2000 – 390 Bay Street,
Toronto, ON M5H 2Y2
T: 416.250.6300
F: 416.250.7584
rutherford@rutherfordinternational.com

Rutherford International ESG

Critical Real Estate HR Challenges 2002 - 2010

By Forbes J. Rutherford, President & CEO

- Linking Variable Compensation to Performance
- Staff Development, Education and Knowledge Warehousing
- Career Enrichment, A Lost Generation & Demographics

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

Strategic HR Advisory Group - Canadian Division

2/5/2003

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

Maintaining competitive advantage in the Canadian commercial real estate industry through pro-active human resource and compensation planning.

INTRODUCTION

Seventeen years of real estate executive search places Rutherford International in a unique position to observe the changing macro trends and oncoming challenges facing the Canadian real estate industry. We have developed insights essential to understanding competing businesses, their organizational culture, needs and weaknesses. This familiarity with industry trends is not only the result of our close partnership with clients, but is due as well to the aggregate of industry information acquired through thorough and candid candidate interviews.

Real estate is cyclical and dynamic, the paradigms, which exist today, may not necessarily exist tomorrow. For instance, ninety percent of institutional investment grade real estate is owned or managed by less than ten companies, however we have more public real estate entities today than we did in the salad days of 1988. The abstraction to this reality is that we will undergo a shortage of trained staff and management talent within five years, as our most seasoned and networked talent begins to gear-back or take early retirement. Currently employee retention levels are stable, with large firms experiencing only a marginal or selective level of churn within their ranks. This is a transitory period of stability and reflects the perceived capital strength and relative employment security of these firms. The near to medium term future however will be less stable; the predicted shortages will not be measured in the loss of human assets but rather in the loss of knowledge assets.

The following list of talking points explores three of the most critical human resource challenges facing commercial real estate CEO's.

1. *Linking Variable Compensation to Performance*
2. *Staff Development, Education and Knowledge Warehousing*
3. *Career Enrichment, A Lost Generation & Demographics*

.1. Linking Variable Compensation to Performance

Observation:

With the consolidation of ownership, large companies have developed compensation philosophies and strategies for their front-line managers and staff, which may be cumbersome relative to more nimble compensation architectures at smaller competitors. This is a distinct competitive disadvantage, which more structured firm's are attempting to address through the inclusion of variable pay programs based on performance. In a variety of instances, companies offer a performance bonus based on the achievement of corporate, divisional and functional (individual) goals.

Challenge:

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.

Approach:

In an industry where the quality of relationships and transactions often underwrites a successful real estate asset, one must be careful that the compensation architecture and review programs have not been designed to simply satisfy legislated equity compliance, or ease the management burden of employee appraisal and job evaluation. Short and long-term incentive programs should provide the employee with "direct line of sight" or clarity in understanding what specific actions they must take to ensure that expectations are met or exceeded in order for the company to achieve superior shareholder value.

Achieving superior returns is the ultimate goal for shareholders or unit holders. Having a program that rewards superior performance at all levels of the company is a powerful message to stakeholders about the CEO's and senior executive aspirations.

Rutherford International has published the first of a three part series on achieving the goal of superior shareholder value by linking all levels of executive, manager and staff performance based compensation. The first part of the series deals with fixed price stock options and addresses their role in the current debate on executive compensation. Links to this article may be found on the Rematrix web site at http://www.rematrix.com/research/research_newsletbriefs.html or the Rutherford International site at http://www.rutherfordinternational.com/newsrutherford021.html

2. Staff Development, Education and Knowledge Warehousing

Observation:

The lack of employee development programs within the industry has not gone unnoticed by a number of real estate CEO's. Their concern was evident in roundtable discussions at Toronto's 2000 Property Forum. I would concur with their concerns, and suggest that the failure to budget adequately for employee development programs is a systemic problem. Companies have long recognized the importance of staff development and education but few have placed sufficient funds at the disposal of human resource departments or business unit managers to adequately fund internal or external programs.

Historically, given the cost differential, the acquisition of knowledge was preferred over internal development. It was easier to leave incubation of the industry's human resources to better-capitalized firms with active HR departments. This trend was of little benefit to the raided company, but was a general benefit to the industry insofar as it disseminated talent and knowledge throughout the industry. If done in a targeted fashion, poaching provided the acquiring company with proven ideas that were stimulative in nature.

Today, the industry has reached a level of maturity with respect to the sharing of information and general knowledge. Non-proprietary information is more readily shared, as it's recognized that today's competitor is tomorrow's joint-venture partner. It's through these inter-corporate relationships rather than poaching, where we'll see a greater pollination of ideas over the coming years. Poaching talent to inject new blood (systems and procedures) into a firm is of less import then acquiring their value adding skills, transactional network and competitive intelligence.

Challenge:

The Canadian commercial real estate industry is framed around an austerity business culture, a necessary survival strategy in the mid-nineties but a disadvantage to the industry today. The culture of austerity has made it difficult for many firms to reconcile the hard costs of training and development.

Corporately, the industry has given insufficient support to education internally nor provided the necessary enrollment guarantees to outside associations and academic institutions to justify the renewal of curriculum or delivery systems. Consequently, a number of associations and community colleges working with limited funds and questionable industry support have contributed to the industry's vocational inadequacy, by serving up an indigestible and aged curriculum using quasi-instructors for usurious fees.

The aforementioned CEO's are right to be concerned about the state of skills development in the Canadian commercial real estate industry. 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.

