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A framework for identifying and measuring value added by corporate real estate

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Abstract

Purpose – The purpose of this paper is to model how real estate strategies can add value to the core business, providing corporate real estate mangers with a tool to illustrate to corporate officers how real estate adds value to the firms.

Design/methodology/approach – The authors review previous research and interview 26 corporate real estate executives to examine what are common approaches to developing real estate strategies and measuring performance. They then model how real estate adds value to the firm and how that value can be measured.

Findings – Many firms do not recognize how real estate adds value to the business. While they may have a corporate real estate strategy, that strategy is often not developed in coordination with the overall business strategy. In addition, the performance measures being used by many companies focus solely on cost, not value added.

Practical implications – Corporate real estate's contribution to the core goal of wealth maximization can be modeled to illustrate the tangible and intangible effects real estate has financial performance. A structured approach to developing a real estate strategy in conjunction with the core business strategy, supported by a performance measurement system will allow corporate real estate executives to better communicate how corporate real estate is adding value to the firm.

Originality/value – Corporate real estate managers need better ways to illustrate, to corporate leaders, how they add value. This paper illustrates such a model with supporting operating decisions and performance measures.

Keywords Value added, Real estate, Corporate strategy, Performance monitoring

Paper type Research paper

Objective

Unfortunately, corporate leaders in many firms still do not recognize the strategic potential of their real estate. They classify property as a cost of doing business rather than a value adding opportunity. Part of the reason for this view is that few corporate officers come from the real estate field or have any experience with strategic property decision making. It falls to the corporate real estate manager to educate the top decision makers about the potential contributions their real estate decisions can make to the overall success of the core business. Corporate real estate mangers, in turn, need to be able to easily illustrate and explain how property decisions directly and indirectly affect the profitability of the firm. Otherwise, real estate will continue to be classified as just a cost that should be minimized rather than optimized.

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Globalization of business, changes in technology, movement to a service economy, and innovations in workplace design create both threats and opportunities for firms to evaluate how property fits into their strategic plan. To meet the challenges businesses are facing today, firms need efficient and productive work environments with physical, functional, and financial flexibility. Human resources managers and operations supervisors want modern workspaces in attractive locations that can be modified to adjust to changing workspace needs. Meanwhile, the finance department is interested in minimizing costs and reducing long-term financial exposure.

Property decisions will contribute to the success or failure of the firm in each of these areas. Research has illustrated the importance of the physical workspace in attracting and retaining workers, improving their performance and satisfaction. Retailers and manufacturers can prove the importance of site selection in their success. It is more difficult to quantify the affect of a positive property image on corporate image or to estimate the dollar value of a flexible lease clause.

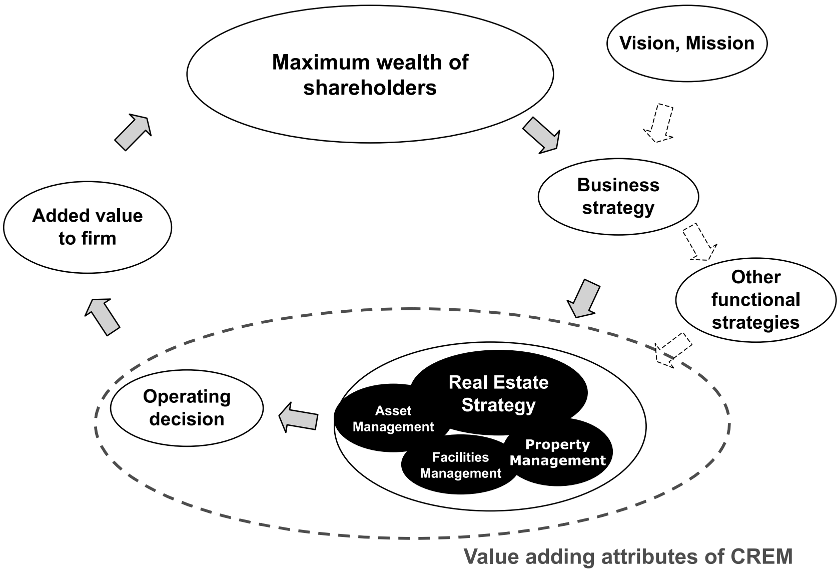
The objective of this paper is to identify the components of corporate real estate management that create added value to the core business. The goal is to develop a framework that will assist corporate real estate managers to better understand the direct and indirect ways property can add value to the core business performance. This will then enable real estate managers to better communicate to the top corporate decision makers how property adds value to their firms. We do this using results from previous surveys as well as our own study of how real estate adds value to 26 firms.

