

Succeeding at Succession

NAREIT HR Forum 2016

Presented by Ben Williams and Lynn Cherney

September 2016

Agenda

Spencer Stuart has worked extensively on critical talent and leadership decisions with global and regional real estate firms. Based on our recent engagements, we have observed and responded to the following trends:

1.

Importance of succession planning and transition support to ensure long-term success and viability of an organization

2.

Increase in M&A activity in the real estate sector and its impact on integrating people and cultures.

Trends in Succession

CEO succession is increasingly important on a Board's agenda

Shift in responsibility – boards taking ownership:

- Historically succession planning led by management (CEO and HR) with some board involvement
- Companies were not required to disclose to shareholders their plans
- Sarbanes-Oxley legislation, now more than ten years old, brought about the unambiguous ownership of CEO succession by boards
- Also, in October 2009, the SEC made a significant shift in policy and reframed CEO succession as a risk management issue and placed its responsibility firmly in the boardroom.

CEO succession is critically important:

- Good governance and it's in the best interest of shareholders
- Protects long-term value – ensures the best CEO is in place at all times
- Avoids damaging PR and reputational “hits” when faced with emergency situations
- Builds stronger ties between the board and the leadership team
- Builds a better talent bench and furthers senior team's development
- Company keeps a forward looking perspective

But fundamental challenges remain

Common hurdles many Boards face in CEO succession planning:

- Lack of a well-defined process
- Ambiguity of “ownership” of succession planning responsibilities
- Addressing the ‘insider vs. outsider’ question
- Scarcity of CEO-ready internal talent
- Inability to objectively assess internal candidates
- Insufficient information about external options
- Other pressing matters such as activist investors

Boards need to consider “Insider or Outsider?”

Spencer Stuart S&P 500 CEO Transition Study

- > Our research reveals important findings on the success of “Insider” and “Outsider” executives
 - Overall, there is no categorical performance advantage between Insider CEOs and Outsider CEOs
 - Insider CEOs outperform Outsider CEOs when taking over the helm of a stable company
 - Outsider CEOs outperform Insider CEOs when taking over the helm of a challenged company

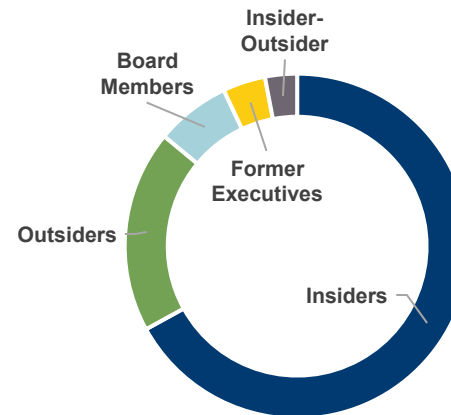
Our Methodology

Situational Analysis:		Performance Assessment Criteria:	
Situational Data Gathered		Quantitative	Qualitative
CEO Transition Information	Company Status	Shareholder Returns	Corporate Reputation
Internal/External	CEO Actions	Revenue Growth	Innovation
CEO Background	Predecessor Background	Profit Growth	Board Evaluation

Each transition was performance rated and force ranked into quartiles:

