

Rewarding Talent

Development, Finance, REITs Top 2015 Leadership Hunt

Hiring: Abundant Capital, Focus on Leadership

By William Ferguson, Chairman & CEO, Ferguson Partners Ltd., a subsidiary of FPL Advisory Group L.L.C.

As 2014 comes to a close, three overarching trends have emerged that will continue to dominate commercial real estate and influence senior leadership hiring in 2015. They are:

- Abundant equity capital to invest, which is also triggering significantly more activity in global debt markets—a possible warning sign that the current expansion cycle is at risk of overheating;
- Increased focus on leadership in the U.S., with a significant amount of turnover at the top of REIT organizational charts;
- Growing interest in opportunistic investing in southern European markets hardest hit during the global downturn—first Spain, now Italy and even Greece.

Equity capital pouring into commercial real estate from global sources, especially Asia and the Middle East, is finding a home in the U.S., which is perceived to be the world's safest market due to its economic stability. Investment activity in the U.S. showed continued growth in the fourth quarter, and was stronger than in previous quarters, despite concerns of interest rates beginning to tick higher. Yet despite the abundance of capital on a global scale, demand in the U.S. continues to outstrip the available supply. This is creating a need for leadership talent with expertise in raising and deploying capital.

Capital is also being invested in major European cities such as London and Paris, and to a certain degree in Germany. Less capital is being committed to Asia because of economic uncertainty, as evidenced by the recent downturn in Japan and China's slowing growth.

The overall abundance of capital brings with it a related demand for debt. In order to compete, some lenders are starting to loosen their underwriting practices, resulting in increased leverage for commercial projects. Although lending has not returned to pre-financial crisis levels, when project financing reached 80 to 90 percent, the amount of debt is edging higher.

As we have seen in prior cycles, increasing debt levels are often a good indicator that markets are beginning to overheat. Escalating debt levels also raise risks in the event of a sudden increase in interest rates or softening of commercial development. This issue warrants a close watch in 2015.

Pressure from activist investors and a greater willingness among board members to make tough decisions about CEO performance have resulted in more leadership transitions among U.S.-based REITs.

Coupled with normal succession, those trends have generated CEO turnover at about 10 percent of equity REITs in 2014. Look for this trend to continue in 2015.

In Europe, the search for opportunistic returns is drawing attention to the southern part of the continent. Having been late to invest in the U.S. (many investors did not recommit to real estate until 2010, when the upside was more limited), opportunistic investors have been flocking to Europe—sometimes prematurely. Spain has been on the radar of hedge funds and credit players and continues to attract attention, even though a recent rush of buying has pushed the prices of what had been distressed properties to fair market value or above. Also on their radar for opportunistic investing are Italy and even Greece.

Looking ahead to 2015, hiring of senior leaders is projected to increase 5 percent year over year, thanks largely to changes in REIT leadership. In Asia, senior-level hiring is expected to show a more modest increase of about 2 percent. In Europe, where national and regional market prospects vary from strong growth to contraction, the overall pace of hiring senior leadership is expected to be about even with 2014. In Canada, no incremental growth in hiring at the senior level is expected in 2015.

While the global outlook is tempered by caution, given the current mix of economic news—recession in Japan, less robust growth in China and a slowdown in much of Europe—the overall outlook for 2015 is modest growth in senior-level hiring compared to 2014.

Following are regional highlights, based on insights from Ferguson Partners' global team and conversations with senior real estate executives in key markets.

Asia: New & Maturing Sectors

New in Asia next year will be growth in asset categories such as seniors housing, student accommodations and data centers, which are developing in markets such as Singapore and Japan.

Overall, hiring will vary considerably from country to country—less in opportunistic markets such as China and India, more in mature markets like Japan, Australia and to some degree, Singapore. Hiring patterns will also reflect the shift in Asia away from opportunistic strategies and toward longer-term real estate investment management, particularly as insurance companies and traditional asset managers continue to expand their Asian holdings with a longer-term investment horizon. Fund-raising expertise will be a priority, along with sourcing, asset management and corporate infrastructure (legal, tax, compliance, etc.).