Strategic planning

The corporations' primary aim is to add to the wealth of investors/owners. In order to achieve this aim the corporation sets specific objectives for it business activities. Strategies should then be developed to provide a roadmap to reach these objectives. Strategic planning will only contribute to the financial success of the firm if it identifies the critical drivers of success and develops functional strategies that incorporate these drivers. Unfortunately, all too often corporate strategy is not directly translated into a real estate strategy to guide property decisions. The flow through which corporate real estate strategies should be developed and implemented is shown in the model in Figure 1. If corporate real estate managers produce real estate strategies that address the business units' objectives (efficiency, customer satisfaction, productivity, etc.), they can then demonstrate property's value and provide a platform for being involved in the broader corporate planning process (Lambert *et al.*, 1995).

Because every organization has different objectives and strategies, a set of real estate strategies is necessary. Managers can choose the most suitable strategy for their business environment and the organization's overall goals, thereby adding value to the firm. These strategies should guide real estate tactical decisions in support of the firm's overall objectives.

However, it can be difficult to determine whether the real estate decisions are having the desired effect. Some property decisions have an immediate and direct impact on the firm – selling land results in a cash inflow and removal of the property from the firm's assets. Other real estate decisions have an indirect and lagged effect on the firm's financial performance. The impact of selecting of a workplace that increases employee morale, satisfaction, and productivity while reducing turnover may go unmeasured or at least go unattributed to the real estate decision.



Source: Lindholm *et al.* (2006)

Figure 1.
Linking real estate strategies to corporate strategy

Ways to measure added value

The metrics used to determine the contribution of real estate are primarily focused on cost reduction or capital minimization. What is often not recognized is that property can also help to improve revenues. Both avoiding costs and enabling others in the organization to improve their services and consequently increasing revenues contributes to profitability and add value to the firm.

One way of looking at how real estate can add value to the firm is using the framework shown in Kaplan and Norton's (1996, 2000, 2004) balanced scorecard (BSC). In their model, organizations can increase economic value through revenue growth and/or productivity. Revenue growth comes from new markets, new products, new customers, and expanded sales to existing customers. Productivity results from reducing expenses and using assets more efficiently. Burns (2002) translates the BSC view to show how corporate real estate can add value through growth and profitability. Most firms only consider how property decisions can improve profitability through space efficiency, cost reduction, and capital minimization. Performance measures focus on cost per square metre and space per employee. However, real estate decisions can contribute to increased revenues as well.

Measuring the value of corporate real estate decisions is much more difficult than calculating the financial return on traditional "investment" real estate. Corporate real estate outputs are usually internal outputs to another part of an overall process. In addition, differently structured and focused firms want different results from their real estate assets, so there is no one indicator of "good" performance by real estate. Rather, the firm should develop a performance measurement system of valid and reliable measures that match their objectives and are reasonable considering available data and resources.

Interviews

To achieve our objective of developing a framework to assist corporate real estate managers in mapping and evaluating how property adds value to the core business performance, we built upon previous research by selecting 26 organizations in US, UK, The Netherlands, and Finland across a variety of industries (including transportation, broadcasting, banking, and data management) on which we gathered data from their web sites, annual reports, and case studies reports. We then conducted personal interviews with corporate real estate executives within each firm.

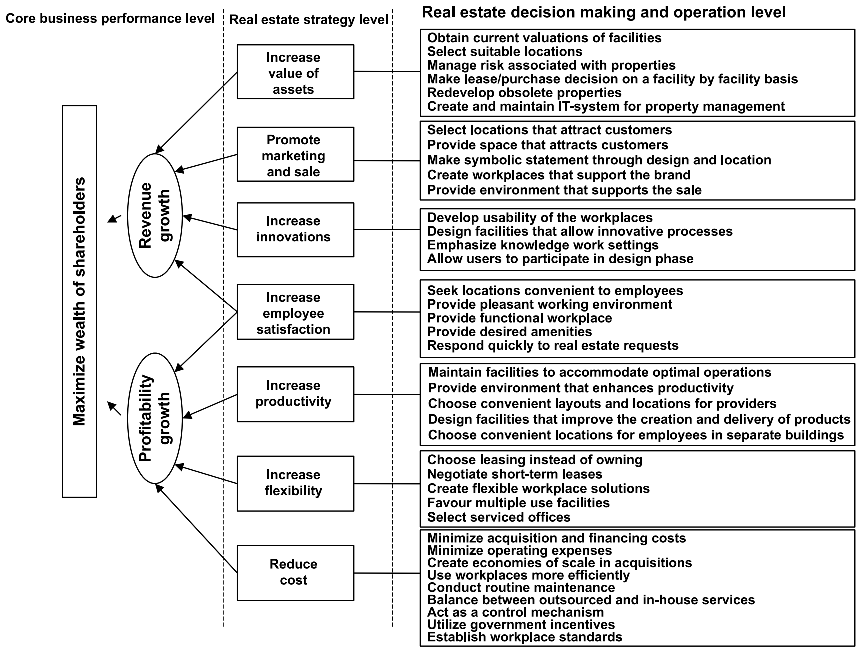
The interviews revealed that corporate real estate executives across markets and industries believe property and facilities decisions can create value for the core business in several ways. The most common is through providing a pleasant and productive physical workplace. Another is to provide responsive and high quality property services to the internal customers. The impact of site selection was identified. However, the relationship with stakeholders was one of the most important themes that emerged. More and more corporate real estate managers recognize that if they are going to add value to the firm that they must understand the core business and communicate effectively with those at the strategic decision making level of their organizations.