POOR	SOLID	OUTSTANDING
Bottom 25%	Middle 50%	Top 25%

S&P 500 CEO Transitions by Category



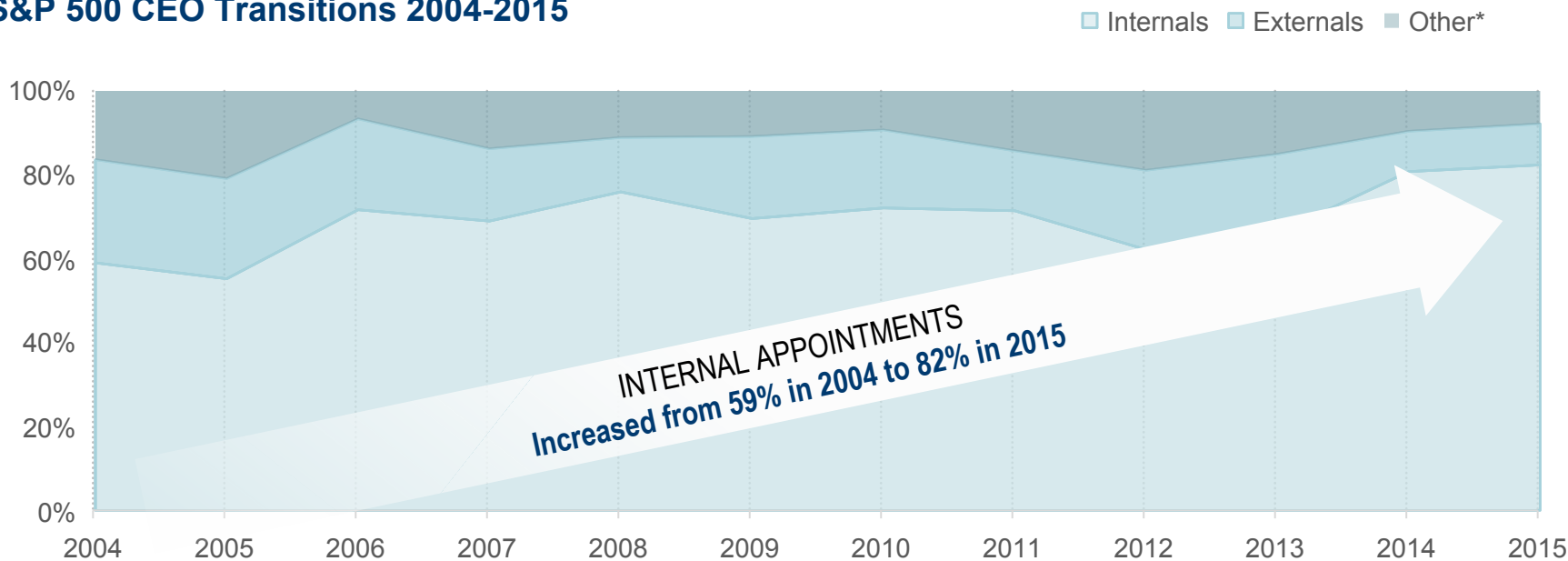
631 Total Transitions
2004 - 2015

Insiders represented 69 percent and Outsiders represented 18 percent. The remainder were appointed from the Board, were a former executive or were recruited as an “Insider-Outsider.”*

* Placement was not previously affiliated with the company, but was placed into a non-CEO role with the understanding that he/she would soon be promoted to Chief Executive. Interim appointments not included.

Data shows internals are increasingly getting the top job

S&P 500 CEO Transitions 2004-2015



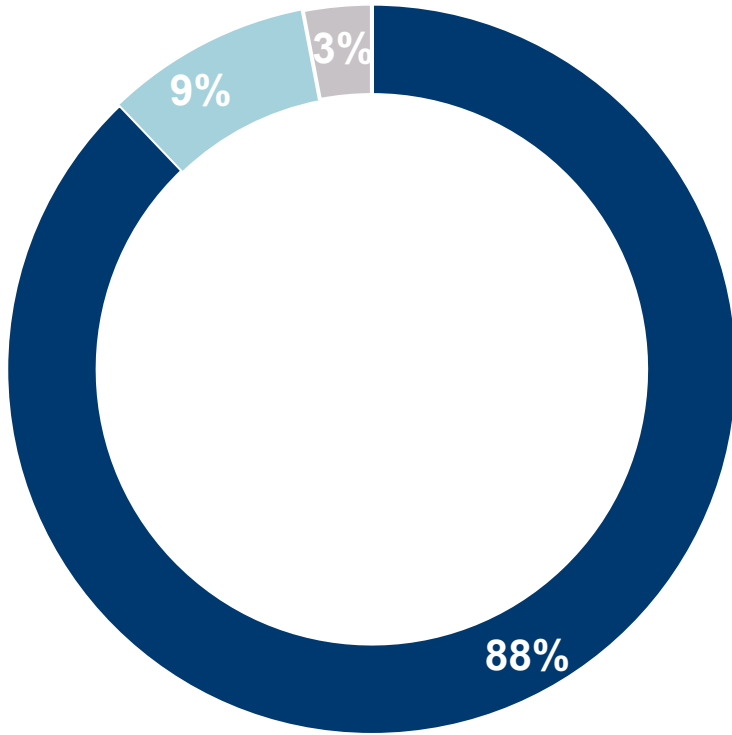
*Other includes: From Board, Former Executive and Insider-Outsider

