Real Estate Insights, Forecasts & Strategies
Editor: Christopher Lee
Strategic Advantage
Issue K102010

Talent…Opportunity Or Crisis?

In This Issue

- ***Talent…****There's A Shortage Looming*
- ***Higher Compensation…****Increasing Demands*
- ***Human Resources…****Elevating The Function Is Essential*
- ***Solutions…****Require A Commitment To Excellence*
- ***Special Outlook Report…****2010 – 2011 Compensation*

Friends & Colleagues:

Oh what a difference the passage of time has had on the real estate industry. A year ago the "announced" recovery was actually a recession in slow remission. Real estate companies were preparing for "more of the same" as the financing marketplace remained off limits to owners and investors. Fast forward to October 2010, and firms are now facing a number of crossroad decisions. Perhaps the most important mission-critical decision pertains to the composition and character of the talent required to be successful in 2011 and beyond. **Getting the right people in the right place at the right time is a cornerstone strategy.** However, when I look at the trending data I am somewhat concerned. We may not have enough talented, experienced and qualified professionals for a future of potential incredible opportunities. This conclusion is hopefully a call to action…particularly if you want to retain a competitive edge and profitability in the years ahead.

Talent Shortage Is Looming

One of the little known but **perhaps most significant future and long-lasting impacts on the real estate industry** may not be access to capital, supply/demand imbalance or lack of job creation…it **may be the looming shortage of qualified and experienced talent and leadership.** Over the next decade, our industry is facing an exodus of Founders, senior-level Executives and experienced professionals that is likely to reshape the industry in unexpected ways. **If current trends continue, the vacuum caused by the accelerating rate of Baby Boomers' retirement will result in fewer real estate organizations and a rise in the number of specialized vendors, entrepreneurs and Independent Contractors**. Harbingers of things to come include increases in: the application of technology; social media; collaboration between competitors; knowledge sharing; unit rather than square foot leasing; operations-based green technologies; energy inefficiency taxes; and other areas.

Since the passage of the Tax Reform Act in 1986, the anticipated number of "replacement" young college graduates entering the real estate profession has not materialized; in fact, staffing demographics are going in the opposite direction. Except for a brief period (2004 – 2007), **the real estate industry has increasingly relied upon an aging workforce of Baby Boomers and inner-directed Gen Xers**.

According to the U.S. Department of Labor, in 2000 (using Occupation Code 11-9141), there were 145,340 Property, Real Estate and Community Association Managers. By May 2009, the latest available data indicates that number increased to only 150,850…a net gain of around 5,500! According to the Bureau of Labor Statistics, in 1998 there were 1.9 million real estate employees in NAICS Codes 531, 532, and 533. By 2018, the BLS projects the total number of employees in those codes will have increased to nearly 2.4 million…an increase of 432,000 jobs over a 20-year period or an annual growth rate of 1.1%. Between 2008 and 2018, the U.S. Department of Labor projects a total employment growth in this code (11-9141) of 25,600 jobs and 52,400 total jobs due to growth and replacement needs, respectively. **Thus the real estate industry under the Real Estate Property Management, U.S. Department of Labor code will have an average of only 7,800 new job openings per year!**

Furthermore, while there has been modest job growth, between the years 2000 through 2009, the number of 5+ apartment units increased by 2,754,000. Thousands of office, industrial and retail buildings totaling millions of square feet were added yet employment was relatively flat. The (probably obvious) reasons for this employment stagnation can be attributed to:

- ♦ The integration of technology resulting in improved processes, procedures and efficiency.
- ♦ Consolidation and downsizing.
- ♦ Increased capabilities of existing employees, along with higher productivity.
- ♦ Enhanced leadership.
- ♦ Training.
- ♦ Outsourcing.
- ♦ Use of temporary employees and independent contractors.

It should be no surprise that real estate CEOs and their respective companies are not looking to dramatically grow their employment base but to "upgrade" their talent pool. A recent CEL & Associates, Inc. survey of national real estate leaders found that in 2011 "upgrading their existing talent base" was ranked third as the "most important" strategy.

Top Priorities In 2011 For Real Estate Executives

Top CEO Priorities	Rank
(Re)financing/Credit	1
Controlling Operating Costs	2
Upgrading Talent Base	3
Reshaping Business Model	4
CRM/Business Development	5
Managing Corporate G & A	6
Retention Of Talent	7
Managing Investor Relationships	8
Portfolio Optimization	9
Achieving Targeted Return Goals	10
Expanding Service Platform	11
Maintaining Corporate Culture	12
Downsizing	13

