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CO-INVESTMENTS: the fourth pillar of incentives

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NAREIM dialogues

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When deals are down, revenues are tight and managers are looking to better control expenses, how do you retain staff?

NAREIM spoke with Tim Kessler, global COO of LaSalle Investment Management for this issue of *Dialogues*, on what he calls the fourth pillar of incentives: co-investment. He believes it gives managers a competitive advantage when attracting and retaining talent, next to the other pillars of salary, bonus and carried interest.

Traditionally an opportunity offered only to a select group of senior-level executives, firms are increasingly looking to expand this incentive program to a greater number of employees.

Part of the LaSalle's rationale is that, by having employees commit 2% to a product alongside a client, co-investment can create alignment with investors and teach employees to think like them. Additionally, it can increase collaboration within the firm and make employees feel like they are a part of something bigger within the firm.

However, there are substantial hurdles to overcome. The administrative burden is a big one, and success depends on C-suite buy-in.

"Without [CEO Mark Gabbay's] conviction, this would not have happened because it is complex, expensive and hard," Kessler said.

For the next generation, it takes more than a name and salary to attract the junior talent in today's market. As NAREIM's Jeff Barclay Fellow Jackie Siegmund writes, Gen Z is looking for mentorship opportunities and a visible career path.

Siegmund, an MBA candidate, conducted a survey among fellow NYU Stern School of Business students planning to pursue junior and mid-level roles in the real estate industry to find out what they are looking for.

Outside of compensation, 60% chose their potential managers' personality and management style as one of the top three most important factors when considering a role. Of those, 71% listed it as their number one consideration. Amid increased flexibility around working from home, junior employees want to see senior members in the office and learn from them.

Cash remains king for analyst and associate/VP job seekers, but the latter also want compensation in the form of carried interest structured for their level.

As Justinn West-Wheatley, HR Business Partner at BentallGreenOak summed up: "It's not just about getting people in the door. It's making them feel comfortable when they're here. That is what's going to lead to retention."

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DC *flows into* REAL ESTATE SOLUTIONS

Daily valued real estate funds that include private real estate offer greater diversification and lower volatility than REITs alone, delivering bricks-and-mortar real estate benefits to defined contribution plans. Market volatility in 2022, combined with private real estate's strong post-Covid performance, resulted in enhanced rebalancing needs due to the denominator effect. Managers of daily valued real estate funds experienced rebalancing outflows in 1H 2022 but are again seeing positive flows. However, investor prioritization may be an issue for new cash flows.

NAREIM spoke with* **Clarion Partners, JPMorgan Asset Management, PGIM Real Estate** *and* **Principal Real Estate Investors** *to get a real-time pulse of the DC market, as well as to understand DC real estate appetite in times of market stress and manager considerations surrounding liquidity and rebalancing.

By Zoe Hughes

PARTICIPANTS

Tripp Braillard
SVP, Head of Defined Contribution Distribution, **Clarion Partners**
In his role, Tripp is focused on the distribution of Clarion's products within the US institutional defined contribution channel. He joined Clarion Partners in 2022 and began working in the industry in 1993. He is a member of the Defined Contribution Real Estate Council (DCREC), Defined Contribution Alternatives Association (DCALTA) and Defined Contribution Institutional Investment Association (DCIIA).

Jani Venter
Executive Director, **JPMorgan Asset Management**
Jani is a member of the Funds Management Team and leads JPMorgan's Defined Contribution (DC) Real Estate Solutions. She serves as Co-president for the Defined Contribution Real Estate Council (DCREC), and actively contributes to the Defined Contribution Alternatives Association (DCALTA) and Defined Contribution Institutional Investment Association (DCIIA).

Sara Shean
Managing Director, **PGIM Real Estate**
Sara is a portfolio manager for the PGIM Retirement Real Estate fund series. She has over 20 years of defined contribution experience and is actively involved in the Defined Contribution Real Estate Council (DCREC), Defined Contribution Institutional Investment Association (DCIIA), Defined Contribution Alternatives Association (DCALTA) and Defined Contribution Investment Forum (DCIF) in the UK.

Diane Smola
Managing Director, **Principal Real Estate Investors**
Diane joined Principal in June 2021. Prior to her current role, Diane led consulting relationships with advisory and delegated corporate, public and higher education defined contribution plans at Aon. She is actively involved in the Defined Contribution Real Estate Council (DCREC), Defined Contribution Alternatives Association (DCALTA), Defined Contribution Institutional Investment Association (DCIIA) and IIDC Institute.

Participants' DC offerings

Clarion Partners: One DC product with $170 million AUM.

JPMorgan Asset Management: $4.5 billion in DC real estate AUM across a number of direct private and blended private/public solutions.

PGIM Real Estate: Two products in the daily valued DC space with $3.5 billion combined AUM.

Principal Real Estate Investors: Daily valued and daily liquidity ODCE fund since 1982 with $13.3 billion AUM.

The market was volatile in 2022. How was it for real estate DC flows?

Tripp Braillard, Clarion Partners: DC capital raising slowed a bit in 2022 as the year progressed, mainly due to the so-called denominator effect. Private real estate performance was relatively strong for most of the year compared to the downdraft in the public equity markets. This led some institutional DC plan sponsors and trustees needing to rebalance away from strong performing assets like private real estate to stay within their target allocations.

Despite the slowdown in inbound capital flows, plan sponsor interest in DC real estate strategies weren't affected. The investment case spoke for itself during 2022: private real estate acted differently, helping buoy portfolios, which is the diversification effect that plan managers are looking for.

Sara Shean, PGIM Real Estate: From the DC perspective, 2022 was really a tale of two halves. In the first half of the year, we experienced a negative cash flow environment as real estate outperformed equities and bonds. The rebalancing moved away given the denominator effect that Tripp mentioned. As real estate values began to come down in the second half of the year, we saw the flows reverse and ended up in a positive cash flow mode. This trend has continued into 2023 to date.

For the full year of 2022, we ended just in negative territory across our two funds in terms of cash flows. But if we include the first quarter year to date, then we're slightly positive, even ahead of where we were in 2022; I would say the previous 12 months were neutralized.

Despite negative rebalancing activity in the first half of last year, we were fortunate that our second product was buoyed by new cash flows coming in. That kept that product in positive cash flow territory in each quarter of 2022. As we look at our pipeline for the first half of this year, we have about $150 million expected to fund by mid-2023. However, committed capital is going to be tricky this year, because it's a matter of when that capital will be freed up to be reallocated.

Although the near-term outlook for private real estate may be challenging, we are hearing from a number of plan sponsors who are now, after experiencing the volatility of the last 12 months, interested in having a discussion about more portfolio diversifiers. So, I do think that some of that dislocation and pain will lead eventually to opportunity in this space.

Jani Venter, JPMorgan Asset Management: I echo Sara's comments on renewed positive momentum. Market trends continue to drive positive new flows into the asset class. We are seeing new investors allocating to real estate and existing investors increasing their allocations as a result of the strong benefits they recognized across time periods, but especially since Covid.

If you think back to the exceptional returns that core real estate delivered in 2021, the rebalancing that occurred in the first half of 2022 year was not surprising. It was more the magnitude of the rebalancing requests that stressed real estate liquidity, largely driven by volatility in the stock and bond markets. You don't have to look further than 2022 for proof that DC plan participants benefit from the inclusion of private real estate. Not only was 2022 among the worst years for a 60/40 portfolio since the mid-1970s, bond performance actually amplified the pain felt in stocks. It is times like these when exposure to private markets can result in meaningful improvements to retirement outcomes.

Over the short term, aggressive interest rate hikes and fears of recession have resulted in shifts in real estate pricing. Real estate continues to be a strategic long-term allocation, demonstrating its net of fee benefit and ability to strengthen participant retirement outcomes across market cycles.

Diane Smola, Principal Real Estate Investors: In the first quarter of 2022, we anticipated more rebalancing than we actually received, but the second quarter was much more active for us in terms of DC plan rebalancing requests.

Looking forward, I think there is some hesitation on timing by investors, as many expect some continued weakening in the market as the Fed rates move higher. We have demand from new clients of our DC OCIO [outsourced chief investment officer] investors. Since onboarding takes some planning, we look forward to matching the timing of those new investments with what may be a very favorable vintage year for investing in core private equity real estate.

We're still looking at a market where there's some capitulation expected on both sides of the transaction in terms of pricing, both from sellers and buyers. We see more opportunities in the market in terms of investment looking forward, especially versus the last quarter of 2022 when there was a fair amount of transactions brought to market, but also those removed from the market and not closed.

“Market trends continue to drive positive new flows into the asset class. We are seeing new investors allocating to real estate and existing investors increasing their allocations as a result of the strong benefits they recognized across time periods, but especially since Covid.”

TB: It was a very similar story for us. Rebalancing in the third quarter was negative for us, but overall we were positive for 2022.

Do you expect this trend to continue in 2023?

SS: As a whole, we should be expecting to see positive cash flows for 2023, given where we are in terms of real estate values compared to equities and fixed income.

The interesting quandary for us is, we're first movers. The flows in the DC space and the DB [defined benefit] space tend to move in opposite directions; I would say DC tends to move earlier. Because DC plans are rebalancing so much more frequently than DB, we see the flows start to move away more quickly and we also see the flows start to come back more quickly.

JV: DC investors and consultants are increasingly recognizing the value proposition of including private real estate in retirement portfolios. We have included private real estate in DC plans for over 15 years and have successfully managed portfolios through prior periods of market inflections. Looking ahead, DC plans with existing exposure could support positive flows if equities continue to recover. For new investors, the current pricing dynamics in real estate may present a unique entry point in late 2023, which could drive flows into the asset class.

DS: We are anticipating positive cash flows from DC investors in 2023. Conversations are ongoing as more plans are looking to increase allocations to inflation-sensitive assets, not only within their target date funds, but also within real asset/inflation-sensitive white label funds.

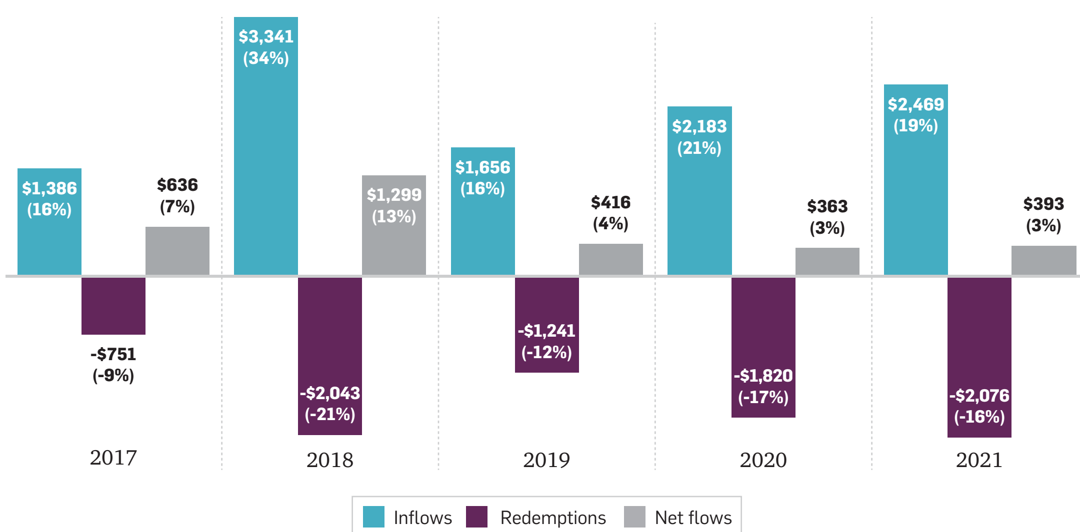
TB: I think the downward rebalancing trend that we saw in 2022 will not continue for two reasons. First, the markets have stabilized and I don't believe we're going to see a dramatic divergence between public and private markets like we did last year. Second, there's optimism in conversations with potential prospects. We're having more frequent and better conversations with plan sponsors and consultants, and generally seeing a lot more interest.

CHALLENGES WITH REBALANCING

Rebalancing was the issue of 2022. What is the best approach to rebalancing in times of market stress?

DS: As I mentioned earlier, we saw fewer rebalancing requests in the first quarter of 2022 than we had anticipated. We did see an increase in them in the second quarter of 2022 as the market started to reconcile a higher interest rate regime and likely downward pressure on real estate pricing. I do think that there are lots of conversations about the size of that

1. Total private real estate DC capital net inflows fell in 2022 but are recovering in 2023



Note: % represents total capital flows as a % of AUM for a sample set of respondents.

Source: The Defined Contribution Survey 2022.

rebalancing range, and investors are moving from a very tight rebalancing range to a lot more flexibility in that range than perhaps they had a few years ago. In a time of significant market dislocation, that flexibility can be helpful for investors.

TB: At Clarion, we serve a broad array of institutional clients and see organizations take different approaches to rebalancing. We see three primary types of rebalancing approaches among our investors. The first is very strict, with no flexibility relative to their target portfolio allocations. These tend to be plans that require rebalancing by statute; public plans tend to fall into this bucket. The second is multi-asset programs that have bands which give the fiduciary some flexibility. Typically, the fiduciary would let real estate run to the upper levels of those bands to avoid unnecessary transactions. Finally, there's full discretion. These firms allowed their real estate allocations to run high in late 2022, because they expected the pendulum to swing back and the market to come back to equilibrium.

JV: There are investors and consultants that are of the opinion that systematic rebalancing isn't always in their clients' best interest, especially during a period such as the first half of 2022. They are willing to step back and take a light touch on rebalancing to ensure the diversification and downside protection is recognized, and not rebalanced away into underperforming asset classes.

To Tripp's point, there are also clients that, from a fiduciary standpoint, have strict guidelines in their documentation to systematically rebalance and there is limited flexibility around that.

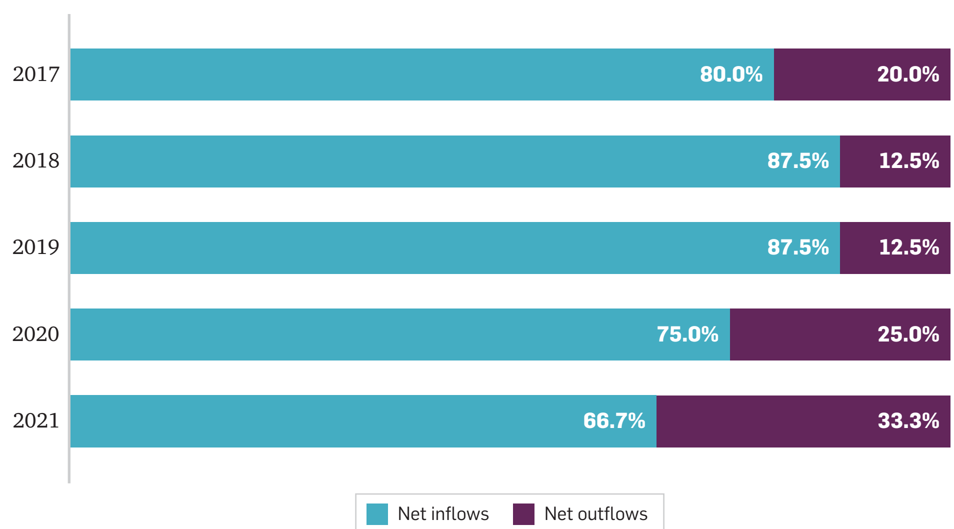
SS: In the DC space, we see a spectrum, from systematic to fully customized rebalancing, and it can be daily, monthly or quarterly. I agree that fiduciaries and glidepath managers are currently evaluating the optimal level of flexibility within their rebalancing guidelines.

Are the challenges of rebalancing causing existing investors to increase their allocations?

SS: The primary theme we hear over and over again is downside protection. While the outsized returns in private real estate were enjoyed in 2021, investors really value the smoothed volatility and downside protection they receive from the asset class. Many clients said: "When I look at what was in positive territory over the last 18 months, it was my private allocations (versus the public allocations)."

JV: It's the diversification and downside protection. Real estate is not going to deliver 20%-plus returns annually as it did in 2021. It's the stability and more consistent positive returns that offer the potential to support stronger outcomes for participants over multiple market cycles.

2. After experiencing net outflows due to the denominator effect, managers say that capital flows of DC capital into private real estate strategies are again positive in 2023



Source: The Defined Contribution Survey 2022.

MANAGING LIQUIDITY

In the Defined Contribution Survey 2022, participants told us that the average liquidity sleeve was 13%, while the median was 10%. As we look to 2023, what do we think that liquidity sleeve is going to be? Do investors need more liquidity?