Brokerage firms will step up hiring as they expand into higher-margin leasing and investment advisory services. As investment funds create global platforms to operate across Asia (as well as Europe and the U.S.), demand for management personnel will rise. In addition, the increase in capital seeking REIT products will spark hiring of institutional talent to tap capital sources such as insurance companies and pension funds in markets like China.



Asia at a Glance

Leading sectors for hiring in 2015:

Equity REITs, investment management, private owner/developers, commercial mortgage banking/lending

Hiring conditions in 2015:

Marginally better (up 2% year over year)

High-demand skill sets:

Acquisitions, asset/portfolio management, capital raising, information systems

Top priorities:

- (1) Recruiting/retaining top performers;
- (2) Developing next generation of leaders

The biggest issue in Asia is transitioning talent from a traditionally opportunistic market to one that places a greater emphasis on income-producing assets.

Senior development professionals are highly sought after in the New York City area to replace talent that was lost during the depths of the recession. On the West Coast, some investment banks are beginning to build structured finance teams. One caveat is concern over deploying capital that has failed to generate the desired level of returns in this liquid market. This places added pressure on firms to hire top talent for development and asset management.

Among U.S. asset categories, hiring has been healthy in the hospitality sector, including hotel REITs. Multi-family development continues apace, creating demand in development and operations. The single-family home sector has remained stable as prices recover.

In retail, recruitment needs include specialized positions, such as chief digital officers to oversee the creation of “omni-channel” solutions that touch customers at multiple points of purchase. Evolving consumer buying trends are also boosting demand for regional and local distribution centers to deliver products to customers, while manufacturing is moving back onshore.

Other active sectors include healthcare, where consolidation is a leading trend, and seniors housing. Despite the recent decline in oil prices, energy remains a hot sector, thanks in part to the growth in hydraulic fracturing (or “fracking”). This, in turn, has generated de-

Europe: Seeking Human Capital

Homebuilding is expected to show strength in some areas, due to a massive undersupply of housing across Europe, while senior living draws increasing attention as an investment asset. Also adding staff will be commercial lenders, as well as brokerage firms, which have been hiring consistently for the past year or so.

Human capital demand in Europe will center largely on functional talent and compliance professionals, due to regulatory changes affecting financial services. Other areas of growth will include capital raising and investor relations, as well as mortgage origination, whether among investment or commercial banks. Acquisition professionals are needed to meet the demand to deploy capital. Another area is human resources, which must adjust to a new regulatory environment that limits executive bonuses, thus raising the question of how to motivate and retain top talent.

Geographically, hiring is projected to be strongest in southern Europe, with more modest increases in northern and western Europe and no significant changes projected for central and eastern Europe or the Commonwealth of Independent States.

North America: Coastal Clusters

Besides expanded hiring by REITs, trends in the U.S. will follow the geographic pattern established in 2014, with the bulk of activity clustered on the East and West coasts, and more specifically, in the New York City and San Francisco metropolitan markets. Texas is also active, thanks to the energy boom and a favorable tax environment.



Europe at a Glance

Leading sectors for hiring in 2015:

Investment banking, homebuilding, senior living, commercial services & brokerage, commercial mortgage banking/lending

Hiring conditions in 2015:

Expected to remain largely the same

High-demand skill sets:

Acquisitions, capital raising/investor relations, mortgage origination, information systems, compliance

Top priorities:

- (1) Addressing skilled worker shortage
- (2) Increasing gender diversity

Spain is on everyone’s radar, Italy is next, and even Greece is getting a look again, thanks to the quest for undervalued properties. But in Spain, where people are still hoping for 30 to 40 percent discounts, even distressed properties are often priced at par because of the rush of recent buying activity.



U.S. at a Glance

Leading sectors for hiring in 2015:

REITs, investment management/private equity, hospitality, seniors housing/healthcare, private owners/developers, commercial mortgage banking/lending

Hiring conditions in 2015: Reasonable growth (5% year over year)

High-demand skill sets: Acquisitions, capital raising/investor relations, mortgage origination, information systems, compliance

Top priorities:
 (1) Recruiting/retaining top performers
 (2) Increased cost of employee benefits and coverage

REITs' recruitment of senior executives will be the big story in 2015. Also, concern over returns is raising the stakes for hiring the best possible talent in development and asset management.

mand for support services including multi-family and workforce housing development. Transportation remains an active sector, as well.

