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Rutherford International ESG

Follow-up Response to Article Titled:

Critical Real Estate HR Challenges 2002 - 2010

By Forbes J. Rutherford, President

- Short-term performance measurements versus long-term results
- Tactical Asset Decisions Supplanting Strategic Goals
- Staff Development & Succession Planning
- Leasing – Great Expectations/Questionable Results

Maintaining Competitive Advantage Through Pro-active Human Resource Planning & Compensation Strategies

Strategic HR Advisory Group - Canada

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Critical HR Challenges Facing Canada's Real Estate Industry 2002- 2010

AN INDUSTRY RESPONSE

INTRODUCTION

Approximately eight weeks ago, Rutherford International ESG distributed an opinion piece entitled "Critical Real Estate HR Challenges 2002 – 2010" to a number of senior industry executives. The text of this article may be downloaded from the North American Real Estate Review section of www.rematrix.com. The article identified three human resource issues, which commercial real estate owners and managers will need to address now and over the balance of the decade. Abbreviations of the points made in the article were:

1. **Compensation**: The link between incentive pay and performance is weak and not necessarily connected to measurements reflecting long-term shareholder value creation,

2. **Education**: Companies have long recognized the importance of staff development and education, but few have placed sufficient funds at the disposal of HR departments or business unit managers to adequately fund internal or external programs,

3. **Knowledge Retention**: Current workforce stability is more the result of industry compression then workforce contentment. The medium term (five years) will be less stable, as experienced managers and executives begin to "gear back," however the predicted shortages will not be measured in the loss of human assets but more so in the loss of knowledge assets.

We've had an opportunity to follow up with a number of executive recipients and solicit their perspective on the issues. Their response varied in tone, ranging from the dismissive to the innovative. For instance, one senior asset management executive was only interested in "today's value" and dismissed the importance of extending a building's life cycle. He certainly didn't subscribe to my comments on how operational staff could impact long-term values. His views were in stark contrast to another first tier executive, who was ebullient in describing his efforts to foster a long-term value-based organizational culture. He welcomed initiative from the rank and file. The industry is clearly of two minds!

Compensation design didn't seem to be an overriding concern for respondents, however I've elaborated on my thoughts on this issue in a rebuttal. The linkage of compensation to short and long term performance measures has never been more vital. It's becoming a question of governance. I've used antidotal evidence to highlight the potential for abuse when bonuses are heavily weighted to short-term financial results.

Executive concerns over succession planning, staff development, education, knowledge retention, character deficits, sales skills and workforce pressures overlapped sufficiently to blend this section into one general response. Owners seem to be universally disappointed with the quality of their sales and leasing departments – many in-house departments have forsaken active end-user marketing in deference to broker networking. This concern by first tier executives compounds the structural shift the leasing function is experiencing at both the owner and broker level. We address these issues as well.

Linking Variable Compensation to Performance

"The concept of pay for performance is widely accepted in the real estate community, however the link between incentive pay and performance is weak and not necessarily connected to measurements reflecting long-term shareholder value creation."

Respondent Perspective
• "What do I care about values five year's from now – I won't be here!" • "Rewards are short-term driven versus long-term interests…" • "Our compensation is balanced relative to asset, fee and industry performance…we have clear measurements based on quantifiable and qualitative goals…" • "Institutions have greatly influenced compensation ranges…" • "We participate in a compensation study every year, we're competitive within the industry…"

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The majority of respondents are relatively content with current compensation arrangements, however it's clear that there are some fundamental flaws in current design which place greater importance on short term results versus long term share holder value creation. To be market competitive is not enough. With "corporate governance" having become a top-of-mind issue, management may want to ensure that their compensation architecture, and that of their employees provides the Board of Directors with some degree of assurance that benefits, base compensation, perquisites, bonuses and long term incentives are aligned with corporate goals and market realities. A compensation program should be designed in a manner, which induces behavior that the corporation needs to move forward to achieve superior shareholder value.

Compensation design has not caught up with the realties of an industry where non-corporate officers are able to commit their firms to significant liability, or influence asset values with tactical rather than strategically grounded decisions. A majority of the current structures are overly dependant on short-term financial performance measurements, and do not adequately contribute to long term organizational effectiveness.

