

From Tactical to Strategic: Adding Value through Portfolio Management

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CoreNet Long Island Chapter
April 19, 2007

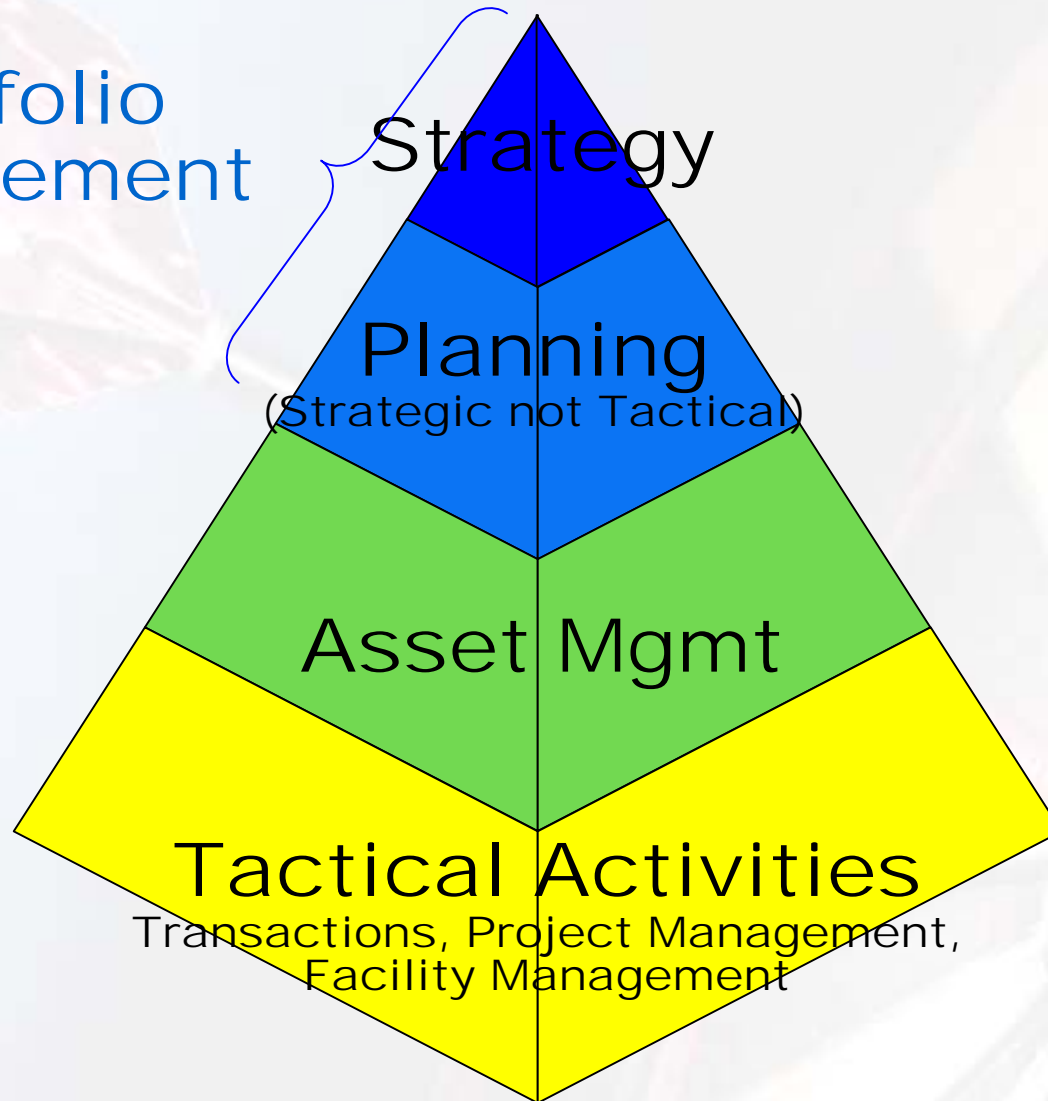
CoreNet Global Executive Development Program

Workshop Goals / Agenda

- **Define what it means to move from “tactical to strategic”**
- **Introductions / portfolio management activities**
- **Provide a framework for portfolio management**
- **Highlight specific portfolio management activities**
- **Identify potential metrics mistakes**

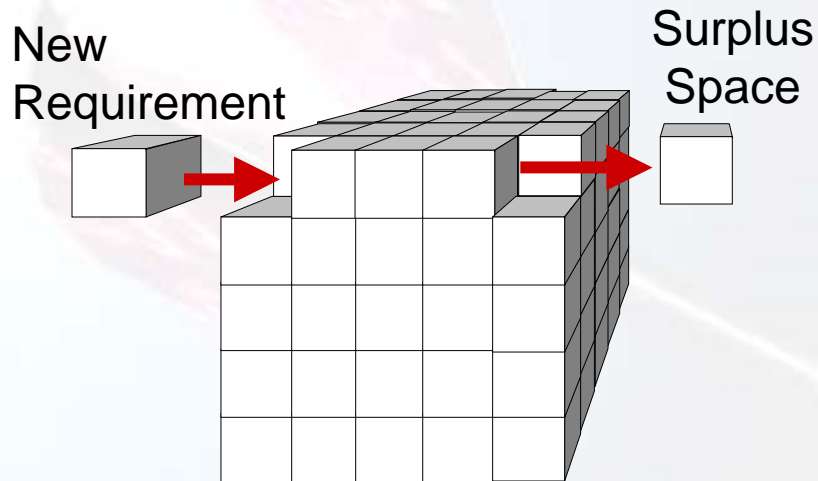
Traditional Explanation – Top of the Pyramid

Portfolio
Management

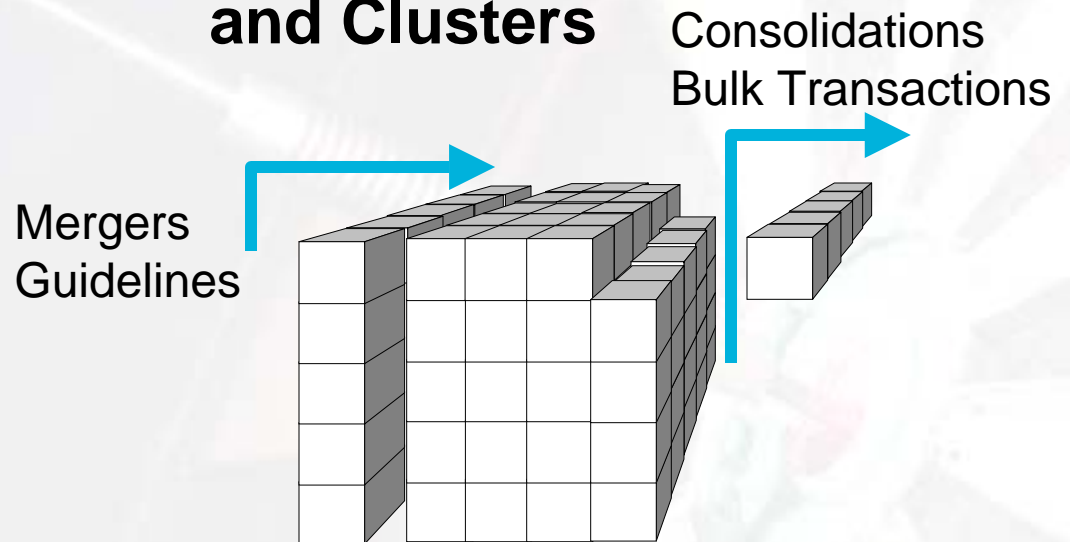


Traditional Explanation – Portfolio Management Looks Across All Assets

Historical Bias Toward “Deals”



Consider Portfolio and Clusters



Webster's Definitions - Tactical

- 1 : of or relating to combat **tactics** : as a
 - (1) : of or occurring at the battlefield <a *tactical* defense> <a *tactical* first strike>
 - (2) : using or being weapons or forces employed at the battlefield <*tactical* missiles> b *of an air force* : of, relating to, or designed for air attack in close support of friendly ground forces
- 2 a : of or relating to **tactics** : as
 - (1) : of or relating to small-scale actions serving a larger purpose
 - (2) : made or carried out with only a limited or immediate end in view
- 2 b : adroit in planning or maneuvering to accomplish a purpose

Webster's Definition - Strategic

Strategic

- 1 : of, relating to, or marked by [strategy](#) <a *strategic* retreat>
- 2 a : necessary to or important in the initiation, conduct, or completion of a strategic plan
- 2 b : required for the conduct of war and not available in adequate quantities domestically <*strategic* materials>
- 2 c : of great importance within an integrated whole or to a planned effect <emphasized *strategic* points>
- 3 : designed or trained to strike an enemy at the sources of its military, economic, or political power <a *strategic* bomber>

Strategy

- 1 a (1) : the science and art of employing the political, economic, psychological, and military forces of a nation or group of nations to afford the maximum support to adopted policies in peace or war
- 1 a (2) : the science and art of military command exercised to meet the enemy in combat under advantageous conditions
- 1 b : a variety of or instance of the use of strategy
- 2 a : a careful plan or method : a clever [stratagem](#)
- 2 b : the art of devising or employing plans or [stratagems](#) toward a goal
- 3 : an adaptation or complex of adaptations (as of behavior, metabolism, or structure) that serves or appears to serve an important function in achieving evolutionary success <foraging *strategies* of insects>

Business Definitions - Strategy

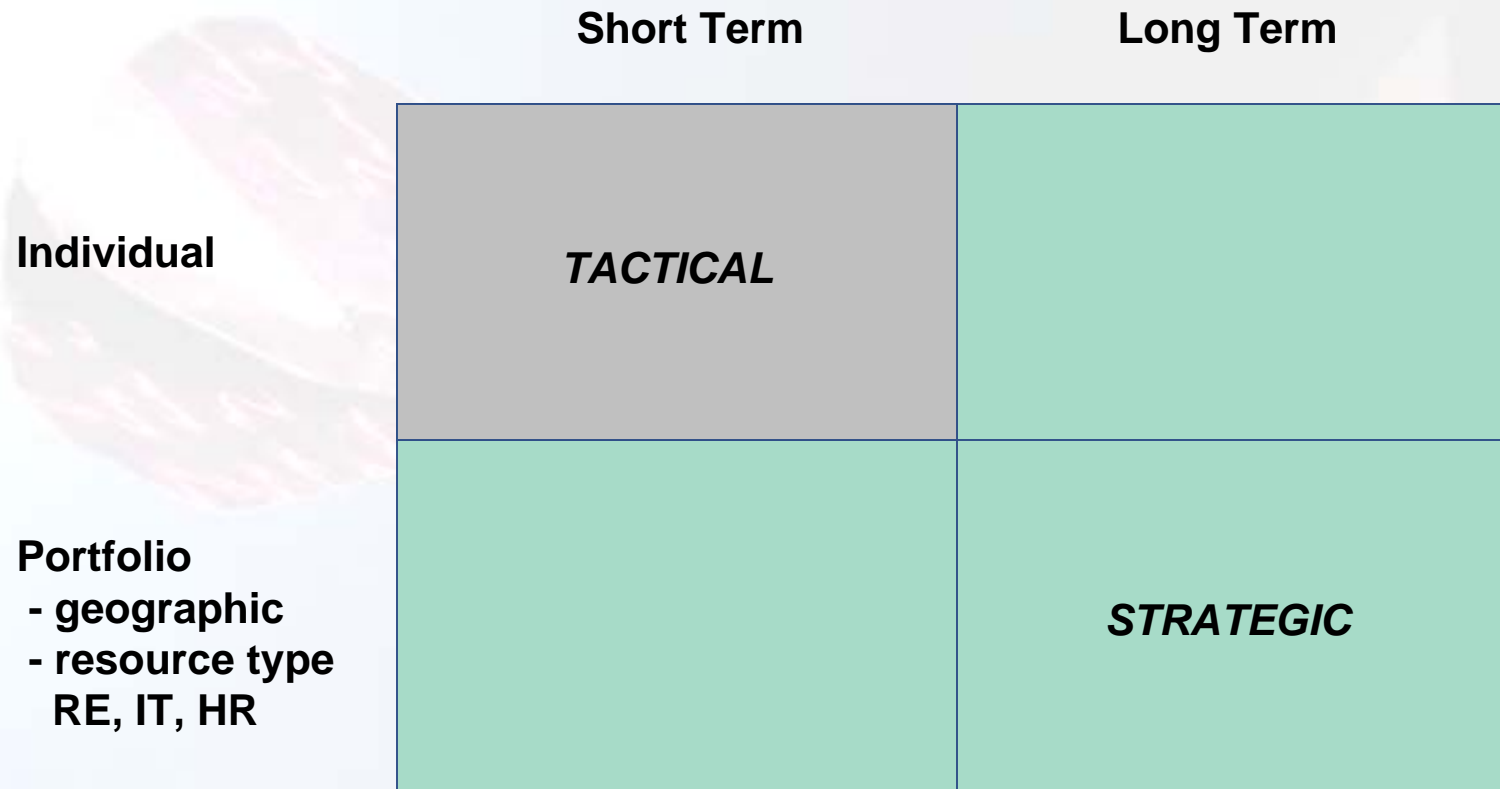
Liam Fahey, *The Portable MBA in Strategy*.