Annual CEO turnover has averaged 7% – 13% between 2004 and 2015.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Internals	59%	55%	72%	69%	76%	70%	72%	71%	62%	66%	81%	82%
Externals	25%	24%	22%	17%	13%	20%	19%	14%	19%	19%	10%	10%
From Board	10%	10%	2%	3%	6%	7%	5%	8%	8%	6%	10%	6%
Former Executive	5%	3%	2%	9%	4%	2%	2%	4%	3%	4%	0%	2%
Insider-Outsider	2%	7%	3%	2%	2%	2%	2%	2%	8%	6%	0%	0%
Total # of Transitions	61	67	60	58	54	46	43	49	37	52	53	51
% of S&P 500	12%	13%	12%	12%	11%	9%	9%	10%	7%	10%	11%	10%

Note: may not sum to 100% due to rounding

The trend continues... in 2016* alone, 88% of S&P 500 CEO appointments have been internal placements



■ Insiders ■ Outsiders ■ From Board

n=33

*Includes Q1 and Q2 2016 transitions

INSIDERS →



OUTSIDERS →



FROM BOARD →



Given this trend, long term succession planning is a priority

2015 Spencer Stuart Board Index (SSBI)

More Boards are proactively engaged in CEO succession planning:

- > 78% of boards formally discuss CEO succession once a year, and 22% discuss more frequently, versus 63% and 17% respectively in 2013

Getting to know internal candidates, and benchmarking them, are critical to the succession process:

- > Nearly all boards (98%) rely on regular interactions during board meetings and presentations to get to know internal succession candidates
- > 71% of boards have a formal process for reviewing internal succession candidates
- > 51% of succession planning processes include gaining insight on potential external candidates

Planning for CEO Succession requires six essential elements

1 The Right, Air-Tight Process

A rigorous and confidential process that incorporates the right stakeholders and enables the best decisions and a positive experience for all involved

2 Well-Defined Requirements for Future Leader

Precise understanding of the critical leadership characteristics and cultural fit essential to the future success of the organization

3 Thoughtful Assessment of Internal Candidate(s)

Rich, accurate assessment of internal candidate(s) and their development needs, utilizing our Advanced Leadership Profile assessment tool

4 Benchmarking Against and Access to Best External Talent

Comparisons of internal candidate(s) with normative data and, if desired, with the most-accomplished and relevant external talent

5 Powerful Vetting and Decision Support

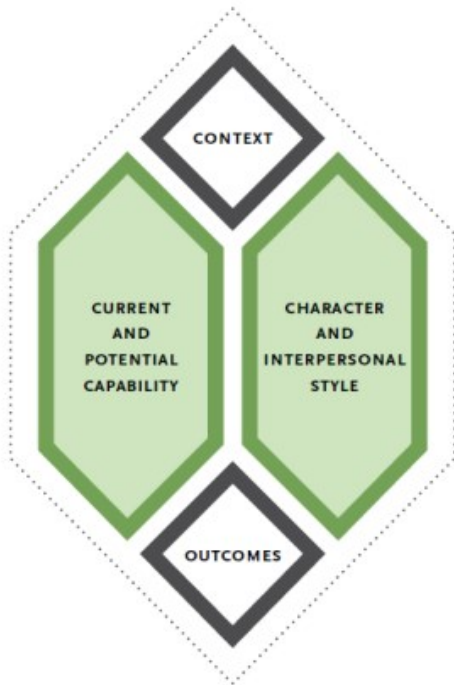
Best judgment about the cultural fit, match of skills and experience with future leadership requirements, supported by rigorous assessment and thorough due diligence

6 Successful Transition Planning & Support

Effective on-boarding and coaching for the new CEO to ensure success based on First 100 Day planning expertise

An effective approach to finding the right successor...

