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BGO Co-CEO John Carrafiell On Using Data to Nail Real Estate Investment

The investment firm scored recently with unlikely assets in unlikely areas

By Jeff Ostrowski

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John Carrafiell, Co-CEO of BGO.

From his Miami Beach office, John Carrafiell helps manage a global empire. Carrafiell since July 2021 has been the co-CEO of BGO (formerly BentallGreenOak), an investment adviser with $83 billion in assets under management in a dozen countries.

After spending much of his career in London, Carrafiell moved back to the U.S. in 2021. He's also chairman of BGO IREIT, a non-traded real estate investment trust launched in 2023. And he's a member of the board of Sandow Lakes Ranch Venture, a 32,000-acre mixed-use development near Austin, Texas.

Carrafiell sat down with Commercial Observer last week to talk about why he's sold on data science as an investment tool and why he's still bullish on office space in … Japan.

This interview has been edited for length and clarity.

Commercial Observer: What's your investment thesis?

John Carrafiell: Industrial is an area we're focused on. Cold storage is another area we're focused on. We look for continued strong demand and somewhat constrained supply because there are barriers to entry. Data centers are an area we're really focused on — probably the best example of demand far outstripping supply, and high barriers to entry. You really have to have domain expertise to be successful in data centers, and there's a limited number of operators and investors that have that expertise.

Cap rates are going to be relatively flat. Average growth is going to struggle to keep up with inflation. So you have to identify these sectors and then the markets where you can capture excess rental growth. That's going to be the differentiator of outperformance over the next decade.

It's a pretty complicated market out there. After the Global Financial Crisis, it was a great time to be an investor in real estate. The beta was really strong up until about 24 months ago. If you deployed leverage, with rates falling, it was an even better beta play. My view is that that is over — that situation where a rising tide lifted all ships. Going forward, to generate outperformance, you can't just make beta calls. And so it's really critical to be focused on sectors that are going to see significant demand

and limited supply. It sounds really basic, but you need to go back to basics.

After deciding on a sector, you need to focus on markets. There will be dozens and dozens of markets that won't see rental growth. You have to be really discerning, and you have to use your local presence on the ground, but then overlay data science to understand demographic trends and supply trends. We look at literally hundreds of inputs in our data science model to make some of these judgments.

How are you using data science to find opportunities?
We've built a team over the past four years that takes in hundreds of inputs on various demographic and supply-demand measures. We built a proprietary model that then uses that data to determine on a look-forward basis how a market is going to perform. We then rank the top 400 markets in the U.S. to understand which will have the best rental growth. We back-test over three-, five-, 10- and 20-year periods to continually refine that model, so its predictive capabilities get better.

The first version of that model was about 40 percent accurate. The latest version is upward of 75 to 80 percent reliable. I might add that artificial intelligence is only making the team's ability to refine those models that much faster.

Here's an example: Back in 2020, our model said that in industrial, Las Vegas was going to be a top 25 market out of 400. Other providers of market views and rankings said it would have been middle of the pack. We took that information, and with our partners NorthPoint Development, we made an investment in Las Vegas. I flew out there myself, and I walked the dirt. You can't do it from a desktop. We bought 130 acres to build two 1 million-square-foot spec buildings. No one had ever built a million-square-foot spec building before in Las Vegas, just to put it in context. Before it was completed, we leased it to Crocs. It ended up being a million-square-foot lease, which was the only million-square-foot lease that had ever been done in Las Vegas, and we did it at a rate that was approximately 40 percent above what we originally expected when we bought the land.

That doesn't happen in real estate. That's a good example of a call that was seriously helped by using data science. There's no market consensus that that was where you should be building industrial. Data science also took us to Tucson, Ariz., for multifamily and to Charleston, S.C., and Columbus, Ohio, for industrial and cold storage. It's a fantastic tool.

