REAL ESTATE CAPITAL

ACORE Capital – Go big or go home
By Al Barbarino
October 3, 2016
https://www.recapitalnews.com/profile-acore-capital-go-big-go-home/

ACORE Capital has shelled out $4bn in loans over the course of the last year, but for its four managing directors who have worked together for decades, this kind of activity is nothing new. Al Barbarino reports

Boyd Fellows grips a freshly pressed ACORE Capital marketing pamphlet, pointing enthusiastically to a timeline mapping the history between himself and the three additional managing partners he formed the firm with in May 2015.

It shows that his relationship with Warren de Haan, Stew Ward and Chris Tokarski dates back decades. In all, he says, the four men have closed over 4,000 commercial real estate loans together.

"It's not like we are four random guys that decided one day to launch a new business," he quips.

Fellows notes various personal and team accomplishments that coincide with the timeline. Well before Barry Sternlicht recruited the team in 2010 to develop Starwood Property Trust's loan originations platform, the group was at Countrywide Financial, accomplishing the feat of remaining profitable during 2007 and 2008, he says. Before that, there was a three-year stint at Coastal Capital, acquiring debt and advising clients on restructurings.

The four men first joined forces at Nomura Real Estate Holdings in 1994, while Fellows' relationship with Ward dates back more than 30 years to 1983, when they launched their careers at Bank of America.

From a corner conference room at the company's 130 West 42nd Street Midtown Manhattan offices, the four managing directors gather to tell Real Estate Capital about the strategy that's allowed them to shell out $4 billion in loans over the course of the last year at ACORE.

"After building out three other platforms with large amounts of capital, it was glaringly obvious going into this that we still liked and trusted each other," says de Haan. "As a four-man team we are far more likely to build a large, sustainable business than we would on our own."

Fellows admits he is frequently asked: "Are you guys doing this too fast?" But he and the other managing partners say the current market still offers so many lending options that it has allowed them to be highly selective in choosing the right deals despite the aggressive growth.

The conference room is surrounded mostly by glass windows and partitions, as are the several offices along the perimeter, allowing one to look through the open-layout workstations at the centre of the floor plan, and all the way to the glass offices on the opposite end of the building.

The literal transparency of the office is a metaphor for one of the guiding principles behind the firm's success.

“We spent the extra money so that everybody in this office can see everybody else; the whole place is incredibly transparent,” says Fellows.

A weekly company-wide conference call is open to all employees, for instance, and “every new transaction we do is discussed, and everyone is welcome to it,” Fellows says. The four partners have distinct responsibilities at the firm, but there is “nothing the other does that we don’t know about”.

Ward and Fellows are in charge of all operations, from marketing to human resources, as well as the raising of capital and leverage; while de Haan and Tokarski source transactions and complete the credit analysis, respectively.

“Warren and Chris are obsessed with market information,” Fellows says. “We always want to know exactly what our competitors are doing.”

The firm has now grown to about 55 employees, including some former Starwood and GE Capital executives, with four US offices now in operation – New York, Los Angeles, San Francisco and Dallas.

If it’s another indication that they aren’t skimping on the details, they’ve even had mugs with the ‘ACORE Capital’ logo inscribed on them, several of which are scattered atop the conference room table as we chat.

Funding

The men departed Starwood in the latter part of 2014, and by February 2015 Real Estate Capital had learned and reported that the executives were mulling a new loan originations business. At the time one competitor noted that “they just have to convince someone that has real money to help them be successful… that’s what this business is all about”.

They did just that a few months later in May 2015, when ACORE landed a $1.6 billion commitment – consisting of $1 billion plus a $600 million warehouse line – from Delphi Financial Group, a subsidiary of the largest publicly-traded Japanese insurer, Tokio Marine Group. (Earlier this year Delphi doubled the equity commitment to $2 billion and increased the warehouse line to $800 million).

The managing partners had never dealt with Delphi before, but they immediately seemed to be on the same page, Ward says.

“Our ask was huge!” he says. “We weren’t interested in anything lower than $1 billion in subordinated debt capital, which would allow us to do $4 billion in loans. These lending platforms require scale to address the market the way we wanted to. We received countless offers between $250 million to $500 million.”

“The large sum from a single source was in line with what we wanted, but we also needed our partner to understand the labour requirements and the size of the staff needed to build and efficiently operate these businesses – and on that we were very ‘like-minded,’” Ward adds.

“Delphi had a very good understanding of what it takes to build these businesses. They weren’t surprised at the size of our budget – whether for systems or staff. They understood the magnitude of the operation and what was necessary to create a market-leading capital provider when lots of others didn’t.”

The $4 billion in loans, spread across roughly 60 deals, is a staggering number that places ACORE boldly alongside non-bank lending giants like Blackstone Real Estate Debt Strategies and Starwood.

Strategy

de Haan notes that it's difficult to raise public money in the current market, which has given the firm an edge over some of the competition.

