

# NAREIM<sup>30</sup>

SPRING 2020

BEST PRACTICES SHARED | VALUE ADDED

*dialogues*

**30<sup>th</sup> Anniversary  
Edition**  
1990–2020



*The **BEST**  
business  
advice  
you'll **EVER**  
receive*

**ALSO IN THIS ISSUE**

Quantifying amenity value when evaluating office investments

How to manage data integration in an M&A

Finding private real estate's place in DC plans

The background of the advertisement is a composite image. On the left side, there is a close-up of a modern building's exterior, featuring white, curved balconies and large windows that are illuminated from within, casting a warm glow. The right side of the image shows a wide-angle, high-angle view of a city skyline at night. The city lights are reflected in a body of water, and the sky is a deep blue with some clouds. The overall mood is sophisticated and urban.

# IT TAKES A STRONG HISTORY TO UNDERSTAND THE FUTURE OF REAL ESTATE

Since 1981, AEW has been a constant for its clients during the ups and downs of the global economy. We've navigated through many market cycles and have successfully provided disciplined, real estate investment solutions to the world's foremost institutional investors.

Tom Eastman, the "E" in AEW was a founding member of NAREIM. In his memory, we congratulate this tremendous organization for its 30 years of helping the real estate industry collaborate in delivering best practices to our clients.

# NAREIM<sup>30</sup>

## dialogues

### CEO

Zoe Hughes

### Head of Programming

Stina Dakers

### Director of Events

Sally Van Der Bosch

### Editorial Director

Wanching Leong

### Design Director

Julie Foster

### For more information about NAREIM, contact:

Zoe Hughes  
zhughes@nareim.org  
917-355-3957  
99 Wall Street #1340  
New York, NY 10005

### Disclaimer

No statement in this magazine is to be construed as or constitutes investment, legal, accounting, or tax advice, or a recommendation to buy or sell securities. While every effort has been made to ensure the accuracy of the information in this magazine, the publisher and contributors accept no responsibility for the accuracy of the content in this magazine and you should not rely upon the information provided herein. NAREIM is not liable for any loss or damage caused by a reader's reliance on the information contained in this magazine and readers are advised to do their own independent research and to consult their own independent investment, legal, accounting, and tax advisers before making any investment decision. Readers should also be aware that external contributors may represent firms that have a financial interest in the companies and/or securities mentioned in their contributions herein and/or may serve as an officer, director, or employee of the companies, or an affiliate thereof, mentioned in their contributions. Neither this publication nor any part of it may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage or retrieval system, without the prior permission of the publisher, NAREIM.

© 2020 NAREIM. All Rights Reserved.

## 2

### From the CEO

### ROUNDTABLE

## 4



### 30 years of change: The key still remains the talent

As NAREIM marks its 30<sup>th</sup> anniversary, we asked five founding members to discuss the biggest structural changes over the past three decades — and to look ahead to the largest challenges that will impact real estate investment management

### SPECIAL FEATURES

## 14

### NAREIM: The beginning

Excerpts from the founding document of how it all began at NAREIM

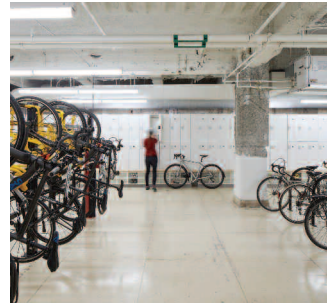
## 16

### 30 best pieces of advice — part one

Real estate leaders share the best pieces of advice they have received, how it influenced them personally and professionally, and what advice they offer their teams today

### ASSET MANAGEMENT

## 24



### Evaluating office investments for attracting talent

Chuck Schreiber, *KBS*

## 44



### Transforming real estate fund operations

Anthony Ross, *State Street*

### DATA STRATEGY

## 28

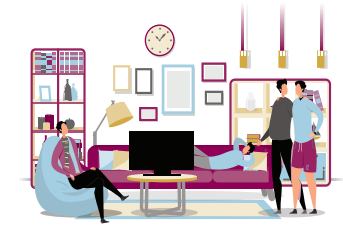


### Prioritizing data integration during an M&A

John Seaton and Jim Valente, *RealFoundations*

### INNOVATION

## 34



### Co-living: A new sector, or a new way of doing old things?

Deborah Smith, *The CenterCap Group*

### IR AND CAPITAL RAISING

## 38



### Private real estate's DC opportunity

Jennifer Perkins, *Principal Real Estate Investors*

### BARCLAY FELLOW

## 50

### Evolving hospitality: Hotels in the Internet era

Peter Laskey





**Zoe Hughes, CEO**

Former British Prime Minister Benjamin Disraeli once stated that change is inevitable. Change is constant. As a global, novel virus sweeps through our towns, cities and countries, change is something that governments, institutions, businesses and individuals alike have had to embrace for the good of all.

We are living in highly uncertain times, where the landscape around us evolves and shifts on an almost daily basis. Despite that uncertainty and the inevitable fear that comes from watching the current status quo rapidly transform into something new and different, it is the stories of our people that are being heard the loudest.

When we say our people, we don't just mean those working in our industry, but our tenants, our friends, our neighbors, our rivals.

Even when discussing tenant rent relief requests and abatements, real estate investment managers are focused not on the legal and contractual elements but, first and foremost, on how to help. How to provide asset management assistance to their clients, the tenants and partners in the success of that deal, and how to help that business stay in business for the long term and keep employing its people.

The challenge for everybody is underwriting the long-term impact of the coronavirus pandemic, whether individually, socially, corporately or as an industry or country. The future remains clouded.

The only thing we can do is embrace change. And do the next right thing.

To mark NAREIM's 30<sup>th</sup> anniversary, we asked senior leaders to provide some of the best business advice they'd ever received. As we sit here in the US, there are two pieces of advice that continue to resonate as deeply during the weeks of shelter-in-place rules as on the first day:

"Embrace change. It is just a part of our business today." Rick Hurd, chief investment officer of Waterton Associates.

"Do the right thing and good things will happen." Paul Michaels, managing director of Invesco Real Estate and NAREIM board member, who retired in April.

Through this pandemic — and the inevitable cycles to come whether real estate, economic or social — we must be open to the changes ahead, and simply continue to keep doing the next right thing.

A handwritten signature in black ink, appearing to read 'Z Hughes'.





## A dedicated advocate for your investment.

As a national, multidisciplinary AEC consulting firm, Marx|Okubo works on behalf of real estate owners and investors at every stage of the property lifecycle to ensure asset integrity, confident decision-making and project success through vigilant risk mitigation. Engaging us means you have an impartial expert in your corner who provides an informed understanding of capital risks and benefits, while competently preserving your property investments.

### BROAD PRACTICAL EXPERTISE & LOCAL MARKET INSIGHTS

Owner's Representation | Property Condition Assessment | Repair/Reconstruction Services  
Sustainability | Structural Engineering | Accessibility | Construction Loan Services





STILL  
*the*

**30 YEARS OF CHANGE:**

# *The* **KEY** **remains** **TALENT**

*As NAREIM marks its 30<sup>th</sup> anniversary, we asked five founding members to discuss the biggest structural changes over the past three decades and to look ahead to the largest challenges that will impact real estate investment management.*

*For AEW's **Pam Herbst**, Clarion's **Steve Furnary**, Northwestern's **Tom Zale**, PGIM's **Cathy Marcus** and **David Reilly**, former CEO of Cornerstone Real Estate, the move from institutional to individual investors will represent a tectonic shift for the industry over the coming decades. But that could be dwarfed by the changes happening within investment management firms themselves as the industry moves to diversify and invest in its own talent.\**

By [Zoe Hughes](#)

\* This discussion took place in February 2020 before the outbreak of coronavirus in the US.



## PARTICIPANTS

**Steve Furnary***Executive Chairman, Clarion Partners*

Stephen J. Furnary is an equity owner and the Executive Chairman of Clarion Partners. Steve led the 2011 management buyout of Clarion Partners from ING Group after a 12-year affiliation. Most recently, he led the sale of an interest in the firm to Legg Mason, where Clarion became Legg Mason's global real estate investment platform. He has been responsible for the firm's strategic direction since its inception. Steve began working in the real estate industry in 1974.

**Pam Herbst***Managing Director and Head of Investment Group, AEW Capital Management*

Pamela Herbst is a Managing Director at AEW and Head of the Direct Investment Group. She is responsible for all of the firm's investment activities on behalf of core and value-added clients. She is also a member of the firm's Management Committee, Investment Committee and Risk Management Committee. Over her 36-year career with AEW, she has served in a variety of roles that have encompassed asset management, portfolio management and acquisitions. She is former Chair and board member of NAREIM.

**Cathy Marcus***Global Chief Operating Officer and Head of US Equity, PGIM Real Estate*

Cathy Marcus is a Managing Director, Global Chief Operating Officer and Head of the US Equity business at PGIM Real Estate. She is responsible for overseeing PGIM Real Estate's business and investment operations globally, and for the development and implementation of PGIM Real Estate's strategy and operations in the US. Cathy is a member of the Global Management Council, the Global and US Investment Committees, the Global Operating Council, the Global Product Committee and the Valuation Committee.

**David Reilly***Former CEO, Cornerstone Real Estate Advisers*

David J. Reilly is the retired CEO of Cornerstone Real Estate Advisers (now Barings Real Estate). His career in real estate spanned more than 45 years with extensive experience in acquisitions, asset and portfolio management, dispositions, development and operations. His experience also included all institutional property types, including office, industrial, residential, retail and hotels. He is presently an adjunct professor at the University of Connecticut and teaches classes specializing in real estate theory and investment.

**Tom Zale***Vice President and Head of Real Estate, Northwestern Mutual*

Thomas D. Zale serves Northwestern Mutual in the position of Vice President—Real Estate. He is responsible for the company's investments in mortgage loans and real estate. He also serves as a member of the Investment Committee and Diversity & Inclusion Committee, as well as Executive Sponsor of the African American Employee Resource Group and Managed Investments Diversity & Inclusion Council. He joined Northwestern Mutual in 1995.

**A**s you look back over the past 30 years, what have been the biggest structural changes to the real estate investment management industry?

**Cathy Marcus, PGIM Real Estate:** The biggest change in our industry has been the drastic increase in transparency across all facets of the business. This shift started to play out about 20 years ago, but the Global Financial Crisis was a moment in time where transparency was no longer a nice to have — it was a must have and it has filtered from the public side of commercial real estate to the private side, as institutional investors have become more and more insistent on transparency.

To me, that transparency is what has led to the greater comfort that investors have with alternative illiquid assets in general. And it has also led to the place we're in right now, where the individual investor wants to gain access to institutionally managed real estate through defined contribution [DC] plans, private REITs, distribution through wealth management, or even through technology platforms.

Another huge change has been the globalization of the industry. Thirty years ago, investors might have said that they have an allocation to “international,” but there wasn't this holistic construct around a global investment strategy that we have now. From a portfolio allocation perspective, it's really a case for diversification, rather than a need to be in every part of the world to achieve higher returns because of the risk premiums that are out there. Instead, it's important to have global exposure for diversification purposes. That has been a very significant shift in our industry.

**David Reilly:**

In reference to structural changes in real estate over the past 30 years, there are two that I consider critical. The first one would be

technology, which has affected all property types in so many ways. For example, retail impacted by Internet sales, apartments incorporating websites quoting real-time rents, visual tours, etc.

The second is a very low interest rate environment. If you go back 30 years, 10-year Treasury rates were hovering around 8%. Today, 10-year Treasuries are below 1% and [coronavirus aside] we have been in a low interest rate environment for about the last 10 years, which has been a definite advantage. Low rates will extend into the foreseeable future and continue to benefit the real estate asset class. An inevitable recession will dampen demand for a period, but attractive interest rates should help mitigate the adverse impact of a downturn.

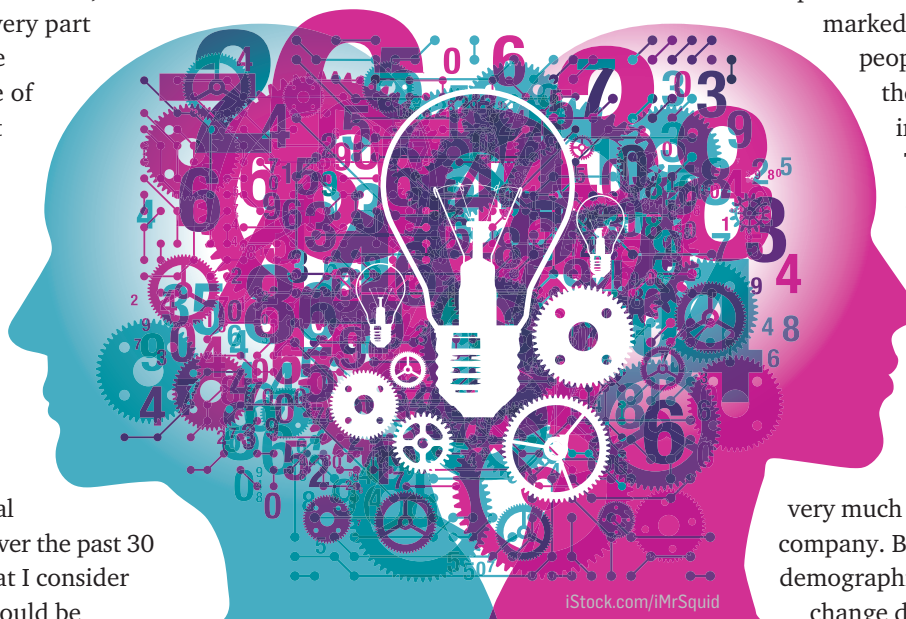
**Steve Furnary, Clarion Partners:** I think the most profound change for real estate investment management has been the evolution of our business into a real asset class. People make a decision to put a percentage of assets, say 10%, in real estate and they leave it there. They do that because we have evolved as an industry, we have good benchmarking, and we have a lot of alternative investment structures and property sectors to invest in.

The diversity of the investment universe and the acceptance of it in the investment world overall is really, I think, quite profound, and why this industry is now a real business. I also believe the accelerating use of open-ended funds and the acceptance of the ODCE Index has

marked a big shift in the way people invest and given them a longer-term investment perspective. That's fascinating and a great step for our industry.

**Pam Herbst, AEW Capital Management:**

We spend a lot of time around technology and data. We've always been very much a research-based company. But research and demographics have and continue to change dramatically thanks to



iStock.com/iMrSquid

data. It's daunting when you look at companies and realize the size you need to be as a platform, and the financial resources required to be able to collect and analyze your data simply to be able to respond to your capital. That's something that's just going to continue.

To also echo Steve and Cathy's comments on investors, I believe there's an ongoing structural change in our industry — that of non-traded private REITs. It's exploding. There is a huge amount of capital flowing into the space and it shows you the appetite globally for institutional quality real estate. It's really incredible because you are seeing a lot of retail investors aging and looking for current income and capital preservation rather than appreciation.

