Ascentris

Taking a generational approach

A Q&A with Ascentris' Gabe Finke co-founder and CEO; Pat Kendall, partner and managing director; and Tony Breault, managing director

Ascentris prides itself on taking a "generational approach" to investing in real estate. Can you elaborate on what this means?

Tony Breault: Ascentris primarily manages its clients' real estate portfolios through discretionary separate accounts. Unlike closed-end commingled funds with a finite fund life, our separate accounts are evergreen and do not have defined timelines for the pacing of acquisitions or dispositions. The structure of our separate accounts enables us to take a longer-term view and capture investments whose investment duration may not work so well in a closed-end structure. We can, therefore, focus our sourcing efforts on property types, markets, submarkets and strategies we believe have more robust long-term fundamentals. We refer to these properties as being "generational" in nature.

In this market, we continue to invest in transitional properties with shorter hold periods, but what gets us truly excited are higher-quality, exceptionally well-located properties capable of sustaining predictable income through volatile market cycles over extended hold periods.

We have made several of these generational investments in Phoenix and Scottsdale, Ariz., Raleigh and Charlotte, N.C., and in Denver, and we are currently working on another special one located in Atlanta. These investments are in properties we do not intend to ever sell. While most of the noted examples are mixed-use developments, some are single-use properties.

That's interesting. We were not aware Ascentris was active in the mixed-use property sector. Can you tell us more about that?

Pat Kendall: Over the years, we have developed exceptional relationships with local operating and development partners who know their respective markets better than anyone. Because of our diversified strategy and evergreen investment vehicles, these partners often approach us with large, sometimes multi-phased sites they have aggregated over time and that require a flexible capital structure that can approach the project with a longer-term perspective to account for the complexity of the business plan.

We have found these mixed-use developments are often unique sites in high-barrier locations, resulting in greater rent and sales premiums, and they offer more attractive development yields. Further, there is a lot less equity competition for the strategy. Our team has extensive experience underwriting complex developments and redevelopments across all the major property types, and they are adept at structuring joint ventures that optimize alignment with our development partners.

Has your team made any changes to its investment approach resulting from this market cycle we've experienced these past couple years?

Gabe Finke: Ironically, we do not feel the need to make significant changes to our investment strategy, as it has been proven through multiple cycles. This down cycle, however, has allowed us to conduct substantial research into property types we consider complementary to our current skillset. With slower transaction volume during the past 18 months to 24 months, our investment teams collaborated with our extensive operating partner network and the broader investment community to conduct comprehensive due diligence into some of the alternative property types that meet our clients' long-term growth and portfolio needs. While we have not yet made any investments, we anticipate investing in a few select opportunities outside of the traditional "four food groups" in the short term. Stay tuned!

In a rising rate environment, or perhaps this particular economic cycle, what has been the biggest challenge as a value-added investor? What specifically has the Ascentris team done to overcome or think through these challenges?

Finke: Every down cycle is different and creates its own unique set of challenges. In this rising interest rate environment, financing has presented challenges throughout the industry. Having senior leadership that has experienced downward cycles through their careers is essential. Our leadership is quick to share these experiences and lessons learned from previous cycles. Similar to the GFC, and previous recessions before it, we have spent considerable time ensuring we have enough reserves to meet the needs of the portfolio during monetary tightening and a challenging lending environment. We have been very proactive in communicating with our lenders and treating them as partners in each of our investments.

Regardless, it is hard watching the value we have created get washed away with the outgoing tide, and it has been even more difficult to acknowledge that values may not recover quickly enough to generate value-added IRRs in the short term. One of the most challenging decisions a value-added investor faces today is whether it should sell at the bottom and redeploy into other people's distress or manage out of its own distress. Maintaining confidence and having the conviction that the value of real estate will recover comes down to the market, the quality of the real estate, the strength of asset-management execution, and the broader behavior of the capital markets.

Part of the confidence needed to have high conviction generally requires both a top-down and bottom-up approach to investing. How does Ascentris apply these approaches in its investment thesis?

