Strategic Advantage
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Editor: Christopher Lee

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The Six Disruptors
Transforming The Real Estate Industry

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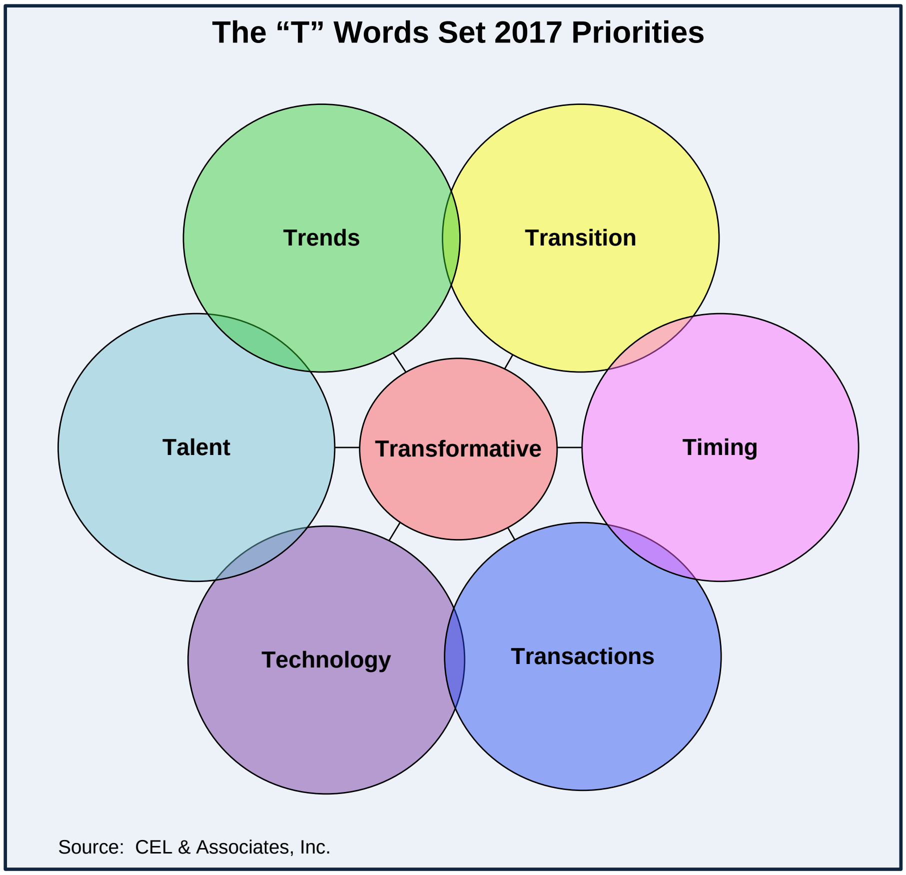
Friends & Colleagues:

During the past 12 months, **the accelerated pace of disruptive innovations, advanced technologies, shift to the gig economy, impact of "Accelerators," and the confluence of nearly 30 emerging trends are rapidly reshaping and redefining the real estate industry**. Occurrences which, months or years ago, seemed improbable or unlikely are real, and the need to internally realign around a shared vision, motivating value propositions, realistic goals and aligned interests is now front and center in every real estate firm. No "one thing" or clear "tipping point" will be the fulcrum of this dramatic transformation. The rapidly changing economic, market, capital, demographic, business, regulatory, asset, occupier and service platforms combined with dynamic talent management conditions are major contributors to this accelerated transformation. **Business as normal and status quo are no longer viable strategies**. The future of the real estate industry now rests with creating valued relationships, incredible stakeholder experiences, a collaborative workplace environment, integrative technologies and the presence of outstanding aligned talent and leadership teams. **The first step in dealing with the future and current challenges is to understand which disruptors are shaping the future, and what is needed to compete and stay relevant**.

Multiple disruptors are reshaping the real estate industry every minute of each day. The future has arrived! **Opportunities are no longer "uncovered," but are "created" in this New Normal**. Relevance needs definition and clarity almost daily. The impact on technology disruptors is changing the way real estate assets are acquired, financed, developed, designed, leased, managed, sold and operated. Industry consolidation (look for 30% fewer firms by 2025), aging founders and leaders, and the emergence of new competitors mandate new business models to succeed and prosper. **Many point to 2017 as the breakthrough year during which long-term winners and losers will be created…and perhaps determined.** The author Arthur Burt said, "Nothing happens until the pain of remaining the same outweighs the pain of change." **We, the real estate industry, are on the "Threshold of New," where innovation, creativity, change and disruption are *a part of* rather than *apart from* long-term success and prosperity**. **Cadence in the New Normal is more about momentum**, the quality of the execution engine, passionate leadership, aligned stakeholders, and a willingness to do different things and not doing the same things differently.

