

14.3.2 Case Study: Jackson Oats Shaw Corporate Real Estate

Jackson Oats Shaw Corporate Real Estate (JOS) is a real estate investment and operating concern formed in 2001 as an LLC under the laws of the state of Georgia. The JOS portfolio includes about 50 income-producing properties, totaling approximately 3.2 million square feet. Specializing in office and warehouse space, about 33% of its portfolio is in Class A office buildings, with another 32% in office/warehouses. Other significant investments are in single-story office, Class B office, and mixed-use office.

JOS is a long-term investor focused on cash flow yield, appreciation, and risk management through diversification. JOS management believes that the company's reputation in the market and among tenants is a crucial element of its success. The company's goal is to create value and maximize return for the company and its investing partners. It executes its goal by active but careful property acquisition, superior property management through its own operating company, and strategic property dispositions timed to capitalize on emerging market opportunities. The company characterizes its method as an entrepreneurial approach to acquisitions, an institutional approach to operations, and a patient approach to dispositions. This carefully chosen mix of capitalization and acquisition strategies, operational strategies, and disposition or exit strategies constitutes JOS's market position in the world of successor entrepreneurs.

14.3.2.1 JOS Capitalization and Acquisition Strategies Remember how Wells raised capital? It used the REIT vehicle and sold many relatively small investment units (shares) to gather a great deal of funds. We can characterize this as a "little money from a lot of investors" strategy. The JOS strategy is the opposite. Using partnership and joint-venturing vehicles, JOS collaborates with prominent individuals, families, and corporations as their joint venture and investment clients. Unlike the Wells approach, JOS collects investment capital, employing a "lot of money from few investors" strategy. JOS augments equity capital with a conservative use of debt by seeking out

loans with favorable terms that can be assumed or by borrowing money long term, say around 10 years, at fixed rates while avoiding short-term (3 year) adjustable rate loans. If favorable loan terms are not available, JOS postpones purchases or buys all cash and borrows when financing terms are more attractive. When leverage is used, JOS views itself as partners with its lenders, not as customers. Building strong trusting relationships with lenders is critical to the JOS capitalization strategy.

JOS does not participate in auctions or in bidding purchase processes and judiciously protects its reputation in the market as a company that always closes its deals, that always keeps its property purchasing commitments. Management is selective in the properties it targets, searching out properties with positive cash flow at price points below replacement costs and with the potential for value appreciation (called value add) through quality management. Due diligence is exhaustive. The physical characteristics of the building are reviewed, market and leasing demand analysis is performed, and financial aspects of the operation are carefully scrutinized. Tenants are also carefully considered: who are they, what is their business, how is their business, what is their credit rating. Relationship building actually starts before the building is purchased, the relevant point for the tenants being that the potential owners and operators of the building may be in a position to help them in the future.

To be a candidate for JOS purchase, a property must ultimately be attractive to tenants, their employees, and customers. Does it have pleasant views, large windows, efficient lobbies, and convenient restaurants? What are its amenities? Would I want to be in this building? Will my employees and customers like it? Will people feel safe here? Given JOS's patient disposition strategy, any purchased property might have to be held for a significant period. Can the property meet target returns if held for the long run? The key is attracting quality tenants and then building their loyalty. No surprise then that JOS operational strategy is centered on tenant relationships.

14.3.2.2 JOS Operational Strategies Believing that the conflicts of interest (called agency issues) inherent in third-party management erode tenant loyalty, JOS manages all the buildings that it owns and only the buildings that it owns through its operating company. Third-party management can also be less responsive to tenant needs than owner management because it places an extra layer of separation between the tenant and its problem and the owner who approves solutions. Much of the risk in owning income-producing real estate is in the tenancy, and JOS controls this risk by attracting diverse, high-quality tenants, working with them to create optimal space, and retaining them by a responsiveness that anticipates their needs. JOS strives to be expert in the psychology of tenant loyalty. The strategy has led to above-market retention and occupancy rates,

with the ultimate goal of optimizing cash flow. Buying and financing at favorable prices gives JOS flexibility in lease negotiations to bargain for long-term cash flow stability. It can afford, in other words, to offer rental rate reductions in exchange for 10-year rather than shorter, more typical lease terms. The JOS philosophy is “when cash flow is good, everything else takes care of itself.”

Rather than simply passing expenses on to tenants, tempting them to seek alternative space, the internal management company strives for operating efficiency through economies of scale and diligent quality control, which lowers overall tenant expenses. Internal property managers are better positioned to offer personalized, high-quality tenant services, improve operating efficiencies, and enhance asset value. Operating expenses are also reduced when architects sit down with tenants to collaborate on tenant improvements and designs to meet space requirements. All of these practices again build tenant loyalty, which in the long run may well be reflected in operating statements and property performance not just by reducing expenses but also by increasing retention, occupancy, and therefore revenue.

