REAL ESTATE FINANCE

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WHERE ARE THEY GOING? WHAT DOES IT MEAN?

During the recent Pension Real Estate Association Meeting, David Shulman reminded us of "where the 1500 SATs had gone." In the 1960s, we needed to beat the Russians so they went into Aerospace Engineering. (A few very bright hippies went in a different direction but the splash they made was relatively short lived.) In the 1970s, the bright (and aggressive) went into oil and gas as well as the legal "profession." In the 1980s, the action was in real estate with the biggest boom in talented people since George Washington opened new parts of Virginia in the 1750s. The 1990s, as we all know, have been about telecommunications in general and the Internet in particular. How could smart people not be attracted to a new infrastructure more powerful than steam ships, rail roads, and automobiles put together.

All this is important because we 1400 SAT types tend to realign when the top people shift. Compensation levels change and the type of people doing different jobs changes. Today the loudest cry from Zell to Zuckerman is about the difficulty of keeping good people .

People clearly matter. As people move, the way investments are managed changes and these changes may necessitate changes in investment strategy. The people competition isn't just with dot.com land, the modern real estate equivalent of "how to keep them down on the farm"; it is also between sectors within real estate.

Consider the REITs. In the middle 1990s, lots of smart and entrepreneurial people "went public" to access cheap capital. Below the primary ownership group, the key people were to receive a good portion of their compensation from stock options. As it turned out, the REITs were really value companies and value companies with high dividend payouts don't produce a lot of "option value." This has led to several departures and the aforementioned Zell-Zuckerman lament.

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This isn't necessarily bad. One doesn't want an entrepreneurial "deal guy" running a value company. Increasingly, as this realization seeps in, the REITs are looking more and more like "core" real estate. There is still some FFO pop from acquisitions and development, but most of the income is from running existing portfolios.

If the REITs are no longer growth vehicles but value companies, then pension funds might be more interested. After all, if you can get invested quickly at below net asset value and have enhanced liquidity, why would you want to pay big fees to an investment advisor to buy individual buildings? This pushes the traditional investment advisors toward "opportunity investing" to keep up volumes, fees and personal compensation. Unfortunately, it's very late at the opportunistic party. This realization has led some people toward private development. Of course that isn't any bed of roses as few markets suffer from under supply and today's lenders want to see some real equity.

The movement of people within real estate continues, as does the movement of some high quality talent out of real estate. Interestingly, this is happening just before a major change in the real estate business; and, as Shulman pointed out, change is what usually draws the smart people into an industry.

Why is it safe to forecast a major change soon for real estate? Because real estate has been and continues to be one of the least transparent and most transaction inefficient industries in the world. The telecommunications revolution enhances productivity and kills profit margins by making things more transparent and transactions easier. Real estate is today both the most exposed and as yet relatively untouched industry. Will the Web totally bypass real estate? Not likely. The period of change is close, the magnitude will be large and lots of people are soon to be doing different things for different firms. Hopefully, the 1400 SATs who are left in our industry will be up to the task.

Mike Miles
Editor