SS: What I think the Survey shows is, as we see additional investments into products that don't have a built-in liquidity sleeve, that average will come down. It was 15% for a pretty long time and it recently decreased to 13%. We may see the level continue to tick down over time.

I don't foresee a big change in the existing liquidity sleeves. We have one product with a 25% sleeve and one with 15% as a sleeve, and that's a strategic allocation for us that we manage fairly tightly. For products with a built-in liquidity sleeve, that level is determined by the manager rather than the client.

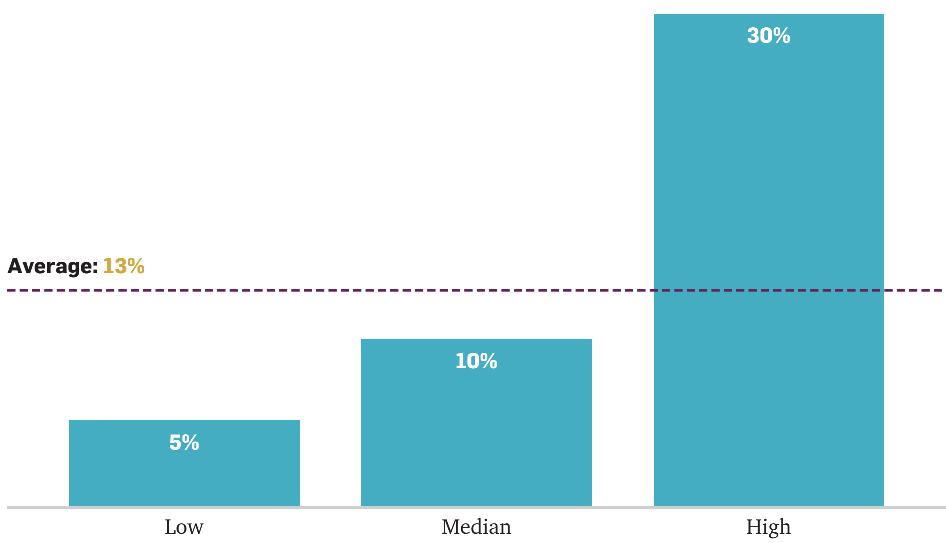
It has been interesting to us that, even though any one of our clients could utilize the 25% liquidity sleeve product, very few in the last 10 years have taken us up on that. The vast majority of our asset growth has come in the 15% liquidity sleeve product. I think this points to investors wanting as much direct real estate exposure as possible if they make the decision to invest in it. They want that liquidity sleeve to be as small as needed to accomplish the job.

DS: Our daily valued private equity real estate (ODCE) product does not include an allocation to REITs. It is a pure-play investment, so the liquidity is accessed via cash and other liquidity mechanisms in the portfolio. Our DC clients manage liquidity primarily through the other sleeves in their multi-asset portfolio, either from REITs or other liquid asset classes. As a result, they may choose to access liquidity from a source other than their REIT allocation when REIT returns have been under pressure. Because the private real estate allocation within a target date fund typically averages 10% or less, the multi-asset portfolio manager has an abundance of liquid investments from which to source their distribution needs.

There are two schools of thought on liquidity. Some managers of multi-asset portfolios want to manage that liquidity on their own, in which case they're attracted to the pure play; others want to delegate liquidity management and access the REIT sleeve within a packaged private real estate product.

JV: The fact that there is a range of daily valued real estate solutions available today demonstrates the evolution of the market over time to address investor needs. Our view is that a blend of public and private real estate best addresses DC plan needs. Investors have generally favored blended solutions that offer investor diversification while delivering the characteristics of private real estate and daily liquidity through public real estate markets.

3. The average quarterly liquidity sleeve for dedicated DC real estate strategies is 13%



Note: Liquidity sleeve allocation may include REITs, cash and other liquidity holdings.

Source: The Defined Contribution Survey 2022.

I don't believe the enhanced rebalancing needs during 2022 will increase liquidity allocations, but they highlight the importance of actively managing liquidity allocations with appropriate daily guidelines. To Sara's point, if the universe brings in more 100% private solutions, that industry average measurement will decline.

TB: I think 15% feels about right for products that offer structural liquidity, but I think it's important to offer choice — one with liquidity and a product without. The key reasons why a plan sponsor would opt into a product with liquidity include structure and flexibility. It's not an investment decision; it's not uncertainty about the private markets versus public markets, or a market timing decision at all.

The other factor is timing around rebalancing. In products with no liquidity, you're limited to very specific windows when you can rebalance. Certain plans aren't on that schedule and may have a mismatch in timing, in which case they may need a strategy with a liquidity buffer to accommodate that plan's particular timing need to push through a rebalance.

DS: Although we do not have a liquidity sleeve within our daily valued real estate product, absent a withdrawal limitation, investors can rebalance as of any date, not just during specific windows.

To Tripp's point, in our product, you're not restricted to entry and exit on a monthly or a quarterly basis. It's daily for cash flows.

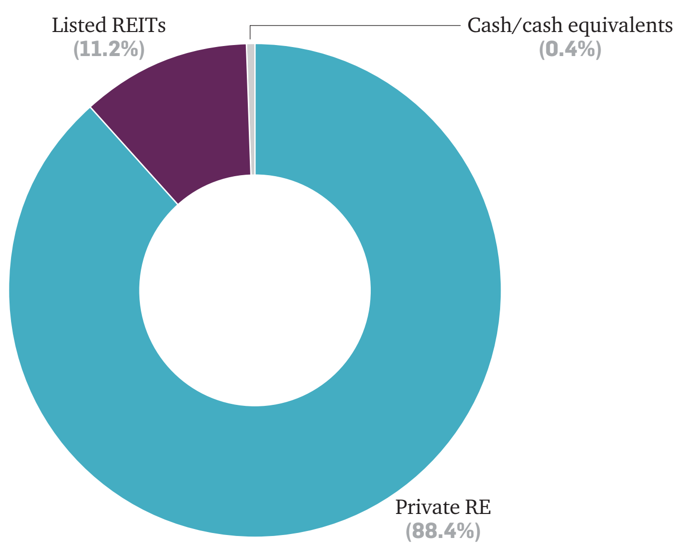
“ The key reasons why a plan sponsor would opt into a product with liquidity include structure and flexibility. It's not an investment decision; it's not uncertainty about the private markets versus public markets, or a market timing decision at all. ”

REIT EXPOSURE

As public market returns are increasing, so will REIT returns. As you look to structuring your own products, will you increase your REIT exposure to capture some of those returns?

JV: We do not take tactical views on public versus private real estate and we implement strategic long-term allocation targets within blended real estate solutions. We recognize that there are changing dynamics between private and public real estate, but REITs serve a liquidity purpose within these solutions. We believe this approach delivers the strongest portfolio outcomes.

4. The average target allocation to liquid REITs and cash or cash equivalents is 11.6% on average



Source: The Defined Contribution Survey 2022.

Key lessons

During your time on the DC side, what has been your biggest takeaway or lesson learned that you would give your younger version joining the industry now?

Sara Shean: Despite short-term periods of stress in the markets, the daily valued products continue to do what they're designed to do — provide access to the benefits of private real estate in a structure that works for DC plans.

Diane Smola: Patience, not panic. We can get through market dislocations because markets recover, and real estate will continue to serve as stabilizer in multi-asset portfolios. Also, patience is paramount when speaking to potential new investors as few DC plans want to be early movers.

Tripp Braillard: Conversations with investors potentially take place over a span of months and years, so patience is important. I remember something that Sara said a few years ago that stuck with me: "When you hear no, it may not mean no, it just means not today." Plans change, investment needs evolve, and private real estate is now much more of a mainstream asset class in multi-asset investment portfolios. It has been a key component of defined benefit retirement portfolios for many decades. It's just a matter of time that it becomes incorporated into more and more diversified and personalized DC portfolio strategies.

Jani Venter: I think it is important to remember that many DC investors are newer to investing in private real estate. This means education, communication and transparency are critical. For example, it is important to communicate with clients and consultants during periods of market stress so they know what they are going to experience. By establishing mutual expectations around private market dynamics, strong client relationships can be formed.

SS: The REITs are there structurally to provide liquidity. We are not making bets tactically, trying to move between public and private real estate. In almost every meeting, we are asked: "Are you trying to use the REIT sleeve to accomplish an investment goal?" And the answer is, from our perspective, we're using them to provide liquidity, nothing more.

ONWARD AND UPWARD

In 2022, DC Survey participants said that 42% of all inflows came from new investors or new mandates. Do you expect this to continue, and, if so, what does the new investor or mandate look like?

JV: We would expect 50% of inflows from existing plans, and the remaining 50% from new investors looking to access private market benefits.

SS: We're hoping that we see more or less an even split of flows from new and existing investors. Given where values are likely to be in 2023 versus traditional equities and bonds, we expect positive cash flows in this environment.

TB: As our business is newer, I think we will probably see more flows from new investors than existing. If our business were more mature, it would probably be 50/50 as well.

DS: We're hoping for the same thing. We're also hearing more about white label inflation-sensitive funds being created and the place for real estate in those funds. These are investors who want more customized product with an individual manager rather than a single multi-asset solution.

Where's the biggest concern?

TB: The conversations that we have with both plan sponsors and consultants are generally very constructive. They understand the investment case for adding private real estate to the DC plan. The conversations really come down to prioritization by plan sponsors. Plan sponsors today are faced with many competing priorities, including overhauling a custom target date series to adding a retirement income solution. The launch of SECURE 2.0 [Act of 2022 aimed to strengthen the retirement system] introduces an additional suite of potential priorities for plan sponsors around plan design changes.

What's the next frontier for real estate in DC plans?

Diane Smola: Will we see the adoption of private real estate debt? I believe that is next.

Tripp Braillard: I think so. Fixed income is a large component of DC assets. At $5 trillion in total assets, the market size for debt is much bigger than just real estate. Fixed income is 50% of DC assets right now.

Sara Shean: When real estate debt actually begins to be adopted, I think it has the potential to grow even more quickly than the equity side has over the last 10 to 15 years.

DS: And what will its place be? Will its place be in the fixed income white label option in the plan, or will it also be included in custom target date funds? I think it has a place in both.

Jani Venter: I agree. It's just a matter of time.

When will private real estate debt come through?

SS: We've been discussing the asset class for two-plus years. Interest remains fairly strong, but as discussed earlier, patience is key in DC.

JV: Two years, potentially three years or more. It's a market evolution where we need sufficient adoption on the equity side that supports investors and consultants looking beyond equity at the benefits of investing in real estate debt.

Plan sponsors think about what will make the most impact for their participants. It may not be changing the investment lineup; it may be implementing other structural changes like emergency savings, college loan repayment accounts and other plan design changes. We want to get mindshare, and that, for me, is the biggest challenge.

SS: Well said. We also continue to see concerns around litigation risk, and I believe that fees tie into the litigation concerns.

DS: I think part of the issue is whether or not the investment committee members already have experience with private real estate from their DB plan oversight. If so, they well understand the benefits of adding it to their multi-asset DC plan options. If not, more education on the benefits of the asset class is in order. As mentioned earlier, investment committees may now prioritize implementing new provisions of SECURE 2.0 over making changes to their investment lineup.

We can't get away from the litigation concern, but I want to reframe that discussion. It's all about what's going to improve investment outcomes for participants, and, I hope, less about explicit fees and the fear of being sued.

JV: I agree with the point shared by the others — implementation priority and litigation fears are holding investors back today. We have conversations where plans recognize the value of adding real estate, but it's not at the top of their priority list at this point in time. ◆

The fourth pillar of incentives: Co-investment

For **LaSalle Investment Management,** *co-investment is key to attracting and retaining employees and to aligning employees with clients' interests and the firm's culture. Once limited to select senior executives, opening up co-investment participation to a 950-strong workforce located globally across 23 offices has been a complex operational undertaking.*

Despite the challenges, **Tim Kessler,** *global COO, spoke with NAREIM about why LaSalle is expanding co-investment eligibility, what it is delivering for the firm, and the pros and cons of expansion.*

Key takeaways:

- **LaSalle has opened up 15 of its real estate funds,** comprising a mix of closed- and open-ended funds and separate accounts, to co-investment by employees.
- **Participation has increased 10x,** to more than 300 employees out of a global workforce of 950 full-time employees (FTEs). Of all FTEs eligible to participate, two-thirds are now doing so.
- **A key driver behind the move was CEO Mark Gabbay,** who wanted employees to be aligned to one another versus being a collection of different teams. Getting employees to think like investors is another win. But C-suite buy-in is critical. “Without that conviction, this would not have happened because it is complex, expensive and hard.”
- **The biggest challenge relates to eligibility requirements.** In many US offerings, only persons who are accredited investors and either ‘knowledgeable’ persons or qualified purchasers can invest.
- **Taxes are another challenge.** LaSalle has dedicated resources working full-time on the co-investment program, while also drawing on broader legal and tax teams.
- **Technology is provided by start-up Sidecar Financial,** which automates the processing and workflow for LaSalle, and delivers the user experience to employees.

LaSalle’s co-investment philosophy

We went through a leadership transition about two years ago when Mark Gabbay stepped into the global CEO seat. He was leading our Asia-Pacific business before that and employee co-investment was a big part of how he had run the region. Bringing that playbook to the broader firm was part of his global vision for LaSalle.

The strategic rationale is threefold. First and foremost, the co-investment program is a competitive advantage in the market for attracting and retaining talent. We have salaries, bonuses and carried interest, which are standard compensation practices in our industry. Co-investment is the fourth tool in the toolkit when it comes to economic incentives. It’s a practice that is not as pervasive across the industry, so it helps us when we offer this to people who otherwise have not had that opportunity.

Second is alignment of interests with our investors. At the end of the day, we’re here to perform for our clients. There’s no better way to demonstrate your commitment to a product and to a client than investing your own money alongside them. We’re big believers in that principle and our clients are believers in it as well.

Using co-investment to shape culture

Third is culture. We’re a global firm with many different products that tend to be country- or region-specific with a team that is focused primarily on executing that strategy. We are a globally integrated firm, but we are also, in some respects, a collection of teams; we believe co-investment is an effective tool to strengthen the bonds between teams, which leads to better collaboration and sharing of ideas.

‘Alignment’ is a word we use a lot at LaSalle. Alignment with clients is a key feature of this program. Alignment among our colleagues is another one. Employees who invest in products outside their day-to-day remit have another reason to walk down the hall or pick up the phone and call a colleague in another part of the business. It makes us smarter. It also fosters a sense of being part of something bigger.

Another element of the cultural push really emphasized by Mark is this idea of training everybody to have an

“We are a globally integrated firm, but we are also, in some respects, a collection of teams; we believe co-investment is an effective tool to strengthen the bonds between teams, which leads to better collaboration and sharing of ideas.”

investor mindset. We're an investment firm and our primary objective is to perform for our LPs. We want employees to put themselves in the investor's shoes. This goes back to that alignment theme as we want all our people, even if they're not in acquisitions or a portfolio manager, to think like an investor.

Eligible employees have the ability to do their own allocations and construct their own custom portfolios. They go through the same thought process that our investors do; they underwrite and evaluate a fund not only on its own merits, but also in the context of their broader portfolios. It functions as a training mechanism to get our people to think like, and be, investors.

Understanding the 'knowledgeable employee' rule

The philosophy and our goal here is to democratize access to co-investment as much as possible: anybody who meets the regulatory eligibility requirements is eligible. We don't, as a matter of policy, exclude anybody from this.

Obviously, we comply with eligibility regulations. What makes the program complicated is those rules are different in every country. And not only are the rules different in every country, but our employees may sit in country A whereas the fund is in country B. Which rule applies? You have to understand the different combinations.

It also depends on the product. We have, for example, products in the US that are established for institutional investors or people who are accredited investors and either qualified purchasers or knowledgeable employees.

For those products, many of our employees participate in reliance on their status as a 'knowledgeable employee.' It is the employee's role that is determinative. Generally, the closer the employee is to investment activities, the more likely the employee is to qualify as a knowledgeable employee. However, policy makers and business leaders in many departments also qualify under the SEC guidance. Our goal is to open up this opportunity to qualifying employees in all departments.

The challenges of expanding co-investment

First and foremost, we had conviction that we wanted to do this. That conviction started at the very top with our CEO, and, without that conviction, this would not have happened because it is complex, expensive and hard. The challenges tend to be primarily in eligibility and taxes.

