Canadian Real Estate Executive Market Condition & Employment Planning Survey

RESPONDENT REPORT – Measuring Third Quarter 2009

Released: September 22, 2009

Rutherford International Executive Search Group Inc.

+ Survey Results

Survey Results

+ A. Purpose

Rutherford International's Market Condition and Employment Planning Survey was designed to provide a third quarter snapshot of senior executive opinion on the state of their industry during the latter month of July and early August 2009. The survey was directed to the top- and first-tier executives within the Owner/Developer/Lender/Service sectors of Canada's commercial real estate industry.

Segmented by sector, opinion was measured on the following:

a) Fundamentals for acquisition, disposition and financing for the next two years;

b) Employment demand within the industry in 2010;

c) Functional changes likely to take place within respondents' organizations over 2010;

d) Critical human resource priorities within respondents' organizations;

e) Economic factors shaping their opinion.

Two survey reports are available. First, a comprehensive sector-based analysis for respondents and, second, a general overview for the industry at large. Some details highlighting analysis from the 'Respondent Survey' may be found at Rutherford International's blog and Forbes Rutherford's LinkedIn address at http://www.linkedin.com/in/rutherfordintl. To receive a copy of the complete survey results, please contact Forbes Rutherford at 416-250-6300 Ext. 227 or by email at forbes@rutherfordinternational.com.

B. Methodology

Data for this survey was collected during the months of July and August 2009. A broad cross-section of the industry was invited to participate with a 50% percent response rate giving robustness to the data and analysis.

The percentage response by industry sector is as follows:

- Lenders – 20%
- Owner/Developers – 56%
- Broker/Investment Banker – 24%

The majority of the Owner/Developer category could be best characterized as "Private" as only a limited response was received from the public owners.

C. Participant Profile

Thirty-two percent of the respondents were Chief Executive Officers and forty-eight percent would be classified as First Tier Executives (or individuals that report directly to the CEO). Another eight percent were Second Tier reporting to a First Tier Executive.

The real estate sectors served by the respondents were as follows:

- Office – 96%
- Industrial – 88%
- Hotel – 32%
- Retirement/Lifestyle – 48%
- Nursing – 12%
- Institutional – 28%
- Corporate – 28%
- Retail – 92%
- Multi-Family – 60%
- Other – 8%

The geographical scope of respondent companies was as follows:

- International – 44%
- National – 36%
- State/Provincial – 4%
- Regional – 16%

D. Key Findings

1. Fundamentals for acquisition and disposition in 2009 through to 2011/04.

Respondents were given three choices – favorable, unfavorable or neither. The questions regarding 'acquisition' and 'disposition' were separate. However, to highlight the contrast of the response, answers for acquisition and disposition are represented in parallel columns. The results suggest the vendors' lack of market cycle certainty in 2010, with the pricing gap between 'buyer' and 'vendor' expectations continuing well into 2010. "There is a perception that lenders are afraid to foreclose, which is keeping sellers hopes high."

	ACQ	DISP	ACQ	DISP	ACQ	DISP
	Favorable		Unfavorable	Unfavorable	Neither	Neither
2009	29.2	13.0	**54.2**	**69.6**	16.6	17.4
2010	**78.3**	21.7	8.7	**47.8**	13.0	34.8
2011	**91.3**	**56.5**	0.0	21.7	8.7	21.7

+ D. Key Findings

1.1 What Thoughts Are Shaping Opinion On Acquisition and Disposition?

a. *"It's a great time to pick up assets for long term holds. Short term might also be a good strategy but in a perfect market, arbitrage opportunities may be rare."*

b. *"Good time to buy but Vendors have not adjusted their 'ask', so not many transactions occurring, compounded by appraisals that are too aggressive."*

c. *"Favorable, but likely to become "More Favorable" resulting in a self-fulfilling deflationary environment."*

d. *"Disconnect between Vendors and Purchasers. Debt is difficult to obtain. Falling rental rate environment. The expectation is for more stability next year.*

e. *"Pure guessing game."*

f. *"Lack of liquidity, interest rates favorable, return to more conservative guidelines."*

g. *"Financing has been difficult, and most vendors have been slow to adapt to the current challenging market realities."*

h. *"Quality product that is truly available for sale has just started to come to market earlier in the year, vendors were looking to sell but at unrealistic prices."*

i. *"Whole new reality on values that will appear unfavorable for vendors who bought from 2007-08 but likely still viable for post 2006 buyers looking to sell."*