A few examples, which provide antidotal evidence of this fact, are:

1. Many of the under-performing loans written in the late eighties and which subjected the industry to a "death of a thousand cuts" through the nineties, were sourced by commercial loans officers and authorized by loan committees who's short term bonus plans were based on volume rather than quality;

2. A financial services firm seeking to lease-up an office building decided to bring on staff two former leasing brokers. Their bonus plan was tied to new lease deals. By the time the asset manager realized his error, the van to remove the final twenty year tenancy was parked at the loading dock;

3. An asset manager turned down a lease deal with a major tenant, which would have given the asset a locked in accretive value for fifteen years. His reason for saying "No" – the deal had no direct impact on his current year's bonus.

The asset manager in example two should probably be terminated for stupidity, whereas the asset manager in example three should have his head mounted on a pike and placed on top of the building in question, surely that or on a pensioner's wall – for what he perpetrated in the name of "self interest" was equal to picking the pensioner's pocket. The question that needs to be put to his employer is, "Was this a lone act of moral impropriety, or was it reflective of corporate performance measurements that are strictly financial and short term in nature?"

Rewards based solely on short-term performance foster tactical decisions. When the tactician supplants the strategist in decision-making, questions related to "governance" by stakeholders are sure to follow.

Achieving superior returns over time relative to an industry index of performance is the ultimate goal for company stakeholders. Designing a compensation plan that drives superior performance at all levels of the company is a powerful message to stakeholders and/or clients about the firm's aspirations.

2. Staff Development, Education and Knowledge Warehousing

> *"Twelve years of under-funding skills development compounded by a net loss of talent and limited success attracting new recruits from post secondary and graduate schools over the same period of time leads to one conclusion – our second string has limited depth to replace what we'll eventually lose."*

Respondent Perspective

- "We're an ideas based organization, we promote problem solving through innovation and ideas...we conduct weekly problem solving case studies"
- "We emphasize leadership in our internal employee development courses…"
- "We cross pollinate nationally and regionally…our managers and executives are responsible for coaching and mentorship…"
- "Education is our number one concern…"
- "Industry is not financially positioned to invest in staff education…"
- "We target our best and brightest and emphasize leadership development…"
- "Staff today are unwilling to sacrifice life style for personal growth…want to go to school on company time and expense…"
- "I don't spend a lot of time thinking about my operations group…"
- "Property manager's have little influence on enhancing asset values…"
- "I wish I could clone my VP Leasing…"

3. Career Enrichment, A Lost Generation & Demographics

"The medium-term human resource challenge for CEO's will be developing policies which address career development aspirations of the company's existing workforce and foster an organizational environment which will attract future talent."

Respondent Perspective
• "Succession planning is our number one concern…" • "We have an aging workforce, finding talent will become an issue…" • "Skills we can teach, finding people with intelligent, flexible minds is the challenge…" • "Our number one concern is attracting talent to meet growth expectations…" • "The available talent filling-in-behind is weak…" • "Staff is more focused on lifestyle versus making sacrifice…" • "We've noticed our younger employees are more willing to take the easy path…they seem to lack hunger…" • "I'm not sure the industry is ready to respond…considering new initiatives is a tremendous challenge…" • "There isn't as much long term thinking today as 3 to 4 years ago…" • "Inflation traditionally disguised management performance, whereas under achieving performance and leadership is exposed in stable accretive markets…" • "We'll solve our talent needs by stealing people…" • "The selling skills of our leasing department is very weak…" • "Owner lease representatives rely too much on the brokerage community…"

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Changes In Leasing

Business process within the commercial leasing profession – at both the owner and broker level is undergoing a state of structural change; this flux is an early indication of what the industry will face in general terms over the next eight years.

In-House Leasing Departments:

Owners are becoming increasing frustrated with the selling skills and underlying character traits of their leasing representatives, however there are multiple causes for this frustration:

1. Twelve years of under-funding skills development compounded by a net loss of talent and limited success attracting new recruits from post secondary and graduate schools over the same period of time has contributed to a relatively shallow pool of experienced talent.