- "Few words are as abused in the lexicon of organizations, as ill-defined in the management literature, and as open to multiple meanings as strategy."
- **Strategic planning** - "the most important, difficult, and encompassing challenge that confronts any private or public organization: how to lay the foundation for tomorrow's success while competing to win in today's marketplace."

Michael Porter, "From Competitive Advantage to Corporate Strategy," *On Competition*

- "Corporate strategy concerns two different questions: What businesses the corporation should be in, and how the corporate office should manage the array of business units."
- "Corporate strategy is what makes the corporate whole add up to more than the sum of its business unit parts."

Moving from Tactical to Strategic



Strategic planning involves the development and implementation of a coordinated, long-term framework that defines the workplace environment and how it should be managed. It:

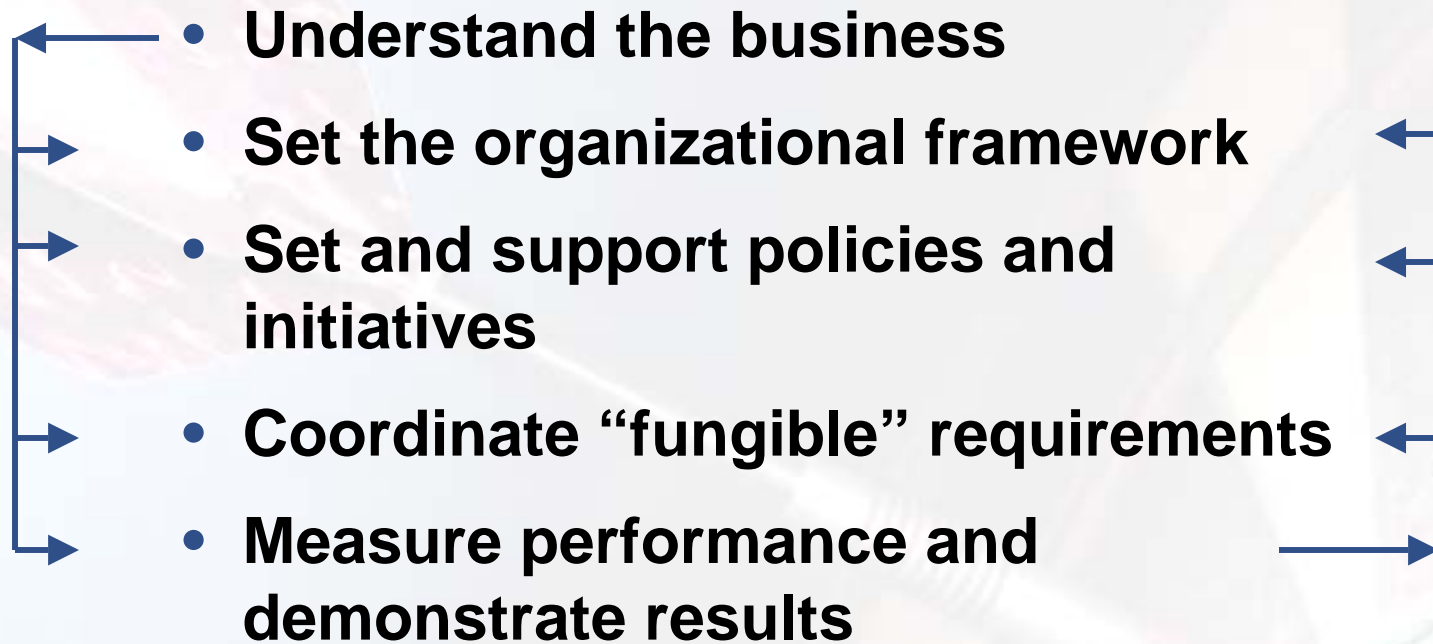
- links the real estate strategy to the business strategy,*
- identifies opportunities for adding value through coordination, and*
- sets the long-term strategy to balance short-term business needs, long-term commitments and an uncertain business environment.*

Introductions

Company and role

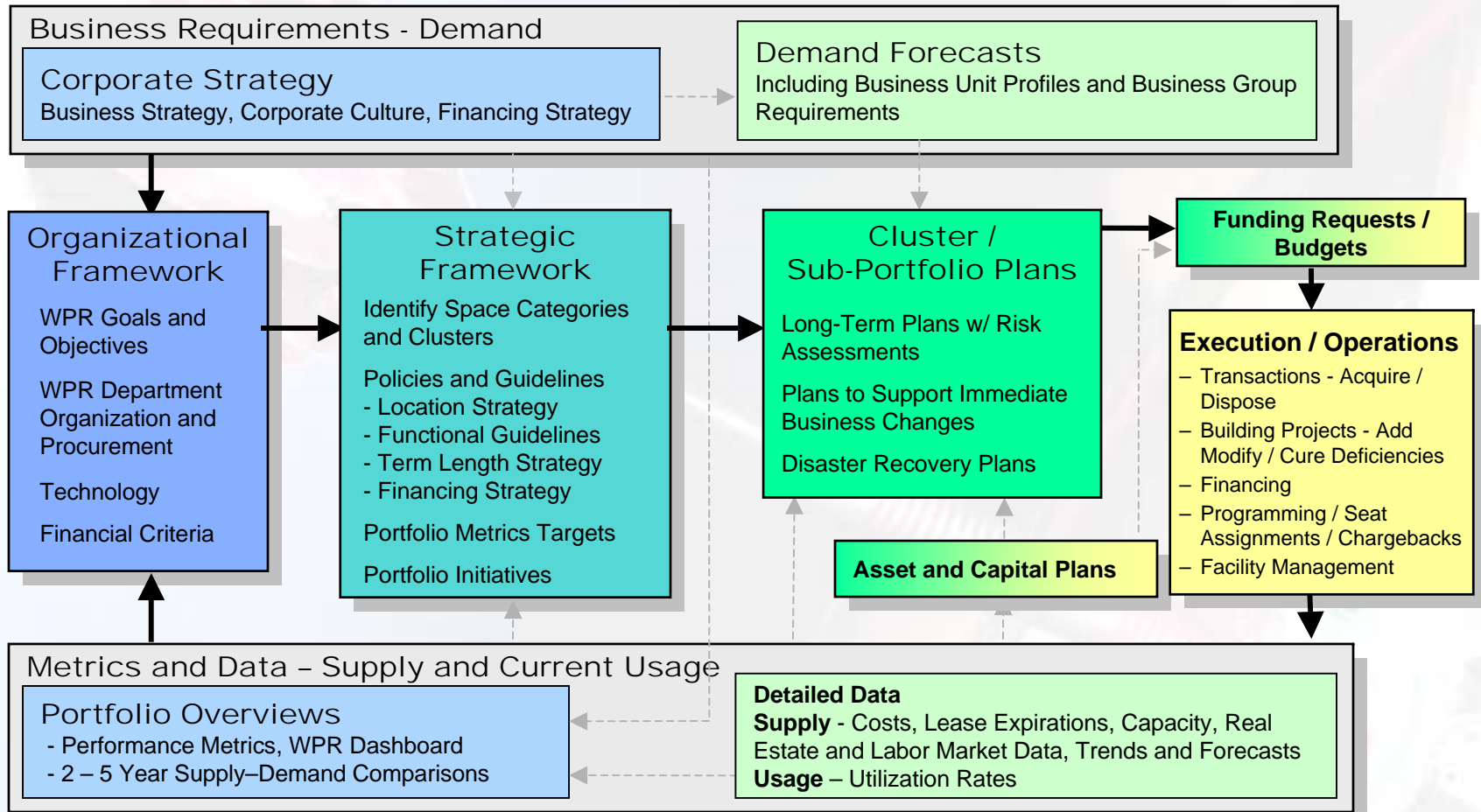
Portfolio management activity – own, client, or good example

Portfolio Management Activities

- **Understand the business**
 - **Set the organizational framework**
 - **Set and support policies and initiatives**
 - **Coordinate “fungible” requirements**
 - **Measure performance and demonstrate results**
- 

More Detailed Portfolio Management Description

Blue and green activities are part of strategic planning and portfolio management.



Activities based on discussions in Open Source Consortium for Real Estate (OSCRE) Strategy and Planning Interest Group

Business – Cost Productivity Trade-off

Do we focus too much on cost?

Average occupancy costs per person

- \$6,000 to \$14,000
- Consider 10% reduction at \$10,000 = \$1,000

Average salary and benefits per person

- \$30,000 to \$200,000
- Consider \$60,000 worker
 - Productivity reduction that would offset cost reduction
= $\$1,000 / \$60,000 = 1.7\%$

Goals

- “Do no harm” - Identify cost savings without negatively impacting productivity
- “Improve productivity” - Identify workplace environments that improve productivity with similar or reduced costs

Business – Cost Productivity Trade-off

Profit-based calculation

Revenue	\$90,000	\$88,200
Productivity	1.5	1.47 - 2% reduction
Costs		
Real estate	\$10,000	\$ 9,000 - 10% reduction
Workers	\$60,000	\$60,000
Other	\$10,000	\$10,000
Total Cost	\$80,000	\$79,000
Profits	\$10,000	\$ 9,200

Value - Long-Term Perspective



Business – Role of Forecasting

“The only thing that you can be certain about is that your forecast is likely to be wrong.”

- **Anonymous**

“The old model . . . persistent pursuers of the right headcount numbers.” . . . “They (*business units*) really have no idea.”

-**Keith Tabacek, Sun Microsystems, on business leaders ability to provide headcount forecasts.**

"A good forecaster is not smarter than everyone else, he merely has his ignorance better organized. "

-**Anonymous**

Business - Scenarios not Forecasts



NCAA Championship Cinderella team

2003 – Syracuse wins

2005 - UVM beats Syracuse

Unlikely things happen.

**Consider what might
happen and whether
you can respond.**

1% means 1 in 100.

