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Paper Title: Increasing shareholder value through quality Corporate real estate management.

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Abstract: This paper will investigate the concept of increasing or enhancing shareholder value through astute corporate real estate management.

As an introduction to this topic the amount of corporate assets tied up in real property will be covered. The amount of corporate real estate varies from country to country but certain similarities emerge from recent studies.

The problem areas that face the corporate real estate manager will be investigated together with actual balance sheet ‘tricks’. Problems relating to reporting procedures, financial performance, (increases and decreases in current value of assets), valuation models, converting real estate into sources of cash, will also be studied.

The available strategies of acquisition, disposal leasing, new funding (financing) procedures, and alternative performance measures will be covered. Short, medium and long term measures in relation to cash flows, return on capital, all from the corporate real estate managers perspective will be investigated. The important area of valuation models will be commented upon, including current market value concepts from upper level management scenarios, as well as clearly defined real estate types and the value management process.

Cost saving concepts will be discussed through a series of new management matrix structures. These should enhance the return to the shareholder.
The two last areas will investigate the flexibility in corporate real estate portfolios and most importantly the bottom line impact of quality corporate real estate management.

The conclusions will show how quality corporate real estate management should enhance overall shareholder value.

1.0 INTRODUCTION.

The areas of corporate real estate and corporate real estate management have been fairly widely discussed over the past 15 years, but even so it is still an emerging, evolving and ever changing property area, especially in relation to its effect on shareholder value. What corporate real estate (CRE) and corporate real estate management (CREM) are have been well defined, but where they sit in relation to company structure, how they affect the 'bottom line' of company profits and ultimately shareholder value needs further investigation. This can be reflected in an increase in actual share value or a higher return (dividend).

The role of corporate real estate in a corporation is crucial, but it has often been pushed into the background by the more high profile units, such as marketing, finance and information technology. No corporation can function without property and it will definitely appear somewhere on the balance sheet, usually as one of the top five, line asset amounts. (But at what figure?).

In 1989 a British survey of some 800 corporations showed that real estate represented 30%+ of corporate assets. The figure in Australia shows that over 65% of companies own their real estate assets as compared to European and North American organizations. (49%). (Kenley et al 2000). Pearson (2001) observes that "With some $35 billion worth of property held by Australia's 20 largest non-financial and non-property organizations – representing some 23% of their total assets – and a total of $230 billion of corporate in Australia, it is becoming increasingly critical for Australian companies to examine their ownership of property."

The use and management of this large asset has to a large extent been ignored by senior management to the detriment of the shareholder.

The corporate real estate management units' place in the corporation structure becomes important when linked to the long term strategic planning of the corporation. This together with the functions, roles and practices of the CRE unit must be defined to add value to the corporations' bottom line. Many ways of adding to the bottom line were considered, including immediate outsourcing. Outsourcing was and to some extent still is seen as a good cost saving mechanism but this was seen as 'treating the symptoms' not actually dealing with the inherent corporate/company property problems.

2.0 CORPORATE REAL ESTATE AND CORPORATE REAL ESTATE MANAGEMENT DEFINED.

What exactly constitutes corporate real estate has been defined as those real property assets, either owned or leased, by a corporation that are essential for its production or continuance in business. It does not include those real property assets that are held for investment purposes.

Corporate real estate management was defined by Zeckhauser & Silverman (1983) as, the management of the real estate assets and related personnel of those organisations whose primary area of business is other than real estate.

Kenley et al., 2000 described it as management of real estate by an organisation which incidentally holds, owns or leases real estate to support its corporate mission (from Rondeau 1992:1, Bon et al. 1998:209, Brown et al., 1993).

The statement is also made by Kenley et al., that,
'The primary value to the organisation is not the investment value of the property but is contribution to the way it does business'.
The definition of corporate real estate does not include corporations or organisations that hold real estate as the main portion or part of their investment strategy. That is Property Trusts (Real Estate Investment Trusts), Superannuation Funds (Pension funds). For the purposes of this paper it does not include public real estate.
Adendorf & Nkado(1996) comment that:
'Most corporations list real estate holdings in the property, plant and equipment part of the asset section of the corporation balance sheets. They are accounted for at their historical acquisition and financing costs, a valuation that is not a true reflection of their current value'

3.0 PROBLEM AREAS DEFINED.

Types of corporate real estate assets. This is the area where the first problem arises. What, on company/corporate balance sheets, actually constitutes real estate/real property? Research has shown that corporate real estate can be classified into six (6) distinct sub-groups: (Adendorff & Nkado. '96).