+ D. Key Findings

1.1 What Thoughts Are Shaping Opinion On Acquisition and Disposition?

j. *"Expect market to improve in 2010 although vendors will likely have to lower their pricing expectations*

k. *"Generally unfavorable except for Class AAA assets which on balance haven't traded."*

l. *"We have sold properties to 'Users' who are willing to pay more than 'investors'; accordingly, those transactions result in acceptable returns."*

m. *"As the equity markets return to higher levels, the large pension funds should return to the market, enhancing the bid for good quality real estate. Also, an expected improvement in the liquidity of the financial markets should in turn improve the liquidity in the property market."*

D. Key Findings

2. Fundamentals for financing and refinancing in 2009 through to 2011/04.

A similar format was used for questions on financing and refinancing as was used for disposition and acquisition. The general view of respondents is one of "uncertainty" about the scope of financing and refinancing being executed in 2010. This sense of "uncertainty" is mostly representative of the "Owner/Developer" respondents. "Lender" respondents were more inclined to choose "Favorable" for both 'financing' and 'refinancing' in 2009 and 2010; however they were less sure of conditions in 2011.

	FIN	REFIN	FIN	REFIN	FIN	REFIN
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	21.7	31.8	**73.9**	**63.6**	4.3	4.5
2010	34.8	33.3	**43.5**	**42.9**	26.1	23.8
2011	**60.9**	**66.7**	17.4	19.0	21.7	14.3

+ D. Key Findings

2.1 What Thoughts Are Shaping Opinion On Financing and Refinancing?

a. *"Only unfavorable for those who overpaid and over financed – anyone with experience and more conventional debt loads should be fine."*

b. *"Deals seem to be getting done generally, spreads have increased but loan amount requests typically being satisfied; plus base rate is low."*

c. *"Depends on the location. USA is much more difficult for refinancing and LTV's are significantly reduced. Canada LTV's are down but not dramatically."*

d. *"Refinancing of CMBS financed properties will continue to be a problem for some time."*

e. *Spreads are still huge in historical terms but the overall rates are satisfactory."*

f. *"2010 will be a turning point."*

g. *"Lenders have limited funds are holding back funds for renewals. 2010 should see more funds available from lenders. The 'wild card' could be refinancing of CMB's loans."*

h. *"Disappearance of the CMBS lenders in Canada has removed about 25% of the liquidity."*

D. Key Findings

3. Based on current economic climate, employment opportunities in the commercial real estate sector will:

	EXECUTIVE	MANAGEMENT	STAFF
Expand	4.0	8.0	**8.0**
Constant	40.0	44.0	**48.0**
Decline	**56.0**	**48.0**	44.0

D. Key Findings

4. Relative to current employment levels, which functions are likely to change at your company in 2010:

	INCREASE	CONSTANT	DECLINE	N/A
Fin / Accounting	31.8	**59.1**	9.1	0.0
Info Systems	22.7	**63.6**	**4.5**	**9.1**
Legal / Compliance	14.3	**71.4**	4.8	**9.5**
Inv Relations	10.0	**55.0**	0.0	35.0
Inv / Acquisition	18.2	**50.0**	13.6	18.2
Development	9.1	**36.4**	27.3	27.3
Construction	0.0	28.6	**38.1**	33.3
Leasing / Mktg	23.8	**42.9**	4.8	28.6
Prop Mgmt	4.5	**54.5**	0.0	40.9
Disposition / Sales	5.0	**55.0**	15.0	25.0
Asset Mgmt	25.0	**58.3**	0.0	16.7
Admin / Operation	13.0	**73.9**	8.7	4.3
Analysis / Research	17.4	**65.2**	8.7	8.7