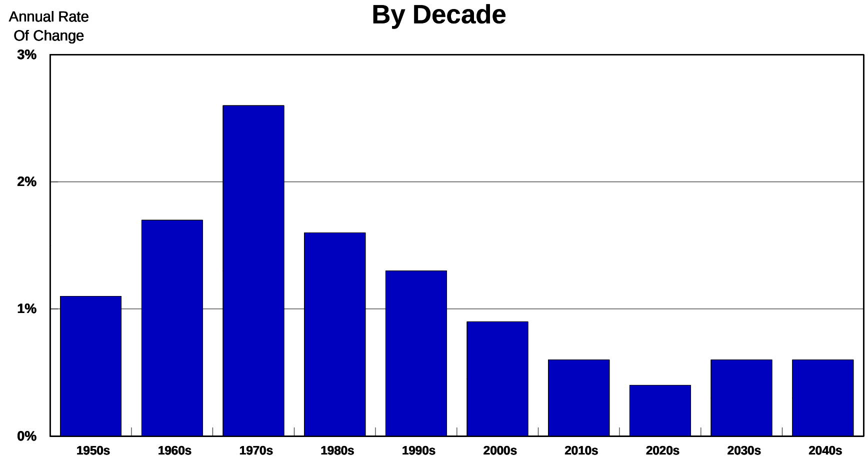
Source: CEL & Associates, Inc. and Participating Firms.

Unfortunately Baby Boomers are one of if not the major employment barrier today in the real estate industry. Faced with dramatic declines in their home values, 401(k) plans, net worth, long-term incentive plans and other investments, the **"First-Wave Boomers" (aged 57 – 64) are not retiring, but are focused on recapturing some or all monies/wealth lost over the past two or three years.** Resistant to change, reluctant to let go and struggling with how to relate and communicate with those 30 years and younger, this group of employees is blocking/restricting the number of openings for new employees. **The U.S. labor force participation rate for those over 55 was 29% in the mid 1990s…today it is around 40%!**

Approximately four million Boomers are expected to retire per year between 2010 and 2025…and I use the term "expected" with a great deal of caution. Yet according to the Employee Benefit Research Institute, only 30% of all Americans have saved enough for their retirement. However, let's assume the U.S. Department of Labor projections are correct. By 2015 the number of new workers aged 21 – 25 entering the workplace each year will be 3.6 million. When offset against the number of Boomers retiring, there will be a shortage of 400,000 workers in the workforce each year from 2012 – 2018. **CEL & Associates, Inc. estimates that by 2015 the real estate industry could be faced with a potential shortage of 15,000 – 25,000 qualified workers per year**. When demand is greater than supply, the resulting effect is wage inflation. If labor costs are 65% – 70% of a company's expenses, and wages, benefits and healthcare costs rise in excess of the rate of inflation (a very strong likelihood), then **real estate companies will either need to dramatically increase fees charged to clients or investors and/or downsize or restructure their staffing models to achieve desired profit margins**.

So here is the conundrum! The average age of an employee within the real estate industry is between 40 and 50 years, depending on the function and level. **CEL & Associates, Inc. estimates that by 2020 over 65% of senior leaders in the real estate industry will retire or be in the process of phasing out**. The combination of the exiting Boomers and a lack of infusion of young/next-generation talent (Xers who aren't ready, and Ys who are still learning) will result in a potential talent vacuum. Currently the demand is accelerating for trained college graduates with degrees in real estate. **Today over 80% of students (in some colleges it is 90%) receive job offers before they graduate**. While this is great, it will clearly not be enough. What will happen when the Boomers retire? Who will take their place? Will their replacements have adequate experience, relationships and capabilities? The real estate industry is about to experience a shock of epic proportions when the lack of qualified talent far exceeds the demand.

Annual Labor Force Growth By Decade

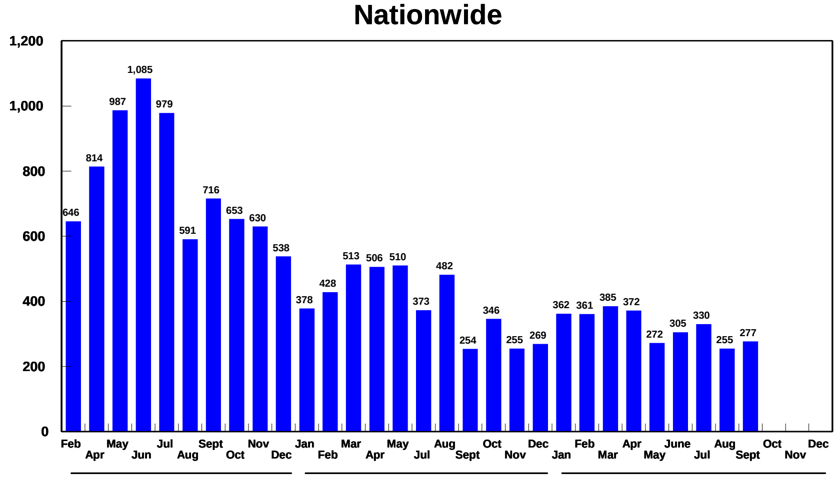


Source: U.S. Bureau Of Labor Statistics.