There's nothing out there that we were aware of, from a technology standpoint, to facilitate this kind of process. When we started, we did most of it manually. We then looked for solutions on the market that could, at least from a process workflow standpoint, make it easier. As we could not find anything that met our needs, we ended up partnering with a start-up company, called Sidecar Financial, to solve this problem. In full disclosure, Sidecar is affiliated with LaSalle's parent company JLL.

We are now live on the Sidecar platform. It has really helped us stay organized and efficient in administering the program. Just as importantly, it has dramatically improved the employee user experience by replacing a cumbersome manual process with a relatively simple digital process in an

intuitive user interface. For example, many people have never gone through a KYC/AML [know your customer/anti-money laundering] process and are not used to signing a subscription document. Sidecar simplifies those steps, which is important because people have their day jobs and are busy. We want to make it easy for them. That was really important.

Technology can't solve regulatory and tax complexity, so those are still big focus areas for us. We have dedicated resources that work full-time on this program, and we draw on the broader legal and tax teams as well in managing those two particular areas. We've invested a lot of resources in our co-investment program; it is so important for us strategically as it is about firm culture.

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Employee take up

Co-investment opportunities used to be limited to a very small group, primarily the dedicated fund teams and select senior executives. Now everybody who is eligible is allowed to invest, but it's an individual choice. We have opened up approximately 15 funds consisting of a mix of closed-end funds, open-end funds and separate accounts.

I've been blown away by the enthusiasm with which our organization has embraced this program. I had no idea how much take up there would be. The program has expanded by 10x or more, far exceeding my expectations. There's no obligation, expectation or pressure for anybody to participate. It is entirely intended to be a personal choice, and so far about two-thirds of people who are eligible have decided to participate. We have over 300 participants in the program across the firm today. We do provide co-investment leverage for employees.

Future of the program

Operationally, I want the program to be simple and easy such that none of these technicalities or complexities dictate any decisions. I want it to be easy for the firm to administer and I want it to be easy for employees to make their decisions and allocate capital where they want to allocate capital.

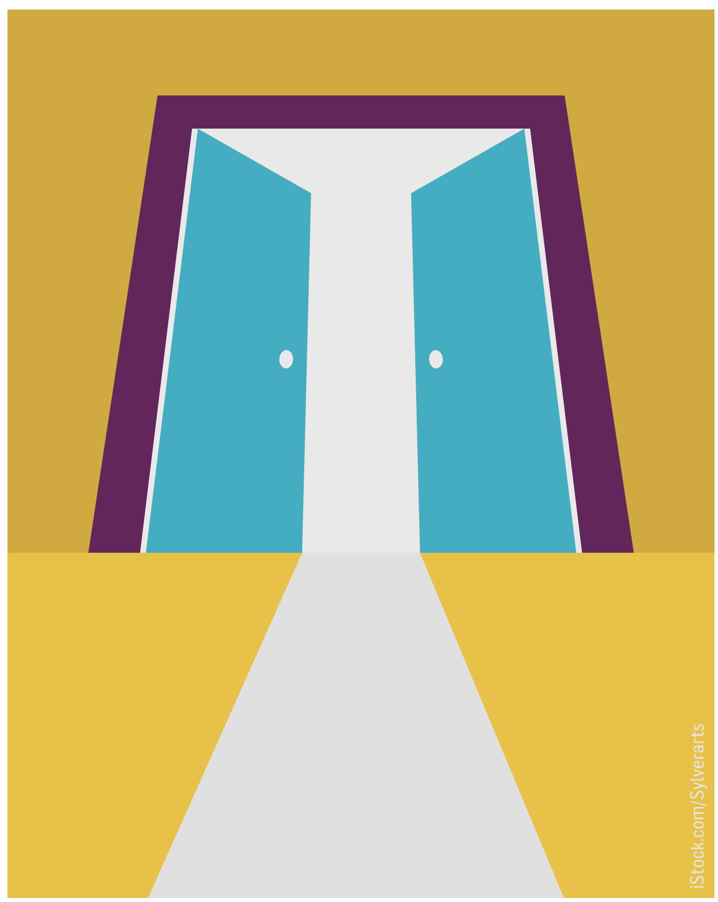
Strategically, we are nothing without our people and our clients. Our vision is that opening up our co-investment program to eligible employees will enable us to attract and retain the best talent; the combination of having that talent with their own skin in the game leads to better performance, which in turn leads to happy investors and a thriving business. I do believe that this program is a foundational element that contributes towards that broader vision for the firm.

We expect to be a high-performing investment manager in all our products globally and you only get that way by having the right people with the right incentives in place. And that's what this program's all about. ◆

“I've been blown away by the enthusiasm with which our organization has embraced this program. I had no idea how much take up there would be.”

Expanding *the* co-investment OPPORTUNITY

General partners or GPs typically invest 2% alongside the LP as co-investment, with the management team — typically executive and senior-level employees — either required or invited to participate in order to have 'skin in the game.' Amid efforts to better retain talent post-Covid, the conversation has changed to firms considering expanding co-investment eligibility. NAREIM spoke with **Lucy Bertsch,** *Director, Compensation Consulting at* **Ferguson Partners** *about key co-investment trends among real estate investment management firms, including opening up the opportunity, loans and downside risks.*



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The co-investment opportunity is under discussion within real estate investment management, with co-investment being seen as a fourth pillar of compensation. Is eligibility being expanded, and, if so, to whom?

There is an accredited investor or 'knowledgeable employee' requirement given the inherent risk of investing in the private market. To date, the opportunity to co-invest hasn't been opened up to a broad-based group of employees. But we're seeing that changing slightly, specifically with respect to mid-level employees such as VPs or Directors who might be first- or second-time participants receiving points in the deal or fund.

> "The biggest challenge to expanding eligibilty has been the administrative burden associated with co-investment."

The biggest challenge to expanding eligibilty has been the administrative burden associated with co-investment. As a company offers co-investment opportunities to a broader group of employees, they will need to be able to handle the required filings and put in place termination provisions.

Where are changes occurring?

To date, a lot of companies have offered co-investment sporadically; there hasn't been a framework in place around the amount, eligibility and which products are included. We are getting many questions around formalizing co-investment programs.

In what ways?

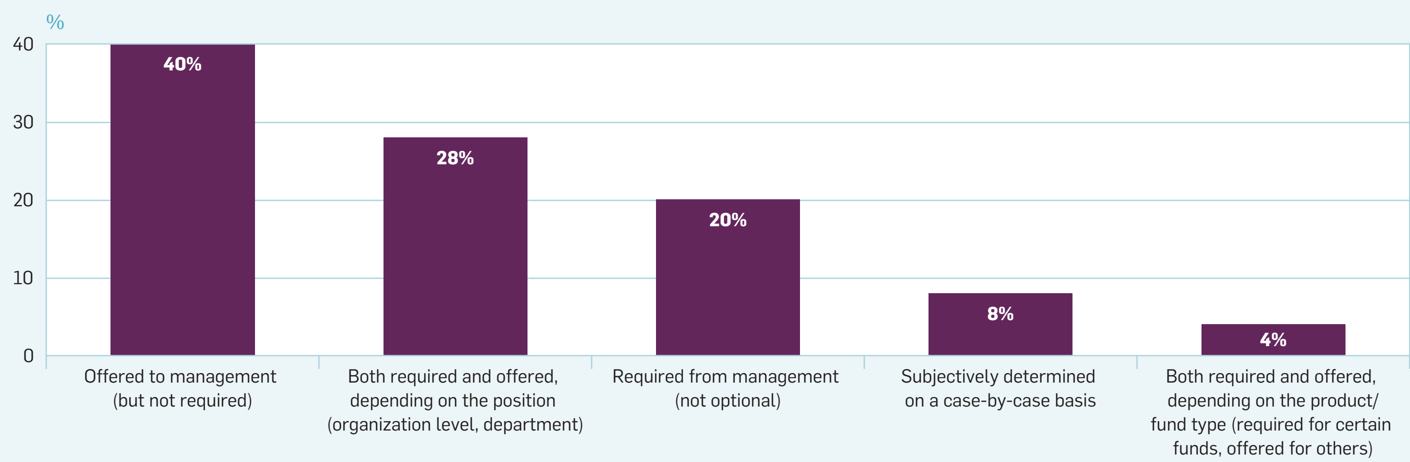
When it comes to formalizing co-investment programs, this typically includes definitions around contributions and eligibility.

On the topic of contributions, we typically see three main approaches in the industry. Firms will use a percentage of total cash compensation, to, say, an average of your base and bonus over the past three years; or a fixed dollar amount by level; or, for those companies that are directly granting promote, it's very common to link promote and co-investment in the form of a ratio. A 3:1 ratio would indicate for every 3% of promote awarded, the employee would be required to co-invest 1% of the GP's total co-investment.

Talk us through co-investment loans, as only a third of firms use a loan program, while more than half don't.

Co-investment can either be required by investors, or firms can offer the opportunity for select members of management to co-invest as a total rewards benefit.

Exhibit 1: Your company's co-investment plan for management

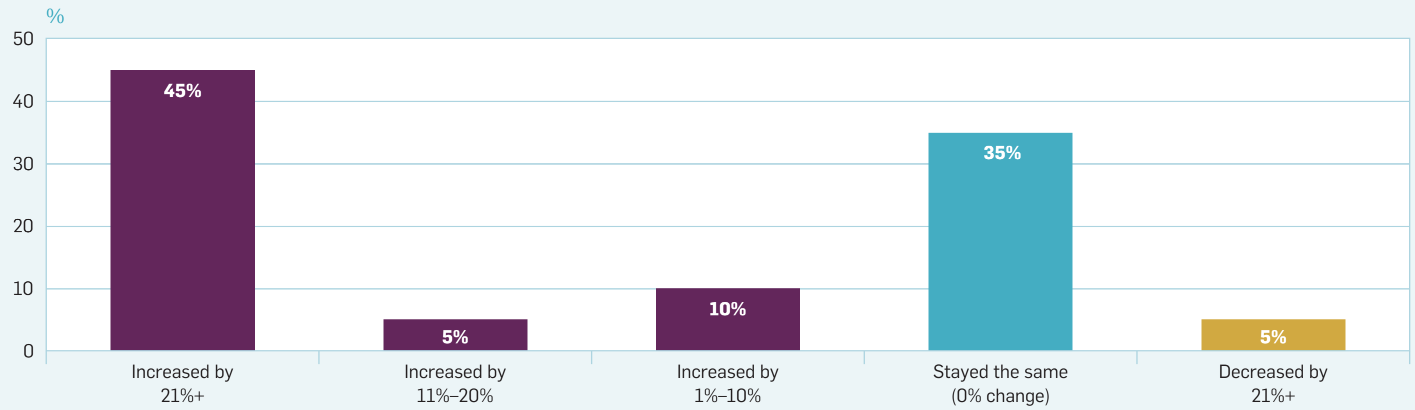


Source: NAREIM Compensation Survey 2022.

Exhibit 2: Total co-investment (across all funds) by the company in 2021 contributed by management ($m)

	25th percentile	Median	75th percentile	Average
Total co-investment in 2021	$4	$6	$24	$15
Amount contributed by management in 2021	$1	$3	$9	$6

Exhibit 3: Co-investment amount contributed by management, 2021 vs. 2020



Source: NAREIM Compensation Survey 2022.

When co-investment is required, it is more common for loans to be provided either off the company's balance sheet or through a third party with negotiated favorable rates. When co-investment is offered as an opportunity (versus required), there isn't the same sentiment that companies have to offer a loan program.

Many investment managers provide loans to help facilitate the inherent benefit of co-investment, but it's not seen as a must-have per se. Typically co-investment loans can make up around 50% to 80% of an individual's co-investment contribution.

If you're a first-time co-investment participant, we oftentimes see that companies might waive or lessen the requirement or offer a more meaningful co-investment loan. I think that's an interesting piece, especially as you think about offering this up to more mid-level employees.

Are you seeing more innovation in terms of co-investment programs?

We've seen some innovation with select clients who have deferred compensation plans, whether a deferred portion of an annual bonus award or a cash-based long-term incentive. For example, the deferred portion of the award is invested on the employee's behalf in the fund or deal. Upon realization, the employee would essentially receive the deferred portion of the award as well as the returns on the invested capital.

But there are downsides to co-investments, of course.

In general, most investment managers think about co-investment in a very positive light. We receive feedback from clients that it is an incredible opportunity for wealth creation, alignment of interests with investors, and a very strong motivator when you have skin in the game.

As we are entering a downturn environment, it is especially important to remember that co-investment is inherently not diversified, and there's a good amount of risk associated with investing in the private market. Further, the capital you've invested isn't liquid; co-investment can be held up in the fund for five to eight years — or more in some cases — so employees need to be comfortable with that fact for personal financial planning. ◆

The 5 CO-INVESTMENT Qs to ask

Co-investment is a key tool for aligning interests with investors and employees. Yet it's something only 52% of real estate investment managers provide.

The reason? The challenges of delivering co-investment programs are significant. Regulation and tax are the two greatest challenges cited, and those alone can make co-investment programs feel daunting to execute upon.

However, as recruitment, retention and culture strategies continue to be top of mind for firm leadership, co-investment is increasingly being looked at as the fourth pillar of incentive programs. But what questions should managers ask themselves as they look to introduce, or improve on their, co-investment programs?

1. What are your objectives?
What is your key objective in relation to co-investment? Is this primarily about alignment with investors, or are you also looking to co-investment programs as an employee incentive tool, to assist your recruitment and retention strategies? All managers providing co-investment attest to the same challenge: It's complex and not for the faint-hearted. The amount raised from employees may be small for the work involved. But it's powerful. For investors, co-investment is a critical, if not essential, means of demonstrating skin in the game; for employees, it's access to a means of wealth generation.

2. Who is eligible?
This very much depends on the country where your employees work, and also the country where the fund is registered, with each country having different minimum requirements around investment eligibility. Legal counsel will be your best friend when it comes to co-investment programs, managers admitted, as there are plenty of gray areas to debate. "There is no one playbook out there," said the CEO of a $100bn AUM investment management firm.

In the US, the SEC sets guidelines around who can invest. Employees must be a qualified purchaser or an accredited investor, and must be able to meet certain financial and sophistication criteria. However, there is no perfect definition of what the SEC means by 'knowledgeable' person — a factor that can result in significant internal discussions as to who (or which functions) are 'knowledgeable,' and which are not. Typically, the closer to the fund, the fund's management and the deals, the safer the assumption surrounding 'knowledgeable.' For more back office roles, potentially HR and IT, the definition can become more problematic.

3. What about the UX, the user experience?
This is imperative for anyone doing co-investment, all managers agree. Hear the lessons learned from one CEO who said the first co-investment fund his firm provided required him (and other senior employees) to file taxes in every US state the fund invested in. It was a painful lesson learned.

But it's not just about taxes and filings, it's also about ensuring ease of investment, communication around fund performance, and the ability to re-up or exit as needed. Make it too complex and employee participation will be low.

4. Who pays the fees?
Employee feeder funds are critical to all co-investment programs, but the costs rise exponentially once a firm expands co-investment beyond domestic employees. That's why understanding your objective to co-investment is vital.

Firms should also think about asset management and performance fees, and whether employees should be required to pay those fees just as LPs do. One organization said they did not charge fees on employee co-investment after investors revealed they were not sensitive to the issue. It was also a move that helped that organization increase co-investment participation tenfold, the manager said.

However, it also raises questions on taxable benefits. Just like legal counsel, tax specialists will be your friend, as you consider co-investment programs for employees.

5. Do you provide employee loans?
Just over one-third of managers provide employee loans for co-investment programs, according to the 2022 NAREIM Compensation Survey. Of the 38% of managers providing loans, half cap financing to 33% to 50% of the co-investment amount, while the other half provide financing greater than 75%.

Loans can be a valuable tool to help expand participation. But for one manager, it was a "step too far," as it diluted the value of the employee co-invest and skin in the game, in the eyes of LPs. Again, fully understanding your objective with co-investment is important here. Is co-investment primarily for LPs or is this a dual-purpose strategy to align with investors and employees?

Q&A

On the VERGE

Outpost market specialists Graceada Partners released a ranking of top tertiary cities in the US. NAREIM spoke with principals and co-founders Joe Muratore and Ryan Swehla about their methodology, 'quantifying' the quality of life factors that make these markets attractive, and building out their acquisition system in new markets.

What is your thesis about third city markets?

Joe Muratore: To start, Ryan [Swehla] and I are both from Modesto, California. Our company is based in Modesto, California, which, by all accounts, is a tertiary market. Between us and nearby Stockton are 2 million people in two counties. But it is very much an overlooked geography. We saw good value for properties, and high demand from tenants and renters. We also appreciated the area's quality of life.

