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THE 2016 INVESTMENT GUIDE
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Real Estate For the Ages

LIFE-STAGE INVESTING IS THE LATEST BUZZ PHRASE ON FINANCIAL MARKETERS' LIPS. WHEN IT COMES TO REAL ESTATE, HARRISON STREET CAPITAL IS PROVING THAT IT REALLY WORKS.

BY NATHAN VARDI

When Christopher Merrill first started telling potential investors ten years ago that he wanted to put their money in student housing, he raised a few eyebrows. "Some could only picture *Animal House*," says Merrill, who has been investing in real estate since 1993. But check out the $40 million property Merrill developed one block west of the University of Arizona campus. There is a rooftop pool, a fitness area and a business center—and 164 units with designer furniture, quartz countertops, stainless steel appliances and in-unit washers and dryers. The place charges $900 a month per bed, with apartments sleeping between one and five students. "Safe, well-lit, gated communities—parents won't pay enough for that," Merrill says.

The private equity firm Merrill cofounded in 2005, Harrison Street Real Estate Capital, invests in student housing as part of a real estate strategy that is exclusively focused on demographic trends. For Millennials, dorms and student apartments are the target; for those in the "accumulation" stage of life, self-storage is a great bet; and aging boomers are driving a boom in health-care-related real estate.

"These are need-based real estate investments where occupancy is not driven all by economic cycles," says Merrill, CEO of the $8 billion (assets) Chicago-based asset manager. "One investing mistake people make in real estate is being tied to the economic cycle."

Innovative approaches to real estate finance are old hat for Merrill, 44. During the 1990s he kicked off his investing career making bets on central European real estate in the years following the fall of the Berlin Wall. When he returned to the U.S. in 2000, he realized that noncyclical events—like a wave of new capitalists in the Eastern bloc—make the best investment catalysts. He honed in on areas like self-storage and student housing, which had not traditionally attracted serious institutional investment. In 2005 he founded Harrison Street with former Motorola CEO Christopher Galvin and his brother, Michael, both grandsons of Motorola's founder.

Merrill's theory was that he could get higher risk-adjusted returns investing in asset classes that were hard to access and were fragmented—those would be more shielded from economic downturns than traditional real estate properties. Even in bad times, people send their kids to college and their parents to assisted-living facilities. What he didn't realize was that this investment thesis would be put to the test practically from the get-go with the massive real estate bust of 2008, just a few years after Harrison Street had opened its doors.

"The financial crisis was a tough time to start a business, but it highlighted our strategy," says Merrill. "We didn't make a lot of money, but we preserved capital." In U.S. student housing, for example, occupancy remained at 93% during the recession while REITs that invested more broadly in apartments had high vacancies and lost money. Storage did well, too. The cash flows of California's Public Storage, for example, were so resilient that it became one of the largest publicly traded global REITs during the crisis as the shares of other REITs crashed.

Merrill's returns have proved his thesis. Harrison Street's opportunity funds targeting capital appreciation have posted an internal rate of return of 25% over their life spans on all realized investments. Its Core Fund, designed for income, has yielded 5.98% since inception, compared with 5.14% for its benchmark index. While his fund is open only to institutions and wealthy investors, individuals can simulate his general approach by building a portfolio of REITs that specialize in the noncyclical sectors he invests in. Incorporating demographics into real estate investing is nothing new, but with interest rates near zero and the current economic expansion in its seventh year, jumping on inexorable long-term trends—like retirement homes for an aging population—is an excellent way to shield your income from a downturn.

Right now Merrill's biggest focus is health care, where he has invested 50% of his portfolio, largely in senior housing. Merrill avoids active adult communities—those live-in country clubs aimed at empty nesters—because he believes if the economy turns, those folks might stay in their current homes. He also doesn't like skilled nursing facilities because of their financial peculiarities. His sweet spot is assisted-living facilities that provide intermediate-level care for seniors who have

Dorms, doctors' offices and storage lockers are a few of asset manager Chris Merrill's favorite things.

