BUSINESS CYCLES

Present Human Capital Opportunities and Challenges:

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

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

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

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

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

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

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

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

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

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

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

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

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

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