Because we grew up in this environment, we have eyes that other people don't; this is our native ground. Secondary and tertiary markets are how we've thought about real estate since the start of our careers. Back then, we didn't know that this was an important strategy; we just saw the markets and opportunities set this way. As we met national and regional players and saw their strategies, we realized that the way we saw the world and investing was different from how other people saw it.

So how do we take that and then make it into a strategy? We started by thinking first about opportunity and then about safety. The key pieces here are demand, value and resilience.

In our opinion, the best way to gauge demand is vacancy rate. In Western states, broadly speaking, most tertiary markets have long-term positive population growth. So demand always grows. But vacancy rate factors in supply. When we started working on our ranking for our latest whitepaper — *The Emergent Value of Third City Markets* — the first thing we did was to rank markets by vacancy. The lowest vacancy suggested demand exceeded supply there for some reason. Usually that's because the cost of construction or rents have not exceeded the point where it makes sense to build new product, which is typical of tertiary markets and secondary markets. It's hard to make those lines cross.

Secondarily, it is value. There are two pieces of value to look at. One is rents relative to median income. On the apartment side, where are people paying 20% of their household income towards rent instead of the 40% average in major markets? The second part of the value piece is, where is replacement cost per square foot or per unit at 50% to 70% of replacement cost, instead of full replacement cost? Buying at a discount is insurance against the new product, especially on the apartment side, where new product tends to be smaller and to command very high rents. Where can we buy more spacious units at a value where our product stands out because of its location, amenities and size?

What is the third point?

JM: Resilience — after we know people want to be there and we know we're getting a good deal and the customer is getting a good deal — now we want to know, 'Is this sticky? Do people come here because of Covid and are they going to bounce back?' The usual indicators are about hospitals and education, but there's also airports.

We looked at the AARP score, because AARP is focused on seniors and on quality of life, walkability, crime, cost of living and opportunity for income. We like it because it is a value-oriented index and it scores every city and county in America.

The next point was to say, for the rent, how many points of AARP score do we get? In other words, what do you get for your money? Where you can get a high return on quality for your dollar is what we think is more resilient. Those will be more walkable, more affordable places with a sense of community, engagement and involvement. The right places tend to have stronger downtowns and better parks.

Ryan Swehla: A key point that Joe hit on is that we weren't just looking at quality of life measures in a vacuum; rather we were looking at quality of life relative to affordability.

Limits of data

We are in the midst of a data boom. Data used to be your value-add, and now it's everywhere. How do you measure more qualitative data against real estate traditional metrics such as vacancies and past projections? Are we moving into new ways of thinking or underwriting deals?

RS: We focus on weighting the present because we know what the current vacancy and rents are. It's important to understand that our interest in these markets is primarily around the idea that it's a mature existing segment of real estate that is uninstitutionalized, much like mobile parks, self-storage or single-family homes were. Every region where we're looking has had historical positive population growth for decades.

> "We weren't just looking at quality of life measures in a vacuum; rather we were looking at quality of life relative to affordability."

That being said, Covid did shine a spotlight on these markets a little bit more. It didn't make us see a change in how the vast majority of people work and live, but on the fringes it allowed people more flexibility in terms of focusing on their quality of life. That certainly has brought more emphasis on markets like these than they traditionally had.

JM: Our strategy is already a contrarian strategy — we go where others aren't going. We develop the thesis and execute based on feel and experience. The data will get you only so far. We have been doing this for 20 years. When evaluating an asset, there is an amount of feel to it; I remember all the deals that went well and all the deals that went wrong. I was in Pueblo, Colorado recently. I saw quality and value everywhere. The downtown was recently redone, the price per door was low. There was nature everywhere. Vacancy is super low. Our job is to uncover value in unconventional places.

What is your favorite market on the ranking?

Joe Muratore: On the tertiary side, it is Bakersfield. We recently made a large investment there and rents continue to move beyond our underwriting.

CoStar ranked Fresno as the best market in the nation for properties below $20 million, yet Bakersfield has a similarly strong vacancy rate of roughly 2% as well as the price per door being 40% lower in Bakersfield. While Fresno is not within close proximity of a larger city, Bakersfield is roughly an hour from Los Angeles, making it a very enticing city for hybrid workers. Bakersfield's vacancy rate, average rent price and geographic location are driving institutional investors toward multifamily properties in this market.

Bakersfield has a 41 score on the AARP, which is not high, but it is a city with a heart and it is commutable to Los Angeles. It has a vibrant downtown, and oil and agriculture are major industries in Kern County in which it is located. It has been an underserved area for a long time. While prices are rising around LA, Bakersfield for some reason has been overlooked. It is a well-located place that needs fresh capital and energy.

Having a house with a yard in a neighborhood with a school and being able to drive to parks and nature is a big add to quality of life. We think markets that offer these characteristics can do well.

RS: Bakersfield, California is another good example of that. Investors tend to be surprised, but the fundamentals are strong. We start with the data and it leads us towards those drivers that allow us to clear away the noise.

Walk us through the process of pulling together this ranking of the top 20 third city markets in the US.

JM: We started the process almost a year ago with CoStar data. We started by excluding vacancies of over 4% or 5%; many areas in the country have vacancies of over 6% for both multifamily and industrial, which are the two property types we invest in. After narrowing the list to markets with rents below $1,600 average per door, we sorted the list for value, price per unit, sale price per unit, and then estimating that to replacement cost, often looking for things that we're selling in about the $120,000 to $170,000 per door range. We did the same analysis on multitenant industrial.

Then we added the AARP score. We created macros to test different ways of sorting: were we going to sort more from value from the renter's perspective, or more from value from the buyer's perspective? For our investment style, we ended up sorting more for value from the buyer's perspective, especially a focus on cost relative to replacement cost, which brings us into that middle part of the market, the Pueblos and Bakersfields that have a greater quality of life than one might have anticipated.

RS: SmartAsset looked at the movement of people earning over $200,000 and the movement of young professionals earning over $100,000. Not surprisingly, Florida and Texas are major destinations, but the Western US featured heavily. By California standards Bakersfield and Modesto are not comparable to San Francisco or Santa Barbara, but the quality of life is high compared to most of the rest of the US.

How hard was it to bring the list down to 20?
RS: A big component that we also looked at is how much we weight the quality of life factor. We ultimately landed on price or quality of life per rent being paid. We were trying to place a value on that relationship between the two factors, and to give value to them in relation to other factors. We had some robust conversations around getting the right measures.

Quantifying the qualitative

How do we quantify the qualitative aspects in investment management? Mental health and wellbeing are also important.
JM: Our company's mission is to create environments that transform people's lives. It's important to us to have a transformative effect on our communities. A lot of this comes down to where are we getting traction, where can we build clusters, and where can we see opportunity in nearby locations.

RS: The data is abundant, but where you excel is how you assimilate and filter and qualify that data. That's just the first bar. And then the qualitative is much more about getting into those markets and deciding which ones are most compelling or interesting.

> “You have to earn your way to tertiary markets by building a base in secondary markets and then expanding into tertiary markets.”

What data do you wish you had or could quantify?
JM: I'd like to see median income growth. Investing has a lot to do with net operating income, which has a lot to do with people's ability to pay. The ability to be able to project pockets of median income growth in non-primary markets would be a leading indicator of values.

Looking forward, what are you most optimistic about? And, conversely, what concerns you most?
RS: I am quite certain that we will look back five years from now and secondary and tertiary markets will just be a mature and growing part of the institutional real estate universe like single family homes once were. I'm excited about explaining how to access these markets, rather than why.

One thing we've learned over the last few years is that we don't know what we don't know. As a growing company, how do we build a resilient organization that is able to handle curveballs that we don't even know exist?

JM: I'm most excited about building out our acquisition system in a larger geography. Investing in tertiary markets is a luxury. You have to earn your way to tertiary markets by building a base in secondary markets and then expanding into tertiary markets. It takes years; most tertiary markets are owned by just a few players that own most of the product. It took us years to build into tertiary markets in California. I look forward to replicating that system and deal flow pipeline in Colorado, Utah and other markets.

In secondary and tertiary markets, your exits need to be more closely timed. You should be selling in better parts of the market cycle. Buying at the right time and selling it at the right time is more important.

What are some challenges in building out the systems and infrastructure to get presence and footprint in new markets?
JM: We're in the trust business. Sellers need to know who you are and they need to believe that you will close. It's one thing to buy a property, it's another thing to buy a property at a great price in an off-market way. So, to build a brand; with each deal, you're casting a vote for you as a future buyer. One has to buy well and then buy in a concentrated way.

RS: This is something Joe alluded to, which we haven't spoken about: 90% to 100% of what we buy is off-market. On the one hand, that is kind of a distinctive feature of these markets because they're very inefficient. But on the other hand, as Joe alluded to, you have to earn that. It's not something that you just get. ◆

Goodbye *parking,* HELLO *housing*

Rethinking transportation needs due to demographic changes and environmental concerns can alleviate housing pressures, reduce developer costs and provide tenants with a better quality of life.

By Clay Grubb,
Grubb Properties

It's no secret that the US has a severe housing supply problem. According to Fannie Mae, the country is approximately 3.8 million homes behind where it needs to be to fulfill current and future demand. The reasons behind that shortage are many and varied, with most pointing to a drastic slowdown in construction following the Global Financial Crisis of 2008 and population growth among the millennials and Gen Z. More recently, supply-chain disruptions caused by the Covid-19 pandemic and accompanying raw material price hikes dampened new housing starts.

But what may come as a surprise is that Americans' reliance on cars exacerbates the already acute US housing shortage.

In fact, the car is often cited as the greatest barrier to affordable housing. Parking spaces take up valuable land. Providing one parking space for each residential unit reduces the number of units possible per acre by 30%, according to the Victoria Transport Policy Institute.[1] And the more parking spaces, the more expensive the rent. The amount of land dedicated to cars in the US results in $1,700 in additional annual rent for the average apartment resident.[2]

This parking dilemma is particularly acute in urban areas, where land and labor are comparatively expensive, and the housing shortage is felt most acutely. For example, building a 300-unit multifamily community with a structured parking deck in downtown Charlotte, North Carolina, would cost approximately $80 million. If that same property could be built without parking, it would allow for a 390-unit multifamily community with similar size homes and amenities for approximately the same $80 million cost. That reduction in total cost would allow us to drop rents by over $250 per month, or $3,000 per year, for each apartment — dramatically increasing the amount of available housing without relying on any public subsidy.

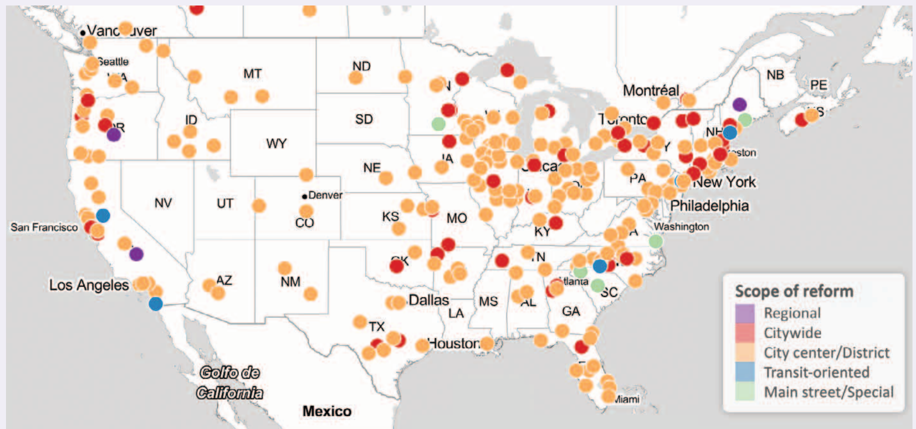
From an individual's standpoint, a car is a significant expense, particularly in our current inflationary environment. According to AAA, the average cost of new car ownership is $894 a month, or $10,728 annually — money that could be earmarked toward home ownership, retirement or other financial goals.[3]

1 Todd Litman, *Parking Requirement Impacts on Housing Affordability*, Victoria Transport Policy Institute, February 15, 2023.
2 Brooks Howell, How We're Innovating to Create Housing for All, Dialogue Issue 35, Gensler Research Institute.
3 Brittany Moye, Annual Cost of Car Ownership Crosses $10K Mark, AAA, August 11, 2022.
4 Eric Scharnhorst, *Quantified Parking: Comprehensive Parking Inventories for Five US Cities*, Research Institute for Housing America, July 2018.

Grubb Properties' sole focus is essential housing, targeting those in the middle of the income spectrum. This underserved demographic earns too little to afford the more-prevalent luxury market, yet makes too much to qualify for subsidized affordable housing. Since 1999, we have studied parking, monitored parking space usage at our properties, and tested and developed creative parking models — all in an effort to build new multifamily housing that is affordable to more people.

Here are some of our conclusions and predictions about the future of parking.

Exhibit 1: Parking minimums are being reformed across the US



Source: Strong Towns and Parking Reform Network.

History of car-focused development

Ever since Henry Ford made automobiles accessible to the general public in the 1920s and 1930s, most urban design has been focused on making car transportation more efficient. While some urban areas simultaneously built out public transportation systems, urban roadways were built with cars in mind and parking was viewed as a public right.

Accompanying this emphasis on the automobile were parking minimums and, often, urban sprawl. Parking minimums, which dictate how many parking spaces developers must build for each residential unit, were designed to ensure that homeowners did not need to rely on street parking. Columbus, Ohio, has the dubious distinction of instituting the first parking minimum law in 1923; other cities quickly followed. By the 1950s, parking minimums were frequently embedded in city codes and for many years were accepted as the status quo.

Today, tremendous swaths of our cities are taken up by parking. According to a study of five cities from the Research Institute for Housing America, an affiliate of the Mortgage Bankers Association, Jackson, Wyoming, has 27 parking spaces for every household, Seattle has 5.2 spaces per household, and Philadelphia has 3.7 spaces per household. Only in New York City, with its well-developed public transportation system, were there fewer parking spaces than households (0.6 parking spaces per household).[4]

But the trend toward more parking is beginning to reverse. Alternative transportation modes have grown in popularity, and younger generations have become less car-dependent than their parents. And through the work of academics like UCLA's Donald Shoup, author of the seminal 2005 book *The High Cost of Free Parking*, city planners have become more aware of the chilling impacts of parking minimums. Over the past ten years, cities as diverse as San Francisco, South Bend, Minneapolis and Buffalo have completely abolished parking minimums, while numerous other cities of varying sizes have begun to whittle away at their strictures, reducing minimums and/or allowing transit-oriented, low-parking development near public transportation hubs (see Exhibit 1).

> “More and more cities across America are beginning to make it easier to live without a car.”

Moving away from cars

More and more cities across America are beginning to make it easier to live without a car, motivated by environmental concerns, technological advances and increased investment in alternative transportation infrastructure. Rideshare services such as Uber and Lyft provide on-demand transportation, short-term car rental is widely available, and bike and scooter-share programs have proliferated throughout the country.

Most major metropolitan areas are at least beginning to take bicycle infrastructure seriously, a trend accelerated by the pandemic. As urban residents turned to their bicycles out of

Case study: Parking-free apartment building

In our hometown of Charlotte, North Carolina we worked with the city government to gain approval to develop CYKEL Apartments, a parking-free apartment building. The 104-unit multifamily development in Charlotte's Seversville neighborhood, scheduled to open in 2024, will be a creative and transformative project for the city.

The CYKEL development is built along a greenway to better facilitate biking and walking, and will have amenities to encourage and enable a car-free lifestyle, including a fully equipped cycle center, repair stations for bikes, a bike maintenance program with a local bike shop, and a private ELF bike and cargo bike for resident use.


Artist rendering of CYKEL Apartments by BB+M Architecture

It also offers innovative solutions to address environmental concerns and the city's shortage of affordable housing. Half of its units will meet affordability standards for residents earning below 80% of the area's median income. With the elimination of parking, we will be able to build these new below-market-rate units without any public subsidy.

boredom and a desire to avoid the close quarters of public transportation, cities responded with designating new bike lanes and shared streets. This shift toward bikes is likely to accelerate as cities become more alternative-transportation friendly, building the infrastructure to accommodate bikes, e-scooters and pedestrians safely and efficiently.

Private real estate developers have a critical leadership role in reducing parking. At Grubb Properties, we have worked with Copenhagenize, a Denmark-based consultant specializing in biking infrastructure development. They have helped our architects and designers to design state-of-the-art bike centers for our apartment communities. We have also enlisted them to help us design traffic patterns, greenways and public transportation access points to ensure that our residents do not need to rely on their cars as their primary mode of transportation.

