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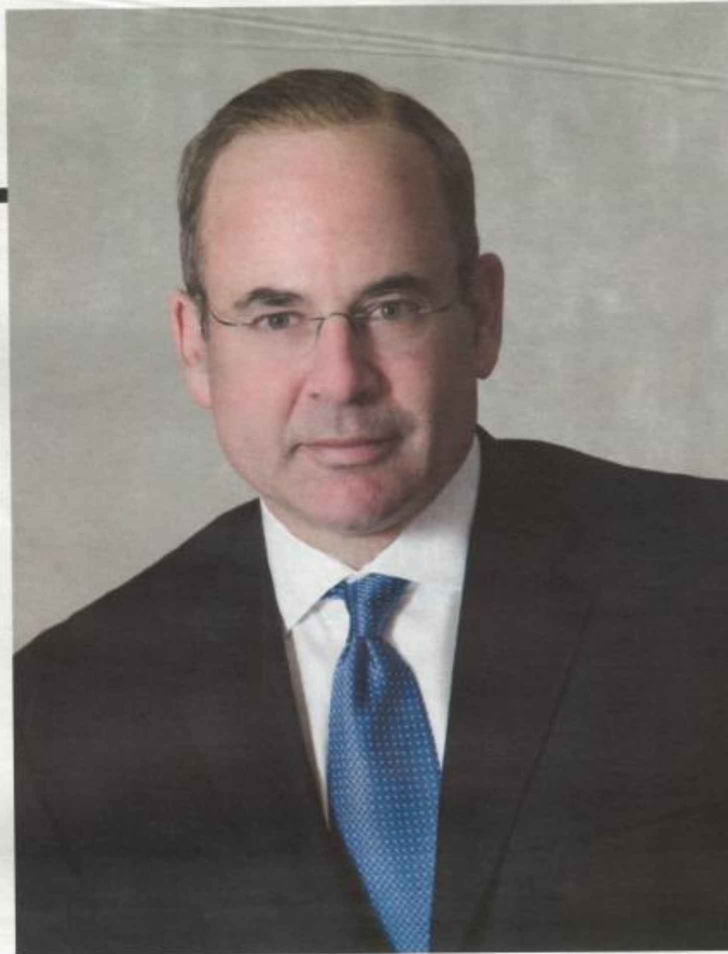
Q&A

PRESIDENT AND FOUNDER OF MADISON INTERNATIONAL REALTY

Ronald Dickerman

By Danielle Balbi



FRED MARCUS PHOTOGRAPHY

Real estate has always been a part of Ronald Dickerman's life. As a child growing up in Boston, he watched his father buy and renovate fixer-uppers. In fact, one of his first roles at his family's firm was working on the maintenance team. Now, Mr. Dickerman oversees a $3 billion portfolio at the firm he founded, Madison International Realty, having used the strategy of joint venturing and buying partial ownership interests in Class A properties in gateway markets. He sat down with Commercial Observer in his Park Avenue office and discussed trends and opportunities he's been seeing both in the United States and Europe and provided a bit of insight into some of Madison International's recent deals.

Commercial Observer: Could you provide an overview of Madison International Realty's investment strategy?

Mr. Dickerman: For all of our years [in the industry] we recognize that a couple of facts about investing in real estate are true: that quality always rises to the surface—quality assets hold their value the best in down cycles and recover the most quickly in up cycles, and that's where tenants of any sector want to be. The second thing is that the world is cyclical. It's always going up and down, and real estate is a very capital-intensive business.

What we've done is put all those themes together, and we've developed a business where we effectively buy out existing joint venture partners in prime quality real estate assets where there's some mismatch and timing between the holding period of the property according to the sponsor and the liquidity need of the underlying investor. It sounds like a little bit of a niche-y strategy, and it might be. But on the other hand, the size of the business is bigger than you could possibly imagine just in terms of dollars that underpin prime real estate. We invest in gateway cities in the United States. We have offices in London and Frankfurt, and we invest in London and key capital cities of Western Europe.

And then we live through these cycles—the global financial crisis and the oil crisis and the U.S. presidential election—and you can imagine why there may be friction or mismatching in timing. We've made a very creative business out of stepping in and buying these interests from investors who want an early exit strategy. That's one of our prime strategies.