Better Scenarios - Understand The Business

- **Mission, Values, Culture**
- **Who - Customers and Markets**
 - Locations
 - Contract terms
 - Business cycles
- **What - Products**
- **How – Suppliers, Production and Delivery**
 - Processes
 - Constraints
 - Technology
- **How – Organization and Finance**
 - Financial criteria
 - Mergers and acquisitions
 - Capital availability
- **External – Competition and Regulation**
 - Innovation
 - Regulation
 - Globalization

*Business fundamentals?
What might happen?
Major factors and risks?
Implications for
portfolio?*

Better Scenarios – Variety of Inputs

Talk with business units

- Ask about the business - workplace professionals are more interested in long-term issues than others are
 - *“At those levels, management does not tend to discuss the things that really impact the future.” Keith Tabacek, Sun*
- Explore what might happen – scenario planning
- Understand ranges rather than point estimates


Go beyond employees

- Include contractors, workers from other business units
- Adjust for alternative officing and changes in multi-user space

Talk with senior executives – business units tend to be optimistic

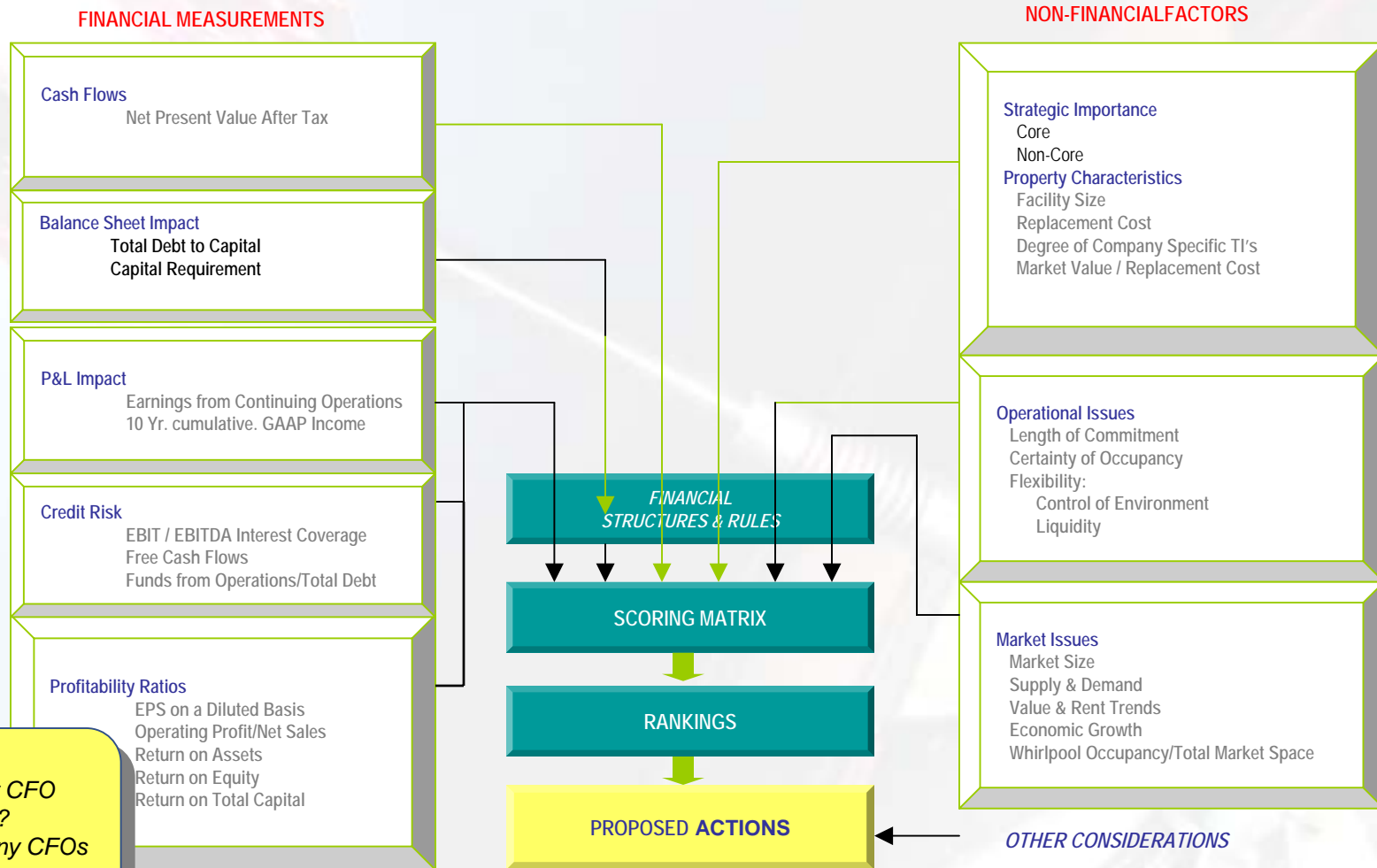
Base on revenue forecasts and historical experience

Portfolio Management Activities

- 
- **Understand the business**
 - **Set the organizational framework**
 - **Department organization**
 - **Procurement / outsourcing**
 - **Technology – automate activities, organize data**
 - **Financial criteria – how to measure results**


Financial Criteria

Whirlpool - real estate financial structure decision model that ranks financial options based on defined characteristics and goals



Discussion:
 What is your CFO interested in?
 Why are many CFOs so focused on accounting earnings?

Portfolio Management Activities

- 
- Understand the business
 - Set the organizational framework
 - **Set and support policies and initiatives**

Value – Economies of Scale



Optimizing Individual vs “Fungible” Locations?

- Categories
 - Segment portfolio into categories / property types
 - Develop policies and identify initiatives that are appropriate for each category / property type
- Clusters
 - Identify fungible properties
 - Add value through coordination

Policies and Initiatives

Identify Space Categories and Clusters

Policies and Guidelines

- Workplace Strategies
 - Functional Guidelines
 - Location Strategies
 - Flexibility - Term Length and Option Strategy
 - Financing Strategy
- ▶ *Monitor transactions*

Portfolio Initiatives

Flexibility – Term Length and Option Strategy

Duration matching

- Basic – Match control structure (own, long-term lease, short-term lease) to demand understanding.
- Stronger – Match control structure to business life cycle.

Empirical finding

- For high-beta companies (high-variance), 10% above average property ownership leads to 1% reduction in annual shareholder return
- For low-beta companies (stable), no statistical relationship

Have we over-responded? Are we paying too much for flexibility?

- Individual properties
 - Consider relative costs, probability of staying, tenant-specific improvements, negotiating leverage
 - Assess value of options
- Fungible activities - many activities in one location or activities that can be transferred between locations
 - Cluster properties

Control Structure Example

High-tech manufacturing company

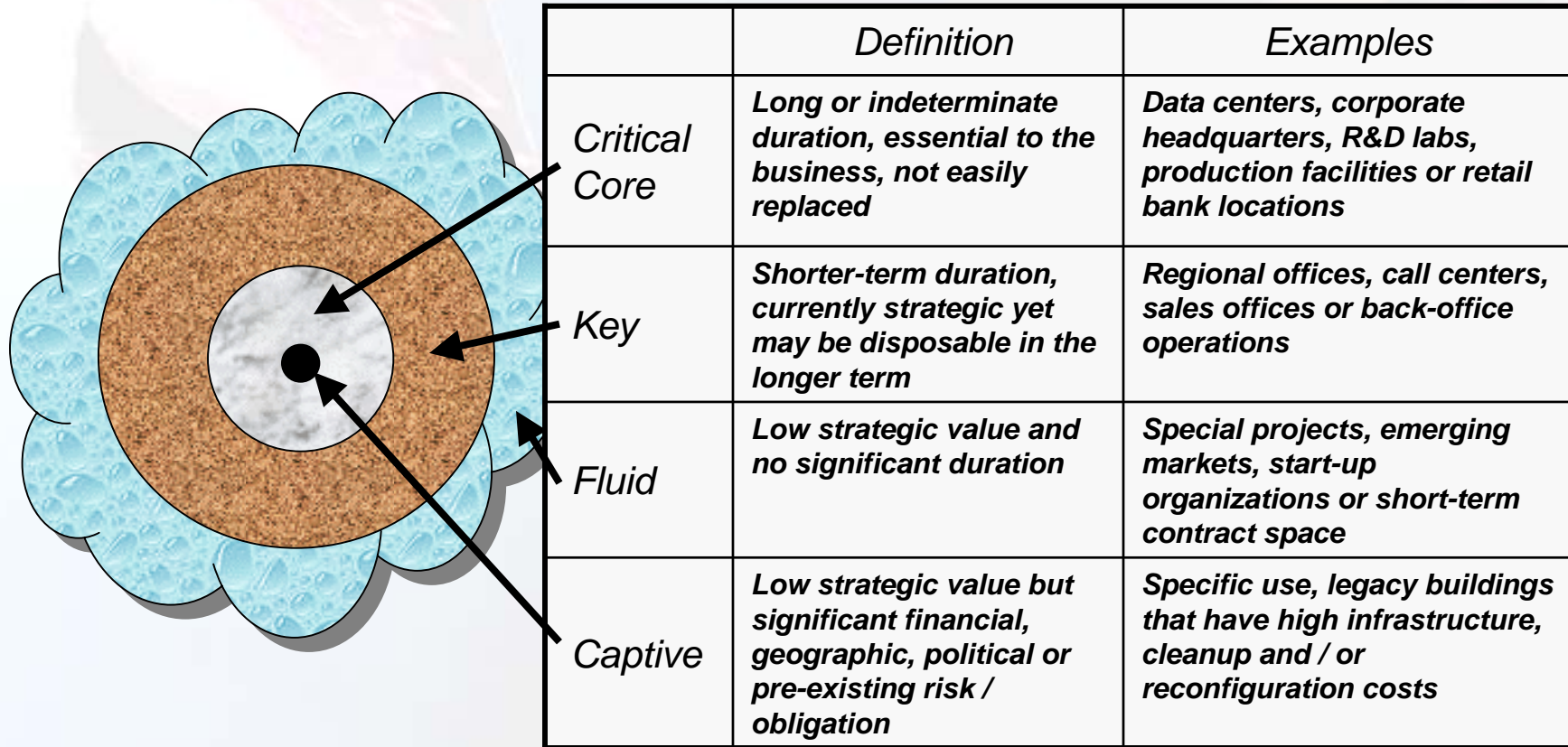
- Product life cycle – very short
- Owns manufacturing properties
- “Product life cycle is not the driving force”

Why?

