

HOW TO USE REAL ESTATE TO LEVERAGE VALUE CREATION: 7 SOURCES OF PERFORMANCE LEVERAGE

Real estate is often the largest asset on the balance sheet of major companies and their second biggest item of expenditure after salaries.

In the light of this, the largest property owners/operators have, for several years in the private sector and, more recently in the public sector, sought to set up a professional real-estate arm with the aim of identifying potential sources of savings arising from the rationalization and optimization of their real estate assets.

However, this real-estate leverage is far from being exercised in an accomplished and systematic way by players in either the private or public sectors. In a general climate of rising budget constraints and the constant search for ways to enhance operational and financial performance, the more systematic optimization of real estate resources has become a major line of action for major owners/operators, as much in terms of realizing cost savings as identifying future sources of revenue. Given the extensive leeway and the fact that implementation is not excessively complicated, especially in terms of restructuring plans, this optimization drive is all the more desirable.

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REAL ESTATE; A MEANS AS WELL AS A RESOURCE

Real estate is not only a factor of production for the provision of services, nor is it merely a cost item, it is also a resource which does not only yield potential cost savings but also:

- / Offers an additional source of revenue to boost financial profits and contribute to the financing of operations;
- / Can play a vital role in the introduction of new operating modes, thus improving functional performance.

REAL ESTATE PERFORMANCE, SEVEN INTERDEPENDENT SOURCES OF LEVERAGE

There are seven strands in real estate performance evaluation, each of which can exert leverage:

- 1 Optimizing space
- 2 Re-examining contractual relationships with lessors
- 3 Taking action to cut real-estate operating costs
- 4 Boosting revenues from real estate
- 5 Exploiting the financial potential of real estate assets

6 Optimizing real-estate organization and operations

7 Implementing and deploying an optimal information system

While challenges differ in type and size for each of these sources of leverage, they are interdependent and, as such, should all be activated at the same time.

Levier 1 - Optimizing space

Optimizing the occupation of the surface area is one of the main sources of real-estate cost savings.

Working space has to be regularly resized and reconfigured in line with all the changes in working methods as well as organizational structures and staffing levels. Very often, this highlights working areas that are either under or badly exploited. The major ways of rationalizing establishments and workspace include optimal allocation of resources according to needs and functions, grouping sites together and pooling locations offering synergies, setting space ratios by type of workstation etc. These measures make it possible to free up space which can then be put to another use or sold off.

In addition, office space densification, through the application of optimal occupation ratios and the emergence of new ways of working (shared workstations, teleworking, third locations, nomadism, etc.) are

also avenues for freeing up m² and, thus, generating financial savings.

Levier 2 - Re-examining contractual relationships with lessors

Over time, rental costs can become disconnected from market conditions: renegotiating rental contracts with lessors can, therefore, offer a significant source of cost savings.

In a bear or more competitive market, tenants can find themselves in a position of strength to renegotiate their leases. To ensure lease renewal, lessors could be prompted to enter negotiations with their tenants over such items as rent, rent-free periods, reduced space, landlord maintenance responsibilities, etc.

In addition, experience shows that over time many tenants do not monitor the terms of their lease agreements. It is, therefore, appropriate to carry out a regular and detailed analysis of rental invoices, paying special attention to the level of charges. This ongoing monitoring should ensure that services are invoiced at a fair level and in line with conditions laid down in the lease agreements.

Levier 3 - Taking action to cut operating costs

Real-estate operating expenses are split between the cost of building services (upkeep, maintenance, water charges,



cleaning, etc.) and the costs of occupant services (IT, telephones, etc.). Cost analysis by item and by building can highlight the sources of high leverage.

In particular, upkeep and maintenance requirements vary considerably, which is reflected in their costs and/or quality. Renegotiating contracts to reflect real needs and fair prices or changing in-house/outsourcing real-estate strategies can lead to substantial savings in the overall bill.

More generally, in order to identify the full potential of optimizing the costs of building and occupant services at the various sites and thus, generate significant leeway, it is necessary to:

- / **Bring real-estate costs under control;**
- / **Define service levels for the provision of multi-technical and multi-service solutions;**
- / **Have a reasoned outsourcing strategy that takes account of core business activities and internal issues and challenges.**

Lever 4 – Boosting revenues from real estate

Real estate may also provide a source of financial income that can be optimized for the major property owners, particularly in the public sector.

