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LEADERSHIP MATTERS

A discussion with Michael Schall, CEO of Essex Property Trust

I'm doing a series of interviews with Bay Area real estate CEOs to talk about their views on leadership, culture and the concept of "DNA" built into today's leading real estate companies. This interview is with Mike Schall, CEO of Essex Property Trust. In orchestrating the 2014 Essex-BRE merger, Schall created the country's third-largest apartment REIT and the only apartment REIT fully focused on the West Coast markets.

SLEPIN: We'll talk today about my favorite theme, which is that real estate has evolved into an institutional business over the last 20 years so that now we have real estate companies that are as much about their culture and business platform as they are about their collection of properties. I'd like to talk about that as a general thesis, and then explore this thesis as it relates to Essex.

SCHALL: When I grew up in this industry, the only "corporate culture" was to figure out how to acquire real estate and then do everything imaginable to create value at the property level. Time passed, organizations grew, things got more complicated, and there was a need to standardize processes. When you reach scale, actually, the cost of creating a world class operating platform is not that great relative to the value of the company or the value of the combined properties. In fact, you must have such a structure so you don't have parts of the organization going in vastly different directions. You need consistency and creating this level of

consistency causes a different kind of culture entirely. This is a long way of saying that I think your thesis is exactly right.

SLEPIN: How do these concepts apply specifically to Essex?

SCHALL: It wasn't that many years ago, maybe ten years ago, that the property managers reported directly to the CEO. There was excellent communication from each property to the CEO. Today? It's probably four levels away. People assume that the senior leadership knows more about what's going on than they actually can.

Managers filter. Because they don't want things to reflect negatively on them, some would rather "manage" an issue than report it. This dynamic is critically important—and new to us, and dealing with this dynamic means quickly becoming focused on systems.

You want your systems to be comprehensive, easy to use, and as efficient and as integrated as they can possibly be because in so doing you are going to make the job of the training people and sharing information with other support staff much easier.

SLEPIN: Did things change much, in terms of systems, after the merger with BRE?

SCHALL: I'll paraphrase George Marcus about the merger. He says, "The complexity of an organization is exponentially larger relative to its linear growth. If you double in size don't expect it to double

in complexity. You'll actually become four times as complex." I agree with that concept! With greater complexity, you have more communication issues because you have those layers I was referring to. You try to offset those things with the benefits of scale. With respect to the BRE merger, we have the ability to pick the best people to lead a variety of functions, and pick the best strategies. And you get to have the ability to leverage your systems investment over many more properties. The result is a world class platform, staffed with the best and brightest people.

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There are also financial benefits to size, too, because investors like size, and so therefore your debt is cheaper. Your equity generally trades a little better. So, overall, you have a lower cost of capital. With a merger, the downside challenges are immediate, overnight, as soon as the merger closes. The upside benefits do not present themselves immediately. You have to continually reevaluate the business and how you provide service. Are you leveraging the people properly? That comes over time, and I think we are still only a third of the way to where this could be going.

SLEPIN: You once told me that you thought that the value of technology is overrated in the apartment industry. Do you still agree with that sentiment?

SCHALL: Nowadays, I'd rephrase that to say the pioneers are the ones with arrows in the back.

Our industry has been a late adopter of technology.

From an Essex standpoint, we want to adopt prudent technology, not just the shiny new thing. We used to have a lot of proprietary

systems. Today, improving the integration of 3rd party systems is the trend. You want all of the data to flow seamlessly. For example, leases originate out of one part of your system. You want to execute the lease and update databases, and hook everything up to a residential portal. You want all of this data to flow through a single system once a lease is executed. We are now at a point where this actually exists and works efficiently.

SLEPIN: Which relates back to our original thesis about the importance of systems and platforms, and the evolution of the business over the last 20 years! Data flow is a great example that a great company is not just about the collection of properties.

SCHALL: Yes, because we are now at a place where customized software is creating systems that all work together. Yardi would certainly be one example of this. Yardi has been highly collaborative with users to refine and improve their suite of products. You can see an industry working together on the systems of the future.

SLEPIN: So you take a company like Yardi, who has to be responsive, especially its biggest customers. The REITs are big enough to afford to lead the way and then the industry can draft behind. Do you actively work with your competitor-peers on technology and, shall I call it, industry best practices?

SCHALL: Sure, some sharing of information is certainly there, although there are a variety of software solutions being used. And communication between software vendors and users are improving as well. I think as time goes on, more and more collaboration with respect to software vendors and major owners drives exactly what you are talking about.

And look, we are very fortunate here in the Bay Area. Essex operates in a supply constrained market where demand is greater than supply is the norm. The people in Texas are not in that type of market, and I marvel at what they achieve, because they are bluffing with a pair of twos.

Another thing about real estate today, especially in the REIT space, is that it's no longer proprietary. Investors share information when they sell some of this stock and buy someone else's stock. Then they say, "Well, here is what Essex is doing." There are not a lot of secrets within the industry, because information passes around via investors. We actually become more and more alike as time goes on. For example, in the last year the brokers have started talking about "accretive" versus "non-accretive" deals. For years this concept was part of the Essex secret sauce! Now even the investors, and the real estate brokers are talking about it. "Yeah, I've got an accretive deal for you." Incredible. It's more and more out there.

SLEPIN: I bet. So are there other companies you most admire? Are there competitors you most admire?

SCHALL: I'll say this: the better companies survive. We went from roughly forty multi-family companies in 1995, and there are fewer every day. The best companies survive. It is a very competitive group of people. I know them all. I think it's just a great industry. There are a lot of very thoughtful, smart people in our space. I love it!

SLEPIN: I would agree with that. And think it's a good place to end. Thank you! 🍷