**Steve:** This transition from defined benefit [DB] pensions to DC pensions is large and pronounced. As an investment manager, if you're thinking about your long-term plan one would naturally want to include access to the DC market as

well as individuals who invest part of their net worth in private equity real estate. Pam made reference to it.

We have been focused on retail capital flows for several years. We've created a retail product structured as a REIT, wrapped in a 1940 [Investment Advisers] Act vehicle that is listed and traded at NAV. Fees are lower and it's a way to help individual investors access institutional quality real estate.

The private real estate industry is going to need to diversify its equity sources and, if the longer-dated capital is in the hands of individuals, there have to be new aggregators to funnel that capital into real estate. Over the next five to 10 years you're going to see many, many businesses in this industry moving in this direction.

**Tom Zale, Northwestern Mutual:** A major factor in our business has been the increased central bank intervention, which has meaningfully reduced performance volatility. It's





reduced performance volatility for all asset classes, but particularly real estate.

This has played a role in rate and spread compression because [until the outbreak of coronavirus] the markets were getting numb to risk. Even now, there's a perception that if there's a hiccup central banks are going to step up and do everything they can to minimize the risk or minimize the impact. We used to have a business cycle that allowed for market-clearing events, which allowed the strongest to survive and thrive and also cleared out some of the weaker performers. That feels muted now.

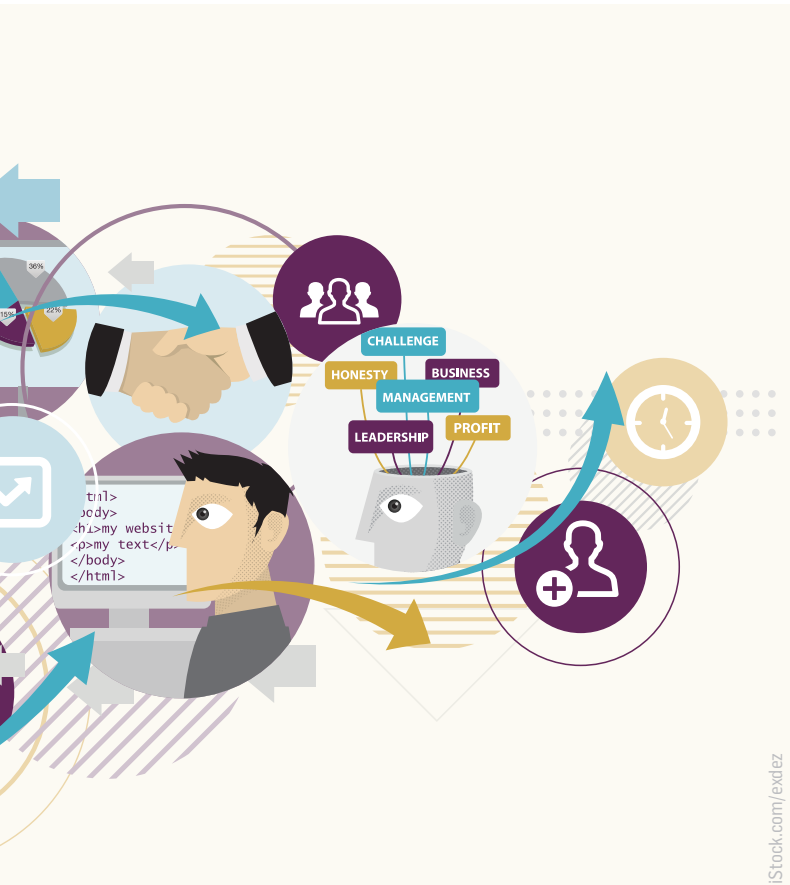
This isn't a bad thing, but together with increased transparency, data and the amount of capital in the market, it has reduced our ability to capitalize on opportunities in the market. A couple of years ago, we thought there was some opportunity to buy core retail, grocery-anchored and it went away before we could even get going.

## SURVIVAL OF THE LARGEST

Picking up on what Tom has said and given what you all say about diversification of capital and the globalization of institutional investor portfolios, does size matter more today than even just a few years ago? Does the future favor the big?

**Steve:** This is not just true with real estate; it's true with everything. Scale makes a difference. When you're small and you're a boutique, you move quickly. There's a whole millennial group that is chomping at the bit to start new businesses. They'll pick a property type, be really good at it and then they'll do what we all did. Then they will merge their way together and grow.

I can tell you it's harder to perform when you're 10% of the index. If you start falling behind as a larger manager then the money rotates to smaller managers.



Invesco Real Estate congratulates one of its founding partners,

# Paul Michaels

for his leadership at NAREIM and for over 35 years of commitment and contributions to our firm.



Invesco Advisers, Inc. Data as of December 31, 2019. NA2963 - 04/20

**Cathy:** For me, I see it as more of a barbell type industry, where large multi-product investment management firms can exist alongside small niche, private equity-style firms.

**Pam:** There's always going to be room for smaller boutique managers. But you've got to have the resources to be able to tackle all of these initiatives to compete effectively. Take responding to an RFP. You need to have all the data readily available, with attribution sliced and diced in 15 different ways. The CIOs and heads of real estate at institutional investors are asking us to step to the plate and be able to prove out our stories.

**David:** We've said for many years that the real estate investment management firms of mid-size will be the one that are under pressure. They cannot compete in terms of the demands in the industry today and will seek out stronger platforms. And as Steve said, the industry is changing. The medium-sized players aren't one-trick ponies, but they probably don't have a lot of ponies in their stable to offer the diversification that investors seek. On the other hand, smaller firms can be more tactical, offering unique products on a smaller scale.

**Steve:** Here's a great word and it goes back to Cathy's point — it's all about diversification. It is so important to be diversified, every way that you can, on a risk-adjusted basis. You have to roll up your sleeves and do a lot of work to do the next thing, and then the thing after that and the thing after that and the thing after that. But if you do the work, you will find you're diversified by many property types, regions, geographies, vehicles, deal structures and client sources.

**Pam:** And people. It's important to be diversified by your talent. Everybody can't look alike.

## DIVERSIFICATION OF TALENT

Diversity is an increasingly important part of the real estate investment management industry, not just in terms of investors wanting more information on what you are doing within your organizations — but also simply in terms of retaining your existing talent and recruiting new talent to your firms. How are you changing the makeup of your platforms?

“ It's important to be diversified by your talent. Everybody can't look alike. ”

**Pam Herbst**, *AEW Capital Management*

**Pam:** Because I'm a female senior leader, I'm very focused on it! I'm proud to say that nearly 50% of our workforce are women. Many of them are in senior roles, particularly in portfolio management, investor relations and asset management, although we have done less well in acquisitions. We're very focused on social causes within the community to get our young people involved because a lot of them are very focused on how we look at the world. We try to get people involved in corporate giving committees, volunteer days and doing all the things that we should be doing to try to create a culture of inclusion.

**Cathy:** This is one of those things that you simply have to invest in because you believe it's the right thing for your organization and the industry.

People hire investment managers for their talent. We don't have factories and we're not making any goods. We are only as good as our talent, but in order to attract and retain the best talent these days — particularly in the more junior ranks — we have to be focused on the social impact. People want to work for an organization that they feel good about, where there is an alignment of mission. This makes employees feel that what they do for a living is about more than just earning a paycheck, and that they are having a positive impact on the world and in their communities. While that's difficult to quantify, it's now table stakes from a talent perspective and from a client perspective.

**David:** I'm currently a professor at the University of Connecticut teaching real estate investment, and the one thing we see in terms of class population is that, on average, 20% of the class is represented by females and minorities. We're trying to improve the ratios at the introductory level so that future participants in the industry are more balanced and represent diversification objectives of the industry.

**Steve:** What has been fascinating and great to see is the increased focus here from investors and consultants. We have just won an RFP where there was a lot of conversation and

digging into the compensation of the entire team, instead of just asking of titles. They wanted to make sure people were not being given cute titles. I can tell you with new hires, we're at 52% women and minorities. We're really working very hard on that.

**Tom:** Northwestern has a great set of employee resource groups, which I recently leveraged when we were competing for a candidate. I asked the head of our African American ERG group to independently reach out to an individual candidate to give him an opportunity to ask questions about what the environment and culture of our firm was like. He said it was a meaningful factor in his decision to join us.

As an industry, we need to improve the diversity profile of our entry-level career path people because to build that leadership pipeline and really make meaningful improvements in leadership diversity, it's a long-term effort. And it's at every stage of developing talent, from talent acquisition to development and management. If you ask what I think about and where I spend most of my time, talent is the answer.

## BACK TO THE FUTURE ... REAL ESTATE IN ANOTHER 30 YEARS

If globalization and diversification have completely transformed the real estate investment management industry over the past 30 years, how will it change again over the next 10 to 30 years?

**Tom:** Real estate and commercial mortgage loans will continue to be an important part of our general account and the portfolios of institutional investors and, as we've discussed, I think you'll see real estate appetite from individual investors, which will support more vehicles like the private REITs. I still

“ People hire investment managers for their talent. We don't have factories and we're not making any goods. We are only as good as our talent. ”

Cathy Marcus, PGIM Real Estate


“ If you ask what I think about and where I spend most of my time, talent is the answer. ”

Tom Zale, Northwestern Mutual

believe margin spread compression is going to continue relative to public alternatives, which will only drive further acceptance of the asset class.

Technology as well will also impact everything we do from both a strategy and execution standpoint. I would say technology will be critical to the business.

**David:** I'll just add on to what Tom said. I think the other issues that are going to be forefront in our conversations and our business are infrastructure in the US and climate change.



BentallGreenOak 

**Congratulations to NAREIM real estate investment management leadership.**

*"The forums for dialogue and idea exchange that NAREIM fosters are especially imperative in today's ever-changing marketplace. BentallGreenOak is honored to continue to advance the association's mission."*

— Amy Price, Managing Partner,  
BentallGreenOak and Chair of the  
Board of Directors, NAREIM

**About BentallGreenOak**  
BentallGreenOak is a leading, global real estate investment management advisor and a globally-recognized provider of real estate services. BentallGreenOak has offices in 22 cities across ten countries and three continents with deep, local knowledge, experience, and extensive networks in the regions where we invest and manage real estate assets on behalf of our clients. BentallGreenOak is part of the SLC Management which is the institutional alternatives asset management business of Sun Life.





iStock.com/yuak

Climate change isn't just a US issue but global. It's going to be extremely interesting to figure out not just how we adjust to this environment but how we provide products that make sense in this environment.

**Pam:** I agree with David on climate change, which is going to have a significant impact on real estate investment policy.

**Cathy:** The biggest changes are going to be around technology — how we use technology and the role that technology plays in the investment management industry. Right now, technology is playing an enabling role, but I imagine that's going to be very different in the future. It will move from being an enabler to increasingly informing and directing decisions.

In 30 years, it will also be interesting to see if there has been more of a democratization of the investible universe between institutional and individual investors, which is already beginning to happen. I think it's very easy to envision a

future where there is a more level playing field in terms of who can access the best investment products, and technology will play a major role in that evolution.

**Steve:** I think investment management firms are going to be for real estate what they are for other investment products, where distribution is a bigger part of the firm. In our business, we have 15 people out of 300 doing institutional investor distribution, which represents the bulk of our capital sources. In 10 years time, I think distribution will represent 25% of our employees. We'll be managing something that is no longer just a real estate firm with distribution into the institutional market. We'll be managing a distribution firm. ♦

“ Climate change is going to be forefront in our conversations and it's going to be extremely interesting to figure out not just how we adjust to this environment, but how we provide products that make sense in this environment. ”

David Reilly

# Available from September 2020

## 2020 NAREIM-FPL Associates

### Global Management Survey

More than 100 pages of enterprise benchmarking metrics for real estate investment management:

- ☐ **Capital raising and AUM**  
*Including:* net and gross AUM growth, investor capital commitment breakdowns by quadrant, asset class, geography, vehicle type and strategy, access to retail capital, dry powder, leverage, acquisition and disposition volumes.
- ☐ **Organizational metrics**  
*Including:* YOY changes in headcount, headcount expectations, employee breakdowns per volume of AUM and revenue as well as by firms size and strategy, employee breakdown by function and seniority and age, turnover, valuation frequencies, workload metrics.
- ☐ **Financial metrics**  
*Including:* YOY financial performance, EBITDA (pre- and post-bonus) margins, bonus pools, revenue and expense breakdowns.

## 2020 NAREIM-FPL Associates

### Compensation Survey

More than 300 pages of compensation trends and individual reports, including functions within:

- ☐ executive management
- ☐ accounting (corporate, portfolio/fund, property)
- ☐ asset management
- ☐ capital markets
- ☐ corporate marketing and communications
- ☐ due diligence
- ☐ engineering
- ☐ environmental
- ☐ finance
- ☐ human resources
- ☐ investor relations
- ☐ capital raising
- ☐ leasing
- ☐ legal and compliance
- ☐ portfolio management
- ☐ property management
- ☐ risk management
- ☐ technology
- ☐ transactions
- ☐ valuations
- ☐ debt and REIT securities

To participate in or access the 2020 report, email **Zoe Hughes** at [zhughes@nareim.org](mailto:zhughes@nareim.org)

Best practices shared  
Value added

**NAREIM**<sup>30</sup>

# NAREIM<sup>30</sup>

## *The beginning*

### EXCERPTS

from the founding document of how  
it all began at NAREIM

#### FOUNDERS MEETING

JULY 24, 1990 — NEW YORK

The meeting began at 10:15 a.m.

#### MEMBERSHIP REPORT

Forty-six companies with whom Fred(ric) Halperin (President) met and discussed NAREIM's proposed services and programs were listed. There were another 11 companies with whom Fred had an appointment to see. In addition, there were 16 firms the group was asked to contact prior to Fred making a membership call. Teachers Insurance and Richard Ellis were added to that list. The overall response to the new Association was very positive.

#### ARTICLES OF INCORPORATION AND BYLAWS

The group agreed to add John McMahan's wordage "to advance the professional education of member firms and their staffs", to the purpose of the organization. The Article that took the most time was the one pertaining to Membership Qualification. It was the desire of the group to more effectively describe the type of firms most appropriate for NAREIM.

#### THE 1990/1991 NAREIM BUDGET

In place of the \$10,000 membership fee proposed, the Board felt there should be an initiation fee of \$2,500 and an annual fee of \$7,000. The proposed "break even" fee of \$500 per attendee for the 1991 Symposium was raised to \$1,000 per attendee. It was felt that the \$500 additional per attendee would help cover any unknown expenses during the Associations first year of existence, since the first budget without an actual track record as an approximation at best.

#### BOARD OF DIRECTORS AND EXECUTIVE COMMITTEE

Since no official nominating committee had been established, it was felt that the 25 founding firms should constitute the initial Board of Directors. This Board would remain in place until such time as a Nominating Committee was formed and had developed a slate of candidates. It was proposed that the ultimate succeeding Board of Directors be made up of 9, 12 or 15 members which would include the Executive Committee.