It is hard to believe that the first cell phone call was made in 1973. Over 40+ years later, cell phones connect nearly every person in developed countries around the world. Within a few years, the cell phone will become the remote-control device for our lives, and in some situations, it will guide decisions, priorities and desired outcomes. Then shortly after, cell phones will begin to disappear as artificial intelligence, wearables and virtual reality ushers in a host of lifestyle alternatives. Work is wherever you are.



Who would have imagined that Uber would have a market cap of $68 billion, or that General Motors would have invested $500 million in Lyft? Who would have envisioned Airbnb would have a $30 billion market cap or that e-commerce sales would be nearly 9% of all retail sales? Or, by 2020, 30 billion devices will be connected to the internet? As the 2016 Nobel Poet Laureate Bob Dylan wrote, **"the times they are a changin'."** Indeed, they are, and disruptors have an increasing role in that accelerated change.

For hundreds of years, the real estate industry has been an asset-centric industry focused on buying, selling, developing, leasing and managing "buildings." **Today, and clearly for the next 10 - 20 years or more, "buildings" will no longer be fixed assets but will become launch pads for connectivity, interaction consumerism and business fulfillment**. In the future, every building (office buildings, retail centers, apartment communities and industrial facilities) will be dynamic, data will become currency, public-private partnerships will flourish and buildings will define the fabric of a community's or region's success. In the not too distant future, the real estate industry will be a web of connectivity, linking culture, work, innovation, education, wellness, communications, experiences and relationships. **Purpose, social impact and entrepreneurship will be integral to creating asset value as well as community value**. Services will be customized solutions…not commodity offerings.

Disruptors will continue to play a critical role in the shaping of the real estate industry. We are moving toward a business model and society in which information and accessibility are available to everyone. **Traditional analytical tools, market studies, supply/demand analyses and pricing methodologies are becoming outdated and may no longer be applicable and/or compatible with newer technologies**. Materials are being created that will render traditional building design and functionality obsolete. Google Now is an attempt to manage the information that surrounds all of us. Amazon has just been awarded a patent for a flying warehouse. **The real estate industry today is too often a passive partner in the race to automation**. Disruption and disruptors are here to stay.

To quote Lyndon B. Johnson, "Yesterday is not ours to recover, but tomorrow is ours to win or lose." How are you and your company prepared to compete in this transformative world?

Six primary disruptor categories currently are within and impacting the real estate industry. People cannot often identify a disruptive technology until it has become an established disruptor, so the six categories highlighted in this newsletter are intended to draw awareness to and create conversation around the impacts of these disruptors. Interestingly, all six disruptor categories begin with the letter "T." It is appropriate that in times of transformation (a "T" word), the contributors to that transformation also begin with the letter "T."

Trends

Several market trends will reshape the geographic opportunities across multiple asset classes. These market trends are important because **demographics and market conditions are not what they were. Bottom-line, consumption patterns among demographic and generational groups are very different now**. **What was thought to be normal in 2000, 2005 or even 2015 is no longer reliable.** We could list another 50 or 100 market trend disruptors. However, the goal is not to scare you, but to open your eyes to the massive and transformative changes occurring daily. Each of these trending disruptors brings significant impacts to the purpose, location and functionality of real estate assets. The new urban-suburban, multifamily, mixed-use and knowledge-based markets with robust mass transit/light rail and "reduced government oversight/regulations" will prosper because of these disruptive trends. The list on the following page contains a brief description of some trending disruptors.

Every "Trend" listed below currently has and will continue to have a dramatic impact on the real estate industry.

- An aging population
- Increasing role of women in the C-suite
- Declining Middle Class
- Rise of Millennials and Gen Zs
- Financial challenges for many Americans
- Unprecedented rise in government debt and entitlements
- Rise in a more ethnically diverse population
- Population shifts to the Sunbelt
- Increasing desire to reside in urban or suburban/urban locations
- Declining workforce amid a rising population
- Retiring Boomers

Talent

The ability to recruit, hire, motivate, recognize and reward talent is one of the top challenges/issues facing all real estate companies today. The gap between great and good firms is clearly a result of the quality of leadership and talent. **Over the next eight to 10 years, the real estate industry will face a potential annual shortage of 15,000 - 25,000 experienced professionals**. This will occur as the Baby Boomers retire/phase-down and the "next in line talent" is not at the same experience level; lacks the depth of valued relationships; and, in some cases, lacks the entrepreneurial enthusiasm necessary to add and create value. With a shortage of available "great talent," recruitment costs, compensation expectations and overall human resources expenditures rise dramatically.

