Argosy Real Estate Partners

Investing In the Lower Middle Market

David Butler, managing partner, is responsible for management and oversight of the firm's investment strategy, fundraising, asset management and operations. Butler has more than 20 years of real estate experience, closing more than $4 billion of transactions. He previously held the position of vice president for the real estate investment groups of J.P. Morgan Investment Management and and AIG Global Real Estate.

Andy Stewart, managing partner, is responsible for management and oversight of the firm's investment strategy, fundraising, asset management and operations. Stewart has more than 22 years of real estate investment and operating experience, involving more than $2 billion of diverse real estate transactions. He was previously a senior manager of acquisitions at M.D.C. Holdings.

Recently, **Jennifer Dohrmann-Alpert,** managing director of *Real Assets Adviser*, spoke with **David Butler** and **Andy Stewart** of Argosy Real Estate Partners. The following is an excerpt of that conversation.

Who is Argosy Real Estate Partners?

Argosy Real Estate Partners ("Argosy") specializes in opportunistic investments in the lower middle market. Argosy invests in multi-family, office, retail, lodging and for-sale residential lot opportunities throughout the U.S. We partner with experienced operating partners to create value through the acquisition, repositioning and/or development of real estate assets. Argosy currently manages $1 billion in gross value of real estate assets and uncommitted equity capital. Argosy is currently investing its fourth commingled, fully discretionary real estate fund and manages capital on behalf of institutional investors, family offices, foundations and high-net-worth individuals. The Argosy team consists of 18 employees across three offices in Philadelphia, San Francisco and Denver.

What is your investment philosophy? What are the core values and beliefs that drive your investment decision making?

Our investment philosophy focuses on value creation at the asset level. We believe that the repositioning and redevelopment of obsolete and/or underperforming assets, as well as the selective development of assets in areas with attractive supply/demand characteristics, are investment strategies that provide the potential to generate strong risk-adjusted returns. Because the success of this investment strategy is greatly dependent upon local market expertise and the ability to execute value-add business plans, we invest in partnerships with experienced real estate operators.

Our investment philosophy is based on five basic principles that form the foundation of our investment approach. These principles provide a framework for an investment strategy that is less dependent upon market timing and leverage and, therefore, capable of providing attractive risk-adjusted returns through the inevitable cycles of the real estate market. These principles include acquiring assets at competitive cost bases, focusing on downside protection, creating value at the asset level, providing for multiple exit strategies and partnering with experienced operating partners.

How do you source investments, and what is your competitive advantage in investment sourcing?

Our operating-partner relationships provide us with proprietary, off-market transaction flow. Our operating partners are deeply ingrained in their markets and have the ability to identify unique situations where assets are underperforming and/or mispriced. In addition, our investment team has deep knowledge of their targeted markets and extensive industry contacts. Few fund managers of our size have three offices nationwide staffed with professionals with deep operating experience within the targeted asset classes. This allows us to react quickly to investment opportunities and to have more extensive local knowledge than other firms of our size that typically try to cover the entire country from a single office.

Why use a diversified allocator fund model, and what are the benefits?

For investors interested in accessing the lower middle-market, we believe a diversified allocator fund model is the most efficient method to achieve desired levels of diversification. A diversified allocator fund can "fill in the cracks" in the investors' portfolio to provide greater diversification than what they would be able to achieve by investing solely in operator funds. This is particularly

Landmark Center – Dallas, TX

DoubleTree by Hilton Hotel LAX – El Segundo, CA

true when trying to access the lower middle market, a segment with greater inefficiency and fewer allocator fund options available. We use a diversified approach so that we are not limited when an asset class or geography becomes overpriced. We do not want to be caught deploying capital into a single asset class or targeted geography when the fundamentals do not make sense, just because that strategy may be the stated target of the fund. As a manager of diversified funds, we have the ability to adjust our strategies to target the asset classes and geographies that we feel are most attractively priced at any point in time.

