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Can We Put a Value on REIT Leadership?

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By Matt Slepín



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What role does the quality of a company's leadership play in the evaluation of firms by REIT buyers? For this article, we asked several REIT analysts how good (or poor) leadership and management is priced into the value of real estate companies. In other words, what do REIT watchers think constitutes a well-run real estate company?

Clearly, the quantitative factors and an analyst's ability to find insights into the numbers, the portfolio, and the property sector are the most important drivers of a company's value. However, qualitative factors are also key differentiators, and the consideration of these less tangible metrics is the art of the stock analyst.

Two themes topped the list in most conversations. First and foremost, "have they screwed up the balance sheet," was the mantra of several of the analysts. Secondarily was how well a company has allocated its capital. Has the company timed its investments well (both acquisitions and dispositions) or have they followed the pack and gotten in late? Management of the balance sheet and a savvy investment track record is definitely attributed to the work of the "management team."

There was less consensus on the importance of human capital and how to evaluate it. One analyst said he just doesn't go there. "It is hard for us to compare how one company operates versus another," he explains. "The REITs are a bunch of 'A' students when it comes to operations -- they are all kind of good at it." When asked if a strong platform might matter more in operationally driven sectors such as multifamily, the answer from this analyst was the same. "No, real estate is essentially a commodity business," so operational differentiation is not particularly meaningful."

Others clearly see meaningful differentiation between companies as operating businesses. One analyst, who has clearly given deep thought to these questions, says that the strength and track record of management is "layered" into his analysis. His use of the word "layered" is interesting, because it conveys that his thought process on this topic is subtle and iterative, rather than formulaic. As examples, he talked about how sheer size and scale has changed the game in the mall business. He contrasted that to the apartment business, where size and scale by itself is less critical but development capacity and operational excellence does differentiate firms.

One investor noted, "As a value investor, I only buy at a discount to NAV, so I have to buy leadership for free." He would not elucidate on how he values leadership, since that is a "secret sauce". Another analyst discussed a REIT for which he has a sell recommendation. Despite the fact that the company is trading at a meaningful discount to NAV, he nixed the strategy articulated by the CEO, its investment track record, and its operating platform as compared to its peers. What's left? Triple whammy.

Several people were able to articulate the negatives more clearly than the positives. Corporate governance, reasonable pay packages, concurrent board terms, and general bad boy behavior came up in several conversations. The phrase "CEOs are stewards of their investors' capital" came up in several conversations. One analyst remarked that "some investors will never invest in a bad management team, even if there is a big discount" in the stock. "Why could Maguire Properties not raise capital even though they had a good collection of assets?" he asked.

While pulling together my conclusions for this article, I had a discussion with a senior REIT executive. I told her that I was not getting a consistent message on the theme of management from my conversations. She was not surprised that corporate excellence is often not considered in valuing companies in our industry. Indeed, she has based much of her leadership on culture and organization, as well as balance sheet and investment performance. She said that she works for three masters – her investors, her employees, and her tenants (customers) – and that culture and excellence of operating platform are key drivers, if not for her investors, then clearly for employees and customers.

In writing this article and as a recruiter, I was seeking confirmation that leadership, operational excellence, and a strong, inclusive corporate culture are clearly valued among investors in the REIT world. Some called out these factors, but others I spoke with minimized their importance. While I did not find a clear consensus or consistent articulation of value for

leadership, we all know that there are great companies, there are middle-of-the-road companies, and there are poorly-run companies in our business. The differentiators are subjective, hard to value, but we all know there are there and ultimately that they matter.

About Matt Slepín

Matt Slepín 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 Slepín at matt@terrasearchpartners.com or 415.433.2244.