According to a recent CEL & Associates, Inc. survey, **by 2025, approximately 55% - 60% of today's leaders intend to retire (32% within the next five to six years)**. Nearly one-third of today's brokers are over age 50. College graduates are enjoying the benefits of a talent shortage. Twenty-one percent (21%) of the 2016 college class accepted a job offer before graduation (up from 11% in 2014). However, starting annual salaries are just shy of $50,000. The disruption of retiring talent is creating financial challenges for many real estate organizations ("How many HIPOs can one afford?"). **Turnover rates are rising, and average base salary increases in 2016 were 2.9%...in 2017, that figure is expected to rise to 3.1%.** Benefits are expanding: nearly 42% of real estate firms offer telecommuting; 48% offer flex time; 71% offer business casual days; and 62% offer tuition reimbursement. Annual performance reviews are being replaced by real-time feedback.

In 2017, real estate companies will be focused on improving their candidate and employee experience. A recent survey indicated that 60% of job seekers had a poor candidate experience, and of those, 72% shared that "poor experience" online at various job search sites. Real estate firms must recognize that **nearly 75% of their full-time employees are either "actively looking for a new job," or "open to new opportunities."** Various methods are used to predict retention risk. These include increasing training options, creating an open and collaborative workplace environment and reliance on people analytics. Top priorities must include **learning how to manage a multi-generational and a more diverse workforce, in addition to blending the full-time with the free-lance employees.** It is imperative to create a team-based environment for all real estate organizations.

Select Market Trend Disruptors

- By 2030, nearly 20% of Americans are projected to be age 65 or older (vs. 9.8% in 1970). The age of mortality is steadily increasing.
- The U.S. is moving toward a more racially and ethnically diverse population. The projected aggregate minority population will be the majority by 2043. The foreign-born share of the population is around 13%. According to the latest Census data, over 41 million immigrants lived in the U.S. during 2013, which is four times the number in 1960 and 1970. Asia has replaced Latin American (including Mexico) as the largest source of immigrants to the U.S.
- Millennials now number 75.4 million and have surpassed Baby Boomers as the largest generation population segment. By 2028, Gen Xers will pass the Boomer population, while Gen Zs, those born from 1996 to present, now represent 25% of the U.S. population.
- Approximately 43% of working-age families have no retirement savings. The median couple in their late 50s or early 60s has only $17,000 in a retirement savings account. Seventy percent of couples have less than $50,000 saved.
- Approximately $22 trillion in assets will shift to women by 2020. A recent Accenture study indicates Baby Boomers will soon begin the transfer of approximately $30 trillion in assets to the next generation.
- The labor force participation rate for women is rising. Nearly 60% of college enrollees are women.
- In 40% of all U.S. households, mothers are sole or primary breadwinners.
- Around 50% of Americans want to live in walkable communities.
- The two-parent household is declining (60% vs. 87% in 1960), and one in six children lives in a blended family. The number of Americans who have chosen not to marry is at an historic high.
- The percent of Americans living in a "Middle Class" household is declining (50% in 2015 vs. 61% in 1971). There is a shift to increasing self- and community-reliance.
- Only 33% of Americans have a bachelor's degree (yet we have over $1.2 trillion in student loan debt).
- Real wages, when adjusted for inflation, have not risen for decades, and 50% of all Americans receive some benefit from one or more government programs.
- Several major U.S. states are focusing on the "lack of water" crisis.
- The population shift to the Sunbelt was a major contributor to the fact that 90% of the population growth in the Sunbelt between 2014 - 2015 was due to this migration.
- Nearly 20% - 30% of the working age population now engage in some form of independent work.

Source: CEL & Associates, Inc.

Leadership and career development programs are increasingly becoming a part of every firm's DNA. Within less than a decade, many aspects of the talent management process will be automated as Human Resources Directors shift to more strategic roles within the organization. They will focus on employee satisfaction, retention, wellness, productivity and creating the desired workplace culture. Incivility in the workplace must be closely monitored. Gamification will dominate training platforms.

Organizational architecture is changing as the talent disrupters take control of many aspects of talent management. Innovation, collaboration, talent management and leadership development will support tomorrow's success. **Managing a remote and multi-generational workforce will be one of the**

biggest disrupters within the real estate industry over the next several years. Getting in front of this curve is the only way to overcome the tsunami of talent disrupters.

Trends In Talent Management

- 76% of real estate firms are hiring.
- Prima donnas are on the way out.
- Title changes are fairly common (the first to go will be "Property Manager" and "Broker").
- Managing internal and external networks is becoming as important as managing talent.
- Approximately 65% of real estate leaders do some work at home.
- HR Directors are allocating more time to finding the best talent and fit, rather than trying to "fill a position."
- Use of psychological assessment is on the increase. Popular assessment vehicles include: StrengthsFinder, Myers-Briggs, The Caliper Profile, Minnesota Multiphasic Personality Inventory (MMPI) and Insights.
- Popular online job boards include: SelectLeaders, BOMA CareerCenter, and IREM Jobs. These sites as well as "local" job posting sites are changing the ways in which employees are recruited.
- To keep employees, 52% of real estate firms do not award prior year performance bonuses until the 1Q of the following year (23% award bonuses in March).
- Annual performance bonuses are increasingly becoming more discretionary to give Management the flexibility to adjust bonuses to keep great talent.
- Annual performance reviews are evolving into an ongoing discussion/evaluation of performance.
- Approximately 40% of HR Directors use data and analytics in recruitment programs.
- More real estate firms are using social media to post job openings.

