
THE BERKSHIRE DIFFERENCE

INCREASING INVESTMENT PERFORMANCE BY LINKING OPERATIONS TO AN INVESTMENT VALUE CHAIN

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THE BERKSHIRE INVESTMENT VALUE CHAIN

To better understand the changing nature of multifamily real estate investment and its impact on the next real estate cycle, we developed a six-point investment value chain to delineate the individual components of total return. This value chain is more than an illustrative device for Berkshire - it is utilized by all the leadership teams to increase portfolio performance. Berkshire's leadership teams accomplish this by continually refining and optimizing operational initiatives oriented to maximizing values. With compensation tied directly to property return performance, the value chain is taken very seriously as a measurement tool throughout the company.

It is Berkshire's goal to utilize *value-chain-driven property performance* to consistently provide investors with multifamily investment returns in the top 10% of the industry.

We believe that Berkshire has the capacity to add

six to nine points of return to a multifamily real estate portfolio by successfully recognizing and implementing *value-add alpha opportunities* along the investment value chain. Alpha opportunities are initiatives that are designed to increase the incremental returns of a real estate portfolio beyond those generated by the market.

We forecasted the contributions of the individual components of the value chain over the next several years, as illustrated below. Although we believe that expanding cap rates will have a detrimental impact on real estate returns, we also believe that Berkshire can overcome this by focusing on *value-add alpha opportunity* initiatives to drive other components of real estate returns.

To address this, we developed a comprehensive multifamily investment plan that evolved out of rigorous testing and analysis of our acquisition and management disciplines. Our company leaders then

Contributions to the Investment Value Chain	Forecasted Internal Rate of Return for Multifamily (Percent)		
	Core/Core Plus Market Expectation 2007-2013	Berkshire Value-Add Alpha Return	Berkshire Total Expectation 2007-2013
1. Purchase Cap Rate Yield*	5 – 5 ½	0 – ½	5 – 6
2. Increase or Decrease in Return Due to Difference Between Exit Cap Rate and Purchase Cap Rate	< 3 >	½	< 2 ½ >
3. Cash Flow Growth Over Hold Period	3 – 4	1	4 – 5
4. Asset Renovation and Rehabilitation	–	1 ½ – 3	1 ½ – 3
5. Other Asset Management Initiatives	0 – ½	0 – ½	0 – 1
Subtotal Unlevered Return	5 – 7	3 – 5 ½	8 – 12 ½
6. Leverage	1 – 2	3 – 3 ½	4 – 5 ½
Total Return	6 – 9	6 – 9	12 – 18

*Purchase Cap Rate Yield represents in place net operating income at time of purchase, less ordinary capital reserves, divided by gross acquisition cost.
 SOURCES: Berkshire Property Advisors
 Torto Wheaton Research

worked together from the acquisition screening and due diligence process, through the implementation of each asset’s management plan, to install our value-add enhancement concepts. After six years of development and refinement, the leadership team identified 13 key drivers of alpha opportunities as shown below.

BERKSHIRE DRIVERS OF ALPHA OPPORTUNITIES

PURCHASE CAP RATE YIELD – ALPHA CONTRIBUTION OF 0 – 1/2%

ROBUST ALL-WEATHER ACQUISITION CAPABILITY At Berkshire we have five traditional acquisition teams targeting major metropolitan

markets from coast to coast. We utilize both top-down metropolitan economic research and bottom-up proprietary submarket research generated by our staff to identify those markets with the greatest opportunities for achieving acquisition goals. In addition to these traditional sources for generating transactions during healthy economic cycles, we have a national distress acquisition team working to uncover foreclosure opportunities during distressed credit cycles. This approach allows us to operate in changing economic cycles, and provides us with an all-weather investment capability.

More than half of our transactions are generated from nontraditional broker sources, giving us access to a large number of transactions at competitive prices not typically available to the general market.