The Ad Hoc nominating committee felt the primary task of the initial Executive Committee will be to implement the planning and establish the appropriate programs and procedures. The Executive Committee proposed: Chairman of the Board — Vincent F. Martin, Vice-Chairman — Bernard Wilbur, Vice Chairman — John McMahan, Vice Chairman — Richard Stearns, Vice Chairman — Tom Eastman and Secretary/Treasurer — Carl Mayer. This slate was unanimously approved.

**BYLAWS OF  
NATIONAL ASSOCIATION OF  
REAL ESTATE INVESTMENT MANAGERS**  
a California Nonprofit Mutual Benefit Corporation

**ARTICLE III  
OBJECTIVES AND PURPOSES**

The purpose of the Corporation is to advance the ability of real estate investment managers to more thoroughly respond to the needs of those they serve and to improve the business environment of the advisory and management segments of the real estate industry. In furtherance of this mission, the Corporation may advance the professional education of its member firms and their staffs, and may promote the communication and exchange of both technical and professional information, publish periodic bulletins, hold local and national meetings, forums and seminars, and share positions on issues of concern to the industry. The Corporation may also advocate legislation which is beneficial to the common business interests of the industry.

**FOUNDING FIRMS**

ALDRICH, EASTMAN &  
WALTCH, INC.

Thomas G. Eastman  
Principal

CHASE INVESTORS

John S. Boynton  
Vice President

CIGNA INVESTMENTS

Phillip J. Ward  
Senior Vice President

CITICORP/CITIBANK

Stephen J. Hennesey  
Vice President

DREYFUS REALTY INVESTORS,  
INC.

Francis (Frank) Tansey  
President

THE RREEF FUNDS

James King  
Principal

TCW REALTY ADVISORS

Vincent F. Martin  
Managing Partner

TRAVELERS REALTY

David C. Graves  
Executive Vice President

T. ROWE PRICE

Reid G. Samuelson  
President & Director

KARSTEN REALTY ADVISORS

Carl A. Mayer, Jr.  
Principal

MET LIFE

Harvey Young  
Senior Vice President

MONY REAL ESTATE

Richard Scott  
President

PRUDENTIAL REAL ESTATE

INVESTORS  
Richard B. Stearns  
Chairman

SCHRODER REAL ESTATE  
ASSOCIATES

Mark Peskin  
Executive Vice President  
& Managing Director

EQUITABLE REAL ESTATE  
INVESTMENT MANAGEMENT

Richard R. Dolson  
Executive Vice President

HRA, INC.

Bernard F. Wilbur, Jr. MAI  
President

JOHN HANCOCK PROPERTIES,  
INC.

Kevin McGuire  
President

JONES LANG WOOTTON REALTY  
ADVISORS

Stephen J. Furnary  
Managing Director

UNUM LIFE INSURANCE CO.

Theodore F. Bernard, Jr.  
Vice President

THE YARMOUTH GROUP

Graham Bond  
Chief Operating Officer

THE BOSTON CO.

Maurice Coulon  
Senior Vice President

NORTHWESTERN MUTUAL

Mason G. Ross  
Vice President

J.P. MORGAN INVESTMENT  
MANAGEMENT

Timothy J. Heise  
Managing Director

AETNA REALTY INVESTORS

David J. Reilly  
Senior Vice President

MELLON/MCMAHAN REAL ESTATE  
ADVISOR

John McMahan  
President



# 30 **BEST** Pieces of **ADVICE** **PART 1**

Real estate leaders share the best pieces of advice they have received, how it influenced them personally and professionally, and what advice they offer their teams today.

*Look out for more advice in Part 2 of this series in the Fall 2020 issue of Dialogues.*



---

**RICHARD HURD****EVP/Chief Investment Officer,  
Waterton**

Embrace change and take some risks with your career — **don't be afraid of making a change**. Being comfortable in your role is not wise as nothing lasts forever. You need to assume there will be change in the future and you might as well take control of your own career decisions by always considering new job opportunities.

**The right career opportunities will create needed passions, happiness and commitments** which are a requirement to being successful over the long term. The advice came from my father in the late 1990s. He was head of a small company and ended up losing almost everything when the company went under. The experience had a profound effect on me and I was afraid to leave the safety of a big corporation.

In 2004, I followed my dad's advice and left a big institutional real estate company to start my own real estate company. The big real estate company struggled in the great recession and soon laid off everyone. My company survived the recession and it performed relatively well. It has since provided many new opportunities. It was a great business decision and I still thank my dad to this day for his advice and support.

To my teams, I stress two things: 1) **always network. You must be out meeting lots of people in this business.** It will lead to potential new deals or career opportunities; and 2) embrace change. It is just part of our business today.

---

**SALLY STOCKS****Managing Director, Portfolio Management,  
Invesco Real Estate**

At its simplest level, **make sure that you have a best friend wherever you work**. I interpreted it more broadly to mean that you should strive to surround yourself with smart friends and trusted advisors. Richard Kincaid, who was the COO of EOP where I was working in 2001, gave me that piece of advice. At the time, he had the huge task of trying to meld the very different cultures of EOP and Spieker Properties post-merger. He wisely chose to emphasize the importance of building camaraderie among the team. He was also pragmatic and convinced that **research demonstrated that strong workplace friendships dramatically reduced turnover**. Fundamentally, I believe that we all want to work and do business with nice, smart, trustworthy people. It's not complicated.

**Take risks, keep an open mind** and don't forget to enjoy the journey with your friends.

---

**JOHN GOCHBERG****President & CEO, TGM Associates**

**Be careful what you commit to or buy.** Once you commit to or own it, for better or worse, you are stuck with the consequences. My father gave me this bit of advice at many different times, but I first remember him saying it when I first started dating my wife and told him that I could see myself marrying her. I find myself thinking about his words every time I am making a major decision in life or in business.

My partners and I often discuss that **some of the best deals we have done, are the ones we did not do**. In business it is just as important to know when to walk away from a deal as it is to pursue it.

## TODD EVERETT

### CEO, Principal Real Estate Investors

The most impactful business advice I've received was on my first day of real estate industry employment, June 10, 1985 at age 22, from a gentleman, Bill Knowles, who was Head of Real Estate for Bankers Life, predecessor to the Principal Financial Group. It was simple guidance involving fiduciary responsibility, humility and to **never forget that you are investing the money of others** — their savings, capital for emergencies and retirement funds. It was advice all of us have likely received at some point. However, receiving it on day one, from someone who's seat you would occupy three and a half decades later, makes it special. For me, **it provided a pillar and foundation in client and fiduciary service** that resonates as strongly within our office walls today as it did in 1985. In fact, I'm very sure that the credit culture and values stressed by our various leaders has driven the subsequent success we've achieved as an organization.

Along with the fiduciary advice above, I stress that our mission is to be our clients' "most trusted and valued" real estate advisor. If we achieve those two factors, other business, financial and professional objectives should ultimately fall into place. The path to trust and value creation can originate in every interaction, but is only enforced in consistently listening, creating solutions, anticipating disruption and generating excess performance overtime. **We are all stewards of a special credit- and client-centric culture** that is driven and thrives by our actions each day.

## WILL MCINTOSH

### Global Head of Research, USAA Real Estate

**"Service, loyalty, honesty and integrity — these are non-negotiable.** They will define you. Straying from these values will forfeit all that you stand for in the eyes of your clients, partners and co-workers and that is unacceptable." *Len O'Donnell, President and CEO of USAA Real Estate, 2012.*

It reinforced the importance of the values of service, loyalty, honesty and integrity and encouraged me to continue to live them every day. Today, **I share Len's advice with my research mentees and make sure they understand just how important it is** — especially in our profession and our personal lives.

## CHRIS MCGIBBON

### Head of Global Real Estate, Nuveen Real Estate

**Focus and specialize.** Get really good at one thing and you will always have relevance. There are no shortcuts; **do all the little things right consistently every day and greatness will emerge over time.** I received that piece of advice from a close friend who is an endodontist in March of 2015. He was explaining why you should not go to a general dentist for a root canal.

Lots of great ideas die on the vine because smart people sometimes don't have the skills to persuade others to come along with their ideas. **Focus as much on people, relationships and communication skills** as you do on your technical skills.



A lighthouse stands on a hill, silhouetted against a vibrant sunset sky with orange and yellow hues. The lighthouse has a dark body and a glass-enclosed lantern room at the top. The background shows a hilly landscape under the twilight sky.

THE BAILARD REAL ESTATE FUND

# PROUDLY CELEBRATES 30 YEARS

## ESTABLISHED AND EXPERIENCED.

Bailard has been investing in real estate for more than 30 years.

## DISCIPLINED YET AGILE.

“Buy right” and deliver value over the long-term.

## DIFFERENTIATED.

Create value through accountability, alignment, excellence, and independence.

In tandem with NAREIM's 30th anniversary, 2020 marks the same milestone for the Bailard Real Estate Fund. For individuals and institutions alike, Bailard proudly serves as a trusted partner focused on achieving long-term investment results aligned with client values and goals. Our cycle-tested real estate investment strategy seeks to provide investors with a methodically constructed, value-oriented approach to core real estate and deliver competitive risk-adjusted returns through varying market environments.

## CONTACT US

To learn more, email Ben Lathrop at [blathrop@bailard.com](mailto:blathrop@bailard.com), call (650) 571-5800, or visit [bailard.com/real-estate](https://bailard.com/real-estate).

# Bailard

*All investments have the risk of loss. Past performance is no indication of future results. There is no guarantee that any investment strategy will be successful.*



**DAVID REILLY****Former CEO of Cornerstone Real Estate****Real estate is a people business.**

You get things done with and through people. Unlike the other two big guns in the industry, i.e. stocks and bonds, **real estate is the one investment class that absolutely requires strong people skills.** You have to be able to work through a myriad of different situations and work with clients, consultants, co-workers, attorneys, architects, engineers, zoning committees, public officials, etc. That, I think, is the key to real estate — it is a people-driven business.

**JANE PAGE****CEO, Lionstone Investments**

A college professor told me to **get as much education completed before the age of 30.** I took his advice and was able to complete an MBA while still working full time. By 30, I was married and was starting a family. Although I have continued learning and adding a few industry designations, it would have been more difficult to work, travel and raise a family if trying to also juggle an advanced degree.

I believe that **having the advanced degree early in my career gave me credibility in my workplace** and also gave me more confidence in my skills and ability. Having confidence in myself helped me be more authentic and strong in my job and purpose in life.

**PAM HERBST****Managing Director and Head of Investment Group, AEW Capital Management**

One of the most teachable moments of my career happened during the real estate meltdown of the early 1990s. My predecessor firm had one of the earlier open-ended real estate funds, did the majority of our deals in joint ventures and undertook a fair amount of development. This was a risk profile not conducive to a major downturn or an open-ended fund structure. We had unwritten exclusive relationships with many experienced operators and strong long-term relationships. As values declined and clients put in redemption requests, we had to do everything that we could do to preserve our clients' capital, including exercising our rights to loan guarantees and bankrupting partners in our network. Our relationships with our partners became strained and it felt like the valuation declines would never end.

In spite of the bad news, **I learned to communicate with clients early and often.** Even before people talked about transparency, I realized that coming forward to clients and being incredibly forthright about both the good and the bad news was appreciated. It kept my reputation and integrity in good standing. I also learned that **while relationships with operating partners were key to our business, I had to be extremely mindful of our fiduciary role to our clients.** While my CEO at the time did the right thing for our clients, he would often comment about the fact that he had mistakenly viewed our operating partners as the clients and had to adjust his perspective throughout the downturn and to always put our investors interests first. I'm very proud that I've always been transparent in everything that I do. Some say it's a fault. If that's a fault, I'm good with it!

**STEPHEN FURNARY****Executive Chairman, Clarion Partners**

In our case and I think for a lot of the founding NAREIM firms, **most of us thought of ourselves as being in the real estate business.** After being in the business for not that many years, what developed was the investment management business in real estate. And with that, a client taught me a lesson with a stern face. As they were firing us he said, "Steve, **what you need to do is make the business work for the client and not your firm.**" That came from a CIO of a major pension fund. That really set the stage for me for actually changing the firm from a real estate firm to an investment management firm. And, by the way, he was absolutely right.

**TOM ZALE****Vice President and Head of Real Estate, Northwestern Mutual**

I have in my office a framed document of my mentor Gene Skaggs's top 10 list. My favorite piece of advice, at least from an investment leadership standpoint, is: **"80 plus percent of the money is made by getting on the right ship at the right time, sailing in the right direction, and getting off at your destination;** not by rearranging the deck chairs." It keeps me grounded in maintaining conviction around a strategy. While it's important to regularly reevaluate the factors that drove conviction in the strategy, this advice helps me manage the noise that could derail it.

**PAUL MICHAELS****Managing Director, Invesco Real Estate****Do the right thing, and good things will happen.**

Be balanced in how you approach investment opportunities. Don't just convey the positives. **Every transaction has its warts.** Put everything out on the table for folks to evaluate.

**PETER BORZAK****Chairman/CEO, Pine Tree**

When I was a senior in college, I had an internship at a real estate consulting company in Washington, DC. My cousin was in the real estate business and he took me to a real estate conference in New York. While we were there, he also took me to a meeting he had with a New York real estate investor. At the meeting, the investor asked me some questions about my plans after graduation and my interest in the real estate business. When I answered him, I guess I was shifting a lot in my seat and looked uneasy and nervous. After the meeting, my cousin told me about the impression he thought I had made, and **explained the importance of looking relaxed and confident.** He told me that **the real estate business was all built on relationships which start when people believe you are capable and can be trusted.** Moving around and looking anxious was not the way to do that. I became hyper aware of that advice every time I met with someone, and even though it's a small thing, it was helpful to me, especially when I actually was nervous in meetings.

## DERRICK MCGAVIC

Managing Principal, Newport Capital Partners

As a very young, inexperienced Lieutenant of Marines, my unit failed spectacularly during a field exercise. While trudging through the muck, admittedly feeling sorry for myself, I looked up and there was the Regimental Commanding Officer. Now I really felt like a failure. Nothing else for me to do, I headed straight for the Colonel. He glowered while listening to my confession of failure as a Marine. Without changing expression or tone, he asked me two questions: "Lieutenant, were any of your Marines killed or hurt?" "No, sir." "Will this cost the Corps more than a million dollars?" "No, sir."

He was quiet for what felt like an eternity and then said, "Well, you really messed up. But we expect Lieutenants to make mistakes. At least **you acknowledged your failure so maybe you're not worthless**. Don't make the same mistake again. Run it again, now, and fix it." (He may have used different, more colorful adjectives.)