Among the 26 firms interviewed, most do have some sort of real estate strategy, although it may go by a different name and not be as formalized as one might wish. Almost half the firms we talked with do have a well formulated real estate strategy created in close cooperation with the strategic business decision makers. However, one-third of the firms with a real estate strategy had either only a weak link between the real estate and overall business strategy or no link at all. In addition, a few real estate departments reported that they have formulated a real estate strategy without any communication with other business units or top decision makers during the strategy development process. Some of them even reported that their supervisor was not aware of the existence or the content of the real estate strategy. One wonders how the firm's decision makers could ever expect their property to be managed in an optimal way to support the organization when the real estate strategy is formulated separately from the organization's strategy.

Creating a framework for how real estate adds value

Based on previous research and the interviews with corporate real estate executives the model shown in Figure 2 was produced that illustrates how seven real estate strategies add value to the core business, with operating decisions that may then follow from the real estate strategies. The framework reflects two basic approaches for increasing shareholder value: revenue growth and productivity. The strategies are:

- increasing the value of assets;
- promoting marketing and sales;
- increasing innovation;
- increasing employee satisfaction;
- increasing productivity;
- increasing flexibility; and
- reducing costs.



Source: Lindholm *et al.* (2006)

Figure 2.
How real estate decisions support strategies and core objectives

In formulating these strategies, we have tried to balance the tangible and intangible contributions of property to the firm. The framework spans the traditional real estate strategies such as cost reduction as well as less recognized strategies such as increasing innovation. It incorporates current business issues such as flexible work spaces. The framework illustrates how real estate strategies follow from the overall business strategy and drive property decisions. The property strategies each firm will choose depend on the broader core business strategy and objectives.

Measuring the added value

From this framework, a performance measurement system can be developed to evaluate how well each strategy is adding value to the firm. The system should be comprised of a minimal number of mutually exclusive measures, balance financial and non-financial measures, and measures that focus on stakeholders' needs (Brown, 1996; Sink, 1985; Thor, 1998; Vokurka and Fledner, 1995). The individual measures that comprise the personalized performance measurement system should be valid (measure what is intended to be measured), reliable (provide consistently valid results), practical (economical, convenient, and interpretable), and relevant (valuable and useful) (Emory, 1985; Hannula, 1999; Sink, 1985).

Our interviews indicated that while most companies are relying on traditional cost per square metre performance measures, many have also started measuring employee satisfaction with the workplace. Space per employee, physical condition of properties, and client satisfaction with services are also commonly evaluated. Few firms are using measures tying real estate costs to sales or revenue. Very few are trying to measure intangible elements of performance, yet recognize how helpful it could be to have such measures. The use of a performance measurement system seems to be more common when the real estate system is part of the company wide measurement system such as the BSC or Six Sigma.

These firms can improve how they demonstrate real estate's added value to the firm through the creation of an organized performance measurement system tied to the firm's objectives and strategies that have been translated into real estate objectives and strategies. Table I provides a list of potential performance measures for corporate real estate managers to select from in creating a personalized performance measurement system that fits the firm's real estate strategies and information availability. The system can be modified over time to adjust to changes in the corporation's core strategies and resulting modifications in real estate strategies.