The second [strategy] is that we provide a lot of joint venture investment capital to prime sponsors who are looking for a friendly supportive capital partner. So over the years we've invested in a very high-quality retail portfolio in New York with Forest City Enterprises. We own half of their New York City retail assets. We recently invested, just five or six months ago, in another property company held by Hudson's Bay, which owns Lord & Taylor and Saks Fifth Avenue. There's an example of a win-win partnership, where Hudson's Bay wanted to finance the acquisition of this German department store chain and they monetized some of the value in their U.S. retail stores to accomplish that goal.

We also have a third pillar of what we do, and that is we invest in the shares of public companies, where the assets are prime but the shares may trade at some off-market discount or price to the value of the real estate itself. That happens a lot in the REIT world, where the shares trade at discounts to the value of the real estate.

We think our strategy is somewhat unique. We think

there's no competitive or similar private equity firm in the market today that does exactly what Madison does. I actually think we probably have the highest quality real estate portfolio in a private equity fund format that exists. Pretty bold statement, but I think it has the added virtue of being true. What we find is that properties like this resonate with investors all around the world. I can go to Beijing, Saudi Arabia or Malaysia or London or Austin, Texas, and talk about properties on Madison and Fifth Avenues or Union Square in San Francisco, and they know exactly what I'm talking about. And that might not be the case if I was investing in warehouses in Austin, Texas. That's been a little bit how this business has gone through a series of inflection points. We've been able to raise more capital. We've been able to write bigger checks. We're becoming more impactful to prominent sponsors who own prime real estate.

One of the things I find so fascinating is that there's never been a more interesting yet challenging time to be investing. If you think of the world today, you've got stock market volatility; you've got an economic stall in Europe with quantitative easing; you've got a U.S. presidential election that no one seems to be able to figure out; you've got falling oil prices that are creating this big shock, and investors are all looking for the magic bullet. But there is no magic bullet. You have to do your work, know what you're doing and really become an expert. I think what we have hung our hat on successfully is quality assets, gateway markets, partnering with prime sponsors and being somewhat measured about the underwriting assumptions that we use to execute transactions.

Given all of this volatility, not just in the real estate market, how have the opportunities changed over the last six to 12 months? Is there anywhere you're seeing opportunity that maybe you wouldn't have a couple of years ago?

I think there's an interesting yin and yang between the U.S. and Europe where, if you had asked me that question 18 months ago, what I would have said is, "Most global investors are getting very skittish about the United States. Values are too high, cap rates too low, margins are too thin. What's the inning of the baseball game?" Everybody was asking that famous question. Europe was where everybody wanted to invest because it was nascent in economic recovery and there's some distress there. Now, it feels almost like it's turned around almost 180 degrees, where Europe is now going through more of an economic stall—it can't get out of first gear—and the U.S. economy is the leading economy of the world. We have 190,000 [new] jobs in the last couple of months. This past [month's] number was 160,000. And the U.S. Federal Reserve can't raise interest rates because the economy can't really get into a true growth mode, so there is this idea about "lower for longer." Part of the answer to the question, at least in our opinion, is that the flip side of "lower for longer" is fatigue. If you own something longer than you thought you would, odds are there's more fatigue in the marketplace. You have investors that have owned shares in properties that they bought in 2002, 2003, 2004. They went through the global financial crisis, they've owned [those properties] for 10 years now or more, and they're saying, "Doesn't this seem like a great time to be selling assets?" The sponsors in the United States are saying that, "No, the U.S. economy is still growing, rents are still rising, why would I sell my property today?" The underlying investor is saying, "I've held this for 10 years—it's really time for us to monetize the value of what we own." Back to our business, we provide liquidity through purchasing that partial interest. The markets are always ebbing and flowing, but it seems like the story has changed. You have to pick your spots as it relates to opportunity.

What have you been buying as of late?

We did invest with Hudson's Bay in Galleria Kaufhof, a series of department stores in Germany. A little bit further away we bought the St. Stephen's Green Shopping Centre, which is an urban shopping center on the Fifth Avenue of Dublin, Grafton Street. We've also bought some office buildings in London.

When you buy into real estate with a partner, do you acquire 49 percent? Is there a particular number you stick with?