By the same token, a search for other sources of real-estate income, such as car-parking facilities, antennae, display advertising, solar panels etc. is also an important factor given that these are potential sources of recurring revenue.

Properties rented at rock-bottom prices and unoccupied spaces that are not put up for rent are examples of potential additional sources of income which could be exploited. Research into the marketability

of a company's real estate stock could be opportune at a time of budget constraints.

Lever 5 - Exploiting the financial potential of real estate assets

Since real estate is an asset, it has a value that can be a potential source of financing. Mobilizing this resource can enhance the value of assets and invested capital.

This entails capitalizing on real estate assets for the purposes of reinvesting in higher yielding placements, financing new projects or even paying down debt.

Outsourcing offering a possible return, may be considered as a means to upgrade assets, to improve their performance via a partner, and/or to generate «cash».

Lever 6 - Optimizing real estate organization and operations

For a long time, the real estate function within companies was little understood and unstructured. However, it has considerably evolved in recent decades both in terms of organization and the range of responsibilities involved to become a recognized business function with the following set of performance objectives:

- / **Meet business needs by providing suitable premises for employees;**
- / **Offer an increasingly extensive range of services for both the buildings and their occupants;**
- / **Contribute to the improvement of company operations by providing suitable premises, incorporating technical and social innovations that promote and accommodate new ways of working;**
- / **Manage assets and enhance their value;**
- / **Optimize costs;**

« L'immobilier a une valeur et constitue une source potentielle de financement »

- / **Offer rewarding careers to in-house management staff;**
- / **Incorporate new technologies in real estate businesses**

In this context, it could be thought that an organizational model of the real estate function would tend to be more homogeneous. Yet it is striking to note that real estate organization remains highly diverse, even though most companies now recognize its importance. It is therefore not surprising to learn that only global groups have real estate divisions with several employees. Conversely, real estate departments that have become companies in their own right, with numerous employees, operate in more or less limited spheres.

5 grands modèles d'organisation peuvent être recensés :

1^{er} modèle : No real-estate division.

There is no real-estate arm and responsibilities for business premises are split among business and support divisions.

2^{ème} modèle : A primary real-estate division.

The scope of the real estate division extends only to the management of complex or exceptional projects such as new construction, removals etc, and business-line appraisal. Some functions (notably asset management) are, however, carried out, but the business divisions control many processes,



notably the operational aspects.

3^{ème} modèle : establishment of a real estate division as part of a client/internal supplier arrangement, but which also sets standards and ratios for the business activities.

Cost accounting systems are set up to highlight the true costs of real estate. All real estate functions are included and outsourcing of certain functions is possible.

4^{ème} modèle : real estate is no longer a division, but has become a business activity in its own right and an ingredient of the core business of the enterprise.

A real-estate subsidiary could be created and thus be an integral part of the flow of economic activity between the various components of the company. The real-estate division strives to find a permanent balance between its status as a services division and that of an "independent" economic player.

5^{ème} modèle : A recognized and confirmed real-estate division... but almost entirely outsourced.

It is, therefore, worthwhile to consider a possible correlation between performance and organization. In other words, every major owner/operator should determine what type of real-estate management organization is best suited to the challenges it faces.

Lever 7 – Implementing and deploying an optimal IT system

The IT system provides support for the strategy, and acts as the operational vehicle of the business processes. It must be designed to serve as a means of leverage in the implementation of the strategic ambitions of the company and not only as the tool for the setting up and operation of the various activities of the business processes.

Although, steering a real estate division does not require a very sophisticated IT system, it does need a minimal set of references and management functions that are essential to cost and occupancy control.

Moreover, ongoing changes in the standards for real estate data exchange and, more broadly, digitalization trends in the sector, raise questions as to the capacity of these systems for change to make them more agile and more reactive particularly in the field of customer service.

DIFFERENT PERSPECTIVES FOR IMPROVED PERFORMANCE

An overall assessment of the real-estate performance of any large owner/operator, necessarily requires a minimum appraisal, on several levels.

Once this has been carried out, the next stage is to identify potential improvement areas. This mainly involves:

- / **Setting up a real estate division with the required structures, skills and tools;**
- / **Drawing up a real estate master plan to identify the needs (especially in terms of surface area, new working methods etc.) and to make informed decisions (notably taking account of changes in market trends, as well as technical and natural risks, etc.);**
- / **Defining management practices inspired by the best methods employed by various players (professional real estate and major operators) as well as making best use of the opportunities arising from the digital revolution.**

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