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OUTER MARKET ISSUE

Big Fish, Big Pond

KKR's Joel Traut helped build one of the biggest direct lending lines in real estate credit

K Factor

It's been an impressive climb for Joel Traut, global head of direct lending for KKR's real estate credit business. It all started in Dallas.

BY CATHY CUNNINGHAM

PHOTOGRAPHY BY MARY BETH KOETH

Many people say it, but KKR's Joel Traut knows the truth of the hoary old adage: Everything's bigger in Texas.

For Traut, partner and global head of direct lending for KKR's real estate credit business, Dallas is where he got his career start at GE Capital more than two decades ago. It's also where he met his wife. But, while the city holds significant meaning for him personally, he now finds life has come full circle, with Dallas being one of the most important markets for both KKR and its clients.

KKR's real estate credit business was launched in New York in 2015, with Traut joining the firm that same year, and the team wasted no time identifying Dallas as a market in which it wanted to lend. Today, it's one of KKR's most active direct lending markets, with $3.6 billion in outstanding loan commitments, representing 10 percent of its loan book.

In 2022, it launched K-Star Asset Management, its special servicing and asset management arm there. K-Star has grown to more than 70 people today, and just doubled its office footprint to 20,000 square feet at the Sterling office building in the city's Preston Center submarket.

That's not all. KKR also launched several operating companies in the Dallas market over the years, including University Partners, focused on student housing, and Elevate, a multifamily platform. Then there's its data center portfolio company CyrusOne, headquartered in Dallas, and, most recently, Arctos, the private investment firm focused on professional sports franchises and leagues that it acquired earlier this year.

We wanted to know what Dallas' biggest draw is for KKR, and why it's hanging its Stetson on the market.

This interview has been edited for length and clarity.

Commercial Observer: Talk us through the evolution of KKR's credit business in Dallas, and how your footprint there has evolved.

Joel Traut: We're thematic investors, and investment activity starts where demand starts. Understanding that demand means we have to leverage the entire firm's capabilities and insights to figure out or anticipate where demand is going to be, and then try to invest ahead of that.

When we talk about this with our investors, we frame up demographic trends, consumer behavior and corporate behavior as three pillars that will dictate how markets interact and behave, and where demand is going to form.

Dallas is one of the easy winners on that continuum. It's a tremendous market, it's scaled, it's got great demographic trends, it's got great corporate relocation and growth activity, and the consumer there is really well positioned and active. So, when you put those things together, it's easy for us to say, "OK, demand is going to be there, and now we've got to figure out which asset types want to invest in, the specific locations we want to invest in, and where we believe has more demand than supply and the ability to generate outsized growth."

Since we started this credit business back in 2015, Dallas has always been on the radar. Our growth has accelerated over the years as we've continued to see the growth and evolution of Dallas as a market.

What typically makes an enticing lending opportunity for KKR in Dallas today?

All of our investment activity maps back to our key criteria, which is sponsorship first. We're lending to really experienced sponsors that have access to capital and expertise in the markets and sectors that they operate.

We think about markets holistically, and when we think about asset quality and location there are certain segments of Dallas that are really interesting. Uptown Dallas has demonstrated tremendous job growth. It's a live-work-play destination, and it's experienced a lot of corporate relocations, which is fueling office demand, residential demand and retail demand.

We've also made loans in submarkets like Frisco, where you see further development, and work-live-play mixed-use assets that really create an ecosystem where companies and individuals can thrive. So we're looking for those types of locations and assets that fit those profiles.

When you began building out the credit business in Dallas, was there a moment that you thought, "OK, this is going to be a much larger part of our business than we expected," that later led KKR to launch further businesses?

The firm's been investing in the Dallas market for long periods of time, and so we always lean into the firm's experience, and then correlate that to what we do in real estate. Post-COVID, we saw a more meaningful surge in demographic shifts, a more meaningful shift in corporate relocations, and you saw further maturation of that market in the submarkets that I've identified that seem to be very compelling from an investment perspective.