The answer is, Not really. Unlike conventional wisdom, we do not think there is any magic to 49 percent. We would buy 25 percent, we would by 75 percent. What we're really looking to do is partner with proven managers who own high quality buildings in win-win partnerships. The traditional sentiment is if you're 51 percent, then you should be able to control everything, and if it's 49 percent it's a minority interest. Our view is that this is a partnership, that we're going to make our decisions together—that one plus one equals three. If you can't structure a partnership like that, then it's not worth doing in the first place. The benefit of our collective thinking always outweighs what we might have done had we just thought of it ourselves. That's the sign of a good partnership, and maybe there is another story there too. A lot of people think real estate is about sticks and bricks and physical assets. What we've learned over the years is that real estate is about people. Real estate is such a people business, and it's what makes it so fascinating.

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That being said, how's your business going in Europe right now?

It's also been going well. We've bought and been able to partner with prime sponsors in Europe. We bought a piece of the Trianon office tower in Downtown Frankfurt. We actually just sold our interest to NorthStar in the last six to eight months. We've owned a share of Canary Wharf and a piece of the Devonshire House [in London] and sold those properties. In Europe right now, there isn't any clear sort of growth story going on there, and you've had crisis to crisis to crisis. It's a Euro-currency crisis—it's a Euro-economic crisis. Then it was Portugal, then it was Greece, and then it was immigration. What we're finding about Europe is that it can't establish a clear growth path. And a lot of investors are throwing in the towel, and they're looking for exit strategies.

Is that why you've been selling?

We've been selling interest that we bought in prime buildings because Europe is still on people's radar screens in terms of what they want to buy, but we've also been buying properties in Europe for the same reason.

In the New York market specifically, with lots of foreign capital coming here, what activity are you seeing?

The whole tidal wave of foreign capital I think is a little bit oversold. Someone once told me that the way they describe the Asian appetite for New York was an inch wide and a mile deep. There's more capital than you could possibly imagine, but it has to be within a little, narrow bandwidth. It also takes months and months to ever transact, and by that time the deal is probably over. We've had some experience—we manage money with investors from Asia. They're great capital relationships, but they hire us because we're local in this market and we see things first. The fact of the matter is I can't remember a time where we were outbid by an Asian investor or we felt crowded out by competition. I'm not suggesting that prices are not frothy and that deals are not competitive. They definitely are, but I would say even in the last six months, there is a palpable, measurable slowdown of transnational volume. People are getting more cautious. They're underwriting a recession in their holding period if they're holding for five to seven years. Probably cap-rate expansion, that's creating a bigger spread between seller and buyer expectations. All of those things are throwing a little bit of sanity and healthy cold water on the speculative pace of transaction volume.

How long have you been seeing this change in underwriting standards?

We've been talking about cap-rate expansion for a long time and interest rate increases, which seem to never really occur, but I think now [the industry] is more focused on the business cycle. If you asked me that question 18 months ago, rising interest rates means borrowing costs are higher. And it probably means higher cap rates, so that was the issue. Now I think it's a little bit of that plus [we're at] the end of the economic cycle.

In the next two years, would you say it's better to be a buyer or a seller?

I think that buying quality never goes out of style, and as long as you're not paying a silly low cap rate and crazy underwriting and you've got a medium to long-term view, you're going to do great, especially in the United States. I worry about London, where you've got a lot of cranes in the sky. It's almost unbelievable how many office buildings are being built. I think that they can absorb a lot of it but not all of it. I wouldn't go out and starting paying 4-caps and 3.6 cap rates, but I would pay timeless cap rates for good buildings in good locations with rents that are hopefully a little below market, or maybe at market, with not a lot of lease roll.

Is this a good time to be a borrower given where rates are?

Great time. I think it's almost surprising to keep saying this, how low interest rates have been, but interest rates have been the great subsidy of the real estate business since the global financial crisis. No one who has been doing this for a long time can even remember, unless you go back to the 1950s or 1960s, when interest rates were low for such a long period of time. It's really been a great run. It's the way to make money in the real estate business—to borrower with positive leverage—buy at a six cap, finance at a 3 percent interest rate, harvest the cash flow and generate capital appreciation—that's what makes real estate a great investment. And real estate has been a great investment over the last five to seven years.