Source: CEL & Associates, Inc.

Technology

Perhaps the biggest disruptor facing the real estate industry is the impact, role and utilization of technology in each functional aspect of leadership. For real estate operators, developers, property managers, brokers and/or investors, technology disruptors are changing the way real estate is bought, sold, developed, leased, financed and managed.

From driverless cars to robotic workers, from the Internet of Everything to 3-D printing, and from mobile phones as a device to a personal *consigliere* and predictive *attaché*, technology will render many real estate companies and select assets of little to no value in the years ahead. The role of Big Data (the very competitive race to the top by CBRE and JLL) could render some data providers less relevant. Cyber security, cloud computing and data transparency are reshaping real estate firms daily.

Wearable technology, the role of "connected" consumers, rising internet retail sales, the increasing role of digital marketing and the pursuit of the perfect algorithm will collectively create organizational and operational disruption within the real estate industry. **The smart phone is now a 24/7 virtual office, and our watch can be the digital wand that could render a growing percentage of existing real estate assets irrelevant and/or not appealing to investors and/or tenants**. Connect; store; compute, share; and sell will become real estate's new mantra as **the value of data may exceed the value of the asset. "Intelligent clouds" will create new value changes in leasing, property management and investment sales**.

Self-managed devices could render the current role of property management less relevant and question the need to use a broker. **The combination of sensory data with AI that will enable more and effective interactions with clients and customers will be exciting for real estate entrepreneurs**. Automated processes, emergence of the tactile internet, virtual reality and augmented reality will spur innovation, client/customer interaction, accelerated asset sales and financings, and improved security, privacy and cyber-attack controls.

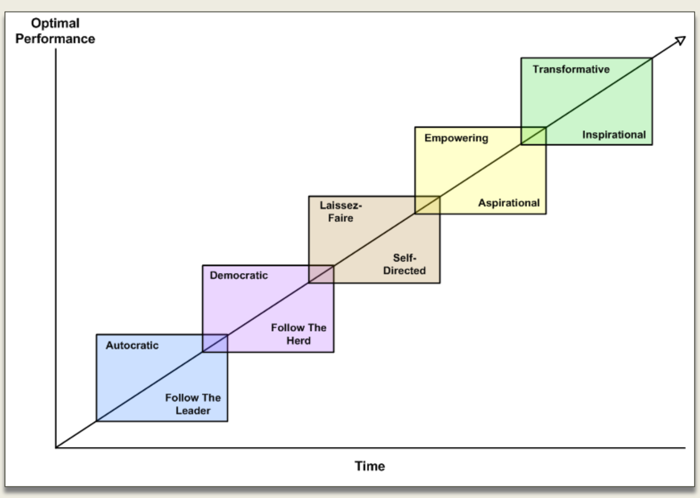
Talent Factoids

Compensation & Budgeting Trends

Year	Metric	Merit Increases					Other Budget / Planning Trends				
		Top Executives (1)	Senior Management	Exempt Employees	Non-Exempt Employees	Overall Company	General Inflation Rate	Incentive Compensation - Bonus Realization	U.S. GDP Growth	Total Medical $ Growth	Employee Share of Healthcare Costs
2008	Average		3.3%	3.5%	3.5%	3.6%	3.9%	73.1%	-0.3%	7.6%	10.1%
2009	Average		1.4%	2.0%	2.1%	2.0%	-0.3%	64.4%	-2.8%	7.5%	14.7%
2010	Average		2.2%	1.9%	1.9%	2.0%	1.6%	67.3%	2.5%	7.8%	8.0%
	75th Percentile		3.5%	3.3%	3.1%	3.5%					
2011	Average		3.0%	2.6%	2.7%	2.8%	3.2%	73.5%	1.6%	7.7%	9.3%
	75th Percentile		3.8%	3.4%	3.3%	3.6%					
2012	Average		2.5%	2.8%	2.6%	2.8%	2.1%	78.6%	2.2%	6.9%	7.2%
	75th Percentile		3.0%	3.2%	3.0%	3.2%					
2013	Average		3.2%	3.2%	3.0%	3.1%	1.5%	81.8%	1.7%	6.3%	6.5%
	75th Percentile		3.2%	3.5%	3.0%	3.2%					
2014	Average	3.3%	3.2%	3.2%	3.0%	3.2%	1.6%	84.2%	2.4%	5.4%	6.6%
	75th Percentile	3.6%	3.5%	3.5%	3.0%	3.5%					
2015 (2)	Average	3.1%	3.5%	3.5%	3.2%	3.4%	0.1%	82.8%	2.6%	6.3%	8.0%
	75th Percentile	3.0%	4.0%	3.6%	3.0%	3.6%					
2016 (3)	**Average**	**2.9%**	**3.2%**	**3.3%**	**3.1%**	**3.3%**	**1.2%**	**84.5%**	**1.3%**	**4.7%**	**5.3%**
	75th Percentile	**3.1%**	**3.5%**	**3.5%**	**3.0%**	**3.5%**					
2017 (4)	**Average**	**3.1%**	**3.4%**	**3.2%**	**3.3%**	**3.3%**	**1.8%**	**85.8%**	**2.6%**	**5.5%**	**5.0%**
	75th Percentile	**3.4%**	**3.6%**	**3.4%**	**3.5%**	**3.5%**					

