

Procurement Category:
Facilities

The real estate hangover: Your Bloated Portfolio Is Dragging Down Your Business

A large blue chevron graphic pointing to the right, containing the text "High performance. Delivered."

High performance. Delivered.

The Real Estate Hangover

Real estate is a critical asset for every organization, representing not only the physical space where work is produced, but also a representation of culture and the location where customers interact firsthand with the brand. As a result, the quality of corporate real estate impacts productivity, brand perception and employee morale. Yet, it is surprising to note that most organizations are encumbered with too much real estate, often of the wrong quality to support modern work styles and brand perception. The average firm has 30 to 50 percent more real estate than it needs and this excess creates a substantial drag on financial performance.



Doesn't sound like your organization? It may not feel like your firm is carrying too much real estate, but the industry aggregate numbers suggest it is a good bet that your real estate portfolio has excess fat to trim. The situation is still more dire than that: beyond the capital tied up in assets and lease commitments are the ongoing operating costs to support these bloated real estate portfolios. For every \$100 million in real estate expenditures, ongoing operating costs account for \$40 million annually. The oversized corporate real estate footprint, combined with poor management of existing assets, is a significant area of waste and a drag on corporate performance. To summarize:

Too much real estate: Companies have too much space—as much as 30 to 50 percent excess.

Usage is outdated: With changes in how work is performed (mobility, hoteling, etc.), existing space is utilized inefficiently.

Poor management: Real estate is traditionally managed in local silos rather than with a comprehensive, big-picture approach.

Few firms have performed a truly strategic analysis of their real estate portfolio and most have little visibility to the amount of waste—and the substantial potential pay-off—from right-sizing their portfolio. Research shows that in a typical working day, corporate employees use an average of only 35 percent of office space (DEGW Time Utilization Study, 2010–2011). This underutilization of space, combined

with the overhang from the bloated real estate portfolio, highlight the first major opportunity: shedding unneeded real estate and yielding immediate cash flow benefits from the asset sales. In addition to the one-time cash benefits from the sales, the release of unneeded real estate delivers ongoing benefits by eliminating \$40 of ongoing annual operating costs for every \$100 of real estate.

The second opportunity is to optimize the operation of the remaining portfolio by centralizing a firm's real estate management capabilities. Today, most firms manage real estate in a highly transactional, decentralized way, leaving local managers to manage properties individually with little visibility to the overall portfolio and service providers. Typical symptoms of fragmented, sub-optimized real estate management include a lack of centralized cost control, unleveraged supplier capabilities, and poor or incomplete benchmarks to understand if costs ranging from security to maintenance to janitorial services are optimal.

The resulting real estate hangover, however, is correctable. The first step is analyzing and right-sizing the real estate portfolio to support corporate strategy and employee work styles; and second, taking a comprehensive, strategic approach to optimizing ongoing real estate services management by combining the economies of capabilities between suppliers and operations. Addressing these two major areas can help mitigate a major area of corporate waste and drive significant financial benefit.

Too much real estate and outdated usage—how did we get here?

Broadly, there are several factors pushing down the demand for physical workspace per employee and leading to waste. Older work paradigms no longer make sense in many cases, as work has become more mobile, technology-enabled and collaborative.

Mobility: Work is increasingly performed outside of the traditional office—70 percent of office workers work from alternative locations on a regular basis with 22 percent visiting the office only once a week.

Collaboration: Firms from Silicon Valley start-ups to more traditional organizations are exploring new workspace designs that foster collaboration between employees resulting in fewer traditional offices, more open, reconfigurable work spaces, and higher-density work environments.

Space efficiency: At the same time, many firms are taking a leadership role in leveraging new workspace models, such as hoteling for highly mobile workforces and reconfigurable space. This trend of doing more with less also contributes to the decrease in demand for space per worker.

The result: space allocation per worker has continued to trend down over time.

Other factors beyond the secular decrease in demand for space are also at play in creating the real estate hangover conditions:

Mergers and acquisitions (M&A): Mergers, acquisitions and divestitures are a normal part of the business cycle. However, because few firms take a strategic portfolio approach to managing their real estate footprints, decisions to consolidate redundant locations often fall to local and regional managers who may be more motivated by individual employee preference than by the global portfolio impact.