Driving parking out of suburban areas

While most of the anti-parking energy has been directed at urban locations, creative developers and planners can also reduce parking in suburban areas where public transit is less prevalent.

Suburban America developed alongside automobiles and our modern highway system, with most pointing to the period between 1945 and 1970 as the era of mass suburbanization. Driven initially by the need for housing for returning soldiers from World War II, the suburbs housed just 10% of the population prior to WWII to more than half by 2010.

To be realistic, there are still many places in the suburbs where cars are practically a requirement. That said, we have worked to redevelop several well-located suburban office parks using creative solutions to limit, if not eliminate, parking.

One technique we have found most effective in suburban settings is to create a shared parking model. We will often purchase older office parks with large surface parking lots located near major employment centers, including healthcare institutions and colleges and universities. These stable employment centers not only provide a market for our apartment communities, but also serve as an endpoint for alternative transportation like greenways or bus routes.

Once we have purchased the site, we upgrade the office buildings and repurpose the surface parking lots as sites for multifamily housing. Parking is provided in more efficient parking decks and shared between the office and residential tenants. While not a one-to-one reduction, this shared parking model allows us to reduce parking spaces by about 35%. By replacing old cracked asphalt expanses with ecofriendly landscaping and amenities, we are able to create a more vibrant, multi-use community.

There is little doubt in our minds that there will be expedited change in the parking landscape in the next five to 10 years. More and more people will realize that reducing required parking is good for residents, neighborhoods and the environment. It can enable more people to afford new, high-quality housing in areas with easy access to jobs and educational opportunities, saving them time and helping them prosper. ◆

Clay Grubb is CEO of Grubb Properties.

NAREiM

Benchmarking research

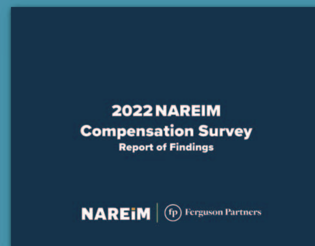
Global Management Survey

Released in July

Produced in collaboration with Ferguson Partners

Covers more than 65 individual data points broken down by AUM and risk strategy, including:

- *Revenue:* Capital raising and net and gross AUM growth, new commitment trends, investor concentration ratios, dry powder and subs lines.
- *Organizational metrics:* Headcount growth, employee per $1bn AUM, employee breakdowns per function, per function and seniority, valuation policies, functional group trends.
- *Financial metrics:* YOY financial performance, EBITDA (pre- and post-bonus) margins, bonus pools, revenue and expense breakdowns.
- *Fund/Account T&Cs:* Target returns, fees, carried interest, co-investments.
- *Governance:* Composition of executive committees, board of directors, management and investment committees, SEC registration.



Compensation Survey

Released in September

Produced in collaboration with Ferguson Partners

400+ pages of individual position compensation reports, plus annual trends relating to base, bonus, long-term incentives, promote/carry, co-investment and benefits including functions within:

- Executive management, accounting (corporate, portfolio/fund, property), asset management, capital markets, corporate marketing and communications, due diligence, engineering, environmental, finance, human resources, investor relations, capital raising, leasing, legal and compliance, portfolio management, property management, risk management, technology, transactions, valuations, debt and REIT securities.

DEI Survey

Released in December

Produced in collaboration with Ferguson Partners, NCREIF, PREA, REALPAC and ULI

First corporate benchmark for DEI metrics and best practices in commercial real estate globally. Covers more than 140 pages of individual data points, including:

- *Employee demographics:* Gender and ethnicity composition by seniority and job functions.
- *Best practice metrics:* Relating to the implementation of DEI strategies and initiatives across investment management organizations, including issues relating to ownership & staffing, accountability, tracking & measurement, retention & recruitment, external partnerships and activities, pay equity & transparency.

Defined Contribution Survey

Released in September

Produced in collaboration with Defined Contribution Real Estate Council and Ferguson Partners

This report covers:

- Scale and growth of DC offerings and the management of DC real estate vehicles.
- Breakdown of trends, including AUM growth and DC real estate capital flows.
- Organizational resources used and planned in supporting DC real estate strategies.

For more information, please visit www.nareim.org

Housing the workforce

The workforce housing segment faces a severe undersupply of attainable and quality rental housing. Investors would be wise to take notice.

By Ken Munkacy, Vincent DiSalvo, Justin Hoogerheyde and Jed Daniel, Kingbird Investment Management

America's housing shortage is a result of a confluence of factors that started with, and have since accelerated from, the 2008–2009 Global Financial Crisis; specifically demand growth spurred by the formation of smaller and non-family households and relative supply dilution resulting from onerous regulations, growing construction costs and labor shortages. While these obstacles constrain supply growth across all income categories, workforce targeted housing has been the most affected, despite the pressing nationwide need for housing suitable to this demographic.

Workforce renters, defined as those earning between $45,000 and $75,000 annually, are among the households most impacted by America's undersupplied housing market. They typically live in rental properties that sit in the middle of the price and quality spectrum — their rents are below luxury rates but above what is considered 'affordable.' New luxury housing is often out of reach for this cohort, but, at the same time, these renters' incomes are often too high to qualify for government supported/regulated affordable housing.

The average workforce renter is employed in the retail, manufacturing, logistics, healthcare or education sectors, and can be often classified as lower-middle class. This cohort represents the largest segment of the renting population, comprising 26.3% of renter households — yet the supply of affordable and quality rental housing available to them is insufficient.

Rising rents and the waterfall effect

The current supply of affordable and quality rental housing does not adequately satisfy the workforce cohort's growing need. As new housing production has lagged household formation, workforce vacancy rates have declined to record lows and workforce rents have grown much more rapidly than incomes, at an average annual pace of 4.2x that of the median renter's income.[1]

These vacancy declines and rent increases create a 'waterfall effect' in which renters with higher incomes push workforce renters out of apartments they could previously afford, and into

[1] CoStar, S&P/Case Shiller, National Multifamily Housing Council and US Census Bureau.

subpar housing product that neither reflects their lifestyles nor meets their needs. As a result of this phenomenon, an estimated 34.8% of units that are both affordable and available to workforce renters are of subpar quality, according to ACS PUMS data.

This workforce housing shortfall is worsened by apartment builders' preference for developing luxury product. Since 2010, builders have delivered approximately 3.3 million apartment units across the US, 2.9 million of which (87%) were luxury apartments. Only 432,000 units, or 13%, were affordable to workforce households, per CoStar data.

Because of the confluence of these factors, as of Q2 2022, the workforce housing vacancy rate was 4.3%, compared to a luxury housing vacancy rate of 7% (CoStar). And, as of 2020, ACS PUMS shows that an estimated 30% of workforce renters were cost burdened, up from 18.4% in 2001 (see Exhibit 1).

Between the high cost of construction and a lack of government policy interventions to subsidize new development and rents, an increase in workforce housing supply that matches demand is unlikely under current conditions. This will exacerbate the existing shortage, driving vacancies even lower and rents even higher, although at more moderate rates than occurred due to the Covid-19 pandemic.

An area of opportunity for investors

From an investor's perspective, workforce housing rentals represent a sustainable and resilient investment opportunity. Vacancy rates are historically lower and rent growth is historically higher for apartments in this category than in luxury units. As of Q2 2022, the workforce vacancy rate was 4.3% vs. luxury's 7.0%. This is indicative of the asymmetric demand for workforce priced product.

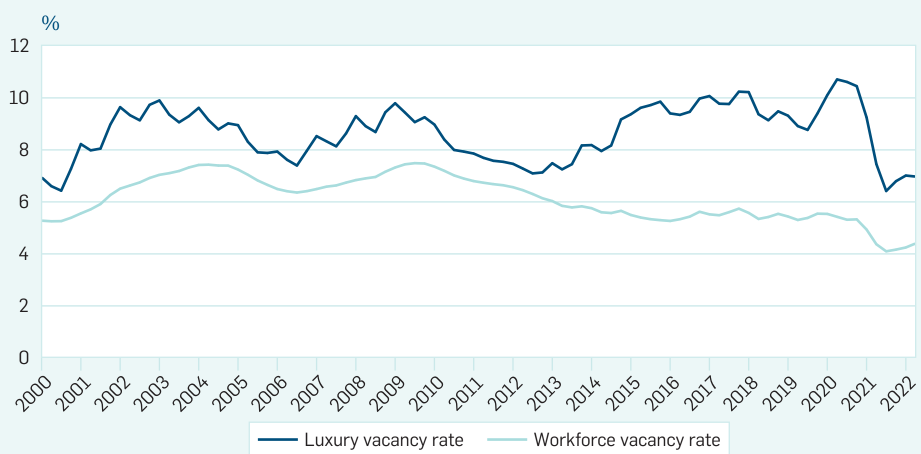
Profile for investors

Due to the low vacancy rates induced by the housing shortfall, workforce housing rents have risen faster than the overall average. As a result, this sector is an ideal target for capital allocation within a well-diversified investment portfolio, as it sits at the center of the risk/return spectrum of private real estate investing. Workforce investments are shielded from economic downturns, as budget-conscious renters will move from luxury to workforce units, maintaining demand during shocks.

Further, workforce properties are less expensive to build and buy than luxury assets, leading to higher yields — properties catering to the workforce cohort typically feature mid-tier amenities (e.g., small clubhouses, pools and playgrounds, less advanced appliances, lower-quality flooring and counters, etc.) and are often located outside of markets' urban cores, but within a reasonable commuting distance to job centers.

Investments in workforce housing rentals can improve cash distributions and enhance capital values for investors. The workforce housing investment return profile has characteristics of both bond investments, through its cash distributions, and stock investments, through its capital appreciation. These cash distributions have the added benefit of inflation protection; given the short time frames associated with apartment leases, owners can adjust rents with inflation annually, a feature that is often unavailable in the longer leases typical of warehouse, office and retail properties. Funds focused on value-add workforce housing returned an average net IRR of 16.4% between 2009 and 2019, compared to an average yield of 10.7% for core/core-plus luxury housing funds, according to Preqin data.

Exhibit 1: Workforce housing vacancy rates have been tightening more than luxury housing vacancy rates



Source: CoStar.

> “The lack of supply relative to demand in the workforce housing segment has created a fundamentals-driven opportunity for investment in this housing class.”

Workforce housing is also resilient: during the 2020–2021 Covid-19 pandemic, luxury rents declined in three out of four quarters, while workforce rent growth remained positive according to CoStar data.

The lack of supply relative to demand in the workforce housing segment has created a fundamentals-driven opportunity for investment in this housing class. This significant housing shortage has driven home prices out of reach for many households, pushing them to rent; thereby driving multifamily rents higher and vacancies lower. This dynamic, in effect, creates a margin of safety for multifamily real estate asset values, creating resiliency in the sector despite the current short-term central bank-imposed volatility and market dislocation.

These phenomena enable durable cash distributions and sustainable capital value appreciation, which, in turn, enhances returns to investors. According to an analysis of Preqin data, private real estate funds focused on workforce rental housing returned an average net IRR of 16.4% between 2009 and 2019, versus an average net IRR of just 10.7% for funds focused on luxury housing.

Our investment approach

While the national story is evident, we take a data-driven approach and target only regions, markets and submarkets with workforce housing shortages, diverse economies and job growth in stable sectors like tech, healthcare and government. Kingbird utilizes a proprietary market research dashboard that aggregates over 100 variables across all markets in the US to track their economic performance and housing needs on an absolute and relative basis, giving us unique, centralized insight into markets.

We have allocated capital to Austin, Texas, where Samsung is building a new $17 billion microchip plant that will bring 4,500 new jobs. This plant is within a 30- to 40-minute drive to two Kingbird properties. In Columbus, where we have made several investments, Intel is developing a new $20 billion microchip facility with 3,000 jobs. Dallas, Huntsville, New York City and Los Angeles — all Kingbird markets — are also launching significant new projects in fields such as technology, infrastructure, media, defense and aerospace, which will create new jobs and accelerate demand for workforce rental housing within commuting distance.

Each of these markets is growing rapidly from an employment and population standpoint, relative to their housing supply, resulting in market-specific expressions of the broader housing shortage. People want to live and work in these cities, but they lack sufficient housing to meet these needs. This has pushed lower income renters further and further from city centers as they are priced out of existing supply.

We have taken a dual approach to workforce investment, developing new workforce assets in target markets where new development is economically feasible and repositioning existing assets through renovations, rebranding and constructing higher-quality rent rolls where it is not. Both approaches have the net effect of increasing the supply of workforce housing, simultaneously alleviating some of the pressure on the cohort while taking advantage of the evident need for more workforce housing in order to produce superior risk-adjusted returns. The ability to address the workforce housing shortage through either new development or value-add repositioning allows us to work around or bypass the issues cited above.

The US housing shortage is a chronic, complex problem for which there is no quick or easy solution. Persistent demand for multifamily housing that is affordable to the workforce renter segment represents an opportunity to diversify investment portfolios by investing in an alternative asset class offering cash distributions, enhanced capital values and attractive returns. ◆

Ken Munkacy is Senior Managing Director, **Vince DiSalvo** is Chief Investment Officer, **Justin Hoogerheyde** is Vice President and **Jed Daniel** is Senior Analyst at Kingbird Investment Management.

It's time to POWER up

As the energy industry transitions to renewable sources, the real estate sector can participate in the growing battery energy storage sector through several interesting plays.

iStock.com/gobyg

By Deborah Smith,
The CenterCap Group

[1] Max Schoenfisch and Amrita Dasgupta, *Grid-scale storage tracking report*, International Energy Agency, September 2022.
[2] Suparna Ray, US battery storage capacity will increase significantly by 2025, US Energy Information Administration, December 8, 2022.

Battery energy storage is a critical component in the world's move towards renewable energy supply. With this shifting focus, the real estate industry could find yet another market opportunity — one that sits at the intersection of real estate and infrastructure.

Before we get into growth in battery energy storage, it is worth understanding how electricity supply and delivery are changing. For the past century, most electricity was produced in large, fossil fuel power plants that operated 24/7. Energy supply from wind, solar and other renewable sources was irregular, intermittent and hard to predict, which limited their economic usefulness. Supply could only reliably meet demand with fossil-based generation.

But in a world that is increasingly electrified (including a surge in electric vehicles that need charging) and focused on renewable energy, change has become necessary. Enter battery energy storage. Large-scale battery systems, together with sophisticated software required for coordination and control, connect to the electricity grid; they charge batteries when supply is plentiful and discharge electricity when demand is high.

Storage owner/operators, operating in organized markets as a merchant, can use a buy low, sell high strategy. Or they can hedge the price and guarantee the supply of electricity for specific facilities, including as emergency backup.

The physicality of batteries and battery storage facilities

Energy storage batteries are like Legos — they are modular and come in all shapes and sizes. Storage facilities also include the power control system (an inverter and equipment to connect the batteries to the grid), the energy management system (software and communications equipment to monitor and control the batteries), and the balance of the plant (enclosure, heating/cooling infrastructure, fire protection systems).

Modern battery storage systems are turnkey and are easy to install and maintain. They can be connected into the transmission or distribution system, including advantageous locations close to variable renewable facilities or close to sources of demand. As an example, Florida Power & Light and NextEra Energy built a battery storage facility in the urban Miami neighborhood of Wynwood. The facility can discharge 10 MW of energy per hour for up to 4 hours, enough to power about 7,000 homes. It has the size and look of a normal building.

Smaller battery systems — individual modules often about the size of a shipping container — are most common. Unlike cell towers which can be a visual eyesore, battery infrastructure can be made to fit in with neighboring buildings or can be landscaped to go unnoticed. Their noise level is similar to a commercial structure's HVAC unit.

The market opportunity

Battery storage is here to stay. According to the International Energy Agency (IEA), a "rapid scale-up of energy storage is critical to meet flexibility needs in a decarbonized electricity system" and investment in battery storage grew by almost 60% in 2021, reaching close to $10 billion.[1] The US Inflation Reduction Act provides for more than $369 billion in funding for clean technologies, which, according to Bloomberg New Energy Finance, will help drive the energy storage buildout. While negligible prior to 2020, the US Energy Information Administration (EIA) expects battery capacity to increase by 20.8 GW between 2023 and 2025.[2]

Battery storage has found its place in the electricity supply sector, and in helping create a cheaper, greener and more ESG-friendly world.