Forecasted Internal Rate of Return for Multifamily (Percent)		
Investment Value Chain Component	Berkshire Value-Add Alpha Return	Berkshire Implementation Drivers
1. Purchase Cap Rate Yield	0 – ½	<ul style="list-style-type: none"> • All-weather acquisition capability • Five day expedited due diligence
2. Increase or Decrease in Return Due to Difference Between Exit Cap Rate and Purchase Cap Rate	½	<ul style="list-style-type: none"> • 5% premium on sales
3. Annual Cash Flow Growth Over Hold Period	1	<ul style="list-style-type: none"> • Uncover rent arbitrage • Deliver unique service and amenities to residents • Maintain high occupancy during rehabilitation
4. Asset Renovation and Rehabilitation	1 ½ – 3	<ul style="list-style-type: none"> • Rehabilitation ROI analysis at initial screening • Compressed time for rehabilitation • Economies of scale to drive purchasing power and product/process standardization
5. Other Asset Management Initiatives	0 – ½	<ul style="list-style-type: none"> • Comprehensive submarket analysis of ancillary opportunities • Proactive use of re-buy analysis
6. Leverage	3 – 3 ½	<ul style="list-style-type: none"> • Competitive financing process • Proactive oversight of leverage
Total Return	6 – 9	National vertical organization with more than 35 years of specialized multifamily experience

FIVE-DAY DUE DILIGENCE An intensive five-day acquisition due diligence allows us to accelerate transaction screening and quickly finalize investment decisions, giving us an edge on the competition. Leadership from each functional discipline at Berkshire including acquisitions, rehabilitation, asset management, property management and finance immediately comes together to determine an asset's potential. When an acquisition opportunity clears the due diligence process, it is presented to the investment committee with a comprehensive management rehabilitation plan in place, to be implemented upon closing. Compared with other operators, we reduce our implementation schedule by as much as 180 days by having a fully vetted plan ready to launch.

INCREASE OR DECREASE IN RETURN DUE TO DIFFERENCE BETWEEN EXIT CAP RATE AND PURCHASE CAP RATE – ALPHA CONTRIBUTION OF 1/2%

FIVE PERCENT SALES PREMIUM Once a recommendation is made for divestiture, our disposition team focuses on the strategic packaging of assets to create the highest demand. Deeply rooted, long-term relationships with principal real estate brokers allow us to present opportunities that often lead to attractive auctions. This well-orchestrated sales process has generated a premium return over the market value of assets in our portfolio. We confirmed this premium in our review of recent sales. Between 2004 and 2006, Berkshire sold more than \$1 billion of assets and calculated a 5% price premium in cumulative sales, based on pricing at final closing relative to initial offer bids.

ANNUAL CASH FLOW GROWTH OVER HOLD PERIOD – ALPHA CONTRIBUTION OF 1%

UNCOVERING RENT ARBITRAGE Berkshire's

property management organization is involved from inception in every prospective transaction. The team is asked to make a determination as to the extent of the under management of a target property relative to its market and submarket. The team specifically focuses on rent differences between the targeted property and its direct or indirect competition and conducts an intense review of the asset for opportunities to increase net operating income. Middle market properties are particularly appealing as residents of these properties are less likely to move to a single-family home, thereby moderating risks associated with turnover.

DELIVERING UNIQUE SERVICES AND AMENITIES TO RESIDENTS After detailed market research, the property management team develops customized service and amenity plans to attract ideal residents to the newly acquired asset. This establishes the property's competitive edge from the outset. The benefits of such a repositioning are illustrated in Berkshire's recent acquisition of two properties in Charlotte and Raleigh, where the resident profile was changed from an unattractive crime-ridden base to a high-quality Hispanic resident group. In support of this repositioning, tennis courts were replaced with soccer fields, education facilities were established adjacent to clubhouses and renter community groups were organized to provide support for the education of resident children. The results have been extremely positive. Residents are engaged in activities and take pride in the appearance of the community, resulting in positive feedback for management and quality referrals. Looking forward, we anticipate continued increases in occupancy and net rental incomes as cultural community bonds continue to grow.

MAINTAINING OCCUPANCY DURING REHABILITATION To maximize revenue and net operating income during rehabilitation, we develop plans at the due diligence phase of each acquisition

to combine the initiatives for occupancy with those for a streamlined rehabilitation. To ensure smooth implementation, the property manager and rehabilitation project manager remain collaboratively engaged on-site until completion. This approach allows us to expedite the rehabilitation process while maximizing revenue and net operating income.

