

Real Estate and Facility Management Solutions

Financial Guide: How to save money and create value in a tough economy



ROI Models For creating Value and Cutting costs

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Problem Statement: Challenges, Opportunities and ROI.

There is an unrealized opportunity to decrease operating expenses and improve shareholder value and profitability through improved management of real estate and workplace assets. This is due to the absence of the following: an awareness of the potential available, a single “source of truth” containing reliable and complete data, a performance measurement system, and a rigorous management approach based upon financial performance targets.

A recent report by CoreNet Global surveyed 100 firms regarding space utilization offers some relevant information. The report revealed that utilization rates range from 45%-65%. This means that at any moment on average, 55% of the existing office space is vacant.

Colliers International reports that there currently is 4.7b square feet of commercial office space in the North American Market. If we assume a very conservative rate of \$15.00/square foot that means there is close to \$40b of overpaid rent being paid each year. A recent report in Commercial Property News indicated that in 2007 there was \$56b of Global Sale-Leaseback Transactions. This strongly suggests there are rich targets of value creation and cost reduction in real estate assets.

Introduction and Background:

For many organizations, the management of real estate and the workplace remains a somewhat opaque and arcane area. Often this function is viewed as a pure cost of doing business. And, while this can be the reality, more often it can be a potential source of value creation and can be a positive contributor to profitability and increased shareholder value.

So, why do many organizations overlook the financial opportunities that reside within this area? We believe that this situation can be traced to the following factors:

- **Analytic Approach:** Perhaps the primary challenge comes from the need to shift perspective from pure real estate performance to one of addressing the business implications of real estate decisions. To maximize benefits one must adopt a viewpoint similar to that of a real estate investor and demand property level performance.
- **Non alignment with business objectives:** There often can be a disconnect between objectives of the C-Suite and that of the real estate professionals. This can result in an in-coherent set of objectives and a lack of awareness of the level of invested capital.
- **Absence of Performance Measurement Framework:** The creation and management of an appropriate and targeted set of Key Performance Objectives is critical to assure alignment with organizational objectives.
- **Absence of Data:** More often than not, data regarding individual properties resides in a variety of discreet internal and external data sources, and may not be complete, accurate or current.

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Financial Impact Guidelines:

In approaching the subject of Creating Value and Return on Investment Models, the findings from a recent study by CoreNet Global of 100 of the Fortune 500 companies are helpful in framing an approach toward influencing the organizations financial performance:

Approach:

- Consumption: Reduce or eliminate the activity
- Rate: Reduce unit cost
- Hidden Value: Determine difference between book and market value
- Development: Determine highest and best use/sell or redevelop
- Release Capital: Arrange sale and lease-back for capital re-deployment

Engaging in a process of portfolio study and rationalization can directly and immediately impact shareholder value by identifying under valued assets revealing a hidden source of value.

Case Studies: Targets of Opportunity:

Absent a complete inventory of the portfolio it is difficult, if not impossible to isolate targets of opportunity by indentifying under-performing or under-utilized assets. Engaging in a process of portfolio study and rationalization can directly and immediately impact shareholder value by identifying under valued assets revealing a hidden source of value.

The following case studies are presented to suggest the range of strategies and tactics that can be employed. One caveat perhaps needs to be extended. Each portfolio is unique and represents its own set of opportunities. Experience has shown that it is rare when one or more of these approaches cannot be deployed. The following represents a brief description of selected case studies and strategies. More detailed information on each case study is available upon request.

