Madison Marquette's Investor-Operator Model

Eric Hohmann, president of Madison Marquette, explains the company's investment and operations model, and discusses trends the company sees in the industry.

Interview by Randall Shearin

Madison Marquette is developing The Wharf, a major mixed-use project in Washington, D.C., designed to bring the waterfront alive in the city for the first time. The project is also demonstrative of the company's investor-operator approach.

With the retail industry changing, *Shopping Center Business* wanted to get a view from a company who owns and operates a variety of shopping centers across the country. Madison Marquette has been a force in the industry for many years, and is known for its talents in repositioning centers of all shapes and sizes. While in San Francisco recently, *SCB* interviewed Eric Hohmann, president of Madison Marquette, to get the company's take on new trends in retail real estate.

SCB: Madison Marquette has a number of interests in centers today. Everyone knows you for developing projects, redevelopments and as an owner. How is Madison Marquette active in the industry today?

Hohmann: We have 51 centers that we are actively managing today. In a little more than half of those, we have an investment stake. We do some fee-based management for clients. Our model is to be an investor-operator. In addition to investing in centers, we also have a property management platform, so we do leasing, construction management and develop as well. Our roots are as a developer, but we have evolved over the years to have an operating capability. Historically, we have been an operating partner for capital partners that we co-invested with. We have expanded our capabilities to investment management, which started with our fund that we raised about six years ago; our commingled discretionary fund. We have followed in the footsteps of many of the other family companies who started as developers like Hines and Shorenstein. We are an investor-operator with co-investment capital.

SCB: Madison Marquette has a long history in this industry, dating back to the 1970s.

Hohmann: At our roots, we are tinkerers. We have that development and re-

Madison Marquette acquired Pacific Place in Seattle and has plans to modify the center in the near future.

development thinking. We get ahold of projects, we work them, we chew on them and we take our time doing them. Our DNA, like so many in the industry, goes back to The Rouse Company, I would say. John Borne attracted many people to Madison Marquette who had a history with The Rouse Company. That brought a lot of thoughtful decision-making, merchandising and placemaking strategies to our company. Jim Rouse, in particular, championed that. I never worked for The Rouse Company. I started at JMB/Federated, which was the pre-cursor to Madison Marquette in many ways. We were surrounded by Rouse people, so I was infected with a lot of their philosophies.

SCB: Today, Madison Marquette technically has two sides to its business. Tell us about those.

Hohmann: We have the investment side, and the real estate services side. The real estate services side is our operating platform.

SCB: What trends are you seeing on the investment side of the business?

Hohmann: On the investment side, we are seeing one major trend. Coming out of the recession, there is a strong interest from capital — particularly international capital — to directly invest in real estate. These capital sources want to have greater control over their operating partner, and the outcomes of the investment. Why? Because in the recession they were burned through some indirect investments with bad partners. Some investors are building their own platforms so they have even greater control of the execution of the assets. Chiefly, they are tired of giving capital to an allocator, who then ventures with an operator; both those partners have promotes and fee layers. It is more efficient for the investor to go direct to the companies who are executing. We have been approached, more and more, by investors directly. Offshore investors like our platform because we have offices up and down both coasts. We are in a lot of markets, we are sourcing deals on our own. We also have a proprietary pipeline of new deals. Investors for specific strategies like having access to our pipeline.

SCB: Explain how you work with investors?

Hohmann: We put together investment vehicles around a specific strategy. We have investors already arranged and pre-negotiated so that when we find properties that fit, we can acquire them without seeking investors. Our platform is appealing to those investors because the real estate industry is deal constrained. There aren't a lot of good opportunities. Our investors can get first crack at a deal that fits a strategy by having a pre-negotiated arrangement with us.

SCB: What are foreign investors seeking when they invest in U.S. real estate?

Hohmann: The United States' economy is perceived as one of the best. We have growth and we have returns. There is perceived safety, in terms of economic soundness and the stability of the dollar. We do suffer from taxation. Our FIRPTA (Foreign Investment In Real Property Tax Act) laws make it difficult oftentimes for offshore investors. We have been developing expertise about tax efficiency for our offshore investors. We have created deal structures and partnership arrangements that minimize the tax bite that an offshore investor might have, as well as the severe withholding requirements that the federal government requires if they want to repatriate capital.

SCB: What types of projects are you investing in today?