2. Many in-house leasing departments have rationalized their primary role as being negotiators and broker network marketers. They justify this preference for taking "the easy path" with arguments based on "sales force leverage;" and/or a concern that if they become proactive sourcing tenants the brokerage community will cut them off. However, senior brokerage executives are of the opinion that owner-leasing departments have become too dependent on the brokerage community for deal flow.

3. *"I wish I could clone my VP Leasing"* was one CEO's refrain. Perhaps his VP's skill sets are more transaction oriented – excellent interpersonal skills with brokers or tenants, but a relatively poor leader. In most instances, it's the responsibility of the VP to lead his staff to perform effectively and help his direct reports grow in competence both in terms of skills and management strengths? To improve selling skills, senior officers will need to assess their management's capability to implement an active coaching policy. Your VP or Director might be very technically capable but lack the administrative and interpersonal attributes to lead. Good coaches do not theorize about what should motivate staff – instead on a case-by-case basis they discover what does motivate each of their reports. Good coaching is a continuous process – subordinates usually best receive advice incrementally rather than in one grand counseling session once a year.

4. Not happy with the productivity of their leasing representatives, a number of companies have revamped their leasing departments, hired new staff in an effort to enrich their gene pool. One company hires and a domino effect is created, as each recurring vacancy is filled-in behind. It's as if all the soldiers on the parade ground took one giant step to the left – the same names - different business cards. The street becomes a revolving door of the semi-talented, hired on past accomplishments and relationships rather than their marketing and sales skills. When hiring a leasing representative, have them dissect their completed deals, determine their contribution to the process. Ask what percentage of their new deals were broker driven; was the tenant mix and renewal dates within their portfolio determined by chance or design. Most importantly, determine their ability to think laterally by asking about econometrics, office ergonomics and competitive influences. Do they really understand tenant needs – now and into the future? If you're facing a paradigm shift in terms of business process – why stick to tried and unsatisfying methods?

5. "*Lack of motivation*" was a common refrain, however motivating a leasing representative with an extra tens cents per square foot is not the answer – you might get them to move, but that's not motivation. Motivation comes from within – you want to motivate your department? – Hire motivated employees!

6. Methodologies for sourcing leasing representatives has been mixed, both in terms of approach and result – targeted Rolodex recruiting, broker referral or dropping dynamite in the shallow end of the pool. One particular firm conducted a search for a mercenary "pardon me - leasing manager" by ricocheting around the industry like a pinball, asking anyone who would listen to them, *"Do you want to make two-hundred thousand dollars a year?"* Forty thousand dollars, two months and two hundred broker interviews later, they were able to compile a "short list" of twenty candidates. In keeping with my penchant for mixing metaphors, this approach to pre-qualifying a candidate is akin to *"target shooting with a shotgun"* and about as satisfying as a Chinese meal one hour after having eaten it.

Commercial Leasing Brokerage

One shouldn't be surprised that so many brokers stepped up to the plate to be considered for the aforementioned position; this sector of the industry is undergoing a substantial reassessment of its value proposition. The compression on fee's brought on by ownership consolidation and a better-informed tenant has forced the brokerage community to approach the delivery of its services in a more consultative rather than transactional fashion.

Brokerage fees are getting compressed - to my knowledge, no deal over 15,000 square feet has paid a full commission this year in Toronto.

Over the next eight years, we will observe the following changes within the commercial leasing departments of the brokerage community:

1. The brokerage firms will undergo a significant cultural shift – and divide or merge in a manner that reflects their senior executive's personalities – some will be highly transactional, faithful to their brokerage and deal based disciplines. It's likely they will be much smaller than they are today and highly networked through international alliances. Other firms will attempt to insert themselves higher up the value chain, by making the leap to a more consultative selling approach offering broader multidisciplinary services to end-users.

2. By positioning one's firm higher up the food chain, this consultative client driven broker will become the "National Account Manager" for major users, earning a predictable cash flow through annualized fees rather than transaction based commissions.

3. Loyalties will shift from owners to end-users; low-level relationship networks between individual brokers and in-house representatives will enter a state of flux.