Expense Reduction and Hidden Asset Value

- **Identification of hidden value through undervalued assets.**
Client: Global Manufacturer of Specialty Glass and Ceramics
Objective: Identify sources of capital for re-deployment in the enterprise.
Result: Multiple locations identified where book value understated market value in the aggregate amount of \$250 m.
- **Sale and Leaseback:**
Client: Global Manufacturer of Aeronautical, Space and Electronics Equipment
Objective: Identify sources of capital for re-deployment in the enterprise.
Result: Multiple owned properties were packaged for sale and lease back negotiation to capital markets. 10 of the 12 properties were successfully negotiated generating \$500 m of capital infusion.
- **Reduction of vacancy rate:**
Client: Global Credit Card & Financial Services Corporation
Objective: Reduce vacancy rates to increase asset efficiencies
Result: Consolidation of space and re-stacking in headquarters complex resulted in a net space reduction of 350,000 sq. ft. and an annual cost savings of \$7.5 m.
- **Introduction of space standards**
Client: Global Manufacturer of Computer Chips
Objective: Rationalize space use across the enterprise
Result: a 20% reduction in space resulting in an annual cost savings of \$48 m.
- **Introduction of Alternative Workplace Strategies**
Client: Global Manufacturer of Hardware, Software and Information Systems
Objective: Rationalize space costs and reduce expenses
Result: Changed the FTE/desk ration from 2.2 to 4.8 resulting in space reduction and annual cost savings of \$78 m.
- **Consolidation of service centers/regional offices**
Client: Global Manufacturer of Networking Equipment and Services
Objective: Map locations and travel times to reduce commutes and reduce number of services centers
Result: Consolidated operations resulting in the closure of 6 service centers at an annual cost savings of \$123 m.
- **Co-location of business units creating overall space reduction.**
Client: Global Manufacturer of Handheld Communication Devices
Objective: Gain co-operation of individual business units to co-locate
Result: A net reduction of 2.5 m sq. ft. at an annual cost savings of \$55 m.
- **Improved utilization resulting in less space.**
Client: Global Manufacturer of Electronic Analysis Devices
Objective: Track actual utilization to benchmark % of time spent in space
Result: Utilization rates ranged from 40%-65%. Space was consolidated and alternative workplace strategies introduced. This generated a 3.5 mm sq. ft reduction in space at an annual cost savings of \$43 m.
- **Reduction in building class/type**
Client: Global Consumer Products Manufacturer and Retailer
Objective: Validate need for Class A office space.
Result: Call centers were shifted to Class B office space at a cost savings of \$10/sq. ft. or an annual cost savings of \$10 m.
- **Review of site location requirements**
Client: Global Marketer and Manufacturer of Consumer Brand Name Products
Objective: Determine proximity requirements to determine if administrative functions could be re-located to suburban locations.
Result: Shared services were re-located to alternative remote locations resulting in savings of \$15/sq. ft or an annual savings of \$18 m.
- **Re-negotiation of rents**
Client: Global Telecommunication Corporation
Objective: Review lease terms to identify cost savings through re-negotiation.
Result: Identified over 500 leases representing over \$700 mm of annual rent expense. By negotiating rent abatements through release of options, annual cost savings of \$250 m was achieved.
- **Charge back of space to Business Unit**
Client: Diversified Global Manufacturer of Industrial and Consumer Products
Objective: Introduce a full charge back of costs for real estate occupancy costs to influence behaviors of business units
Result: Over 40% of the business units requested assistance in space reduction and rent re-negotiation as a result of occupancy costs hitting their operating statement resulting in \$42 m annual cost reductions to date.
- **Reduction on number of moves/costs of moves:**
Client: Global Automotive Manufacturer
Objective: Reduce churn rate by 50%
Result: Annual run-rate move costs exceeded \$300 m per year. By charging all costs back to business units, moves were reduced by 35% resulting in an annual cost savings of over \$100 m.
- **Reduction of employee turnover:**
Client: Global Credit Card and Financial Services Corporation
Objective: Reduce recruitment and retention costs
Result: Through a series of pilots, various space alternatives were tested to determine how work conditions/space design impact retention. New design alternatives revealed versions that reduced turnover from 28% to 15% resulting in an annual cost saving in recruitment and training of \$8 mm.
- **Reduce Space and Improve organizational performance:**
Client: Global Marketer and Manufacturer of Computer Equipment and Services
Objective: Reduce annual occupancy expense without impacting organizational performance.
Result: To provide for both face-to-face and virtual collaboration as well as knowledge sharing, over 3 years 20 m sq. ft. was taken down and the balance re-configured. Net annual cost savings run rate is currently \$35 m. Stock price increased 250% in the same period.



