terrasearch PARTNERS

REIT.com

November 28, 2012

REITs Looking Forward to 2013

Matt Slepin

REITs have enjoyed a great run coming out of the recession. With their access to the capital markets, REITs were among the early buyers and most have used this window to position their balance sheets for stability and strength going forward. With the election over and, hopefully, continued recovery ahead, what are some key things to watch for in 2013?

From our perspective, there are four measures that form the basis for long-term success in this business -- strong leadership teams, strong operating platforms, strong balance sheets, and a portfolio and strategy that resonates within a particular sector. If a company has these four key attributes, chances are high that it is poised for long-term success. Success is possible in the absence of any one of these elements, but missing two or more suggests it is time for meaningful change. These elements also provide a useful framework for understanding the trends that may lie ahead of us in the coming year.

In general, the order of the world is for the strong to get stronger, which in many cases just means that the big get bigger. Just look at the recent announcement that Lehman has given up on the Archstone IPO in favor of an acquisition by Equity Residential (NYSE: EQR) and AvalonBay (NYSE: AVB). Archstone had a strong team and operating platform, but EQR and AVB's size and scale won out. Over the long-term, there is not a lot of room for mediocrity in this business. What this likely means for the industry is that there will be more M&A while still some go-publics in 2013.

This march toward scale is particularly prevalent in the industrial sector -- who could have imagined the global size and scale of ProLogis/AMB (NYSE: PLD) half a dozen years ago? In the mall sector, the big three or four aggregators have used their critical mass to their advantage so successfully, particularly with their retailer clients. Similarly, a company like Digital Realty Trust (NYSE: DLR) has managed to gain a head start and scale in their niche sector. The apartment sector is fairly democratized, which suggests opportunity for M&A, although technology and other factors act as levelers in that business.

I recently wrote an article for NAREIT that articulated a debate on the importance of operating platform. Several of the REIT watchers with whom I spoke minimized the relevance of operating platform, saying that "they are all kind of good at it." With scant empirical data, but as a real estate practitioner in the human capital business, I cannot help but believe in the importance of great people and a great platform as a major factor in a company's long-term success. The investment in operating platform at the types of companies mentioned above is enormous; they are not just a collection of assets -- each has created operating platforms that distinguish them from both from other REIT and non-REIT competitors. REITs have the luxury of investing in their platform over the long term and those that do should distance themselves from their competitors.

In addition, balance sheet matters a lot, and one aspect of platform is access to private equity – those REITs that have created ongoing off-balance sheet ventures will compete more effectively through different cycles in the capital markets.

Politics continue to be tremendously important. We are still hopefull that the country will make it successfully across the fiscal cliff. However, this does not mitigate concerns about political gridlock and the ability of Washington to move forward in a problem-solving fashion. For the apartment sector, it is possible that the GSEs will be reorganized in 2013, meaning that the apartment REITs could lose their access to Fannie and Freddie money. That would take away a comparative advantage that apartment REITs now enjoy over other REITs; however, with their access to Wall Street, the listed apartment REITs might then gain additional advantage over their non-public counterparts.

One last thought in looking forward to 2013 is looking at the composition of the executive suite in REITs, particularly as compared to corporate America. Looking at CEOs and CFOs at the top 60 REITs (by equity market capitalization), the average CEO tenure is just a little more than six years, compared to more than eight years in corporate America. This means REITs have a relatively fresh group of CEOs. Fourteen of the 60 REIT CEOs are 60 years or older, so watch for succession moves in those companies. In terms of CFOs, quite often the successor to the CEO, current REIT CFOs have an average tenure of just under five years, while the average tenure of a CFO in corporate America is just over five years. Also, while only 5 percent of REIT CEOs are women (compared to 12 percent among the Fortune 500), 18 percent of the REIT CFOs are female; hopefully, this portends a continued move toward more women in the top slots in our industry.

So, 2013 should be an interesting year for the REITs and their leadership teams. There is plenty of opportunity, but the business still must be ready for threats, continued evolution, and change. Stay tuned.

About Matt Slepin

Matt Slepin is the Founder and Managing Partner of Terra Search Partners, a retained executive search firm helping real estate companies build great teams. Terra Search Partners serves many of the country's foremost REITs, private equity firms, pension fund advisors, private developers and owners, family owned businesses and non-profits. Matt writes frequently on matters pertaining to human capital in the real estate business. To see additional articles written by Matt and others at Terra Search, click through to www.terrasearchpartners.com. Contact Matt Slepin at matt@terrasearchpartners.com or 415.433.2244.