Our approach to executive assessment employs multiple methods to evaluate an individual's ability to perform, fit, and make an enduring impact in a critical leadership role



SPENCER STUART
LEADERSHIP
FRAMEWORK

Context

- > Understanding the impact of the environment on your organization – both in terms of challenges and opportunities - will inform the leadership capabilities required

Current and Potential Capability

- > Leadership today requires a new set of knowledge and skills; and the ability to adapt and learn to respond to the ever-quickening rate of change. An analysis of capabilities, knowledge, skills, and abilities provides a profile of an individual's overall competence (and fit to role), as well as his/her Executive Intelligence (ExI®) and future potential as a leader

Character

- > An assessment of character provides insight into the person's style and how he/she influences and resonates within the organization's culture

Outcomes

- > We work with you to define the desired business outcomes from your digital leadership roles; and provide insight into where a candidate will likely excel, and those that are at risk if not managed

Once you have chosen a successor...

Effective onboarding is a critical investment

Departure cost for top leadership within 18 months ranges from 10-20x annual compensation

- > Significant investment is already complete...effective onboarding will protect and enhance the company's investment in the new CEO.
- > Transitions at the top often fail because the major players are unprepared for critical issues because they underestimated or ignored the complexity of the transition process.
- > Executive onboarding is a dynamic process. The best approach is thoughtfully planned and quickly adjusted throughout the assimilation process based on the needs of the individual and the organization.
- > Long-term success can frequently be linked to a formal, effective transition

Case Study 1

Executive Vice President, Chief Operating Officer, Tanger Outlets

Assignment Requirement

- After Steve Tanger assumed leadership of Tanger Outlets, he decided to streamline his direct reports and created the new position of Executive Vice President, Operations. While the person we were seeking would effectively serve as the Chief Operating Officer of the company, Steve Tanger preferred an individual who was willing to earn the title over time. He was also seeking a long term potential CEO successor. Direct reports to the EVP, Operations role included the Senior Vice Presidents of Construction and Site Selection, Leasing, Marketing, Asset/Property Operations and Legal. The position reports directly to the CEO and is a peer to the Chief Financial Officer.
- Our search strategy targeted senior executives with at least 15 to 20 years of experience from a broad group of retail property owners, since real estate experience was preferred. While the position was very attractive from a scope of responsibility perspective, the Greensboro, NC location was a challenge. Crucial to the success of the placement was an entrepreneurial orientation combined with an ability to implement a more institutional culture. Finalists would:
 - Lead the expansion of the tenant base, evaluate and upgrade talent if necessary and scale the business through successful marketing and flawless execution
 - Elevate the profile of the company, capitalize on operational efficiencies, and increase profitability

Search Process

- Our Real Estate and Retail practices collaborated on this search to ensure that the landscape of target companies and prospects was covered.
- We reviewed more than 100 profiles, sourced approximately 25 individuals and presented eight candidates (including the ultimate placement).

TangerOutlets



Thomas E. McDonough
Executive Vice President, COO

Thomas McDonough, one of the eight candidates presented, was the placement for this search. He was promoted to Chief Operating Officer of the company after one year. Prior to his appointment, Mr. McDonough was the Chief Investment Officer of Equity One, a REIT specializing in the acquisition, asset management, development and redevelopment of properties anchored by supermarkets, pharmacies and retail store chains, where he completed over \$300 million of joint ventures with affiliates of CalPERS and DRA Advisors.

Job History:

- > **Equity One, Inc.**
Chief Investment Officer
- > **Kahl & Goveia Commercial Real Estate**
Partner
- > **Regency Centers Corporation**
National Director, Acquisitions and Dispositions
- > **Pacific Retail Trust**
Senior Vice President

Academic Credentials:

Harvard Business School, M.B.A., 1984
Stanford University, B.S., Mechanical Engineering, 1980

Case Study 2

President and Chief Executive Officer, Education Realty Trust, Inc.

