FAMILY OFFICE INSIGHTS
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Peer Insights

REPORT

Q&A with Oscar Vasquez

Chief Operating Officer, Encore Capital Management

Principle Series:

Peer Insights Review sits down with Encore, a real estate development and investment firm for an exclusive look into their latest fund and the current state of the real estate market. The firm was founded in 2009 by Art Falcone, a Florida-based developer; Tony Avila, an investment banker focused exclusively on the residential real estate industry; and Bill Powers, a 20-year veteran of PIMCO. While their original mandate was to focus on the distress and dislocations created by the housing and financial crisis of 2008-2009, today the firm has evolved its strategy to match the investment opportunity landscape.

Q: How does Encore differentiate itself amongst the industry?

A: Our vision was to "build a better mousetrap" - a new and unique vertically integrated firm that could create value for investors at every step of the residential real estate lifecycle, from sourcing through financial workout, entitlement, development, design, construction, and sales. Unlike most other private equity real estate companies that are just allocators of capital, we maintain the key operational real estate capabilities in-house. This eliminates the "double promote" paid out by the larger firms to their local sponsors, thereby enhancing returns for our investors.

Q: Why is residential real estate at a high level a great investment?

A: Well, as evidenced by the housing crisis, you cannot say that all residential real estate is always a great investment. However, when performed by experts at the right time in the right locations, it can be a great asset class. While we can always build more homes or apartments, we can't create any more land. So if you can acquire well-located land at an attractive basis, you are basically creating an irreplaceable asset. The most important factors to success in residential real estate investing are deep, local expertise in order to identify or create off-market sourcing opportunities in the right locations, and the discipline to stick to your underwriting and not depend upon cyclical price appreciation to hit your targeted returns. We assume no price appreciation, rent growth, or cap rate changes in any of our acquisitions.

Q: What are some current myths surrounding the residential real estate market?

A: The biggest one we see now is what we call "The Myth of Oversupply". There is a misperception that there have been too many apartments built over the past few years, or that we are in "the 8th inning" of a multifamily housing cycle.

Historically, we have created about 360,000 new apartment units per year in the United States. In 2009 we produced about 90,000. This was 50% lower than the previous low since World War II. Production slowly increased each year until 2014 when we reached about 330,000. This was a five-year period where we had been under-supplying the market. Much of the construction that has been visible in the past 2-3 years led people to exclaim "Wow, look at all the cranes! We must be over-building!" however, most of these were merely the projects which had been planned but stalled dating back to 2008 and only got revived in late 2012 through 2013. Concerns about either over-supply or it being "too late" in the cycle for apartments are clearly not supported by the facts.

Q: What is your primary investment thesis for the firm?

A: Our current primary investment thesis is that we are significantly under-supplied in new rental / apartment communities in key urban centers. We just discussed the myth of over-supply but that just assumed a steady-state demand for apartments consistent with our historical averages. We actually think that due to macro-demographics associated with the "Millenials", we are entering into several years of localized under-supply of apartments in very specific urban metros.

There are 83 million Millenials in the United States - this is the generation that was born between 1980-1990, who are between 24-35 years old now. This is the largest population cohort, even larger than the Baby Boomers. While it's tough to generalize about 83 million people, there are a few undeniable trends within this age group. First, they are in frightening financial shape - they have very little savings, they just crossed $1 trillion in total student loan debt, and they are entering the housing market in the tightest mortgage lending environment in decades. These people would have an extremely hard time qualifying for a mortgage to purchase their first home. Second, and just as importantly, they are increasingly seeking an urban lifestyle. They like to live, work, and play in high-density, high-energy urban environments.

You combine these two trends and you come to the undeniable conclusion that there is a tremendous under-supply of new for-rent housing in key urban markets with job growth and population growth, such as San Francisco, Los Angeles, Dallas, Austin, and Miami/Ft. Lauderdale. We have launched our current Rescore REIT fund specifically to exploit this opportunity.

Q: Can you briefly discuss your first two funds and how Rescore is different?

A: Encore Fund I was launched in 2009 and focused exclusively on the distress and dislocation caused by the housing crisis. We were able to find tremendous bargains by acquiring properties out of bankruptcy, via foreclosure of bad loans, or working with property holders under financial duress. We raised and deployed $160M across 18 investments in Florida, California, and Texas, with 80% of our capital going towards investments in for-sale homes and 20% to apartments. We used our local teams in these geographies to source off-market opportunities, and used our in-house skills to complete whatever entitlement, development, and construction was required to create value and monetize the assets.

Encore Fund II followed in the footsteps of Fund I pursuing the same strategy, same geography, and same for-sale / for-rent mix, but at a much larger size of $462 million. Both funds are on track for delivering net 20%+ IRR and 2x equity multiples to their investors.

Rescore is different in that it is focused exclusively on building new apartment communities, with no for-sale product. What remains consistent is our team, our hyper-local focus, our off-market sourcing, and our in-house development and construction capabilities.

Q: What is the fund's exit strategy?