Increasing Demands For Higher Compensation

Compounding the pending shortage of qualified talent is the probable rise in demands for increased compensation. For nearly two years, most real estate firms froze salaries and wages, suspended or significantly decreased annual bonus awards, reduced or suspended contributions to 401(k) plans, passed along higher healthcare cost premiums to employees and reduced the overall "cost per employee." As the market bottoms out in 2010, the cry is underway for salary/wage increases, renewed bonus awards and a "rebuilding" of net worth lost because of asset value declines. From California to New York and from Florida to Minnesota, **real estate professionals are becoming or will soon become very vocal in their requests for increases in remuneration**.

Real Estate Jobs Posting Nationwide



Data represents real estate job postings within the first full week of the month in the 7 online job posting sites.
Source: Cornell University.

For those over age 55, "recapturing what was lost" is a major priority – even if that means changing jobs. **For those under 40, "being fairly paid" is very important** so the sacrifices of the past will be acknowledged. Healthcare benefits, retirement plans and long-term incentive programs are now under greater scrutiny and often can cause friction between the employer and employee. Brokers who saw their income drop 50% – 70% or more want changes in split arrangements. **The new mantra for employees appears to have become "compensation recalibration."** Real estate companies are responding by setting "realistic" performance expectations before incentive rewards kick in.

Following are highlights gleaned from recent CEL & Associates, Inc. surveys.

- New hiring within real estate firms will be up 3% – 5%.
- Replacement or "upgrade" hiring will likely be up 7% – 9%.
- Contributions to 401(k) plans will resume.
- Approximately 91% of real estate firms expect to award base salary increases in 2011.
- A growing percentage of the annual increase in healthcare costs are being passed along to the employee or the deductible/co-pay levels are being increased.
- Healthcare costs are likely to rise around 8% – 9% in 2011.
- With "company average" wage increases expected to be around 2.3% – 2.5% in 2010, the next 12 months will be a transition period for employers.
- The next 36 months will be an "Employee's" market for exceptional talent, despite the high unemployment numbers.

Emerging Trends
Compensation

Year	Senior Mgmt.	Exempt Employees	Non-Exempt Employees	Company Average	Inflation Rate	Bonus Realization
2009	1.4%	2.0%	2.1%	1.9%	-0.3%	64.4%
2010*	2.0%	2.5%	2.2%	2.4%	1.8%	69.8%

* 2010 based on CEL tracking at 3Q 2010.

Source: CEL & Associates, Inc./CEL Compensation Advisors, LLC.

Elevating The Human Resources Function

When the challenges of recruiting, hiring, training, motivating, rewarding and recognizing outstanding talent begin to surface as among the top priorities for real estate organizations, **the elevation of the human resources function will be essential**. In times of struggle, transition, challenge and transformation, how and when workforce issues are resolved can mean the difference between making and losing money. At a minimum I recommend that real estate companies take the following six actions.

1. Leading, high-performance organizations should elevate HR to a strategic partner relationship with management.
2. Best in class firms must develop and deploy a robust talent management plan.
3. A considerable effort must be made to develop next generation stars/leaders.
4. A long-term strategic workforce plan must be created to preempt future staffing challenges.
5. Real estate firms must look at their staffing models with a critical eye toward the current competencies within each position.
6. Real estate CEOs, Boards of Directors and Senior Management teams must review/revise their current compensation plans to reflect the new reality.

Human Resources is not a personnel, record-keeping function… it has a leadership partner role in financial performance and productivity.

Over the next 3 to 5 years, I expect **compensation, staffing and the entire human resources function to become as big an issue as access to capital. Without talent, a real estate firm cannot survive. Without meaningful compensation, talent will not stay**. Without a perception that tomorrow will be better than today, employees increasingly will seek greener pastures.

The Solutions Require A Commitment To Excellence

This potential crisis can be avoided if and when a real estate organization undertakes and embraces the following solutions.

- Hire and retain only those who embrace and believe in the vision, value proposition, goals and priorities of the company. It is a great deal easier working with those who have embraced corporate dogma than those with one foot out the door.
- Step back and take an independent look at your annual and long-term incentive program. Is it market competitive? Does it properly reward exceptional performance? Does it motivate and retain talent? Is it attractive to potential new hires?
- Modify your hiring practices so employee turnover can be reduced. Consider adopting core competency hiring practices.
- Upgrade and expand your training and leadership development programs.
- Enhance the frequency and quality of employee communications.
- Implement actions that enable employees to be participants rather than observers of organization strategies and initiatives.
- Create and deploy a robust leadership development program.
- Take an independent look at your organizational structure, reporting relationships and staffing plan. Utilize external staffing metrics to validate your service delivery platform.
- Revisit and enhance your employee recognition programs.
- Open a dialog between employees and management. Reinforce the “one team” concept.
- Prepare detailed succession plans for all mission-critical positions.