Assignment Requirement

- Education Realty Trust (EDR) is one of America's largest owners, developers and operators of collegiate housing. A self-administered and self-managed real estate investment trust (REIT), EDR has a large national footprint, with locations in 22 states.
- Since 2000, EDR has developed more than 33 privatized housing communities and has completed more than \$2.4 billion in collegiate housing transactions both on- and off-campus. Of these transactions, EDR invested more than \$1.3 billion in private equity.
- EDR sought a seasoned executive who would have direct responsibility for the company's strategy as well as day-to-day management of all key functional areas. The successful candidate for this position would be a proven leader with a track record leading a public real estate or hospitality firm with a national reach. Furthermore, the finalist would have a history of progressively responsible leadership positions with a real estate owner/operator, including previous experience as an executive officer of a public company.

Search Process

- Our Spencer Stuart team interviewed each of the Board members to solicit views and build consensus to develop the position specification. We spent a great deal of time with the company's founder and current CEO since his input and buy-in were critical to the successful outcome of the CEO succession process.
- After reviewing more than 75 profiles, we interviewed nine of the highest potential prospects and presented four candidates to EDR's Board.
- Throughout the process, we maintained regular communication, with biweekly updates and periodic calls with the EDR search committee.



Randall Churchey President and Chief Executive Officer

Prior to joining EDR, Randall Churchey was a founder MCR Development, LLC, a privately held hotel construction, ownership and management company. He had served on EDR's Board of Directors from January 2005 until May 2007. Previously, he served as Interim Chief Executive Officer of Great Wolf Resorts, Inc. and President, Chief Operating Officer of RFS Hotel Investors. He began his career in the real estate practice of Coopers & Lybrand.

Job History:

- > **MCR Development**
Founder and Co-Chairman
- > **Great Wolf Resorts, Inc.**
Director and Interim Chief Executive Officer
- > **RFS Hotel Investors**
Chief Operating Officer
- > **Felcor Trust**
Chief Financial Officer

Academic Credentials:

University of Alabama, B.S., Accounting, 1982

Case Study 3

Chief Executive Officer, Boston Properties, Inc.

Assignment Requirement

- Boston Properties (NASDAQ: BXP), a self-administered and self-managed real estate investment trust (REIT), is one of the largest owners, managers and developers of first-class office properties in the United States, with a significant presence in four core markets: Boston, Washington, D.C., Midtown Manhattan and San Francisco. The company was founded in 1970 by Mortimer B. Zuckerman and Edward H. Linde in Boston, where it maintains its headquarters. Boston Properties became a public company in 1997.
- Boston Properties sought to hire a top executive to succeed the company's founder who would continue as Chairman. The new CEO would have direct oversight over all aspects of the company and its future strategy. This was a delicate recruitment since the son of one of the founders was President of the company and assumed to be the future CEO successor. Candidates therefore needed to have prominence in the real estate industry as well as deal-making prowess and gravitas. The successful candidate would also assume the responsibility of representing BXP in the industry from the current CEO and President with major tenants, investors, financial institutions, and all stakeholders.

Search Process

- After a thorough, confidential investigation of the marketplace and a complete CEO succession process, our Spencer Stuart team fully evaluated 30+ executives, including internal candidates. The top 7 candidates were introduced to the Board of Directors.
- Throughout the process, we maintained regular communication, with biweekly updates and periodic calls with the Boston Properties search committee.
- Mr. Thomas emerged as the ultimate placement after a year long process.

Boston Properties



Owen D. Thomas Chief Executive Officer

Prior to joining Boston Properties, Mr. Thomas was Chief Executive Officer and Chairman, Real Estate at Morgan Stanley. He joined Morgan Stanley in 1987 as an associate and rapidly progressed to head up the Firm's Real Estate Funds (MSREF) during its rapid growth until 2005. He then transitioned to a broader role within Morgan Stanley Investment Management and led all business lines for the firm in Asia. He has served on the Board of Lehman Brothers Holdings ("LBHI") since 2012.