ASSET RENOVATION AND REHABILITATION – ALPHA CONTRIBUTION OF 1 1/2 – 3%

REHABILITATION ROI ANALYSIS AT INITIAL SCREENING All acquisition targets are reviewed for rehabilitation opportunities. As part of this process, the competitive submarket is analyzed in depth to confirm targeted post rehabilitation rents. When a property makes it through our rigorous scrutiny and a purchase and sale agreement is executed, engineers then engage with teams from acquisitions, property management and asset management. Together, they develop a comprehensive plan for rehabilitation or renovation designed to meet financial forecasts and successfully compete at the highest rent levels within the market.

COMPRESSED TIME FOR REHABILITATION Rigorous rehabilitation planning efforts have allowed Berkshire to compress its rehabilitation schedule by as much as 40% while maintaining occupancy in the high 80% range during construction. To manage resident expectations for unit delivery and rental adjustments, a comprehensive plan for staging and scheduling unit work is in place before construction begins. In addition, materials and supplies are secured before a property's closing to ensure a quick start. Finally, on site property management is engaged early to implement clear communications to current residents and develop effective marketing plans to attract new residents.

ECONOMIES OF SCALE DRIVE PURCHASING POWER AND PRODUCT/PROCESS STANDARDIZATION Berkshire has the critical mass to secure favorable contract terms with product and service vendors. We consistently take advantage of *just-in-time delivery* to sites at the lowest market costs. In addition, our rehabilitation team has standardized processes for design, materials procurement and construction while maintaining an appropriate local market character for each project. For example, in a recent acquisition of four multifamily assets in Atlanta, we are utilizing a single rehabilitation plan with two stratified looks consisting of a high end finish for the upscale apartment community and an affordable rehabilitation look and finish for the remaining three middle market assets. This construction standardization has reduced costs and shortened time frames for rehabilitation, and as a result, we anticipate completing the four rehabilitations within one year — 6 to 12 months faster than the competition.

OTHER ASSET MANAGEMENT INITIATIVES - ALPHA CONTRIBUTION OF 0 – 1/2%

COMPREHENSIVE SUBMARKET ANALYSIS OF ANCILLARY OPPORTUNITIES Ancillary charges have become a significant contributing factor in property revenue. In an \$800 million portfolio liquidation in 2004, we calculated that ancillary income contributed \$40 million, or 5%, to our total proceeds.

Berkshire's asset management division has implemented utility bill-back programs at more than 50 properties. In addition, we currently offer an array of *for-fee-services* including trash pick-up, valet services, carports, garages, washer-dryer rentals, van transportation, carpet cleaning, cable hook-ups and more. Individual properties and their submarkets

are now continuously screened for additional ancillary revenue opportunities.

PROACTIVE USE OF RE-BUY ANALYSIS Berkshire Asset Management performs an annual re-buy analysis on each asset to define its status as *hold*, *hold and invest*, or *harvest*. An individual property re-buy analysis begins with a market value determination by a third party market maker. We then assume an acquisition of the asset at market value and forecast both future rent and expense growth as well as capital investments for the remaining hold period. Finally, we underwrite the asset for sale. High-yield return estimates result in a *hold* or *hold and invest* strategy, and those assets with low forecasted returns will generate a recommendation to sell. This process forces an annual underwriting of each property and its market and submarket, with important implications for portfolio management and future acquisition decisions. It also provides a meaningful vehicle for leadership from all Berkshire disciplines along our investment value chain to contribute to strategic decisions and take advantage of emerging opportunities.

LEVERAGE – ALPHA CONTRIBUTION OF 3 – 3 1/2 %

COMPETITIVE PROCESS FOR FINANCING

Berkshire has a dedicated finance department with responsibility for securing tailored financing for each acquisition. Financing proposals are requested from two to four lenders, from an active group of 45 relationship lender firms, to capitalize on the competitive process and negotiate the best financing solution for the asset.

Berkshire employs a *best-of-terms program* whereby lenders stretch their standard financial terms and structuring to accommodate our value chain yield requirements. Berkshire has considerable multifamily financing experience, having previously owned

Berkshire Mortgage Finance, one of the country's leaders in multifamily financing. We estimate a savings of 10 to 25 basis points of debt expense for our portfolios due to our capacity to negotiate low spreads, reduce closing costs and maintain flexibility in debt buy down options as well as principal amortization relief.

PROACTIVE OVERSIGHT OF LEVERAGE

Berkshire's finance group has the ability to execute better than market loan terms while conservatively monitoring portfolio leverage for the debt in place. Incremental loans are managed and adjusted to provide low risk leverage at below market rates with flexible terms.