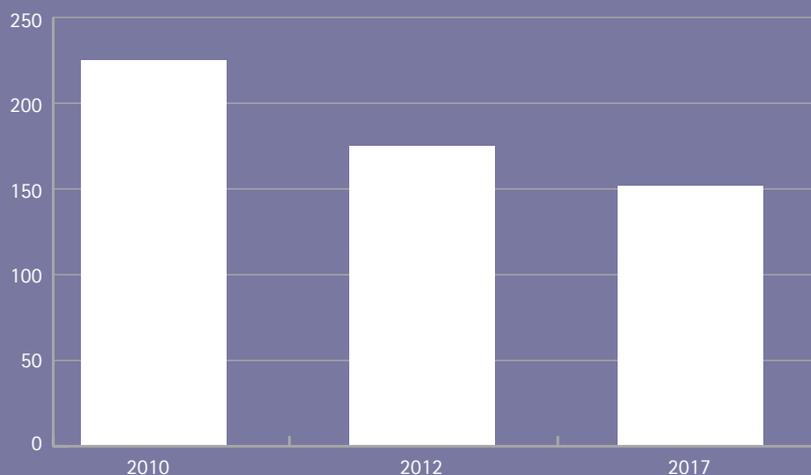
Idled/mothballed facilities: Production capacity and headcount can be more easily relocated than physical assets, but most firms are hesitant to immediately close or downsize square footage, preferring to mothball capacity in order to save it for a rainy day if that capacity or that headcount returns. What might seem like a prudent, short-term decision

is often overwhelmed in the longer term by the impact of the ongoing operating and maintenance costs, which could easily eclipse the total cost of selling unneeded assets at the time that they become underutilized and purchasing new space when needed (often with better capabilities, etc.).

Business cycle volatility: The "Great Recession" serves as one example that illustrates how violently business and economic cycles can alter demand, impacting corporate headcount and capacity in turn. While employee headcount rises and falls with the ebbs and flows of the business cycle, real estate is much less fungible and flexible, and psychologically, shedding real estate seems more "permanent." For these reasons, despite business cycle volatility, total space on corporate books tends to go in one direction—up—contributing to general over-supply.

Declining demand for space, along with corporate business cycle and restructuring activity, have converged to create the over-supply and mismatch between existing real estate portfolios and space needs.

Space Allocation per worker Trending Down



■ Sq Ft/worker

Source: NAIOP

Poor management: How old approaches to real estate hurt your company



The current approach to managing real estate is broken. Corporate Real Estate (CRE) professionals are not motivated properly, and there is a lack of a portfolio approach to managing real assets at most companies. The symptoms also hint at the solution: more coordination would result in less waste.

Consider the traditional transaction-driven CRE professional. When given a mandate like “we need to secure 20,000 square feet of class B office space in Memphis, Tennessee,” the first thing a traditional CRE professional will do is to concentrate on executing the project as a single transaction. Traditionally, the mentality for most professionals in corporate real estate has been to focus primarily on acquisitions and deal making rather than on long-term portfolio management.

The lack of a longitudinal and strategic portfolio management orientation at most companies is understandable given the dearth of management tools and processes made available to CRE professionals in the past. However, as companies start to realize the potential in leveraging their portfolio of assets, management of acquisition, utilization and disposal of assets has become a much more important competency. Especially in challenging economic periods when companies may need cash injections into the business, asset releases from corporate books can be a boon to the cash flow needs of the CFO. A better planned, cost-controlled and coordinated property portfolio with a clear strategic plan needs

to be in place to provide the business with cash flow and ensure the ongoing use of corporate real estate is not disrupted.

In the absence of a centralized portfolio management orientation, lease management and associated service decisions are left to local/regional managers and/or lower-level staff. This often results in sub-optimal decisions that lead to higher ongoing operating costs. It is not uncommon that such companies lack visibility to the true costs of excess real estate or a view of their global real estate portfolio utilization. Without global visibility, the corollary also holds—it is nearly impossible to visualize and quantify the potential savings opportunity from real estate portfolio optimization and centralization of related services.

Visibility is only one aspect of optimizing related facilities services. Visibility allows organizations to quantify spend in various categories and begin to get a sense of the potential to capture economies of scale in certain spend areas. But to truly capture maximum savings potential requires deep supply market intelligence, at both a national and local market scale, to achieve the optimal mix of the most competitive prices at the highest possible service levels.

Traditional Model	Optimal Model
Transaction-driven	Strategic planning/portfolio management approach
Focus on transaction-specific metrics (i.e., purchase price per square foot.)	Total cost of ownership orientation (property costs plus ongoing operating cost, applying benchmarks and market intelligence)
Long cycle times tolerated	Focus on strategic plan—and plan for rapid execution
Facilities services specifications dictated by activity-based metrics that may be sub-optimal (i.e., vacuum floor every other day using specified equipment and specified number of passes versus service-level based agreements)	Outcome-based, key performance indicator-driven supplier agreements with incentives for joint process improvement
Over-focus on detailed hourly rates and fees	Manage overall space as the number one cost driver, then determine the optimal service portfolio based on per square foot service level requirements

Source: Accenture

Three steps to getting real estate back under control

Getting real estate back under control is a challenge not for the faint of heart, but the potential financial benefits, not to mention the impact on employee productivity, morale and brand perception, are substantial. Following are three major steps you can take to recapture control of your assets and relieve the real estate hangover.

