

'Experience Will Be Critical': A Q&A with Peter Lewis

By Paul Bubny

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Lewis

Founded in June of last year, Madison W Properties focuses on value-added opportunistic investments in out-of-favor markets, out-of-favor property types or properties that are overlooked. At the time the investment management firm, an affiliate of Madison Capital Management, opened its doors, few anticipated the potential market for these types of properties that has begun to emerge as stress turns to distress. Real Estate New York discussed this evolving market—and

why we're still months away from seeing it blossom—with Peter Lewis, a veteran of real estate investment and operation who now serves as Madison W's president and chief investment officer.

RENY: Has Madison W's strategy had to evolve at all in the current market?

Lewis: Madison W was really the culmination of the longstanding relationship between Bryan Gordon, the founder of Madison Capital Management, and me. We agreed that somewhere along the line, the markets would correct. Madison Capital's orientation has been distressed assets, and mine has been as an operator of real estate, and we realized that if we put some money together, there could be some good opportunities. It sounds kind of obvious today, but 18 months ago, nobody had any idea that this downturn would unfold as deeply and as rapidly as it has. The strategy from the inception has been to focus on distress; it's just happened in a quantity we never thought possible.

The basic premise of the firm, and implicit in the assets that we've recently acquired, is that it's not enough just to buy stuff that has issues or "distress." They have to be good assets, and they have to be able to withstand what I see as a very painful two to five years ahead of us. If someone gives you an opportunity to buy a shopping center where Circuit City and Linens 'N Things were the tenants, you'll be pretty guarded about what you're willing to pay. The game plan is to buy great assets at really good prices. It sounds like a very simple mantra, but except for this downturn and the effect it's going to have on owners, we would never be in a position to buy the assets that will be coming to market.

RENY: Tell us about the thinking behind some of your recent acquisitions.

Lewis: We recently purchased two properties in New York City. One was a warehouse building on 61st Street between First and Second avenues. That property is unique in that it has been an art storage building for more than 70 years; the tenant, Hayes Storage, has been in business since 1860. When the property went to market in the fall of 2007, there was still a condominium business out there. There was a ton of guys looking at the building with the intention of converting it. However, the market started getting worse about 60 days into the marketing process, and all of a sudden there weren't many who were willing to buy an art storage building. I happen to have extensive

experience in storage; my partner Jack Gutman and I have owned over 20,000 self-storage units in and around New York City. We stepped in and acquired the property through funds; Jack had a joint venture partner with us, and Prudential put up the debt.

While we were in contract, I ran across town and talked to the property's only competitor—a company called Cirker's on 55th Street between Ninth and Tenth avenues—and asked if he was interested in selling. Their reaction was, "If we sell, we want a ridiculous number because major developers are looking to buy this building to knock it down." As the other potential buyers disappeared, and he saw that we had the financing in place and knew what we were doing, the price that was ridiculous became fair and attractive. So the market softening dropped out the competition and enabled us to shake loose two assets that were family-held for generations. By doing that, we were able to effectively control the art storage business in Midtown Manhattan. We plan to make additional acquisitions and grow the business.

The nice thing about art storage is that it thrives whether the markets are good or bad. In bad times, people are consolidating, there are bankruptcies where things have to go into storage, galleries are closing. So we are seeing a tremendous amount of activity right now from these dynamics.

We also acquired the Lexington Downtown Hotel & Conference Center in Lexington, KY, which was a 360-room hotel and 250,000-square-foot office building. A local partnership controlled the property in conjunction with Blackstone in New York. Blackstone wanted to get out, and the local operators wanted to stay in. We ended up buying out Blackstone's interest at a good price. You're going to see more and more of these types of deals as we move ahead into this year and next year.

The process of convincing an owner that he has to give back his property to a lender is slow-moving. The guy is not giving back his property to the lender until he's on the ground with his arm behind his back, and then he says "uncle." Until he's at that point, he's going to fight like crazy. Right now, we're winding our way through that process, and until those capitulations occur, you're not going to see the deals that you need to see until toward the end of this year. The smart buyers are waiting for that moment. We're going to see a day where the real estate players with cash are going to be sitting at a banquet with a myriad of things to eat. After that, it's going to require a very patient investor. The hallmark of the new era upon us is buying assets that will be largely capitalized with equity and having the patience to hold these assets for five to seven years.

RENY: Is it fair to say that the opportunities that will present themselves are not just going to fall into people's laps?

Lewis: Experience will be critical; having capital will be critical. The inexperienced guys who had easy access to capital are gone. The earth was scorched. What you have left are the real players, the people who have managed and owned real estate. The guys with the deep knowledge and who have been through the cycles are going to be the winners here. And they'll be the ones to attract the scarcer equity that's now available.