NAREIM

National Association
of Real Estate Investment Managers

Dialogues

FALL 2016

PERSPECTIVE

POWER OF CHANGE

MARKET PEAK?

PRIME NUMBERS

SUSTAINABLE PROPERTY

FLIGHT TO DOWNTOWN

A PERIODICALS SUPPLEMENT TO INSTITUTIONAL REAL ESTATE AMERICAS, NOVEMBER 2016

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2017 MEETING SCHEDULE

JANUARY 18
CHICAGO
S&I: SUSTAINABILITY & INVESTMENT MANAGEMENT SUMMIT

FEBRUARY 06
ATLANTA
A&D: ACQUISITIONS & DISPOSITIONS

FEBRUARY 15
CHICAGO
R&I: Research & Investment Management

MARCH 01
SAN DIEGO
EO: Executive Officers Leadership Retreat

APRIL 04
DENVER
A&P: Asset & Portfolio Management

MAY 03
CHICAGO
A&I: Accounting & Information Meeting

MAY 10
CHICAGO
20/20 INVESTOR SUMMIT

AUGUST 01
CHICAGO
HR: HUMAN RESOURCES

OCTOBER 11
CHICAGO
EO: EXECUTIVE OFFICERS FALL MEETING

OCTOBER 24
DENVER
A&E: ARCHITECTURE & ENGINEERING

NOVEMBER 07
DENVER
L&C: LEGAL & COMPLIANCE

DECEMBER 06
CHICAGO
C&I: CAPITAL RAISING & INVESTOR RELATIONS

> To register for these meetings, go to www.nareim.org

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"Prediction is very difficult, especially if it's about the future."
– Niels Bohr

What Should We Do About the Future?

WHAT IF WE COULD DO A BETTER JOB OF PREPARING FOR CHANGE AND HOW MIGHT WE DO THAT?

THE FUNDAMENTAL ESSENCE of real estate investing is prediction. What does an investor believe the value of an asset might be in five to ten years? What changes in the economy, what changes in the region, what changes in the tenancy, what changes in capital might influence the final outcome?

It's interesting to reflect however that our pro-formas are almost never absolutely correct. Perhaps that's because the future is always changing – and the investor, no matter how diligent, can't possibly see everything that hasn't happened yet.

But what if we could do a better job of preparing for change? How might we do that? Perhaps we should discuss what might happen, what could happen, then prepare for the implications ahead of time.

Recent discussions at NAREIM have focused on just that effort.

What might happen if LP's decide that they will only invest with GP's that are able to provide radical, real time data transparency? No longer would it be good enough to provide strong quarterly reports and respond to data requests. If even one firm provides truly transparent data, LP's would demand granular, real time reporting on every aspect of every asset from every manager – and leverage data collected on the industry and their assets to find better strategies and better predict the future.

This is not so far-fetched. Several firms today are raising the bar on what is possible, and more advanced management platforms are adapting new strategies and processes that put data at the center. However, according to Jason Kern of LaSalle Investment Management, "There is a sense of complacency in our industry. If you look at any other industry, such as banking, they already understand that tech disruptors are threatening their business models for lending, credit card processing, even payment settlements." How long before aspects of our industry are replaced by some sort of data driven solution?

What if, thanks to breakthroughs in micro fuel cells, solar technology and other renewables, commercial buildings become completely self-powered, automobiles quickly switch to electric, and the demand for oil, gas, and coal only decreases. How would strategies have to adapt?

That may sound unlikely or strange, but in March, The National Renewable Energy Laboratory announced that the average cost of solar power from rooftop panels is now 12.2 cents per kilowatt hour in the US, about the same as the average retail electrical rate. Since 2009 the cost of solar power has gone down by 70%, and price decreases are likely to continue over the next 20 years.

What happens as the disruptive changes in manufacturing continue to take place? The way goods are manufactured today is changing radically. Because of advances in robotics the cost of labor is dropping across the board. As a result, America is growing manufacturing capacity on shore. Simultaneously, 3D printing can bring manufacturing of other goods to the neighborhood or even into the home. What happens as these trends continue?

Discussions at NAREIM quite often center on how disruptive technology, demographic shifts and changes in capital require one to think differently about the real estate investments. How should investment committees think through the impact of a fast changing world?

> "One thing is certain. The earth is now more cultivated and developed than ever before. We've become a burden to our planet. Resources are becoming scarce, and soon nature will no longer be able to satisfy our needs."

The above warning was originally written by theologian Quintus Septimus Florens Tertullianus in 200 AD. Either he was very much ahead of his time or worrying about the future is nothing new for human civilizations. Infrastructure has been crumbling and being re-built for ages. Capital and revenue streams have dried up and sprung to life in other places countless times throughout history. Energy has come from many different sources as they present themselves. Change happens. The trick of course, is to anticipate it so you can take advantage of it.

Real estate investors are risk takers, soothsayers, and fortune tellers. They are cautious adventurers, pessimistic assessors, and historians. They are geeks, nerds, and at times, rocket men. In trying to address the unanswerable question, "what do we do about the future?" Matt Henry of Chatham Financial put it best in a discussion about risk last spring, "We know the next problem that tanks the market will not look like the last one. We need not try to divine what it will be, but set ourselves up to weather many scenarios." The flood may come from any direction, but if you are resilient, flexible, and thoughtful, it doesn't matter where change comes from, you will be ready to thrive.

Power of Change

By Matt Eggers
VP, Yardi Energy

Electrification is perhaps the greatest technological advancement of the 20th century. The electric power grid, the system that delivers electrification, is considered by many to be the largest and most successful machine ever built. But it may be about to die. The power grid "machine" is an interconnected system of long distance transmission lines, local distribution systems, transformers, substations, generating power plants, and the computers and control systems that manage it. In the United States, it delivers $400 billion in electricity annually over 7 million miles of power lines and through the efforts of 3,200 utility companies. The infrastructure in the system is valued at over $850 billion. Uptime is an astonishingly high 99.97% (I certainly wish my laptop could approach that level of reliability) and growth in the system is delivered relatively reliably by simply calling your utility. All this is delivered at price that is slightly below where it was in 1960 in real terms. This is an incredible success story; it seems like there is little here to concern real estate investors and owners…right?

If only it were so simple. We have entered a period of incredibly rapid change in energy technologies, and the future of the utilities that deliver power to our buildings, and even the future of the electric grid itself, is in considerable flux. The forces threatening to disrupt the power grid include distributed solar systems, energy efficiency software, demand response technologies, fuel cells, battery storage, electric vehicles, and various micro grid technologies. We can sum these up with the phrase: be your own power plant. Or to be cheeky, "adios, utility company." Even if you think your particular investments, assets, buildings or properties won't mess around with something like that, you may find that your access to cheap and reliable power could be seriously at risk if you don't adopt the new paradigm.

It's important to note that "climate change" has not yet appeared in this narrative and nor will it again beyond this paragraph. While the threat of climate change has been a driver behind various incentives that support new energy technologies, many are now growing at a rate that will disrupt the utility system regardless of future government incentives. A U.S. government that chooses to support clean energy technologies in a substantial way will only further hasten these trends.

THE RISE OF CHEAP SOLAR POWER

The story starts with photovoltaic solar energy. Photovoltaics are the energy generating cells that you've seen on calculators for years, and are increasingly showing up on residential and commercial rooftops across the U.S. and the world. Since the mid-1970s the cost of solar panels has fallen 99% as installed solar energy capacity has grown 115,000x. This cost decline continues at a rapid pace, and has now made solar the cheapest form of new generation in some markets around the U.S. and the world. In fact, in 2015 the price of solar energy fell below $0.05 per kWh in 4 of 5 U.S. regions. Several contracts signed in 2016 have fallen under $0.04 per kWh, within the range of average U.S. wholesale power prices of $0.03 to $0.05. Bloomberg New Energy Finance predicts that a staggering 3.7 terrawatts (roughly equivalent to 4,000 nuclear power plants), or 43% of all new energy generation capacity built over the next 20 years, will be solar.

The Rise of Cheap Solar Power

Electrification is perhaps the greatest technological advancement of the 20th century. The electric power grid, the system that delivers electrification, is considered by many to be the largest and most successful machine ever built.

But it may be about to die.

THE UTILITY DEATH SPIRAL

The U.S. utility industry spends roughly $95 billion per year upgrading and maintaining the grid. Many observers suggest this is far too little to maintain an effective system and at some point the level of investment will need to increase substantially to maintain service levels. Despite that massive, and potentially increasing, investment retail prices remain low due in part to the huge number of customers served. Utilities can amortize costs across so many customers because essentially every single consumer and business is a customer. Not a bad business model! But what if some of those customers start to find a better deal somewhere else? Customers fleeing the grid could lead to what industry observers call the utility death spiral.