Real estate strategy	Potential measures
Reduce cost	Occupancy cost per square foot/metre
	Occupancy cost per seat
	Occupancy cost per employee
	Occupancy cost per dollar/unit of revenue
	Occupancy cost as a percent of total operating expense
	Occupancy cost as a percent of operating revenue by business unit
	Occupancy cost as a percent of operating revenue by building
	Occupancy cost per unit of production
	Occupancy cost as a percent of total labor and overhead by business unit
	Occupancy cost by building
	Space (square feet or metres) per employee
	Whether workplace standards are used
	Percent of space occupied
	Percent operational space versus non-operational space
	Total owned and leased space (square feet/metres)
	Persons per seat
	Number of moves per year
	Cost of under utilized space
	Real estate cost per CRE employee
	Total CREM operating expenditures versus budget
Increase flexibility	Percent leased space relative to total space
	Length of lease terms
	Use of virtual and flexible workspaces
Increase productivity	Employees' opinions on how well the workplace supports their productivity
	Distance employees commute
	Distance among company sites and businesses
	Time wasted with interruptions (due to open space layout)
	Percent shared services
	No loss of business due to real estate service failure
	Real estate spending as percent of gross margin
	Real estate spending as percent of total operating expenses
	Time used on real estate projects versus time budgeted for projects
	Money spent on real estate projects versus money budgeted for projects

(*continued*)

Table I.
Real estate performance measures

Real estate strategy	Potential measures
	Amount of real estate advice given to other business units
	Number of service providers/service level agreements
	Number of transactions/projects/leases per FTE employee
	CRE employee qualifications
	Employee turnover
	Number of steps/time for real estate approval process
	Use of audits for service providers
Increase employee/internal client satisfaction	Distance to required transportation modes for employees
	Employee satisfaction with work environment
	Quality of indoor environment (lightning, temperature, noise)
	Workspace (size, shape)
	Amount of nearby amenities for employees
	Range of services offered by CREM
	Employee/internal customer satisfaction with responsiveness of CREM staff
	Employee satisfaction with CREM staff professional skills
	Employee satisfaction with CREM information sharing
	CREM response time to requests
	Competence of CREM staff
	Investment in training per CREM employee
Increase innovations	Number of teamwork settings
	Number of workstations per employee
Promote marketing and sales	Distance to required transportation modes for customers
	Distance to customers
	Use of company logos and colors in workplace design
	Image rating based on building attributes
	Energy consumption (conservation)
	Number of energy audits
	Environmental sustainability of buildings
Increase value of assets	Real estate cost of acquisitions versus returns/IRR
	Lease vs construction or ownership cost comparisons
	Aging reports for leases
	Real estate holding costs per year
	Number of building quality audits
	Real estate return on investment
	Real estate return on equity
	Business return on real estate assets
	Sales or revenue per square foot (metre)
	Space (square feet or metres) per unit (dollar) of revenue
	Market capital value versus book value by building
	Percentage of surplus assets sold
	Time to dispose of properties versus plan
	Cost of disposal of property versus savings
	Time to clear buildings versus plan
	Number of development projects for obsolete properties
	Status of risk management activity (contaminated sites)

Table I. (*continued*)

Real estate strategy	Potential measures
Effectiveness in corporate strategic process	Percent CREM employees indicating strong understanding of how their jobs fit into attaining corporate objectives
	CREM involved corporate strategic planning
	CREM integrated with other functional strategies (HR, IT, etc.)
	CREM actively involved in firm-wide initiatives such as special asset use, consolidations, or shared services opportunities
	Number of formal and informal CREM meetings with top executives
	Fulfillment of CREM strategic aims
	CREM communication time with top executives
	Self evaluation of how well CREM decisions support strategy

Table I.

Conclusion

As businesses strive to improve their competitive position in an ever more crowded marketplace, strategic use of all their resources, including real estate is necessary to succeed. Maximizing the contribution of property to the wealth maximization of the firm's shareholders requires development of an organizational strategic plan that drives a supporting real estate strategy. Each firm must assess its position in the market and select the proper strategies to support its objectives. Firms may choose from among seven general real estate strategies to support the two main corporate strategies of revenue growth and profitability growth.

Successful implementation of the selected real estate strategies will require the development of a comprehensive performance management system to provide a feedback loop to assess progress and make adjustments as needed. Each firm must choose from the list of potential measures those that are practical and appropriate to the business, its core objectives, and its information availability. Development of a strategic plan with the associated operating decisions and a performance measurement system as outlined in this paper provides the corporate real estate manager with a framework that is easily explainable and defensible to the top level decision makers in the firm. In this way, corporate real estate management can move more squarely into the strategic planning process and live up to its potential to add value to the firm.

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