



## WELCOME TO THE NEW NORMAL

**T**he real estate industry, its leaders, its employees and its organizational and operational delivery systems are entering into an era of perpetual change, uncertainty, challenge and opportunity. There will be those who hold on to the vestiges of the past and long for a return to the predictable normalcy of “presented” versus “created” opportunities. There will be some who acknowledge the inevitable need to embrace the unknown, but will hold on to the past so that they can complete “just one more deal.” And then there will be those leaders and organizations that, like the entrepreneurs, innovators and risk takers before them, find opportunities, create value and enjoy success where others only see challenge. In 2004, everyone will be presented with opportunities... the winners will be those who recognize and seize the opportunities. Welcome to the New Normal!

Over the next 12 months, the real estate industry and property management sector will be shaped, defined and governed by “re” words. Fueled by an accelerating economy, impacted by global events and presented with unprecedented challenges, the real estate industry and those who work in it will be faced with daily reminders that 2004 will be a year of repositioning, recovery, restructuring, reconnecting, re-election, resolve, reengineering, re-defining direction and re-instilling passion in a workforce searching for a clear vision. Real estate leaders, managers and employees at all levels will be asked to re-dedicate, review and redefine their roles, contributions and accountability to their Shareholders and strategic partners. Tenants in 2004 will likely accelerate renewals, redefine their relationship with their building owner and

service provider and re-examine what they need in a productive workplace environment. Success in 2004 will not be achieved by implementing a business-as-usual strategy... it will be defined by how well each organization, its leaders and its employees anticipate and respond to each and every “re” word that is likely to arise.

### **Emerging National Trends**

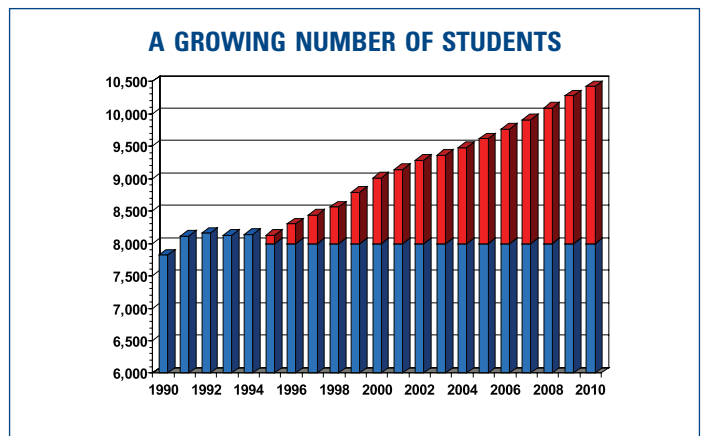
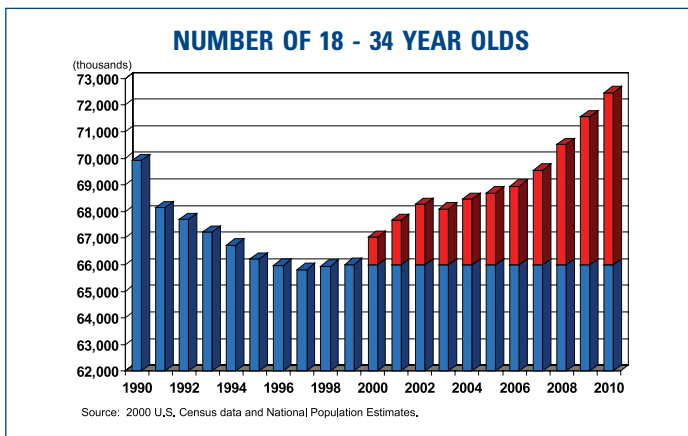
As the country moves toward a November Presidential election, the economy will continue its recovery and growth. While global unrest, threats of terrorism and unresolved remedies to looming Federal and State deficits and growing trade imbalances will result in unpredictable shifts in consumer confidence; modest job growth, increased business spending and sustained levels of worker productivity will likely occur. These forces, among others, will boost GDP growth to the 4% - 5% level in 2004. Interest rates are expected to remain low (although a 25 – 50 basis point increase is not unlikely) and consumer spending is likely to remain high. While instances of corporate malfeasance will continue to garner headlines in 2004, investors will benefit from a rise in corporate earnings and growing confidence in the stock market. Spreading globalization, stable oil prices and generally fully employed Baby Boomers (born between 1946 – 1965) in their peak earning years, will keep the U.S. economy in growth mode throughout 2004. The only variable that could derail what is likely to be a very rewarding year for business owners and the consumer is another major act of terrorism... an event thought unlikely until 9/11. In general the U.S. economy is