Strategic re-alignment—commit to a comprehensive real estate management approach. To be successful, organizations need to confront important questions about workplace and facilities strategy. This starts with a comprehensive review of the demand for space. “Do we need the space at all?” is the first question for the organization to confront. This discussion should be coupled with defining or refining the corporate position on work style, planned workforce requirements, the role of mobility, and ultimately workplace density and configuration. Depending on the outcome of this strategic exercise, challenging traditional paradigms of demand for space can result in a new footprint that delivers enhanced collaboration and improved workspace environments, while also resulting in as much as a 40 percent reduction from typical space footprints. To challenge the demand, however, organizations need to build a central database that captures all leases and facility services contracts in order to bring real estate-related spend within the scope of professional management. This enables central visibility of the portfolio in scope and its cost control in conjunction with the business demand for use of space.

Once overall space demand is clearly defined, it is imperative to mandate and incentivize corporate real estate teams to partner hand-in-hand with procurement and operations. By encouraging CREs to take a more strategic, long-term view of portfolio planning and utilization, procurement teams can create better policies and strategic plans to support the sourcing of property service and management supply chains to leverage economies of scale between CRE teams and suppliers.

Force multiplier: De-fragging the real estate portfolio. Driving savings on facilities services contracts can yield savings of 10 to 20 percent on existing spend. But the real force multiplier is in reducing the total footprint and completely eliminating recurring cost streams. Recall that for every \$100 million in real estate expenditures ongoing operating costs amount to \$40 million annually. Not only do organizations net upfront cash benefits from disposing of assets, but they eliminate recurring cost streams as well. Consolidating multiple locations in one city or region or deploying policies to enable flexible working reduces square footage while also resulting in workforce benefits like increased morale, enhanced collaboration, better work-life balance and improved productivity.

Optimize facilities management. Part of the reason that organizations overpay for facilities services is that management of services contracts is frequently left up to local office managers or even administrative staff. This includes everything from janitorial services to waste management to security and even lease management. Because these contracts are often handled in local silos, there is no global visibility to services contracts, and often no visibility to important items like leases and the terms they contain.

Common mistakes that result from this approach include one-off deals, leases that do not support planned future corporate changes or activities, etc.

The first step to improve facilities management is to start with service specification. This means looking at specifications in terms of outcome-based metrics rather than prescribing exactly how a service should be performed. Focusing on outcomes and service levels allows for more supplier innovation and incorporation of supplier best practices rather than suppliers working inefficiently to fulfill service requirements.



Re-engineering specifications

- Output based
- Quality metrics
- Supplier developed innovation
- Benchmarked to the best
- 10 to 15 percent savings

Enterprise contracts with suppliers

- Compatible terms and conditions
- Proper performance risk transfer
- Challenge fixed and variable costs
- Annual improvement factors
- 10 to 20 percent savings

Control demand – forecast

- Challenge reactive spend
- Ensure proven benefit
- Leverage across sites
- Risk based maintenance
- 10 to 20 percent savings

Enterprise capabilities

- Introduce open book costing
- Monitor and track delivery
- Increase spend visibility
- Market Intelligence application
- 5 to 15 percent savings

Source: Accenture

The second opportunity is to consider enterprise-wide contracts with standard terms and conditions as a targeted outcome. This makes the most of a company's scale while limiting risk.

Third, manage demand for services by challenging reactive spend, and for remaining planned spend, ensure there is a real operating purpose or business case behind each service performed.

Finally, build increased visibility and monitoring so that facilities spend can be measured against compliance, supplier performance and outcomes. The organization can also drive out waste through supplier invoice management and transparency in charges. Bringing services contracts under centralized professional management allows for standardization of terms and the ability to implement standard practices.

Conclusion

Corporate real estate is a critical, but often poorly managed asset for most companies. Whether your firm is being negatively affected by an oversupply of physical space, or managing existing facilities in a sub-optimal way, tackling the real estate hangover will drive substantial short and long-term financial benefits for your organization while also having a positive impact on efficiency, productivity, morale and brand perception.

Sources:

DEGW Report: The Impact of Change, retrieved from <http://www.europlan.co.nz/documents/DEGW%20Report%20on%20Workplace%20Change.pdf>

About Accenture

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