+ D. Key Findings

5. The three most and least critical human resource priorities within respondent's organizations are:

HR PRIORITIES	MOST	LEAST
Employee Retention	**54.2**	
Employee Development	**45.8**	
Bonus Structure	**33.3**	
Performance Appraisal	**33.3**	
Knowledge Transfer	**33.3**	
Succession Planning		**16.7**
Innovation		**8.3**
Pay Equity		**0.0**

+ E. Key Findings – By Sector with Commentary

1. Fundamentals for acquisition and disposition in 2009 through to 2011/04.

None of the respondents by sector are enamored by the idea of "disposing" of investment real estate in 2009/10, however "acquisition" was identified as 'favorable' by all beginning sometime in 2010. One might surmise that the operative strategy for acquisition is to ***"buy and hold"***; whereas for vendors it is to ***"hold and hope."***

LENDER	ACQ	DISP	ACQ	DISP	ACQ	DISP
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	**50.0**	25.0	25.0	**50.0**	25.0	25.0
2010	**100**	25.0	**0.0**	25.0	0.0	**50.0**
2011	**100**	**50.0**	0.0	0.0	0.0	**50.0**

OWNER	ACQ	DISP	ACQ	DISP	ACQ	DISP
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	21.0	14.0	**64.0**	**55.0**	15.0	21.0
2010	**71.4**	7.0	7.1	**50.0**	21.5	43.0
2011	**85.7**	**43.0**	0.0	36.0	14.3	21.0

BROKER	ACQ	DISP	ACQ	DISP	ACQ	DISP
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	33.0	0.0	**50.0**	**83.0**	17.0	17.0
2010	**80.0**	**50.0**	20.0	**50.0**	0.0	0.0
2011	**100**	**100**	0.0	0.0	0.0	0.0

E. Key Findings – By Sector with Commentary

2. Fundamentals for financing and refinancing in 2009 through to 2011/04.

The Lenders' enthusiasm for doing deals in 2009/10 appears not to resonate with the owners and certainly not with the Brokers, who depart from the common view even more so in 2011. As well, the variance between Owner and Lender relating to what constitutes acceptable LTV ratio for financing a purchase would appear to be as wide as the variance between Vendor and Buyer. The variance in opinion between Lender and Owner bears further analysis; however, one might surmise that the Owner is witnessing a more rapid erosion of tenant fundamentals. I suspect this information has not filtered through to the lending community to-date. If this is the case, then any lingering malaise of the "real economy" into 2010 will likely drain away Owner and Tenant financial reserves, creating an "Opportunist" market for private equity pools that are unencumbered with traditional financing mechanisms.

+ E. Key Findings – By Sector with Commentary

2. Fundamentals for financing and refinancing in 2009 through to 2011/04.

LENDER	FIN	REFIN	FIN	REFIN	FIN	REFIN
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	**75.0**	**75.0**	25.0	0.0	0.0	25.0
2010	**75.0**	**75.0**	0.0	0.0	25.0	25.0
2011	**50.0**	**50.0**	0.0	25.0	**50.0**	25.0

OWNER	FIN	REFIN	FIN	REFIN	FIN	REFIN
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	14.0	23.0	**79.0**	**77.0**	7.0	0.0
2010	14.0	31.0	**50.0**	**46.0**	36.0	23.0
2011	**50.0**	**61.0**	26.0	31.0	14.0	8.0

BROKER	FIN	REFIN	FIN	REFIN	FIN	REFIN
	Favorable	Favorable	Unfavorable	Unfavorable	Neither	Neither
2009	0.0	20.0	**100**	**80.0**	0.0	0.0
2010	**50.0**	0.0	**50.0**	**75.0**	0.0	25
2011	**100**	**100**	0.0	0.0	0.0	0.0

+ E. Key Findings – By Sector with Commentary

3. What are the main factors shaping your forecast?

Lenders:

- Employment in Canada begins to rise in mid-2010;
- Operating in a recessionary environment;
- Employment is a concern;
- Perception that lenders are afraid to foreclose, which is keeping seller hopes high. "Why die today, when you can die tomorrow."
- Concern about how long it will take rents to bottom.