I have tried to live by the lessons he was teaching throughout my career:

1. **Everyone makes mistakes.** If you are not making mistakes, then you are not learning or stretching your mental boundaries.
2. **Making a mistake once is not a failure.** Making the same mistake twice is.
3. **Prioritize damage and place appropriate emphasis on what is, and what is not, important.** We are in real estate; if no one died and it didn't cost an extraordinary amount of money, the error can likely be fixed.
4. **Acknowledge actions/inactions and take complete accountability for mistakes.** Never hide behind something or someone else — and never trust anyone who displays that behavior pattern.
5. Finally, **take advantage of the opportunity to learn from every situation.**

## CATHY MARCUS

Global Chief Operating Officer and Head of US Equity, PGIM Real Estate

A business colleague once gave me a piece of seemingly simple advice, which was to **show up at work as my entire self**. When I was younger, I felt that — as a woman in a male-dominated industry — I had to have a serious and almost non-human type of persona in order to prove my worth. As you can expect, **it was very draining to act like someone else in the workplace**, where I spent so much of my time. It impeded my ability to foster real connections because I was relating to people in a way that was not natural for me. It may be natural for others, but it wasn't for me. I took this advice to heart, and it prompted me to begin showing up to work in a more authentic way. **That shift in my attitude undoubtedly helped me to build stronger relationships with my peers** and connections across the industry, and — in turn — has aided me in becoming more effective at my job.

Q How do you | transform operational processes?

"Yardi Investment Management transformed our operational process by giving us the ability to process an entire structure's worth of data in the same system. It's all at your fingertips."

ALEX DROSTE  
DIRECTOR - GLOBAL REAL ESTATE PLATFORM LEADER  
ALTER DOMUS

Yardi  
Investment  
Management



800.866.1144  
[Yardi.com/IM](https://Yardi.com/IM)

See the interview:  
[YARDI.VIP/ALTERDOMUS](https://YARDI.VIP/ALTERDOMUS)





# *Evaluating* office investments *for* attracting talent

**Today's corporate tenants are increasingly utilizing their office space as a tool to compete for the best workers. Buildings that provide four key variables for attracting top talent rank highest in value for office investors.**

By Chuck Schreiber,  
KBS

Investors are changing the way they evaluate office acquisitions as they recognize the role of talent in corporate America's real estate decisions. Achieving a mix of culture, amenities and work/life balance is key to drawing talent to companies.

The modern workplace is becoming a key differentiator in the market, helping top companies to bring in and keep the very best employees. According to *Work Design Magazine*, forward-looking organizations are rapidly merging human resource and real estate functions to create a formidable weapon in the war for talent.<sup>1</sup>

But what specifically is attracting skilled workers to companies or markets? And how can today's office owners and investors leverage this momentum?

There are four key variables KBS uses when evaluating office properties and leveraging the proximity of talent pools in specific markets.

## **1 Location: Watch for continuing growth in secondary urban nodes**

Location begins with focusing on strong office markets throughout the country with solid job growth, excellent infrastructure and proximity to major universities. Along with primary gateway markets, office growth is occurring in nodes within secondary markets with sustainable, growing economies and projected long-term growth. Examples include Austin, Raleigh, Salt Lake City and Portland, Oregon.

Proximity to transit plays a vital role in the location of office assets. Accenture Tower in Chicago, for example, is situated directly above Ogilvie Transportation Center, one of the main suburban train stations connecting downtown Chicago to the suburbs. This gives office tenants at the property direct access to city trains, buses and expressways.

<sup>1</sup> Marie Puybaraud, Why Real Estate and HR Are Better Together, *Work Design Magazine*, July 2018.

<sup>2</sup> Jillian Richardson, The Office of the Future is Like a Full-Service Hotel, Catalyst by Convene.



Another significant factor is walkability. Talent pools are attracted to areas where they can easily walk to dining, shopping, fitness facilities and daily-needs retailers during the workday. Walk Score is a valuable tool to use when assessing transit orientation and walkability in office investments. The platform scores over 20 million properties each day based on the expertise of its advisory board, which includes urban planning, environmental and technical experts from institutions such as the Sightline Institute and the Brookings Institution.

## 2 Amenities: Integrate offerings that promote work/life balance

Amenities in some office properties are becoming more luxurious and hospitality-like. In fact, Convene reports that the office of the future is akin to a full-service hotel with offerings including fitness and

wellness centers, swimming pools, concierge services, restaurants and even gourmet chefs on demand.<sup>2</sup>

While luxury amenities are appealing, today's office tenants are actually seeking something more fundamental: amenity offerings that help them with their everyday needs. As time is the most in-demand commodity, properties that offer time-saving options will best leverage this demand.

The Meier & Frank Building, a 16-story mixed-use property owned by a KBS client portfolio and Sterling Bay Development in Portland, provides tenants with a 15,000-square-foot amenity floor featuring a professionally operated spin/yoga/meditation room, a full fitness room with available personal training, showers and a bike storage facility equipped with 200 bike parking spaces, lockers and drying closets, which are ventilated compartments designed to dry clothing throughout the day. Tenants particularly appreciate this

“ A proactive asset and property management strategy will address this need by engaging with tenants and integrating activities that create a sense of community within the building. ”

property's bike amenities because many Portlanders bike to work and can then safely store their bikes and dry off before the workday begins.

While many office property owners choose to provide a wide array of building features in order to stay competitive, it is possible to invest too much capital in amenity offerings. Focusing on the amenities that most tenants at each property want, and will use, is a more effective strategy.

<sup>3</sup> Robert Carr, Data Links Sustainability with Office Tenant Satisfaction, NREI, February 27, 2015.

## Quantifying amenity value

**While premium amenities are a cornerstone of attracting top talent, how does the cost of providing these amenities compare to the returns they yield?**

### *On performing a cost-benefit analysis on amenities:*

Well-amenitized buildings help attract and retain top-tier tenants, which typically more than compensates for the cost of any value-added improvements.

### *On quantifying metrics, such as a WalkScore rating:*

Establishing the premium is about what the whole experience is worth to office tenants. That experience — location, good real estate “bones,” the best amenities package in the city and well-executed building programming — creates a sense of community for the tenant that is difficult to quantify. However, it has the potential to generate strong occupancy and rental rates in a short period of time and appeals to existing tenants choosing to renew or expand their lease.

### *On deciding on amenities to add to properties:*

The amenity must correspond to the specific needs of the tenants at that particular property and must have the potential to add significant value to the property. The new generation of talent moving up through the ranks is increasingly seeking environments where they can walk to great restaurants from work.

At 201 Spear Street in San Francisco, we recently introduced Gozu, an open-fire chophouse with a tasting menu that spotlights Japanese Wagyu beef, seafood and whisky. A dining experience like Gozu works in such a location and appeals to that type of tenant.

In Portland, where cycling to work is common and the weather is often rainy, a bike room with heated lockers is a great fit. At the Meier & Frank Building, we installed a bike storage and repair facility with drying lockers as part of the building’s “amenity floor.”

These amenities were selected because we know this is what existing and prospective tenants are looking for in these specific properties. Certain amenities make sense for certain properties in certain markets — the key is understanding each market, recognizing what tenants want and need, and then determining how much they would be willing to pay to have those amenities. There’s no simple formula for that — it is determined on a case-by-case basis.

### *On the applicability of high-end amenities to new developments:*

Tenants are not always seeking a brand-new building. Many technology and creative firms prefer vintage buildings that have been upgraded with the latest amenities. We refer to these properties as “non-commodity assets.” Owners of older high-rise towers are staying relevant by adding amenity floors like we did at the Meier & Frank Building that provide a touch of culture and a place to relax. Older, retro buildings in great locations are often excellent candidates for modern amenities and are especially in demand.

A recent survey of more than 1,200 KBS portfolio property office tenants revealed that the most valued amenities include on-site dining and fitness offerings, overnight mail drop boxes, a conference facility or meeting center and recycling programs, among others (see Exhibit 1).

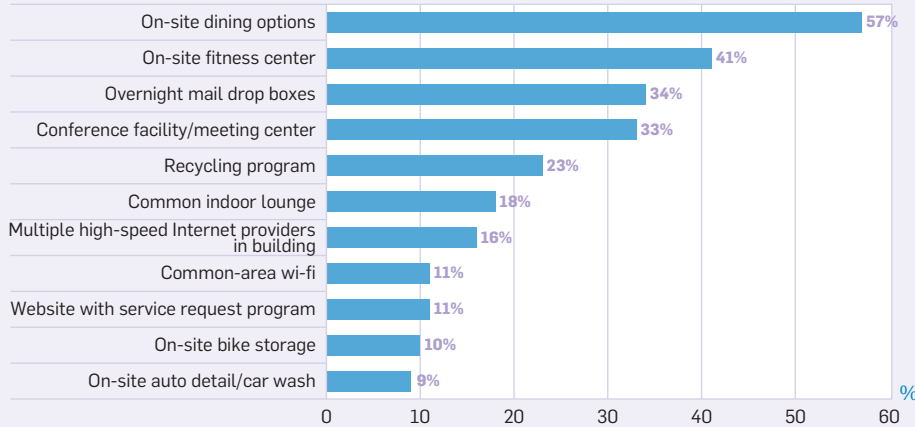
This research reveals that amenities that cater to tenants’ comfort, convenience and productivity are the most utilized, and it is these amenities that drive new and renewal leasing decisions. Knowing and understanding tenant preferences are essential when evaluating which amenities make the most sense for a particular property.

## 3 Physical property attributes: Focus on connectivity and sustainability

Connectivity is a necessity in modern office buildings, so much so that WiredScore was created to measure commercial properties’ connectivity levels. Buildings that meet a high bar for connectivity can achieve Wired Certification, which tenants are using as a metric to help determine a property’s desirability.

For example, Northland Center, a two-building, 465,000-square-foot Class A office park in the greater Minneapolis market, was awarded Wired Certified Gold status, indicating that it meets the international standard for cutting-edge Internet connectivity in office buildings.

Sustainability is another growing factor as tenants are increasingly concerned about climate change and protecting the environment. In fact, research shows that office buildings’ sustainability is directly related to tenant satisfaction.<sup>3</sup>

**Exhibit 1: Most valued tenant amenities in office properties**

Source: Kingsley Associates and KBS.

As office tenants make decisions about the space they will occupy, several sustainability certifications are increasingly garnering their attention, including LEED, BREAMM USA, Green Globes, WELL, Living Building Challenge, Zero Energy Building and Parksmart. These certifications are awarded to buildings that meet or exceed specific sustainability standards.

In addition, tenants are evaluating buildings' sustainability scores based on environmental, social and governance (ESG) factors, which assess the societal impact of their companies and helps determine their future financial performance.

## 4 Asset and property management: Community is key

The right management strategy can have a direct impact on tenant satisfaction and retention rates. While good managers respond quickly to tenant communications, excellent managers are proactive. This means conducting HVAC,

“Vetting office properties on their ability to help tenants compete for talent in the current workforce is a sound strategy for future growth.”

electrical, plumbing and elevator systems checks before they are due, repairing and replacing roofs, upgrading restrooms and common areas, and refreshing flooring, lighting, carpeting and painting before they wear out or begin to look worn.

Beyond these basic requirements, tenants are also seeking a deeper connection with office ownership. This is a trend that will continue to grow in the years ahead. A proactive asset and property management strategy will address this need by engaging with tenants and integrating activities that create a sense of community within the building.

At Accenture Tower in Chicago, tenants and visitors are greeted by a personalized concierge and treated to weekly events such as “Sangria and Karaoke,” coupled with regular professional workshops and community-driven events that benefit local charities.

Activities can contribute to a shared positive culture, which in turn deepens tenants' connection to the property, helps them to attract top talent and increases the likelihood that they will renew their lease when the time comes.

## Conclusion

Given the growing role of talent in real estate decisions across the country, vetting office properties on their ability to help tenants compete for talent in the current workforce is a sound strategy for future growth.

Paying attention to location — including market fundamentals in primary and/or secondary urban nodes, transit orientation and walkability — is key in partnering with tenants to compete for talent. In addition, amenities that support and promote work/life balance, market-leading connectivity and sustainability make a difference for these companies. Lastly, proactive, community-focused management remains critically important.

By evaluating and selecting the optimal combination of factors in office investment properties, investors can leverage the rising focus on talent in order to drive occupancy and support asset stability for the long term. ♦

**Chuck Schreiber** is CEO of KBS.



# Prioritizing data integration *during an* M&A

## How organizations handle the integration of data can determine the success or failure of an M&A.

**M**ergers and acquisitions (M&As) have potential to positively transform companies by making the combined entity more efficient, profitable and valuable. In today's data-driven world, one of the most important things that companies joining together can do to ensure long-term success as a single enterprise is to thoughtfully and skillfully integrate their data and the underlying technology systems.

Successful M&A outcomes require integration of virtually all functions of the two legacy companies into one unified operating platform. Data integration is especially important. Among a real estate company's most valuable assets, on par with its physical properties, is its operational and financial data. In our decades of experience, the health and competitiveness of any real estate company directly correlates to the effort and investment it makes to manage and govern this critical asset.

## Why data is important

The real estate investment industry is no longer driven by relationships. Today's companies rely, instead, on big data analysis to make informed strategic and operational decisions for running their businesses. Data is essential for actively managing assets, reporting to investors, complying with regulations and raising new capital. The ability to have full command of your data — to get it to the right place, at the right time, in the right format and with accuracy — is now a competitive necessity.

In the case of an M&A, a well-executed data integration project can enable the new entity to optimize performance, achieve target efficiencies and synergies, and keep investors and investment managers informed without disruption. Conversely, a poorly managed integration project will have the opposite impacts. According to a *Harvard Business Review* article, an

By John Seaton and Jim Valente,  
RealFoundations

<sup>1</sup> Alan Lewis and Dan McKone, So Many M&A Deals Fail Because Companies Overlook This Simple Strategy, *Harvard Business Review*, May 10, 2016.

<sup>2</sup> Ibid.

<sup>3</sup> Analysis limited to deals where the deal values were disclosed by the entities engaged in the transaction and covered SNL.



analysis of 2,500 M&A deals found more than 60% of them actually destroyed shareholder value.<sup>1</sup>

Similarly, a KPMG study found that 83% of mergers failed to increase shareholder returns.<sup>2</sup>

This topic is especially important now for investors and investment managers because real estate-related M&A activity has been increasing in the last few years. Based on RealFoundations' research of global real estate companies covered by SNL Financial (part of S&P Global Market Intelligence), real estate M&As publicly announced and completed in 2019 had a combined value of over \$68 billion.<sup>3</sup> By contrast, the aggregate value of M&A deals in 2018 was just over \$58 billion. Moreover, most deals today involve hundreds of assets across multiple geographies and entail an unprecedented volume of data points housed in an incalculable number of disparate systems.

**“ It's imperative to understand what a successful data integration involves. ”**

### Common data integration challenges

With more companies going through mergers or acquisitions, it's imperative to understand what a successful data integration involves and to be clear-eyed about the challenges.

#### Scope and complexity

The typical real estate company can easily be operating on dozens of different systems for the multitude of functions within a real estate firm, ranging from enterprise resource planning (ERP) to accounting and financial management, lease

management, customer relationship management (CRM), reporting and analytics, debt management, human resource and payroll, payment/transaction management, utility management, collaboration, property marketing, document and content management, and capital project management. Now imagine consolidating all this information — and more — for two companies that use different applications, policies and processes.

