they will be less competitive. But this is New York City, we are never buying a dollar for 80 cents. There is always someone out there to create a competitive market.

James Nelson: What is your metric when you are looking to invest? What type of returns are you looking for? What is the equity you’re looking for?

Joshua Carson: L&L is a long-term holder of our office assets. Once we have re-positioned and redeveloped, we never look to sell, instead we will recapitalize the asset and swap one equity partner for another. So for us, it is really about that stabilized return of cost.

James Nelson: Jessica, how important is location today? Are retailers taking smaller stores? Does e-commerce have an effect on the brick-and-mortar store?

Jessica Zaski: Fundamentally for retail, location is one of the most important factors. That being said, every tenant has a different objective with their brick and mortar presence and so what may work for one does not work for another. People are shopping online more, and retailers are starting to re-evaluate their entire strategy and the touch points with consumers. The brick-and-mortar presence has probably never been more important in some ways. People still need to have a relationship with the products, which is why you see much more experiential retail and specialized flagships designed to create a buzz and a relationship with the consumer.

James Nelson: How does that all play into flagship locations? How do tenants look at flagships today?

Jessica Zaski: Following up on what I said about location, it’s all about connecting with your customers, so creating the right impression at a location that has the most impact is crucial. I think retailers accept lower profitability at certain locations, but when they are underwriting a location they are optimistically looking at their projections and saying, “This has to make sense.” Retailers are not signing on Fifth Avenue expecting to lose money. That being said, retailers on the prime retail corridors, like Times Square and Fifth Avenue, can generally attribute a certain part of the rent to a marketing or advertising part of the budget, especially if they have amazing signage.

James Nelson: Can, tell us a little bit about other Chinese developers you see out there. Is this the tip of the iceberg? Is there more to come?

Can Tavsanoglu: We see a lot of interest from China. There is a lot of Chinese capital chasing deals in New York City, but developing here is a very different animal. It is still very difficult to enter the New York City market, or any foreign market, on the development side. We have a lot of people coming to us for education and expertise. On the other hand, we will see a lot more Chinese capital coming here for limited partnership deals once they resolve transparency and trust issues.