I realize it is not an easy task, and in fact, for many it may be perceived as a daunting challenge. But you have no choice. The lack of talent, compounded by a highly mobile workforce, will create many sleepless nights for CEOs and HR Directors. As Ralph Waldo Emerson wrote, “No great man ever complains of want of opportunity.” **This potential crisis, however, is actually an opportunity. It is an opportunity for those organizations that become talent centric. It is an opportunity to deploy a robust talent management plan. It is an opportunity for those who adhere to standards of excellence and mandate getting the right people in the right spots at the right time**.

Real estate firms in the 1980s actively recruited and were welcomed at Stanford, Harvard and many other outstanding colleges and universities. **Over the last two decades, the real estate industry lost some of its cachet**. We need to recapture the career interests of young professionals. We need to replace outdated titles (e.g., Property Manager) with titles reflecting the true nature of the responsibilities. We need to restructure compensation plans to align the interests of all Stakeholders and to utilize the proper metrics of performance. We need to elevate talent to the same priority as capital.

The Shifting Business Focus

Shift From		To
Focus on Service	⇨	Focus on Solutions
Information Gathering	⇨	Knowledge Sharing
Performance-Driven	⇨	Relationship-Driven
Interpreting Technology	⇨	Linking Technology
Reporting	⇨	Advice and Guidance
Collecting Commissions/Fees	⇨	Collecting Customers
Silos	⇨	Collaborative Teams
Responding to Change	⇨	Creating Change
Property Focus	⇨	Strategic Focus
Broker	⇨	Advisor
Property Manager	⇨	Enterprise Leader
Founder	⇨	Visionary

Source: CEL & Associates, Inc.

Remember, nothing happens in the real estate industry without talent. **Those real estate organizations that are able to attract, motivate, retain and reward the best of the best will emerge as the future leaders of our industry**. Those who address—today—the looming challenge of a future talent shortage will outperform their competitors. It is not a question of who has the best site or best building…it will be who has the best talent. Is your firm up to the challenge and opportunity?

To provide additional context and content to the 2010 – 2011 compensation issues facing real estate firms, I have included on the following pages a recent report by Jim Wright, Managing Partner of CEL Compensation Advisors, whose insights and perspectives are highly valued throughout the real estate industry.

Executive Compensation Within The Real Estate Industry
A 2010 – 2011 Outlook

By James B. Wright
CEL Compensation Advisors, LLC

Compensation in 2010 and into 2011 undoubtedly will be a topic at Board meetings, in Executive Committees and on the "To Do" list of every Department, Regional and Business Unit Leader. However, compensation is an art as well as a science. **An effective compensation plan, structure and governance can make the difference between average and great performance and results**.

Today there are six key trends every real estate firm must closely monitor and carefully respond to in this period of transition and transformation. The six trends are:

- Greater Independence Regarding Compensation Decisions
- Re-Calibration of Compensation to Markets and Performance
- Increased Disclosure
- Growing Shadow of Regulation
- Private vs. Public Performance and Compensation Trends
- Changing Compensation Policy and Strategy

A review of each trend and its impact on the real estate industry is highlighted below.

Greater Independence Regarding Compensation Decisions

Reducing the potential for conflicts of interest is at the heart of the "independent" Board and Compensation Committee policy and regulation of many private and public companies.

For the compensation mandate of Boards, several factors are changing the way Boards are hiring and using outside compensation consultants. **New regulations require that all fees paid to those compensation consultants in support of the Board's determination of Executive and Director compensation must be disclosed**, as well as fees paid to the same firm (or firms) for other services to the Company (under $120,000). Fees paid to a compensation consultant for services related to broad-based plans and other non-company customized information supporting Board knowledge and context for compensation decisions also must be disclosed.

The Board's role in the oversight of risk and the relationship of executive compensation programs and incentives to decision-making and risk is a new area of disclosure and one which will open the door to **further scrutiny**, particularly for Chairman, Chief Executive Officer and Chief Financial Officer positions, plus the lead Director and the Chairman of the Compensation Committee.

CEL & Associates, Inc., has observed and believes that in response to the pressures of greater independence, several changes to policy and Board philosophy regarding compensation review will occur within the real estate industry. First, to reduce the potential for conflict by large, multi-service Compensation/HR firms, more real estate firms will seek smaller and more specialized real estate compensation experts for advice on trends, benchmarking, program structure and the alignment of compensation and performance. Outside investors may view large and varied consulting fees paid to one firm as the foundation for bias toward larger pay packages for Senior Executives and Directors. In another emerging trend, which may also be utilized by larger real estate companies, the Board's solicitation of a "second opinion" on compensation may be a technique to reduce shareholder concerns regarding the large Compensation/HR firm services or a firm that has provided compensation advice and guidance for, say, the past three or more years. Variety and validation will be the rule rather than the exception, going forward.

Re-Calibration Of Compensation To Markets And Performance

Although much capital awaits a repeat of the historic shift of troubled assets from lenders and Special Servicers back to Investors (as occurred in the early 1990s), the decline in values from 30% to 50% (peak-to-trough) is reshaping and redefining performance benchmarks and rewards.

