Hines

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Adding value for both occupier and investor

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, Americas, recently spoke with **Dan Box,** senior managing director, fund management, responsible for strategy development, deployment and execution for Hines' U.S. Property Recovery Fund. Following is an excerpt of that conversation.

Tell us about your role and fund.

The Hines U.S. Property Recovery Fund is a U.S.-focused, closed-end, value-added and opportunistic vehicle making investments across the main sectors in real estate. We leverage the Hines local teams and their block-by-block knowledge alongside the top-down view from our internal research department to find the best opportunities to create an attractive portfolio. We look at renovations, lease-up plays, redevelopments and even ground-up development. My role as fund manager is to be squarely focused from start to finish on the success of the fund and, by association, the success of our investors. Our focus is on two broad areas. First, overseeing the execution of the business plans for the assets already in the portfolio, including deciding when it's time to exit and provide a return for our investors. Second, to always be searching for that next potentially great opportunity for our portfolio. We lean on the Hines local teams across the United States to identify interesting investment opportunities, many of which are off market.

What does the value-added and opportunistic landscape in the United States look like currently?

One of the persistent themes during the past few years has been a lack of transaction volume. There have been monumental shifts in the capital markets, but they haven't been accompanied by a broader economic recession. Typically, the two tend to happen in tandem, and that's when we've seen the floodgates of opportunities open in the past. With the exception of office, asset- and market-level fundamentals have generally held up, which has contributed to a relatively low transaction volume despite real estate being in an early-cycle environment. Nevertheless, the volume of deals coming to market has picked up in recent months. These tend to be assets hitting some kind of unavoidable event, whether a debt maturity, the expiration of an interest rate hedge bought when rates were much lower or the end of a fund life. Across sectors, these opportunities tend to have solid asset-level fundamentals, but many are trading at a deep discount due to the movements in capital markets. In some ways, deal profiles look more like core or core-plus than value-added. But where we can find opportunities at a reset basis with some value-added component to layer on top of that – whether it's unit renovations in multifamily, marking older leases up to a new market rate in industrial, or retail assets with the opportunity to densify with other uses – those elements make these investments more interesting for our return profile.

How are you finding value in the current market? Are there specific attributes you look for in deals?

We lean on the Hines local teams to identify opportunities that may have been overlooked by other players and also to identify specific value-added elements that may not be obvious to someone not in the market who may be doing a desktop underwriting. At some residential assets, for example, we're looking at ways to turn unused or underutilized areas into revenue-producing space by adding storage, particularly in dense markets where purpose-built self-storage product is in short supply. In a market where there is a lot of capital chasing relatively few deals, it comes down to a battle for basis points. We're using lessons we've learned elsewhere in our portfolio to push value at the asset level using the Hines local teams and their knowledge to find those physical elements of value.

We also rely on the insights of our research team, which provides us with an unbiased, unemotional view of markets and product types. They look not only by market, but by submarket and, in many cases, micro-market, to help us find pockets of value where certain product types may be undervalued or where rents seem poised to pop. We look not only at a submarket's fundamentals – rent growth, absorption, vacancy – but also the momentum behind those fundamentals to identify assets and locations with the highest likelihood of market tailwinds.

Many people expect lower rates by the end of the year. How would lower interest rates affect deal making and development?

Even if rates start to come down, they're still likely to remain elevated well above the lows we saw through 2021 and early 2022. The burden of higher debt costs for deals undertaken three to five years ago will likely continue, which is what is creating many of the opportunities we're seeing today and allowing us to get into attractive assets on an early-cycle, reset basis. But marginally lower rates should help contribute to a narrowing of the bid-ask spread that has kept a number of potential opportunities on the sidelines. I would expect to see a pickup in transaction volume.

When you're upgrading a property as part of your value-added strategy, are there key upgrades you look to include across your projects? Have those changed over time?

Our job is to create assets that fit both occupier and investor preferences. Those tastes have shifted over time, and the pace of change has probably never been, in our opinion, as rapid as it has been during the past three to four years. People are living, working, shopping and playing differently. One theme we have seen is that tenants across all product types expect flexibility in their space. Our residential tenants, for instance, are often looking for unit layouts and common area features that accommodate hybrid-work schedules. Those accommodations are easy for new builds, but for renovations, we need to make sure the structural limitations of an existing building will allow for them.

We also focus on the tenant experience. If you think of the building as the hardware, the tenant experience is the software. Sometimes that analogy is literal, and we offer apps and other digital solutions that make our office and residential buildings more convenient. Sometimes it's more figurative, offering programming and high-level customer service at all of our assets that make it easier and more pleasant to be in that space.