A common investment strategy that JOS does not employ is acquiring property, lowering operating expenses, and quickly reselling to realize the gain in net cash flow. This process is commonly referred to as **flipping**. Tenants are often concerned about flipping because the short-term lowering of operating expenses is sometimes accomplished by cutting services. Building owners with the reputation of flipping properties may not have a deep commitment to their properties and the people who occupy them and may not enjoy the loyalty of their tenants. Conversely, tenants appreciate the long-term owner-managers who take care of their properties and tenants by reinvesting in their buildings. Tenants are more likely to exhibit loyalty to building owners or managers who focus on keeping their properties occupied than to those who focus on the cap rate.

Flipping: A 3-step, short-term real estate wealth building strategy consisting of acquiring property at bargain prices, inexpensively adding value typically through operating efficiencies, repairs or improvements, and quickly reselling to realize the gain.

14.3.2.3 Disposition or Exit Strategies Even when not interested in flipping property, the strategic time for selling may arrive. Predicting the optimal time to sell is difficult. The JOS strategy is to let the market decide, to enhance both revenue through tenant relations and operating efficiencies through property management, let the property carry itself, and wait for buyers to come knocking on the door. In this position, ownership is indifferent about selling and will negotiate from a position of strength, holding out for an advantageous sale. This is the “patient money” approach to disposition. The strategy is simply to be happy to keep the property, selling only if an offer is truly too good to pass up.

INSIDE THE INDUSTRY



Scott Jackson

An Informational Interview with Scott Jackson, CEO and Founder of Jackson Oats Shaw Corporate Real Estate

Q: What attracted you to a career in real estate?

A: Originally, I pursued a career in residential real estate; the plan was to sell luxury condos on the beach in Florida. I was attracted to the idea of being able to work near the ocean, with unlimited financial opportunity and compensation based on my performance.

Q: How do you define real estate entrepreneurship?

A: As an area or career in real estate that requires independent thinking and action, regardless of the area of expertise or focus. Entrepreneurs are typically compensated based on positive performance, which requires self-initiative, motivation, and the ability to handle pressure, risk, and rejection.

Q: As a successful real estate investment entrepreneur, you have a great overall vantage point from which to view the industry. From your perspective, what are the different areas of real estate and where are the available careers?

A: Careers in real estate are well documented and numerous; however each career or job is very different from the next; thus, it is important to first understand which career path is the best suited for each individual and his or her talents. I've always been an advocate for any student or person entering the industry to first gain experience with a reputable and knowledgeable firm. Find a mentor and try to avoid commission-only jobs during initial years. Gaining experience, learning the business, and matching your strengths and interests to the job are the keys to a rewarding and long-lasting career.

Q: What is the most rewarding aspect of your career? The least rewarding?

A: The most rewarding is being in an industry that I enjoy. I believe a truly successful career must be fulfilling in all areas of life, not just compensation or any other single factor. The least rewarding is the early struggles and rejections, the low compensation that most real estate entrepreneurs encounter when first entering the field.

Q: Looking back, is there anything that you would change?

A: I am comfortable with my experiences, and believe I made good decisions early in my career, decisions that were based on the future, not on the present. I would definitely choose this career again.

Q: What is a "typical" day like for you?

A: It's really about the responsibility of trying to understand the future and being prepared for it. Every day, I must be focused and constantly thinking about opportunities and challenges. I start each day by reading the Wall Street Journal and other news and industry media to keep me current and on top of the market. The typical day includes speaking with management, reviewing investments, and preparing for the future.

Q: What obligations does your work put on you outside of the actual job?

A: Our firm is a part of the larger community. We are active members of our community and spend significant time supporting area organizations and causes as best as we can.

Q: What are some lifestyle considerations for this career?

A: With entrepreneurship comes freedom; thus, lifestyle considerations can be positive and negative. Freedom to choose how to spend time is priceless; however, true entrepreneurs are always working or thinking and are prepared to work hard, sometimes at the expense of their personal lives.

Q: Can you recommend any life or job experiences that would help someone prepare for a career in real estate?

A: Work in a service industry, gain people skills at all levels.

Q: What education do you think is best to prepare someone for a career in real estate?

A: Education is key. The more the better. You might want to start with a bachelor's degree in business, perhaps with a major in real estate. Work toward obtaining a master's in real estate. Always continue to learn and grow.

Q: What is the future outlook for this career?

A: Real estate has become a major asset class; the industry will increasingly require educated professions. The securitization of real estate has great potential. Follow the REIT industry. More and more, education will be required in real estate and a more focused approach to careers and investing will take shape. I believe the winning strategy is to become very good as a specialist in one asset class or area of investment.