What did your model find in Las Vegas?
One, there was very little supply. Two, there was very strong demographic growth. Three, no state taxes. Four, availability of blue-collar labor. And, then, five, when you did a nodal analysis, the hottest market for years was the Inland Empire in California. Well, you can reverse back in there, depending on traffic, in under four hours from Las Vegas, and you can be at a rent that's down 60 percent from the Inland Empire. That's an enormous savings. Those were the ingredients that really identified Las Vegas.

Back in 2020 and 2021, the Vegas economy was the weakest in the country. The Strip had shut down, and Las Vegas had the highest unemployment in the nation.
Exactly.

How did you reconcile what was happening in the local economy with what the model was telling you?
That's a great question. Most investors like to talk about being contrarian. Most investors think of being contrarian as, "Let's buy office now. It's on its back. Pricing is down dramatically, there are distressed sellers, we can make a great buy." That's a classic contrarian call. In some previous cycles, that's worked. I think there's a tremendous amount of risk in that now.

The view on Vegas was, "This won't last forever. We don't know how long, but we're going to buy the land and do the development. Will COVID end at some point? Will people want to go back to Vegas?" Our contrarian view was, "Things look really bad right now." And also, "Yes, the Inland Empire is a really good market. But will it compound at 20 percent rates now that the top rents have gotten into the $20s?"

Our view was no. A lot of times, you have to just check your biases. The bias on the Inland Empire was, "This is going to continue to be the No. 1 market." It was for a long time, but the Inland Empire just reported its first-ever flat to declining rental rates.

How much have you invested in data science?
Between team, hardware investment and all the data we have to acquire, we've spent millions. A lot of investors have identified it as something to focus on. I'm sure we're not alone, but we have a four-year head start.

The other aspect of it that's absolutely critical is that if the top of the organization doesn't believe in it, it's really hard for an entire organization to get behind it. Our teams are literally interacting with our data science team several times a day. It's become an integral part of our market research and our investment decisions. I want to be really clear: We are real estate investors. We actually enjoy walking buildings, and nothing will ever take over that role. But pairing that with data analytics is really powerful.

What's your biggest challenge?
Trying to navigate this current macro environment is the biggest challenge for all of us. The macro will be what it will be. It's really hard to predict where interest rates are going to be, where inflation is going to be. I mean, everyone has been wrong the past several years in a material way, including Federal Reserve officials. We can't impact that.

So, if we have elevated inflation for a long time, and therefore elevated interest rates and elevated cap rates, what investment strategy is going to succeed in that environment? We go back to basics. What sectors, based on our analysis, are going to have significant demand in spite of the macroeconomic environment? And where is supply, if not constrained, checked by some barriers to entry? That's where you need to be. That's what's going to dictate outperformance. At the end of the day, our business is all about performance on behalf of our investors.

What's your view on the office sector?

If you bought an office building in the last 12 months because you thought we were at the bottom, the price today is a lot lower. Trying to call a bottom is a really difficult thing.

We don't profess to be able to do that. We're really careful about distress that can look attractive but that could be a value trap. We keep our biases in check about what has worked in past cycles, because we don't know what's going to happen in this cycle. We've never in the history of the world provided as much fiscal and monetary stimulus as we have in the last three years. You can't look at a playbook and say, "This is how it's going to play out." This is uncharted territory. So we're being really thoughtful about sectors, and about markets.

Since I arrived in the U.S. during COVID, we haven't bought a single office building. We've sold a ton. Office represents a tiny percentage of our assets under management in the U.S. and Europe. Asia is different, because work from home did not take hold at all in Asia. Office in Asia is a good investment. The U.S. is the most affected market from an office perspective. I'm not sure when it's going to be safe to go back in the water.

What's different about Asia's office market?

A couple things. First, from a business culture perspective, if you're not in the office, you're not working. It's just a very different culture. Second, apartments and housing in Asia are much smaller, and are quite expensive in relation to salaries. We literally had team members doing Zoom calls in their closets.