Here's how the death spiral works. Solar and energy efficiency technologies become so cheap that power users with the most expensive prices will be economically better off to cut ties with the grid and generate their own power. As those utility customers defect, the cost of maintaining the grid must be absorbed by fewer remaining customers so electricity prices rise to compensate. Meanwhile, solar costs have continued to decline. Now the next group of electricity users find it economic to defect leaving even fewer customers to pay for the grid so prices rise again. This continues until utilities are left with the worst customers and are forced into bankruptcy as they can no longer afford to maintain a massive portfolio of stranded assets. The Edison Electric Institute (EEI), a utility trade group, said in a 2013 report that "the longer-term threat of fully exiting from the grid (or customers solely using the electric grid for backup purposes) raises the potential for irreparable damages to revenues and growth prospects."

Other forces are also working against utilities. Investment continues to pour into energy efficiency technologies such as intelligent HVAC optimization software and LED lighting. This is leading utility industry revenues to fall as a percent of GDP. The EEI described the march of energy efficiency as "a meaningful impact on utility load…that will create significant additional lost revenue." As with grid defections, this will lead to increases in per unit electricity costs which will make efficiency upgrades that much more attractive. Other technologies that may enable large scale grid defections are improving at rates similar to solar. Battery storage is a key example. Just a few years ago lithium ion batteries were deemed impossibly expensive for large scale energy storage. But batteries are gadgets and the price of gadgets tends to go down fast; batteries have plunged in price, and are being deployed for large scale energy storage at a rate more than 100x greater than just two years ago. Finally, the U.S. is likely to begin exporting large volumes of natural gas which could lead to large price increases in the most important input for electricity generation.

IMPACT ON REAL ESTATE

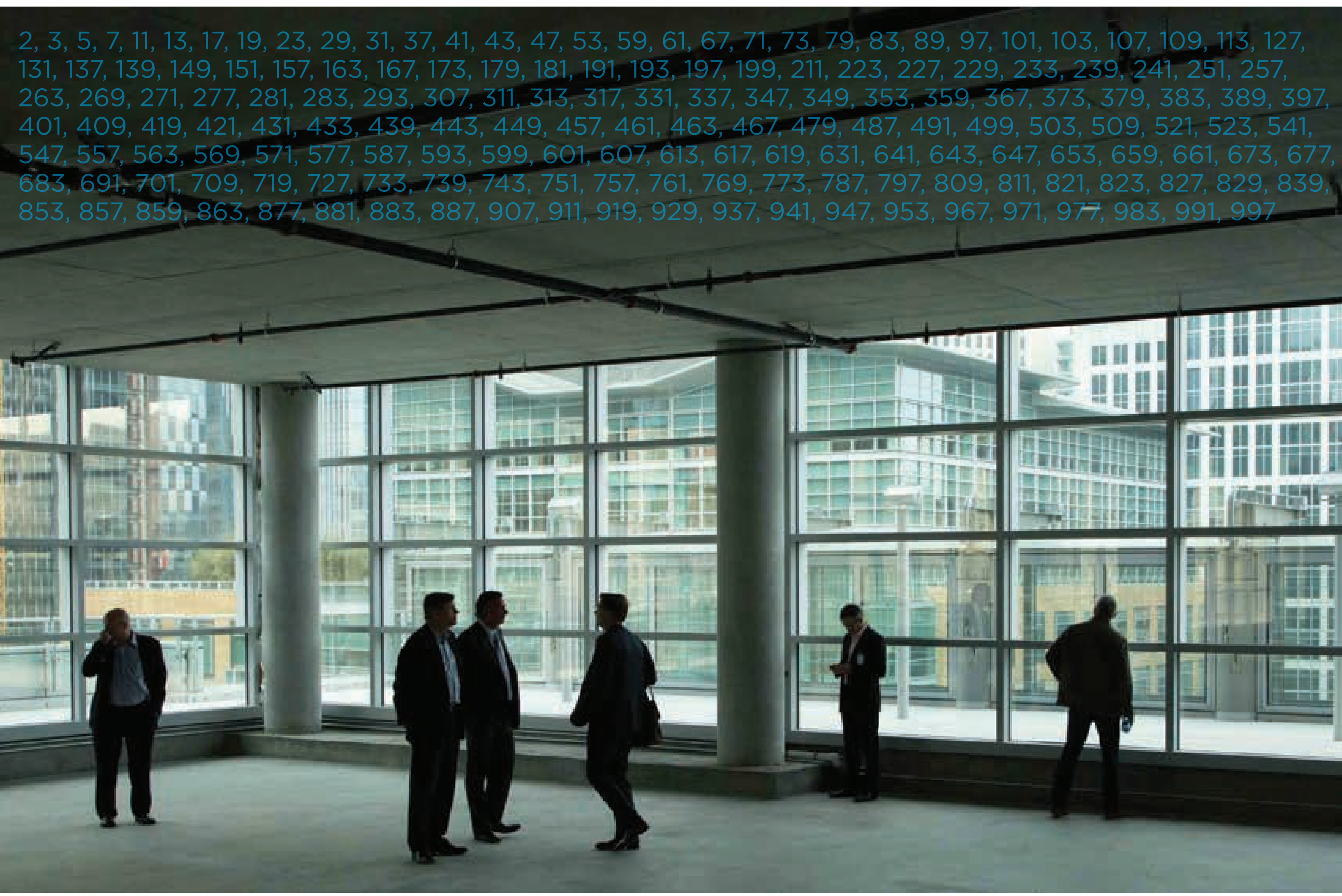
What does this mean for the real estate industry? The first takeaway is that there is a big opportunity available to increase NOI due to the maturity of various technologies. Is it profitable for many buildings to install solar today? Yes. Are there NPV positive (and under 3-year payback) projects in energy efficiency software, batteries, demand response, variable speed chillers, LEDs and the like in your portfolio today? In greater than 80% of the buildings in North America the answer is a resounding "yes."

But what about the utility death spiral? What do you need to do about that? First, keep in mind that with new technology the world seems to change only very slowly or not at all until suddenly it's clear that nothing will ever be the same again. Think of television, smartphones, laptops, automobiles, email, nuclear power, air travel…and of course the electric grid. That's happening now with energy. Will you be prepared for a world of suddenly spiraling energy prices? What will happen if several major utilities declare bankruptcy? What if your competitors are completely insulated from energy cost increases? What if the best tenants all demand backup energy under any conditions and an ENERGY STAR score of 90 to boot? On topics such as these, I can only assure you of one thing: expect change, and a lot of it.

Prime Numbers

Are you ready for data to disrupt commercial real estate?

By Chris Happ
CEO of Goby, Inc



Thoughtfully designed and operated buildings can provide practical solutions to the most challenging issues, while creating value for shareholders.

If our planet's ability to digitally share, study and collect valuable information went from zero to Internet in two decades, then what will 2030 look like? To catch an informed glimpse, Accenture Strategy surveyed more than 1,000 CEOs in "Agenda 2030: A Window of Opportunity."

This U.N. Global Compact study, reached a clear conclusion: "The glare of the spotlight influences [companies] to improve productivity, cut costs, secure trust with local stakeholders, and build customer loyalty,".

Whether that glare comes by way of the media, watchdog groups or increasingly sophisticated consumer activists, it's not a welcome sight. Yet growth and innovation driven by the intelligent use of harvested data can turn it into a positive light every business can bask in.

Eighty six percent of global CEOs believe "transformative action will be underpinned by a new approach to identifying common metrics that allow companies to measure, track and communicate impact on sustainable development goals." What's more, the report emphasizes that the same strategy that creates societal value drives shareholder value as well.

To the point: Sustainability equals value, especially in commercial real estate. A data-driven approach to monitoring electricity and water usage, tracking sustainability performance or showing the cost savings improvements that will yield over time can achieve two things:

- In the near term, it can positively impact NOI, as these numbers play a crucial role in building valuation during a sale.
- An owner or investor, well versed in valuable, can spot inefficiencies or opportunities while in the acquisition process.

And once that's achieved, so comes another tangible benefit: data equals value, too.

That data will play a dominant part in future cost savings is beyond question at this point, especially if you take a look at industry momentum. The conclusions in the Accenture study are echoed in a 2015 report by GRESB. Here's what they shared: Technical building assessments to provide more detailed information on energy efficiency opportunities rose to 83 percent of GRESB participants, up from 61 percent the previous year. That's a jump of more than a third.

"There is strong evidence," GRESB notes, "that thoughtfully designed and operated buildings can provide practical solutions to the most challenging issues, while creating value for shareholders."

Those words alone should provide a springboard into a data-driven culture—and paramount reasons that compel us to gather the data our buildings generate. But if you collect energy data just to report it, for example are you missing the mark? If it's little to no risk to capture the data, and if you're already reporting, can you turn it up a notch?