So, as we planted further flags in that market with Elevate, University Partners and K-Star, it became very clear to us that there was an enormous amount of talent in that marketplace that could fit perfectly with our company and with the platforms and the objectives that we have, and that's only been reinforced every week and every month and every quarter that we've operated in this region.

Can you talk me through why 2022 was the right time to launch K-Star?

We've always wanted to make sure that we can build a world-class real estate credit business, and to be world-class we have to have the most institutional asset management capabilities in the marketplace. So we asked: How do we deliver better service to our sponsors, how do we deliver better oversight of those investments, and how do we better manage risk for our investor base?

There was a point in time when we decided that it was better to build than to rent that capability, where we could have our own influence on becoming that destination for talent, acquiring the best talent in the marketplace, and then building institutional processes around those people.

As we built that business out, we decided that, as a large CMBS B-piece investor, we had a unique opportunity to bring that in, and become a rated special servicer and oversee what is nearly a $40 billion special servicing book. When you put all that together, we now have an $87 billion credit book that that team oversees, and that's incredibly powerful in terms of how we service those relationships, whether it's sponsors or issuers, and how we manage risk more acutely, and then capture that information and deploy that for new investment opportunities.

Our insights are more acute and more impactful than many others', and so it's one of these businesses that again is incredibly powerful for our franchise and arguably underappreciated by those that aren't as close to it, because it's hard to understand how much information, how much oversight, and how much talent we have built in a short period of time.

It must be better for clients, too, to make one call and speak to someone at KKR rather than an outsourced firm.

We spend 60 days or so closing loans with our sponsors, and we always ensure that we can deliver a great process, but the reality is those clients live with that loan and with us for three, five, seven, 10 years. There's an exponentially higher amount of touch points after the closing — and there's certainly more complexity — and if we can ensure that that client has a really institutional experience where we can enable the progress of their business plan, we're going to really benefit.

Looking at our business now, in this past year, around 70 percent of the loans that we closed were with repeat sponsors. I think that's a testament to the experience that they're having with us, our relationship managers, our investors and, importantly, our asset management team. That's where a lot of credit is due.

When you look at your business in Dallas before and after K-Star, are there any key advantages it's brought?

Real estate is local, and while we have global capital we always want to have local expertise. There's power in having people in those markets to strengthen relationships beyond what Adam Simon [a managing director at KKR who leads loan originations in Dallas] has been able to build so well, but to really understand where our employee base is living, working, spending, commuting.

Those insights are incredibly powerful for us to have a deeper understanding of a fast-moving market like Dallas, and we've leaned into that on many occasions. Every time that we talk about an investment in Dallas, or Texas, we have people on the ground that have lived, worked and played in those same regions and can give us real, firsthand experience about what their perspective is, and we can put that perspective into our decision tree and make better decisions.

For us, it's about spotting demand, figuring out those insights ahead of the market, and then investing before the market shifts

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Joel Traut at KKR's Dallas offices in the Sterling Building at 5949 Sherry Lane.

to it. If we can do that, we'll outperform others.

What are some of the biggest lending opportunities you're finding in Dallas today?

We recently closed a very large-scale financing for one of the premier retail centers in the country [Highland Park Village] and I think this is a tremendous example of long-standing, deep relationships with a sponsor, a local understanding of how important that retail center is to that community, how successful it has become, and having the quick reaction to understand that and engage in that and that opportunity set, and to provide a solution to the client that met their needs. It was pretty differentiated in size, scale, and just understanding it from a retail perspective.

In addition to that, we were one of the earlier movers on office lending in Uptown. We made a $230 million loan on a project called Quad, and this was a situation where the market was office-curious and we were office-interested as far as the right institutional-quality assets in really strong locations with really high-grade sponsorship. We leaned into that knowing that we had a lot of conviction of the sponsor's ability to stabilize the asset, and then ultimately exit the asset.