#### Different operating platforms

Although the merging companies may be in the same business, they will operate with different management philosophies, organizational structures, ways of working and systems to support the work. Even if the two firms rely on the same enterprise applications, the configuration and use of these systems tend to be very different from one firm to the next, often due to customizations or legacy data sets.

### Case study: Data integration post-M&A

Mid-America Apartment Communities' (MAA) 2016 merger with Post Properties produced the largest US multifamily REIT by unit count, with more than 100,000 units. Aggregating residential property management and accounting data from these two industry leaders into a consolidated platform for future analysis and reporting would be no easy feat, so MAA took a methodical approach to ensure its success.

At the time of the merger, both MAA and Post were operating on numerous different systems configured for how each company was running its business. With a focus on business process improvement, MAA's primary objectives were to: 1) reduce the number of disparate technologies each original entity utilized; and 2) increase the efficiency and effectiveness of property and portfolio accounting by incorporating leading practices in property and portfolio accounting, operations and asset management, and analysis. MAA engaged RealFoundations to provide program management and technology strategy services over an 18-month period to support the initiative.

In the immediate post-merger period, among MAA's most critical needs was to produce consolidated corporate financial reports using data from the legacy companies' disparate systems of record. RealFoundations partnered with MAA to design and implement a "financial data bridge," or transitory platform which permitted timely, accurate and consolidated portfolio reporting from Day 1 and throughout the duration of the integration project with minimal disruption to operations.

Leveraging RealFoundations' proprietary M&A Data Integration Approach, members of the integration management office worked together to evaluate the complexity of the data integration and develop a migration strategy to accurately consolidate both companies' historical financial information. This team considered and made decisions pertaining to a range of issues including, but not limited to, data mapping, data definitions, charts of accounts, security and reporting requirements, eventually leading to creation of a plan for an interim data bridge.

Once the confirmed plan was executed, the data bridge was designed and created, followed by multiple rounds of testing. Financial data from both companies' system of record was then staged and validated, and reports were generated for stakeholder consumption.

#### Lessons learned:

- All key stakeholders must be fully and actively engaged from the start of the project to reduce the need for incorporating late feedback and 11<sup>th</sup>-hour requirements.
- Dedicated and knowledgeable team members from both legacy companies must be involved when mapping data and documenting conversion rules for the deployment team.
- The earlier you can bring a team onboard to design and build a financial data bridge, the better. Do not underestimate the amount of time it can take for mapping, development and testing leading up to a merger.
- Include more than one mock data conversion in your timeline to ensure stakeholders are comfortable with the output and validation before the first reporting deadline.
- Carefully consider how much legacy company history gets brought over with the data bridge. The more history, the more challenging the mapping and validation becomes.

MAA and RealFoundations successfully integrated financial and operational data from both legacy companies into a single, consolidated platform, enabling the post-merger enterprise to achieve the business objectives originally envisioned for the transaction with Post Properties. The financial bridge was the first big step in reporting a combined portfolio and driving an effective integration. Now, several years after the merger, MAA benefits from a consolidated and scalable system for highly efficient resident management as well as portfolio accounting and investor reporting. The company's technology landscape is optimally configured to take advantage of digital technologies and critical for continuing company growth and expansion.

#### Data inconsistencies

Rarely do any two companies define every piece of data in the same manner. KPIs, metrics and calculations vary from organization to organization. These

differences in how the companies define, store, manage and report specific leading indicators create serious data integration challenges. Net operating income (NOI) is a good example, as

organizations often include different financial items "above" and "below" the line to calculate NOI. Occupancy is another example, as firms are often unclear if they are reporting on

## Managing the pitfalls

Companies going through a merger or acquisition not only need to understand common data integration challenges and success factors, but they must also recognize and avoid potential pitfalls that can derail them. These pitfalls include:

- **Application bias.** The combined entity must achieve an efficient, scalable and unified platform that supports future state operations and reporting requirements. This platform will be unique and distinctive from each legacy company's platform. An integration management group should assess the tool sets from both legacy companies' platforms, consider which sets are best suited for long-term needs, as well as determine whether to keep existing systems, implement new systems, or do both. Legacy company preferences for, or against, specific applications can stall the realization of synergies and the future state technology framework.
- **Data errors.** If companies don't take the time and/or lack the expertise to validate their respective data as they unify their platforms, they risk reporting inaccurate information. For example, erroneous data-mapping can result if the two companies have inconsistent naming conventions or use different metric calculations. Additionally, data entered manually, as opposed to system-generated, is more prone to mistakes and can lead to reporting inaccuracies. This, in turn, can result in publication of incorrect information and cascade into suboptimal business decisions and reputational damage. Data validation must be a priority throughout an integration.
- **Budget shortfalls.** During underwriting, there's often a lack of understanding about the cost to combine systems and technology for operating without disruption during the first 180 days post-M&A. The investment committee overseeing the deal must ensure that underwriting includes budget for the requisite post-deal integration, which is usually about 2% to 4% of the overall value of the acquisition.
- **Overextension.** Organizations tend to believe erroneously that existing staff can run the business as usual day-to-day while simultaneously creating a new operating platform that integrates the legacy companies' data. This is short-sighted and can produce conflict between managing the business and driving change throughout the entity. Even a strong operator is almost never qualified to lead the tasks essential for success in a large and complex integration and change management program. An external consultant with M&A integration experience can help lead the company through the first 120–180 days, stabilizing the operating platform(s) and controlling the velocity of change to minimize adverse impacts on daily operations.

“physical” or “economic” occupancy. The differences in calculations can cause confusion when trying to compare numbers between firms or consolidate them for portfolio reporting.

### Reporting

In the early stages of an M&A, the merging companies must report unified financials and operating performance as a single entity although they are still operating on separate platforms. This bifurcated reporting environment can create a financial reporting nightmare if data inconsistencies are not resolved during the due diligence or transition phase of the acquisition or merger.

### Underestimation and constrained resources

Because most companies have never undergone a merger or acquisition, they tend to vastly underestimate what is required to integrate two organizations' data. Furthermore, they almost always lack the resources and expertise to do the integration themselves. Senior executives and department/function leads have to focus not only on running the business as usual, but also oversee all the other aspects of the M&A. They are hard pressed for time to do the important upfront work of defining the data that the new entity will need for research, managing investments, daily operations, reporting to investors, etc.

## Keys for successful integration

Although significant, these challenges are very manageable if the combining companies apply a rigorous methodology to their data integration initiative (see Exhibit 1). Here's what they must have to do to ensure a successful outcome.

1. **Establish a cross-functional integration committee, or management office,** to plan and implement the integration. This should happen as soon as the intent to merge or acquire is announced, typically six months before the deal closes. Often, the COO of the combined entity serves as the sponsor of the group. Other members may



**Exhibit 1: Sample data integration timeline**

A sample timeline depicting the high-level, critical milestones that must be achieved when merging two separate technology environments into one unified landscape

High-level activities	Plan (through close)	Stabilize (first 100 days)	Transform (complete integrations)
Identify stakeholders & align objectives			
Analyze complexity			
Evaluate infrastructure			
Identify project resources			
Develop & maintain communication			
Develop/update adoption plan			
Develop migration strategy & tools			
Execute security & load testing			
Develop training & data validation plan			
Develop cut-over & contingency plan			
Execute cut-over plan			
Execute training & validation plan			
Provide post-integration support			

Source: RealFoundations.

include the CFO and the head of asset management along with department leads for accounting, technology, operations, revenue management, HR and more (see Exhibit 2). These knowledgeable professionals can make informed decisions regarding their respective areas of the operating model. They will identify risks that must be addressed, enforce standards as the organizations come together, and keep stakeholders informed of progress and challenges.

2. **Collaborate with a firm that specializes and has a strong track record in real estate M&A**, including data integration. Be realistic about the complexity and challenges of post-M&A data integration, especially the expertise, time, resources and

effort required for a successful outcome. Honestly evaluate what the organization can handle on its own, where it falls short regarding capacity and capabilities, and the need for outside assistance.

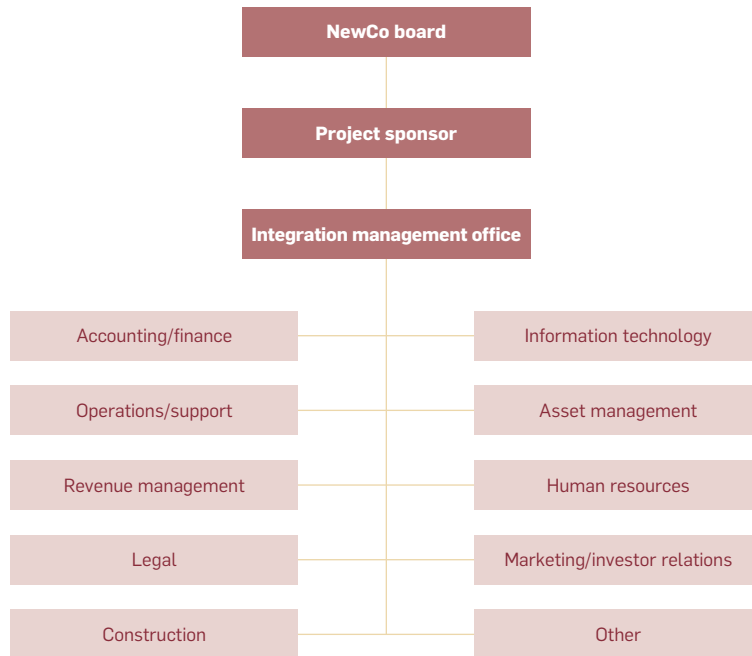
3. **Design and build a data reporting bridge (or interim staging environment)** that will aggregate financial and operational information from both legacy companies into a transitory platform to enable unified reporting as of day one of the new entity. The data bridge (a data warehouse or simple database) will also be used to stage, standardize, validate and transform data before its migration from legacy systems to the new ERP. Factors to consider when designing the bridge

are security, workflow, archiving and audit tracking.

4. **Research and select the most appropriate technology stack to support the business functions** that the integration office earlier identified as mission critical, including, but not limited to, property operations, general ledger accounting, core financial reporting, revenue management, CRM, payroll, etc. Determine which legacy applications survive or get retired, and/or which new technologies get integrated into the new, single, unified platform. Then, design and configure the new platform to support operating and reporting requirements identified by the cross-functional integration team.

**Exhibit 2: Common structure of an integration management office**

The integration management office (IMO) oversees the project, bringing discipline and structure to the work. This group reports to the project sponsor, typically the COO or the CFO of the merged company



Source: RealFoundations.

5. **Develop and execute a data migration plan** to move data from older technologies to newer systems. The plan should consider the level of data granularity of legacy technologies to ensure that these data sets can be consistently moved into the unified ERP. Older technologies and the underlying data sets typically have gaps as well as naming conventions that do not align with modern applications. These discrepancies must be accounted for in the plan and validated for complete and accurate conversion of all data sets.
6. **Create and adhere to a data governance program** to make sure that the new entity's data is fit, or high quality — accurate, timely, consistent and complete — throughout the

organization. The program keeps data fit by establishing and continuously applying an exacting framework of policies, procedures, standards and definitions for how the enterprise will manage its data. It should include a data dictionary that lists and defines every applicable data element that matters to the organization. It also should include company-approved methods for calculating each element, the class of data and data type (alpha, numeric, integer, etc.), information users and the source system from which the data originates.

7. **Implement a change management, or an adoption acceleration, program** to keep employees informed of system changes and new data practices that affect their work. This

helps mitigate disruption to the business and keep morale positive. A good program announces the merger or acquisition and explains how the organizations will form and operate with collaborative, cross-functional teams. It also includes frequent communications to manage expectations, provide integration updates (especially on milestone achievements) and offer training. The latter is key for team members who, post-M&A, have to use new systems and/or handle data differently.

## Conclusion

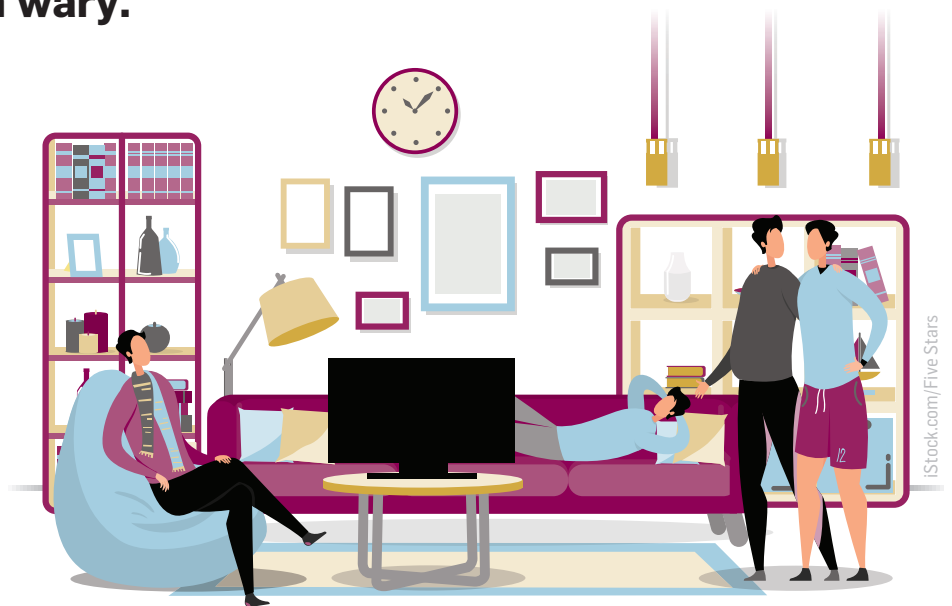
An organization going through a merger or acquisition must proactively plan for integrating its existing and newly acquired data into a single, unified platform. Although a significant undertaking, it is an opportunity for “cleaning up” both companies’ data and structuring the information in a way that empowers the new entity going forward to attain its business goals. These goals include cost savings and synergies envisioned at the outset of the M&A event. An organization only gets one bite at the apple, so it’s crucial to invest the resources and time required to get everything right. Without that investment, the enterprise is likely to develop serious problems that can take months to fix or, worse, lose data permanently, leaving money on the table. ♦

**John Seaton** is an enterprise sales executive with RealFoundations.

**Jim Valente** leads RealFoundations’ global Data Services Team.

# CO-LIVING: *A new sector, or a new way of doing old things?*

The concept of co-living is gaining momentum, but institutional investors and debt lenders remain wary.



By Deborah Smith,  
The CenterCap Group

**W**hen you ask real estate professionals what “co-living” is, and how it works, answers vary substantially. In my view, at its most basic level, co-living is simply formalized room-mating. If you are from out of town and heading to New York City, cannot afford to live alone, and do not have any roommate prospects, pursuing a co-living option may be perfect for you. Instead of veering towards Craigslist, typing “co-living” into an Internet browser will yield a plethora of co-living operators that offer an affordable, convenient apartment with one or more roommates to make living in the Big Apple as cost-effective and convenient as possible. Furthermore, reputable co-living operators will prequalify and prescreen tenants through background checks.

