GREYSTAR™

Combining infrastructure and real estate to provide solutions for everyday living

Jorge Fernandez, Institutional Real Estate, Inc.'s managing director, infrastructure, recently spoke with **Michael Hoverman,** executive director of infrastructure at **Greystar,** about the benefits of adding infrastructure to Greystar's long-time rental housing business. Following is an excerpt of that conversation.

How has infrastructure evolved over time?

I've been in infrastructure for almost 20 years and, when I started, infrastructure was an asset class established almost exclusively for large-scale institutional investors. Investment was focused on potential privatizations of large-scale public assets, such as airports, toll roads and utility companies, because that's what infrastructure investment looked like in the markets where it was already well established, such as Australia and Europe. However, this model was hard to execute in the U.S. Most of those types of assets in the U.S. were – and still are – owned by the public sector. Since that time, the market has evolved and matured significantly. As municipalities look for help in building and upgrading needed infrastructure, we are beginning to see more acceptance of public/private partnerships. However, perhaps the largest shift in infrastructure investment has been the realization that those large-scale, headline-grabbing transactions represent a very small fraction of the U.S. investable infrastructure universe. Market participants are awakening to just how much opportunity there is in the broader infrastructure ecosystem in the U.S., specifically in the middle market, which we define as a transaction size in the $200 million to $500 million equity range.

What are some of the areas in the broader ecosystem that you are referencing?

If you think of infrastructure as the essential physical structures that allow a city or country to function and grow, you can see it involves a lot more than roads and airports. You have water treatment plants, electrical grids, centralized heating and cooling systems, energy storage facilities, data centers, short-haul rail lines, fiber lines, hospitals, court houses – the list goes on and on. These are the structures that affect people in their day-to-day lives, just as much as airports, toll roads and ports. Some of the areas that we think offer the most opportunity include those involved in energy transition, digitization, transportation and social infrastructure in the middle market.

How has the middle market changed infrastructure investment?

This is a very undercapitalized segment of the infrastructure universe. The large-cap space represents less than 5 percent of infrastructure deals by volume, yet more than 70 percent of the capital is focused on that space. It's that supply-demand mismatch in the large-cap space that really creates a huge gap in the mid-market for funding transactions. Institutions are coming to the realization that it is a lot easier to move the needle in a smaller company than a large one. In fact, there is significant empirical data that demonstrates returns in the mid-market have consistently outperformed the larger-cap managers and funds.

Because the sizes of assets in the middle market are smaller than in the large-cap space, there is tremendous opportunity to invest in growth. Investing in growth, whether it be organic or through M&A, increases the importance of selecting strong management teams and operating partners, which creates an opportunity to generate outsized returns. It's these companies and assets in the middle that are best positioned to ultimately make a meaningful impact when it comes to providing a tangible and real benefit to society, as well as moving the needle for end buyers, which may include larger-cap funds and managers, strategic buyers or the public markets, depending on the sector that you're looking at. One of the key advantages that the mid-market offers is exit optionality, since there is a much deeper pool of potential buyers for assets that mid-market managers have built, grown and institutionalized for the benefit of large-scale buyers.

How does Greystar differ from others in the infrastructure middle market?

Greystar is unusual because we have such a large and long-term real estate business focused on housing. Our consistent approach to investing in real estate, which is always first and foremost investing in tangible hard assets, is equally important in infrastructure. This hard asset-based approach provides downside protection through the underlying collateral, which protects the principal of the partners that we work with. We also take a heavily research and data-driven approach that looks at the macroeconomic drivers, such as population growth, urbanization, and the transition to a more modern form of urban living that requires modern infrastructure, as well as modern housing. When you think about the needs of people in society, they need a roof over their heads. They need power and water. They need their waste managed properly and taken away. They need internet where they live. When you think about why infrastructure is so critical, it sits right alongside housing as being one of those very essential needs. Whether it's housing or infrastructure, we want to make sure that we're delivering an asset at a lower cost to our end customers. I think that's what really differentiates us. We're not trying to provide luxury infrastructure for private jets and yachts. We're trying to provide infrastructure that serves the daily, everyday needs of most Americans.