THE BERKSHIRE ADVANTAGE

Focused exclusively on multifamily investing, Berkshire has built a reputation as a trusted sponsor by implementing innovative value-added plans to consistently deliver returns that surpass NCREIF. We are guided by research, operate with an incomparable team of professionals and rely on 40 years of multifamily real estate experience to respond to market conditions with agility. Across the organization we focus on the six elements of the investment value chain to drive returns in our multifamily portfolios.

In addition, the firm's unique acquisition sourcing, geographic reach, integrated organizational disciplines, refined human resources capabilities and adaptive corporate culture are designed to allow us to rapidly adjust to changing environments and position us to take advantage of all alpha opportunities along the investment chain.

UNUSUALLY BROAD AND ROBUST ACQUISITION SOURCING

An outstanding acquisition pipeline is fundamen-

tal to the success of a sponsor. Our acquisition teams have long-term, deep relationships with traditional and non-traditional sources providing us with a consistent flow of potential transactions — with more than 50% of our acquisitions sourced from limited or non-auction processes. We have 17 acquisition professionals on six teams located throughout the United States, giving us both geographic reach and market penetration breadth.

CRITICAL MASS AND GEOGRAPHIC REACH

Aside from broad-based acquisition sourcing, we now have more than 500 employees within our rehabilitation and property management divisions. These employees are located in over 25 markets throughout the country to give us *on-the-ground* implementation capability to generate value-added returns across our portfolios.

INTEGRATION OF ORGANIZATIONAL

FUNCTIONS The management of a \$1 billion multifamily portfolio requires approximately 200 to 400 people, including property site personnel. Acquisitions management, asset management, debt management, property management, rehabilitation management and portfolio management require a sophisticated and talented organization. While some sponsors have chosen to outsource certain disciplines, we believe it is impossible to link the components of the investment value chain without a unified sovereign approach. It would be very difficult to screen acquisitions for value-added rehabilitation potential if property management or construction management were outsourced. We believe occupancy would suffer if rehabilitation projects were supervised solely by construction management personnel. Instead we choose to link the critical functions and manage our people on a decentralized geographic basis with superior controls to ensure consistency in quality and standards. Our current

staff of over 600 manages approximately \$2 billion throughout the United States. In addition, we have an infrastructure in place to scale our organization for the successful management of more than \$4 billion of multifamily real estate.

HUMAN RESOURCES INFRASTRUCTURE AND UTILIZATION

As Berkshire's assets under management grew from \$1 billion to \$2 billion, our staff increased by 40%. We were compelled to rapidly absorb new staff, train them in the Berkshire methods of portfolio investment and property management and incorporate them as quickly as possible. Additionally, given the nature of the multifamily investment cycle, it was imperative for us to have a plan in place to both retain essential personnel as assets were moved out of the portfolio and absorb new staff as assets were added. The result is a well-tested program for managing human resource needs. Historical turnover rates are low, exceptional training programs are in place and successful performance measurement systems are widely utilized to oversee our large employee group.

RESPONSIVE CORPORATE CULTURE Changing market conditions call for an agile structure to respond quickly and proactively. Berkshire's sizable, decentralized organization is designed to manage a portfolio of up to \$4 billion with a corporate culture structured to recognize opportunity, make rapid decisions and focus on execution. We have honed this responsive culture over the past six years and continually make improvements. Site managers, rehabilitation engineers, finance supervisors and executives alike share a common vision of managing opportunities through the investment value chain to improve investor returns. Each of us is individually accountable for our contributions and we believe Berkshire's track record demonstrates the effectiveness of our corporate culture to create value over time under changing economic conditions.

SUMMARY

Berkshire has now spent more than six years testing and developing its proprietary techniques to uncover and implement alpha opportunities along the investment value chain. We believe that our initiatives translate to superior returns generated from our real estate assets. At Berkshire, we continually spend time and effort planning for and managing our organization as we grow our portfolios. As our company expands its national presence, our challenge is to remain locally focused and continue to take advantage of superior individual asset return opportunities. We accomplish this by fostering an adaptive culture of shared leadership that has proven successful in growing a national company while maximizing local returns. We believe this approach will allow us to remain a leader in multifamily real estate as we move into the future.

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