Plenty of bells and whistles talk about “experience,” “shared interests” and “specialty designed” in a typical co-living marketing pitch. Yet, at the end of the day, it is still just formalized room-mating. However, there are a few differences from traditional rental properties that are mainstay to the structure and marketing of the co-living concept.

First and foremost, the properties are marketed on a “per bedroom” basis rather than a “per unit” basis. Therefore, they are at a lower price point than the cost of renting a similarly situated apartment by yourself. This makes it affordable. Second, the co-living operator typically furnishes the units, pays utilities, and may provide cleaning and linen services. This makes it convenient. Third, it’s a fairly straightforward and streamlined process for the tenant that can be entirely managed through a phone or computer. This makes it efficient. But

“The successful players have figured out that technology is the linchpin to mastering the execution.”

when all is said and done, you probably have two or three people in an apartment, each with their own bedroom, and sharing a kitchen, bathroom(s) and other common spaces.

Beyond the basics, operational sophistication rolls in. The infrastructure behind the thriving co-living operators are technology platforms that play a prominent role in their marketing, leasing and property management strategies. It is about drawing in potential tenants, converting them into tenants and keeping them at the operator’s property(ies).

The successful players have figured out that technology is the linchpin to mastering the execution. I like to call this niche sector “technology-enabled” apartment operators. The phrase “We have an app for that” is used more often by co-living operators than by any other real estate professional. Renters can download an app and find co-living apartments, rent an apartment and, once moved-in, organize their day-to-day lives at a touch of a fingertip. Traditional sales and retention tactics such as apartment tours (ditch that for an online virtual tour), picking up a phone to call maintenance when the dishwasher doesn’t work (no need because there is app that handles the entire service request), even meeting or speaking to an actual person through the entire rental process (of course, there is an app for all of it) and after you move

in (there’s that app again) — are relics of the past. For millennials, this is an iPhone paradise.

A tenant need not bring anything other than an Away carry-on (the millennial’s suitcase of choice). Think fully furnished. Turnkey. Travel right. Travel light.

### An evolving model

The co-living operating model is still evolving. Operators are still experimenting with optimal tenant lease terms (which can range from one to 365 nights), amenity packages (cookware, cleaning product and toilet paper make all the lists, but there is a vast spectrum of amenities after that), furnishing mix and quality, target rental rates, whether to own (and how much of) the real estate, and appropriate benchmark comparisons. Underlying these conflicts is an identity quandary which overlaps between hospitality, student housing and traditional rental apartment living. As the sector continues to define itself, there will be a wealth of opportunity for market leadership.

What is in it for institutional investors? To date, institutional capital has been cautious. But it does seem clear that investment dollars are wading in. Market leader versus fast follower is a tale that is playing out real-time. For investors, co-living units can offer a 20% to 30% net rent premium per square foot as compared to traditional apartments. Higher rents mean comparably higher yields. Co-living operators such as Common, Quarters, The Collective and Ollie have collectively raised hundreds of millions of dollars in third-party capital to acquire and manage thousands of co-living units. In 2019, Quarters, a



subsidiary of Germany-based Medici Living Group, announced it had raised \$300 million for its American venture; Common, which is backed by tech venture capital, announced a partnership with Tishman Speyer to develop product offshoot, Kin; while UK-based The Collective has raised \$800 million to do ground up development across Europe and the US.

One major inhibitor to product growth is the availability of debt. As a perceived new asset class, most, if not all, lenders are underwriting projects to a conventional rental scenario. In some cases, lenders are requiring relatively higher equity stakes and/or replacement reserves just to make it a little more painful. Lenders remain concerned that “co-living” is unproven.

Underwriting material premiums, which translates to significant jumps in dollar per square foot pricing, require proof in spades. But, for what it is worth, my view is that the underlying question whether renters are willing to focus on total rent versus dollar per square foot rent was answered affirmatively years ago. The concept of highly amenitized apartment buildings, focusing on more amenity-centric common spaces at the expense of apartment size, is more prevalent in the industry today than ten years ago. The emergence of the urban “micro-unit” — e.g. really small apartments typically less than 400 square feet — is further evidence of the shift in renter mindset. Over time, hopefully lenders will evaluate current lending standards and adjust accordingly.

While it is unclear who ultimately will be the winners and losers, the real disruption to the sector that these co-living operators bring may not be in creating the “new new thing” but in its contribution to redefining the role of technology in the housing sector (and perhaps beyond) in general. I suspect we will look back and realize that a lot was learned from the co-living entrepreneurs who entered the real estate sector with an undeniable flair for marketing and micro-targeting techniques, an abundance of fresh new ideas, incredible talent and, most importantly, a new way of doing old things. ♦

**Deborah Smith** is CEO of The CenterCap Group.

# A brave new world

Join the conversation in NAREIM Dialogues this Fall as we celebrate the 30<sup>th</sup> anniversary of NAREIM's founding and assess the changing landscape for real estate.

**Submit articles by: July 24, 2020**

**Publication: October 26, 2020**

To participate, email Zoe Hughes at [zhughes@nareim.org](mailto:zhughes@nareim.org)

**NAREIM**<sup>30</sup>

**INSTITUTIONAL  
REAL ESTATE, INC.**



# ALIGN YOUR ECOSYSTEM

## SEE PERFORMANCE ACROSS 360° WITH **REALPAGE AIM**

Smarter performance analysis & visualization

Faster risk assessment for assets & investments

Better transparency for you & your stakeholders



### System Integration

Connect all operational and financial systems to Foundation, our real estate-ready enterprise data warehouse



### Data Management

Collect, aggregate, and govern all operational, financial, and market performance data in Foundation seamlessly and effectively



### Analytics & Reporting

Visualize, analyze, and report on performance across your portfolio of investments and assets quickly and easily for your stakeholders

For more information, visit  
[RealPage.com/AIM](https://RealPage.com/AIM)

 **REALPAGE**  
OUTPERFORM

© 2020 RealPage, Inc.  
All trademarks are the property of their respective owners.

# Private real estate's DC opportunity

**Private real estate is increasingly finding its place within professionally managed multi-asset investment strategies designed for defined contribution plan use.**

By Jennifer Perkins,  
Principal Real Estate Investors



<sup>1</sup> Defined Contribution Real Estate Council (DCREC), 2019.

<sup>2</sup> 2017 Defined Contribution Plan Sponsor Survey, Willis Towers Watson.

<sup>3</sup> 2020 Defined Contribution Trends Survey, Callan Institute.

<sup>4</sup> Ibid.

Private real estate has been available to defined contribution (DC) plans for over 30 years. The first daily valued, daily liquid offering has a track record of DC plan investment since 1982. Three additional offerings followed in 1995, 2006 and 2008, each with track records exceeding 10 years. There are now 16 daily valued private real estate-focused offerings available for investment by DC plans.<sup>1</sup>

Historically, REITs were the real estate vehicle of choice for DC plans, but private real estate is increasingly gaining its own allocation and, in some cases, replacing REIT allocations. Private real estate's place within investment strategies for DC plans is poised for growth with new regulation in place and its recognition among the proliferation of multi-asset investment strategies. However, questions on liquidity, fees and litigation remain key focal points for DC plan sponsors and consultants.

## Overview of DC plans

In the last 30 years, DC plan assets surpassed private, state and local government defined benefit (DB) plan assets as the dominant retirement vehicle for American workers (see Exhibit 1). According to Willis Towers Watson, currently 81% of plan sponsors only offer a DC plan to new hires.<sup>2</sup> A primary catalyst of this growth was the passing of the Pension Protection Act (PPA) in 2006, which provided employers additional protections for taking a proactive role in helping employees save for retirement. Automatic enrollment in a 401(k) plan and an employer's ability to select a "qualified default investment alternative" (QDIA) in which to

automatically enroll their employees, as allowed under the PPA, supported robust growth in DC retirement assets.

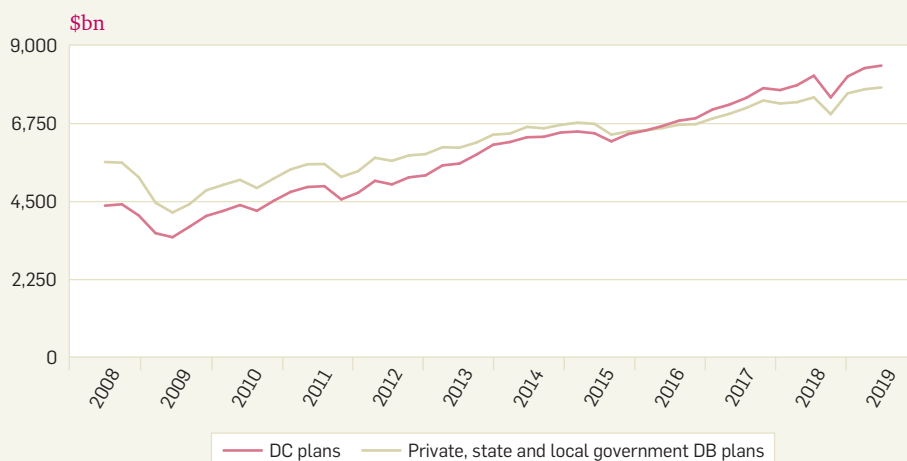
Target date funds (TDFs) are also a product of the last 30 years. First introduced in the early 1990s, TDFs have led the way in the development of multi-asset investment strategies. Such strategies are an easy and helpful way to gain access to professionally managed solutions for many DC plan participants who do not have the time and/or expertise to manage their own investment fund selections. The proliferation of TDFs has also been fueled by the PPA's approval to use TDFs as a QDIA (default investment) for a DC plan. Today, almost 71% of institutional DC plan sponsors automatically enroll

employees into their DC plan to help employees start or maintain saving for retirement.<sup>3</sup> Additionally, 87% of plans use TDFs as the default investment, compared to 35% in 2006.<sup>4</sup> Automatic enrollment, plus a default into a TDF, has proven to be a major catalyst of growth in TDF use.

Another trend occurring within the retirement plan market is the rise in "outsourced CIO" or delegated services offered by the consultant community to DC plan sponsors. This has also been a source of growth in multi-asset investment strategies by helping to ease plan sponsor angst over fiduciary risk. Through such delegated services, consultants may take on a co-fiduciary role for investment selection, review and

“ Private real estate's place within investment strategies for DC plans is poised for growth with new regulation in place and its recognition among the proliferation of multi-asset investment strategies. ”

Exhibit 1: Total US retirement assets



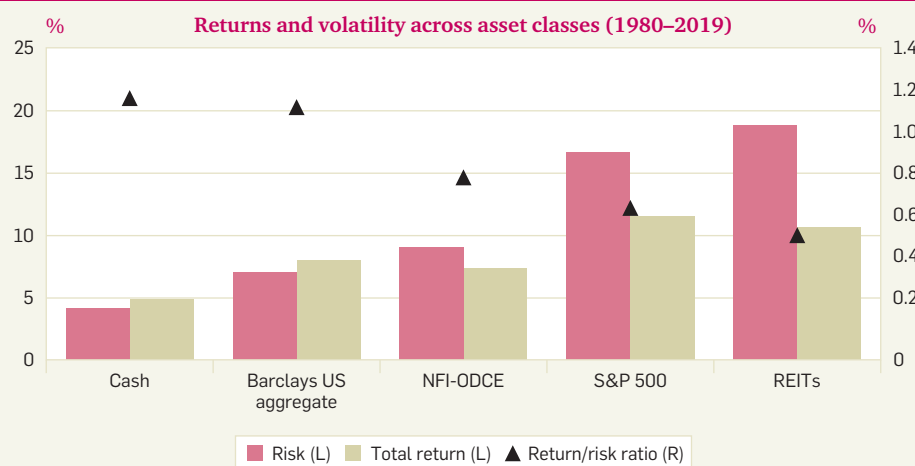
Source: Investment Company Institute, Q3 2019.



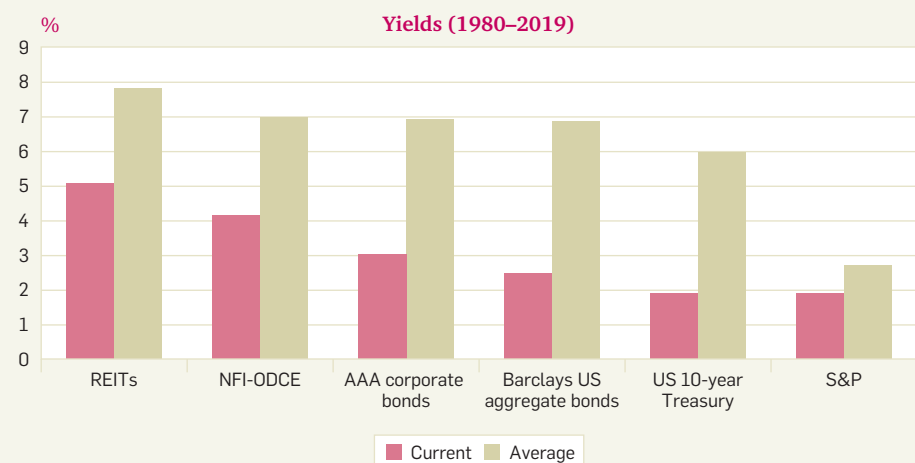
**Exhibit 2: Private real estate is not highly correlated with other asset classes**

Correlation matrix	S&P	NFI-ODCE	Barclays US aggregate	REITs
S&P	1.00	0.18	0.22	0.54
NFI-ODCE	0.18	1.00	(0.18)	0.14
Barclays US aggregate	0.22	(0.18)	1.00	0.26
REITs	0.54	0.14	0.26	1.00

Sources: NCREIF, NAREIT, Barclays, Bloomberg and S&P. Data as of Q4 2019.

**Exhibit 3: Private real estate has historically provided attractive risk-adjusted returns**

Source: NCREIF, NAREIT, Barclays, Federal Reserve and S&P. Data as of Q4 2019.

**Exhibit 4: Real estate provides yields comparable to/in excess of other yield-focused investments**

Source: NCREIF, NAREIT, Barclays, Bloomberg and S&P. Data as of Q4 2019.

effective investment mix for offerings to DC plan participants. As consultants are armed with research teams covering all major asset classes, they are poised to help DC plan sponsors select, construct and oversee investment solutions that are best for a plan sponsor's employees.

### Real estate's place within multi-asset strategies

The proliferation in the use of multi-asset investment strategies has also seen an increasing recognition among investment strategy providers and plan sponsors that more than just stocks and bonds are needed as holdings within a well-diversified portfolio. Increasingly, private real estate is finding its place as an investment within such multi-asset investment strategies.

Private real estate has historically offered:

- increased diversification (see Exhibit 2);
- reduced portfolio volatility;
- income generation; and
- hedge against unexpected inflation (real asset).