Approach:

This second-string weakness can easily be rectified through implementation of a variety of external and internal employee development strategies – the key is to subtly shift the culture of the firm to one that emphasizes learning, knowledge management and mentorship. I believe the success of 'brick's and mortar' in the twenty first century will be less contingent on 'location,' and more so on the performance and competencies of the people that develop, own and manage them. The essential assets and strengths of a property reside in the people that nurture its life cycle; ergo the essential assets and strengths of a property portfolio will be determined by the ability to integrate best practices and processes throughout the organization. An organization, which fosters a cultural environment that underscores the importance of collective knowledge and the education of its employees through the disbursement of its inherent knowledge, will result in their creating a competitive differentiation.

Cost effective technologies and strategies exist today, that allow companies to deliver credible academic programs to their staff in conjunction with capturing the wealth of knowledge that flows in and out of their organizations on a daily basis. The motivation to implement these strategies requires a champion in the executive suite.

An example of collaborative information sharing at an industry level, can be found on the REmatrix commercial real estate portal at http://www.narer.com/resummit/forums1.html

3. Career Enrichment, A Lost Generation & Demographics

Observation:

A career in real estate is a direction only a few consciously choose, it's a career that tends to come looking for you and once you've become immersed in the psyche of the business, it rarely lets you go. It's this intangible connection, which keeps our brightest stalwarts in the business even though other competing industries offer greater financial compensation.

Unfortunately, for most of the last twelve years, the industry has not presented itself to Canada's graduates as an attractive alternative to competing industry sectors. 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. This fact was glaringly apparent when our firm recently conducted a search for a VP Development to build an office tower in Toronto. When we compiled our long list of candidates that possessed practical experience taking a tower of this size out of the ground, only four were under the age of forty-five.

The shortages I'm predicting are supported by demographers, yet one might be reluctant to act on this advice given the relative stability of the current workforce. Turnover is normally a leading indicator of long-term corporate value and most of the larger firms are enjoying some statistical stability in this area. There is a dark side to this stability. In an industry with oligarchic overtones in some sectors, one should not assume the lack of turnover is necessarily indicative of a satisfied employee base. Subject to the financial strength of their firm, people are staying put hoping for promotions but settling for lateral enrichment. For the most part, companies are not providing this sought after lateral enrichment, and in some instances, we've observed a trend towards functional diminishment.

For example, consider the office property manager responsible for an office building greater than or equal to 500K sq. ft. – he/she has their CPM or RPA; or a regional mall manger with a GLA greater or equal to 750K sq. ft. – he/she has their CSM II or III – this group of experienced employees represents the top tier of your property management class and represents a wealth of experience, industry knowledge and vocational commitment. Yet both of these functions – in general, feel diminished in their scope of responsibilities relative to what they had ten or twelve years ago.

Recognize that I'm generalizing, as certain companies are attempting to enrich the scope of the senior property managers requiring them to take greater ownership of their asset's budgets, assuming roles of construction coordination, procurement management and innovate cost efficiencies. However, coupled with this desire for managers to take a more integral role in suggesting or implementing value adding strategies for their portfolio, is the need for a strong corporate commitment on education and mentorship. The folly in this strategy is to enrich the scope of a position without reciprocal action on increasing the employee's capacity to meet the raised benchmarks of performance.

Challenge:

Assuming one agrees with my prognostication that the industry by remaining on its current course will begin to suffer a noticeable shortage of its knowledgeable talent within five years – how does one go about insulating their firm from this shortage?

Improved information management technology may mitigate workforce supply pressures by increasing individual productivity, however the most effective means for alleviating this approaching pressure is to extend the employee's life cycle through qualitative retention measures. The short-term solution is to delay the attrition by revaluing the role and scope of your key employee's contributions.

The medium-term human resource challenge for CEO's during this approaching phase in the industry's history, 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.

Approach:

To replenish our supply of talent in the past, we depended on attracting our junior development officers from engineering and post-graduate business schools, our leasing executives from the ranks of Xerox and IBM, and our finance and control managers from senior accounting houses; we poached talent as needed; and, we maintained through job enrichment and cross-training, a reasonable second tier team of fast-tracking stars. Not all of these avenues are open or relevant to us today – poaching talent is always a tactical and strategic option, whereas job enrichment and cross training remains a critical means for retaining and attracting star performers.

If one were to conduct a "Rewards of Work" study on their employees – a study, which determines your employees' job satisfaction matrix, it's highly probable your employees' general sense of career and personal development will rank higher in importance than compensation. It's imperative for a CEO to understand which drivers' impact employee performance, retention and satisfaction, as this measurement is a strategic tool in the overall human resource and skills development planning process.

At Rutherford International, our work reward model is an amalgam of features, which include direct financial (pay), indirect financial (benefits), work content (the work itself), career (long term opportunity for development and advancement) and affiliation (feeling of belonging). Understanding where employees measure their personal rewards or benefits of work, allow our clients to be creative is meeting employee needs.

For example, there is more to job enrichment then upgrading the scope or raising management's expectations for a given function. You can enrich a position by elevating the importance of affiliation through the introduction of a mentorship or knowledge-sharing program. "Affiliation" (feeling of belonging) is probably the least understood feature of the 'ROW' model, and yet creative management strategies that address this feature can be both powerful employee motivators and provide significant impact on adding to shareholder value.

Identify the key individuals that are nodes of positive influence and/or links to external information and resources within your company's business units and departments, by mapping or modeling the social network within your firm. You will discover the organizational map of this internal corporate network is dramatically different from your actual organizational chart. The 'Go-To' person as perceived by field staff on technical, market or personnel issues might not be their direct supervisor, but rather a peer with a reputation for solving problems and facilitating resources. You can entrench their perceived value by legitimizing their role as a facilitator and staff trainer either through recognition rewards or performance pay. The message you send to rank and file suggesting that the practice of sharing information and knowledge with fellow employees will not go unrecognized or unheralded is a powerful and positive message. You've enriched this person's role in the company, raised their recognition factor and assured their retention with little financial expenditure relative to the returns the company is likely to receive.