Does Greystar get involved in the business of running the infrastructure asset, or do you bring in a management partner?

Typically, we're working with partners. Infrastructure is unique as an asset class, because you're really dealing with 10 to 20 different industries. A power plant is obviously very different from managing a railroad, which is very different from managing a data center. All of those are obviously very distinct industries requiring very specialized skills and expertise. Typically, we're partnering with best-in-class management teams, experts in those individual fields, and investing through those platforms to build, develop and deliver infrastructure at a lower cost. That's really the critical thing for us.

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What are some of your unique levers for value creation?

Operational improvements and driving growth in some format within our investments are critical. We're really looking to build and grow great companies with best-in-class management teams. It's how we deliver attractive returns for our partners. Within the mid-market, you can have a much greater impact in that respect than you can by going out and buying a stabilized infrastructure project or a large-scale business. The opportunities for operational improvements within those assets are far more significant in the mid-market.

Two things that we don't do. We don't rely on excessive leverage. We're really trying to deliver returns through successful business plan execution as opposed to putting on leverage that might be viewed as imprudent for a particular investment. We also don't rely on excessive subsidies. We really look at the fundamentals of the underlying business to drive the returns, not a subsidy that may or may not exist a week from now.

What subsectors are you specifically looking at now?

It's a very different discipline to invest in the mid-market. It's not chasing the deals that you're reading about in the Wall Street Journal. It's unearthing the deals that others haven't seen. In terms of sectors, we focus on a diversified basis across energy transition, digital infrastructure, waste and water management, transportation and logistics, as well as social infrastructure. We want to invest in assets that are significantly downside-protected for our investors but provide an opportunity for growth and outsized returns by growing and building best-in-class businesses within those respective sectors.

Areas of short-term focus are within the district energy space. Those are closed systems that deliver energy for a specific municipality, university, development district or other similar system. Centralized systems can deliver that needed energy at a much lower cost to the end customer. In an environment where we're seeing utility rates going up 10 percent to 20 percent on an annualized basis because of the demand for power nationally, having those solutions that deliver heating and cooling at a much lower cost ultimately saves people money and reduces emissions. The same is true for digital infrastructure, so that can include in-building digital infrastructure, such as internet to buildings and apartments. This opportunity is particularly interesting because, in many cases, Greystar is already operating the housing assets. We are also interested in things like short-line rail that makes the transportation of goods and freight cheaper and more efficient. We want to make sure that we're able to deliver transportation solutions to that market at a lower cost.

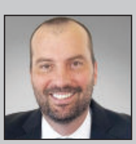
Infrastructure is relatively new for Greystar. What advantage do you see it giving the overall Greystar corporation?

In recent years, we've seen a convergence of real estate and infrastructure. Real estate sits under every piece of infrastructure, so being a competent real estate investor provides a true advantage when investing in infrastructure. We believe our real estate success gives us a leg up, particularly in the mid-market, because mid-market real estate is really what Greystar has been doing for more than 30 years. Extending that experience to infrastructure and assets that deliver essential needs for everyday people is a natural extension of what we have been doing for most of our history.

My partners and I have been working together in infrastructure for nearly 20 years. We're combining the infrastructure knowledge and capabilities we've built throughout our careers with the experience and scale of the Greystar real estate platform. We expect this marriage to produce a one-plus-one-equals-three outcome from having both of those capabilities within the Greystar business.

We're very excited about what we're doing here. We think that we have a pretty unique opportunity. It's such an obvious opening and gap in the market. There's been this exodus from the mid-market as most of the large-cap firms have grown and been victims of their own success in many ways, as they now need to move on to larger assets. But it creates a huge opening in the market where we think Greystar can be a market leader on a global basis.

CONTRIBUTOR



Michael Hoverman
Executive Director, Infrastructure

CORPORATE OVERVIEW

Headquartered in Charleston, South Carolina, Greystar-affiliated companies manage and operate approximately $320 billion of real estate and infrastructure assets in nearly 250 markets worldwide. With offices across North America, Europe, South America and the Asia Pacific region, our global platform is designed to meet the evolving needs of institutional investors, wherever they arise.

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