When GRESB and Accenture Strategy use the exact same words—"shareholder value"—it's not just about saving money, but making it as well. Yet it's also the question of spending money: If GRESB's 83 percent isn't 100 percent, no doubt it's due in part to the resistance involved when the return on investment for data-gathering technology seems to be a one-trick pony. Yes, energy efficiency initiatives can save building owners substantial sums of money. But that's far from the end of the line—in fact, quite the opposite.

A compelling argument exists within a new report by EnerNOC and PwC, with a title alone that speaks volumes: Transformational Energy Strategy: From Cost Management to Value Creation." Goby ranks among the advisory council members that contributed to this report.

"Energy is typically delegated down to facility-level managers, where it is disconnected from broader corporate strategy," says Tim Healy, Chairman and CEO of EnerNOC. "We're at the beginning of a new era where an effective energy strategy is essential to remaining competitive in the marketplace."

Nor do you have to look far for examples of how some companies have turned data mining into gold mining.

Over the last three years, the stock of Amazon.com (NASDAQ: AMZN) has soared 175 percent, a performance built in large part on data analytics. EKN Research reports that 80 percent of e-commerce giants say that they lag behind Amazon in analytics maturity.

In the dealmaking of the 21st Century, data will only continue to grow in richness, sophistication and complexity.

Amazon CEO Jeff Bezos has turned that advantage into a revenue stream worth $2 billion per year. Big money equals big data. But remarkably, Amazon is just getting started reaping the rewards.

On Christmas Eve 2013, the company patented an algorithm-based system that will eventually ship products before customers even place an order. The forecasting model uses data from prior Amazon activity to extrapolate what the customer needs and when they need it. This will allow Amazon, like the hockey legend Wayne Gretzky, to skate not to where the puck is, but where it will be. And like the Great Gretzky, they will score again and again.

Amazon's forward-thinking use of data offers a profound lesson—and an urgent one—to the real estate sector. Too often, even the brightest minds in development and sales don't skate to where the proverbial puck is: We go to where it was.

For all the firepower applied to the buying and selling of buildings and land, or tallying square footage and subdivided space, the commercial property model that calculates value in tangible physical assets—and nothing else—goes back hundreds of years to an era of quill pens and parchment.

Are we leaning backward as opposed to forward? According to Piper Jaffrey's Real Estate Technology Overview for 2016, commercial real estate's IT spending as a percentage of revenue comes in at an anemic 0.8 percent—the lowest rank of 16 business sectors. Remarkably, even food and beverage processing (1.3 percent) beats out CRE by a healthy margin, though many in and outside real estate might find that inconceivable.

LinkedIn established itself as a digital business pioneer by employing as many as 150 data scientists, a figure cited by the high-tech publication VentureBeat. How many real estate companies have even one? Think long and hard about being the first: The ones that have a data scientist or two on board, or a platform that manages the data for them, will have a distinct advantage.

Today, data science and analysis allows us to collect the data a property generates and create a storehouse of great worth with permanence and purpose—in categories ranging from energy usage to the number of well-heeled pedestrians that walk past the exterior security system.

To that latter category, consider this trio of hypothetical questions: What are the general demographics of the people who dine in or near the building? Which people possess key cards? What do those cameras tell you about foot traffic? Unless building management is evaluating security, these inquiries may seem irrelevant.

But in fact, these data points can prove the building sits in an increasingly desirable environment. For example: What if you could count the number of artsy, bohemian males and females that pass by and through the entrances? This data set—a "hipster quotient," if you will—indicates how the block is becoming a magnet for trendy dining, arts and nightlife—and a locale where property values are set to climb.

Knowing what is happening in your building represents a very valuable asset. And in the dealmaking of the 21st Century, that data will only continue to grow in richness, sophistication and complexity. Even when every square inch of space is rented, and every tenant amenity taken into account, data creates a value stream that never runs dry.

No one wants to leave value on the table when a commercial property is sold; nor does anyone desire to ignore leverage that allows for the lowest purchase price possible when buying. But the peerless advantages that come from gathering and monetizing this data, and making it a part of sales negotiations, separate the smart, savvy and successful from the rest of the pack. Imagine that you can do this.

Or to be more direct: You can do this. The methods and tools exist to make it all possible, though as with everything else in the high-tech sphere, changes are coming at breakneck speed. While it's a ground-floor time to get acclimated to this new paradigm, those who delay because "we've always done it this way" will find themselves running up the stairs in vain to catch the elevator.

Consider, then, the exciting alternative. Predictive data and analytics—perceived as buzzwords and futuristic tech—can make real bottom-line differences if you utilize it correctly. Properly harvested with the right technology, the ones and zeros in our midst will allow us to add a long string of digits to property portfolios.

Are you ready to embrace the possibilities—and the certainties—that already multiply energy savings into financial energy and competitive advantage? If so, we invite you to get started. It is now time to look up and move up together: The elevator, energy efficient, of course, is waiting.

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SUSTAINABLE

THE COMPETITIVE ADVANTAGE THAT ADDS AND PROTECTS VALUE

By Amy Price
President and COO,
Bentall Kennedy U.S.

Sustainability has been a buzzword and an aspiration for decades, and a company's ability to demonstrate purpose and a commitment to stewardship has become an increasingly important driver of reputation. But a sustainable approach yields value well beyond brand perception, and real estate investors seeking an edge will find that a green approach to property management not only increases the value of assets that showcase sustainable features, it also helps to mitigate the risks should a downturn come.

PUTTING A VALUE ON SUSTAINABLE PROPERTY

Having a focus on sustainability is more than good citizenship and public relations. Through our experience at Bentall Kennedy we've upheld that a sustainable approach to property development and management adds quantifiable value as well as a powerful and often overlooked risk management benefit.

In a recent study, we found that sustainable buildings, whether newly created or retrofitted, are having a significant impact on tenant satisfaction. The 2016 Tenant Satisfaction Survey[1] conducted by Kingsley Associates on our behalf revealed that tenants are more aware of green building programs in 2016 than they were in 2014 and that a healthier work environment and cost savings are driving interest in green programs. According to the Kingsley IndexSM, Kingsley's national database of office tenant survey results[2], nearly 35% of tenants now see green practices as a high priority when conducting a space search.

An academic study we commissioned found that sustainable office buildings also deliver both higher income and greater value. Dr. Nils Kok of Maastricht University in The Netherlands and Dr. Avis Devine of the University of Guelph in Canada studied nearly 300 office properties we manage

PROPERTY

across North America. Their research found that improved property performance is strongly correlated to green building certification.

More specifically, the research found:

- Higher rent premiums: Rental rate premiums of 10.2% CDN and 3.7% U.S. were found in LEED certified buildings.
- Lower rent concessions: Rent concessions were down 4% in CDN LEED and BOMA BEST certified buildings.
- Higher occupancy rates: An occupancy rate premium of 4% was seen in U.S. LEED certified buildings.

In aggregate, the findings from the study suggest a premium for green office buildings of roughly 8-10% compared to equivalent non-certified assets. Clearly, the value of sustainability practices goes well beyond brand reputation and the impact will only grow with the rise of the millennial workforce and the changing dynamics they are bringing with them. This is a workforce that is growing rapidly – according to the Pew Research Center[3], "Millennials have surpassed Baby Boomers as the nation's largest living generation."

While the modern sustainable movement may be a product of the baby boom generation, Millennials have certainly grown up with it as a central, everyday theme in their lives. Today, sustainability and environmental issues have

We have seen clear evidence that major corporate tenants are now expecting and even demanding green buildings.

a profound impact on the choices that Millennials make. Companies seeking to recruit the best and brightest Millennials need to consider sustainable factors among other features of their workplace in order to attract and retain the top talent they need to grow.

THE SUSTAINABLE APPEAL

For office tenants, attracting and keeping Millennials and the STEM Generation is vital as their workforce presence expands. These groups have an evolving mindset when it comes to long-term company-employee relationships, one that is requiring companies to provide a different environment and culture. According to a recent study of Millennials[4] by Deloitte Touche Tohmatsu, Millennials "express little loyalty to their current employers and many are planning near-term exits. This remarkable absence of allegiance represents a serious challenge to any business employing a large number of Millennials. However, because most [Millennials] choose organizations that share their personal values, it's not too late for employers to overcome this 'loyalty challenge.'"

That is good news for companies in properties that incorporate green practices into their property management, because sustainability is in high regard with this cohort.

How important? According to a recent Nielsen study that called Millennials The Green Generation: "Despite the fact that Millennials are coming of age in one of the most difficult economic climates in the past 100 years, [Millennials] continue to be most willing to pay extra for sustainable offerings—almost three-out-of-four respondents in the latest findings, up from approximately half in 2014."