At the heart of the issue of current vs. future real estate executive compensation design is performance, the common measure of success and the metric(s) linking to financial reward. Working through the severe downturn of the past 24 – 36 months remains a substantial and unprecedented challenge, but also sets the stage for growth and opportunity when markets and liquidity return. Many current compensation policies and practices of the past, however, are not likely to apply. The current uncertainty of how incentive compensation programs and governance should be redesigned to align with changes in regulations, capital markets, asset values, risk assessment and organization structure is being clarified, tested and rebuilt during this period of change.

For example, REIT performance expectations for 2009 probably were not the 28.8% total shareholder return delivered by the market. Weak operating financial performance sets the stage for re-calibrating performance awards vs. historical metrics, and it requires considerable Board and Committee assessment of "degree of difficulty" and "degree of control" aspects of compensation decisions. Performance results, poor by historic standards, may have been harder to achieve than in prior years, yet the capital markets proved strong, and share price delivered high returns. **So, the question arises again, should companies design new**

performance-based plans calibrated to today's market, or wait to see how the recovery unfolds?

In many companies, new and creative elements have addressed the aftermath of the economic downturn including but are not limited to:

- ♦ Greater discretion by Boards/Committees (or criteria which trigger greater discretion).
- ♦ Sustainability criteria encompassing multiple years and performance adjustments.
- ♦ Indexing with inflation.
- ♦ Multiple weighted absolute and relative performance criteria, less emphasis on stock price (or TSR) and greater on long-term strategic goals or the development of future leaders.
- ♦ Greater emphasis on LTIP holding periods, ownership policy and post-separation performance criteria.

The correlation of performance and compensation should continue to be measured and presented as evidence for incentive award rationale, but also is vulnerable to the question of "adapting the bar" to the situation. Changes in design and measurement using multiple-year results compounded (pre- and post-award) may require more "dynamic benchmarking," examining relationships over time and with more sophisticated analytical tools, including LTIP values adjusted to market; but this could open a new avenue of the "view" and interpretation of performance.

Bridging the recession period also has given rise to "interim" incentive plans aimed at immediate needs for operating efficiency. **Such features as "Bonus Banks," deferred with continued performance hurdles, sustain the performance pressure at the risk of de-motivation**. Long-term plans also may take on multiple forms, offering executives staggered time frames, multiple vehicles and stratified performance criteria to align with both medium and long-term objectives and the risks of each.

Despite methodological change, the meaning of pay and performance relationships will endure for executive compensation, and the capacity for management to succeed in the next growth era in real estate is equal or greater than in past periods. However, today Compensation Committees grapple with the short-term pressures for adapting performance goals to a recessionary market and retaining talent without overreacting or overextending. Both are hot-button shareholder issues.

Increased Disclosure

New SEC compensation disclosure rules are in place for Proxy disclosure (2010 forward), marking **new precedents in public disclosure**, and in many ways influencing the questions asked and the information required by institutional and private capital investors. Proxy compensation disclosure (particularly the Compensation Discussion & Analysis – "CD&A") has increased in mandated requirements and in length of presentation annually since required. In the SEC regulations of December 2009, alone, changes **mandate greater disclosure** of: discussion of compensation policies and practices for employees as a whole rather than the Named Executive Officers only; discussion of whether any material "risks" arise from compensation policy or practices; and any offsetting or mitigating factors reducing such risk. Relative to the compensation data presented in the Proxy, new regulations return to the presentation of Grant Date Value of equity-based awards in the Summary Compensation Table (and for all years reported), and for performance-based vesting the "probable" outcome, based on grant date conditions rather than maximum value.

But this is just the beginning of what may lie ahead in terms of disclosure. The Financial Reform Act of 2010 (Dodd-Frank Bill) included the long-discussed **"Say-on-Pay" requirements for public companies**. The Proxy document is the "vehicle" for disclosure related to executive compensation, and fulfilling its mandate will be even more challenging in the coming years. The document moves beyond just an information exchange for shareholders, shifting to one of "marketing," as shareholders under Say on Pay will vote (non-binding) on CEO and executive pay plans and potential payouts as a matter of annual balloting. **The communication requirements supporting compensation plans must be more carefully crafted and less obscure, forcing the question of disclosure vs. transparency**, and the shift from "reasonable" decision making to a clear, logical and concise risk-adjusted rationale. The CD&A will emerge as much more of a shareholder relations document that tells a coherent story, compared with just a legal document.

Proposed Say on Pay guidelines related to the Dodd-Frank legislation have recently been issued by the SEC (October 18, 2010), and include the requirement of a shareholder non-binding vote on executive compensation at least every three (3) years. The SEC proposal would also allow shareholders to choose how often they would like cast the "say-on-pay" vote (annual, every other, or every three years). The "frequency" vote must be conducted at least every six (6) years. The proposed rules would require disclosure on the say-on-pay vote in the Proxy Statement, and within the CD&A as to how the company considered the results of the vote. Golden parachute compensation arrangements in connection with a merger would also fall under say-on-pay non-binding shareholder vote requirements. The SEC proposals would also require institutional investment managers to annually file their votes on "say-on-pay", "frequency" of say-on-pay votes, and "golden parachute" arrangements.