1. *Buildings. The cost of building included in company's property, plant and equipment account.*
2. *Construction in progress. The capitalized amount of plant and equipment, and construction that has not been completed.*
3. *Land. The cost of land used in production revenue.*
4. *Leases. The capitalized value of leases and leasehold improvements included in property, plant and equipment.*
5. *Natural resources The cost of irreplaceable natural resources including mining properties, oil fields and timber lands.*
6. *Other. Additional components of property, plant and equipment that cannot be placed in any of the foregoing categories.*

Other research indicates that the balance sheets vary from country to country with differing approaches and standards for accounting practice that makes the role of the CREM unit even more important in identifying what is actually real estate.
Value reporting. Another problem is that of reporting long-lived assets, like corporate real estate during periods of changing price levels. Most observers tend to think of real estate as an ever increasing value asset, whereas in many countries and instances it can be a decreasing asset value.
Realistically, a true measure of financial performance should recognize the increase or decrease in the current value of the asset/s. This ultimately should be reflected in the shareholder value.
Although comments have been made by those who have been surveyed, such as, 'we are not in the real estate business', it becomes apparent that no firm can function without real estate, either leased or owned. It is how the real estate is used and the management of it, to the best advantage of the corporation that is of prime importance.
Corporations that have both real estate and non real estate holdings could show the earnings separately, or combine the two into a single sum to report in total, and on a per share basis.

Again, what is the appropriate valuation model for corporate real estate?
Disposal of corporate real estate assets. Many shrewd corporate/company managers, accountants and directors employ a strategy to convert corporate real estate into sources of cash: viz.
The sale of (supposed) excess real estate.
Sale and leaseback.
Sale, then repurchase of equally satisfactory but less expensive real estate.
'Shutting-down' of leases. Where business departments are unprofitable the lease could be 'paid out' to minimize loss.

This can influence profit, (and the return to managers, through bonuses), stock prices, price earning ratios and dividend payouts.
It should be noted here that this, in many cases is a short-term solution, which leads to the corporation having to pay high rents in the future, or purchase more real estate in an inflationary market.

4.0 THE ROLE OF CORPORATE REAL ESTATE.

The percentages of corporate real estate that comprise an organisations assets seem to vary greatly. Again, as early as 1983, Zeckhauser & Silverman identified that between 25% and 41% of corporate assets were real estate. (North America). In 1992, Flegel estimated that between 20% & 35% of all US corporations assets were real estate.
The most recent evidence from Australia by Kenley et al (2000, p.20) stated that,
'On average Australian organisations own a higher proportion of their real estate (65%) than European and North American organisations (49%). Therefore, in Australia property costs make a higher proportion of organisations' annual operating costs. However the share of the property in total company assets is virtually identical with Europe and North America. This suggests that European and North American organisations are managing their CRE more efficiently and with greater profit than Australian organisations, and is further evidence that there is less use of CRE tools in Australia.
Pearson (2001) now notes that a recent study by Wharton Business School conducted over the past 10 years involving 718 US firms across 57 different non-real estate industries, highlights that firms owning property in excess of the median sample level of ownership produce returns to shareholders up to an average of eight per cent less than those of firms with ownership at or below the median level.
The average time horizon for long term planning in Australia (4.9 years) is very similar to Europe and North America (4.6 years).'

What does all of the beforementioned really tell us? It simply means that real estate, like it or not, is an integral part of any corporations' business and sometimes a large part of it. The most important fact to emerge is that the real estate assets must be managed properly and fit in with the overall corporation strategy. Ultimately, the effectiveness of the corporate real estate function relies upon connecting real property transactions to the overall corporate strategy aided by an explicit corporate real estate strategy. (Nourse & Roulac, 1993).