We're also heavily focused on occupant experience through our ESG initiatives across all sectors. In our industrial assets, for instance, we make sure there's ample access to natural light. We provide opportunities at some of our larger industrial parks for fitness areas, basketball courts and walking trails. Other elements we incorporate in most of our projects include electric-vehicle chargers, bike racks and locker rooms. At some of our distribution assets, EVs have started to make up a greater percentage of the distribution fleet our tenants are using, so accommodating those shifting tastes is important. If you make an asset more attractive to the occupiers, you're almost guaranteed to make that asset more attractive to potential investors, which is our goal with every project we have.

Thinking ahead to your next buyer, what do you think buyers will be looking for in the next one to three years?

After a number of volatile years, we think investors want to minimize the uncertainty in their portfolios, and early in the cycle is a great time to get back to real estate basics. People are looking for permanence. Necessity-based real estate, often mentioned in the context of retail, is that indispensable neighborhood center where you and all of your neighbors do your grocery shopping or go to the pharmacy. It is real estate that justifies its own existence. Sometimes you know when you see it — based on location, the tenants, the foot traffic — why that real estate needs to exist. Our goal is to make it obvious why the real estate we create is necessity-based real estate. We always look to turn out a core asset and attract a core buyer, demonstrating the permanence of the real estate that we create across product types.

What is your long-term vision for value-added real estate?

It will continue to evolve. Real estate goes through cycles. Individual sectors go through cycles. Rather than trying to predict exactly where each sector is going in the next three years, we focus on flexibility, which is an important feature of being a diversified fund, able to invest in multiple sectors. Funds such as ours generally have a three- or four-year investment period. What's compelling when you're in the pre-marketing phase or in the early part of your investment period may not be what's compelling or where the most value is two to four years later, at the end of your investment period. Thus, flexibility is really important.

What sustainable systems and processes have you promoted in aligning with the Hines Global ESG framework?

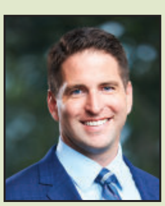
As a fund, we have a fairly robust sustainability policy and ambitious ESG goals. We participate in the GRESB[1] survey every year, and Hines has a goal for all of its vehicles to be sector leaders. For every development or major redevelopment, we issue a series of standards to the local teams in the very early planning phases of their projects to make sure they're accounting for a wide range of sustainability and, more broadly, ESG-focused elements. We're focused on adding solar, either as a way of lowering operating expenses or increasing the revenue generated at the property. Hines as a whole is focused on social engagement, making sure the community is involved as we go through our pre-development process and our development process. Community members are given opportunities to speak into elements of the design that are going to affect the neighbors of the project. In some cases, we have brought in representatives from local Tribal nations to ensure, as we're excavating, that any artifacts or relics encountered are treated with an appropriate level of respect. It's a holistic approach beyond the typical building certifications that were the standard 10 or 15 years ago.

Can you elaborate on how you've reduced the carbon footprint in any of your current projects?

We have two industrial developments in California, one in Orange County and one in San Jose. Both opportunities are designed to be all electric, which is a big step toward lowering the carbon footprint. Our fund is also undertaking an office-to-residential conversion in Salt Lake City. There are significant savings in terms of embodied carbon by utilizing the existing structure of the former office building when compared with doing a ground-up residential development. Our calculation shows the adaptive reuse there should save about 74 percent of the embodied carbon compared with new construction.

Note: [1] GRESB is a mission-driven and investor-led organization that provides actionable and transparent environmental, social and governance (ESG) data to financial markets. GRESB collects, validates, scores and benchmarks ESG data to provide business intelligence, engagement tools and regulatory reporting solutions. Hines pays to participate in GRESB.

CONTRIBUTOR



Dan Box
Fund Manager
Hines' U.S. Property Recovery Fund

Dan Box is senior managing director, fund management, responsible for strategy development deployment and execution for the U.S. Property Recovery Fund. As part of the dedicated fund management team for the Recovery Fund, Box combines his experience sourcing and acquiring deals with the top-down, research-driven, strategic approach to seek to ensure successful deployment and execution of the fund. Since joining Hines in 2007, Box has worked in acquisitions, fund management, property management and development roles in the firm's Houston and Washington, D.C., offices.

COMPANY OVERVIEW

Hines is a leading global real estate investment manager. We own and operate $93.2 billion* of assets across property types and on behalf of a diverse group of institutional and private wealth clients. Every day, our 5,000 employees in 30 countries draw on our 65-year history to build the world forward by investing in, developing and managing some of the world's best real estate. To learn more, visit www.hines.com and follow @Hines on social media.

* Includes both the global Hines organization and RIA AUM as of Dec. 31, 2023

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