Job History:

- > **Morgan Stanley**
 - Chief Executive Officer and Chairman, Real Estate
 - Chief Executive Officer, Asia
 - President and Chief Operating Officer, MSIM
 - Head, Morgan Stanley Real Estate Funds

Academic Credentials:

Harvard Business School, M.B.A. 1987
University of Virginia, B.S., Mechanical Engineering, 1983

Best Practices for Merging Teams and Cultures

De-risking M&A

Post-merger decisions must create value and manage risk

- > We have found that fully 2/3 of top team appointments will not create value post merger
- > Assessment identifies the value creators – typically, the best people are those who will find it easiest to exit
- > Smart companies seize this as an opportunity to upgrade

It is essential to bring order and objectivity to disruption

- > The first 30 days are the most challenging
- > Experience in post-merger integration is required
 - We help organize, implement, and de-risk the process
 - Setting a timetable that's mindful of shareholder value and people
 - Clearly communicating logistics and process
 - We provide objectivity and neutrality, drawing on well-established third-party models

Lessons learned from our M&A experience

Critical success factors:

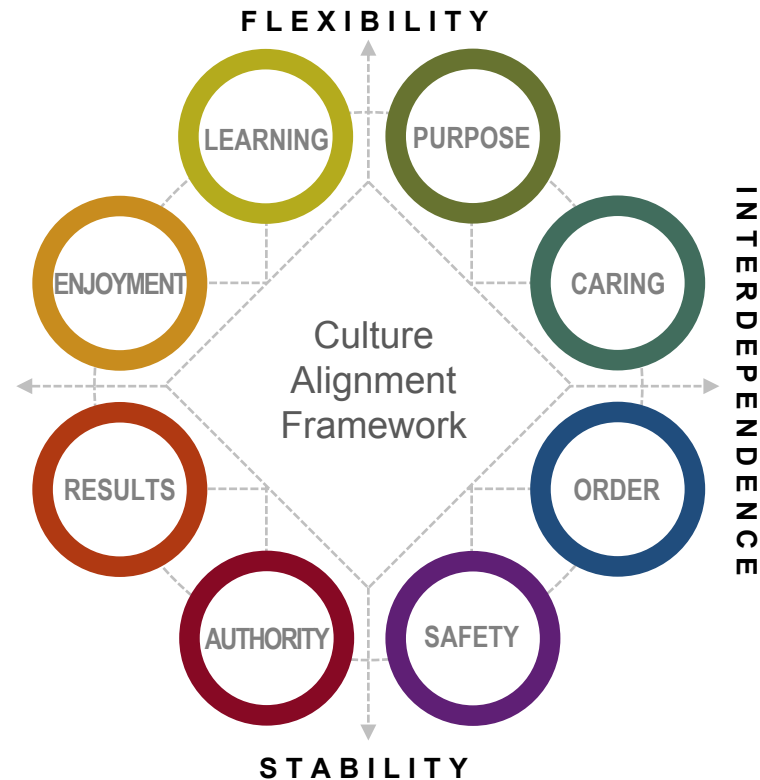
- > **Sensitivity to the executive:** Recognizing the stress and emotion of an M&A for those assessed; leaving candidates feeling that the process was thorough, objective, fair, and, despite the stressful circumstances, enjoyable for those assessed
- > **Efficient, time-sensitive project management:** Executing efficiently and respectfully in a challenging environment to reduce unwanted noise and keep executives focused on the business and the inherent demands of a merger
- > **Objective assessment:** Increases success rates from 45% to 67% (Ernst & Young data) through a transparent, highly-calibrated and validated process
- > **M&A specific capabilities:** Strategic Thinking and Collaborating & Influencing are critical in understanding and communicating a common purpose and successful integration
- > **Cultural fit:** The majority of M&A failures are due to “culture clash”. Assessing fit to culture provides insight to manage team dynamics
- > **Multiple methods:** Reducing risk and deepening talent understanding and the nuances of mergers through multiple perspectives on individuals, teams, and the organization as a whole

Understanding and aligning the desired culture of a NewCo

A culture is described by how the organization responds to change and how people interact and work together

Decades of research on organizational culture and performance confirm the primacy of two dimensions: an orientation towards people and change