(1) New Merit Increase category in the 2014 CEL National Compensation Survey - defined as positions reporting to the CEO, generally "C" Suite positions and/or Senior officers.
(2) Final 2015 Merit Awards as reported in CEL 2016 National Compensation Survey.
(3) 2016 figures based on CEL 2016 National Compensation Survey (2Q/3Q 2016).
(4) Forecast for 2017 incorporates early feedback on assumptions for budgeting.
Source: CEL & Associates, Inc./CEL Compensation Advisors, LLC.

Shift In Leadership Styles



Source: CEL & Associates, Inc.

Percent of Real Estate Leaders Retiring

Category	Percent Respondents
Within:	
– 1 – 2 Years	7%
– 3 – 4 Years	12%
– 5 – 6 Years	13%
– 7 – 8 Years	9%
– 9 – 10 Years	14%
– More Than 10 Years	37%
– Don't Know	8%
Total	100%

55%

Source: CEL & Associates, Inc., IREM Survey 2015.

Additional Factoids

- ✓ 70% - 74% of employees value wellness in the workplace.
- ✓ The shift to "Activity-Based Working" is mandating new ways of conducting business.
- ✓ There are 49 million "free agents" in the marketplace today.
- ✓ Watch for "life planning accounts" to emerge as a Millennial benefit.

Biggest Concerns of CEOs

Top Priorities	Rank
Reshaping The Business Model For The Future	1
Growing Recurring Revenues	2
Attracting And Retaining Talent	3
Brand Differentiation And Brand Management	4
Securing Growth Capital	5
Containing Operating Costs	6
Acquiring And Keeping Clients	7
Mitigating Risk	8
Building The Balance Sheet	9
Keeping Up With Technology	10
Growing Market And Client Share	11
Succession Planning	12
Tax Reform That Is Unfavorable to Real Estate	13
Increase In Interest Rates	14
Rising Tenant/Resident Demands And Expectations	15
Cyber Security	16

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

For the real estate industry, "trusting" the internet and technology disruptors will be one key to success. **Literally every real estate job today can be eliminated and/or dramatically changed with existing technology**. The challenge for the real estate industry is not an "awareness of the risks and impacts of technology" but an ability to invest the capital necessary to be a viable competitor in the years ahead.

Being all things to all people all the time is not a solution. From self-driving cars (imagine city zones without cars), clean energy, drones, artificial intelligence, "flying" warehouses, pocket supercomputers, crypto currency and block-chain technologies, online education, computerized medicine, crowdfunding, automated retail and grocery stores, floating farms, cashless society (think PayPal, Google Wallet, WePay, 2Checkout, Intuit, among others), self-driving trucks, ingestible robots, smart clothing and bio-media materials (think self-cleaning buildings), **the real estate industry is being turned upside down.**

Online worker marketplaces (e.g., Fiverr, Behance, Upwork), virtual tours and self-sufficient energy ecosystems are beginning to raise strategic questions. What does traditional brokerage look like in 2020 or 2025? Do we even need brokers? CEL & Associates, Inc. research indicates that 50% or more of today's brokers will be replaced by strategic advisors or real estate strategists by 2025.

Major CRE Disruptors	Asset Category			
	Office	Industrial	Retail	Multi-Family
Airbnb				X
Amazon	X		X	X
Blue Apron			X	X
Craigslist	X	X	X	X
Drone Deliveries		X	X	X
Kiva Robots		X	X	
Netflix			X	X
Pinterest	X			X
Robotic Car Parking	X		X	
Skype	X			
Square			X	X
Travelocity			X	
Uber	X		X	X
WeLive				X
WeWork	X			X
ZipCar	X		X	X

Source: CEL & Associates, Inc.

For real estate brokerage companies, technologies must be an ally, not a resource commodity. If buildings can self-manage through technology, what happens to the property management industry?