A: Rescore was structured from Day 1 as a private REIT, to enable a couple different exit strategies. We can either:

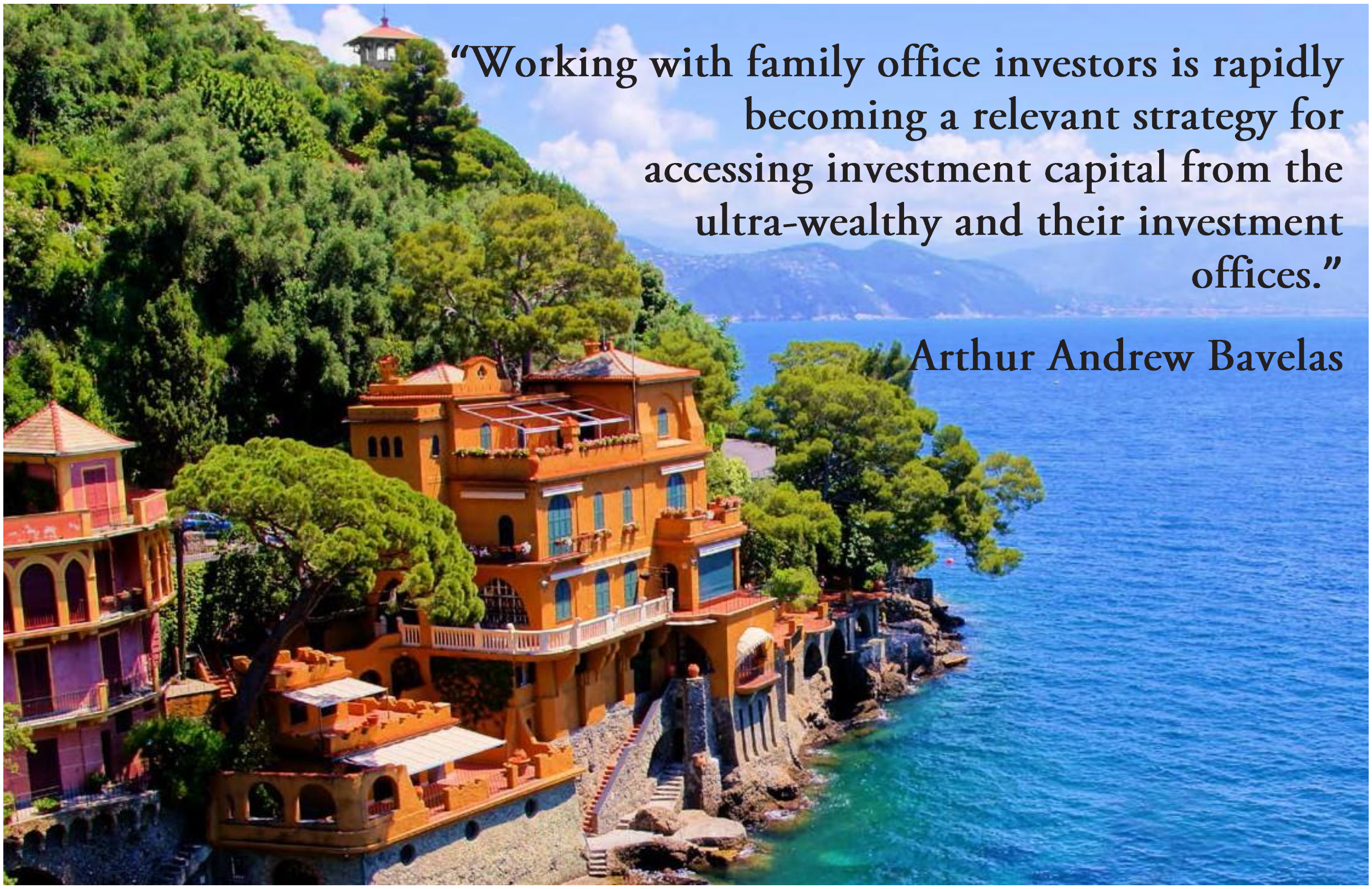
- sell the entire portfolio to a large public REIT via a merger, then distributing shares to investors
  or
- if the capital market environment is right, have an IPO ourselves

In either case the investor would end up with REIT shares that they could hold *and* continue to harvest the quarterly dividend or sell the shares at an appropriate and tax-advantageous time. We like providing our investors this optionality.

Q: Why is it attractive for family offices to invest in emerging managers such as yourself as opposed to larger ones?

A: We find that our investors, particularly family offices, greatly appreciate the direct access to real estate expertise that they get by investing with Encore. We are small and nimble enough to be extremely transparent. We invite all of our investors to our board meetings where we discuss all of our target markets, investments, and strategies in great detail. We all find that the exchange of ideas and information that occurs in this setting is very valuable for all parties. Many family offices have had their first exposure to real estate investing either through huge megafunds which are effectively just macro/beta plays where returns are naturally watered down just through the sheer size and breadth of allocation, or through doing riskier, concentrated direct investing in individual real estate deals. Investing with Encore allows family offices to partner with a nimble, experienced real estate expert to take advantage of a very compelling opportunity created by a combination of an under-supplied urban apartment market and a large and growing renter demographic.

Oscar Vasquez is the Chief Operating Officer of Encore Capital Management with over $1.5B in AUM. Oscar is responsible for fund operations including structuring, legal, compliance, technology, fundraising and investor relations. Prior to Encore, Vasquez worked in as a management consultant leading business organizational change and technology implementation initiatives at Fortune 500 companies. For more information, please go to http://www.encorecm.com/. To contact Oscar please email oscar@encorefunds.com.


"Working with family office investors is rapidly becoming a relevant strategy for accessing investment capital from the ultra-wealthy and their investment offices."
Arthur Andrew Bavelas