The key elements to consider when developing a property that will be state-of-the-art sustainable and a draw for the Millennial workforce starts with location – with transportation infrastructure and nearby services and amenities all difference makers, particularly for Millennials for whom connecting and being connected is so essential. Importantly, a location is assessed not only for its current assets but what the future potential is for making additional connections within the community.

As Millennials continue to desire living within a CBD, work's proximity to a modern transportation system is critical – and the key to "getting out of your car." As a result, telecommuting is no longer the "must-have" it once was. This environment also provides a sustainable benefit that may be less obvious—the need for less parking, which results in using less concrete, producing less greenhouse gases, and additional environmental advantages.

Internally, the desire for connecting means creating spaces that improve the chances for spontaneous interactions and impromptu meetings. Incorporating the extensive and effective use of natural light also promotes a sense of well-being for the workforce, in addition to reducing energy consumption. Externally, it means developing green spaces, rooftop gardens, public art projects and other efforts that will get the community to interface in a positive way. And of course, the trees in these outside spaces also reduce carbon footprint.

GETTING THE GREEN EDGE

Once a sustainable property is developed, how best to institute an operational approach that can gain a "green edge" in real estate? Success is found in three pillars that focus on a building's physical characteristics and operations, and on tenant and resident relationships:

1. Energy management systems. It's vital to implement a system that tracks and monitors energy efficiency across all properties in a portfolio. This way, landlords can better understand utility consumption and identify best practices that can be shared to drive value and reduce environmental impacts.

2. Certification. It may seem obvious, but it's important to strive to make buildings certified for sustainability, preferably through the LEED certification, BOMA BEST (in Canada) and Energy Star rating programs. These certifications are symbols of a commitment to sustainability and are increasingly being expected by tenants. The competitiveness of a property could be considerably altered if it does not have any level of certification.

3. Tenant engagement and communications. After the physical work is complete and a property is certified, additional improvements and efficiency can be achieved through the active engagement of tenants. This is where the overlooked value-add is hiding. As an example, at Bentall Kennedy, we've created ForeverGreen, a communications program for tenants that won the 2015 Green Building Council Innovation in Sustainability Award. It's an engagement campaign that includes an annual twelve-poster series, resource guides, newsletters, team packets and more; the 2016 campaign is movie-themed, leveraging pop culture and humor.

As part of this program, property managers are prepped on the topics each quarter – energy efficiency, water conservation, healthy workplaces, etc. – and there is a high level of communication. This program aims to get tenants on board to influence a big portion of consumption. The higher the level of engagement, the more you can save. By engaging tenants, we're also engaging the Millennials they recruit – appealing to their sense of purpose and commitment to sustainable causes that can have an impact on their choices for employment and, potentially, their loyalty.

So the value of sustainable practices is evident on the bottom-line. Plus, it gives tenants an advantage when seeking to recruit and retain the best and brightest Millennials in the CBD. We also believe it presents the potential for risk management benefits should the economy slow and office vacancy increases.

First, the cost savings from energy-efficient, consumption-reducing sustainability programs can be passed along to tenants, thereby increasing a property's ability to compete on rental rates.

Furthermore, sustainable properties generate greater tenant satisfaction that would be hard to replicate in non-sustainable properties should rental rates be competitive. The same higher quality properties that are sought after in up markets due to their sustainability advantage will likely retain tenants longer – especially satisfied tenants seeking the best and brightest Millennial talent. We have seen clear evidence at Bentall Kennedy that major corporate tenants are now expecting and even demanding green buildings. As such, sustainability is becoming an important characteristic of Class A properties. Similarly, institutional investors are seeking increasing amounts of sustainability information in their asset manager RFPs.

SO WHAT'S NEXT?

If the Millennial generation was raised on sustainability, the next generation – some call it Generation Z – is most certainly being raised on technology. Future sustainable properties must factor in broader use of technologies that not only help to drive increased sustainable benefits, but integrate those benefits with how the next generation wants to be connected and how they communicate.

And while technology will always change, the need to make sustainable practices a priority is urgent and permanent, and not just for the sake of property owners and tenants. No, the need is far more profound: it's for the sake of our planet.

Footnotes:

[1]http://www.mept.com/pdf/1Q%2016%20MEPT%20Trust%20Report%20for%20Distribution.pdf

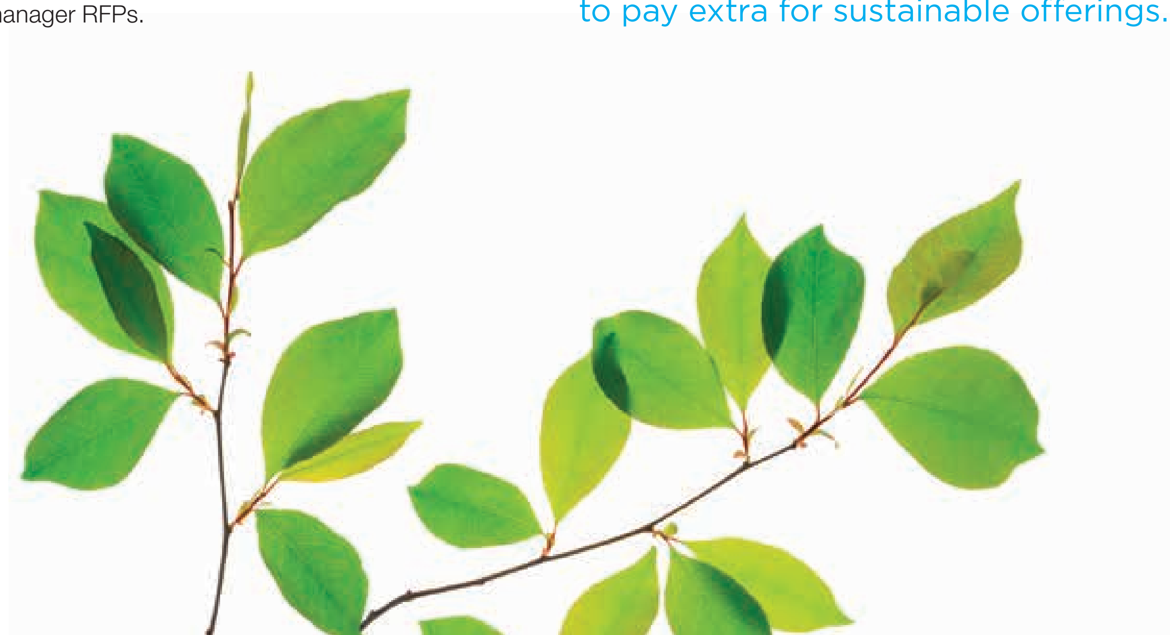
[2]http://kingsleyassociates.com/about-us/the-kingsley-index/

[3]http://www.pewresearch.org/fact-tank/2016/04/25/millennials-overtake-baby-boomers/

[4]https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/gx-millenial-survey-2016-exec-summary.pdf

[5]http://www.nielsen.com/us/en/insights/news/2015/green-generation-millennials-say-sustainability-is-a-shopping-priority.html

Millennials continue to be most willing to pay extra for sustainable offerings.



Market Peak

OR BACK TO LONG TERM AVERAGE?

37 YEARS
of Performance Data

WHAT SHOULD WE EXPECT NEXT?
Commercial real estate in the US has had a great run during the past five years as the market has been recovering from the financial crisis.

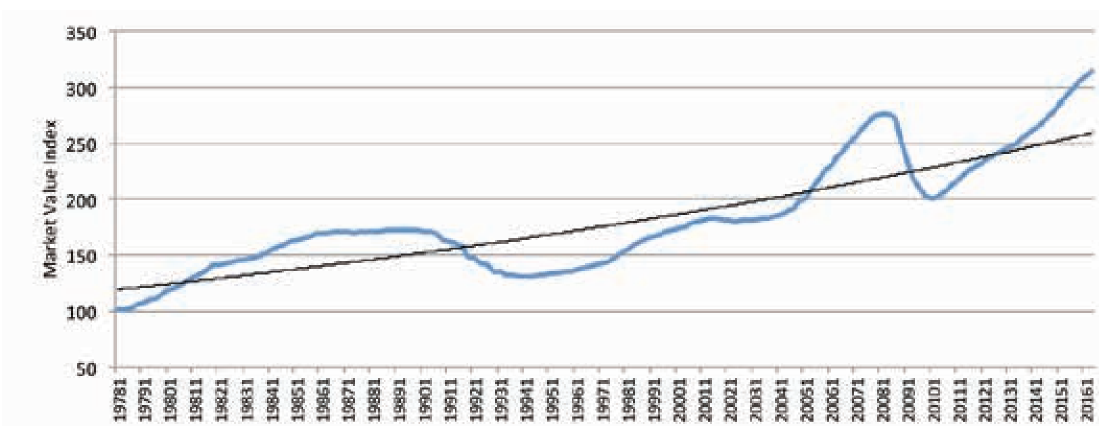
By Jeffrey D. Fisher, PH.D.
NCREIF Academic Consultant

Commercial real estate in the US has had a great run during the past five years as the market has been recovering from the financial crisis. As shown in Exhibit I, the values of institutional grade commercial real estate have recovered to be slightly above its pre-recession peak and slightly above a long term trend line since 1978.