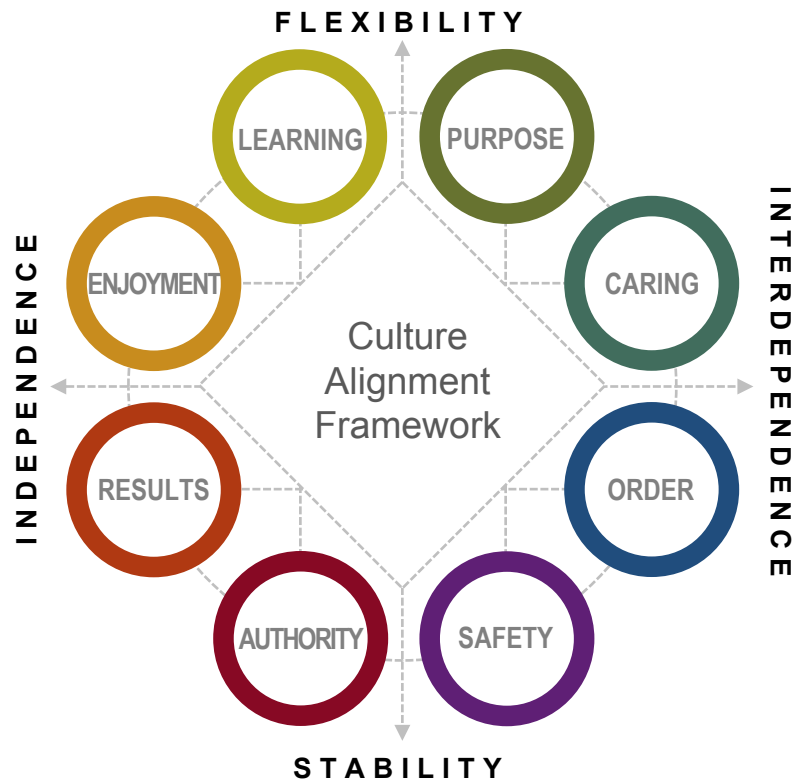
This model can be used to understand and assess both cultures and individual leader styles



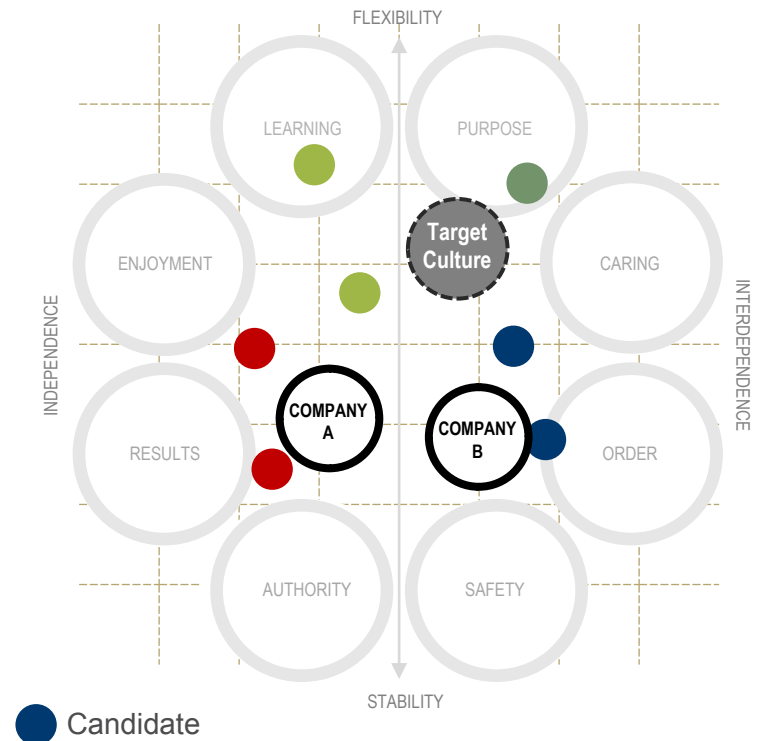
A focus on culture is essential in ensuring merger success

Organizational culture and leaders' individual styles are both characterized along the same dimensions, making assessment of cultural alignment straightforward and actionable

Mapping attitudes towards **change** and **people**



Mapping alignment of candidates (internal and external) and organizational culture



SpencerStuart