- Core to business
- High-tenant specific improvements
- Tied to location through trained work forces
- Retool as needed

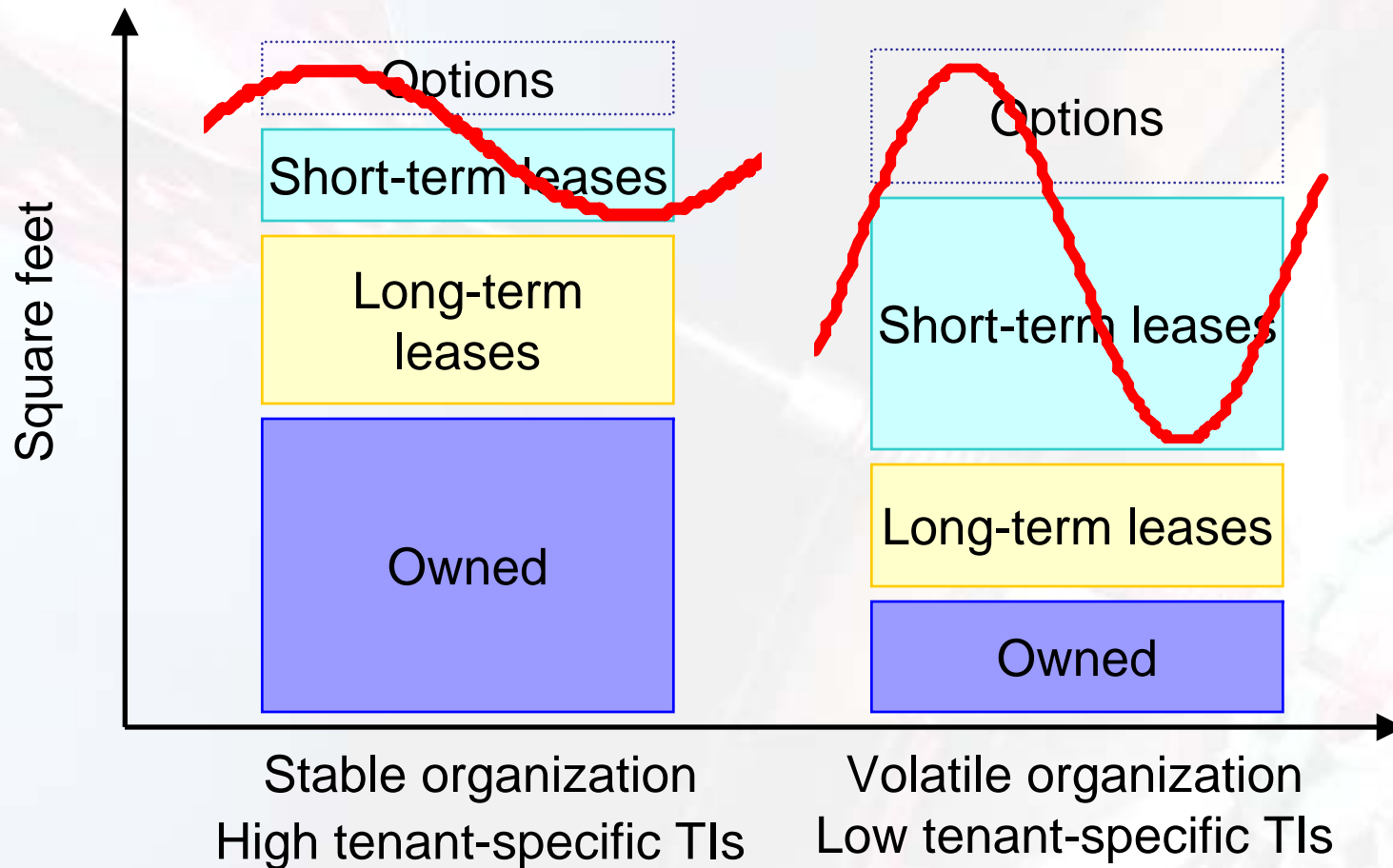
CoRE 2010 Resource Classifications

This classifications reflects both business variability and the extent of tenant specific improvements.



Optimal Cluster Financial Structure

Design to accommodate **Demand Volatility** and **Tenant-Specific Improvements**



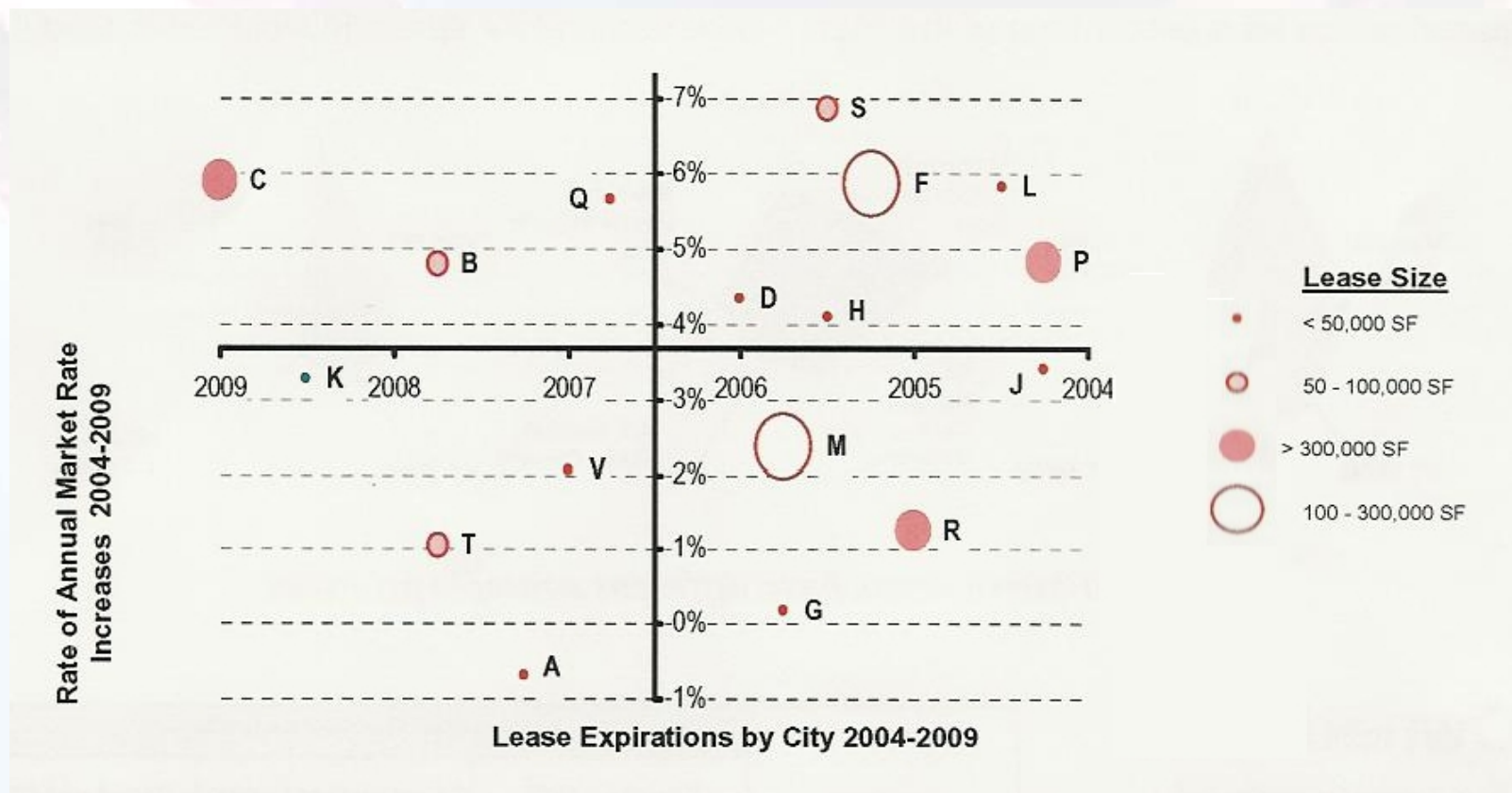
Value – Identify Opportunities



- **Different kids / business units to manage**
- **For each category, identify where additional attention is needed**

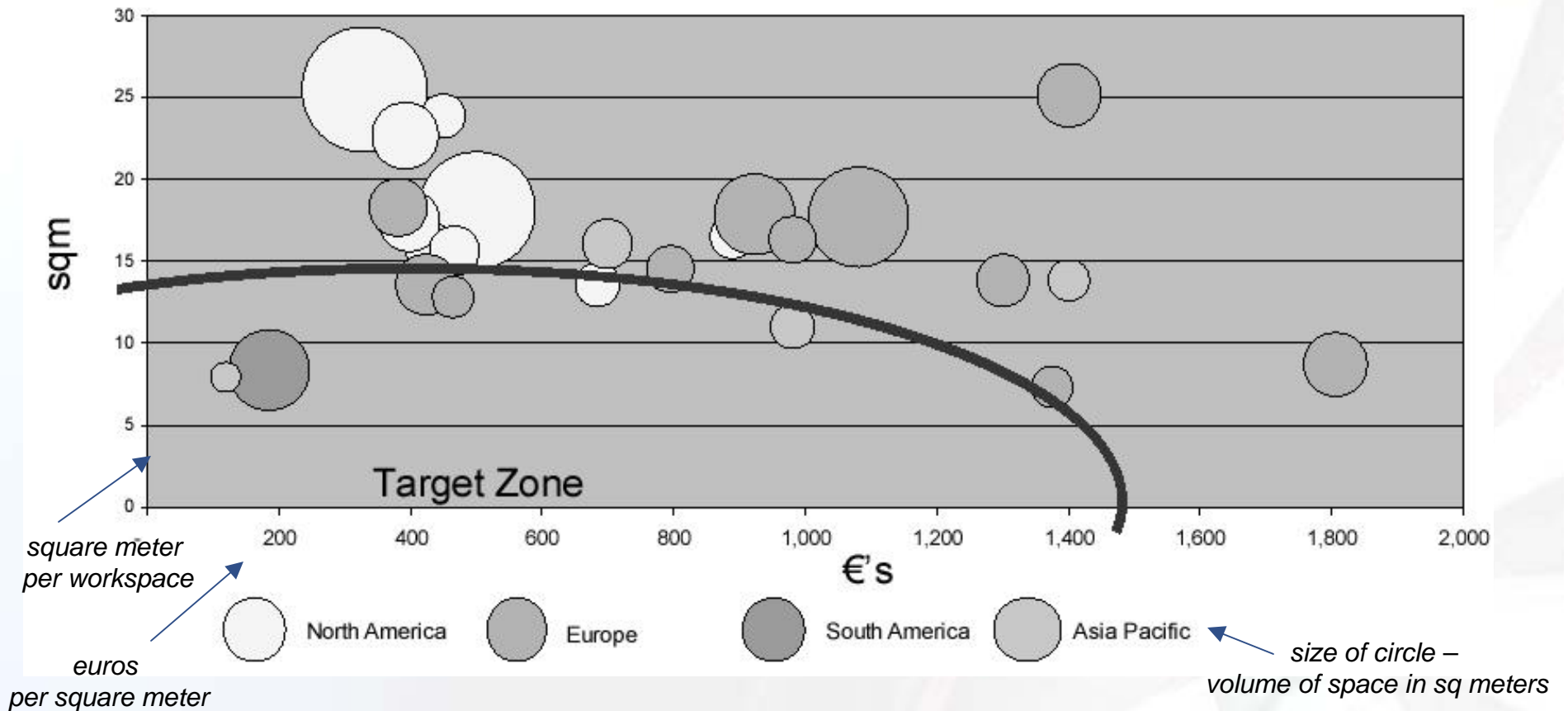
Portfolio Visualization - Early Renewals

Which properties need attention - CP Analytics




Portfolio Visualization – Excess Space

Which properties need attention – ABN AMRO



Portfolio Management Activities

- 
- Understand the business
 - Set the organizational framework
 - Set and support policies and initiatives
 - **Coordinate “fungible” requirements**