As shown in Exhibit 3, private real estate has historically provided attractive risk-adjusted returns and, when added to a multi-asset portfolio, aids in dampening volatility of the overall portfolio. Some plan sponsors and professional asset allocators have identified this as a key characteristic and thus incorporate increasing allocations to private real estate midway through the glidepath to help decrease volatility as participants move closer to retirement. Exhibit 4 also supports use of private real estate as a means of generating income along the glide path.

Inclusion of private real estate to date has mostly occurred within custom

<sup>5</sup> *How America Saves*, Vanguard, 2019.

<sup>6</sup> Research Note, Vanguard, March 2009.

TDFs constructed for the large DC plan sponsor community. Large plan sponsors (\$1 billion-plus) are well versed in using private real estate within investment holdings for their DB plan and, in several cases, have requested the inclusion of private real estate within the custom investment mix they or their consultants built specifically to meet the needs of the employee demographics of their DC plan.

However, incorporation of private real estate has also occurred in off-the-shelf or pre-packaged TDF offerings. To date, five TDF series have included allocations to private real estate ranging from 5% to 15%, depending upon the position along the glide path. Growing support for private real estate inclusion is also occurring within white label funds centered on investment strategies such as a “real assets fund” or “inflation protection fund,” with such funds largely offered and supported by the consultant community.

### What about liquidity?

Because private real estate experiences periods of illiquidity during which investors are subject to investment or redemption queues, liquidity has been a focal point for DC plan sponsors with most concern focused on redemption queues. There are three mitigating factors (and likely more) that address this concern:

1. “Set it and forget it” behavior of DC plan participants.
2. Professional manager use of strategic asset allocation ranges.
3. Advanced notice of DC plan changes.

A vast amount of industry analysis exists that points to DC plan participants exhibiting “set it and forget it” behavior and low propensity for participants to

““ Because private real estate experiences periods of illiquidity during which investors are subject to investment or redemption queues, liquidity has been a focal point for DC plan sponsors with most concern focused on redemption queues. ””

make changes after initial investment. Vanguard, in their annual *How America Saves* publication that shares data from across their DC record-keeping business (5 million participants), found that only 8% of DC plan participants traded within their accounts during 2018.<sup>5</sup> This behavior also occurred during one of the most volatile periods in market history in 2008, when 84% of DC plan participants did not trade.<sup>6</sup>

At the portfolio level, professional managers employ the practice of setting a strategic allocation range generally once a year for each underlying investment. Frequent rebalancing (e.g. monthly or quarterly) occurs to keep allocations within a range as market values fluctuate across multiple asset strategies in which the strategy (e.g. TDF) is invested. A service provider that has the ability to turn cash flows “on” and “off” to underlying investments of the multi-asset strategy is an essential execution tool to keep allocations within their range and in employing gates if needed, should the private real estate investment experience a period during which liquidity is not available. Service providers (custodians and record keepers) well-versed in this practice have aided in the inclusion of private real estate in custom, as well as off-the-shelf, multi-asset strategies.

In addition, the idea that 100% of the DC plan’s assets need to be liquid 100% of the time is not as prevalent as it once was among the DC plan community. With the ability to rely on record keeper data to help understand behaviors of their own plan participants, plan sponsors are able to consider investor behavior when building or utilizing an investment strategy to aid in determining an optimal fit to help plan participants best achieve retirement savings outcomes.

For real estate fund managers looking to participate in the DC market, it is important to understand that DC plan sponsor interaction and behavior is different from DB plans. The number of third parties involved is far greater when working with a DC plan than a DB plan. In addition to consultants, DC plans rely on multiple service providers such as record keepers, trustees and custodians and, at times a separate trading agent, in effectuating the operation of their DC plan. This not only makes the initial decision, onboarding experience and ongoing communication more complex when working with DC plans, but also the notice period from a DC plan sponsor of any future changes is also longer. Changes that a DC plan sponsor wants to make to underlying investment options, service providers and the like are generally well known in advance (e.g. six months), which is helpful

“ DC plan sponsors are subject to litigation risk in their pursuit of assisting plan participants in saving for retirement, because perfect harmony is difficult to achieve among all employees when it comes to investment offerings and costs. ”

for a private real estate manager's cash planning.

### And fees?

It is also well-known within the institutional investor community that private real estate's higher price tag is commensurate with the high touch nature of the asset class. To date, cost has been an inhibitor of wider adoption as many DC plans have increased their focus on expenses and shifted toward passive strategies during the post-Global Financial Crisis bull market run. However, as more DC plan sponsors and their consultants grow wary of the market's ability to continue to produce double-digit returns without much volatility, there is growing appreciation for the need to protect against the downside and diversify investments, with private real estate able to help address both. Hybrid strategies, including both active and passive funds within the underlying investment holdings, have been a popular way of mixing higher and lower cost strategies to blend to an overall fee that is palatable for DC plan sponsors.

### The question of litigation

DC plan sponsors are subject to litigation risk in their pursuit of assisting plan

participants in saving for retirement, because perfect harmony is difficult to achieve among all employees when it comes to investment offerings and costs. Unfortunately, there are law firms who prey on this, leading to heightened plan sponsor sensitivity to litigation at a level that has arguably stunted innovation as a result. However, plan sponsors' increased awareness in being held to the same standards for their DC and DB plans and encouraging plan committee crossover has helped identify differences in plan investments that may not have originally been intentional but are now more evident without DB and DC committee separation.

There is also growing awareness that simply picking the lowest cost fund offerings may not avoid litigation. DC plan sponsors need to consider several other metrics such as how return characteristics (e.g. net returns and risk-adjusted returns) can affect retirement savings outcomes when choosing the right investments to offer. Hiring an outside fiduciary can help mitigate against unintentional plan design oversight, but it too does not completely shield a plan sponsor from litigation risk. Plan sponsors are not at risk for simply choosing to include or exclude certain asset classes within the investment mix for DC plan investment offerings; they are at risk if plan

governance is lacking. In fact, one of the most important ways to mitigate risk is by ensuring there are well-documented policies and procedures of why and how investments were selected.

### The next 30 years

DC plans have become the dominant source of retirement savings and multi-asset investment strategies serving as the primary investment options in the past 30 years. The next 30 years will undoubtedly bring about as much, and likely more change, as technology serves an increasing role in the retirement plan market.

With Baby Boomers now at or near retirement, increased focus on the decumulation phase will be of greater focus. We are already seeing more interest in investment strategies offering guaranteed income. In addition, the signing of the SECURE Act in December 2019 may bring more participants into DC plans as small- to medium-sized businesses evaluate banding together to utilize multiple employer plans (MEPs) versus offering their own DC plan. While MEPs could create larger pools of capital for investment, greater personalization is expected to occur within TDF offerings.

With the continued use of multi-asset investment strategies, the potential for larger pools of capital to band together via open MEPs and a greater focus on guaranteed income products, private real estate continues to be well-positioned for inclusion in, and a compelling investment for DC plans. ♦

**Jennifer Perkins** is Senior Director, DC Real Estate Solutions at Principal Real Estate Investors.

For over 30 years, ARA has provided effective real estate investment solutions to institutional investors through core and value-add commingled funds, tailored separate accounts, and expertise in portfolio takeover and workout strategies.

---

Visit [aracapital.com](http://aracapital.com) to learn more about our investment solutions.

**For more information, contact:**

Jay Butterfield | 213.233.5743

[butterfield@aracapital.com](mailto:butterfield@aracapital.com)

**\$10.2B IN AUM | 100% EMPLOYEE OWNED**

**LOS ANGELES | CHICAGO | ORLANDO | PHILADELPHIA | SAN FRANCISCO**



# Transforming REAL ESTATE *fund operations*

**Managers considering outsourcing to achieve operational efficiencies should assess their needs based on four criteria.**

**R**eal estate investment managers have experienced explosive growth over the past several years. However, the headwinds of extensive regulatory and market change, increased investor demands and fee compression could dampen future prospects.

According to State Street's 2019 Growth Readiness Study, the growth outlook is weakening across all types of asset managers, who are less optimistic about hitting their growth targets than they were just 12 months ago. Of the alternative asset managers surveyed, the biggest threats to growth over the next five years are: the equity outlook, political outlook and economic growth in key markets, as well as regulatory attention to investment fees. To be able to compete effectively, managers recognize the need to focus on their core business of sourcing, managing and transforming assets, while fulfilling

stakeholder requirements of greater transparency, better reporting and tighter accounting controls.

One solution to optimizing the operating model is to offload non-core tasks to a trusted partner. As with any journey, taking the first step can be the hardest. Managers should approach enhancing their operations more holistically in a process we call an "operational transformation." Operational transformation involves changing the operating model, adopting a risk-based approach to managing operations and deploying third-party solutions for non-core tasks.

To help managers frame an execution plan for transforming their real estate operations, below are insights and State Street's best practices gained from our experience supporting multiple clients, as well as the author's own experiences overseeing the real estate fund operations for a large asset manager.

By Anthony Ross, State Street



## Where to begin

In thinking about undertaking an operational transformation, managers should first assess their existing capabilities, as well as identify gaps and opportunities in getting them to their goal. This starts with defining the components of the organization's fund administration. Fund administration typically encompasses the back office and some middle-office functions necessary to successfully support the operations of a fund. This includes accounting, recordkeeping, financial reporting, audit and tax return support, capital call and distribution processing, investor anti-money laundering/know your customer reviews, and execution of all investor deliverables.

The next step is to decide which transformation structure is right for the business. There are three common models:

### 1. Outsourcing of new fund launches

When launching a new fund, the manager would maintain its current operational infrastructure, technology and staffing, while outsourcing additional headcount. By doing so, the manager will not add headcount as the fund scales. Single-strategy managers that want to enter a new strategy but lack operational expertise often opt for this model.

### 2. A full or partial conversion of existing funds

In a full conversion, the manager converts all of its historical data to the fund administration firm. The manager of an older vintage fund, perhaps in the fifth year of its 10-year fund term, that may not want to convert all of the historical data may choose a partial conversion. In this case, the manager may opt to have the administrator start with opening balances at the fund's new

fiscal year. This approach works well for managers that have a separate mechanism for tracking returns and investor historical data.

Under a full or partial conversion, the fund manager would continue to manage its operations and IT infrastructure until the conversion is complete; there will be a transitional period of overlap between the existing and outsourced operations. As part of the outsourcing process, managers will need to review the quality of their data and the age of funds. Managers should keep in mind the need for targeted hiring or transfer of employees to the third-party fund administrator.

Once the conversion is complete, the fund manager's in-house employees focus on fund oversight and front- and middle-office engagement. The third-party partner will manage the fund's administration and other back-office requirements.

Exhibit 1: Examples of operational transformation

Client	Initial drivers for change					Outsourced income
	Scale and growth	Self-administration	Technology	LPs	People	
Large, complex asset manager with \$80bn+ in private equity commitments and large private equity fund of fund business	x		x	x	x	<ul style="list-style-type: none"> <li>Expanded outsourcing and vendor consolidation solution allowed firm to focus more on growth (40,000+ investors).</li> <li>More efficient model is introducing opportunities to decommission systems (shadow book).</li> <li>Streamlined operating model allowed firm to focus on core business and investors and scale their fund of funds business to \$80bn with numerous product launches annually.</li> </ul>
Asset manager with \$21bn+ in private equity commitments and large private debt book. Complex closed-ended and evergreen structures	x		x	x		<ul style="list-style-type: none"> <li>Focus on technology and integration with administrator allowed the manager to efficiently scale and grow, while streamlining the review process and timeline.</li> <li>LP reporting enhancements driven by market forces (ILPA) and facilitated by operating model and scalability.</li> </ul>
A large, global alternative investment manager with a diverse and complex product offering	x	x	x	x	x	<ul style="list-style-type: none"> <li>A cohesive, bundled back-office outsourcing solution enabled client to reduce headcount and IT expenses, saving over \$4m annually.</li> <li>Automated client's reporting, reducing risk of error by 90% and enabled them to focus on enhancing investor returns, along with strategic product and asset growth and scale.</li> </ul>
Top 10 real estate manager looking to avoid major technology investment, reduce costs and simplify their business model	x	x	x	x	x	<ul style="list-style-type: none"> <li>Lift-out of personnel and proprietary technology to State Street, establishing a real estate Center of Excellence in Atlanta.</li> <li>Improved service delivery through a 25% reduction in reporting times.</li> <li>Transition of personnel from "back office" to "client service" created greater career development opportunities.</li> </ul>

Source: State Street.

### 3. A full lift-out of fund operations

A full lift-out includes technology and people. It involves the transfer of ownership of databases and systems, as well as fund administration. The fund administrator would retain the manager's staff and over time integrate the team into the fund administrator's infrastructure. The administrative work is immediately transferred to the fund administrator so that the team that remains with the manager — the "oversight team" — can quickly focus on fund oversight and asset and portfolio management. We typically see this with firms that are growing at a faster pace than their fund operational infrastructure can support.

Managers on this growth trajectory tend to require more dollars invested to upgrade their current accounting systems and technology; require more headcount, often as result of turnover combined with growth; and require a solution that can manage the increased volume of investors and their need for transparency.

There are several approaches as noted that may yield varying results depending on where the manager is in its lifecycle (see Exhibit 1).

### The execution plan

The execution process requires a tremendous amount of internal

reflection to understand the organization's key challenges and aspirations. It is critical to fully understand core strengths and which areas require a more focused effort. Once the type of transformation structure is decided upon, managers should conduct an in-depth evaluation in four areas: operations, technology, human capital and cost analysis.

#### 1. Operations

Operations covers processes, controls and risk environment. *Keep these best practices in mind before you transfer responsibilities:*

- Conduct a detailed review of the operational infrastructure to identify

gaps in your model, map the risks and create a governance framework. Identify areas typically outsourced, such as tax preparation and filing, property and fund accounting, and treasury and cash management to determine if these are strengths or weaknesses for the organization.

- Investor reporting and portals should be designed to track activity, provide insight and analytics, and deliver required documents. The ideal platform would have the ability to connect fund-level data with investor-level data.
- Create documentation that clearly delineates critical business processes, handoffs, dependencies and workarounds.
- Plan projects to clarify scope and establish a strong reporting structure to maintain control and establish strong KPIs.
- Move toward new technology, including analytical and investor tools.
- Assess the post-transition impact on other teams, such as asset management, investor relations and transactions teams that rely on data from specific technology systems.
- Data migration and whether to maintain historical data versus starting with opening balances.
- When evaluating the administrator's technology capabilities, pay attention to its investor portals, accounting platforms and analytical tools. Fund administration platforms typically

allow data to be tracked at each level of a fund structure, from the investor commitments and fund-level data through to the underlying real estate investment. These systems often involve a costly and time-consuming process of implementing and maintaining the technology in-house, which can be avoided almost entirely with a fund administrator.