In the previous edition of this journal, Jim Costello observed that last January, the Moody's/RCA Commercial Property Price Indices (CPPI) national all-property composite index recorded its first monthly drop in six years. Since then, we have seen a continued decline of real estate returns in the NCREIF Property Index (NPI) from the double digit unleveraged returns we had been experiencing. The CPPI resumed growth in May and June which is consistent with the price increases observed in the NCREIF market value index (MVI) ending in the June quarter.

There are, of course, differences between the two indices. The CPPI uses repeat sale data from Real Capital Analytics (RCA) and includes properties with transaction prices as low as $2.5 million whereas the MVI is based on appraised values for much higher value institutional real estate. Yet we can learn by observing both indices and trying to discern what they are telling us about whether the market appears to be peaking or just reverting to the mean. The 37-year history of the NCREIF data that spans two major recessions as well as the tech bust and 9-11 can help give us a longer term perspective about where returns are compared to historical levels.

Exhibit I: NCREIF Market Value Index for Institutional Real Estate



[1]Views expressed in this article are solely those of the author.

Exhibit II shows the returns over the history of the NCREIF Property Index (NPI). These are unleveraged returns displayed on a four quarter moving total basis. While returns have been moderating over the past 6 quarters, we see that they are still slightly above their long term historical average.

Exhibit II: Returns (unleveraged) for Institutional Real Estate

The strong double digit growth annual returns we have had in recent years has been due to a combination of improving fundamentals (higher occupancy and NOI growth) as well as declining cap rates due in part to lower interest rates. Rent and NOI growth continue to be strong and occupancy at or near historical highs. Returns have only moderated due to a leveling of cap rates.

The lower price appreciation over the past 5 quarters means that an increasing proportion of the return is due to income. The income return has not dropped as NOI growth remains strong and cap rates have leveled off. It has been pointed out that the income portion of returns also tends to increase as we approach a recession because cap rates begin to increase with less expected appreciation in values and interest rates are often increasing. This prompted us to look at the proportion of income return to total return preceding past recessions. Exhibit III shows the results. Whereas the income portion of the return has increased slightly in recent quarters, it is nowhere near the danger zone that we observed prior to past recessions.

Exhibit II: Returns (unleveraged) for Institutional Real Estate

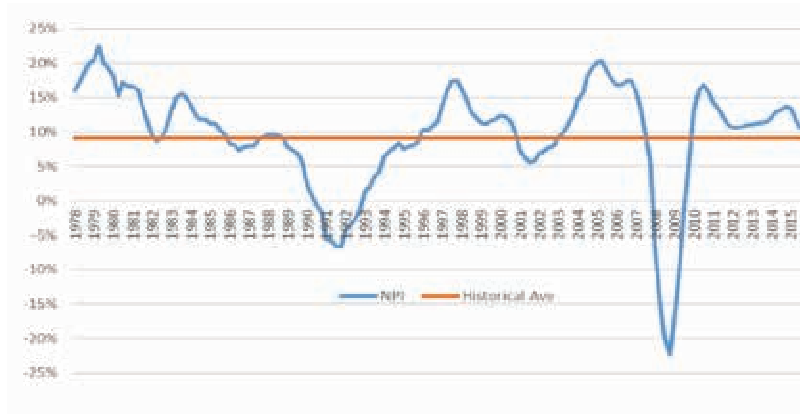


Exhibit IV: NCREIF Returns vs. GNP

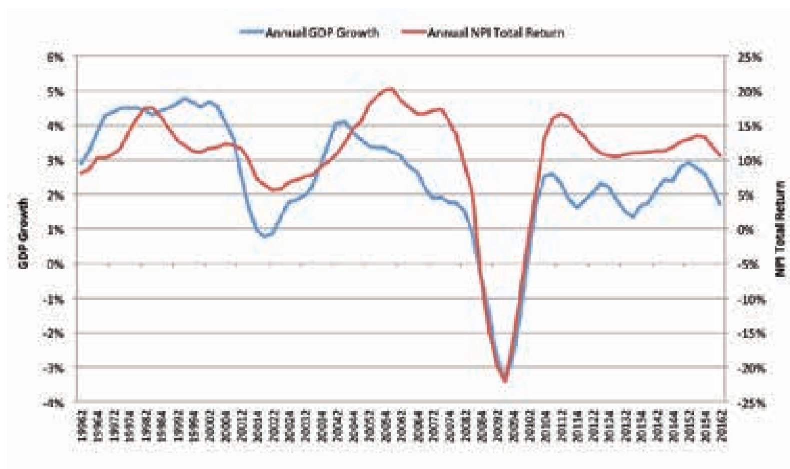


Exhibit III: Income Return as % of Total: Quarters Before Recessions and Current Quarter

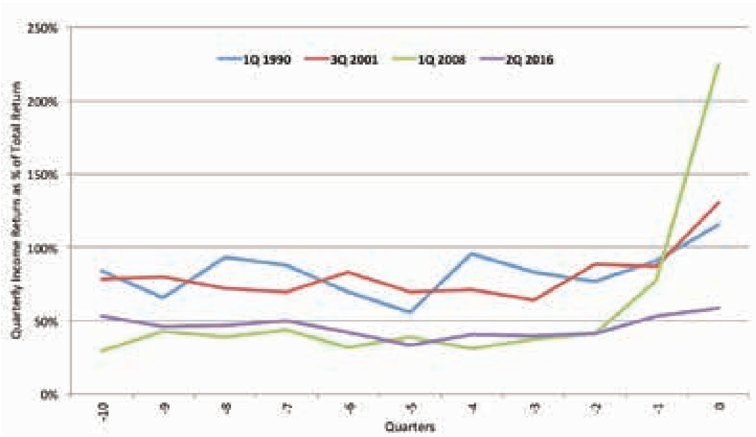


Exhibit V: NCREIF Returns vs. Employment Growth

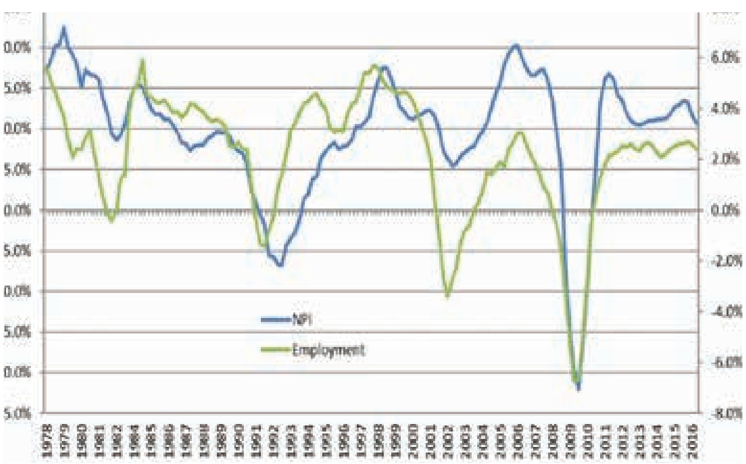


Exhibit III: Income Return as % of Total: Quarters Before Recessions and Current Quarter

0 = Ending Quarter with Negative Capital Return or Current Quarter

That said, the exhibit also suggests that we don't get much warning before there is a sudden increase in the portion of return from income due to a combination of price increases grinding to a halt and cap rates rising because investors now require a greater return from income. So we should keep our eye on what the data is telling us along with signs as to where the economy is headed. Big moves in the market are generally due to swings in in economic indicators such as the GNP and employment growth as we see in Exhibits IV and V. These exhibits suggest that as long as GNP and employment growth continue to be healthy even if at a more moderate pace, commercial real estate, especially investment grade as represented by the NPI, should continue to deliver acceptable risk-adjusted returns.

Although higher interest rates accompanied by moderate inflation may be on the Fed's radar screen, at current occupancy levels for CRE, inflation is likely to result in higher rents and pressure on replacement costs and may not put upward pressure on cap rates.

Readers are encouraged to continue to monitor indices like the NCREIF NPI and Moody's RCA CPPI in addition to forecasts from economists of GNP and employment growth to see signs of where the market is headed.

