What Every Leader Should Know About Corporate Real Estate

Perception is finally changing! Corporate real estate is not merely an operating necessity; it's a strategic resource. It affects everyone – customers, employees, investors, regulators. Real estate is not easy to manage. In many organizations, real estate remains a reactive, second order staff function, focused on discrete projects and transactions rather than on the company's broader strategic issues with a holistic view.

FIVE MAXIMS FOR BETTER PROSPECTIVE

❖ ***Actively (not reactively) Manage the Portfolio***

A company's portfolio of real estate holdings should be more valuable to the enterprise than the sum of its individual sites. To ensure this, executives need a high-level view of their real estate situation, which they won't get from the site-by-site analysis that is generally the focus of internal staffs and systems. Leaders also need a dynamic, moving picture of where corporate strategy is driving their real estate holdings and of how the footprint could change depending on the route they take. Made up of robust scenarios of a company's known and potential needs, the analysis will reveal some misalignments. The company may have too much space in one location and too little in another, the wrong kind of space in certain areas, or be in the wrong location to best achieve the company's strategic goals and objectives. A key question is "How will the locations and sequence of expirations support, complicate, or even block, future actions?"

The portfolio approach is especially important when a company is going through a major change, such as a merger, an acquisition, or a divestment. Rationalizing an organization's real estate – that is, matching space and facilities (supply) to strategic and operational needs (demand) – can be as important as rationalizing the workforce. The process of equating supply and demand, physically, financially, and operationally, often involves addressing redundancies, relocations, closures, and dispositions.

Portfolio analysis can also inform leaders about a property's value, flexibility, costs and use levels over time. Taking a "portfolio view" allows for better strategy, planning and forecasting. By comprehending this data holistically, leaders can anticipate and possibly avert – project-level actions that compromise portfolio-wide gains.

Beware the shadow portfolio. As companies strive to reduce costs through outsourcing, they should keep in mind their indirect responsibility for facilities that house outsourced functions. Workers at those sites may not be company employees, but their productivity depends heavily on the location and configuration of the facilities. In addition, companies can be subject to stakeholder activism and even legal action if workplace health and safety standards aren't met. Companies that have outsourced a significant portion of their functions – Citigroup and Nike, for example – have found themselves with substantial de facto portfolios that must be managed as adroitly as the real estate they hold directly. **Armed with these insights, a leader can take advantage of portfolio opportunities that a site-by-site analysis will not reveal.**

❖ ***Build In Flexibility***

The nimble organization ensures that it has flexibility throughout its real estate holdings – even if that means paying more up front in some instances. Flexibility can be financial (leasing instead of owning), physical (designing modular space), and organizational (redistributing work). Companies that prize flexibility will own less and lease more.

Coordinating the end dates of leases, subleases, and exit clauses in adjacent spaces also allows organizations to shift or disband operations. In volatile times, up-front costs may be low relative to the hidden operational costs of having too little or too much space, or the wrong type of space in the wrong place.

Buildings and spaces can be designed with future uses/flexibility in mind, making it easier for organizations to trade a costly, complex, or obsolete use for a new, more marketable one. These fungible designs have simple, generic common areas, standardized space modules, movable walls, and accessible electric and HVAC infrastructure, all of which make the space easier to reconfigure when anticipated uses or operating expenses change. Building in flexibility at the beginning is an order of magnitude cheaper than tearing down walls to create new configurations, particularly when the operating unit is still in place.

❖ *Cultivate Intelligence*

It is no surprise that leaders not deeply trained in real estate strategy may rely on instinct or casual chatter when making real estate decisions – nor is it a surprise when those decisions fail. Leaders need *real estate intelligence*, accurate data, synthesized into relevant information, interpreted in the context of corporate and competitive realities. This kind of intelligence allows them to understand trade-offs and to connect real estate decisions to corporate strategy. The foundation of real estate intelligence is a database that includes square footage, occupancy costs, uses, capital values, utilization levels, and other relevant information, arrayed by line of business, function, and location. The quality and effectiveness of the database increase with scale. So, leaders need a dashboard that focuses on fundamentals and synthesizes the key issues.

Wise leaders pay more attention to internal measures of facilities' costs, productivity, and utilization than to fluctuations in the real estate market. Four ratios link real estate to business economics:

- Occupancy cost per person and per unit
- Occupancy cost as a percentage of revenues and/or expenses
- Utilization of building space and land, per person and per unit
- Asset performance (measured by return on total investment)

Leaders should also insist on periodic reporting of those internal ratios across business units, markets, submarkets, and building types. Benchmarking peers and competitors is no less important, but those data are hard to capture and it may be difficult to find strictly comparable properties in competitors' portfolios.

Real estate deal makers are known for quick back-of-the-envelope analysis. The typical business leader may not be as adept but can use many tools, such as space budgeting, lease decision analysis, and employee location mapping. What used to take weeks of effort with occupancy cost formulas and P&L impact analysis can now be done in days or even hours with models that permit real-time iterations as assumptions or goals change.

❖ *Team with Professionals*

Beware the "insider"/ direct deal and clear conflicts of interest. Companies that negotiate for/develop their own real estate rarely achieve results comparable to those of independent entrepreneurs and professionals. In part, that's because real estate is not a core competence for most companies. In addition, internal real estate groups are subject to organizational pressures that outsiders can escape. The real estate industry is filled with peril for the unaware consumer corporation. Make sure to align with firms that have no conflicts (obvious and not so obvious) and that are fully aligned with your best interests.

❖ ***Embrace Sustainability***

As WPP CEO Sir Martin Sorrell said in a personal interview, “Our ‘green’ approach is not altruism; it’s good, responsible business. CEOs ignore [this issue] at their peril.”

Green buildings cost more up front, but they deliver high returns over the long term. Consider indicative data: Energy savings in green buildings routinely exceed 20% and reach 50% on the hottest days. Oxygen-rich air, injected into enclosed space, improves employees’ health and increasing productivity. Raised floors cut air-conditioning costs by 70%. Dry toilets save millions of gallons of water. A short-term view will discount or ignore those metrics; a long-term, life-cycle view will embrace them.

To find out more about optimizing your company’s real estate.
Call Mike for a free consultation.

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