If consumers can make purchases electronically, why have brick and mortar stores? What is more valuable, real estate assets or the consumers controlled/contained within those assets? **Technology is truly a disruptor!**

Transition

Many of today's Founders, Partners, CEOs and key leaders of the nation's real estate firms are age 60 and older. Retirement, phasing-out, and/or sale of all or a portion of their organization has become a reality for many. **In 2015 - 2016, the volume of real estate mergers and acquisitions approached a level not seen since 2007**. In 2015, there was nearly $80 billion in M&A activity within the U.S. real estate industry, and in 2016, approximately $247 billion worldwide. **Around 60% of today's CEOs/Presidents in the real estate industry intend to retire or phase down by 2025**. The transition of any C-suite leader to retirement can be very disruptive to the organization if not planned properly.

Key Growth Disruptors

- Accelerating property obsolescence.
- Internet of Everything.
- Sustainability and green technologies.
- Robotics.
- Demographic shifts.
- 3-D manufacturing.
- Cloud computing.
- Personalized experiences.
- Talent scarcity.
- Resource constraints.
- Mobile technologies.
- Disintermediation.
- Generational shifts.
- Post-election macro-economic factors.

Source: CEL & Associates, Inc.

Currently, more than 10 active mergers in the real estate industry should close in 1Q/2Q 2017. Creating succession plans and recapitalization strategies for the future has become an increasing focus of CEOs and boards of directors nationwide. **However, today nearly 60% of real estate firms do not have a formal succession plan**. This lack of planning could become a major disruption in 2017 and the years ahead. REIT consolidation (there are now more than 1,100 REITs in the U.S.) and REIT shifts to separate disparate businesses will continue in 2017 and beyond. I expect an increase in foreign capital investing (due to changes in FIRPTA) and a heightened interest in entity transactions. Securing a sustainable pipeline of deals will have tremendous value in 2017 and the years ahead. In a recent KPMG survey, 84% of firms surveyed intend to do at least one M&A deal in 2017. **Drivers piquing potential acquirers' interests are a transformative market place, the need to acquire a consistent pipeline of opportunities and access to new business models**. When leaders exit, when firms merge or are acquired and when new business models emerge that are more appealing to capital and/or customers, the disruptions created by transitions can be both a risk and an opportunity.

Worth watching in 2017 - 2018 are the 200 or so public REITs, 50% of which have a total market capitalization under $2 billion. The gap between Greystar and all other multifamily operators reveals some interesting consolidation potentials. The Regency Centers/Equity One merger (total cap value of around $11.7 billion) is a harbinger of similar mergers to come. Transition in service companies is also accelerating. **All-in-all, 2017 and beyond will be a robust year for niche, specialty and strategic mergers and/or entity acquisitions**.

Priorities Checklist To Address Timing Disruptor

- ☑ Build recurring reserves that offset/cover overhead.
- ☑ Review organizational architecture and staffing plans. Consider if you have the right people in the right place at the right time.
- ☑ Outsource non-essential activities.
- ☑ Increase the amount of creative/collaborative work space.
- ☑ Remove barriers to employee productivity.
- ☑ Create empowered leadership/management committees.
- ☑ Lock in HIPOs.
- ☑ Eliminate redundancy.
- ☑ Create a sense of urgency throughout the organization.

Source: CEL & Associates, Inc.

Timing

For the real estate industry, timing is everything, ranging. From when and where to buy, when to sell, when to develop, when to walk away, what to design, what terms to accept, entitlements and permits, lease negotiations, etc. Everything in real estate comes down to a timing decision…timing creates winners and losers. Timing creates relevance and irrelevance.

The Perfect Storm Of Transformation Is Happening Simultaneously

➢ Abundance of Capital	➢ Geo-Centric Market Shifts	➢ Retrenchment of Debt Markets
➢ Accelerating Technological Advancements	➢ Growth of the Sharing & Collaborative Economy	➢ Rise of Experiential Real Estate
➢ Anemic Economic Growth	➢ Housing Affordability Challenges	➢ Rise of the Independent Worker
➢ Changing Global Economy and Boundaryless Marketplace	➢ Increasing Government Regulations	➢ Rising Operating Costs
➢ Declining Workforce Participation Rate	➢ Increasing Role of Big Data	➢ Robotics & Artificial Intelligence
➢ Demographic And Generational Shifts	➢ Industry Consolidation	➢ Shifting Consumption Patterns
➢ Disruptive Technologies	➢ Internet Of Everything	➢ Shifting Household Formation Patterns
➢ Emergence of New Competitors	➢ Legacy Exits Amid Multi-Generational Workforce Shifts	➢ Unprecedented Federal Debt
➢ Energy Shifts & Emergence of Alternative Options	➢ Product & Service Innovation	➢ Urbanization and the Emergence of Multi-Purpose Real Estate

Source: CEL & Associates, Inc.