The real estate play

At a basic level, battery storage is like another familiar asset class — data centers. Akin to data centers storing information, battery storage stores energy. But, dig a little deeper, where does an operator locate battery storage units? That's where the real estate angle comes into play. There are several ways to look at the opportunity.

1. The first is a land acquisition play. For investors and fund managers who have typically been reluctant to land bank or acquire land without a specified purpose, battery storage offers a new purpose.

   The land required is different because it is its proximity to the right location on the grid — where it will have the easiest and cheapest access to energy sources and uses — that matters. This is not a typical approach to how a real estate investor would assess end-use.

   These sites do not represent an alternative use of land, but rather an additional use for land that may otherwise be viewed as unattractive, like a backlot, for example. These are sites that real estate owners do not typically put at the top of their location lists.

Interestingly, the right locations are also changing because of changes and trends in electricity use: converting a large fleet of delivery trucks from diesel to electric, for example, creates demand in a new location. Think about it as a potential covered land play where an independent power producer (IPP) seeks entitlement.

2. Battery storage provides for an alternative use of a pad or excess land as part of a larger project. This presents a very different, viable option beyond a Walgreens, Chick-fil-A or Wells Fargo ATM branch.

   Battery storage creates a stable and noncyclical source of long-term income for underutilized or repurposed land. This is a new way of making the most of every inch of land. Potential revenue streams include option premiums, long-term lease rents and potential for the appreciation of land value.

3. The third opportunity is one where battery storage facilities bring additional benefits to the primary use of the development.

   For example, a battery storage facility adjacent to an industrial facility, shopping mall or office building may offset energy costs for owners/tenants. An industrial facility or hospital campus may utilize a microgrid setup where storage capacity is typically sold into the grid, but could be used internally as emergency backup power if needed.

   In addition, as institutional investors implement ESG and net-zero carbon targets, investment in projects that include components that contribute to decarbonization will become important. A project that includes battery storage may help a project fit that bill.

Let's sketch out a sample business plan. An industrial property owner has a few extra acres of land beyond warehouses. The building owner leases a connection to the battery storage site to an IPP, charging a flat fee and participating in any upside that the IPP creates (think net lease or ground lease). The IPP trades electricity using battery storage to take advantage of pricing arbitrage. A real estate investor could buy (or leverage existing owned) sites and then partner with an IPP whose job it is to get approvals, build the battery storage facilities, undertake the development and hook it up to the grid.

A new, new way of making money

There are a number of existing partnerships between independent energy companies and real estate investment managers/owners/operators. Stream Realty Partners is partnering with independent power producer Catalyze to deploy solar and battery storage projects across its industrial property portfolio. Trammell Crow Company and Altus Power have announced a strategic partnership to bring clean electrification solutions to TCC's real estate development projects. In the initial plan, Altus Power brings solar, battery storage and charging stations to TCC's 35 million square feet of industrial assets. NorthBridge Partners and Green Bridge Energy have formed a strategic venture NetZero Logistics Inc. to invest in energy transition infrastructure for the logistics real estate sector. Then there is BlackRock, which in the last 12 months announced a partnership with UK-based KX Power, and the acquisition of Australian-based Akaysha Energy. BlackRock announced both deals were focused on developing battery storage assets, with the latter announcement coming with a A$1 billion ($700 million) commitment.

Others are tackling battery storage from indoors. LBA Realty's Park Place project, in Irvine, California, which at the time of announcement was held to be the largest indoor battery storage system in the world, has the capacity to store 1.3 MW. The project delivers automated electricity savings to Park Place while also providing on-call demand reduction to help Southern California Edison balance the grid during peak times. The intelligent tech-driven storage system is set to automate energy by directing batteries to store power when energy costs are low, then deploy it in peak times to keep prices down and add stability to energy pricing — all without impacting tenant comfort or operations.

Conclusion

We have seen how the real estate sector responded to the pandemic, from last-mile logistics to cold storage generation, converting, repurposing and reimagining how space can be used. There is now an opportunity to respond to the support for renewables and the desire to cut carbon emissions. It's an emerging niche product called battery energy storage. Battery storage sits at the intersection of real estate and infrastructure, bringing two giant sectors together; and the best part is, it's just getting started. ◆

Deborah Smith is Co-founder and CEO of The CenterCap Group.

Serving *the* middle

The growing pool of middle-income earners, rising barriers to home ownership, and historically low supply make "Attainable A" multifamily housing an attractive proposition. However, construction costs, labor supply, regulations, and NIMBYism are challenges.

By Jamil Harkness, Bailard, Inc.

In the largest 40 metropolitan areas of the US, roughly one-third of the multifamily housing inventory (comprising 20 or more units) is made up of "Class A" units. Within this category, the more expensive "Trophy Luxury A" and "Luxury A" units represent 11% (480,000 units) and 52% (2.3 million units) of the available inventory, respectively. The lower cost end of the spectrum, which constitutes 37% of the total (1.7 million units) and represents the second largest segment, is composed of "Attainable A" properties.

According to data obtained from CoStar, multifamily supply and demand dynamics at the end of 2022 favor "Attainable A" properties over other "Class A" categories. Despite a general slowdown in resident demand across all segments and geographies in the past year, the vacancy rate for "Attainable A" only increased by 100 basis points, reaching 6.4% by year-end 2022. In contrast, the vacancy rate for "Trophy Luxury A" and "Luxury A" properties increased by 120 bps and 110 bps, ending the year at 8.7% and 9.2% vacancy, respectively.

Rent data showed a similar trend. Rents for "Attainable A" increased 3% year-over-year in 2022, with average asking rent for all unit types within this segment reaching $1,726 per month. Comparatively, average asking rent for "Trophy Luxury A" and "Luxury A" hit $3,425 and $2,250 per month, representing 2.6% and 2.3% rent growth, respectively, lagging "Attainable A".

We believe that "Attainable A" multifamily properties offer the best value to renters within the "Class A" universe, providing high-quality residential options to millions of renters who either cannot afford, or do not wish to live in "Trophy Luxury A" or "Luxury A" apartments. Moreover, we opine that this multifamily investment approach presents the opportunity to construct "Class A" apartments in a suburban locale at a fraction of the cost of developing luxury "Class A" apartments in densely populated urban cores or urban infill nodes, providing compelling risk-adjusted returns.

Defining "Attainable A"

The Bailard Real Estate team defines "Attainable A" as high-quality, well-amenitized, recent-vintage, moderately priced multifamily properties generally located in close-in suburban markets.

Based on this definition, these properties are typically garden style or low-rise wood-frame construction. “Attainable A” differs from “Trophy Luxury A” and “Luxury A” in several respects, including design, materials, finishes, amenities, and locational attributes (see Exhibit 1).

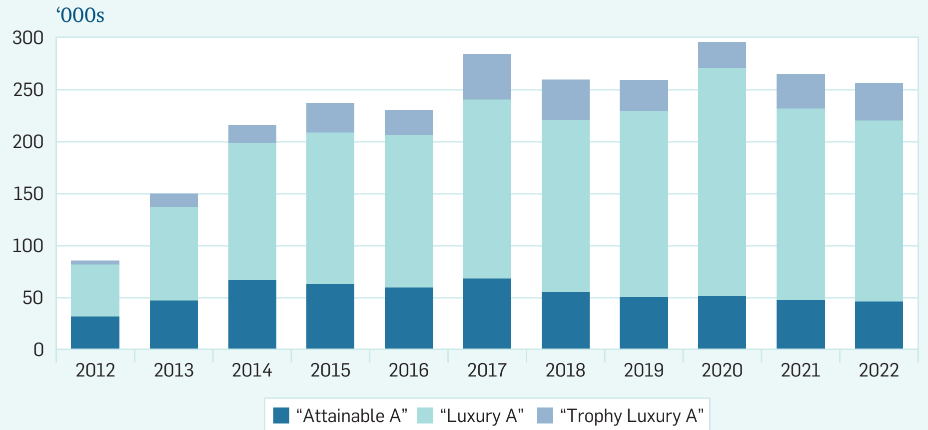
“Attainable A” multifamily is often a good fit for middle-income renters by necessity. Pew Research defines middle-income earners as individuals who make between 75% and 170% of the median income. According to the Bureau of Labor Statistics, median income for an individual in 2022 was $54,132. Therefore, target renters for “Attainable A” are those who earn an annual income of $40,600 to $95,000.

Data obtained from CoStar indicates “Trophy Luxury A” and “Luxury A” one-bedroom apartments in urban or infill neighborhoods average $3,000 and $2,100 per month, respectively, making them unaffordable for most middle-income individuals. However, an “Attainable A” one-bedroom apartment in a first-ring suburban market rents for approximately $1,440 per month, a discount of 51% and 33% to “Trophy Luxury A” and “Luxury A” rents. To qualify using the traditional “35% of salary” rent affordability metric, $49,000 per year is needed for “Attainable A”, while $102,000 and $75,000 per year at minimum are needed for “Trophy Luxury A” and “Luxury A” properties.

Exhibit 1: Characteristics of “Class A” multifamily properties

Bailard Real Estate definition	
“Trophy Luxury A”	• Architecturally distinctive • Highest-quality materials (stone, wood, glass, and metal) • High ceilings (9'+) • High-speed elevatoring • Highest-quality fixtures, hardware, and appliances • Amenities: Clubroom, fitness center, business center, pool, valet, pet park, etc. • Primarily urban and infill neighborhoods
“Luxury A”	• High-quality materials (stone, wood, glass, and metal) • High ceilings (9'+) • High-quality fixtures, hardware, and appliances • Amenities: Clubroom, fitness center, business center, pool, valet, pet park, etc. • Located in urban infill and close-in suburban neighborhoods
“Attainable A”	• High-quality, durable materials • Predominantly “walk-up” and low-rise with hydraulic elevators • Good quality finishes (wall-to-wall carpeting and hardwood laminate flooring, granite and manufactured stone counters, balcony/patio, in-unit washer/dryer) • Site amenities: Clubhouse, fitness center, business center, pool and pet park • Primarily in urban and first-ring suburban markets

Exhibit 2: Only 18% of “Class A” completions in 2022 were “Attainable A” properties



Source: CoStar, 2022.

The case for “Attainable A”

Over the past decade, the 40 largest metropolitan areas have seen a total of 2.9 million completed multifamily units. “Class A” apartments, across all segments, accounted for the majority of new deliveries, comprising 2.5 million units or 86% of the total. However, combined “Luxury A” apartments totaled 1.9 million units, with only 587,000 “Attainable A” apartments constructed. As a result, middle-income Americans face a restriction in the supply of affordable “Class A” housing options, as shown in Exhibit 2.

Despite the limited number of “Attainable A” apartments completed in the last ten years, the middle-income renter pool remains sizable. Middle-income renters account for 54.3% of US renters and the majority fall within the 22 to 45 age group, which comprises Gen Z, millennials, and Gen X. Almost half, 49.6%, either live alone or with roommates. This economic cohort holds a variety of occupations including: carpenters, plumbers, firefighters, police officers, office managers, nurses, 1 https://fred.stlouisfed.org/series/ASPNHSUS , https://fred.stlouisfed.org/series/MORTGAGE30US, CBRE-EA.

2 The return on cost represents the investment's returns, net of joint venture partner fees, and investment-level leverage. As such, fund-level fees and expenses are not included in the calculations.

teachers, sales associates, marketing managers, surgical technologists, IT professionals, project managers, and real estate agents.

In fact, the proportion of middle-income earners in the US has remained stable at around 51% of all workers, vs. 52% in 2012. However, due to employment and population growth, the absolute number of full-time working earners has substantially increased in the past decade. Our analysis, using data from the Census Bureau and Pew Research, suggests that across the 40 largest metropolitan areas, 3.5 million new middle-income earners were added to the workforce over the past decade, as depicted in Exhibit 3. Given the sheer size of the pool of working adults in the middle-income bracket, which is growing and constantly being "refreshed" by new (and younger) workers entering the labor force, "Attainable A" product is well-positioned to reap the benefits as an attractive and affordable housing option.

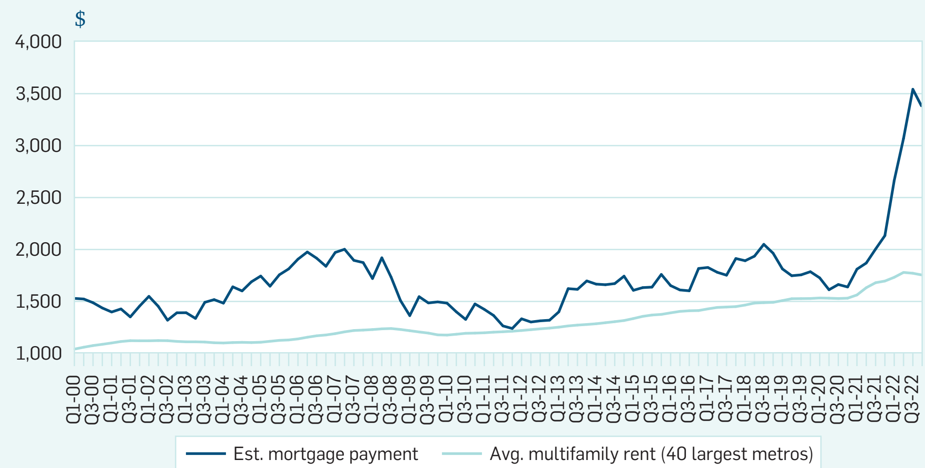
Another crucial factor which has recently expanded the growing renter pool, especially for those in the middle, is the declining affordability of single-family homes. Due to the recent increases in interest rates, the average 30-year mortgage rate reached 6.5% in Q4 2022, up from 2.7% in 2020.[1] Average home prices have also increased dramatically (33%) over that same two-year period, from $403,900 to $535,800. Assuming a 90% loan-to-cost, 30-year amortizing mortgage, the average monthly mortgage payment is $1,570 higher than average multifamily rents. The widening rent vs. own gap is illustrated in Exhibit 4. Of late, the pool of renters is expanding beyond middle-income earners to higher-income earners who may have previously considered buying a home but can no longer afford to do so.

Exhibit 3: The absolute growth in middle-income earners has outpaced other earners in the largest 40 metros

Year	# of full-time, year-round workers with earnings (in millions)	# of low-income earners (in millions)	# of middle-income earners (in millions)	# of high-income earners (in millions)
2011	51.8	12.9	**26.9**	11.9
2021	59.7	14.9	**30.4**	14.3
Change	7.9	2.0	**3.5**	2.4

Source: US Census Bureau, American Community Survey, Pew Research, 2022.

Exhibit 4: The obstacles to buying a home are growing, thus widening the rent-to-own gap



Source: US Census Bureau, CoStar Group, Bailard Research, 2022.

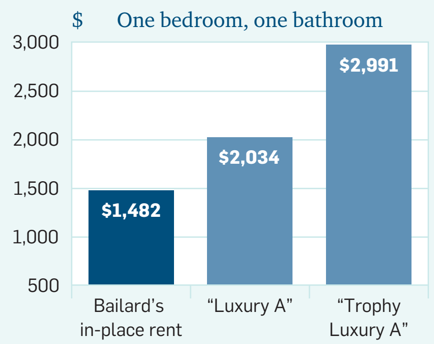
Develop or buy?

"Attainable A" properties are often located in suburban locations. With limited land in both the core and infill micro-markets in many metropolitan areas, multifamily development in those nodes tend to be vertical, dense, and expensive. Because zoning and land-use restrictions in many suburban markets limit the height of most properties, including residential buildings, garden-style, and other low-rise multifamily projects are the norm.

When deciding to develop or buy a property, factors like market dynamics, capital costs, and regulations must be vetted. Generally, if buying an existing property costs materially more than developing a new one, developing is the preferred choice. Bailard Real Estate's 271-unit apartment in suburban Austin is an example of a development that generated a return on cost of 6.6%; 250 bps higher than what Bailard could have achieved by purchasing an existing stabilized asset of similar quality in a comparable location at the prevailing capitalization rate.[2]

The rental rates for Bailard's suburban Austin development are significantly lower than other "Class A" properties, as demonstrated in Exhibit 5. Using the

Exhibit 5: "Attainable A" rents are much more affordable in Austin, Texas



Source: CoStar, Bailard Research, 2022.

standard "35% of salary renter affordability" metric, a resident of Bailard's project would need to earn $50,800 per year to qualify, compared to $70,000 per year for "Luxury A" and $102,500 per year for "Trophy Luxury A".