In Canada, the bulk of hiring will continue to take place in the gateway markets of Montreal and Toronto in the east and Calgary in the west. Overall, hiring is expected to increase marginally, with stronger demand in fields such as development, construction, asset/portfolio management, property management/leasing, capital raising/investor relations and information systems. The most active sectors in Canada in 2015 will likely be REITs, real estate investment management/private equity, commercial services and brokerage, homebuilding and seniors housing.

Conclusion

The tone of the global hiring forecast for 2015 is cautiously optimistic. Hiring of senior leaders is on course to increase modestly over the next 12 months compared with 2014. Among the most active areas will be U.S.-based REITs, which have seen a significant number of leadership changes. Other trends warranting attention are an abundance of investment capital, increased activity in the debt markets and opportunistic investing in southern Europe.

Compensation: Growth Rooted in Performance

By Vanessa R. Garza, Director, FPL Associates L.P.,
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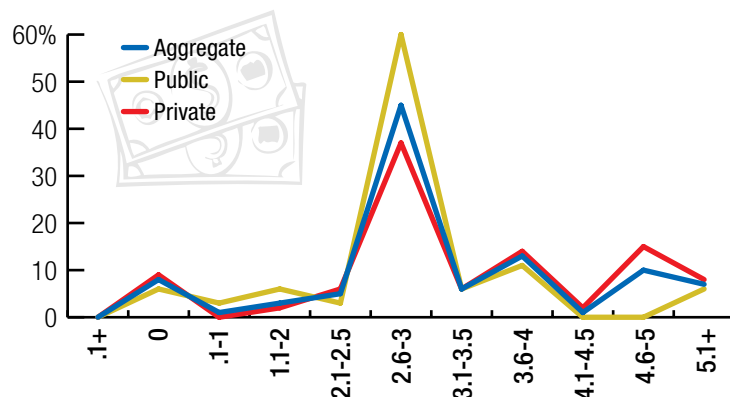
For real estate companies, 2014 was a relatively strong year, and against the backdrop of compensation programs that are increasingly rooted in performance, compensation vis-à-vis bonus payouts is expected to rise. Bonus payouts are largely expected to exceed target levels, according to FPL's 2014 Real Estate Compensation Pulse Survey, the only survey of its kind to gauge "real-time" compensation expectations at year-end for more than 100 public and private real estate companies.

So how did real estate companies fare in 2014? As of mid-December, the industry had outperformed by a solid margin, as measured by total shareholder return within the public marketplace. The total return of the FTSE NAREIT® All REIT Index was 26 percent, more than double the returns of the S&P 500 Index (12 percent) and the NASDAQ Composite (12 percent) for the same period and multiples above the Russell 2000. On the private side, the NCREIF Property Index, which measures the total rate of return of investment performance for commercial real estate properties, is similarly on pace to hit double-digit returns after three quarters. That would mark the fifth consecutive year of such returns.

While equity capital raises in the public REIT market for 2014 declined 10 percent year over year, there has been an uptick in debt issuances as companies have taken advantage of the favorable inter-

Paycheck Predictions

(expected changes in base salaries, 2014-2015)



Source: FPL Advisory Services surveys of real estate executives

est-rate market. The result has been an extraordinary rise in property values in the last year. According to Green Street Advisors' proprietary Commercial Property Price Index, real estate values have appreciated above the peak August 2007 levels by 15 percent, with 10 percent of the total change occurring in the last 12 months.

By most accounts, compared to 2013, a year when public REITs' returns lagged the broader public indices, 2014 has been marked by solid income growth and healthy returns for investors, both public and private alike. The headline is that 2014 will be a better year than 2013 for many real estate companies.

Participants in the Pulse Survey share the sentiment. When asked about year-over-year performance, three quarters responded that 2014 would be better than 2013; only 10 percent expect the year to be worse. Moreover, 12 percent of participants classified 2014 as the "best year ever."