Readers of *Strategic Advantage* know that we have **correctly predicted the timing of the past two cycles, and going back to the early 1990s** have been very public on our projections as to when this cycle is likely to end. Based upon our analysis of over 25 factors during the past five decades, it is clear that this cycle ("The Age of Capital Asset & Entity Rebalancing") probably will end around 2018 (depending on government and/or federal intervention/actions). While we are not, at this time, predicting a prolonged recession, we are predicting:

- A rise in cap rates.
- Lower asset values.
- Normalized rent increases.
- Over-building in select markets.
- A rise in interest rates and more stringent lender underwriting.
- Tenant/resident fatigue after years of aggressive rent growth and operating costs.

Clearly a number of factors could kick this downturn into a recession; however, over the next few years timing will be critical. One cannot afford to "wing it," perform perfunctory due diligence, or assume that yesterday will continue forever and tomorrow will never come. **Planning for the eventual slowdown and 4-year transition period between cycles must become a priority for every real estate company**.

You must be "lean and mean" heading into 2017 and beyond. Get the timing wrong, and you will experience significant disruption. Remember, prioritize and follow through with each of your timing decisions…you cannot do everything at once. **Make timing an ally, not an enemy**.

Transactions

Clearly there is a dichotomy between available capital, pricing and transaction volume. While overall deal volume in 2016 was below 2015 levels, it was still higher than the volume in 2013 and 2014. According to Real Capital Analytics, Inc., deal volume in 22 of the 101 largest markets saw record high volume levels. As core market pricing rose to surprising high levels in several top metro markets, the shift to secondary markets and assets has enabled overall deal volumes in 2016 to reach a level that CEL & Associates, Inc. believes will begin to slow in 2017. Through YE 2016, U.S. commercial real estate transaction volume declined around 11% YOY on sales of $489 billion. In both volume and growth, the apartment sector led transaction activity in 2016.

Regional and local banks have increased their commercial lending as CMBS lenders reduced their lending volume. According to Preqin, fundraising by alternative investment funds dropped from $637 billion to $602 billion in 2016. Real estate fund managers closed on 214 funds ($104 billion) in 2016, down from 274 funds ($123 billion) in 2015.

Real Estate Companies & Investors Rebalance

- Long-term debt is secured with lower leverage.
- Greater focus on fundamentals.
- Operational efficiencies ("scaling") are enacted.
- Next-generation and rising stars are pursued and secured.
- Technology upgrades are fully-integrated into operations.
- Succession plans are created for all C-suite positions.
- Long-term strategic plans are prepared.
- Core business lines are strengthened and expanded.
- CRM platforms become high priorities.
- Work space/environments are redesigned/reconfigured.
- Non-core assets are sold…portfolios are rebalanced.

Source: CEL & Associates, Inc.

In 2016, 119 private debt funds raised $74 billion, down from 152 funds that closed on $96 billion in 2015. Literally around $200 billion of closed end real estate capital is yet to be deployed. Another $200+ billion or so in capital from high net worth investors, sovereigns, syndicators, REITs, institutions, corporations, endorsements are also looking for real estate opportunities.

Cap rates are unlikely to go lower, construction lending is tightening, around 48% of fund managers are concerned about asset pricing, interest rates have risen and could continue to rise, and "finding deals that pencil" are getting harder to find. The real disruptors in Transactions are:

1. Changes to Dodd Frank.
2. Tax reform that changes the benefits of real estate investing (e.g., changes to carried interest, depreciation and 1031 exchanges, among others).
3. The impact of infrastructure spending.
4. Lower rent increases.
5. Rising construction costs.
6. Protracted entitlement processes.
7. Impact of Chinese and other foreign capital or real estate investing as a result of FIRPTA changes.
8. Uncertainty about what will happen in Washington, D.C. as a result of political changes.

Transaction volume in 2017 will likely be 5% - 10% above or below 2016 levels, based on the amount of uncertainty and multiple disruptors impacting the purchase and sale of real estate assets.

Important Strategies To Deploy In 2017

- Target business development.
- Brand development and brand management.
- Centralized and shared databases.
- Market and client segmentation. Market/product/service positioning.
- Geographic and client coverage.
- Strategic accounts.
- Client intelligence and outreach. Track key business drivers of your clients.
- Digital marketing strategies.
- Create a differentiating story.

Source: CEL & Associates, Inc.

Key Strategies For 2017

In the past three to four years, the real estate industry has experienced the accelerated opportunities and challenges created in the aftermath of the 2007 - 2009 recession and the transformative technological advancements that have rendered old ways of conducting business obsolete and irrelevant. **The real estate industry is not immune to the mega-shifts, or tsunami-shifts (as some might say) occurring and reshaping the real estate industry**. These shifts are not "what" the real estate industry does, but "how" the real estate industry is going to be defined in 2017 and the decade ahead. For years I have written on the fixed and variable role of real estate in society. Today we are in the fixed phase, where real estate and the real estate industry will have a significant role in shaping and defining our culture and communities. **We are in a back-to-basics market place where getting it right is becoming as or more important than getting it done**.