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recovering, businesses are beginning to re-invest and the consumer is gaining a renewed confidence in the future.

There are eight megashifts, however, which are and will continue to cause megachanges within the real estate industry. These megashifts are a reality every real estate organization and its leaders must be prepared to respond to and capitalize on their occurrence.



**Shift From A Young To An Aging Workforce:** The nearly 83 million Baby Boomers are getting older (some are now retiring), but this generation is acting younger and consider themselves to be at the peak of their game. While the impact of the dot.com, telecommunications and high tech meltdown of the late 1990s wiped out the “paper” retirement nest eggs and early retirement dreams for many, today’s Boomers are now faced with a need to work and a desire to slow down. To meet these demands of an aging but financially vibrant population sector, employers are being asked to: modify existing compensation programs; offer balanced work/life options; provide flexible work schedules, improved healthcare benefits and additional perks; and to make “exceptions” for personal

needs and situations. The needs of an aging population will create many opportunities for those real estate enterprises that specialize in medical/healthcare facilities, age-restricted housing, vacation/retirement destinations and travel-related entities.

**Shift From Hiring To Productivity Solutions:** Over the past three years, U.S. employers have re-engineered work processes, work space and workplace environments. Investments in technology and business re-engineering have reduced the need to hire additional workers and expand existing facilities. In addition, U.S. companies have exported jobs to countries with lower pay scales. While the net result has been work productivity levels at or near their all time highs, the impact on the office sector has been devastating. Overall,



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vacancies are still high. The amount of vacant space has increased by 245 million square feet in the past three years. The average lease size has declined 40 percent over the past six months and many experts believe that there is a 5 – 7 year supply of vacant office space that, if absorbed, would reduce overall office vacancies to only 10 percent. According to some analysts, 3.3 million white collar jobs will be going overseas over the next 15 years... meaning a loss of nearly 660 million square feet of office space demand. While overall tenant satisfaction is up, the lack of tenants and the prospect for several years of continued struggle will keep building owners very nervous in the short term. To meet this challenge, office building owners and service providers are re-designing their business models to a more customer-centric platform that places high value on building recurring relationships and achieving the highest levels of customer satisfaction and worker productivity.

**Shift From Many To Few Qualified Employees:** By 2010, there will be 10 million more jobs than there will be people to fill them. The overall size and quality of the available labor pool within the real estate industry is shrinking. Today, approximately 80 percent or more of the replacement hires come from competitors. This “passing around” of employees has created a free agent class of employees who will follow the money and perceived better opportunity. In addition to the lack of talent to fill new openings, pay differentials are widening by geographic location, employer type and size of firm. Employee turnover rates, while down slightly from their 1999 peak, are still between 30% - 35%. Further compounding this megashift from

many to few talented professionals is the beginning exodus of aging Boomers and company founders and a rapid rise in turnover costs (now 1x annual base salary). To cope with this crisis, real estate firms will likely continue in 2004 with the restructuring of existing compensation programs, re-defining hiring practices, re-instituting more employee-centered benefits and activities, and re-energizing a workforce that is at or near their productivity potential.