FLIGHT TO Downto

By Ken Robertson
Central Regional
President for KBS

McDonald's is one of the world's most celebrated brands with some 36,000-plus restaurants in more than 115 countries. While we may be talking hamburgers, Happy Meals and McFlurries here, this fast food behemoth is now one of the latest major companies taking part in sweeping trends impacting the way advanced industries work.

"The employment market is fiercely competitive for young talent, especially in today's hyper-connected world …"

This summer, McDonald's announced plans to move its 88-acre Oak Brook, Illinois, headquarters where it's been since 1971 to Chicago's vibrant West Loop neighborhood. This announcement comes on the heels of a recent trend of companies relocating their operations from more generic, typically suburban locations to bustling live, work and play city cores.

Early this year, General Electric announced that it plans to trek to one of the hottest real estate markets in the country — Boston's Seaport District, restyled the South Boston Waterfront, from its 20-plus-year home in Fairfield, Connecticut. In late 2014, Toyota announced it would move its headquarters housing nearly 5,000 jobs from Torrance, California, to Plano, Texas, and the examples go on.

While major office relocations are nothing new, the quantity of downtown relocations and the similarities behind the worker-centric rationale is a major trend. This trend has in large part defined the nature of the commercial real estate recovery since the Great Recession; that is, places that offer location attributes attractive to young, educated workers were often the last to tank (in many cases, less severely so) and early to recover. Conversely, locations associated with aging workforces, generic sprawl and less business-friendly governments still experience tepid growth seven years into the recovery.

As a commercial real estate portfolio manager, I see three major trends that have driven this change. First, almost every major industry is at some level intimately connected to technological innovation and the workers who shape these advances. Second is the rise of the millennial generation, including their cultural preferences and practical implications, such as where and how they live, work and play. Third, there is a majority of job growth stemming primarily from knowledge workers as well as the reduction of many workers who perform manual labor and repetitive tasks due to automation and offshoring. While the Great Recession (like other recessions) put a lot of pressure on employers to retool their operations, it was the convergence of these factors in the middle of a deep recession that contributed to the speed of change we see today.

What these major and many not-so-major location trends similarly point to is a change in thinking around the role of “talent” as a key component in business success. But how businesses choose to maximize the benefit of their talent depends upon a lot of factors, including average employee age, industry type, the importance of being together and real estate operating costs.

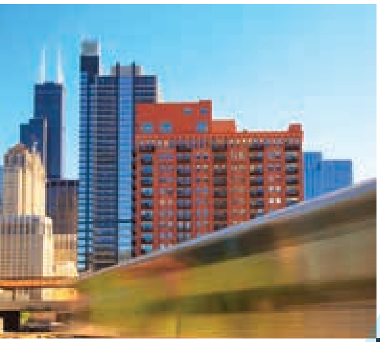
For Toyota, identifying a location that would allow collaboration of a large workforce (approximately 5,000), great cost-of-living benefits, being closer to its manufacturers and the chance for its workers to take part in the American dream were cited as key drivers for its headquarters relocation. Another key ingredient was the business-friendly climate in Texas. Consequently, Toyota chose to build a custom headquarters campus in a mixed-use business complex known as Legacy in Plano, Texas, one of the most dynamic and popular relocation targets in the U.S. today.

When you look at a company like General Electric, it's interesting to think that you are talking about an over 100-year-old company that is really going through a major transformation. Many of these changes relate to shedding businesses and revamping its identity as an innovation leader. For example, check out a series of General Electric commercials entitled "What's the Matter with Owen?" These commercials are part of a major rebranding strategy to portray General Electric as an innovation leader where the brightest young minds should want to work, and the HQ relocation to Boston is part of this strategy.

Interestingly, in the case of General Electric, not all employees will be making the move. In fact, it will only be a relatively small group of professionals compared to the company as a whole. This fact underscores the trend of some companies to consider split operations where certain aspects of their workforce locate in more dynamic downtown settings and others operate outside the city core. The drivers for these split operations can be many, such as separately operating business units or adding commute options, but in many cases the divisions are reflective of the fact that some jobs simply don't warrant the added cost of being in the city.

McDonald's cites business momentum, innovation and better customer engagement as drivers, while General Electric claims the business ecosystem, long-term costs, employee quality of life, connections with the world and proximity to other important company assets. However, perhaps the most commonly shared factor among most relocating companies is access to and recruitment of talent.

The employment market is fiercely competitive for young talent, especially in today's hyper-connected world where booming tech companies with creative work environments and live, work and play flexibility are scooping up the best of the best new hires. Classic brands with decades-long histories are forced to rethink their business models and employee structures to stay competitive and relevant. In fact, it's hard to find a business or industry that has not been impacted by these factors in some way.



Recent Smart Growth America research revealed six common factors explaining why companies choose to locate downtown:

1. To attract and retain talented workers
2. To build brand identity and company culture
3. To support creative collaboration
4. To be closer to customers and business partners
5. To centralize operations
6. To support triple bottom line business outcomes

There are literally hundreds of downtown locations to choose from, and what Smart Growth America has also uncovered is what companies are looking for when choosing a new location:

- Walkable neighborhoods
- Access to several transportation options
- Renovated office/warehouse space
- Unique building and city architecture
- Welcoming city with features such as outreach, permit assistance or financial assistance
- Safe and clean locations

As with Toyota, it's important to note that this trend toward locating in more dynamic places is not just taking place in downtowns. In fact, some of the most attractive locations are the ones that replicate the benefits downtown places offer. These mixed-use locations offer urban-like qualities in the middle of the suburbs and can be hugely successful. It's the best of both worlds — the benefits of urban-like settings, but also with more housing options, better schools and for some, easier commutes. And for these urban-like, suburban places, success begets more success as added attractiveness, people and development (read "density") improve the comparative quality to the sometimes more authentic character of "true" downtowns.

Whether it's a high-energy downtown or leafy suburb, many markets are connected to one another in some fashion and are sensitive to fluctuations occurring in neighboring markets. This means that while the actions of McDonald's, General Electric, Toyota and others alike are spurring activity in downtowns and the best mixed-use locations, surrounding areas and secondary markets are also impacted as many smaller and medium-sized companies are following suit in an effort to stay proximate to their larger business partners.

Another key factor to consider is how aging of the millennial generation will impact these migration trends. Will millennials, like generations before them, be drawn to the space more suburban locations offer as they grow older, marry and have children? Will companies follow the talent back to the suburbs as they have in prior times or perhaps double down on split locations and better use of technology to pioneer digital workplace collaboration?

Irrespective of where you fall in your opinion of the future, it's clear to see that all of these factors link back to a focus on talent like never before. It's this focus on gaining a competitive edge in the talent arena and use of this resource that will change the playing field for many years to come as our ability to innovate has become a central theme for the U.S. economy.

Staying ahead of these trends and how they impact the real estate market is especially critical in today's slow-growth economy where "shifting demand" can be as impactful as "new" demand. It's clear to see that these relocation shifts have a domino effect and that understanding this trend is really about understanding how the focus of business has changed and how this might provide valuable insight into what comes next.

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The talent revolution is in full swing, and it's where to look for what comes next.

BUSINESS CYCLES

Present Human Capital Opportunities And Challenges:

By Steven N. Schrenzel
Global COO for The Taplow Group, SA and Managing Director, North America for Taplow

Optimizing for the future requires critical evaluation of the most recent cycle. This includes not only how firms reacted in 2008 -2009, but also how they've performed since. The following analysis, based on discussions with executive decision makers in all aspects of real estate investment management, considers work force optimization, how to protect investors, and manage clients and costs more effectively throughout the business cycle.

Organizational structure is always a complex puzzle of people, process, and skill requirements, but if one looks at a problem, not from the perspective of replacing someone, or expanding a department, but rather looking for force multipliers and ways to creatively cross silos, investment managers can create true resiliency for the eventual downturn. Isolation and rigid silos are neither flexible, nor economical. Force multipliers may help your firm thrive no matter what happens in the market.

For example, some strategic leaders have taken advantage of the critical skills and knowledge of real estate economics (including research and in some cases transaction management), salesmanship, relationship management, effective and thoughtful communications and intellectual curiosity to merge roles which cross all aspects of sales, marketing and client servicing. By including the high level understanding of real estate economics and performance management/performance attribution in the client facing team, they have reduced the distraction for investment professionals. By using client facing professionals in these roles, product management is enhanced as client feedback tends to be less self-serving and more indicative of investor interests rather than justifying growth in the area of expertise of the portfolio manager currently sitting with the client.