4. The "tenant based" brokerages will be seeking a different breed of talent, one who is more client-focused rather than transactional. Brokers and owners will be competing for the same "client relationship management" sales traits, resulting in greater pressure on the talent pool.

5. I expect the under performing transaction oriented brokers that are unable to shift to a client driven focus will "wash out," leaving the top tier "deal junkies," their protégés and broker-consultants intact.

6. Depending on the nature and corporate culture of the firm, owners and asset managers will need to determine what kind of leasing representative they want on-board. You have and will continue to receive a steady parade of brokers across your desk, seeking to "come in from the cold."

The Great Talent Search & Succession Planning

In total, I've been involved in executive search for nineteen years. I began practicing in real estate in 1986. The greatest challenge in my profession is finding people that are able to recognize opportunity, to be able to visualize value where others cannot. Highly motivated people, with strong intuitive skills, who are able to conceptually perceive the "whole" and lead people to perform – these are the 20% that out perform the 80% regardless of the industry. To fly in the face of the behaviorists, these qualities are innate and are rarely learned after adolescence - no matter how many remedial Executive MBA courses you put the manager through.

1. If you are planning for succession at your most senior strategic levels, then you need to determine the quality of your staff in the context of these innate qualities, however if succession planning for positions where experience, technical and interpersonal skills are sufficient then management should implement a policy of development through courses, mentoring and coaching.

2. We failed to attract a generation of professionals in the nineties, and have been remiss at actively developing our existing middle tier talent. Clearly, we have an aging workforce. I'm

not convinced that the industry has sufficient time to groom, or locate enough knowledgeable top tier P&L oriented executives to support the Strategic Business Unit (SBU) organizational structure, which has become prevalent within the industry. In isolation, a firm would be able to source the necessary strategic talent, however all firms in five plus years will be looking for the same "innate" skill sets. Demographics may well dictate a return to a centralized organizational structure; or at the very least, a hybrid structure where internal infrastructure services are centralized. We're seeing evidence of this happening already.

3. When I assess a person's abilities for a junior or intermediate position, it's not a question of judging them for who they are, but rather for "what they will become." I've met many individuals with five or ten years of experience, that in fact, have "one" year of experience five or ten times.

4. Judging a manager is an exercise of distinguishing between their knowledge and skill. Knowledge is an amalgam of experience and technical competence and can be learned. Quite often, individuals are promoted too quickly to positions of responsibility over staff lacking the primary management attribute – "interpersonal skills" - either within his business unit or at the client level. The industry is rife with highly technical managers that have no business managing staff until they've addressed their interpersonal weaknesses.

Our Services

If one subscribes to current management theory, then you will agree that the essential assets and strengths of a property reside in the people that nurture its life cycle, and therefore corporate investment in education and skills development becomes a priority. To retain your most valued people, they need to know you value them - more often then not – mentoring, coaching and recognizing them carries greater rewards then money.

If you don't have an internal human resource department to provide you with strategic and candid advice, to oversee implementation of best practices and processes, oversee recruitment, conduct independent candidate assessment or review your compensation strategy – you might want to consider outsourcing this requirement to my Strategic HR Advisory Group. Unlike search, these services are charged by the hour or per diem.

If you need an executive search consultant that approaches his assignments from a perspective of solving organizational problems, brings candid insight, conducts thorough research, provides rigorous assessment, works internationally as well as nationally – then you need to speak to Forbes Rutherford of Rutherford International ESG at 416-250-6300. Electronic Brochure: www.rutherfordinternational.com

If you know your annual recruitment needs, relative to standard attrition and expansion – and prefer to manage the hiring process from within – then I would recommend you use the REmatrix.com CareerSite. This is a dedicated commercial real estate job board, with on-line job posting and database search capabilities, which allows your hiring manager's to set search agents that notify them when an optimum candidate registers to the system. The same is true for the candidate that is seeking the optimum position on the opposite side of the country or the world. This CareerSite may be found at www.rematrix.com .

We welcome your comments, and would be pleased to forward you additional information on the scope of our services and/or methods. My email is: Rutherford@rutherfordinternational.com

