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Homegrown Funds Taking on the Street

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Portland, OR—When Rance Gregory first moved to Portland, OR a few years ago he was surprised by the dearth of private equity funds, not to mention the lack of a developed mezzanine finance market. True, having worked at **Credit Suisse First Boston**, among other firms, his benchmark was Wall Street. But Portland, along with Seattle, is the Pacific Northwest's largest market. “I was very surprised at how little local activity there was,” Gregory says.

Fast forward two years. Gregory is now the CEO of **NBS Real Estate Capital**, a Portland-based investment management firm providing equity, preferred equity and mezzanine debt capital to commercial real estate developers and investors throughout the region. “I like to think we are on front edge in terms of being one of the only true private equity funds in the Northwest and being one of the few locally based providers of mezzanine financing and preferred equity,” says Gregory. “That is all still pretty new here.”

Yet that is starting to change, not only in Portland but in other secondary and even tertiary markets. In short, local real estate investment funds that target smaller deals are—like every other aspect of the commercial real estate finance industry—starting to proliferate as new capital continues to pour into this asset class.

What is different about these funds compared to, say, a Wall Street mezzanine or debt or one-stop shop is that these firms tend to fly under the radar, especially as they normally target small and mid-sized deals. That's a space that a New York-, Chicago- or Los Angeles-based firm with nationwide coverage typically shuns. As the saying goes, it takes just as much work to finance a $3 million project as it does a $30 million. Indeed, in some markets, Gregory says, a New York-based fund might not even be interested in a $10 million loan if it has to go in and learn the local market from scratch. “A mezzanine shop in New York would find it easy to figure out Chicago or San Francisco or Los Angeles, but it would be a different matter to go to Portland to underwrite a $5 million mezzanine loan,” he notes.

Now, though, Gregory and others that focus on this area say that emerging local private equity and other such financing sources are having an impact on the real estate markets. “I am seeing now some trends towards the development of localized mezzanine players and to some extent some of the larger players willing to go to secondary—but not tertiary—markets, although most are not going down far enough in deal size to make it work in these markets,” says Gregory.

The middle market is underserved, agrees Peter Tippen, managing director of corporate real estate for **Challenger Capital Group**, a new investment bank in Dallas. “We were formed because we see a real void in the middle market for all kinds of capital,” he says.

Tippen agrees that market dynamics make larger deals more cost-effective. The middle-market space, though, is a good play for a firm such as Challenger because it provides a greater diversity of deal flow, he says. “There is a great growth potential among firms,” he says.

Indeed, as it happens, more than a few New York-oriented funds are willing to venture beyond Manhattan's boundaries in order to tap this space anyway. **Meecorp Capital Markets** is a privately owned commercial real estate lender and investment banker specializing in value-added commercial real estate projects and residential land development based in Fort Lee, NJ, within sight of Manhattan. Recently, the firm completed a host of little deals in farflung cities: a $1.2-million mezzanine loan in Neptune Beach, FL; a $3.8-million loan in Bensalem, PA and Schwensville, PA; a $4-million bridge loan in Kansas City, MO; and a $1.3-million bridge loan in Two Harbors, MN. Naturally, there will always be local participants for the smaller bridge transactions, notes Meecorp director Daniel Edrei, adding, “Deals above $10 million to $15 million have a larger market.”

But below that, Edrei says, there is little homegrown competition, at least in the mezzanine markets. “There will always be private investors in the bridge market,” he says. “But as far as mezzanine goes, that is a sophisticated product that requires players that understand the CMBS market.” He says he has not found much competition from local firms and funds outside the main markets. To be sure, the numbers of such local funds are still relatively small. But those that do exist are quickly gaining a good reputation. Gregory cites such firms as Boston-based investment management firm **Suffolk Advisors**, founded by Ivy Freedman, a former senior vice president at **Cigna Realty Advisors**, and Erin O'Boyle, a former chief operating officer of **Beacon Capital Partners**; Denver-based **Carmel Partners**, a relatively new multifamily investment management firm run by alumni from **Trammel Crow Residential**; **Acacia and Finova**, which invests in apartments in California, Colorado, the Pacific Northwest, Hawaii, and Washington DC; Houston-based **Lionstone**, a spinoff of the **Hines** organization which invests in office property; and **Greenfield Partners**, a Connecticut-based value-added/opportunistic investment advisor.

Then there is David St. Pierre, president of Cleveland-based **Legacy Capital Partners**, who raised $44 million last fall for his private equity fund. “We are a little unique in that we are looking to invest at the equity level and because we have a long-term outlook on our investing approach as opposed to a lot of capital today,” he says. Key to the investment, he says, is working with local operators who understand the market. “Working with the right local operator there will always be good investment opportunities regardless of the size of the community.”

The fund has invested in student-housing projects in Gainesville, FL and San Marcos, TX, and is currently evaluating prospects in Boston, Las Vegas, Denver, Atlanta, Phoenix, Manhattan and San Jose, CA. The typical investment is between $3 million to $8 million.

St. Pierre is the first to agree that local funds are starting to make their presence felt—and not just because of his own fundraising. “In all the deals we have looked at there have been local players that proved to be very formidable competition,” he notes. “They are in the market and thus are able to react faster to opportunities.”