To undertake this, the Corporate Real Estate unit (or CRE unit) becomes an essential part of any corporation.

5.0 STRATEGIES AVAILABLE TO ENHANCE CORPORATE REAL ESTATE/SHAREHOLDER VALUE.

The strategies that are available to increase shareholder value include:

- acquistion
- disposal
- leasing
- new funding (financing)
- valuation models
- alternative performance measures

Acquisition. This is area that is often overlooked by many corporations. The strategy of owning assets increases return on equity and cash flow, whereas the strategy of leasing assets increases short term return on capital invested. Many corporations, through lack of a long term strategic property plan, grossly underestimate their real estate needs. The question of what constitutes long term real planning for many companies is a problem. As stated previously long term planning in Australia, Europe and the U.S.A. does vary greatly. (time factor). A recent case study revealed that the corporation needed to increase space requirements three times in five years, with a final purchase of new premises nearly doubling their space requirements. Where was the long term planning? Many may contend that it is impossible to plan that far in advance, but as has been shown the corporate real estate people are quite often the last consulted, many times after the event.

Disposal. Disposal of excess/surplus real estate is a logical solution to rectifying the balance sheet and shareholder value concept.

Leasing. Leasing of space requirements is often a good solution to making capital available and increasing shareholder value. This is especially true where company growth is problematical and space requirements are uncertain. The length of lease (and terms and conditions) can give many options in the strategic plan. Of course leasing places a specific drain on the cash flow, but it is a known quantity and therefore can be easily budgeted. There are other distinct advantages in leasing, including, mobility, rights to sublet, (offset costs) and tax deductibility.
This strategy can also include sale and leaseback..
Other advantages of this sale and leaseback option are increased liquidity, permanent financing, lower transaction costs, off-balance sheet financing, increased earnings, higher dividends, increased borrowing capacity and defined tax savings.

New Funding (Financing).
One of the major techniques for corporate wealth maximization is the new methods of funding company real estate resources.

The manner in which corporations normally finance their real estate largely reflects the former corporate attitude that real estate is a production factor rather than a resource with its own potential.

Valuation models.
The old question here is, how should the asset value figures for real estate holding be shown of the balance sheet?
There is the acquisition or historical cost basis, but what does it really mean? How accurate is the figure?
There is the written down/depreciated book figure.
There is the replacement cost figure. Again, what does this mean in the real world?
Finally there is the current market value figure model. How is this figure calculated? That is what method of valuation is used and is it appropriate for the holding?

Alternative Performance Measures.
These are becoming more popular as the role of the corporate real estate management team becomes more recognized.
Real estate in a company can now viewed as separate accounting center. That is it can be divided into types and defined as cost or profit centers. Separate reports on each can be prepared and the performance of the center monitored.
This concept involves each center actually charging for the use of the land/premises. The cost goes back to the other department/center using it. That is, say the human resources (department) center needs space to function and it must "lease" the space and the cost is built into their budget. In a real sense this gives and much clearer indication of how each department in a company is performing. In the past it was (and still is in many cases), that real estate was just a cost borne by the 'whole'. You needed it, it was there and you used it, free of costs.
It is now becoming common practice for companies to set up separate performance measures shown as 'real estate earnings'.
These figures may, in many instances, be 'book' figures, but they give a much more accurate representation of performance.

6.0 RECOGNISING REAL ESTATE TYPES IN THE CORPORATE PLAN.

Adendorff & Nkado, (1996) classify corporate real estate into the following types:
Strategic Property. These are the real property assets that the corporation needs to own and control for its operations and long term business strategy. An example of this is a firm's manufacturing or distribution center.

Core Property. The property that the company needs to control (not necessarily own) for medium term operations. Examples could include industrial, commercial or retail facilities from which the company operates.

Surplus Property. Disposal property. This is an area that should be under constant review as the company needs and wants change. The property does not fit into the corporation's long or medium term strategy or business plan.