Within the CD&A (or separately) it is the single annual opportunity to present compensation philosophy, strategy, incentive guidelines and criterion, and why each is aligned with shareholder interests. **The CD&A of the coming years will have to explain much more of the "why" than the "how" and "what" of executive incentive plans**, and it will be aimed at award decision rationale related to risk and performance. SEC regulations for disclosure do not fully reflect executive LTIP value loss, and this dimension is needed in order to give complete perspective to a chronicle of the compensation and performance relationship. Of rising consideration: **the issue of not only external benchmarking of compensation levels but the same assessment in terms of internal equity models**, a completely different perspective of relative value. Risk assessment will be a major topic of this administration's attempts to establish greater regulation on executive compensation, including the impact on operating costs (reduction) and incentive payout, and the prospect of policy and structures to mitigate.

Growing Shadow of Regulation

The economic downturn of the past two years has rationalized many scapegoats, including executive compensation. Economic stimulus and financial institution bailout funds were established with specific constraints on compensation and have opened the door for wider federal policy action. Prohibitions on incentive or retention bonus accrual (or payment) and on payout of golden parachute payments, holding period and clawback terms, and the prohibition (or restriction) of gross-ups are already in place, as are limitations on total compensation. And these are finding their way into all public company policy. Legislators are looking at these actions as impetus for a call for more widespread "reform." Even the establishment of a "Pay Czar" offers a glimpse into the extent of the political backlash related to compensation as well as **the possibility of far-reaching oversight. Congress has made shareholder "Say-on-Pay" (non-binding) a requirement for all public companies**, and the administration's actions regarding the regulation of the securities and banking sectors impacts real estate directly in the oversight of risk and securitization of mortgage debt, as well as underwriting and incentive compensation for transactions. Never has so much regulatory attention been considered or placed on executive compensation.

A pending Bill in the Senate last year included provisions for requiring annual public company re-election of all Directors, prohibition of the CEO from serving as Chairman, and changes to shareholder ownership criteria for nominating Directors. Among other looming regulator issue with huge impact on the real estate industry and executive compensation include proposals to split the CEO and Chairman roles, a reduction of the Section 162(m) limit on compensation deductibility, rising marginal income tax rates, and Congressional pressure to shift "carried interest" to ordinary income taxation. Ironically**, the public real estate sector has received high marks for governance and generally has not been the subject of executive compensation issues**, a reflection of careful oversight from Boards, Committees and Management. Dealing with the magnitude of potential additional regulations and requirements will be a significant additional burden for management, and governance will raise the bar of cost to be a public entity, spilling over into private company investor requirements and compensation policy.

Private vs. Public Performance and Compensation Trends

REIT access to public capital market debt and equity in 2009 and into 2010 re-set the REIT model of ownership and demonstrated its capacity and value in this economic period. It also may have created a dichotomy (albeit temporary) relative to compensation among private and public companies. The ability to re-structure balance sheets, reduce leverage, revise debt repayment schedules and create liquidity is occurring when most of the industry also is dealing with challenging operational issues and pressure on achieving financial targets.

In the wake of lost property values, many private companies continue to face the hard reality of re-capitalization as future re-financing maturities loom. Although the net result on incentive compensation for public real estate executives is just now emerging, **the probable scenario is that the gap in public vs. private company compensation will be larger than in many years past**, both cash and long-term equity-based awards. Rising value of REIT shares in 2009 (22.24%) has increased the value of vested and unvested Restricted Shares and Stock Options after a period of significant loss. Correspondingly, private companies do not have such marketplace valuation and have suffered a continuing down pressure due to overall asset values.

This "have" and "have-not" scenario is not a growing gap of relative opportunity, occurring at a time of significant pressure for cost containment and operating efficiency, but it is a circumstance which has not occurred for several years. For 2011 CEL would anticipate **Base Salary increases for executives as well as other employees, to be 2.9% – 3.3%...up from 2010 but generally below merit increases in prior years**.

Annual cash bonuses linked entirely to operating performance will be constrained but showed improvement in 2009 as target performance levels may have been re-set for the dramatic change in market conditions. **For public companies with TSR included in annual cash incentives, the 2010 results should create a higher payout by 2011**. As for LTIP awards, the TSR figures which trigger many award decisions no doubt will produce significantly higher equity awards, even as Boards try to balance the success reflected from the market compared to management-controlled performance. Most private company executives are not looking at similar opportunities, and despite many who have performed well in these challenging times, long-term incentive compensation vehicles are also a long way from recovery.