Hohmann: Our investors are interested in gateway cities, especially urban, infill markets in those cities. That's where they want us to deploy capital. In those markets, the ground up development opportunities are in the mixed-use sector. We have a project underway now in Washington, D.C., along the Potomac River called The Wharf. We commenced construction in April 2014. It will be a multi-year, multi-phase project with a retail base. There will be subterranean parking. Above and around the retail will be apartments, condominiums, office space, entertainment, dining, a marina and three hotels. We are working with a local multifamily developer, PN Hoffman. With mixed-use we are finding the retail space — which we are experts at — creates the opportunity for the other uses. We are investing in a vertical slice — in all the uses; we are not just the retail partners. We think one-plus-one equals three; the retail can make the other uses better, if executed well. We have another major project underway in Alameda, California, that is a reuse of a former naval air station. Our placemaking skills helped land the opportunity, but the economic engine of the deal will be the multifamily.

SCB: In addition to those two projects, you are also active with redevelopment.

Hohmann: There are not a lot of major pure retail development opportunities anymore, particularly in the denser markets. There is an unending supply, it seems, of assets that need retuning or refocusing. Retail is an ever-changing industry. It is an organic sector. Last summer, we closed on Pacific Place. This is a vertical retail center in downtown Seattle that was built in 1999. At the time, it was a groundbreaking project. Now, not only has the retail world evolved, but Seattle

Eric Hohmann

has changed too. The project sits between Sixth Street and Seventh Street and fronts Pine Street. The back door sits on Olive Street. That neighborhood — South Lake Union — has exploded, and residential has moved into Seattle since this project was built. We should no longer have a back door; that project essentially has its back on that growing neighborhood that it needs to embrace. It's an interesting challenge for us to evolve the merchandising mix to fit our times. We want to evolve the look and feel and to address the city's wants.

SCB: Madison Marquette's reputation as a turnaround expert has allowed you to work on some incredible projects. What is driving turnarounds of centers today?

Hohmann: In the retail sector, we don't need a lot of new space in the United States. We now find trends in the business that cause us to create a need to reposition assets. One of those is the decline of the traditional anchors. Food is becoming increasingly important, as well as entertainment. We are now looking at entertainment concepts as taking over some big boxes and becoming anchor draws to centers. We are sitting here in the Bay Area, the capital of the slow food movement. The focus on food has spread nationally. We have been trying to figure out how to harness that, especially with the food hall concept. You will see us make some strategic plays in that area to satisfy the customer's desire for better food options. We think of properties as being either specialty centers or commodity centers.

The Edge is a mixed-use project Madison Marquette owns in the Williamsburg area of Brooklyn.

We operate in both of those areas, as well as the regional mall sector. In the traditional mall sector, we have been working on some de-malling strategies. Those might include adding density or other uses to the center, taking advantage of the well located nature of these properties. The parking fields at malls are mostly underutilized today. We've been looking at adding office or multifamily to some of those. Many projects we've dealt with have had too much small shop space, so we've developed an expertise of aggregating space, creating some exterior openings. We really like to change the battleship nature of malls so they are not inward focused. There are a number of newer retailers, like Ulta, DSW, Ross Dress For Less, Nordstrom Rack, Saks Off Fifth, who are now considered mall anchors. Tenants like Forever 21 and H&M are really mini department stores. Fitness is also a use that is being added to many commodity centers. They will take a lot of what I would consider to be difficult-to-lease space. They may not bring a customer who is on a shopping trip, but it is the same customer who shops the center. In the specialty sector, we are always looking for new concepts and new entrants to the market.

SCB: Your model with management services is a little different than a pure third-party manager. Can you explain that?

Hohmann: We think like an investor and owner. We have a deserved reputation for taking on challenging projects that need to be repositioned. For that reason, we are often retained by new owners of projects once our investment vehicles sell their share. Last year, in two-thirds of the assets that we sold, we remained as the property manager and/or leasing representative. That is a real vote of confidence from the new owners and we love to do that. When we do that, we keep the same teams on the properties; we don't have an A team or B team. It is one company, one execution.

SCB: As retail is always changing, where do you see the opportunities for Madison Marquette in the future?

Hohmann: We are moving out of pure retail. Our capital investors are taking us into dense, urban markets, where a variety of uses is just part of the atmosphere. We are also buying office buildings now, some without retail. In the boroughs of New York City, we have bought pure office buildings. We are being led into the creative office space. Office space that is not Class A in the right market with the right transportation characteristics, can be creative office space. With the enjoyment the multifamily sector has had, we are finding more opportunities in that sector through our involvement with retail; we want to continue that. We have always been in mixed-use projects, but as a rule we were 'the retail partner' and kept to our retail piece. Now, we are getting involved in the entire deal. We think the right way to approach mixed-use assets is holistically. **SCB**