Performance Measurement:

As stated in the introduction, a key enabler to support these initiatives is the establishment of a comprehensive decision support system. Aggregated, current and accurate data is essential to the process. The approach to creating such an environment includes the following components:

Data Creation/Quality

Experience has shown that many organizations lack complete, accurate or current data regarding their real estate and workplace portfolio. This is further complicated by the fact that what data is available, is typically found in a variety of discreet and disparate databases. These problems can be due to lack of portfolio level perspective and attention, absence of assigned responsibilities or simple lack of awareness of opportunities. Recommendations for correction would include:

- Establish Business Objectives and Accountability:

Real estate and workplace performance must be viewed in the context of how it supports business line objectives. In doing so, performance targets become grounded in business goals and accountabilities are established to create and maintain the data to support performance measurement

- Establish Standard Processes:

The creation of both data standards and standardized processes to maintain the data is fundamental to a successful performance measurement program. Data accuracy and currency can only be assured through enforcement of standards.

- Establish System Consolidation Strategy:

Data consistency and accuracy is more easily delivered when there is “a single source of truth.” It is preferable to initiate a strategy to consolidate data sources to the degree that is possible. A logical and methodical retirement and consolidation of discreet systems can result in both more accurate and timely data and a reduction in system maintenance costs.

- Establish a Plan for Data Aggregation:

Aggregation of data remains the Holy Grail for an effective and efficient performance measurement system. This supports the presentation of timely and relevant key performance indicators to the respective stakeholders on an on-demand basis.

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Performance Dashboard

To begin to address the issue of absence of data access, the creation of a performance dashboard would be critical to the alignment of real estate and the workplace with organizational strategy. In doing so, organization financial and business objectives would be linked to the real estate strategies. Key components of the dashboard would be:

- Transparency:

This term has become part of the standard lexicon of business. And the importance for performance management cannot be overstated. Universal access by appropriate stakeholders, any time, any place and via any device is the current mantra. Transparency allows for collaboration on real-time data that speeds the decision process and focuses behaviors.

- Relevant Metrics:

One size does not fit all when it comes to metrics. This applies when looking at different vertical markets and industries. However, it also applies when looking at different management levels in the organization. Metrics can and should be few in number, but should be laser focused on those that the individual can influence.

- Real Time:

The provisioning of current data is critical to success of the performance management system. It is predicated on standard processes and clear accountabilities, but also must provide an infrastructure that accesses the most current data and presents that data in a clear and coherent manner.

- Trending:

Historical information can be valuable and interesting. However, historical information is just that. What is needed is information by which we can influence the future. Therefore, historical information that is presented in a temporal context and displays trend lines provides decision support in the form of where to place attention and take action.

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Key Performance Indicators (KPI's) & Metrics:

Following upon the old adage “you can’t manage what you don’t measure” we suggest that the establishment of relevant, personalized and agreed to metrics can be at the heart of the matter. It is important to discern what your organization values, and measure that. These need not be overwhelming in number, but speak directly to organizational performance. Key factors would be:

- Actionable: Able to be influenced
- Accountable: Clearly Assigned responsibilities
- Transparent: Collaborative/On-demand
- Relevant: Industry targeted and multi-tiered

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Suggested Starting List of Recommended Key Performance Indicators:

The Executive Committee typically does not routinely need real estate information. However, a small but targeted set of KPI's is suggested. The following is representative of a baseline set of starting KPI's that will allow for both tracking internal performance and to conduct external benchmarking.

Executive Committee Level	Real Estate and Workplace
Occupancy Cost/Business Unit Revenues	Occupancy Cost/Square Foot
Occupancy Cost/Invested Capital	Occupancy Cost/FTE
Occupancy Cost/ Business Unit S G & A	Annual Maintenance Cost/Replacement Value(CRV)
Occupancy Cost/Business Unit Headcount	Vacancy Rate/Business Unit
Unlocked capital/Business Unit	Utilization Rate/Business Unit

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Summary

Real Estate and Workplace industry metrics and studies strongly suggest that hidden value on the balance sheet can reside within real estate and workplace assets. It is equally true that a potential positive impact upon operating statements can be enjoyed by a rigorous and focused examination of property level performance.

This can be facilitated and enabled by a adopting a strategic view, setting financial performance objectives and the provisioning of a space & portfolio management system to provide decision support. Huge opportunities await those organizations choosing to adopt such an approach.



