# CORPORATE REAL ESTATE MANAGEMENT PRACTICE: CONTRASTS BETWEEN FINANCIAL AND SERVICE PROVISION PRIORITIES IN CORPORATE AND GOVERNEMENT ORGANISATIONS

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The adoption of strategic Corporate Real Estate (CRE) management has changed property's role in organisations. It is now seen as contributing to achieving the organisation's strategic goals rather than being a cost to the business. As part of an enquiry into competitive practices in the emergent field of Australian Corporate Real Estate (CRE) management, two focus groups were held to investigate practices and opinions and to identify current and future issues in strategic CRE management. Corporate organisations provided participants for the first group and local government organisations predominated in the other. Each group emphasised different aspects of strategic CRE management. The financial benefit from a corporation's property is contrasted with the service provision benefit derived from government property. Both organisation types employed a variety of methods to finance their property requirements. These conclusions have implications for service providers and property developers, as they provide insight into the procurement decision processes of client organisations.

Keywords: corporate real estate, local government, property, service delivery, strategic management.

## INTRODUCTION

Financial issues and the role of real estate as an investment have typically dominated research into property. In recent years, however, property has come to be seen as a facilitator of an organisation's operations. In line with this new role increasing attention has been given to the management of property.

Corporate Real Estate (CRE) management refers to the management of property that is incidentally held, owned, or leased by an organization to support its corporate mission (Rondeau 1992, 1; Bon *et al.* 1998, p209; Brown and Rhodes 1993). As such the primary value of CRE to the organisation is not its investment value but rather its contribution to business operations. Management techniques to derive operational benefits from property include site selection, facility design, and space utilisation (Manning and Roulac 1999, 268).

An awareness of the value of property to support business operations dates from the early 1980s. Zeckhauser and Silverman (1983) identified that between 25% and 41% of corporate assets are real estate. Subsequent research (Veale 1989) showed that property occupancy costs make up 10-20% of operating expenses, or 41-50% of net

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operating income. Since the early 1980s much research has been carried out in Europe (predominantly the UK) and North America (predominantly the USA). The European studies include an ongoing comparative study of European and North American CRE practices and attitudes to CRE management (Bon 1996; Bon and Luck 199); Bon and Luck 1999), management tools (Lopes 1996), the value of CRE management (Krumm et al. 1998), and flexibility in property suppliers meeting changing corporate requirements (Gibson and Lizieri 1999). In the USA, significant studies include managing real estate to provide value (Apgar IV 1995), benchmarking performance (Noha 1993), outsourcing (Bergsmann 1994; Manning and Roulac 1997). In a recent article, Manning and Roulac, (1999) document and summarise the status of CRE research, particularly that carried out in the USA. Carn *et al.*(1999) have recently used a Delphi research method to examine current and future issues in CRE management from a corporate organisational and operational perspective.

The strategic implications of CRE were identified as early as 1986 (Roulac 1986) but it was only from the beginning of 1990s that they gained recognition alongside other pragmatic management concerns (Joroff *et al.* 1993; Nourse and Roulac 1993; Duckworth 1992; Weatherhead 1997). Because the strategic implications of CRE have only received significant attention in the last decade, it may be described as an emergent field of research.

Interest in CRE research has also increased in Australasia in recent years (Teoh 1993; Adendorff and Nkado 1996; McDonagh 1999). In Australia, this inrest has been driven by domestic demand for attention to be given to the needs of CRE in organisations. (Evidence of this is the Victorian Department of Infrastructure together with the Property Council of Australia (Victoria) and Australia Post providing funds supporting a collaborative research project in conjunction with the Australian Research Council (ARC) exploring issues in Australian Corporate Real Estate).

## AIM

This study explores current attitudes and beliefs about CRE management in Victorian based organisations to investigate the relevance of issues identified in international CRE research to the Australian context. Understanding attitudes of key property managers to financial and business management, as well as their more familiar property management domain, is an important step in understanding the role of the CRE unit in the organisation.

This paper examines how corporate and government organisations in the study differ in their priorities when managing the supply of property to meet their organisation's objectives (Another aspect of the study, the identification of the hybridisation of property and financial knowledge, was presented at the 6th Pacific Rim Real Estate Conference (Kenley *et al.* 2000).)

## METHOD

In order to understand the current attitudes and practices of industry leaders in CRE management, this study used a focus group process. Focus groups were selected as the research method because they yield qualitative, contextual data appropriate to the examination of complex issues. The groups were a purposive sample drawn from CRE experts in Victorian based Australian organisations. Participants were familiar with strategic CRE management and were from organisations with substantial property portfolios.