In weighing the considerations of building in suburban markets vs. urban centers, several elements are either neutral or stand out in favor of suburban locations, including:

- Business friendliness (including tax and regulatory burdens)
- Population characteristics
  - Suburban household count (affected by population and job growth)
  - Educational levels
- Micro-market factors
  - Accessibility
  - Visibility
  - Proximity to amenities and shopping
  - Safety and security (both perceived and actual)
  - Quality of schools
- Return metrics and alternative investment pricing
- Affordability considerations (including cost of living and rent-to-income ratio)

In assessing the criteria listed above, the Bailard Real Estate team identified a number of markets within each of NCREIF's four geographical regions across the US which "check the box" on most or all of the factors enumerated, and are attractive targets for "Attainable A" development (see Exhibit 6).

Risks

Although we believe the investment case for "Attainable A" is strong, several barriers to entry limit additions to supply. First, "not in my backyard" (NIMBY)ism remains a significant deterrent to multifamily builders and developers. Homeowners fear that certain multifamily developments could bring undesirable impacts (i.e., traffic, congestion, strain on public services, etc.), and also potentially depress surrounding home property values. This can result in significant public opposition, and/or more regulatory burdens that prevent building new homes in areas that sorely need them.

Second, elevated construction costs due to inflated commodity prices, higher labor costs, increased costs for planning, permitting, and approvals, and the higher cost of capital (i.e., construction loans and equity) can stand in the way of new multifamily developments getting built. According to CBRE Research, construction costs increased by 14.5% in

Exhibit 6: Representative "Attainable A" markets

West	Midwest	South	East
Denver	Cincinnati	Atlanta	Charleston
Phoenix	Columbus	Austin	Charlotte
Portland	Kansas City	Dallas	Philadelphia
Sacramento	Milwaukee	Houston	Raleigh-Durham
Salt Lake City		Orlando	
Seattle		San Antonio	

Source: Bailard Research, 2022.

[3] *2022 US Construction Cost Trends*, CBRE, July 2022.
[4] *2022 US Construction Cost Trends*, CBRE, July 2022.

2022 (vs. 2.8% per year average in the prior 10 years), primarily due to increases in hard and land costs which account for 60% to 80% of total construction costs.[3]

Third, local zoning and regulations remain resistant to new multifamily projects in favor of single-family housing in nearly every state across the country. As a result, many multifamily builders encounter higher burdens, including a broad range of fees and other requirements imposed at different stages of the construction process.

Last, but not least, labor availability has the potential to curtail housing development, in general, and multifamily construction in particular, as the workforce is not expanding at the rate necessary to meet demand. According to CBRE Research, construction employers are struggling to hire and retain crews; job openings increased by 11.3% while construction worker unemployment ended the year at 3.5% (the lowest since Q4 2019).[4] Labor shortages is a problem even if other construction costs remain in line.

Conclusion

The "Attainable A" product segment will continue to be a solid performer due to population/demographic trends, favorable supply/demand dynamics, and the unfavorable affordability challenges for single-family home ownership. This reality will help keep multifamily assets at the top of investors' list of preferred property types. Furthermore, more cost-efficient, less dense suburban markets are primed to continue to benefit from longer-term secular trends. Given the expected growth of the target renter pool across the country, the need for housing, especially affordable housing, is more acute than ever. ◆

Jamil Harkness is a Research & Performance Associate at Bailard, Inc.

Improving SEISMIC risk management

ASTM's incorporation of earthquake hazards in their forthcoming Property Resilience Assessment Guide may offer clarity and consistency to managers struggling to improve seismic resilience in portfolios.

By Jason G. Coray,
Partner Engineering and Science

The recent 7.8 magnitude earthquake in Turkey and Syria, as well as a smaller 3.8 magnitude earthquake closer to home in Buffalo, New York, underscore the importance of understanding and mitigating for seismic activity in the greater constellation of growing risks brought about by natural disasters and climate change.

In response to growing pressure to document and disclose risk exposures, ASTM International is expected to release a guide later this year that will provide recommendations for property resilience assessments (PRA).

Resilience (the 'R' in ESG+R) refers to how an asset can adapt to the ongoing effects of rising sea levels, changing flood maps, droughts and extreme temperatures, as well as the immediate impact of natural disasters such as hurricanes and wildfires. How does seismic resilience factor into these new standards?

While the relationship between climate change and seismic activity is a topic of debate in scientific circles, there is no doubt that earthquakes have the potential to drive sudden and significant losses to a real estate portfolio. Managers with properties vulnerable to seismic risk should thus take measures to boost the seismic resilience of their portfolios. Accordingly, ASTM International will incorporate seismic resilience in the new PRA standard under a hazard category called 'geologic phenomenon.'

The new PRA standard will address three stages of the risk assessment process: hazard, risk and resilience measures. The hazard stage is the fairly straightforward process of reviewing regional hazard data, including US Geological Survey's seismic hazard maps, California Geological Survey (CGS), the National Oceanic and Atmospheric Administration (NOAA) Tsunami Program, and other state and local sources to identify known hazards to the property.

The challenge in establishing guidance for seismic resilience lies in the risk and resilience stages: standardizing risk assessment, a practice that currently encompasses a number of diverse methods; and defining resilience as it pertains to earthquake hazards.

Standardizing seismic risk assessment

Preceding ASTM committees have standardized and continue to refine the practice of assessing buildings for financial risks from physical seismic damage. Still, different assessment methods and models — yielding different results — do not address resilience and may leave managers

“The challenge in establishing guidance for seismic resilience lies in the risk and resilience stages: standardizing risk assessment, a practice that currently encompasses a number of diverse methods; and defining resilience as it pertains to earthquake hazards.”

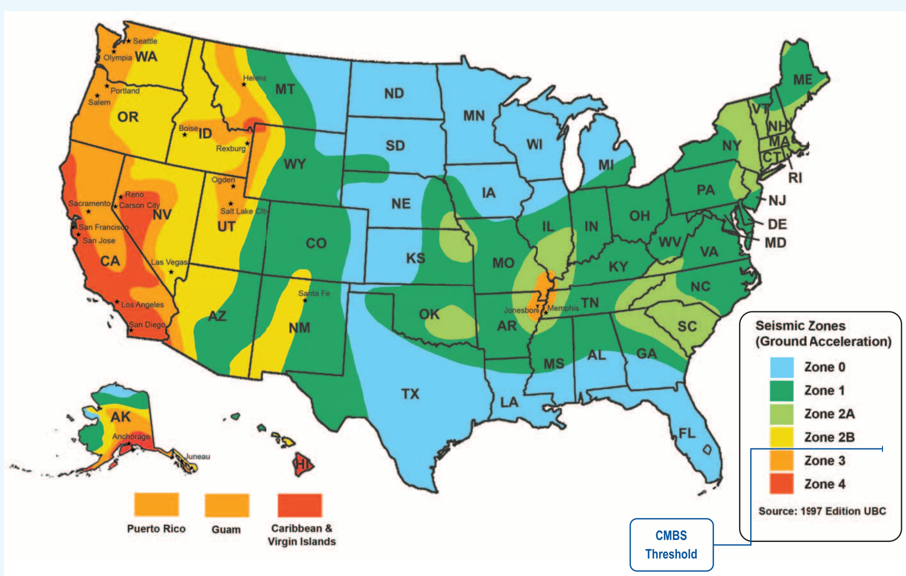
Seismic risk assessment 101

Seismic risk assessments (SRAs) are used by property owners, lenders and others to understand and manage earthquake-related risks. SRAs encompass site stability, building stability and building damageability, though evaluations of damageability of building contents and business interruption can also be completed.

Typically, SRAs are conducted for properties in areas with greater potential for damaging earthquakes, such as seismic zones 3 and 4 on the UBC seismic zone map (see map below). However, some lenders require SRAs in other areas. Freddie Mac and Fannie Mae, for example, require evaluation of seismic risks for properties based on thresholds for 'peak ground acceleration,' a metric available on the United States Geologic Survey (USGS) website.

Unlike a PRA, SRAs typically do not include resilience/recovery components. For properties that would typically require an SRA, seismic should be included in the PRA, and it is time- and cost-effective to complete a PRA and SRA in tandem.

UBC seismic zone map



The problem with PML

One of the most common expressions of earthquake risk is probable maximum loss (PML). PML assessments typically provide a statistical estimate of building damage based on user-defined risk tolerances. Most are performed in accordance with ASTM standards E2557 and E2026, which define common terminology and identify levels of assessment, so they are a useful basis for communication and scoping assessment projects.

However, in terms of risk calculation, they allow multiple methodologies and models including "proprietary methods both disclosed and undisclosed," which can introduce subjectivity and wide variance between outcomes.

Furthermore, many of the loss models used in seismic assessments are based on statistical performance data of large populations of building types, much of which was collected prior to 1980 and have not been updated since. These models do not consider individual building characteristics, recent earthquake performance data or recovery time; therefore, evaluation of potential risks will require significant engineering judgement.

confused as to the best way to evaluate their exposure.

The risk stage of a PRA addresses the specific vulnerability of a real estate asset based on-site and building characteristics as evaluated via site observations. It is noteworthy that the new PRA standard includes a site inspection as part of the minimum scope.

While an increasing number of consultants offer climate resilience assessments, many limit their assessment to a review of regional and local hazard data such as flood maps, seismic maps and historic weather data. This method provides an incomplete picture of risk, as it fails to consider the attributes of the building and building site.

For example, two office buildings on the same city block would be exposed to similar seismic hazards. Using only a seismic zone map, a potential buyer might assume the same level of seismic risk for both buildings. Of course, if one of the buildings is a wood-framed structure and the other is constructed with ductile steel, the buildings would perform very differently during the same earthquake; steel-framed structures can reduce seismic risk. However, even with hazard maps and building plans in hand, the potential buyer may not be able to accurately determine the relative risk of each building.

A reliable assessment must include a site visit to evaluate architectural features, building systems and equipment, as well as building contents that could be considered risk factors. For this reason, the PRA will rely heavily on existing ASTM seismic risk assessment standards and seismic resilience assessment (SRA) results, the necessary performance of which would typically already have been commissioned concurrently during transactional due diligence.

> "While an increasing number of consultants offer climate resilience assessments, many limit their assessment to a review of regional and local hazard data such as flood maps, seismic maps and historic weather data."

New tools

In recent years, the structural engineering community has developed new tools to improve seismic assessment. One such tool is FEMA P-58. Developed by the Applied Technology Council (ATC) and funded by the National Science Foundation, this model for seismic assessment and design incorporates almost two decades of earthquake performance research and contributions of over 100 engineers and scientists. P-58 is used for building-specific loss estimates, including structural elements and non-structural elements such as windows, cladding and elevators.

The drive for more accurate and consistent seismic risk assessment has also prompted the development of seismic performance rating systems that include recovery time. Two prominent rating systems have emerged and collaborated, namely the US Resiliency Council (USRC) and the Structural Engineers Association of Northern California's (SEAONC) Earthquake Performance Rating System (EPRS).

> In defining seismic resilience, it is also important to understand that compliance with building codes and/or local seismic ordinances does not necessarily guarantee resilience.

Recognizing the inconsistencies between seismic risk assessment models and outcomes, the new PRA guidance provides recommendations for the minimum scope of resilience assessment, minimum qualifications of providers, and parameters to encourage consistent outcomes. Ideally, it will offer investors a comprehensive and holistic means to evaluate seismic risk and discriminate between high seismic risk investments and lower risk investments.

Defining seismic resilience

The resilience stage of a PRA will identify and estimate the cost of specific resilience measures. This is where the definition of resilience comes into play.

Property resilience is the ability of a facility to adapt to and withstand disturbances while retaining the same basic structure, function and self-regulation. Expressions of resilience include the capacity of an asset to adapt, adjust, withstand and recover from various external forces, including global climate change.

However, even this basic definition leaves room for interpretation. What constitutes recovery from earthquake damage? Is it when the structure is restored and cleared for re-occupation? Or is the asset recovered when occupants have resumed operations and cashflow and/or rental income is restored? Return of normal building operations is referred to as 'functional recovery,' a concept currently being studied and developed at the national level by NIST-FEMA, ATC and others. Depending on the needs and perspective of the PRA user, either answer could be correct.

In defining seismic resilience, it is also important to understand that compliance with building codes and/or local seismic ordinances does not necessarily guarantee resilience. Modern building codes are written to support life safety and prevent collapse, but offer less guidance regarding damage reduction and recovery.

Similarly, mandatory seismic retrofit ordinances enacted by many West Coast cities were written to protect the public from seismically hazardous buildings that might otherwise collapse in an earthquake. They are not designed to limit building damage or speed recovery time. Furthermore, resistance by building owner and tenant groups concerned about cost and displacement of tenants during such retrofits often results in constrained scopes that balance these concerns against safety objectives. In other words, the level of building resilience achieved by compliance with a mandatory retrofit ordinance likely would not meet resiliency objectives.

Not all PRA users will understand the gap between compliance and resilience, just as not all users would have the same definition of resilience. The new PRA standard will provide guidance for determining the needs and objectives of the PRA user to encourage meaningful, transparent communication of PRA findings. User objectives will also inform measures recommended in the resilience stage of a PRA.

Resilience recommendations

Beyond structural measures, such as seismic retrofit, recommendations for seismic resilience could include recovery measures such as post-earthquake alert and management programs, systems for rapid assessment of earthquake damage, or occupancy resumption planning.

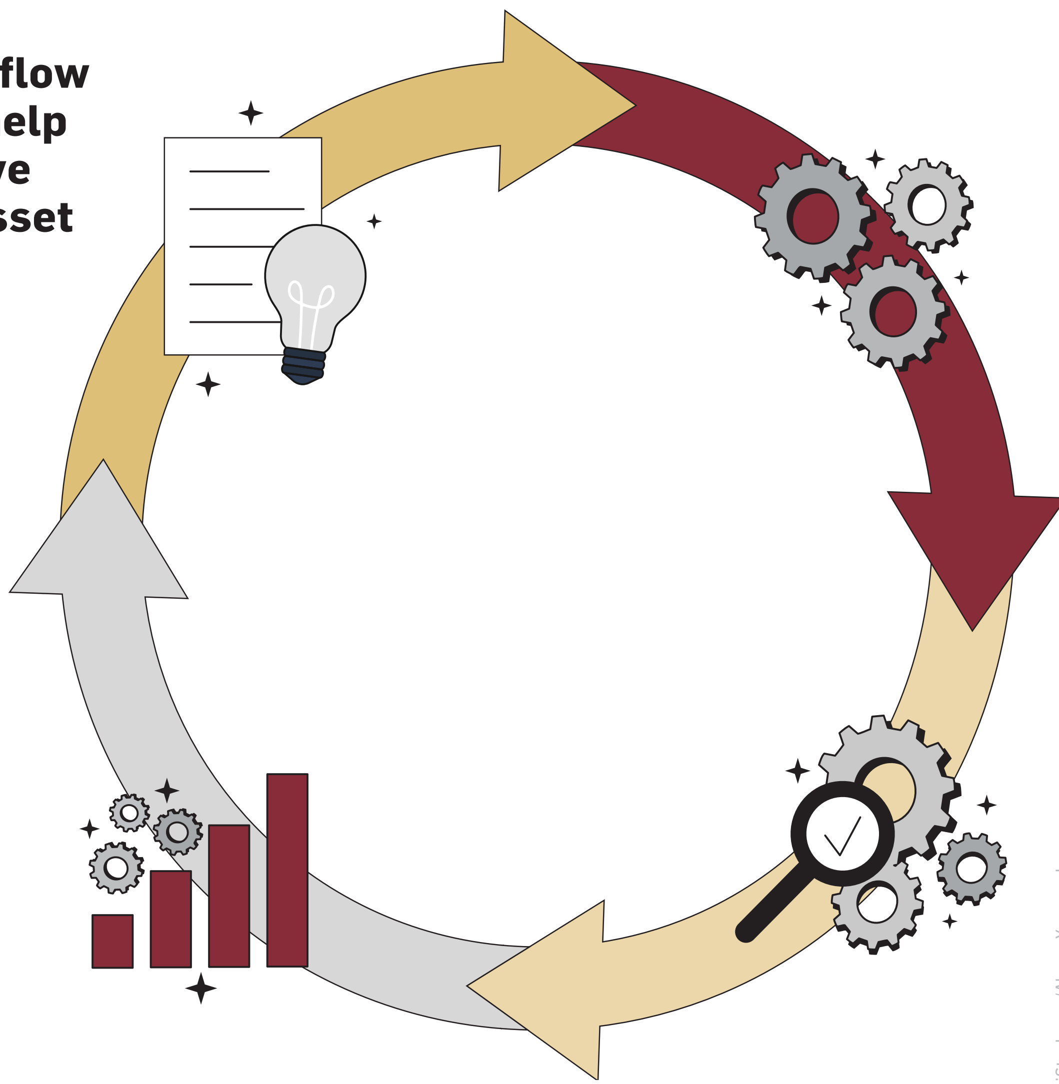
The new PRA standard also addresses community resilience, which considers the impact of a seismic event on neighboring structures and resources that could affect the recovery of the subject property. These resilience concepts and tools can potentially aid compliance reporting, asset risk management and property management, as well as increase investor and stakeholder confidence.