As a side note, after we closed that loan, the market continued to tighten. It became more interested in office investing in Dallas, and maybe in other markets around the country, and so I think that was a really prime example of understanding the demand base, staying on script with our strike zone sponsors, asset-quality market, and then leaning in quickly to secure financing.

KKR also has a few other big investments in Dallas, including Cyrus One, which you've owned since 2021 and, more recently, Arctos. What can you tell us about them?

Both companies are based in Dallas, and both companies are significant participants in the segments that they operate in. Cyrus One, as you know, is one of the world's premier investors in digital infrastructure. We acquired that company years back in partnership with Global Infrastructure Partners, and we've scaled that company meaningfully behind some of the growth in capex spending around AI and technology, but in a really focused way. We're excited about continuing to invest behind that trend line.

Arctos is our most recent acquisition. It's also a business that we are incredibly excited about — focused on sports investing, GP solutions, and then secondaries, and we think all three of those are really interesting and exciting categories for our firm to scale behind the tremendous leadership and talent that exists in the Arctos franchise.

I know you're a New York Knicks fan, but do you also have any favorite Dallas teams?

None that I can disclose [laughs].

How did you get your start in real estate?

I grew up in Wisconsin, in a very small town of 440 people. My upbringing was quintessential Midwestern United States — small school, close-knit community, a lot of focus on hard work and sports. I had interest in getting into business before, probably, the normal person would as my father had me trading stocks with him — or at least pretending to trade stocks with him — at 12. That was my first foray into getting excited about investing activity, and so I credit him a lot with my journey toward investing.

He also worked in technology and, if you dial the clock back, I graduated high school in 1998, when there was a big tech boom that was actually very similar to what we're seeing today, so I had a really keen eye toward technology in the markets. I went to the University of Kentucky when the tech wreck of 2001 was upon us, so some part of my interest around getting into tech was thwarted by market dynamics.

At the time, GE was coming to the university to recruit for their long-standing financial management program. It was a very competitive field and, by chance, the individual that I

interviewed with was the CFO of the plastics division at GE. When he asked me questions, every answer I gave him had an investment response to it, in how I think about the markets, how I think about trading stocks, this and that. He said, "You're not an industrial guy, you're a GE Capital person." So I always give him credit for pointing me in the right direction.

Then my offer letter came, saying your first six-month rotation will be in Dallas, Texas.

So, Dallas is where it all started!

Yes, my first job was in Dallas in 2002, working for GE Capital at Addison Circle. GE had this massive real estate office down there, and I fell in love with the people and the city. I did one six-month rotation, I liked it, I lobbied for a second six-month rotation, different type of function in Dallas, and I did that, and really enjoyed it. After that, they asked me to move to Connecticut to work for GE Capital corporate headquarters. I did that for six months, working for the CEO and CFO of the business, and then I went to the aviation business, which was where we lent and leased planes to Delta, United and whatnot.

When I was done with the two-year program, I knew I wanted to go back to real estate, and I moved to Atlanta, where the head of originations for GE Capital, a gentleman named Ed Coco, resided. I was in this mobility mindset and became an originator in 2006, so I was on the young end of the originator spectrum for sure. But they gave me a chance, and I just knew that I had to build relationships and be analytical and earn the trust of the credit team. I did that well, had a lot of success — and then the Global Financial Crisis happened.

We were originating again by the second half of 2010, and I scaled up my presence with the firm. Then, in 2014, they asked me to move to New York to run the New York office, and so my wife and I — we had one child at the time, we had another one on the way — made the move. I think we did $2 billion in the first year, just in the New York office, and then that company was sold to Wells Fargo and Blackstone. That was when I had a chance to go back and look at what the world of opportunities looked like.

What attracted you to KKR?

