Sousou Partners

Q&A with an executive search firm

The way private equity real estate in every region hires, retains and compensates its talent has changed materially since the market peak of 2007. Ghada Sousou[1] of Sousou Partners explains what is driving demand for talent in the near term and how and why some institutions are diversifying their human capital to meet their new investment strategies

PERE: How would you describe the near-term compensation outlook for executives in the private equity real estate asset class over the next 12 to 18 months? Are there specific themes and trends evident across institution types, seniority and geography?

Ghada Sousou: For some private equity real estate executives the outlook is decidedly better as their prospects improve. For others though the near-term future will offer flat opportunities, and unfortunately it will be bleaker for some. To understand what is on the horizon, you have to have a solid appreciation of what has happened in recent times.

Over the last two years, many funds have been undergoing internal exercises to reassess their strategies, focus and processes. Many have included areas such as talent retention or attraction, new product offerings and more transparent investor reporting. Those funds that have managed to put their house in order, those with relatively strong investment track records, and those with excellent fundraising capabilities and / or "dry powder" are well positioned to do much better than their competitors. Conversely, those funds that are downsizing, focusing on workouts or continuing to restructure their businesses are less likely to do well in compensating their teams compared with their better-positioned competitors. We have seen relatively high levels of compensation for some of these workout groups, though it has been more retention than growth based.

There is evidence of different trends emerging in different regions. There is more attention on the major economies in Europe, including the UK. In these markets there is less focus on the most senior ranks, but the vice president and director levels are more in demand. In addition, those individuals with experience of the actual assets, the bricks and mortar side of real estate, remain in demand. In addition, there is increasing interest in building strong relationships among operators in niche geographies and / or asset classes with proven track record and revenue streams.

In Europe, some of the larger institutions are struggling to retain their talent. Groups with strong fundraising capabilities and minimal or no legacy issues will be able to retain talent. One of the most interesting trends, and one that is garnering a lot of attention in talent circles, is the emergence of small teams in private equity real estate. These specialised teams are being sought by institutions of all sizes looking to absorb the expertise they can offer. What is appealing to many hiring institutions is a team's track record, its niche focus, strong relationships with limited partners and close affinity with the real assets the team has invested in and manages.

More junior, up-and-coming talent is being drawn to the new wave of managing directors spinning out of some of the larger institutions- We are seeing an increased interest in Europe among high quality US based funds. In many cases, these funds are sending over a senior level individual as a carrier of culture and investment strategy, and are looking to add local talent with strong European relationships at the aforementioned VP or Director level.

[1] I would like to thank my colleagues Kate Hammar, Serene Hamzawi, Maaike Kitsantas, Jennifer Novack, Jennifer Skylakos and Hoda Tahoun for their input into this interview.

PERE: Are compensation and incentive trends in the private equity real estate asset class taking the lead from other asset classes or are any changes relatively independent?

GS: This is not a followers' market as many of the experienced practitioners have learned their lessons the hard way about being part of the herd mentality. The private equity real estate asset class is very focused on its own industry, and as importantly on each fund's own circumstances and positioning.

PERE: How does the level of financial compensation and incentives compare with the height of the market in 2007?

GS: The levels of compensation and incentives are yet to catch up with 2007 levels, especially for the more senior talent. However, you need to be careful when comparing 2012 and 2007 data. When we examine our proprietary data of compensation levels in private equity real estate it is clear there are generally fewer executives in each of the categories, which therefore means, in theory, that there is more to share among fewer participants. With this in mind, some categories of talent appear to be better paid in 2012 compared with 2007. Although demand for some talent groups, such as vice presidents, has recovered and compensation levels are good, other groups have suffered. Our data shows that the median level (excluding outliers) of compensation for managing directors has declined by over 20% since 2007.

In Asia, specifically, where talent is thinner and there is increasing focus on growing local talent, we have seen some aggressive compensation packages at the vice president and director levels. While the compensation at the senior end is generally in line with the US and Europe, the median level of compensation for talent in the 12 to 15 years bracket tends to be higher, reflecting more responsibility for the number of years.

PERE: Is it fair to say that pay scales, bonus and carried interest/promote levels will remain generally more sober for the foreseeable future?

GS: This is a difficult call to make because much is influenced by regulation, legislation and a combination of willingness and appetite among limited partners to revert to the old compensation and incentive models. Based on our work with limited partners, it is clear that some of them are structuring their businesses so that they do not need to return to how they conducted their business in 2007, but instead build out their teams to invest directly or via joint ventures.

PERE: Is it likely the hiring bubble of the last cycle will ever be seen in private equity real estate again?