Value – Coordination



- **Working as a team is more successful than operating individually**

Value – Coordination

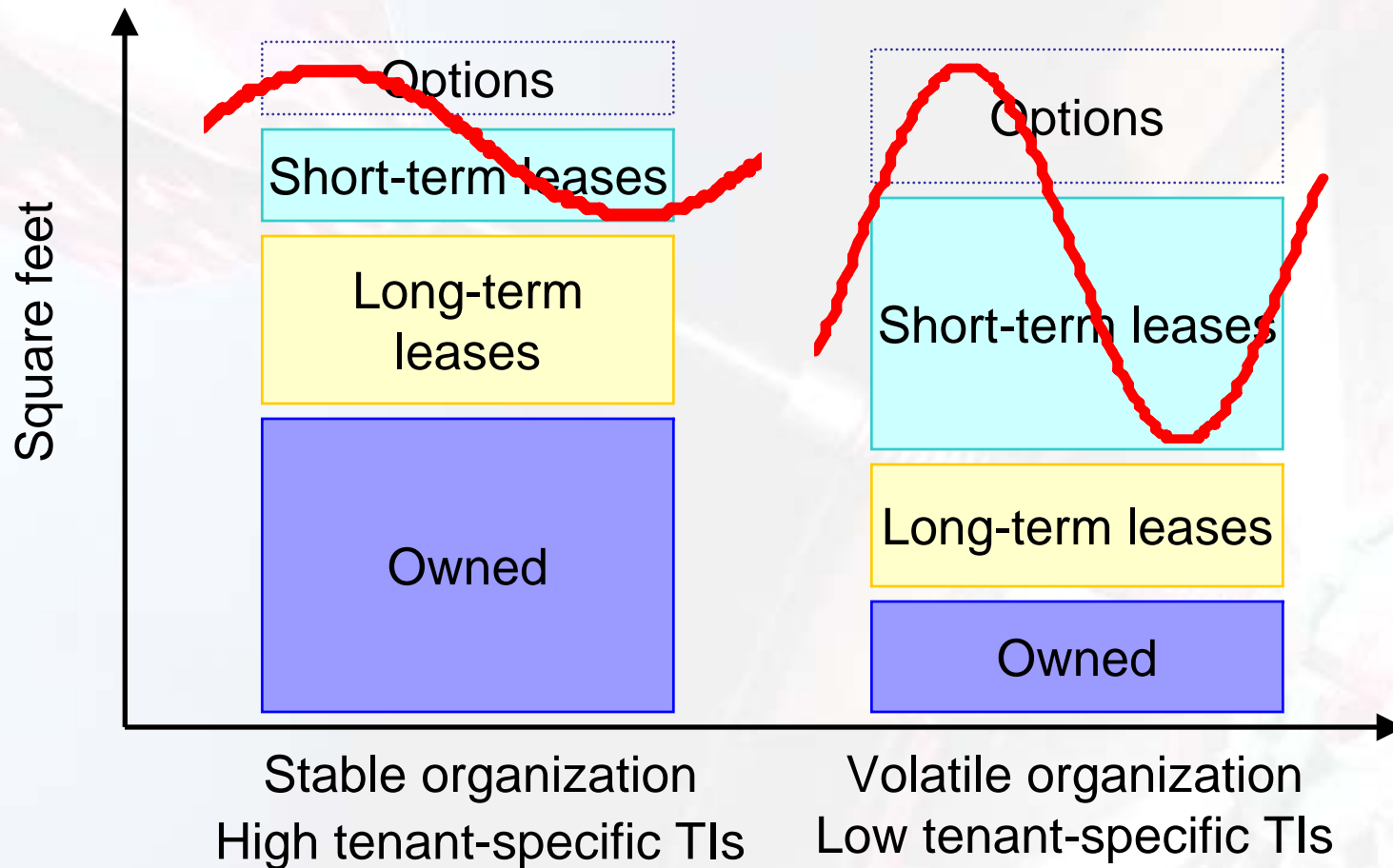


Investment portfolio

- Diversification
- Risk management

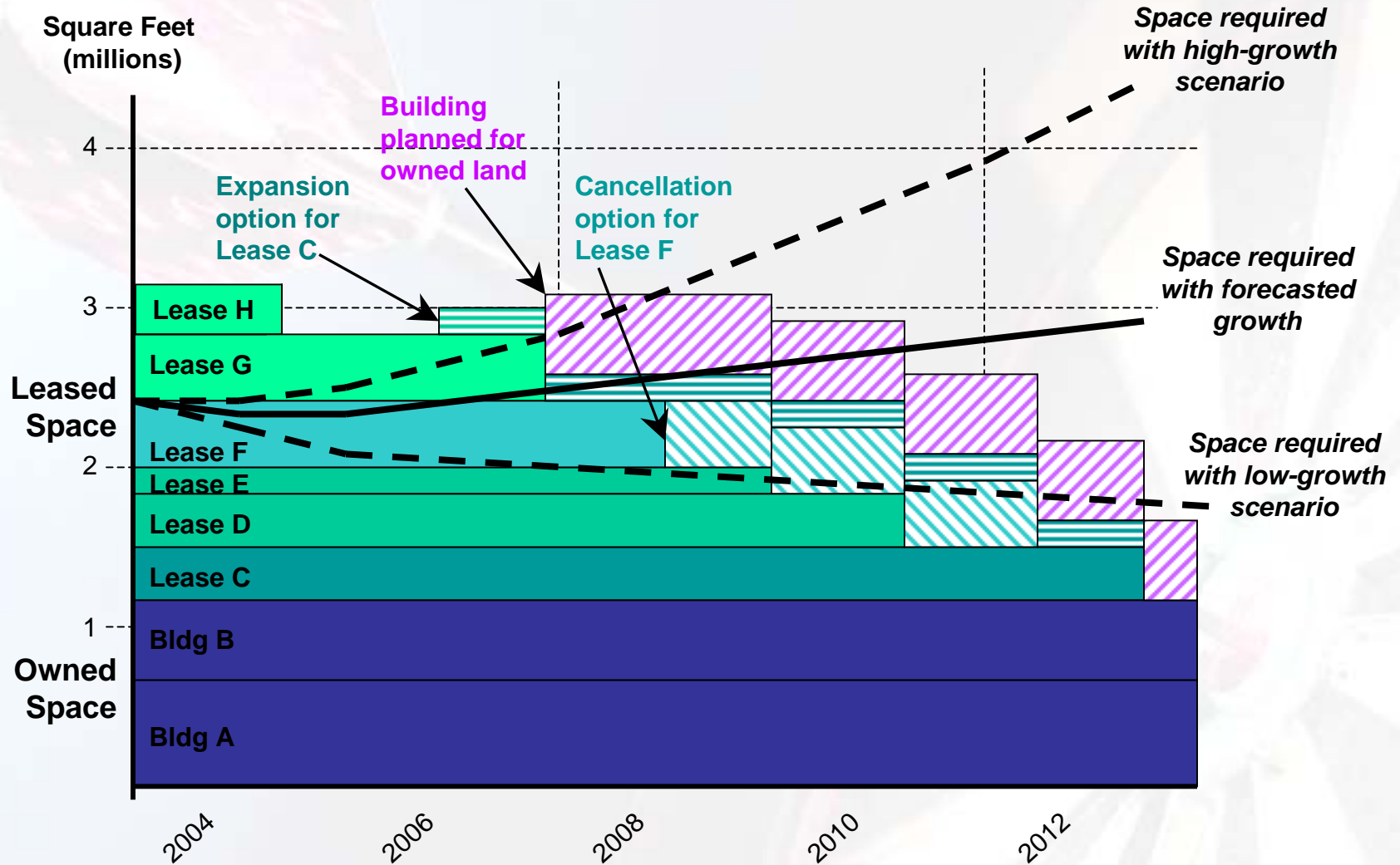
Optimal Cluster Financial Structure

Design to accommodate **Demand Volatility** and **Tenant-Specific Improvements**



Clusters with Coordination Provide Flexibility

Plan for a range of outcomes. Flexibility can be achieved through options and staggered lease expirations.



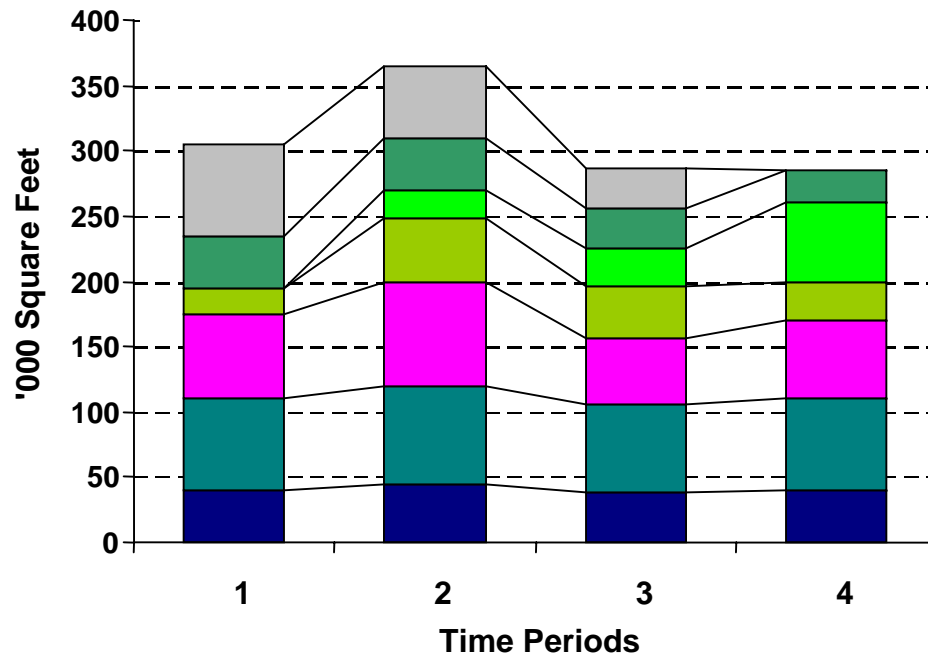
Clustering Benefits

Clustering reduces space requirements and mitigates risk

GE CEO Immelt HBR Interview – “fewer rooftops”

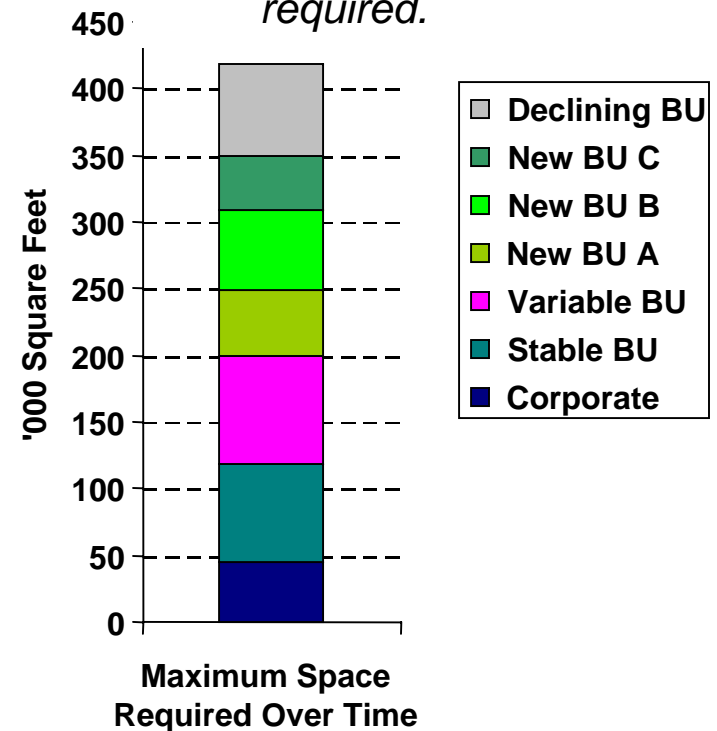
Clustering Groups

If groups are in one building or in a cluster of buildings, as one group shrinks another group can absorb that space.



Individual Spaces

If each group has its own location, then each group needs enough space to accommodate its maximum requirement. In total, more space is required.