**Shift From Prima Donnas To Team Players:** If there is one “truism” within the real estate industry in 2004 (and beyond), it is that there is “no more room for prima donnas.” In the past, real estate firms tolerated these behaviors and me-first personalities because of that individual’s production or key client relationship. In 2004, this practice will decline rapidly. Faced with an inability to retain or attract talent because of a prima donna, lost opportunities, reduced profitability and concerns over spawning prima donna wannabes, real estate organizations are increasingly shifting to a more team-based organizational structure. Client relationship management, integrated business lines, knowledge sharing and the elimination of silos will mean the difference between growth and status quo. The removal of prima donnas will eliminate turf issues, improve workflow processes and limit the number of “change killers” in the organization. In 2004, those real estate firms that focus on creating customer-based solutions in a team-based environment will prosper.

**Shift From Market Share To Customer Share:** For decades, real estate firms have often defined success in terms of market share. Real estate trend publications,



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business journals and industry reports have consistently ranked firms based on their volume of business activity or market share. In 2004, real estate firms are going to increasingly conceive, develop and implement strategies and initiatives that focus on generating more revenue and opportunities from their existing client base. Successful real estate firms over the next several years will be targeting customers that have the greatest potential for multiple fee-generating opportunities and which have the best chance of securing a valued, long-term relationship. In 2004, real estate firms will begin to compete for business based on the quality of their business model, not on who has the lowest fees. Branding, standards and organizational values will play a key role in the re-positioning and reconnecting era of service providers.

### **Shift From One Generation To The Next:**

Over the next decade, nearly 60 percent or more of today's CEOs will be gone. Today, however, only 24 percent of real estate firms have a plan of succession and 65 percent of those plans have not been formalized or announced. CEL & Associates, Inc. expects a 30 percent turnover at the CEO level over the next five years. Transitioning from one generation to the next will accelerate in 2004. Succession planning, restructuring of corporate governance provisions and restating the organization's long-term goals will be a priority over the next 12 months.

**Shift From Managing Process To Managing Expenses:** Over the past five years, considerable resources were invested by real estates organizations in manuals, check lists, how-to-do guides and process charts. Standardization, consistency and

"everything the same" were the mantras of many CEOs and functional leaders. In 2004, that focus has shifted from concern over process to concern over controlling expenses. The combination of rising healthcare costs (up 14% - 16%), compensation costs (up 3% - 5%), IT costs (up 5% - 7%), pursuit costs (up 7% - 10%), insurance costs (up 25% or more), and general operating costs (up 4% - 6%) has mandated the creation of new business, staffing, pricing and purchasing models. The "re" word (restructure, reengineer, reprioritize and reexamine) will likely dominate every real estate CEO's agenda in 2004.

### **Shifting From Entities Seeking Capital To Capital Seeking Entities:**

If there was one lesson learned from the recessions of the late 80s/early 90s and the late 90s/early 00s, it was capital does not buy buildings people do. In 2004, there will continue to be a plethora of capital chasing too few opportunities. To gain a competitive edge, capital will seek talent and relationships with those real estate organizations that have the business model and capability of creating a strategic advantage on the buy side. Real estate has become (again) an attractive option for pension plans that have to fund their near-term liabilities and plan for their long-term obligations. Foreign capital has raised its level of investment interest in U.S. real estate. The returns on other traditional investments (stocks and bonds) have declined the past three years. The level and quality of research has improved and a more disciplined investment process has reshifted the focus of capital from looking for assets to looking for talent (who can locate the desired assets).



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How and when to respond to these eight and other megashifts in 2004 is both the challenge and opportunity for real estate leaders. However, it is clear to most real estate firms... they must change or they will be left behind. There is no “wait-and-see” option. There is no “follow-what-others-do” alternative. In 2004, doing different things, not doing things differently, will be the focus of every entrepreneurial real estate organization. A recently completed study by CEL & Associates, Inc. on “Key Strategies For 2004” revealed the following eight areas of opportunity.