Breault: Most real estate practitioners learn a bottom-up approach to real estate from the early stages of their career. Each investment must support itself on the metrics and data that are typically underwritten, and nearly every firm is required to meet those standards if they intend to attract and retain client capital. That said, with the proliferation of data providers and market research firms, most institutional investors draw from the same

data providers and then apply specific house views when taking a bottom-up approach to building an investment model. Utilizing, or prioritizing, a bottom-up approach may work well for a local firm with regional or single property-type expertise. Ascentris, however, has learned a blend of both top-down and bottom-up is paramount to effectively meet the portfolio objectives for our clients.

For example, in 2022 we embarked on what we named "Project Megatrends," a 12-month research project led by a recently retired global head of research working in close coordination with our portfolio management teams. Megatrends ultimately identified 16 long-term structural trends shaping all aspects of U.S. society and playing out over 15 to 20 years, with impacts felt over two or more real estate cycles. We then distilled these further into three trends we believed to have the most direct and measurable impact on commercial real estate demand. In turn, we have been able to apply these themes when reviewing our target markets and, particularly, identifying markets where robust data and secular themes support long-term investment strategies. Given the recent disruptions resulting from the pandemic period of 2020–2022, understanding and separating secular from cyclical trends – yet being aware of both – has become an integral part of our market selection, property underwriting and portfolio construction process.

How has financing changed in the value-added space since 2022?

Finke: Financing new investments is undoubtedly a challenge. Several investments, particularly within the multifamily and industrial property types, currently underwrite to property yields that are less than the cost of debt for the first years of an investment. Value-added return strategies have shifted in favor of investors capable of applying rigorous and creative asset management to generate rent growth or improve net operating income. As for existing investments, refinancing is the greatest challenge most teams face at this moment in the cycle. Many lenders are simply "out of the market" as far as office is concerned for portfolio construction or regulatory reasons. "FOMO" or "fear of more office" is a recurring theme we are all hearing a lot of these days.

We have always been intrigued by Ascentris' rotational investment strategy. What property types or markets are you currently rotating into?

Kendall: Our senior team has extensive knowledge and experience across all major property types and U.S. regions in both acquisitions and development. That experience enables us to rotate and invest our clients' capital no matter where we are in the market cycle.

Our approach in this cycle has been unique in that we are currently rotating more by geography rather than by property type. That may change as the market stabilizes and the relative behavior of the various property types evolves. For now, however, we are focused on growth markets where we feel we have a competitive advantage and deep access to the local operators, brokers and other market participants.

We are starting to research and underwrite some of the traditional gateway markets, particularly San Francisco and Seattle, as pricing in those markets has shifted toward the buyer. While it is still early, we believe we are likely to see in-migration back into some of those markets as employment, pricing and supply/demand dynamics mature.

Over this past cycle and market run-up leading to the downturn in 2022, we felt the greatest risk-adjusted returns were found in development strategies. We prefer not to underwrite cap-rate compression or unsustainable rent growth assumptions, which was often needed to "land the bid" during that very competitive market period. Given the depth of development experience on our team, we were much more comfortable with a development approach. Now, we are rotating into more acquisition strategies for several reasons, including a discount to replacement costs and replacement rents. As equity owners have slowly recognized write-downs resulting from higher cap rates, discount rates, lower occupancy rates and expected future returns required by buyers, we have begun to see more attractive acquisition opportunities.

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CORPORATE OVERVIEW

Ascentris is a real estate private equity firm based in Denver that manages a series of fully discretionary institutional vehicles targeting both value-added and core investments across the major property types and geographic regions within the United States. Since 2003, Ascentris' management team has relied on an investment philosophy and organizational structure for the purposes of getting its investors to opportunities ahead of the market and providing an unmatched level of service, transparency and accountability. Ascentris is a privately held and management-owned SEC-registered investment adviser* that maintains an unwavering commitment to putting its investors' needs first.

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