GS: Of course there will be peaks and troughs in the future as the industry follows its natural course.

There was a mini bubble in China in 2011 / 2012, which has been calming down in the final quarter of the year. In Asia in general, it looks like the trend going forward will be on market-specific dynamics rather than a general hiring bubble taking over the region's private equity real estate asset class.

Overall, the playing field is changing and we are seeing new entrants coming into the market, which will drive hiring up.

PERE: When it comes to attracting the most talented executives in real estate, how are institutions trying to distinguish themselves to attract the best talent? Are they offering heightened earnings potential, carried interest/promote, ex-pat packages, domestic/family assistance, knowledge advancement, professional/career development and skills training?

GS: In today's market it is really none of these elements – it's all about opportunity. The way to attract talent is relatively straightforward: this largely comes down to having a good track record, the ability to fundraise, clear evidence of successfully raised capital and a solid echelon of senior talent heading the brand. New entrants to a market, such as US players looking to Europe, can also attract talent because they do not come with negative legacy. Many candidates today are risk-averse, which is another influencing factor.

There are also some limited partners that continue to build up a direct business, and as a group with a steady and continual source of capital, this is appealing to many.

Some platforms do place emphasis on carried interest or promote, but it's more of a retention element rather than an incentive to attract talent. Also, it is not a trend, but seems like a natural incentive for smaller platforms to capitalise on in the long term rather than short-term compensation.

From a retention point of view, there are a select number of institutions who have given retention packages to one or two of their current employees they view as integral to the team and very difficult to replace. This is in the minority, and often within firms that are going through a major transition (potential merger or disposition), and want to ensure some stability.

PERE: Does the supply of suitably qualified executives in different regions generally match the level of demand for their skills and services in those countries?

GS: Not always. In many cases when private equity real estate firms are looking to hire local resources they are unable to source sufficiently strong talent with a good track record and comfortable cultural fit. It's still clear today that the US has the deepest pool of talent, followed by Europe and then Asia.

Despite the smaller talent pool in Asia, there is very little to no appetite to attract people from other regions to compensate. This is true of all regions (other than US platform sending their talent overseas) for locally based platforms. Every region wants experience and track record in their local markets.

We are seeing a lack of top notch talent, at a variety of levels, within Brazil and Colombia. US funds that have set up shop in these countries are in need of associates with excellent modeling skills, as well as very senior level professionals who have experience investing in the US, an understanding of the particular country's culture when conducting business, and the desire to live abroad / return home. Another issue, specific to Brazil, is the often difficult employment visa process, which can be time consuming and not guaranteed. In addition, the tax rate in Brazil is quite high, as is the cost of living, making it in many cases cost-prohibitive to build a team with expats. Colombia on the other hand is much friendlier in these matters.

PERE: Are certain institutional investors and fund managers in certain regions disadvantaged at being able to hire the best staff because of visa restrictions/immigration issues and cross-border taxation considerations?

GS: Attracting talent to cross borders has not really been a major issue. If anything it's easier to get talent to move across borders because of a lack of opportunity in some local markets.

We have not seen visa restrictions or immigration issues and cross-border taxation considerations being an issue in the European or US markets. Middle Eastern groups will continue to play the tax card and ex-pat package card, which can help to attract talent. Immigration issues and cross-border taxation considerations continue to be less of an issue in Asia. With Asia being a very fragmented region with very different cultures, levels of development and consequently investment strategies, demand has been strong for local talent with language skills who understand their specific markets and can operate in the cultural and business environments.

The talent pool in the Asia Pacific region has developed especially in the more mature markets such as Hong Kong, Singapore and Japan. However, since the financial crisis there has been a period of consolidation with groups exiting, merging or being acquired, which has resulted in available talent at different levels, and particularly at the more junior and senior ends. By contrast, the quality of talent in less developed, less mature markets is much thinner and much more specialised.

PERE: Are some roles, such as those focused on raising capital, more in demand than others?

GS: Capital raising has continued to be a constant theme in the last two to three years and anyone who has access to capital has been in demand. That said, the focus on the types of executives hired has changed and it's not just about going through the processes of fundraising; it goes much deeper and focuses on real credibility. Employers and candidates have realised that it is not only down to relationships, it comes mostly down to a general partner's track record.

In the second half of 2012 we have been hearing more about demand for strong Asia fundraisers from clients in Europe and the US. This is due in part to the emergence and growth of Asian institutions allocating more than they had done in the past and of course to the tough fundraising environment, which means GPs are trying to reach all regions.