**Apartments:** Perhaps the most attractive sector within the real estate industry, the multifamily sector should continue to attract investors and capital. The emergence of the 80.2 million Y Generation (now 8 - 27 years of age), rising percentage of minority populations (49% of all households headed by a foreign-born householder are renters), a peaking of home ownership and a likely rise in interest rates over the next five years will increase the demand for rental properties. Student, affordable and retirement housing are also expected to increase. When the obsolete or no longer market-competitive properties are deleted from the nation’s housing stock, the opportunities for ownership, development and management are likely to be increasingly robust for years to come.

**Senior Housing:** While the senior housing market is expected to grow from \$126 billion in 2005 to \$490 billion by 2030, the primary opportunities will be in the assisted living sector. Expected to grow dramatically (150% increase by 2030), these facilities will house the Boomers and the parents of the Boomers. Over the past 40 years, the number of persons over the

age of 85 years has increased 274 percent. Today, over 35 million people are age 65 or older. In less than 20 years, the number of Baby Boomer seniors will be 53 million. The population aged 55 to 64 is expected to increase by nearly 11 million people by the year 2010. Age-restricted communities, adult communities and retirement communities are expected to increase as a growing population of retirees downsize, seek “maintenance free” housing and prefer more “safe and secure” housing.

**Investment Sales:** The volume of investment sales is expected to increase dramatically over the next five years as real estate becomes the “secure” or “safe haven” investment for institutional, foreign and private investors. The apartment and retail sectors should continue to receive the most buyer interest. Real estate firms are expected to expand their expertise and talent base in this area in 2004.

**B-Malls:** While the average square feet of retail space per resident is 12.5, B-malls (which tend to be located in suburban markets) average nine square feet per resident. The high barriers to entry to develop large retail properties in suburban locations are now creating demand imbalances that favor the owners of B-Malls. The combination of increasing NIMBYs, communities’ preference for more lifestyle retail projects and strong demographic trends are likely to make B-malls an attractive investment opportunity today and in years to come.

**Retail:** While occupancy levels are expected to decline slightly in 2004 and bankruptcies/restructuring of retailers is expected to continue, well-located neighborhood/community centers, ethnic centers, lifestyle centers or mixed-use



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developments (retail and multifamily, retail and office) continue to perform well. In several states, ethnic centers are growing rapidly and the U.S. populations' continued desire to "eat out" will create many opportunities for owners and developers of retail properties. Consumer spending remains high and while the "Wal-Mart effect" can be both a blessing and a curse, this sector should remain fairly stable in 2004.

**Advisory:** Real estate firms are just beginning to recognize the value and benefits of an advisory or consulting capability. Increasingly expected by investors, relied upon by lenders and valued by tenants and communities, consulting opportunities within the real estate industry are expected to grow 15% - 20% over the next five years. Moving beyond demographic analysis and information gathering, these knowledge workers will offer advice, guidance, recommendations and implementation assistance.

**Gas Stations:** There are an estimated 200,000 abandoned gas stations in the U.S. In 2000, the Environmental Protection

Agency ("EPA") began offering grants for clean-up and, in 2002, the federal Brownfields Revitalization Act expanded its definition to include land contaminated by petroleum.

**Timeshare:** The retirement of Baby Boomers is just beginning. Over the next 10 years, the number of 55-64 year olds will increase dramatically. Concerned about rising healthcare costs, retirement and longterm financial security, these Boomers will be reluctant to purchase a second home, but believe they have "earned" an exchangeable, extended vacation option. The current branding of "credible" timeshare operators has increased the level of confidence in now making such an investment.

The "re" word will be alive and well in 2004. Over the next 12 months there will be many opportunities to grow and expand one's firm or career. Not since the early 1990s has there been such a cornucopia of value creating opportunities. It will not be easy and those who expect their fair share are likely to end up empty handed.)