Owners:

- Liquidity, LTV's and vendor expectations;
- Shortage of financing and an unmanageable spread between "bid and ask;"
- Unemployment and credit markets;
- Economic recovery, availability of debt, stable rental rate market;
- Closer alignment of Vendor and Purchaser expectations;
- Reckless performance of the Obama administration;
- Deal flow, availability of funds for the industry as a whole;
- Operating fundamentals – rates and occupancy;
- Over the next few years in Toronto, there will be an increased supply of office space with shrinking business needs;

+ E. Key Findings – By Sector with Commentary

3. What are the main factors shaping your forecast?

Owners (cont'd):

- Return of shadow banking system for commercial real estate lending – a re-launch of plain vanilla securitization;
- The lack of funds, increasing spreads in interest rates;
- No leasing velocity and a decrease in rental rates.

Brokers:

- Current size of the 'bid-ask' spread between buyers and sellers;
- Apparent acceleration of financing terms coming more in line with historical levels;
- Continued steady improvement in GDP;
- Deleveraging, lower L/V's, higher spreads, many REITs and REOCs trading below NAV, flat to negative earnings growth;
- Collapse of the CMBS market;
- "Denominator effect" causing large pension funds to cease their real estate activities;
- Huge slide in public equity values;
- Fear associated with uncertainty as to how long and deep the recession will be;
- Pressure on clients to reduce overall spending;
- Competition entering Canada.

F. Commentary

"Appraising Back to the Future"

In terms of acquisition and disposition, aggressive valuations have been blamed for contributing to the variance between "Buyers" and "Vendors." In the last major recession, Rutherford International was retained by the head-office of a major American bank to recruit an appraisal team to value the assets behind their Canadian division's commercial mortgages. The search was national in scope and resulted in our becoming very familiar with a broad cross section of Canada's commercial property appraisers.

We learned a great deal about the strengths and weaknesses of the appraisal process. In particular, we concluded that depending on which approach to appraisal is used, certain methods can be likened to valuation by looking in the rear view mirror. As a result, it's not uncommon for the appraisal process to be pilloried in a recessionary market. It was only after the 1989-1995 real estate depression when property values and iconic developers dropped into the basement that discounted cash-flow based appraisal became popularized. Valuing real estate in this current market of limited transactions using "top of cycle" historical comparables spanning multiple regions is analogous to a "drive by shooting."

"I'll Have a Bromo with that Denominator Effect"

It is also assumed that an increase in the equity markets will result in ameliorating the 'denominator effect' leading to a return of institutional capital to the real estate market for Class AAA and AA assets. Aside from fears of 'W" shaped recovery, one may well ask if there are other factors to consider when measuring the pension funds' appetite for acquisition? Such as: institutional debt and equity positions with 'under-water' REIT's and JV partners; shifting risk profiles of the portfolio when some *"institutional investment grade assets yesterday are tertiary today"*; more pliable opportunities south of the border; unfunded liabilities; increasing distributions as the baby boomers retire requiring greater liquidity on-hand; continued weakness in the real economy leading to tenant downsizing and erosion of the all-important 'face rate'; capital demands associated with repositioning existing assets to a 'Green status,' to ensure tenant retention and greater operational efficiencies.

+ F. Commentary

"Sitting on a Picket Fence can Hurt!"

With respect to responses regarding the condition of the employment market, it would seem the prediction for a decline in opportunities conflicts with the suggestion that most functions within the respondents' firms will remain constant subject to normal attrition (which averages around 5% in most companies) in conjunction with some targeted increases and terminations. Overall, there seems to be a determination to 'hang tough' at current numbers (short of development and construction roles) and not force any hard staffing decisions. "No new hires and hold on until we see what is happening." It's a bit of high stakes game that's being played in some shops – ante up with house stakes – 'Check' when able – and enter 2010 with a plan to make fine adjustments and seek quick opportunity plays; but in general – mark time until the industry completes its deleveraging. Requirement for development and project management expertise will continue to be asset or project specific whereby practitioners' will be hired on an out-sourced basis under personal service contracts or through corporations of professionals. Rutherford International has developed a global clearing house of interim development and project management professionals that can "plug and play" into organizations as an "outsourced" project team.

