

Analyze This: Looking Beyond the Numbers

by Matt Slepín

In the column “Leadership, Leadership, Leadership” (March/April Portfolio), I explored the premise that leadership has replaced location as the distinguishing characteristic of real estate companies, at least for those firms in the public markets. For this column, I tested that premise and took it a step further by asking some analysts and institutional REIT buyers what they look for in real estate stocks besides the numbers. A number of consistent themes emerged.

The first recurring theme was that the public markets call for specific behaviors and that the most successful public real estate companies have fully adapted to this reality.

When asked what behaviors are desired, one REIT buyer said, “we look for a sensible strategy that is well articulated and consistently acted upon, with lots of transparency, and few surprises.” For analysts and investors, the best companies are great fiduciaries for their shareholders and are driven by building shareholder value first and foremost.

Transparency, disclosure and communication were words that came up again and again in my conversations. Several analysts spoke about the importance of long-term relationships and building trust over time with management teams. Mistakes are accepted, particularly if the management team is seen as learning and not developing a pattern of egregious mistakes that dilute shareholder value. The Enron debacle permeates the landscape and transparency helps counter this risk.

In addition, the public markets bring numerous advantages over private companies and the best companies have learned to maximize these benefits. Taking advantage of these benefits means many things, including the demonstration of a consistently savvy, sophisticated approach to corporate finance.

The public markets allow a wider range of property level and corporate finance vehicles to be used. Since rates and different finance windows are open on a somewhat cyclical basis, companies that, over time, use this range of resources wisely are well respected among analysts and institutional investors. Maybe because this is a discipline that develops with experience, the companies further along the public-company learning curve clearly distinguish themselves in this regard.

Strategic Advantage

A frequent theme expressed by analysts and REIT buyers was that the best companies have developed a well-articulated strategy and gained a natural advantage through which to excel over their peers in its implementation.

For example, AvalonBay Communities, Inc. and Cousins Properties, Inc. have developed great discipline as developers and are (usually) rewarded for the risks associated with employing this strategy. Other companies may try development, but do not have the focus and do not receive the same rewards in the marketplace. Vornado Realty Trust is known as a great deal shop and is given leeway by the investment community to pull off complex transactions. Their sheer size distinguishes Equity Residential and Equity Office Properties Trust from the competitors in their respective sectors.

This reminds me of the famous interview that Roger Mudd had with Ted Kennedy during his run for the 1980 Democratic presidential nomination. Somewhere in the middle of the interview, Mudd asked Kennedy exactly why he was running for president, particularly against an incumbent Democrat. Kennedy, who had been doing well until then, was stunned and

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could not answer that most basic question. His candidacy died. My guess is that those companies that cannot clearly articulate their reason to exist will be merger fodder; the bellwethers know where they are going and why they are going there.

Taking the Lead

There was little surprise that a third theme was that leadership at the top does indeed matter to REIT buyers and analysts. The companies that received rave reviews were typically lead by the industry's most-respected CEOs. On the flip side, companies that were not in favor with the industry watchers I spoke with had the least-respected executives.

I was surprised by one analyst's comparison of two of the industry's most illustrious CEOs. "Mr. X gets it and keeps pushing the envelope to think about how the company can do things better. Mr. X is trying hard to figure out how to be a world-class company; he keeps looking at market-leading, non-real estate companies for inspiration," the analyst said. "Mr. Y pays lip service to that stuff, but he still has a transaction mentality. He talks first and foremost about real estate assets and real estate markets. Mr. Y is comfortable in the role and resting on his laurels." The analyst added that, not surprisingly, Mr. X is also light years ahead of Mr. Y in terms of disclosure issues.

In many ways, Mr. X represents the new breed of executive who looks to transcend the genre. I know and respect both CEOs, so we are talking about gradations of excellence here. But that is what the future of this business is about and these comments were a call to what skills will be valued going forward.

Valuing a Solid Team

Although top-level management is critical, the analysts and REIT buyers agreed that leadership throughout the organization is just as significant. The group spoke less about individual CEOs impacting their views than they did great leadership teams. The collective strengths, tenure and working relationships of the leadership team (primarily the three Cs—CEO, CFO and COO) seemed more important than the individual strength of just the CEO.

When analyzing companies, those I spoke with were interested in issues like the depth of the management team, succession planning, diversity, independence of the board of directors and overall esprit de corps. The analysts wanted to see the overall qualities of the organization being demonstrated in the field as well as at the corporate headquarters. Most analysts perform property tours and look not only to the quality of the real estate assets they visit, but the strength and spirit of employees in the field.

This brings me to one of my favorite personal stories about REIT management. Several years ago, my wife worked in an Equity Office building in San Francisco. Every time I stopped at her building, the doorman would say hello, ask about my daughter, Cali, and say something like "Diane hasn't come down yet, should I call her for you?" This man's level of service so knocked my socks off that I wrote company chairman Sam Zell to acknowledge his work. Shortly after, Zell sent him a personal note of commendation for customer service. In the end, I don't know which was more impressive, the doorman's service or the acknowledgment he received from the company due to my letter. In a business that will increasingly be more about customer service than making deals, that is evidence of a company that gets it.

Overall, the industry watchers agreed that maximizing shareholder value in public companies is not about excelling in one skill (merely amassing great real estate assets), but about sustaining excellence in the range of disciplines needed to run a public company. Everything matters—transparency, teamwork, governance, capital markets savvy, acquisitions, asset recycling, property management, customer service.

The companies that investors and analysts recommend can answer the Roger Mudd question without hesitation. They have a cogent strategy and an internal ability to execute that strategy better than their peers.

(Author Credit: Matt Slepian is an executive recruiter based in the San Francisco Bay area.)