Calendar year 2017 is the year to prepare for an eventual downturn and to create a launch pad to capitalize on the emerging opportunities ahead of us. To succeed in the preparation and growth phase simultaneously, **real estate firms must embrace and implement the following 12 key strategies in 2017**. This list has not been presented in order of importance or enactment sequence. Our industry has been the leader in shaping our country. We need to recapture that mantle over the next several years.

Key Strategies For 2017	
➢	Now is the time to reinvent yourself.
➢	Create a long-term vision and strategic plan.
➢	Enact operational scaling where appropriate.
➢	Lock-up your next-generation stars and High Potentials (HIPOs).
➢	Dispose of non-core assets, services and verticals.
➢	Develop and enhance your brand and brand differentiator.
➢	Lower your leverage and strengthen your balance sheet.
➢	Strengthen and expand all sources for recurring income.
➢	Reduce Corporate G & A and focus on fundamentals.
➢	Align all Stakeholder interests, expectations and goals.
➢	Create succession plans for all mission critical C-suite positions.
➢	Discover ways to make a difference in society.

Changing Competitive Environment	
➢	Accelerated continuation of mergers and consolidations.
➢	Expanded specialization and niche expertise (services, products and capital).
➢	Greater utilization of and dependency on technology and "Big Data."
➢	Increased emphasis on branding and innovation.
➢	Increased utilization of non-traditional performance metrics.
➢	Increased focus on financial services model and identity.
➢	Rising investments in research, analytics, CRM platforms and entity differentiators.
➢	Increased resources dedicated to perfecting Next-Generation leaders and succession.
➢	Greater focus on raising the cost of disengagement.
➢	Increased use of ICs, Specialists and Contingent workers.
➢	Increasing reliance on product and/or service "Centers of Influence."
➢	Focus on "Unify-ers" not "Add-Ons."
➢	Seek clients more like you (shared values).

Closing Comments

There are six primary disruptor categories. If you are not ready for significant changes in 2017 and beyond, this edition of *Strategic Advantage* provides reason to pause, think and respond. **A part in each of us wants the impossible to happen, our fears to disappear and our dreams and aspirations materialize**.

Unfortunately, disruptors block, inhibit and cause us to rethink our strategies to actualize the way we plan. **As a leader, you have an integral role to play in minimizing the impacts of each disruptor. The choice and opportunity are yours. How will you respond?**

I welcome your comments, feedback, insights and perspectives.

Regards,

Christopher Lee

SPECIAL ANNOUNCEMENT

Over the past 20 years, we have received hundreds of emails and inquiries asking us to create a more frequent "one- to two-pager" on matters of strategic importance. We are pleased to announce that **in 2017 we will send out a bi-weekly brief entitled *Leadership Conversation***. This will feature one topic, provide recommended strategies, include a prediction and highlight key questions to ask at your next Executive or Management Committee. The results of our pilot test with the concept and format have been very positive, and we are excited for this kickoff. ***Strategic Advantage*, our regular newsletter, will continue as a quarterly publication.**

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The Real Estate Industry In 2025 100 Bankable Predictions You Need To Know Part III

http://www.celassociates.com/onlinenewsletter/BankablePredictions-PartIII-SA-K031416.pdf

The Real Estate Industry In 2025 100 Bankable Predictions You Need To Know Part II

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http://www.celassociates.com/onlinenewsletter/BankablePredictions-PartI-SA-K021416.pdf

Millennials Will Have A Dramatic Impact On Real Estate!

http://www.celassociates.com/onlinenewsletter/MillennialsImpactOnRealEstate-SA-K091215.pdf

The 6 Ps For Success

http://www.celassociates.com/onlinenewsletter/The6PsForSuccess-SA-K042615.pdf

It's All About Jobs

http://www.celassociates.com/onlinenewsletter/ItIsAllAboutJobs-SA-K111214.pdf

The Future Of Retail Real Estate…A Tsunami Of Change Is Underway

http://www.celassociates.com/onlinenewsletter/FutureOfRetail-SA-K051914.pdf

Succession Planning Must Begin…Now!

http://www.celassociates.com/onlinenewsletter/SuccessionPlanning-SA-K041114.pdf

The Future Of The Office Sector

http://www.celassociates.com/onlinenewsletter/TheFutureOfTheOfficeSector-SA-K062013.pdf

Breaking Strategic Gridlock

http://www.celassociates.com/onlinenewsletter/BreakingStrategicGridlock-SA-K041713.pdf

The Great Generational Divide

http://www.celassociates.com/onlinenewsletter/TheGreatGenerationalDivide-SA-K091812.pdf

Becoming A Customer-Centric Company

http://www.celassociates.com/onlinenewsletter/BecomingACustomer-CentricCompany-SA-K040212.pdf

It Is Time To Get Rid Of Oldco!

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A Contrarian Perspective

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