As the commercial real estate industry continues to prioritize ESG+R, including seismic resilience in ESG+R policy and standards can result in reduced repair costs and faster recovery, thereby decreasing economic losses due to physical damage, loss of use, lost rent and business interruption. The engineering and real estate investment communities will both benefit from clarity and standardization in seismic risk evaluation and increased efforts toward seismic resilience. ◆

Jason G. Coray, PE, SE is National Technical Director-Seismic Division for Partner Engineering and Science, Inc.

Better asset FORECASTING

Continuous cash flow forecasting can help managers improve the visibility of asset performance in real-time market conditions, thus improving decision-making and outcomes.



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By Damien Georges,
RealPage, Inc.

> “Unlike quarterly cash flow, which is a periodic analysis, continuous cash flow is a more frequent and ongoing process. It enables managers to monitor financial performance in real time and make adjustments as market conditions change.”

Real estate asset managers understand the importance of making informed investment decisions. But what happens when the market takes an unexpected turn? That's when continuous cash flow forecasting is most valuable to project future cash flows based on past and current financial data from sources including rental income, property expenses and market trends.

Continuous cash flow forecasting is a process that involves regularly updating and analyzing financial projections based on the most up-to-date financial data. Unlike quarterly cash flow, which is a periodic analysis, continuous cash flow is a more frequent and ongoing process. It enables managers to monitor financial performance in real time and make adjustments as market conditions change. Continual updates can include changes in market leasing assumptions, budget assumptions or specific leasing events.

Here we look at the benefits and challenges of continuous cash flow forecasting for real estate investment management. This guide to continuous cash flow forecasting includes best practices and recommendations for effectively implementing this process. Doing so can enable managers to make more informed investment decisions, minimize risk and ensure the long-term success of their portfolios.

The benefits

Continuous cash flow forecasting offers a range of benefits, including:

- ***Improved investment decisions.*** Projecting future cash flows to identify trends, spot opportunities and make more informed investment decisions helps maximize returns and minimize risk, ensuring long-term portfolio success.
- ***Increased transparency and accountability.*** A clear and comprehensive view of future cash flows can increase transparency and accountability to demonstrate due diligence and give stakeholders detailed information to make informed decisions.
- ***Better risk management.*** Projecting future cash flows helps to quickly identify potential risks and act to mitigate them, aiding in prevention or minimization of financial losses and ensuring portfolio stability or growth.
- ***Increased flexibility.*** Greater visibility facilitates quick response to changing market conditions and adjustments in investment strategies towards capitalizing on opportunities and minimizing risk.
- ***Improved portfolio analysis.*** A comprehensive view of portfolio performance makes it easier to identify trends, spot opportunities and make informed investment decisions.
- ***Accurate budgeting.*** Having access to reliable, timely and precise information to budget and allocate resources is critical to investment success.
- ***Better communication with stakeholders.*** Having clear and direct access to current portfolio information for stakeholders ensures they receive the latest information and timely updates to make informed decisions.
- ***Early identification of issues.*** Seeing changes in performance and market conditions sooner allows faster action to prevent financial losses and minimize risk.
- ***Streamlined decision-making process.*** Removing reporting delays and minimizing manual steps with advanced integration and analysis improves speed, reliability and efficiency in the decision-making process.
- ***Increased confidence in investment strategies.*** A clear and comprehensive view of future cash flows, increased access, visibility and accuracy helps achieve better investment outcomes.

How it helps to manage risk

Continuous cash flow forecasting plays a crucial role in managing risk through expanded opportunities for insight and decision support:

- ***Real-time data and tools.*** Managers who have access to real-time data and tools can quickly identify and respond to potential risks with proactive measures to mitigate issues before they become major problems.
- ***Identifying risks earlier.*** Revealing problematic conditions or activities when they are still small and

manageable allows time to gather the right data and gain context to make informed investment decisions and avoid costly mistakes.

- ***Improved portfolio analysis.*** By regularly analyzing and updating forecasting models, managers can gain a deeper understanding of how portfolios can, and will, perform against emerging trends, potential risks and strategic decisions expected to affect their investments.
- ***Understanding tenant behavior.*** Continuous cash flow forecasting can also give managers more visibility into rent roll information and tenant relationship components. For example, tracking tenant payment patterns quickly reveals specific instances of potential rent payment defaults.

Best practices for effective continuous cash flow forecasting

Because effective continuous cash flow forecasting is critical to successful real estate investment management, managers should adopt a set of best practices that support the delivery of reliable projections of future cash flows with consistently relevant and accurate forecasting models.

One key best practice is incorporating real-time data into forecasting models, to provide a clear, credible picture of future cash flows. To ensure that data is accurate and reliable, take steps to validate and cleanse data as well as to verify data sources.

Another essential element of effective continuous cash flow forecasting is collaborating with other teams, such as leasing, property management and financial planning, to ensure models accurately reflect the current state of portfolios and their future outlook. Seeking expert advice from industry professionals can also ensure that forecasting models are up to date and reflect the latest best practices.

Using advanced forecasting tools, such as RealPage FUEL, Anaplan or Argus, can improve the accuracy of projections. Managers should communicate the results of their forecasting models to investors, tenants and other relevant parties.

Continuous monitoring and adjustment of forecasting models to ensure they remain accurate and relevant is critical to their effectiveness. When a culture of forecasting is encouraged within the organization, the practice becomes a regular part of the investment management processes and teams in the forecasting process.

Implementation challenges

A few of the most common factors that can slow down or limit success without the right resources, tools and planning are:

- ***Data accuracy and reliability.*** One of the biggest challenges of implementing continuous cash flow forecasting is ensuring that the data used is current and free of errors. To overcome this challenge, managers must invest in high-quality data sources and implement rigorous data quality checks.
- ***Integration with other systems.*** Integrating with other systems used by the investment management team can be a complex and time-consuming process. However, it is critical to ensure that all relevant data is being correctly and securely captured, shared and used for maximum integrity in the forecasting process.
- ***Overcoming resistance to change.*** Implementing any new process can be challenging, especially if it requires changing established ways of working. Managers may encounter resistance to change from their team members, who may be uncomfortable with using new tools or processes. Overcoming this resistance requires training and communication about the benefits of continuous cash flow forecasting, the availability of dedicated training and support, and encouragement of a culture of continuous improvement.

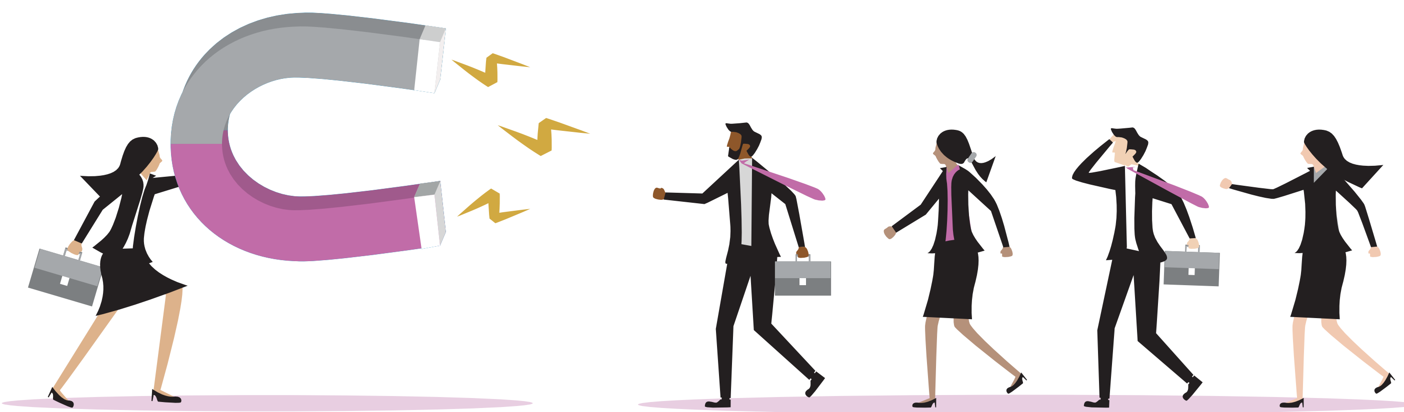
Conclusion

Continuous cash flow forecasting is a critical component of real estate investment management. It has numerous operational benefits, including improved investment decisions, increased transparency and accountability, and better risk management. By incorporating real-time data, ensuring data accuracy and reliability, and regularly reviewing and updating forecasting models, you can improve the quality and success of your continuous cash flow forecasting efforts.

In a rapidly changing market, continuous cash flow forecasting is increasingly important to remain competitive and stay ahead of the curve. Whatever your level of experience or expertise, continuous cash flow forecasting is a valuable tool that will help you make better investment decisions, respond to change more efficiently and achieve your goals. ◆

Damien Georges is SVP, Investment Management Sales at RealPage, Inc.

What young talents want



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It takes more than a brand name and cash to attract and retain young real estate talent — inspiring managers and a visible career path are equally, if not more, important for the industry's next generation.

By Jackie Siegmund, NAREIM Jeff Barclay Fellow

The year of the 'Great Resignation,' as 2022 was known, featured a labor market unlike any in recent history. A record 50.5 million people in the United States quit their jobs, and, because of a surplus of roles, had no trouble finding new ones. This led wages to increase at their fastest pace in decades, making it extremely difficult for companies to retain employees. The real estate industry was not immune.

While the current quit rate has decreased from this time last year, employers are still focused on tactics to retain top talent and win over new junior employees in conservative preparation for more real estate market activity when the Federal Reserve backs off on increasing interest rates. While compensation is the most important factor for junior and mid-level candidates when accepting and staying in a job, other efforts by employers can facilitate a star talent's job satisfaction necessary to keep them at a firm.

I am currently finishing my second year of the MBA program at New York University's Stern School of Business. During my studies I have focused on real estate and finance and I am pursuing a career in real estate investment management. As a young talent entering the real estate industry, I know what is important to me when choosing to accept a job offer or stay at a company; I was curious to understand if my peers felt the same.

Over the course of five weeks in January and February 2023, I conducted an informal but structured survey of 16 Stern students who are planning to pursue junior roles (Analyst and Associate) and mid-level roles (Vice President) in the real estate industry in the next two years. Of those surveyed, 25% were undergraduate students and 75% were MBA students. I asked them qualitative and quantitative questions about their motivations when choosing to accept or stay in a role relating to compensation and other factors. My goal was to determine how important compensation really is, and what other elements come into play in an effort to provide managers with insight into what can be done to win and retain young talent.

Remember to manage your managers

The survey revealed that 60% of MBA participants, primarily applying to Associate and Vice President roles, chose their potential managers' personality and management style as one of the top three most important factors outside of compensation when considering a role. Of those, 71% listed it as their number one consideration outside of compensation. This shows that companies need to train their managers not only to manage effectively, but to interview successfully as well. Leadership should consider this when promoting employees into management roles — performance is important, but the ability to manage, inspire and build loyalty is also necessary when building a successful team.

Justinn West-Wheatley, HR Business Partner at BentallGreenOak, has seen this firsthand. "The number one reason people quit jobs is, they don't quit the company, they quit the manager."

West-Wheatley emphasized the importance of the employee-manager relationship, which starts with onboarding: "The onboarding aspect increases retention. It's hard to build that connection virtually, but now that we're back in the office and hiring people, having a connection to the company, to their colleagues, to their manager increases retention and helps develop a career path when the candidate is able to see where other people have gone and have conversations with them one-on-one about, for example, how they started as an analyst and now they're a VP or MD. Having those conversations in person is really impactful."

Employees in junior roles in the real estate industry are particularly eager to come into the office and interact with their colleagues. Less than 7% of survey respondents seeking junior roles indicated that hybrid or remote work options were important to them. Part of a good relationship with a manager includes in-person interaction. Junior employees are often unsatisfied with a workplace where they are in the office five days a week and their managers and senior team leaders are not.

One MBA student recounted their summer internship experience: "I was able to get to know the Associates on my team really well. I learned from them every day and felt like I built strong personal relationships with them. The MDs on the team were rarely in the office, so not only did I not get to build relationships with them or learn from impromptu conversations or overhear phone calls, but the Associates on the team felt the same way."

At the analyst level, while all respondents listed having a relationship with their manager in their top three most important factors when accepting a role, 75% of undergraduate respondents indicated that the most important factor is seeing a clear path for career growth. These candidates are acutely focused on growing out of entry level and want to know that a job will provide support for their growth and that great performance will be rewarded. The importance of career growth is stronger with mid-level candidates, with 83% of MBA respondents listing it in their top three considerations and 30% selecting it as their number one.

One tactic to address this key attraction and retention factor is to create formal internship and analyst programs to bring in young talent at the beginning of their careers and educate them on the opportunities both in the real estate industry and in the future at the company. David Norman, Vice President of Human Resources at Prologis, has worked with his team to formalize the company's internship program, building it to 30 summer

> “Part of a good relationship with a manager includes in-person interaction. Junior employees are often unsatisfied with a workplace where they are in the office five days a week and their managers and senior team leaders are not.”

> The majority of NYU Stern MBA and undergraduate students surveyed consider a visible path for career growth to be the most important element when deciding whether or not to stay in a job.

interns working on teams across the firm.

Additionally, Prologis is focused on reaching diverse talent pools. Norman added: "We're now partnered with Project Destined [a nonprofit organization supporting the next generation of real estate professionals], to help beef up our pipeline of junior talent coming from historically marginalized communities."

By addressing any shortcomings in recruiting tactics when it comes to reaching talent, and then building a funnel to keep young talent engaged while in school and shortly after graduation, companies can create larger, more diverse, better prepared and all-around stronger talent pools to hire from. The chances these stronger candidates will accept the roles are also higher because they will already be familiar with the firms.

Prove it isn't all talk to retain employees

In almost all scenarios, compensation is king. But when it comes to retention, compensation increases can be coupled with other elements to keep employees happy. The majority of NYU Stern MBA and undergraduate students surveyed consider a visible path for career growth to be the most important element when deciding whether or not to stay in a job. Having a positive relationship with their manager was the second most common answer. Third was interesting work and compensation increases.

While there is no getting around the importance of salary levels at or above market, components like communicating career growth opportunities and expectations, training managers to lead their teams positively and effectively, and ensuring junior staff are challenged by and interested in their work can help keep employees engaged for the long term.

Because of the importance of salary in retention, it is important to address salary levels regularly, not just annually. "Once an employee is onboard, compensation is hugely important," said Norman. "We're looking at compensation all the time. It's an ongoing process, not just a once-a-year process."

For entry-level candidates and employees, base salary is the most important part of a compensation package. West-Wheatley said, "A lot of junior people, especially if this is your first corporate job, you're focused on what you're getting right now. I tend to find when we're negotiating offers that more junior folks are really focused on the base salary number."

But, West-Wheatley finds that once talent starts to move up the ranks, even at the associate level, they are more open to the bonus forming a larger percentage of their overall compensation package. One Stern MBA who worked in the industry prior to business school and is seeking an Associate or VP role upon graduation said: "During my most recent job more than 50% of my compensation came in the form of a bonus payment. That's something I enjoyed because I felt it added a large incentive to perform and push towards a common goal as a team. Obviously, though, base salary cash is important for day-to-day life."

The Stern MBA continued: "Regarding carried interest, I'm interested in that form of compensation depending on the firm's standard investment horizon and how it is structured. I'd be less interested if the carry was paid out for 10 years, as opposed to a 3- to 5-year horizon." Non-salary compensation can be used to entice and retain mid-level talent, but it needs to be structured specifically for that level.

Finally, business leaders need to consider the environment they are creating for their employees, particularly those at the junior and mid levels. "We're all focused on creating a space that people want to be in, creating different avenues for people to feel welcome," said West-Wheatley. "It's not just about getting people in the door. It's making them feel comfortable when they're here. That is what's going to lead to retention." ◆

Jackie Siegmund is a 2023–2024 NAREIM Jeff Barclay Fellow and an MBA candidate at NYU Stern School of Business.