Bulk Transactions – B of A and AFRT

Sale-leaseback with flexibility – June 2003

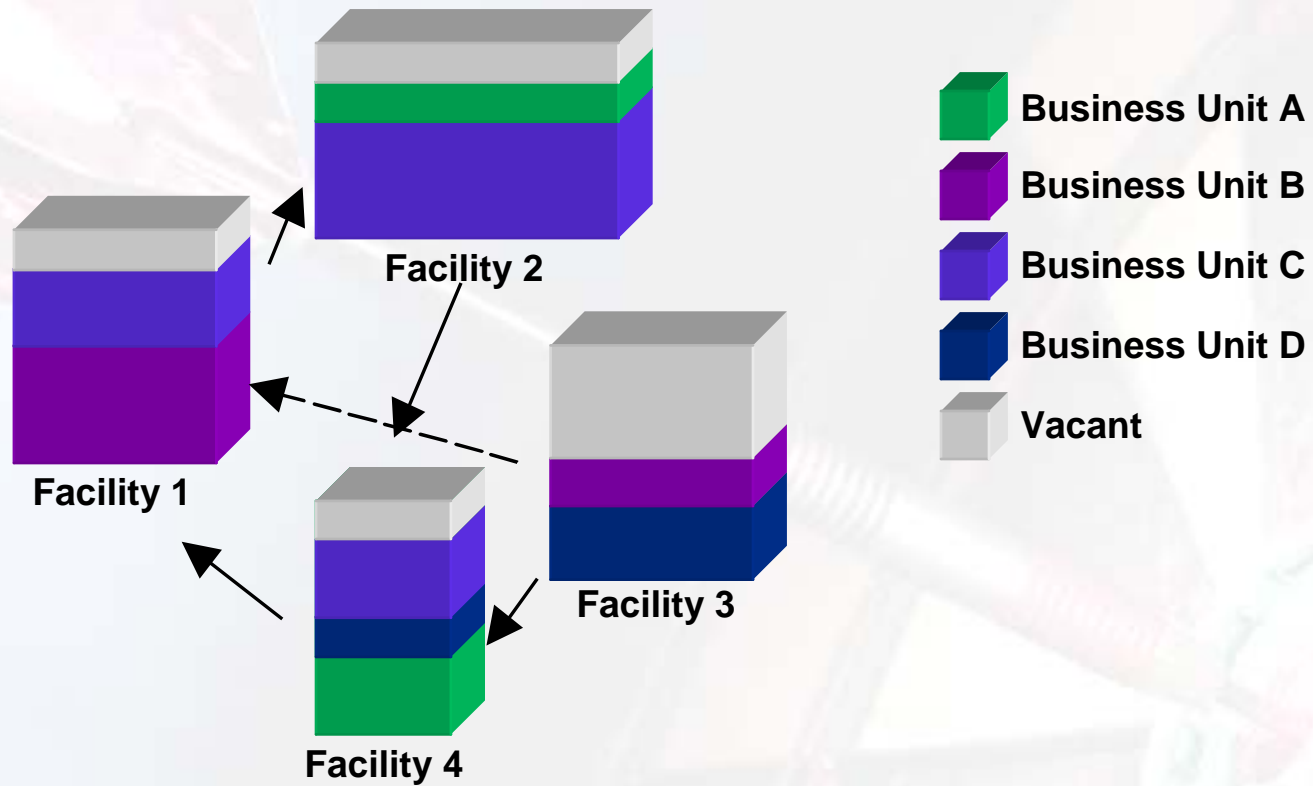
- **American Financial Realty Trust – AFRT**
 - **Focus on financial corporation assets**
- **158 buildings in 18 states, 8.1 M SF, \$774 million**
- **20 year lease with substitution**

B of A Benefits

- **Occupancy cost savings - \$420 million over 20 years**
- **Focus on core banking business**
- **Eliminated third-party tenant admin**
- **Ability to shift space over time**

Responding to Change

Within a cluster, what is the best strategy?



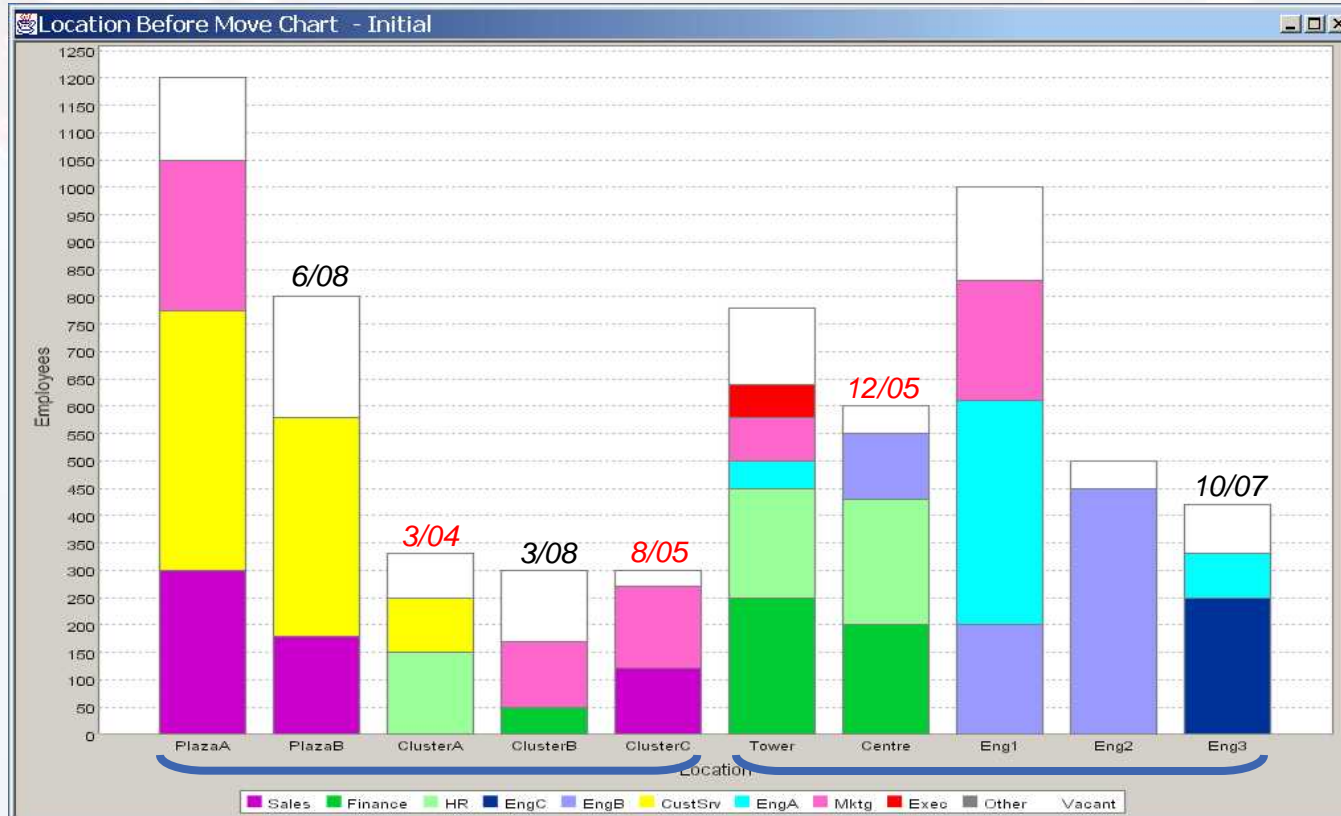
Factor Checklist for Cluster Analysis

Growing importance of HR and data and telecom infrastructure issues.

Demand	Supply
<p>Business Group Existing Conditions</p> <ul style="list-style-type: none">• Employee locations in facilities, regions, cities, countries• Special-use space usage (labs, trading floors) <p>Business Group Requirements</p> <ul style="list-style-type: none">• Workspaces required in future<ul style="list-style-type: none">• Number and space types• Based on persons housed and sharing opportunities• Special-use space requirements<ul style="list-style-type: none">• Lab spaces• Trading floors• IT and telecom infrastructure required• Feasible and suitable locations• Facility preferences• Adjacency requirements• Amenities - parking, training, etc.	<p>Real Estate Existing Conditions</p> <ul style="list-style-type: none">• Facility sizes and configuration• Facility costs<ul style="list-style-type: none">• Lease rates, operating expenses• Accounting values - depreciation, book value• Expiration dates and options• Space efficiency – rentable sf, usable sf, density• Amenities, parking, security <p>Real Estate Opportunities</p> <ul style="list-style-type: none">• Feasible new locations and costs• Market rents and trends for renewal rate forecasting• Sublease benefits and costs• Sale benefits and costs• Construction costs <p>Labor Market Opportunities</p> <ul style="list-style-type: none">• Wage rates and trends
Costs of Change	
<p>Facilities</p> <ul style="list-style-type: none">• Relocation• Reconfiguration costs (demolition, construction, furniture, wiring)• Capital improvements• Infrastructure improvements	<p>Employees</p> <ul style="list-style-type: none">• Relocation costs• Hiring and training costs• Severance costs

Sample Situation – What do you do?

- Initial locations with excess space, occupancy rate of 79%
- Reducing employment from 5,360 to 5,000
- Improve adjacencies so groups are split between at most 2 locations and within at most one cluster of locations
- Increasing sharing ratio from current average across business groups of 1.35 to 1.6



Possible Portfolio Optimization Strategies

Vacate as many leased properties as possible

- **What is the right amount of vacancy?**
- **Lower vacancy rate is not necessarily lowest cost**

Sublease / sell owned properties to increase flexibility

Minimum cost for different requirements

- **Occupancy cost**
- **Moving, reconfiguration, and infrastructure improvements**
- **Sublease high-value properties**

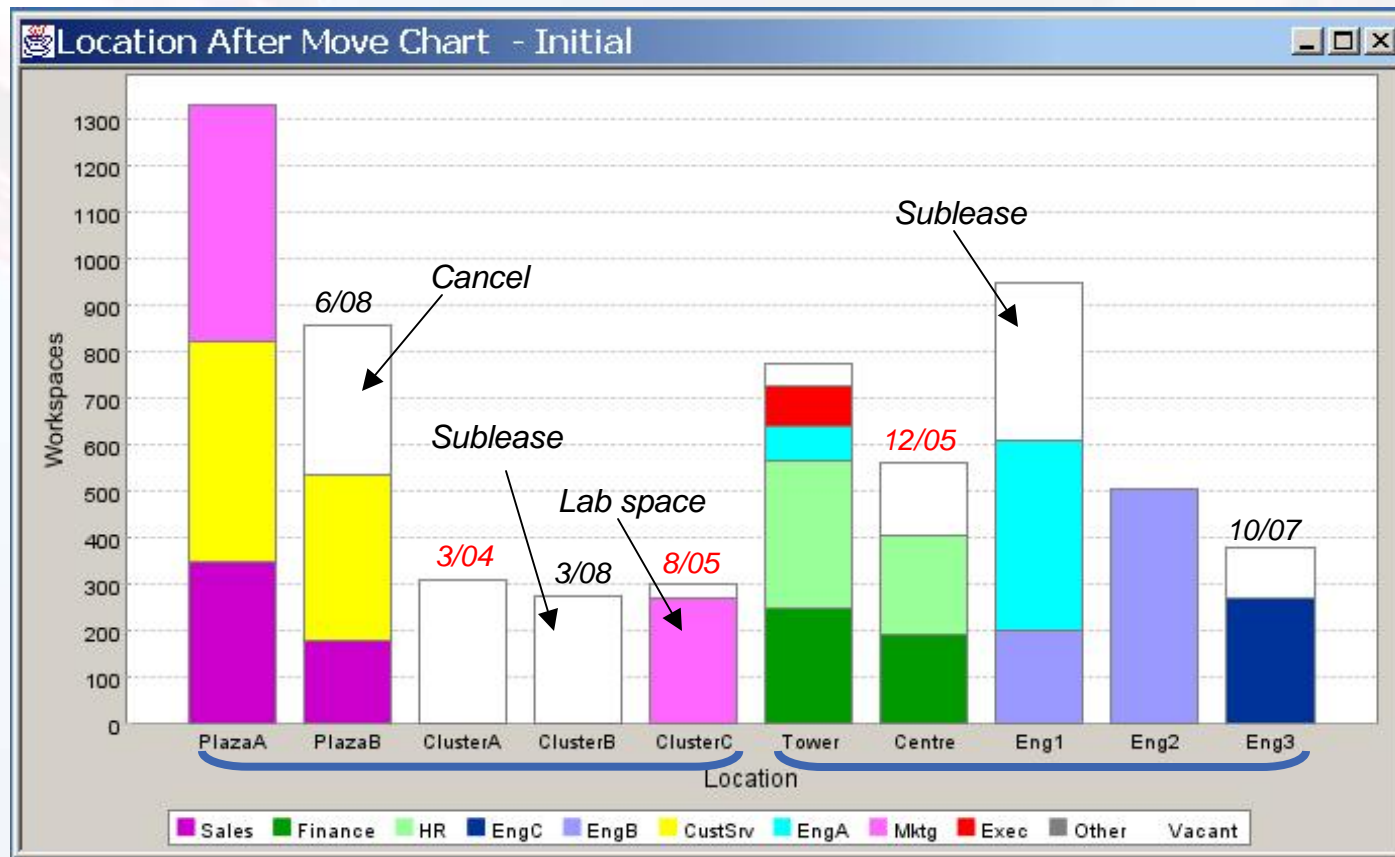
Business units are offered opportunity to pay for higher cost alternatives

Other considerations?