In general, we are seeing demand for in-house fundraising and investor relations professionals who bring principal investment or transactional experience in their background. These professionals bring an added ability to answer some of the questions that would typically be funnelled to investment professionals. As fund managers are spending more time on the road than ever for the fundraising process, and investors' questions have increased, the need for another pair of hands on deck has been a consistent theme.

There is an interesting trend taking shape in London where new entrants are hiring and building small teams of two to four people, but those new hires are much more junior than they would have been in 2006 or 2007. In fact, before the global financial crisis we would have seen groups hiring real estate industry veterans with 20+ years of experience, but today, in late 2012, they are hiring less senior employees perhaps with 12 to 15 years of experience. Where the head office of a London office is based in another city, such as New York, we are seeing senior management there stepping in and being much more hands-on.

PERE: Are you specifically seeing team building for traditional investment strategies, direct investment strategies and other strategies such as debt and credit investing?

GS: There is still a lot of talk about building debt funds, both to focus on mezzanine and senior debt. But despite a lot of general interest in debt and other credit strategies, there has been little success so far in terms of fundraising. That said, it is clear there will be more hiring in this space, especially among the insurance companies, a group which forms a natural fit for debt and credit funds. The distressed debt investing teams and their special servicing groups have grown primarily by acquisition rather than organically.

On the limited partner front, some institutions have built their direct investment teams. Institutionalised family offices are attracting good talent, too.

PERE: On the investment side, is there greater demand for those with demonstrable real estate asset experience who know how to improve the value of the property created value streams?

GS: There continues to be a tremendous amount of ongoing interest in hiring real estate experts with strong hands-on industry experience coupled with great financial skills. Demand for key professionals who are able to create valuable new revenue streams pre-dates the financial crisis. The rationale behind this trend was that many private equity real estate groups recognised the need to extract value from already-expensive deals. These groups have tended to continue with this hiring strategy because they have realised they have been heavy on financial engineers rather than value-creators. Even more in demand are investment professionals that have relationships with operators that are expected to be most successful in this next investment cycle.

PERE: When it comes to compensation consultancy and advisory, which sorts of institutions are seeking advice about updating or overhauling their compensation structures?

GS: All groups are always interested. Unsurprisingly it is the one area that clients continue to ask us about. The banks continue to restructure their end-of-year compensation with more complicated and lengthy vesting and/or deferral schedules. We have seen this trend play out less on the private equity real estate side though. These schedules can sometimes have the opposite effect of their intention. Instead of locking professionals in, candidates feel that their compensation is too far-dated. They greatly discount it, and are more inclined to look for opportunities outside their firms.

Groups are also more interested now in paying attention to compensation for roles in areas such as marketing, investor relations, origination, and for CFOs.

PERE: In terms of attracting and retaining talent at this stage of the private equity real estate asset cycle, how are institutions ensuring they have the best talent in place?

GS: They can achieve this by completing a considerable amount of due diligence and referencing in the market. There has been a stronger emphasis on assessing track records and focusing on cultural fit when hiring. With greater attention to detail, clients are taking longer to make decisions in order to ensure they hire the right person for the long-term viability of the firm, and rightly so.

Ahead of any hiring process, once the individual has been indentified it is imperative that momentum is strong and that focus is on full disclosure, with all questions answered in full.

PERE: Have real lessons been learned about how fund managers and fund investors handled their talent strategies during the global financial crisis and in its wake? Are those institutions that mishandled their talent retention paying for it now? Are they having to set out more incentives and pay more compensation to attract people back?

GS: Ultimately candidates will care about the success and stability of a group's platform as one of the key criteria, regardless of how the platform handled its people in the past. There will always be lingering personality / cultural fit clashes, but those are difficult to change. One thing that has been done in some cases is people have been brought in to be more management/recruiting/talent retention-oriented, relieving some fund managers of these duties as they focus on deals and fundraising. The best producers are not always the best managers; introducing a new senior manager focused on management/recruiting/talent can therefore go a long way in addressing historical issues.

PERE: Is increased regulation of private equity real estate, for example the systematic changes in Europe and the US, and/or less favourable taxation policies and regimes, in certain countries, really having an impact on the willingness of key talent considering certain roles?

GS: Asia and the Middle East generally offer better tax regimes compared with other regions, so that makes those regions more attractive to some. But as we discussed earlier there isn't that much appetite in Asia for attracting ex-pat talent.

A difficult job market will always be a considerable driver of candidates widening their geographic scope. Or if they are at a natural inflection point, such as between one fund's investment period and a questionable capital raise for the next fund, they have more time to step back and consider other career tracks.