SUGGESTED STARTING LIST OF REQUIRED PROPERTY DATA

The following chart outlines our recommended starting data set required to initiate a real estate decision management and performance management system. You will note that the data requirements vary in perspective: Financial/Physical/Operational/Legal. This suggests that the requisite data will likely be found in a variety of source systems. The extraction and aggregation of selected data into a consolidated real estate management system would be the preferred best practice end-state.

PROPERTY INFORMATION	OPERATING EXPENSE INFORMATION	LEASE & TENANT INFORMATION	BOOK & DEPRECIATION INFORMATION
<p>Ownership Type:</p> <ul style="list-style-type: none"> • Owned • Leased <p>Property data:</p> <ul style="list-style-type: none"> • Property Name • Property address • City • State • Zip code • County • Country Code • Company/Division Affiliation • Region/District • Property Type: <ul style="list-style-type: none"> Warehouse Distribution Office Manufacturing <p>Property Use</p> <p>Total Square Feet</p> <ul style="list-style-type: none"> • Office • Warehouse • Distribution • Manufacturing • Mezzanine • Vacant <p>Total Land Acreage</p> <ul style="list-style-type: none"> • Building Parcel • Legal Description 	<p>Current Budget</p> <p>Occupancy Costs</p> <ul style="list-style-type: none"> • Rent Expense • Real Estate Taxes • Utilities • Insurance • Repairs and Maintenance • Property Management • Depreciation: Building • Depreciation: Building Improvements • Rental Income • CAM Recovery <p>Real Estate Tax Bill</p> <ul style="list-style-type: none"> • Assessed Market Value • Assessed Building Value • Assessed Land value • Current tax rate 	<p>Corporate Information</p> <ul style="list-style-type: none"> • Lease Origination Dates • Lease Expiration Dates • Lease Type: Capital or Operating • Land Lease Expiration • Base Rent and/or Step Rent • Gross or Net Lease • Purchase Options • Termination Options • Renewal Options <p>Tenant Information</p> <ul style="list-style-type: none"> • Tenant Lease Origination • Tenant Lease Expirations • Tenant Square Footage • Tenant Rent • Tenant Pro-Rata Share. • Tenant Options 	<p>Total Book Value</p> <ul style="list-style-type: none"> • Building Book Value • Land Book Value • Building Improvements • Other Book Values <p>Total Tax Value</p> <ul style="list-style-type: none"> • Building Tax Value • Land Tax Value • Building Improvements • Other Tax Values <p>Depreciation</p> <ul style="list-style-type: none"> • Monthly Depreciation • 12-Month Depreciation Projection • Year Booked to System. • Existing Reserve • Year built



About the Author

Laurence Barkley is currently the managing partner for Barkley Advisory Group, LLC, an organization of senior real estate professionals who provide advisory services to the real estate, workplace and facility management professionals of Global 2000 companies, higher education, healthcare and other large portfolio occupiers. These services include:

- *Strategy* – strategic planning, visioning, organization re-design, process re-engineering, supply chain management, strategic sourcing, benchmarking, and portfolio wide master planning and restructuring.
- *Technology* – information systems design, implementation and operations with a focus upon leveraging existing investments in systems and data to create client specific performance metrics.
- *Operations* – a focus upon comprehensive cost reduction, technology leverage, extended organizational design, strategic sourcing, and service provider selection and contract negotiation.



Mr. Barkley possesses a diverse real estate background which provides a unique perspective on the Corporate Real Estate industry. Mr. Barkley has held previous positions with the Deloitte and Touché Real Estate Consulting Practice. He also served as the CIO for CoreNet Global Prior to that, he was the Director of Sales and Marketing for a proprietary software company, providing solutions to the corporate real estate management professionals.

Real estate operational experience includes, COO of a national chemical manufacturing company, where he directed the construction of five manufacturing plants across the United States. In this process he faced numerous real estate and facility management issues such as process re-engineering, maintenance & operations and benchmarking.

Mr. Barkley possesses a Bachelors degree in Economics and Finance from Drake University and a Masters in Corporate Real Estate (MCR) designation from CoreNet Global. He is on the faculty for CoreNet Global Learning and is the author of numerous articles appearing in a variety of trade journals.



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