Changing Compensation Policy and Strategy

Regardless of the differences in private vs. public financial fortunes in 2010 and the arguments regarding long-term or only immediate market strength of the REIT investment model, the changes in real estate values due to the economic downturn have caused significant change and re-thinking of compensation philosophy, strategy, policy and practice, and they will continue to do so in the coming years of recovery. CEL & Associates, Inc. has posed some trends and changes in compensation anticipated and occurring in the marketplace which will guide companies in their management of this important component of survival, success and growth.

The following pages highlight in table format several critical factors facing real estate CEOs, Boards of Directors, Compensation Committees and Senior Management.

Compensation Policy Category	4Q 2010 – 2011
Compensation Strategy	▪ Business models and strategy have undergone considerable scrutiny and change, much capital awaits troubled assets and debt, but implementation is generally limited or on hold awaiting a clearer picture of: lender economics and strategy, the "bottom" of the real estate cycle and the overall economic recovery. ▪ Role and responsibility adjustments are among the biggest changes in organizations, as reduced workforce and changing market conditions have forced job consolidation and additional duties. Fewer are doing more, a situation which has limited sustainability as morale declines faster than conditions improve. ▪ Compensation plans are under review (and some salary and bonuses remain frozen). Companies are looking at new and re-set performance metrics and "governors" related to financial results as additional components of incentive plans. ▪ Adjustments to performance metrics and "Target" levels of payout are part of the re-calibration to what could be long-term changes in the marketplace. ▪ Absolute and relative measures of performance are essential to insure performance is placed in its proper context. ▪ For public companies, new SEC requirements will demand a more thorough presentation of risk vs. executive incentive compensation. ▪ CD&A documentation continues to be longer and more complex, requiring greater attention by Boards and management. ▪ Major overhauls of compensation plans or scrapping of plans for new designs is beginning to occur. ▪ Compensation strategy is now, more than ever, an integral component of overall business strategy.
Budgeting and Targets	▪ Budgets in most real estate companies (property and corporate) have had more scrutiny in the past year than ever before. Corporate overhead has been considerably reduced in most companies, a healthy outcome from a difficult period. ▪ Target bonus levels are under considerable review – as there is a need to re-calibrate the level of performance achievable (compared to prior year) vs. the "targets" of incentive compensation for achieving them. ▪ Relative performance (vs. a peer group for public companies, or a prior year or multiple year benchmarks for private companies) is an increasingly important context of measuring real performance. ▪ Employees are keenly aware of the financial circumstances for most companies, and they have adapted. ▪ Sustained period of compensation reductions and freezes on increases will erode morale, and consideration of any adjustments will have high value in an environment where retention is increasingly evaluated with potential emerging opportunities in an improving economy.
Base Salary	▪ Salary freezes initiated in 2008/2009 for the most part (75% +) have been removed in 2010. ▪ Consideration of re-instatement of salary where reductions occurred will be completed in 2010 for most companies. ▪ Top performers remain a retention priority, but solid performers are also essential to sustaining operations. ▪ There is growing pressure to make adjustments, as the extent of the downturn has created employee fatigue. ▪ Watch inflation as recovery emerges. This will be a factor in fixed compensation costs as real estate will lag overall recovery, and economic pressure to meet "expectations" will occur.

Compensation Policy Category	4Q 2010 – 2011
Merit Increases	▪ Merit increases remain under pressure and will likely be awarded in 2011. An overall increase in 2011 is anticipated for Executives (2.9% to 3.1%) and overall employees (3.1% to 3.3%). ▪ Top performers will get priority. ▪ Many have performed with "merit" in these difficult times, but financial reality and conservative management prevail. ▪ Job load and required time commitment will emerge as more important considerations.
Annual Cash Incentive	▪ Annual bonus compensation took its largest "hit" in 2009, recovered some in 2010 and will continue to rise in 2011. ▪ Ironically, the complexities of the economic downturn on most real estate companies has made performance metrics and distinction of performance among employees more difficult, requiring greater discretionary consideration. ▪ The success of public companies in raising capital (debt and equity) and the market response in TSR has created a dichotomy between public and private executives. This will play a strong hand in retention as the economy improves. ▪ Short-term performance has been emphasized consistent with the horizon of recovery and the need for survival in some firms. ▪ The meaning of year-over-year comparisons is fuzzier than in years past, and a footing of performance vs. the market is elusive. ▪ Scorecards for evaluation of performance remain the most popular, flexible, fair and adaptable methodology for annual cash incentive. ▪ Review of weighting remains important, and in many situations an increase in discretionary elements has been useful to best adapt to a difficult and unpredictable period in the marketplace.
Staffing Levels/ Reductions	▪ Staff reductions were completed during 2009. Staffing was stalled in 2010 and will begin to rise in 2011. ▪ Most employers are now at "fighting" weight (re: headcount) and are focused on recovery.
Talent Retention	▪ Retention is not an immediate problem for most companies, but one that concerns all companies and HR executives for the 2011 economy and market recovery. ▪ The issue is timing (as always). When recovery begins, many will take the new cycle as a moment for change. ▪ Most companies believe that specific retention actions will be necessary soon to retain key talent and top performers.
Benefits	▪ Many cuts were made in Benefits during 2009, in employee share of all health care plan premiums, and in coverage, co-pays and maximums. ▪ These changes are largely completed and will remain in place for 2011 and beyond. ▪ The impact of the new Healthcare Legislation will impact smaller companies more than large, but will become a more complex and challenging aspect of the cost of employees, and a factor of retention. ▪ Many companies reduced (or eliminated) 401(k) matching, and some (50%) of firms reinstated this in 2010/2011. ▪ Employees are not happy about cuts on both compensation and benefits.