An insight that came up repeatedly is the need to re-think professional functions, from entry level to executive, to develop a better understanding of job families and avoid the narrowing of silos of expertise that occurs naturally during expansionary periods. Generally, real estate investors are not optimizing human capital during periods of expansion to better prepare for the inevitable periods of contraction. During several previous growth periods, firms hired and developed far fewer experienced professionals to accomplish goals than they might have liked. A representative comment, paraphrasing slightly, from one investment executive summarizes the problem well: "When the crunch came, we tended to hold on to the longer term executives and professionals. We lost some of our best analytical and executional talent – we really didn't plan for the next recovery."

Arguably, the economy is now (August 2016) in month 85 or 86 of the current economic expansion. While economists and statisticians may argue about the definition of a business cycle, everyone in the real estate business has experienced expansion and expects to experience contractions – but no one can precisely predict the timing of the cycles. During periods of recovery, real asset owners tend to shift from managing costs and credit relationships to raising capital, expanding capital deployment, and increasing capital spending to take advantage of investment opportunities that are usually abundant in the early stages of a recovery but tail off during the later stages. As contractions occur, everything starts again with lowering of costs and managing investor and lender relations more actively.

Team development during periods of expansion generally has been a combination of internal development and external hires. However, from 2008 – 2010/2011, the loss of potential mentors that occurred during the contraction coupled with the early adoption of "Fintech" and other technologies presented a serious challenge to many investment firms as the "wall of cash" came rushing in. While the energy and creativity of seasoned real estate executives usually overcame the limitations of not having been as well prepared as they might have been, no one can know if they really achieved as much as they might have had they been better prepared. At this point, some executives will opine that they were as well prepared as they needed to be. There were exceptions, some firms took measures to conserve human capital during the downturn and were quite well prepared.

In 2009, there were many companies that struggled with the narrow silos of expertise they had created in their organizations during the prior expansion. Silos of expertise became narrower and deeper as the recovery expanded. Many of the executives we spoke with bemoaned the need to cut the talent they had hired in order to reduce costs during contractions in the business cycle. In fact, most who have been leaders through one or more contractions recognize that organizations often lose key skills (including relationship management) as cutbacks occur.

Real estate investment firms tend to form around a few patterns. Silos tend to form around the expertise of the founders and other senior leaders rather than in a well-considered organizational design. When two firms merge, the practices of both organizations, even if inherently different, often survive largely intact with only the readily apparent redundancies being resolved after the transition to the new firm and brand are completed.

In all but the smallest firms, capital raising, marketing, client servicing, consultant relations and even product management are separate silos of expertise within a large and generally cohesively organized structure based on product, geography or type of client (investor). Usually, new business development (capital raising) is separate from client servicing in about the same percentage of firms at every point in time. Marketing is more likely Marketing Communications (including RFP response) rather than true strategic marketing.

Outside of some specialties that require very specific training and experience, such as legal training, it is possible to create a competitive advantage by hiring and developing professionals who can be effective "force multipliers" across silos.

A few examples of concentrations of expertise we observe and where silos often develop include:

- CIO and Portfolio Management, Research
- Asset Management, Property Management
- Acquisitions & Dispositions including transaction management and financing
- Development, Design & Construction/ Construction Management
- Financial Management, Operations, Audit, Compliance, Legal, Governance
- Sales, Marketing, Client Servicing, Consultant Relations, Product Management

All of the silos appear to have some potential for economy of forces. The challenge is how to assess and take advantage of the various opportunities to achieve economy of force without creating chaotic disruptions in management and relationships.

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WORK-FORCE HOUSING

By Andy Sands
Managing Director of Multi-Family Investing

Peter Finley
SVP of Marketing and Capital Raising

ECONOMIC TRENDS HAVE FORCED WORKERS TO SEEK SUBURBAN HOUSING ALTERNATIVES PARTICULARLY IN THE FIRST AND SECOND RINGS AROUND OUR MAJOR CITIES.

"WORK-FORCE HOUSING" is a term that is bandied around in the multi-family investment business. Lenders, particularly the agencies, define it as unsubsidized, affordable housing that serves the majority of low to middle-income households. The guidelines are fairly specific and relate to rent relative to median income levels, which varies by area, and property characteristics such as vintage and the level of amenities. Many institutional investors apply a definition that is broader and more flexible, but the objectives are very similar.

WORK-FORCE HOUSING renters are typically renters by necessity due to financial constraints. These renters include teachers and police officers, construction workers, employees in manufacturing facilities and everyday service industry employees. Their wages have gone up only marginally during this economic cycle, while average rental housing costs have skyrocketed, particularly in the urban core, pushing these renters further outside the core economic centers. This dilemma forces these workers to seek suburban housing alternatives particularly in the first and second rings around our major cities. Even within these ring areas, particularly in coastal markets, there is a significant shortage of modern, yet affordable housing for these individuals and families.

The economic reality isn't great for most of the households in the US, and particularly for those renters by necessity. Real income growth is essentially flat for the past 15 years. Additionally, the increase in multi-family supply over the past decade has clearly favored those who can afford to live in CBD locations. Units delivered, as a percentage of inventory, have almost doubled for CBD properties over the last decade, whereas the stock of new construction in suburban locations has remained flat during the same time period.

The opportunity exists to help individuals and families who rent by necessity through targeted renovations of select 1980s to early 2000s vintage Class B multi-family assets in primary and secondary markets. Through focused renovations of impactful areas, one can reposition the assets at only modest rent increases that maintain affordability and provide a higher quality living environment for these workers and their families. These renovations are selective in delivering functional and modern finishes and amenities that are more efficient and attractive. In turn, these property improvements provide the added benefit of supporting environmental sustainability with increased energy efficiency through things such as new appliances, energy systems and insulated windows and doors. These significant social benefits can be accomplished while providing investors with attractive risk adjusted returns through an active value added investment strategy.

The opportunity to help these individuals and families has economic support on a macro and micro investment level. From a macro perspective, work-force housing assets enjoy lower vacancy rates as compared to Class A CBD assets, particularly over the past few years. This is the result of demand growth outpacing supply growth in primary work-force housing locations, as compared to CBD areas. In a cyclical environment, rent history favors suburban locations over CBD areas. In the 2009 downturn era, rent losses were more severe for CBD properties and rental rate increases for work-force housing assets has outpaced CBD assets by a good margin in a stabilized market.

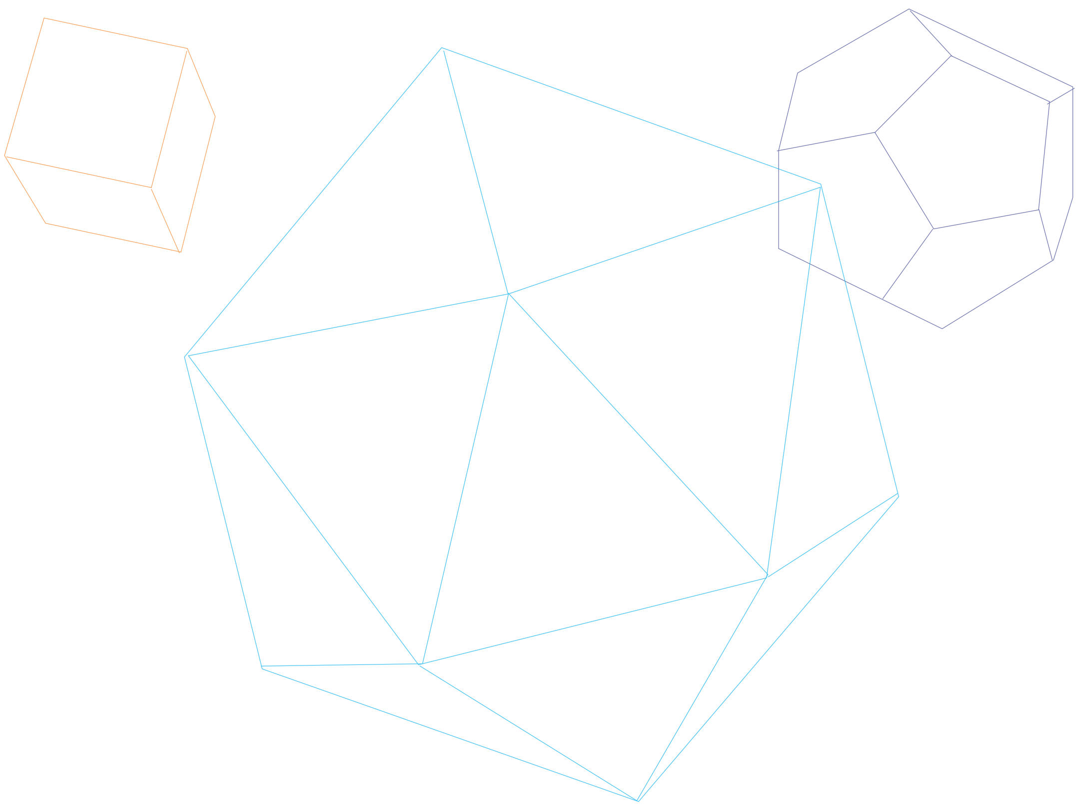
On a micro level, work-force housing investing can be highly profitable and a great value in the risk reward equation. There is significant opportunity targeting 1980's to early 2000 vintage Class B apartments, with 150 or more units in primary and secondary suburban locations. By spending $6,000-$10,000 per unit, our experience has shown that the return on this equity through rent increases can exceed 20%. Unit renovations include new modern flooring, which typically includes faux wood vinyl in the common areas and new carpet in the bedrooms, fresh paint, new base and door trim, updating the plumbing fixtures, hardware, electrical outlets with USB ports, window coverings and lighting, which include new LED blubs in all fixtures, installation of Energy Star kitchen appliance packages including refrigerator, range, dishwasher and microwave, upgrading cabinets, if not replacing them and installing new countertops in the kitchen and bathroom. Other opportunities include the replacement of all interior doors and select sliding glass doors & windows for improved insulation. Unit improvements are tangible and make for a more satisfying living environment for individuals and families.