Bonuses Expected to Rise

Accordingly, compensation driven by performance is expected to increase. When asked about projected performance-based cash bonuses, 60 percent of respondents answered that payouts for 2014 would increase, with the majority of expected increases ranging from 1 to 10 percent. Approximately one quarter of both public and private company respondents expect larger increases, though this is balanced by another quarter of companies that expect bonuses to stay flat on top of last year's high baseline levels.

Historically, performance for private real estate companies has lagged compared to their public counterparts, and the impact has been a differentiation in compensation. However, this year's survey indicates that the private real estate sector is a bit more optimistic in regard to year-end incentive payouts compared to their public peers. Note the real estate private sector includes a diverse universe of investment managers, equity players, developers, property managers and others.

Separately, base salaries are expected to rise by approximately 3 percent for 2015, which is largely consistent with the salary increase expectations across other industries.

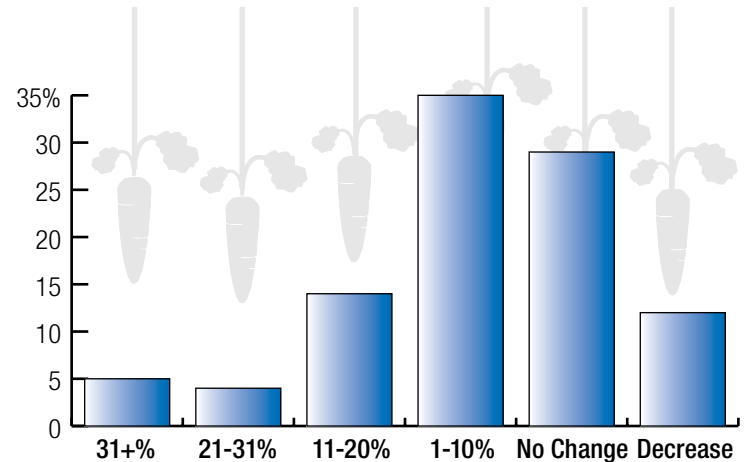
The Outlook

The term "pay for performance" is no longer just an expression or a catchphrase used in the board room—it is the norm (though definitions of "performance" vary widely). In part due to the U.S. Security and Exchange Commission's implementation of Dodd-Frank legislation in 2011 that codified what we now know as Say-on-Pay, compensation in the public real estate sector is largely correlated with value creation for shareholders, as well as other elements of performance measured by achievements in portfolio and earnings-based metrics. On the private side, though compensation is not subject to the same legislative standards, pay practices are likewise linked to performance.

However, this year's Pulse Survey results indicate that even when

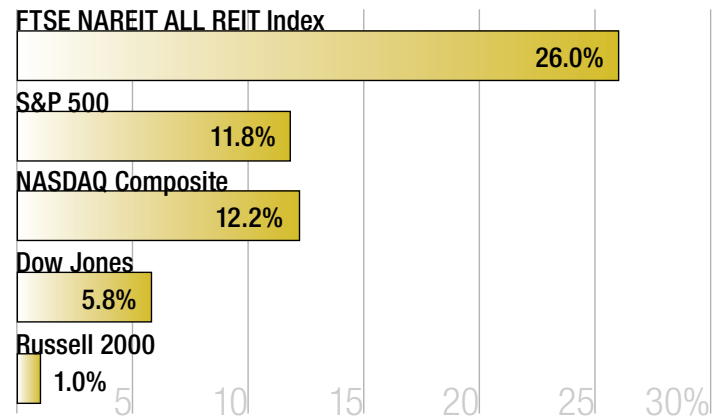
Incentives Barometer

(estimated 2013-2014 changes in cash bonuses)



Measuring Returns

(projected 2013-2014 changes for leading indices)



Source: FPL Advisory Services research; national Indices of investment returns

real estate experiences a notably strong year, compensation increases are still relatively modest, keeping (on average) within a +10 percent bandwidth.

Beyond bonuses paid for 2014, the compensation outlook is somewhat hazy. Real estate companies in 2014 were beneficiaries of the low interest-rate environment, among other macroeconomic factors that may change over time. The impact on performance has yet to be seen, though we expect that pay and performance will continue to be largely aligned.