"The market opportunity for a well-capitalised group with a very sophisticated and connected team is significant, given that the banks are facing more regulation, CMBS has shrunk significantly and many REITs are trading at a discount to book value from time to time, limiting their access to capital," he says.

Though transaction flow has been robust, that might not last forever, he admits, indicating that he is "seeing some pullback" as the real estate cycle progresses.

"Any macro event could destabilise the economy and in some ways people are cautious, and some real estate buyers have slowed down and created a speedbump in transaction flow," de Haan says. (Transaction activity came in at $105.2 billion in Q2 of 2016, down 14 percent year-over-year, and through H1 2016 it was down 16 percent, according to Real Capital Analytics).

However, Fellows notes the advantages of investing in value-add real estate, which has a "built-in buffer" compared to fully stabilised assets. For instance, he points to a representative value-add deal from June, when ACORE originated $53.3 million in financing for the acquisition and residential conversion of the Millennium on LaSalle.

The financing, including a senior mortgage and mezzanine loan, will allow developer DLC Residential to convert the 13-story tower in the Chicago Loop neighbourhood – at 29 South LaSalle – into 216 apartments and add an additional floor for tenant amenities.

The conversion has a lot more rent growth potential than would a stabilised, occupied office building, Fellows notes.

"With an office building that is being converted to an apartment building, we see a material increase in the value of the converted building based on current apartment rents in the market," he says.

The team helped put Starwood – the nation's largest commercial mortgage REIT – on the map as a transitional, value-add lender, making that segment of the market a natural target when ACORE was formed.

The managing partners say loans on properties with a value-add component have made up a large majority of their business so far. Light to moderate rehab have made up about 40 percent of the deals, about one-third were gut rehab or ground-up construction loans, and the remainder represented stabilised assets.

"Our borrowers need flexible capital from a true balance sheet lender, and we understand that the business plan may change and they may need someone to talk on the phone with about strategy," de Haan says, noting that the firm is able to offer flexibility in loan structure that adapts to change.

"We tailor-make each loan to the situation," Tokarski adds. He also notes that "a lot of our competitors run equity businesses where they were also competitors," a conflict of interest that isn't present at ACORE. "We don't want to take their buildings back."

Among the desirable loan covenants is the firm's pre-payment flexibility. The scope of the ACORE operation also has allowed it to provide future funding for tenant improvements, which means the borrower doesn't have to pay interest on loan proceeds until it withdraws the funds as the business plan progresses. "Good news money," de Haan calls it.

Then there's the firm's ability to make whole loans as a 'one-stop-shop,' which goes back to the core business model that required scale and large capital commitments.

"We almost never simply make a mezzanine loan or invest in a piece of subordinated debt," Fellows says. "We take down the entire cap stack at one time. Later we decide if we want to retain the A-note, or in other cases we auction the A-note to potential investors."

"As a borrower you might become uncomfortable if your lender would like to own your property. We just want to get paid back – with interest."

The non-bank advantage

"We are filling the void created by Basel III, which puts constraints on very large banks, and accordingly we are doing very large loans," Fellows says, noting that ACORE's loan-to-values will typically stretch between 65 to 75 percent, while the banks are significantly more conservative, peaking around 60 percent. Meanwhile, smaller banks don't have the scale to compete on large loans.

When it comes to the company's large non-banking competition, de Haan says "it's a big enough market for all of us to play in".

"We are always hustling," he adds. "We also focus on making the process and execution simple so that when a borrower signs up a loan with us they know we will do exactly what we say we'll do."

Though the non-bank – or so-called "shadow bank" lenders – often come under scrutiny for escaping regulations, the ACORE team argues that the industry has effectively self-policed itself over the last couple of years. Ward notes that ACORE's underwriting is "incredibly thorough," and that there are very few lenders out there offering LTVs in excess of 75 percent.

"Our space is dominated by balance sheet lenders in the same risk position as us who need loans to pay off in order to be successful, as opposed to the conduit businesses where lenders get their money returned by selling the loans to bond buyers," he says. "We need all of them to repay and we can't tolerate defaults. Luckily we compete against others with the same exact perspective."

That self-regulatory aspect of the market collapsed during the economic downturn, when the structured finance market allowed transfer of risk to "thinly capitalised, passive investors, but that business plan isn't viable anymore". de Haan notes that there were many, many borrowers who became overleveraged at that time, but that borrowers today prefer to have more skin in the game.

As for ACORE's business plan going forward, the management team stands by its 'go big or go home' mentality – that without the scale afforded by a backer like Delphi, meaningful opportunities will dissolve.

They have no intention of becoming a 'run of the mill' lender, and they even admit that they would have likely gone their separate ways if they hadn't been able to secure a large commitment from Delphi.

The managing partners believe there is a continued opportunity to lend between $3 billion to $5 billion per year going forward, which would secure their status among the country's non-bank commercial real estate lending elite.