It was an incredible franchise firm that had been around for 39 years at the time, and they had this desire to build this real estate business. They'd already started the equity business a few years prior, but the credit business was literally just getting started. Matt Salem and his team had joined four months before they hired me, and I love this idea of investing capital alongside the equity business, which I did at GE, competing in the arena of real estate credit, and then building something.

So, those pillars were really what attracted me, and you know much of the story from there — we started with $400 million, we built relationships one by one, we built our team, built up our assets under management, we expanded our product suite, and that journey has been incredibly rewarding. But I try to remind the interns, the analysts, everybody that's new, that we're just getting started — we're going to keep growing from here.

(Western) Boots on the Ground

Adam Simon on KKR Real Estate Credit's early days in Dallas

To truly cover a market, you need to have a dedicated pair of boots on the ground. In KKR Real Estate Credit's early days of planting flags in Dallas, the person wearing those boots was Adam Simon. Simon had worked with Matt Salem, now KKR's head of real estate credit, at Rialto Capital before joining Salem's team at KKR in 2015 to build out the firm's credit business.

"It was a small team, and the entire country was up for grabs in terms of geographic coverage," Simon said. "I basically raised my hand and said I would love to cover markets outside of New York. They were always interesting to me, and I was particularly excited about Dallas, Austin and Denver. I was happy to get on an airplane anytime and go anywhere. New York-centric people were clamoring to cover New York, and I said, 'I'll cover everything else.' "

He took the road (or sky) less traveled for a couple of reasons back then.

At the time, the country was still recovering from the Global Financial Crisis, but the economy was steadily stabilizing. Meanwhile, cities were creating new dynamic environments with homes and offices, companies were relocating to new locations, and restaurants and other play activities were flourishing around them.

"I really liked the idea of getting in relatively early and becoming an expert in markets like Dallas, Denver, Seattle and Portland — markets outside of New York that demonstrated a lot of that growth trajectory, and not in a 'hyper boom and bust' cycle, but in a very measured growth model," Simon said.

Secondly, KKR has a mantra of "Do business with people you like and trust," and he felt that in his very first visits to those markets, especially in Dallas.

"The way that people handle their business there is very community-oriented in the sense that people are generally in similar social circles and see each other frequently, and so you treat people in a certain way and you do the right thing," Simon said. "Coming out of the GFC, you wanted to do more business with people you liked and you trusted in an environment you enjoyed. I found that in spades in Dallas, which made me want to start spending a lot of time there."

Building out a client roster with a new platform is something Simon describes as a "healthy challenge," but "it was the challenge that I wanted for myself. I wanted to do it in a way that was authentic to me, and I really enjoyed building those relationships."

The firm also gave him plenty of space to work his magic.

"It wasn't a case of, 'We've got a budget, this is your first year, you have to hit it,' " Simon said. "It was very much, 'This is a relationship-driven balance sheet lending model that we're building out within KKR, and you'll build that out over time, but do right by the client, do right by the real estate, and build it the right way.' "

Simon's team in New York focused on their deeper relationships to help the credit business get off the ground, while some of those early seedlings were being planted in Dallas and elsewhere.

Ten years later, those seedlings are fully fledged. New York-based Simon is in Dallas six to 10 times a year, and KKR actively lends in just about every asset class in Dallas.

While the competition is fierce, KKR's lending track record, together with its servicing and asset management arm, K-Star, puts it on advantageous footing.

"When we're all competing on price and proceeds," Simon said. "We're able to show not only what we've done in the market today and good referrals and whatnot. We're able to say, 'Our team that's underwriting this loan lives in this market, they know this market, they know your analysts and your associates and the asset managers who are in this market, and the post-closing asset management team is based here, so when you want an amendment, or something is going less well and you want to have a conversation with someone, it's our team and they're in your market already. They've also probably shopped at your center, or stayed at your hotel.' It's important." —*Cathy Cunningham*

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TENACIOUS D: The New York-based Adam Simon is in Dallas regularly.

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