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INVESTING

A Unique Real Estate Bet Takes Shape At Energy Investing Giant Kayne Anderson

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The big story in private equity right now is the record cash flowing into the industry's biggest firms such as Blackstone, Apollo and KKR, who all now have tens of billions of new investor dollars to put to work. But amid this money gush, some investors are cutting the other way and looking for niche markets where they can build large portfolios of assets before the big money inevitably arrives.

Take Los Angeles-based Kayne Anderson, best known on Wall Street for institutionalizing investments in the oil and gas sector and the associated energy infrastructure master limited partnerships that are the backbone of today's drilling boom. During the 1990s and 2000s, while many investment firms chased mega leveraged buyouts, Kayne Anderson built a leading presence in un-sexy pipelines and storage hubs. Once niche assets on Wall Street, these businesses are now prized in today's low-interest-rate world because of the stable cash flows they generate by transporting growing hauls of oil and gas from shale basins across North America.

Quietly, the vaunted energy investor is building a new investing niche, this time in real estate. Over the past decade, Kayne Anderson's real estate private equity investing platform has grown from virtually nothing to \$5 billion in assets. The

business, Kayne Anderson Real Estate Advisors (KAREA), has built a toehold in markets like senior housing and medical office properties that are beginning to attract the world's biggest pools of pension and sovereign wealth money, as they hunt for safe yields.

Leading Kayne Anderson's real estate push is Al Rabil, 54, a niche-obsessed



KAYNE ANDERSON

Al Rabil, of Kayne Anderson Real Estate Advisors

real estate investor who's spent the past 15 years canvassing America in search of under served markets with strong demographic tailwinds. In 2002, Rabil left his post as head of UBS's real estate investing arm to venture out on his own. As the U.S. housing market bubbled over, Rabil's investment firm focused, instead, on building large portfolios of off-campus student housing in markets with major private and state universities. His bet? Dorm room supply at universities like Michigan State University, the University of Oregon, the University of Texas and the University of Alabama couldn't keep up with enrollment growth, particularly coming out of the crisis.

"What we look to do is identify demographically-driven sectors of the real estate market that are highly fragmented and operationally intensive," says Rabil of his student housing bet. "We look to be a first mover and want to be an aggregator in scale prior to huge institutional dollars coming in," he adds. That's exactly what happened.

In his first handful of years, Rabil, then running a small independent investment firm plowed some \$500 million into student housing, building one the industry's biggest portfolios with a heavy presence in college towns like Eugene, Ore., Tuscaloosa, Ala., Lansing, Mi., Kennesaw, Ga., and Richmond, Va. Coming out of the crisis,

big institutional investors, having experienced a roller-coaster real estate market, sought the safety of college campuses and took interest in Rabil's portfolio.

Since 2012, Rabil has sold tens of thousands of dorm rooms to investors as big as REIT American Campus Communities and Singaporean sovereign wealth fund Temasek. Overall, Rabil's team did some \$3 billion in student housing deals, building a 50,000-bed portfolio at 46 universities in 25 states.

Also taking notice was Richard Kayne, founder of Kayne Anderson. In 2007, Kayne was looking to diversify his energy-gearred firm to niche areas in real estate. Al Rabil was at the top of his list of people to bring to his firm. Kayne offered to leave Rabil in full control of his investment platform but give him the infrastructure and marketing his bigger \$25 billion in assets firm. The opportunity was too good to pass up.

Starting at \$500 million in assets, KAREA has been a wild success for Kayne Anderson. In real estate private equity, KAREA's funds have quickly grown in size on the back of strong returns and high institutional investor demand. This year, KAREA topped \$5 billion in assets, buoyed by the creation of a multi billion-dollar real estate debt investing platform.

As KAREA becomes an increasingly prominent real estate player, Rabil's focused on a new demographic in real estate: the aging U.S. population.

"We are gearing our strategy specifically towards the Baby Boom generation," Rabil says. He's now hard at work consolidating portfolios medical office buildings and senior housing communities in areas like Florida, Texas, California, North Carolina and South Carolina where demand for senior services is expected

to dramatically outstrip supply.

In the coming decade, the U.S. population of 65-year-olds and 75-year-olds will double and eventually there will be more people in retirement than working, Rabil forecasts. The real estate market, however, has not built the capacity for this demand. In Florida, for instance, 4,000 units for independent senior living have been built since 2008. Well over 100,000 Floridians, however, will turn 75 in the next decade. "You do the math," says Rabil, who expects real estate investors will increase their allocations to these demographic trends, particularly if overall GDP growth falls short of today's rising expectations.

"Fifteen years from now, in my view, there is no way senior housing and medical office are considered alternative asset classes. They will be considered core real estate assets," he says, similar to office buildings, multifamily homes and retail.

Since May 2013, KAREA has acquired nearly 10 million square feet of medical office space across 30 states and a further 34 private-pay, senior living communities totaling 5,554 units. Rabil wants to consolidate large portfolios in both markets, expecting that there will be heavy demand for fully stabilized properties by bigger institutional buyers. KAREA's focus is the higher end of the market, where issues like the volatility of Medicaid reimbursements or the broader housing market aren't expected to have a big impact.

Is Rabil gearing up for a next real estate investing niche? Surprisingly, the answer is no.

"We don't have any next right now," Rabil booms, and he's not excited enough about hot niche markets like data centers or industrial space to change course. "I see

five years of runway, if not more, in medical office and senior housing investments," he says. "We see so much opportunity in what we are doing today."

How To Play It

There's a way for ordinary investors to get in on the expected "baby boom" demographics in real estate. Rabil is competing in the medical office and senior living markets with a handful of unheralded but publicly-traded real investment trusts.

Ventas, with a market capitalization of \$23 billion and a dividend yield of nearly 5% leads the way. It is moving fast in consolidating real estate, having recently purchased Ardent Health Services for \$1.75 billion and a life sciences portfolio from Wexford for \$1.5 billion. Analysts consider Ventas a best-of-breed operator, already holding significant scale and cost of capital advantages to its peers.

Welltower is another option. Also offering near 5% dividend yields, the Toledo, Ohio-based firm's underleveraged balance sheet gives it significant dry powder for acquisitions. This year, Welltower's portfolio has outperformed peers according to analysts at Stifel Financial. Recent joint ventures with large hospitals like Johns Hopkins University also may provide new patient growth opportunities.

Not all REITs in this space have performed well. Brookdale Senior Living, a far smaller player than Ventas and Welltower, is currently being pressured by activist investors to sell assets or the company outright. Amid reports of a sale process, Brookdale recently struck a standstill with REIT activist Land & Buildings. However, if a sale does eventually go through it may confirm demand for senior living assets by big money investors.