Goal - Comprehensive approach

Vacating Short-term Leases Is Not Always Best

- Costly to relocate Cluster C activities
- Reduce space through subleases and cancellations



Optimal Solutions

Sun Microsystems rates the different solutions based on risk considerations.

Business Risk – BU, Corp, Emp Productivity

(9 Pts Possible)

- business acceptance of inconvenience
- risk to employee productivity
- parking impacts
- customer contracts require the office remain open
- business believes growth will occur
- reducing class of building may be negatively perceived
- headcount plan is disconnected
- business acceptance of inconvenience
- BU's have different views of proposed solution
- reducing flexibility increase risk of obsolescence
- extended lease duration could impact flexibility or corporate valuation
- reorganizations
- business strategy change
- future workforce size
- business acceptance of iWork/wfh

Implementation Risk

(9 Pts Possible)

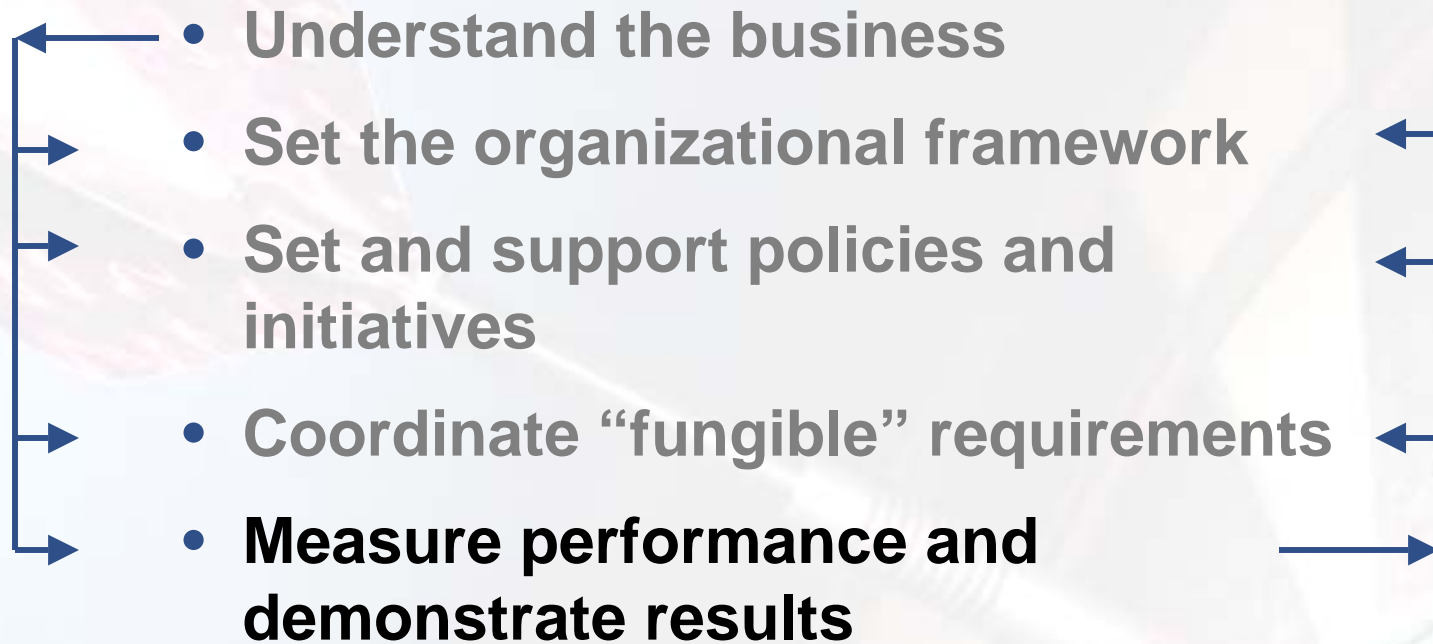
- continuing market fluxuation makes forecasting of reserves difficult
- wfh not feasible due to feasibility (technology, home workplace)
- untested iWork assumptions
- business does not have cash to fund wfh component
- government vs employee regulatory issues
- contractual landlord barriers
- unable to downsize because rentable square foot is minimum landlord size
- space not easily divisible
- potential security risk

Employee Satisfaction

(6 Pts Possible)

- employee satisfaction (commuting)
- employee acceptance of iWork/wfh

Portfolio Management Activities

- Understand the business
 - Set the organizational framework
 - Set and support policies and initiatives
 - Coordinate “fungible” requirements
 - **Measure performance and demonstrate results**
- 

Value – Demonstrate Results

“The single most important reason why corporate real estate and facilities managers fail to have an influence in the boardroom is that they lack the information to demonstrate that they are doing a great job.”

Christopher Hedley,
Occupiers Property Databank, UK,
“Getting to grips with information



You Can't Manage what You Can't Measure

Or - “You get what you measure”

GE CEO Jeff Immelt

- **“The only things that move the culture are ones that show up in our income statement.”**

Portfolio managers

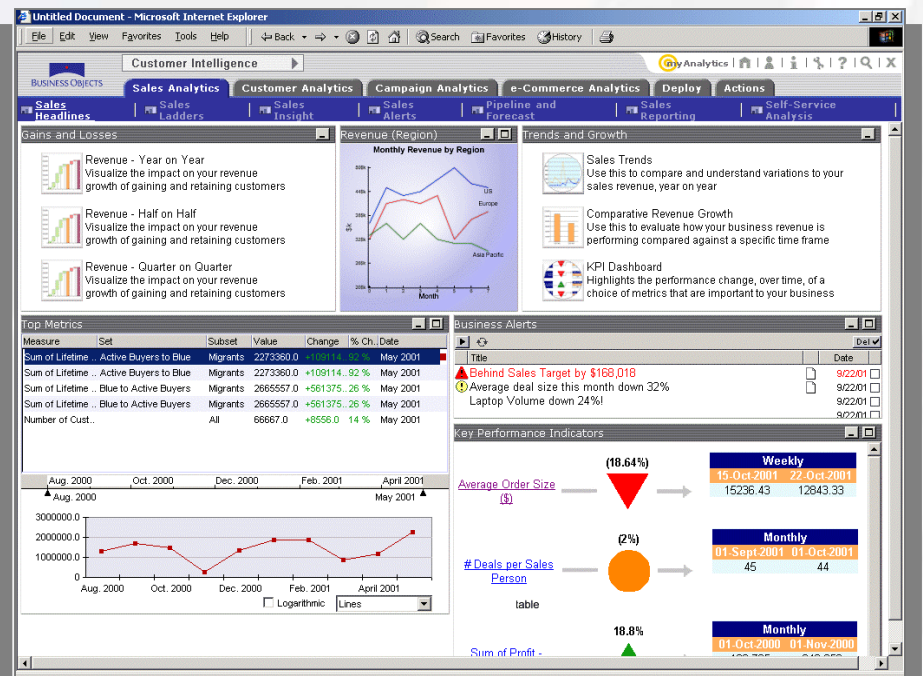
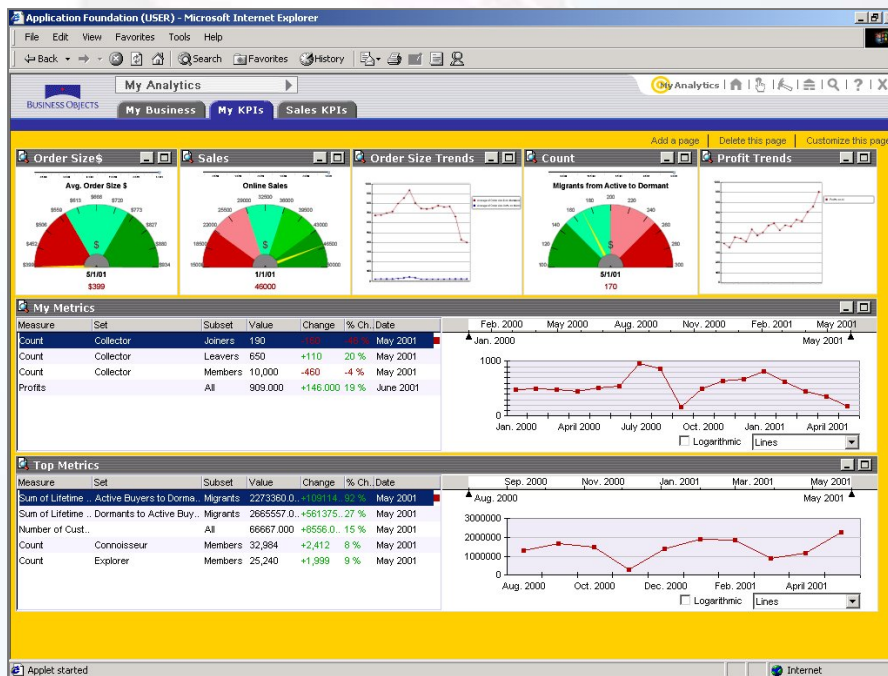
- **Are responsible for accountability**
- **Need data to evaluate portfolio and performance**
- **Can identify opportunities for improvement**

But, look beyond costs

Possible Metrics – Balanced Scorecard

Metrics Categories	Stakeholders			
	CEO, CFO	Business Group Executives	CRE Executive	Planning and Strategy Team
Financial Cost	<ul style="list-style-type: none"> • WPR / CRE expense / revenue, corporate expenses • WPR / CRE expense / persons housed • WPR / CRE expense / demand driver • CRE impact on balance sheet • Cost saving achieved through initiatives – consolidation, flexible officing, outsourcing 	<ul style="list-style-type: none"> • WPR / CRE expense by business group • Business revenue / real estate supply measure – revenue per store 	<ul style="list-style-type: none"> • WPR / CRE expense / SF (including sub-components and additions for cost of capital) • WPR / CRE expense / seat • CRE overhead expenses / persons housed • Cost per move, seat reconfiguration, other real estate activity • Contract rent relative to market rent 	<ul style="list-style-type: none"> • WPR / CRE expense / other demand drivers
Volume	<ul style="list-style-type: none"> • Utilization rate 		<ul style="list-style-type: none"> • SF / persons housed • SF / other demand driver (engineer, clients, product, etc.) • Persons housed / seat • Share of FTE or workstations moved per year 	<ul style="list-style-type: none"> • SF / Seat • Share of space devoted to site services, team space
Customer Asset Quality	<ul style="list-style-type: none"> • Client satisfaction measure 	<ul style="list-style-type: none"> • Workplace quality measure • Marketing, brand, image value • Business continuity measure, space concentration 	<ul style="list-style-type: none"> • Forecasted percentage change in space by classification • Share of persons served by work type (traditional, mobile, telework) 	
Process and Service Quality	<ul style="list-style-type: none"> • Project completion time 	<ul style="list-style-type: none"> • Disruption, churn rates 	<ul style="list-style-type: none"> • Forecast of workload • Share of authorized projects completed • Planning results vs goals 	<ul style="list-style-type: none"> • SF managed / planner • Persons housed / planner
Process Flexibility	<ul style="list-style-type: none"> • How readily can portfolio contract or expand to meet changing needs – time and cost measure 		<ul style="list-style-type: none"> • Commitment duration (lease vs. own, lease term distribution) • How much can be disposed or added within time period 	<ul style="list-style-type: none"> • Measure of ability to switch space between usage and types • Share of expensive fixed improvements in core space

Sample Dashboards



Metrics Implementation

- **Keep simple and focused on organizational business drivers**
 - Different measures for different stakeholders
- **Go beyond financial measures**
- **Develop for whole portfolio and relevant segments and clusters**
 - Space categories
 - Geographic locations
- **Establish consistent metrics**
 - Owned versus leased properties – include cost of capital
 - RSF vs USF
- **Set targets and benchmark metrics**
 - Are metrics consistent with CRE strategy?
 - Are metrics better or worse than peers?
- **Use in performance evaluations and compensation decisions**
- **Develop strategies to improve performance**

Metrics Mistakes

- **Targeting vacancy rates may increase costs**
- **Increasing leased space can increase cost metrics if owned space costs are not measured correctly**
- **Metrics are not for forecasting**

Metrics Mistakes – Owned Properties

NPV may lead to leasing properties, but could increase cost metrics?