"Retaining your Walking Assets"

It may also suggest that companies don't have excess headcount to downsize in a manner reminiscent of the last recession. Investment in technology and the development of an austerity culture *"doing more with less"* has fostered leaner companies. The predicted demographic labour supply bust, which all industry and government sectors are currently experiencing – and self evident by respondents concerns over 'employee retention, employee development and knowledge transfer' (a surprising change from our mid-1990 surveys of executive attitudes) – will provoke upward pressure on salaries, bonuses and associated employee burden as firms compete for scare and "*effective*" human capital resources in late 2010.

F. Commentary

"Forward to the Future"

The worrisome trend that emerged from the analysis is that respondents appear to place little importance on 'succession plans' and 'innovation.' One cannot afford to set aside these priorities. An organization that is innovative and 'future focused' suggests underlying traits of resilience and creative problem solving – one affects the future by managing the present.

"Peter's Principle Exposed"

- We purposely referenced the term "*effective*" to emphasize a human resource reality that generally becomes evident in recessionary markets after a long wave rise in the economy. A rising economy – ergo rising property values such as we've had for 18 years – tends to camouflage underwhelming talent within an organization. Their lack of "effectiveness" when the market turns negative is palpable; and often has a demoralizing affect on the high performers, especially if a portion of their compensation package is based on a "gain sharing" plan. It's a false economy to carry a manager constantly requiring remedial help – better to terminate and take the predictable hit on the bottom line than manage the incompetence by tasking executive time to manage around and/or risk long term costly errors.

"Economic Recovery and Generational Knowledge Transfer"

Good managers are the product of acquiring "tacit" knowledge, which is achieved on the job through apprenticeship, mentorship and direct – but guided experience. "Tacit knowledge" cannot be acquired from a book or from periodic lectures by industry experts. Hiring for sound character, optimism, a thirst for learning and an outwardly focused value system will enable any organization, regardless of industry to adjust "on the fly" to the demands of a down or static cycle. When hiring staff, the key personality trait that employers should seek now and in the best of times is "resilience".

In general, anyone under 45 today wasn't in a position of management and leadership during the last major recession and may well struggle while adjusting to this recession (or if not an official recession – then economic "malaise"). This statement is not intended to denigrate the middle generation of real

F. Commentary

estate professionals but speaks to the harsh reality that the "Dark Age" of the early 1990's real estate depression led to lean, compartmentalized organizations with little time or inclination for knowledge transfer. This generation of real estate professional didn't acquire "tacit" knowledge through transference from mentors. In many cases, understanding the nuance of what will work and won't work will need to be relearned. Errors and omissions are bound to happen.

"Best Case – Leveraging Brand & Grabbing Talent on Waivers"

Companies that prepare for recovery by investing in their corporate brand and their product delivery platform tend to lead their competitors for three to five years post recovery. Not only should a CEO invest in their brand; but they should seek to improve their company's bench strength when competition to attract quality staff and management is weakest.

"Worst Case - A Dead Cat Bounce"

Lenders are less sure about the fundamentals for real estate in 2011 then that of the Broker and Owner respondents. Perhaps a rising American accumulated debt, which is currently broaching 13 Trillion dollars, has given them pause to think about the inflationary impact of the unsustainable monetary maneuverings of the US Federal Reserve and Obama's first term initiatives.

Rising annual American deficit's to the tune of $1.5 Trillion in 2009 and again in 2010 would suggest that we're in for a lengthy period of monetary indigestion. It would seem to us that the ability to think laterally, to problem solve creatively; to sort out the winners and losers when identifying tenants for "blend & extend" negotiations (or to inoculate an asset's mix with a good balance of recession and high interest rate resistant tenants); or to squeeze out additional "Net Operating Income" or negotiate financial workouts will be long-term and valued skills in our industry going forward.