7.0 THE VALUE MANAGEMENT PROCESS.

Research has revealed that there is a well defined value management process to enhance shareholder value. (based on Adendorff & Nkado. '96).
1. Firstly identify all real estate holdings. This can be classed as a real property asset audit. The types of real estate must be identified as well as what is owned and what is leased. Many times through company acquisitions and mergers the actual real property holdings are 'confused'. A recent case study revealed that one large company 'discovered' some 15 properties it did not know it owned. Many occupied by 'non-paying' tenants.
3. Establish the role of the corporate real estate manager/team in the corporate framework..
This is an area that deals with the company structure and the role of the corporate real estate management team.
3. Where necessary use consultants in specialist areas. Many corporation feel that they know all there is know about real estate, but the use of skilled consultants can lead to more productive use of assets.
4. Calculate the contribution of each parcel of real estate to the 'bottom line'. This area goes back to concept of making each department/unit responsible for the cost of their real estate. That is, either it is a cost of profit center.
5. Change real estate cost centers into profit centers. This will usually mean that most department managers will have to change their way of thinking in relation to accommodation costs.
6. Prioritise the property areas to which management has the greatest opportunity to allocate resources.
7. Establish policies and procedures for financing, acquisition, leasing disposal etc. (as discussed previously, especially in relation to long term planning.
8. Monitor and manage the process. Use benchmarking and returns on property types to give an indication of real performance and as well advising and listening to other department heads.

8.0 THE 'BOTTOM-LINE' IMPACT ON COMPANY PROFITS/SHAREHOLDER VALUE.

What is 'bottom line' management in CRE? Is this pure profit for the real estate center, or is it overall shareholder value? To achieve a profit it is often necessary to have a profitable CRE center, an area often overlooked by many corporations.

Return on investment can be enhanced by corporate real property managers talking the 'same language' as senior management and business unit managers to creatively integrate real property decisions corporate strategic planning, business unit planning and operational decision-making.

Can there be a reduction in space needs? This could be where expert facilities managers are used to minimize staff space needs, without sacrificing working conditions. Greater workforce productivity in space design. This area is closely related to the previous statement but covers actual design rather than area.

Improved management of all information systems can lead to a more productive use of space and time. The concept of ‘hot-desking’ and multi-function space can be a reality for many offices where staff are ‘on the road’ many hours a day. The ‘mobile’ office or home office is becoming a fact of life.

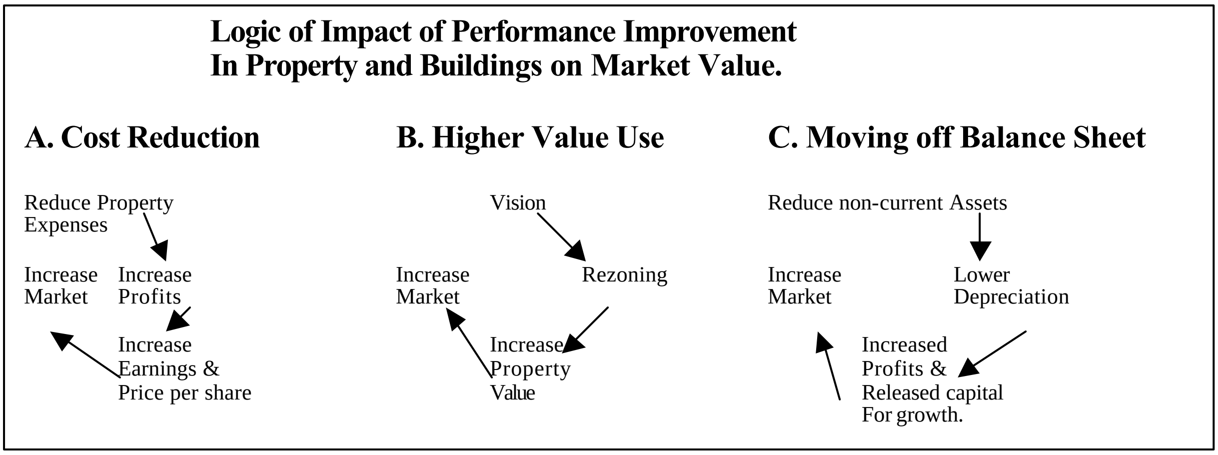
The emphasis is on cost reduction, but at what cost? Opposing this (or supposedly complementing it) is improvement in quality of service. This is where outsourcing can be become crucial, either as a success of as a failure. Service delivery arrangements are changing rapidly (Outsourcing).