Are owned properties really less expensive? With better cost metrics for owned properties, owned and leased properties show similar costs per square foot.

They are also consistent with results of NPV analysis.

	Cash Expenses / SF	Accounting Expenses / SF	Market Rent for Owned / SF
Owned – Avg.	15.43	21.64	37.05
Plaza A	14.00	18.92	33.00
Tower	16.00	22.00	36.00
Engineering 1	16.00	21.73	40.00
Engineering 2	16.00	25.60	40.00
Leased – Avg.	35.05	37.31	
Plaza B	32.00	35.20	
Cluster A	34.00	34.00	
Cluster B	31.00	36.40	
Cluster C	36.00	36.00	
Centre	35.00	39.00	
Engineering 3	41.00	41.00	

Cost per Person Metrics Analysis

Top-down metric decomposition - works well for historical comparisons and understanding real estate cost drivers.

$$\frac{\text{Cost}}{\text{Persons Housed}} = \frac{\text{Cost}}{\text{Square Foot}} * \frac{\text{Square Feet}}{\text{Seat}} * \frac{\text{Seats}}{\text{Persons Housed}}$$
$$\$ 9,176 = \$ 35 / \text{sf} * 226 \text{ sf} / \text{seat} * 1.16 \text{ seats} / \text{PH}$$

Reflects space and tenant improvement costs and quality

Reflects space efficiency, workspace size, and other amenities

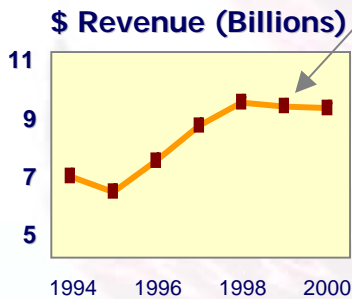
Reflects utilization rates (86%) and sharing ratios (1.35 PH / seat for shared seats) for 15% of workers

For sample sub-portfolio metrics
1.4 million square feet, 10 buildings
5,360 workers

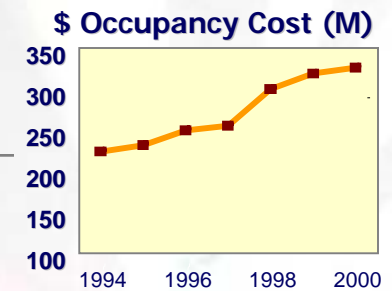
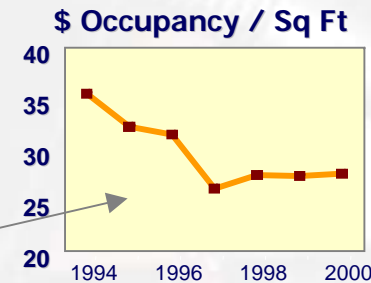
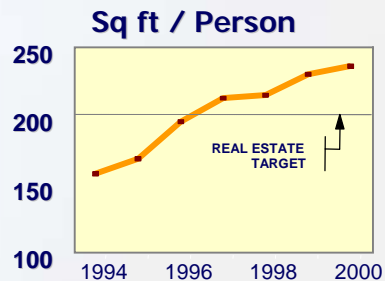
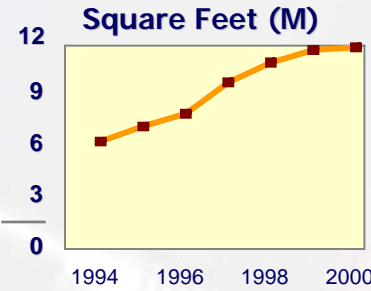
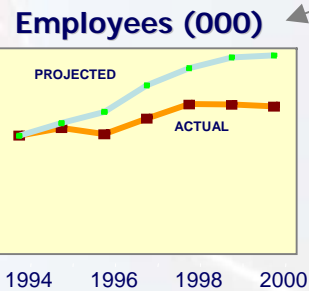
Historical Metric Analysis

Accruent's PortfolioPlanner module tracks the historical relationships between revenue, headcount and occupancy costs.

The business grew quickly; then it flattened out.

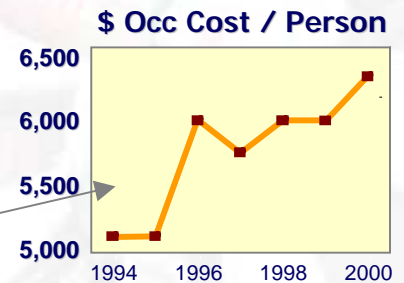


They added space faster than people.



They picked lower cost locations and negotiated great deals.

Cost per Person jumped.



Metrics are *Not* for Forecasting

"The performance data featured represents past performance, which is no guarantee of future results." *From mutual fund investor information.*

$$\frac{\text{Cost}}{\text{Persons Housed}} = \frac{\text{Cost}}{\text{Square Foot}} * \frac{\text{Square Feet}}{\text{Seat}} * \frac{\text{Seats}}{\text{Persons Housed}}$$

Sample portfolio metrics

Current \$ 9,176 = \$ 35 / sf * 226 sf / seat * 1.16 seats / PH

Target created with metrics formula

\$ 6,170 = \$ 35 / sf * 188 sf / seat * 0.93 seats / PH

New space standards

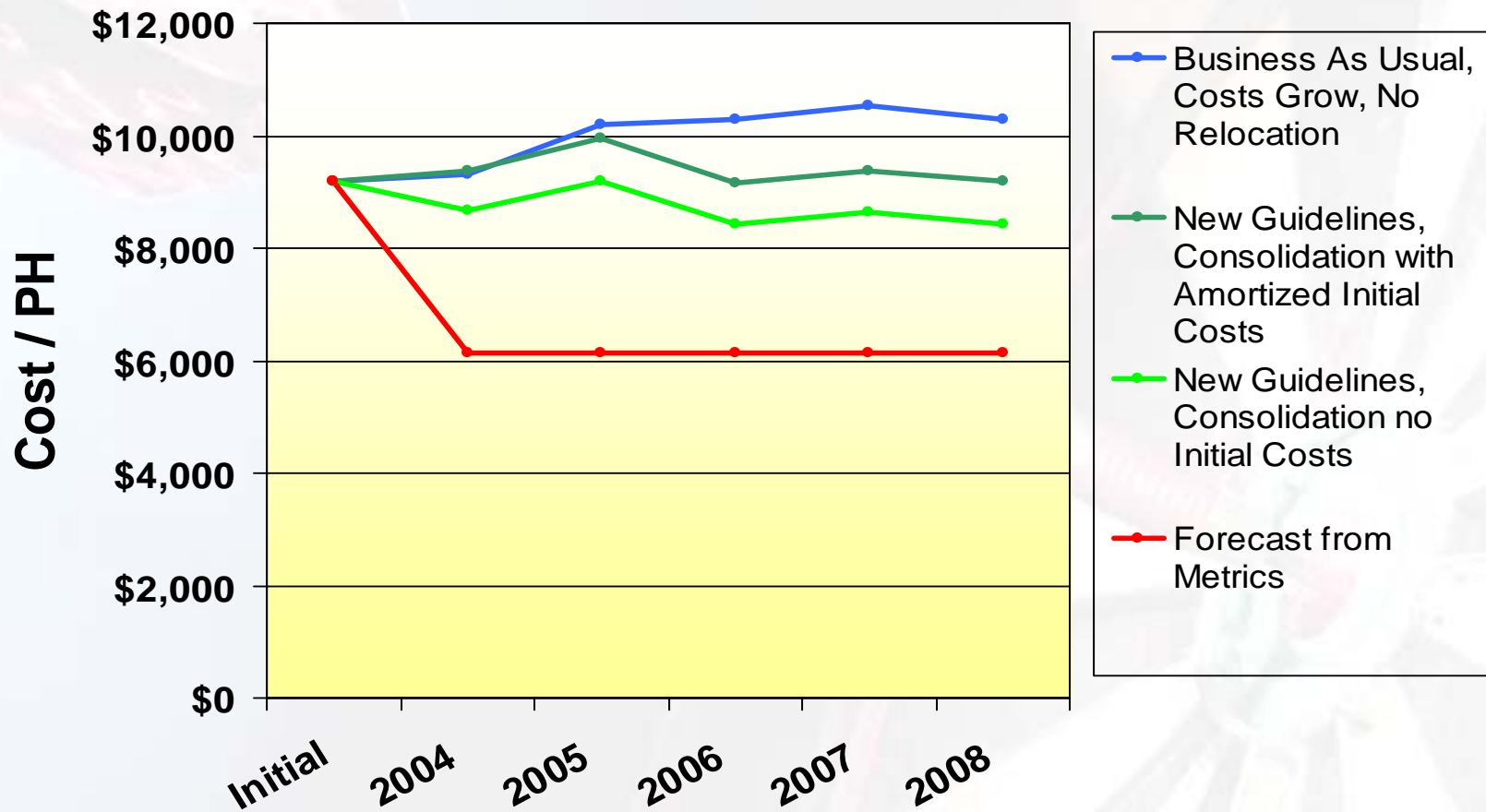
*New average sharing ratio –
from 1.35 PH / seat to 1.6 PH / seat
for more workers (15% to 18%)*

Problems with the metrics decomposition forecasting approach

- Seats / persons housed – can't dispose of excess space.
- Square feet / seat - costs of change, can't dispose of excess space, special use space / person unchanged.

Metrics and Bottoms-Up Forecasts

To forecast metrics, planners need a comprehensive bottoms-up model. With this model, new guidelines and consolidation reduce Cost per Persons Housed slightly compared to “Business As Usual,” but not by as much as predicted using the metrics decomposition as a forecasting tool.



Workshop Summary

Understand the business

- Don't focus just on costs
- No longer persistent pursuers of the right headcount numbers - what might happen?

Set the organizational framework

Set and support policies and initiatives

- Workplace strategies to increase productivity and flexibility
- Are we buying too much flexibility, but can we take the risk?
- Portfolio visualization - use data to identify opportunities

Coordinate “fungible” requirements

- Clusters provide risk management – “fewer rooftops”
- Consider all costs – RE, capital improvements, IT / Data, HR

Measure performance and demonstrate results

- CRE need to demonstrate value, but . . .
- Avoid metrics mistakes – vacancy targets, owned property costs
- Don't focus just on costs