Compensation Policy Category	4Q 2010 – 2011
Board of Directors/ Compensation Committee	▪ New SEC disclosure regulations will increase the responsibilities of Directors. ▪ CD&A disclosure requirements have changed and increased, and they are likely continue to do so in coming years. ▪ Legislation, particularly the new "say on pay" regulations, will change the dynamics of the shareholder to Board (Compensation Committee) relationship and require much additional time. ▪ Taxation, gross-up and clawback actions remain "on the table" relative to legislative intent to control executive compensation. ▪ Most Boards are not changing existing executive employment and severance agreements relative to gross-up and other structural features, but are setting time frames for contracts to be renewed (rather than automatic renewal) to address these issues/changes.
LTIP Programs/ Opportunity	▪ Despite the economic situation, for public REITs, the market was quite good in 2009 – up 28.89% (and 26.47% YTD October 18, 2010) in Total Shareholder Return. ▪ This will encourage LTIP awards to reward securing debt and equity, reducing leverage, gaining liquidity and improving balance sheets. ▪ For the private sector, similar trends have not occurred. Refinancing of property level debt remains a critical problem, and the lending stall could lead to crisis. ▪ Lack of transaction volume has kept asset pricing soft, and cap rates are rising. LTIP opportunity in private firms has suffered in value and will likely continue so. ▪ New funds are being formed for acquisition of distressed assets (and paper), but the volume of opportunity has not materialized as anticipated, mostly due to bank negotiations which have largely pushed off the pending crisis of value to borrowers and on the books of lenders. ▪ For private firms with Enterprise level (or property level) LTIP opportunity, 2010 will not offer much hope of recovery.
Communication	▪ Communication remains an important element of HR management in both the financial downturn and as recovery emerges. It is no guarantee of reduced disenchantment, but there is little downside. ▪ Motivation is delicate in these times, and more communication of policy, plans, financial status, anticipated direction and decisions will mitigate a tough situation.

If you'd like to share your comments, insights or ideas with me, please email them to newsletter@celassociates.com.

Regards,

Christopher Lee

Give Us Your Opinion: We want to hear from you and to have future issues reflect your needs and questions. Please email your comments, ideas, suggestions and insights to newsletter@celassociates.com.

For More Information: For more information regarding our services (Strategic Planning, Compensation, Opinion Surveys, Benchmarking, Performance Improvement, Succession Planning and Governance/Management), please email us at newsletter@celassociates.com or call 310.571.3113.

To Subscribe: To subscribe to CEL & Associates, Inc. and Christopher Lee's *Strategic Advantage* newsletter with ongoing insights, opinions and forecasts regarding issues, trends and opportunities within the real estate industry, please email us at newsletter@celassociates.com with *"Subscribe"* in the Subject line and provide your full contact information.

To Change Your Contact Information**:** Please email us at newsletter@celassociates.com with *"Change Contact Information"* in the Subject line and include your new contact information.

Disclaimer: The opinions, forecasts, information and insights presented in this article are of a general nature and do not constitute the provision of investment, management or economic advice to any person, organization or governing board, and this article does not contain any recommendation(s) to buy, sell and/or invest in any security, real estate asset, fund or adopt as an element of any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy.

Prior Newsletters*: If you would like to download the prior four newsletters, please go to the following links.*

2010 Economic Outlook:
http://www.celassociates.com/onlinenewsletter/EconomicOutlook-2010-SA-K012010.pdf

2010 Real Estate Outlook:
http://www.celassociates.com/onlinenewsletter/RealEstateOutlook-2010-SA-K022010.pdf

Real Estate Cycles – They Exist…And Are Predictable:
http://www.celassociates.com/onlinenewsletter/Cycles-2010-SA-K040110.pdf

Real Estate Outlook 2010-2020 Part I:
http://www.celassociates.com/onlinenewsletter/RealEstateOutlook.2010-2020-PartI.SA-K050110.pdf

Real Estate Outlook 2010-2020 Part II:
http://www.celassociates.com/onlinenewsletter/RealEstateOutlook.2010-2020-PartII.SA-K060110.pdf

Twelve Cornerstone Strategies 2010-2011:
http://www.celassociates.com/onlinenewsletter/TwelveCornerstoneStrategies.2010-2011.SA-K070110.pdf