More efficient use of invested capital. (See previously on use of sale and leaseback etc.).

A better trained ‘higher level’ real estate function within companies plugged into both, line and staff management through a superior decision support framework is crucial for strategic planning.

The effectiveness of corporate real estate function relies upon connecting real property transactions to the overall strategy aided by an explicit corporate real estate strategy.

Much progress has been made over the last 5 years, but an adequate decision support framework and reporting of information on corporate property assets is still not available to line managers, (Department or unit managers), corporate real property staff and senior management.



Source: Pearson, 2001. Corporate Real Estate. Is the Giant Awakening? p.17.

9.0 FLEXIBILITY IN CORPORATE REAL ESTATE.

Today corporate real estate managers are looking for greater flexibility in their portfolios. But what are they willing to pay for this flexibility? (Gibson, 2000).
As Manning & Roulac (1999) point out, there is a use of corporate facility location strategy to maximize shareholder wealth/value. Larger companies have an advantage in facility location decisions and this can lead to an 'agglomeration' value accretion to the surrounding land arising from the planned growth in business activity at that facilities site. Such companies can profit from their own (legal) inside information about likely impacts to the land surrounding the facility when it holds additional adjacent land (excess to its own operating needs) for resale.

There is more consideration of cost factors related to corporate real estate location decisions. The possibility of the sale, in the future, of infrastructure development carried out as part of the overall corporation plan can be reflected in a growth in share value at the end of a project. (Even in mineral developments).

Location choice and its impact upon revenue must be taken into account. (See previous comments on cost and profit centers).
The impact of location choice on continuing shareholder value has to be viewed in the long term planning scenario. That is there may be short term 'pain' for shareholders through acquisition and set up cost, but long term gain through less expense (no rent etc.).

Revaluing of corporate real estate assets has to be undertaken on a more regular basis. This has been covered earlier but, what figures are actually shown on the balance sheet and what the real property assets are worth could be two totally different scenarios. This area is crucial to shareholders, but is only really talked about when companies are taken over, assets sold off (usually real estate) and amazingly their sale price way out-strips balance sheet figures.

10.0 CONCLUSIONS.

Some of the conclusions below are written partly 'tongue-in-cheek' but give an indication of how we must start to view the concept of shareholder value in relation to corporate real estate assets.

Accountants or should it be said the accounting (especially in relation to company reporting) requirements are the problem. What value is shown on the balance sheet?

Valuers are the problem. What method do they use to arrive at the figure or do they just value as instructed using the information supplied by the instructing party?

The changing market is the problem. Many corporations do not re-value their real estate asset value as the market changes. (Especially when the market falls!). This is also a problem of the accounting requirements.

The inflexibility of corporate real estate is the problem. Corporate real estate is hard to quickly convert into 'cash'. The disposal process, especially for large properties can literally take years, so the inflexibility can exacerbate value concepts.

Upper management is the problem. The reluctance of upper management to accept the advice of the corporate real estate manager occurs too often, much to the detriment of shareholders. Timely, acquisition, disposal and leasing can definitely add to the 'bottom-line' of the company.

Lack of communication is the problem. Many believe that this area should rate number one in any corporation study, but with electronic communication, accurate market data, (even in relation to real estate), there should be no excuse.

Corporate strategy is the problem. This would also include the changing corporate strategy. As can be seem from the long term planning period (usually a maximum of 5 years), strategy must be revi ewed very often. The ability of the corporate real estate manager to adjust to changes in overall corporate strategy is vital.

Long and short term planning are problems. As discussed this area is becoming more important as change sweeps through many companies. Take-overs, (hostile and friendly), mergers and floats all impact on the real estate

However, the corporate real estate manager is never the problem.

It can be however that through a series of well structured management scenarios and the effective use of corporate real estate strategies that shareholder value can definitely be enhanced.
It remains to be seen if Australian companies can catch up to their European and American counterparts. Time will tell, but unless some hard decisions at high levels are made soon, then shareholders will the ones to suffer.

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