What do you think is particularly unique about your strategy and your approach to investing? How is it different from the strategies and approaches advocated by other real estate funds?

Much of the discretionary capital is being allocated to the mega-funds (funds with $1 billion or more in capital). These funds are generally not focused on our targeted $5 million to $20 million equity investment size in the lower middle market. It has become more difficult for smaller funds to enter the market. As a result, we believe we have a distinct competitive advantage. Given the relative lack of capital raised targeting lower middle market opportunistic transactions, we believe this segment has the greatest opportunity to achieve outsized returns.

We believe that many investors currently do not have sufficient allocation to the lower middle market, which is a less efficient space relative to other segments of the market. However, we believe that if you have an experienced team, a disciplined investment process and a substantial back office infrastructure, you can successfully deploy capital in this underserved market segment, as we have done over the long term through multiple market cycles.

What is the value proposition you provide to your fund investors?

Argosy is an entrepreneurial firm with a proven 26-year successful investment track record. We are large enough to have a professionally-run, institutional fund management process but small enough to be entrepreneurial and focused on returns rather than management fees. We have a deep infrastructure that is unique to a fund of our size. We are able to maintain such an extensive back office due to our ability to share resources with the other groups in the Argosy Capital platform, which also contains corporate private equity and credit strategies. Our investment team members all have extensive operating experience and work closely with our operating partners on each investment. Our team also has extensive experience working for larger institutional fund managers, and we have put into place many of the best practices of their previous organizations, while also creating an entrepreneurial culture.

We believe our relationships and long-term reputation in this market allow us to stand apart from other real estate investors. Our sourcing capabilities offer another area of differentiation. We believe that our team's extensive operating partner relationships allow us to source lower middle-market transactions efficiently and typically outside of highly competitive auction processes. In addition, we are unique in that Argosy is a significant (generally 10 percent or more) investor in each of our funds, therefore providing a significant alignment of interest.

Where are you seeing the best investment opportunities today?

There is currently a great deal of competition among investors on the national level, forcing us to look beyond the standard opportunities pursued by larger fund managers. While pricing has exceeded peak levels for core assets in many major markets, Argosy believes that attractive investment opportunities still exist in transitional assets and smaller, lower middle-market investments. There are certain markets and asset classes that have come back from the trough and are trading at or above previous peak pricing levels. However, in other markets and asset classes, we see the potential for continued improvement in fundamentals, but with pricing still below their previous peaks. We focus on selected primary and secondary markets that we believe are poised for growth.

Argosy believes that the upcoming maturities of small balance (sub-$30 million) CMBS loans will present opportunities for the purchase or recapitalization of transitional assets, especially those located in top secondary markets that require equity for loan rebalancing and deferred capital improvements. We continue to locate unique off-market investment opportunities through recapitalizations of assets owned by operating partners. For example, there may be a fundamentally sound asset that was purchased at the peak of the past cycle by an operating partner. This asset, however, may be over-leveraged or have an undercapitalized investor. We have provided new equity (often on a last-in, first-out preferred basis) to rebalance a maturing loan or to fund deferred capital improvements.

CORPORATE OVERVIEW

Argosy Real Estate Partners, founded in 1990, specializes in opportunistic real estate investments in the lower middle market. Argosy Real Estate Partners invests in multifamily, commercial, lodging and for-sale residential opportunities throughout the United States. Argosy currently manages $1 billion of gross value of real estate assets and uncommitted equity capital. Argosy is currently investing its fourth commingled, fully discretionary real estate fund and manages capital on behalf of institutional investors, family offices, foundations and high-net-worth individuals.

CORPORATE CONTACT

Sarah M. Busch, Vice President Investor Relations
950 W. Valley Road, Suite 2900, Wayne, PA 19087
Tel: 484-588-6829 | sbusch@argosyrealestate.com
www.argosyrealestate.com