+ I. Conclusion

The fourth quarter of each year has become a traditional period for crystal-ball gazing and genuflecting to industry soothsayers at various property and economic forums. Once you get through all the verbiage, you'll discover that understanding the direction of our economic future is an educated guessing game.

In good times, the prognostication is for sunny weather. In hard-times, the group think is generally gloomy. We all tend to look at the future through the lens with which we've become most comfortable. This might explain why the opinions regarding acquisition/disposition, financing/refinancing fundamentals for 2011 vary with each respondent sector.

Having worked for the weather office for a short time in my youth, I came to realize that a forecast calling for "Partly Sunny/Scattered Showers" was a euphemistic phrase coined by the climatologist when he didn't know what was going to happen. In keeping with this analogy and in the fine tradition of our local weather office, each respondent sector – albeit somewhat different in their scoring – is calling for "Partly Sunny/Scattered Showers" in 2010.

Having done my fair share of crystal-ball gazing at one podium or another during the 90's, I can recall with sheer horror the number of times I inserted into a speech the banal phrase that "we are living in changing times" or that "change is the one constant in our lives."

I'm older now – and a bit wiser – and able to ask the questions: *"Do we really live and manage in times of change? Or, are we simply managing and living in chaotic times that remain in context somewhat the same?"*

The lessons from 19 years ago that gravity and finance co-exist are being relearned with a vengeance. A Senior Vice President of real estate lending with a major Canadian bank told me while collecting answers for an "Attitudinal Survey" in 1990, "Forbes, we were Lotus fried – we had all these MBA's in here convincing us to do a deal by simply changing the variables on a spreadsheet. Of course their compensation is based on volume of deals written, not on the quality."

"What do you think you have learned from this experience?" - I asked. "Nothing, we have no institutional memory. We're doomed to repeat ourselves. I give it 15 or 20 years."

Everything that is 'old' is 'new' again.

+ H. About Forbes Rutherford

Through **Rutherford International Executive Search Group Inc**., Forbes Rutherford specializes in executive, strategic partner and interim executive search. Prior to starting his firm in 1990, he was a Partner with an international search firm, where he was responsible for real estate executive search, compensation and market research. He consults to real estate developers, owners, banks, life companies and fund managers on matters of executive and management selection utilizing a referral network of real estate advisors, lawyers, accountants and investment professionals in over forty countries.

Forbes offers a *"Partner Search"* service where he facilitates joint-ventures by matching capital with executive talent; and/or compatible companies poised to increase market share through merger. His "*Interim Executive"* practice supplies contracted expertise to clients in need of development, project management, asset stabilization, restructuring and financial workout.

Forbes has created a separate management and staff selection service called ***North American Real Estate Recruiters*** **(NARER)** which project manages on a time and material basis the recruitment and assessment of project teams and/or key staff. NARER utilizes an external network of contingent recruiters, job boards and internet tools to access talent; and then filters the candidates through Rutherford International's assessment methodology.

Prior to his real estate executive search practice, Forbes worked in real estate development, investment syndication and resort promotion.

+ H. About Forbes Rutherford

Experience:

A partial list of past search assignments: President & CEO, CFO, COO, CIO, VP US Acquisitions, Project Architect for Canary Wharf, Regional Property Manager in Puerto Rico, Fleet Operations Manager in Tunisia, VP Chief Economist/Investment Research, VP Corporate Funding – Euro Financing, VP Real Estate Valuation, Manager US Bond Trading, VP Development(s), VP Financial Services, VP Strategy & Planning, VP Finance (REIT) Corporate Controller(s) (REIT & Pubco), In-house Legal Counsel, VP National Accounts, VP Facilities Management, Project Director – Waterfront Development - U.A.E., Project Director – India, Development Leasing (Major Project), Senior Design Architects, Retail Transaction Managers, Leasing Executive(s), Director Asset Management, General Manager(s) – Major Complexes – Retail & Office, Airport Retail Leasing Manager, etc

Forbes has sat on the Toronto board of IFMA; CCIM, and a global top 10 real estate brokerage.

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