JEFF SCIORTINO FOR FORBES

FUTURE OF MONEY DEFINED

Shark Tank Effect \'shärk-tank-i-'fekt\ *n* Everyone will be a venture capitalist. Newly liberalized laws and a slew of matchmakers online will let anyone invest in small businesses around the world, no matter your income or net worth.

trouble with daily activities. He also likes projects that deliver Alzheimer's or "memory" care. Few will stop caring for a parent with dementia just because the economy turns ugly.

The rest of Merrill's health care portfolio consists of medical office buildings, an area he thinks will benefit from rising medical expenses, the move of services away from hospitals and ObamaCare, which has already created 18 million more insured Americans. "Before, uninsured doctor visits were handled in the emergency room," says Merrill. "More insured people means more business to doctors, and consolidation in physician groups means credit in medical buildings is getting stronger."

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DO IT NOW!

- Inject a dose of medical office buildings into your portfolio with Healthcare Trust of America (HTA), yielding 4.5%.
- Sock it away, and earn 3.2%, in Sovran Self Storage (SSS).
- Sleep well with 4% dividends from dorm REIT American Campus Communities (ACC).

After a five-year bull run during which U.S. health care REITs doubled, 2015 has been dismal. Thanks to rate fears, the sector has recently traded at a discount to net asset value. Also, institutional money has flooded into the sector chasing returns, so competition has eroded its profitability.

Kevin Tyler, a health care analyst at Green Street Advisors, prefers REITs that are largely exposed to medical offices, like Healthcare Trust of America. "Physicians are pretty sticky, they tend to stay in their offices, and what the REITs own tend to be right next to or affiliated with a hospital, so it's not like owning a single-physician practice in the suburbs," Tyler says.

Self-storage is another cash machine. Demand for storage rooms, lockers and containers is often the result of life events, like moving or becoming an empty nester. It's great insurance against a recession. In fact the sector benefits during recessions because it often forces small businesses to use storage lockers as temporary inventory warehouses during downsizing.

Five-year returns for most storage REITs have been stellar. Utah's Extra Space Storage, for example, has returned 500% to shareholders since 2010, and it continues to pay a 3% dividend yield. Thomas Bohjalian, manager of Cohen & Steers' $25 billion U.S. real estate portfolio, continues to overweight self-storage.

The wave of institutional money looking for life-stage investments is likely to grow. Martha Peyton, who manages a portion of TIAA-CREF's $89 billion in real estate assets, recently reported that her firm is creating its own strategy devoted to student-housing assets. "Universities are creating dependable demand," says Peyton. "It's attractive because the schools themselves don't have deep pockets anymore, and they are looking at the private sector."

Merrill couldn't agree more. His firm already owns residences adjacent to 80 different colleges. Public universities are his favorite because they are more likely to be cash-strapped, and these schools typically house only about 30% of their students on campus. "We are not focused on private schools where education is expensive," says Merrill. "In tougher times people are going to move from them to public schools."

To this end Harrison Street recently paid $1.9 billion to take private Campus Crest Communities in Charlotte, N.C. With more than 75 housing properties near large public universities, Campus Crest is a leader in swanky, fully furnished off-campus dorms. Despite its claim to having "Harvard-style" libraries, its 41 Grove apartment complexes, near the likes of Auburn and Penn State, scream not the filth of *Animal House* but the entitlement of *Entourage*. In a promotional video entitled "Life at the Grove Is Dope," shirtless frat boys play beach volleyball and poolside beer pong, while bikini-clad coeds visit the facility's tanning booth and coffee bars, and mix around the outdoor fire-pit, all while a rock song croons "where it's Friday night forever."

With 90% occupancy levels and healthy revenue per bed, it's music to Merrill's ears: "I love an asset class that can preserve capital in a down market." F

DANIEL HERTZBERG FOR FORBES