### 3. Human capital

Assessing staffing needs may be the most challenging component of the outsourcing process. Ask a few

## 2. Technology

Conducting due diligence on your current technology stack, including applications, general ledger and cloud-based tools, will help you better understand process flows for critical operations, potential failure points and system dependencies. Investors require managers to have technology in place to provide detailed reporting on their investments and to provide a mechanism for transparency. Identifying and mastering the best technology applications that can support the reporting needs of investors is not necessarily a core competency of most managers, but is certainly expected of the fund administration industry.

*Best practices include:*

- Establish realistic targets for decommissioning or continuation of existing technology platforms.

## Broadshore Capital Partners

Salutes

# NAREIM

For its 30 years of leadership guiding the  
real estate investment management industry



[broadshore.com](https://broadshore.com)

Investors who know real estate.



important questions: Can your existing team evolve to meet the needs of your future-state operating model? How do you transition the team from day-to-day fund accounting tasks to a risk-based approach using analytics? In the case of a lift-out, which individuals should move to the fund administrator and who should remain in an oversight capacity?

*Best practices include:*

- Conduct a thorough evaluation of intellectual capital ensuring appropriate resourcing of the oversight function and create a strong governance framework. While internal teams are often deliberately lean, a manager builds out staff with bench strength in areas like investor relations, compliance, valuations and security. For the administrator, hiring a large team of technical experts who support multiple funds makes financial sense. The cost of building a similar team in-house can be prohibitive.
- Oversight staff should be trained on the fund administrator's platform to develop future economies of scale and serve as a foundation to drive mutual organizational success.
- In a lift-out scenario, prepare the team for new roles and responsibilities under the future-state model. The team will no longer be responsible for detailed preparation of workpapers, but will now focus their attention on KPIs, risk metrics and strengthening internal operational controls.

Proper evaluation can help your workforce grow and enhance their roles, while the organization benefits from a stronger operating model that allows it to achieve its strategic goals. The decision to move specific staff to an administrator can be challenging. However, there are clear benefits for

“ To keep the focus on managing and buying real estate assets, a fund manager can outsource its fund administration to a competent and trusted partner. ”

all parties involved. The team being lifted to the fund administrator may have opportunities to work with new clients, to move from a cost center at the fund manager to a revenue center with the new fund administrator, and career progression that is not contingent on the fund manager's growth. The team that is retained — the “oversight team” — expands their analytical capability, moves to provide enhanced support to the asset and portfolio managers, and maintains a higher focus on critical risk areas of the business.

#### 4. Cost

With the operational house in order, it's time to think about finances. Fixed overhead costs like back-office salaries and benefits in a growth scenario can be turned into a variable expense when outsourced. For example, most limited partner agreements (LPAs) allow for fund administration costs to be paid by the fund; many LPAs specifically allow for the cost of a fund administrator like audit, tax and legal professional fees.

*Best practices include:*

- When a fund is being wound down, the manager is saddled with fixed costs while not earning management fees to support the overhead and

infrastructure. An outsourced back office reduces costs.

- Consider the true cost of full-time hires, which not only includes salary and benefits, but also recruiting, training, developing and housing a team which equate to fixed costs. When using a third-party administrator, these fixed costs convert to variable costs that increase as new funds are launched and decrease as funds wind down upon reaching the end of their term.
- Consider the current projection of financial costs by category (personnel cost, occupancy, IT, outsourcing costs, others) for the next three to five years. This allows you to compare the costs of using a third-party fund administrator against your projected operating model cost as you make the cost-benefit analysis on your operational transformation decision.

## Conclusion

To keep the focus on managing and buying real estate assets, a fund manager can outsource its fund administration to a competent and trusted partner. A manager considering outsourcing should take an in-depth assessment of its own strengths and weaknesses and how a transition would impact its investors, operational infrastructure and other teams within its organization. A deep and robust evaluation of operations, technology, human capital and cost will help put an organization in a strong position to transform its operations. ♦

**Anthony Ross** is a Managing Director at State Street.

Best practices shared  
Value added

# NAREIM<sup>30</sup>

The future of real estate investment management investment and operational strategies

## NEWSLINES

A **FREE**  
digital news  
service delivered  
daily to your  
inbox.

IREI publishes four  
Newslines — each  
one contains  
stories about  
the latest news,  
transactions,  
hires, fundraising  
and more within  
a particular sector.

- Real Estate
- Infrastructure
- Real Assets Adviser
- iREOC

SIGN UP AT  
[www.irei.com/subscribe](http://www.irei.com/subscribe)

 **INSTITUTIONAL  
REAL ESTATE, INC.**

## EVOLVING HOSPITALITY:

# HOTELS *in the* Internet era

**By having creative concepts that cater to each corner of the market, big brand hotels are well-positioned to withstand changing consumer tastes and the threat of Airbnb.**

By Peter Laskey,  
Barclay Fellow

**R**ecently, my wife and I sat down to plan a weekend getaway to the East Coast. We eased our way through buying flights to Washington, DC and moved on to the task of choosing accommodations. As a seasoned hotel revenue manager, I was confident. I consider myself quite adept at booking lodging: I know the tricks to find good deals and I have the wherewithal to recognize them.

However, much to my chagrin, I was dumbfounded by the plethora of different lodging options that have sprung up over the past few years, which made my usual tactics of finding hotels a bit more complicated. There seems to be a dizzying array of options, from new brands to professional vacation rentals, hotel/multi-family hybrids, rental arbitrage hosts, micro-hotels and hostels. Even as an industry professional, I felt a little out to sea in finding the best accommodation for us due to the vastly different options available.

Just as travelers like myself might feel overwhelmed with what seems like endless and confusing hospitality

options, investors now face the same dilemma. The concept of a lodging asset has been expanded in the sharing economy. Although this definitional shift has allowed intrepid developers to push creativity, it has also caused a lot of confusion among both those in the industry and on the periphery. Cities have struggled to categorize their tax codes. Hotel franchisers seemingly introduce a new brand each year. And operators find it difficult to determine both their target audience and their main competitors.

Despite all the changes occurring within the lodging sector, big brand hotel owners have enjoyed a decade of relative prosperity and stability. Let's examine how we got here, the hotel landscape in 2020, and where we are headed in the short and long term.

### **What has changed? The brand takeover**

Traveler appetites changed over the past decade and the standardized and admittedly tired concept of a hotel was

<sup>1</sup> Julie Weed, "Independent Hotels Are Disappearing As Chains Grow," *New York Times*, October 21, 2019.

<sup>2</sup> US Lodging Industry Overview Year End 2018, Cushman & Wakefield Valuation & Advisory.

<sup>3</sup> Ibid.

<sup>4</sup> TE forecast further slowing for US hotels, *STR*, August 15, 2019.

<sup>5</sup> US hotel RevPAR projected to flatten in 2020, *Hotel News Now*, January 28, 2020.

not enough to meet those needs.

Consistent with larger societal trends, consumers began to crave authenticity and unique experiences, which they found in Airbnbs and "lifestyle" hotels. To ward off further market share loss, big brand hotel marketing and development teams strategized. The response was to build a hotel portfolio that catered to each corner of the travel market through creative new concepts and acquisitions. Whether it be price point, design, market or room type, big brand hotels now have an option for everyone.

As we enter a new decade, the fruits of hotel brands can be seen in every American skyline, airport and beach. The five biggest American franchisors now have a total of 97 brands: Marriott 30, Hilton 18, Hyatt 15, IHG 15 and Wyndham 19. These 97 brands, and many more not mentioned, sprawl out to cover the needs and desires of almost every kind of traveler. Micro-hotels (Motto by Hilton, Moxy by Marriott), wellness resorts (Miraval by Hyatt, Six Senses by IHG), and independent brands (Two Roads by Hilton, Kimpton by IHG) have all fallen victim to the brand takeover. Many boutique hotels have joined via "soft brands" (think Autograph Collection by Marriott or Unbound Collection by Hyatt), or those hotels that attempted to keep the appearance and environment of an independent establishment but have the structure and marketing engine of a brand. Even the veterans of hotel brands have been significantly altered; for example, Residence Inn by Marriott has tried to remove the tired, lonely aura of extended-stay hotels with strategic locations and fun design choices.

Over the past decade, brands have quietly consolidated, resulting in a

“ In a decade when the hotel industry began in more or less an existential crisis due to the Global Financial Crisis (GFC) and the Internet propelling the new home-sharing industry, how did it end with more brands than ever? ”

current state where the selection of hotel brands has never been greater, yet the backbone behind the proliferation remains solidly within the same handful of names. In fact, 30 years ago about two-thirds of hotels were true independents, whereas today, only about 40% are independently owned and operated.<sup>1</sup>

This begs the question: in a decade when the hotel industry began in more or less an existential crisis due to the Global Financial Crisis (GFC) and the Internet propelling the new home-sharing industry, how did it end with more brands than ever? From 2010 to 2018, US hotel demand increased 24%, according to Cushman and Wakefield.<sup>2</sup> More travelers led to higher NOIs, lower cap rates and a development surge, thus increasing total keys by 8% in the same time frame.

For a brand, however, adding keys to an urban market is tricky: in order not to dilute their demand base, existing owners usually have covenants with brands limiting the number of products in certain neighborhoods. But franchisors recognized that competitors and boutiques were capturing excess demand in these neighborhoods. This issue then became a pattern in multiple cities and, thus, helped to instigate the creation of a new brand.

In short, the introduction of new brands enabled umbrella organizations to cover more real estate within a city

without endangering existing products or alienating ownership groups.

### Short-term outlook

The uptick in hotel development since 2010 has largely been well-absorbed, with occupancy rates increasing from 57.6% to 66.2% in 2018, despite the added keys.<sup>3</sup> Nevertheless, alarm bells have started ringing, indicating a tip in the supply/demand scale.

In 2019, hotels posted their most stagnant year since the recession, with only 0.9% revenue per available room (RevPAR) growth. STR predicts supply will outpace demand in 2020 — 1.9% supply growth versus 1.6% demand growth — applying downward pressure on occupancy rates, leading to stagnant RevPARs.<sup>4</sup> The following year, 2021, is forecast to tell a similar story: 1.9% supply increase yet only 1.7% demand increase.<sup>5</sup> As the industry knows all too well from 2002 and 2009, tourism is swiftly affected during recessionary times as families and businesses tighten budgets. Although no signs point to a -16.5% RevPAR decline like in 2009, owners should be aware of the revenue challenges that lie ahead and prepare to tighten their operations.

Despite the cloudy forecast, premium-branded hotels should provide stability to owners through the next downturn. Although franchise fees for brands are generally 8% to 10%, the



<sup>6</sup> Dror Poleg, *Rethinking Real Estate: A Roadmap to Technology's Impact on the World's Largest Asset Class* (Cham, Switzerland: Palgrave Macmillan, 2019).

<sup>7</sup> Short-Term Rentals, A Maturing US Market and Its Impact on Traditional Hotels, CBRE, 2020.

backing of a brand cuts travel agency commissions from online travel agencies (OTAs) like Expedia and Booking.com from roughly 20% to 15%. And with tech giants Google and Amazon quietly diving into the hotel booking game, OTAs will inevitably become more aggressive with commission structures, potentially leaving independents as vulnerable. The brands also provide a certain reach with global distribution systems, meeting planners and corporate chain codes, as well as provide a marketing engine that is nearly impossible to duplicate as an independent.

Of course, independents will still endure, especially in the luxury and resort segments, and their bottom line will benefit from reduced franchise fees. But as we move into a potential recessionary period over the next 24 months, the backing of a brand seems to be especially prudent. In the recessions of 2002 and 2009, independents saw a greater RevPAR decline than many of their branded competitors. Economy, midscale, upscale and upper-midscale hotels all fared better than independents. While all segments of travel see immediate and dramatic effects from turn downs in the economy, business and convention travel tend to stay afloat better than leisure, and the backing of a hotel brand helps enormously when chasing business accounts or convention groups.

### Long-term outlook

Moving beyond the next few years, the traditional premium-branded hotel model will prove to be viable and stable in the long run. It is true that much of the gains reaped by hotels since the GFC can be attributed to general

“ The traditional premium-branded hotel model will prove to be viable and stable in the long run. ”

macroeconomic growth, but credit is also due to hotel operators, owners and franchisors for the creative work done to ward off the threat of home-sharing. Hotels have become so “cool,” for lack of a better word, that vacation rentals and Airbnb seem like much less of a threat than once thought. Ten years of growth and a record-setting 2018 indicate that mainstream travelers, both domestic and foreign, still prefer the safety, comfort and amenities of traditional hotels.

As Dror Poleg indicates in his book, *Rethinking Real Estate*, it seems that even Airbnb themselves have recognized the limited growth of their home-sharing platform. In recent years Airbnb has invested heavily to diversify its business: incorporating hotels and even flights into its booking engine and continued experimentation in multi-family development partnerships. In fact, as Poleg points out, a Merrill Lynch study in 2017 indicates that shared lodging “could be more niche than previously thought.”

Taking it a step further, Poleg contends that the 2020's iteration of Airbnb could potentially disrupt multi-family development more so than hotels.<sup>6</sup> CBRE points out that the growth of short-term rentals available has slowed dramatically from exponential growth in the early part of the decade to 39% growth in 2018 and 26% growth in 2019. They are forecasting only 19% growth of short-term rentals available in

2020, with a large chunk of that in rural and suburban markets.<sup>7</sup>

The moral of the story is: Airbnb did not do to the hotel industry what Netflix did to movie rentals or what Uber has done to taxis. Despite the expected economic slowdown over the next two to three years, the hotel industry is not facing an existential threat like once thought and will continue to delightfully serve the world's travelers.

### Conclusion

As my online search of accommodations in DC showed, the lodging market has undoubtedly changed over the past decade. However, hotels have landed in a comfortable spot post-Airbnb and GFC. The products of big hotel brands have proven to be stable investments, friendly to lenders and investors alike, and more recession-proof than their independent counterparts. More importantly, they are still the preferred choice of most travelers, as the expanded offerings match modern tastes. The short term might see some casualties as supply outpaces demand, but days like those in 2009 are far in the rearview mirror. It's not all roses — it never is in hospitality — but it increasingly appears as though hotels have survived the threat of home-sharing and will continue to push the envelope on creativity, authenticity and comfort that travelers enjoy. ♦

**Peter Laskey** is a 2019–2020 Barclay Fellow and an MBA candidate at the Graaskamp Center for Real Estate, Wisconsin School of Business at the University of Wisconsin Madison.



# MIXED-USE RE-MIXED™

Lionstone is reimagining mixed-use by combining different product types to create *real experiences* — not just real estate.

**Investing in Places for Productive People.**



Lionstone Investments is an offering brand of Lionstone Partners, LLC,  
which is a wholly-owned subsidiary of Columbia Management Investment Advisers, LLC.



# YOUR PARTNER

for responding to crisis and  
returning to business.



**Industrial Hygiene and Pandemic Response Services**



**Environmental Consulting  
& Remediation**



**Building Engineering  
& Assessments**



**Construction &  
Development Services**



**Energy & Sustainability  
Consulting**

**PARTNER**  
Engineering and Science, Inc.

(800) 419-4923  
[www.partneresi.com](http://www.partneresi.com)