While the renovation of existing work-force housing represents the bigger opportunity given the inventory of older vintage apartments, there are selective opportunities to newly develop work-force housing in certain markets. That being said, it is very difficult to accomplish without some form of subsidy, so non subsidized development can only pencil in certain low cost markets and even then require a very efficient development process including leveraging repeat use of architectural plans and materials. Subsidized development can take place in many forms but generally involve some type of tax credit or subsidy to enable projects to make economic sense.

From an investment return perspective, investing in work-force housing can be highly rewarding. Implementing a targeted and cost effective renovation coupled attractive agency financing, can provide investors with double digit current cash returns and an attractive value add total returns. Combining this attractive investment profile with creating a higher quality living environment for working class individuals and families has proven to be richly rewarding for investors and for an underserved group of members of our society.

A New Angle on Succession

By Jennifer Novack
Managing Director, Head of Global Real Estate Practice at Sheffield Haworth



BALANCING THE FORCES FROM WITHIN AND WITHOUT

Succession is a hot topic – everyone agrees that it's crucial to maintain a strong investment track record with longevity, keep talent engaged and retained, and allow owners to realize long term profits on their life's work.

Most succession conversations focus on potential challenges within the fund platforms, such as founders' hesitancy to let go or share in economics, a perceived (though not always real) "shortage" of talent within a particular "vintage", and the institutionalization of real estate as an asset class over the last 30 years.

There may be, however, an unexamined force – in some ways real, and in some ways perceived - at work from outside the funds: investors.

Investors are considered the lifeblood of funds. It stands to reason that funds' interaction with them, and the direction provided by them – real or perceived – impacts General Partners' behavior. One of the key attributes examined by investors looking to invest with managers is their consistency: how many years has the senior leadership team been in place? How consistent has the team been? How little change has there been?

Despite all the fine print and warnings that "past performance may not be indicative of future success", investors still value consistency—in personnel, in strategy, in results. A change in leadership or fund management could easily trigger a "wait and see" reaction from LPs, who may elect to sit out committing to a new fund in order to assess how the new regime performs. Managers that have changed staff or approaches are, by definition, put into a defensive position. Baked into the assessment and due diligence of investors and consultants, there may be a subtext against a crucial ingredient for future success.

In short: Is a succession plan something that investors want to see, but actual succession something that they would rather not?

THE DISCUSSION

There is no doubt that a key part of the due diligence discussion between investors and managers is related to a firm's succession plan, whether it has a "deep bench", and alignment of interests, typically in the form of promote across the team. This does force funds to think through these issues. What may not be reflected in promote statistics, however, are qualitative motivation and retention factors within the team such as "when will I have a seat at the leadership table", and "what is my path to partnership or owning a piece of the firm?"

Because the future and markets are difficult to predict, some investors may naturally focus more on questions that give them comfort surrounding the life of the fund they are investing in, such as deep bench in case of departures, and alignment of carry. As with any investment, it can be difficult to underwrite for a timeframe beyond that and, practically speaking, the priority is preserving the current capital at play, even if the goal is programmatic and ongoing fund participation.

RISK AVERSION AMONG INVESTORS IMPACTS RISK AVERSION OF FUNDS

According to recent Preqin investment data, the real estate industry has seen 715 funds raised between in 2013 and 2015, garnering more than $329 billion in capital investment.

While there has clearly been a huge amount of fundraising in the Real Estate private equity space, almost anyone who is a capital raiser (or founder, or portfolio manager, who is on the road accompanying them), will tell you that it's not easy. It takes longer and requires many more conversations and answered questions—as it should, in many ways. However, when it's not easy, there may be the inclination on the part of funds to mitigate any risk in the presentation of the firm, namely by focusing on aspects of consistency, and professionals within the firm that are familiar.

In short: Is a succession plan something that investors want to see, but actual succession something that they would rather not?

In one of the most frustrating examples of this attempt to mitigate risk dictating behavior is if senior personnel leave right after a fund-raise, having had the intention all along or for at least part of it. Not wanting to have the open conversation or rock the boat, they elect instead to leave right after a close, hoping the years between fundraises will allow water to pass under the bridge, good investments to be made and new faces to become more familiar.

Funds may be loath to introduce new styles and personalities. As one source commented, when thinking of future leaders that investors will like, they may choose and present those that fit the model of, "If you like Bob, you'll like Andrew." In hiring, at all levels, many managers, whether consciously or subconsciously, often look for carbon copies of themselves, or even jokingly asking for "clones" of their star performers when bringing on new talent. While a strong company culture and focus is crucial, different people bring different strengths and a readiness to adapt is good.

A complicating factor in the real estate industry is that many firms are not collectives but rather dominated by one or two personalities at the top. In corporate private equity, it is more common to have several senior partners. More power in fewer hands means each pair of hands is that much more important to the story and underwriting. Firms may add more people to the equation to dilute the importance of a single person, or choose to keep power in those same hands for as long as possible.

MAKING SMART SUCCESSION AN ADVANTAGE

Not only do management teams need to understand the importance of succession and make succession a key part of their jobs, they must also clarify for themselves and their investors how succession is a key strategic advantage. Like other industries, real estate investment managers will succeed over the next 10 years because they are able to adapt, not because they remain the same.

If succession is done well, it's almost impossible for outsiders to know exactly when it begins. Investors have years to get to know future leaders of the firm. Future leaders are included in LP interactions and socialized for years, not months. The good news, in terms of LP-driven behavior, is that the best successor is almost always the organic one from within. They are not only more familiar to investors and easier to underwrite and understand; they also have been given the time necessary to integrate with the firm's culture and ethos.

The most impactful and successful succession hire is often not the banner senior placement. It's the professional who comes in as the "heir apparent", or even earlier. The former—or the "arranged marriage", as one fund manager calls it—can be successful. However, just as with real-life arranged marriages, it takes time for all parties to learn how to work best together and those synergies may not be immediately apparent to GPs or LPs.

ANOTHER TYPE OF INVESTOR TO EMERGE

If there isn't a focus on succession, it will create opportunities for another type of investor: the acquirer. Succession doesn't happen overnight. If it's "too late" by the time it's needed, the best exit-strategy or path forward for all parties – founder(s), talent within the firm, and acquirer – is to merge and/or be acquired, adding not just capitalization but new growth opportunities.

WHAT'S TO COME?

The term "founder" is often still used interchangeably with "leader" in many real estate private equity firms. It's a hallmark of the real estate world, and its growth over the last 30 years, that founder and leader often remain one in the same.

But in the future, as transitions happen, the leaders will not be the original founders. With limited data points to date ahead of the upcoming wave, in many instances, it's too soon to say how investors will react to actual succession. For this reason, it may be assumptions that are at work. As Billie Jean King said, "You have to see it to be it." Funds and LPs may be feeling their way through this new issue together.

Jennifer Novack is Head of the Global Real Estate Practice at Sheffield Haworth, a financial services focused executive search and advisory firm with twelve offices globally across the US, Europe, Middle East and Asia. Over the past decade plus, Jennifer has partnered with top-tier investment managers to achieve their vision and create value through hiring transformational talent.

A global leader in investing sustainably

Bentall Kennedy has been ranked among the top firms globally for its commitment to sustainable investing by Global Real Estate Sustainability Benchmark (GRESB) for the sixth consecutive year.

At Bentall Kennedy, sustainability isn't only about protecting our environment – vital as that is. Sustainability is also a catalyst for strengthening tenant relationships and continuous innovation.

Our ESG excellence enhances long-term value by increasing property occupancy and income, reducing risk of obsolescence and strengthening tenant loyalty – all while reducing emissions to protect our environment.

TOP FUND

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