Corporate organisations have traditionally been the focus of research into CRE and therefore made up one of the focus groups (corporates sector). However, government organisations also hold significant property portfolios, and thus a second group was assembled from Local and State government organisations (government sector). Table 1 summarises the sampling outcomes with regard to organisational type and participant numbers.

Table 1

| Sector | Approached | Agreed to participate | Participated |
|---|---|---|---|
| Corporates | 15 | 8 | 6 |
| Government (Local and State) | 16 | 7 | 4 |

While the recommended number of focus groups is between 3 and 5 and the recommended number of participants ranges between 6 and 12, fewer groups are acceptable where there is a limited diversity of opinion and smaller groups are very suitable where the participants are experts in the topic being examined (Morgan 1998, 71-7) -A parallel study carried out by the CREAM research group at the University of Melbourne compared the international and Australian take-up of CRE practices. That study identified that the pool of available CRE experts in the potential sample population was not extensive.

Prior to conducting the focus groups a structured guide was prepared that included trigger statements to prompt discussion. The trigger statements were organised in the following topic areas:

- Making CRE more strategic
- Organisation of CRE within the firm
- Performance measurement
- Financing CRE
- View of CRE within the firm
- CRE decision processes
- Skills needed by CRE managers in the future

During the sessions a further question was put to the groups examining

- Governance within the organisation and the relationship to CRE.

**Data capture**

The groups were recorded with 2 omni-directional mikes recording onto a 2-track digital tape via a mixing deck. The digital recordings had their signal strength adjusted and background noise masked prior to being transferred to analogue audiocassettes.

Transcripts were prepared from the cassette tapes, checked to ensure fidelity of transcription and revisions made to match the transcripts with the audio recording.

**Analysis**

Based on guidelines recommended for focus groups (Krueger 1998) it was decided to analyse the focus groups' transcripts using qualitative analysis coding techniques.

Initially a categorisation process was used to identify the transcripts' broad conceptual themes (Miles and Huberman 1994, 55-69; Burns 1997, 339-342). The categories were developed from the trigger statement topic areas and the titles of groupings of CRE practices from other research into CRE practices. These categories were assigned master codes with sub-codes related to specific topics grouped under the master codes. The sub-codes were developed from the trigger statements and the practices from the research into CRE practices. The categories and codes were manually applied to the transcripts of both groups.

**Discussion**

The analysis identified many issues in Australian CRE practice. Some were raised in both focus groups and may be considered generally relevant. Others were raised in only one focus group. While specific to a particular organisation type (corporate or government) they collectively enlarge our understanding of the issues.

The most significant outcome from the focus group process was that government and corporate organisations have differing priorities when it comes to managing their CRE in line with their diverging strategic outlooks. Corporates emphasised the necessity for CRE to contribute to the organisation's financial outcomes, while the government sector group was more concerned with benefit to the local community through service delivery. That corporate and government organisations would emphasise different aspects of CRE management is not surprising, but specifically how did the focus group participants identify their differences with regard to financial and service provision priorities?

**Corporate organisations**

Corporate organisations recognised that their corporate property was the physical place where the organisation created its wealth. This emphasises the importance of property to corporate organisation's financial activities. The corporate focus group recognised property as strategically important by acknowledging property's significant worth to the organisation through influencing the organisation's ability to delivery its business aims.

The strategic management of property was identified as requiring the coordination of business and property strategies by the corporate group. Achieving this requires consideration of 3 distinct and dynamic aspects:

- That property assets are part of the organisation's capital and therefore compete with other assets for capital finance;
- Property financial criteria, consisting of the financial methods available to provide property and property considered for its investment value; and
- The customer interface through a retail outlet or some other means of providing service to customers.

Property is one of the capital needs of the organisation and must be measured against the returns on that capital in comparison to other capital investments. These other capital investments may, however, be closer to the organisation's core business than property and therefore be considered to have higher value to the organisation. The use of financial measures such as return on investment and internal organisational investment rates are part of the process of asset comparison.

Focus group participants identified that a comparison of the capital cost of a property asset and the general cost of organisational capital was often used as the basis of any decision to include the property asset on the balance sheet or not. Property capital on the balance sheet was also identified as being able, by way of providing security, to underpin borrowings for organisational core business.

The present, orthodox, view is that property assets do not belong on a corporation's balance sheet, as they are not core business. They also lock up large amounts of capital that would be better deployed in core activities. The focus groups challenged this orthodoxy. Rather, removing property assets was identified as short-term reactive thinking that was at odds with strategic approaches to corporate property. They suggested a strategic approach which emphasises how property provides benefit to the organisation through each of the 3 aspects identified above.

Assessment of a specific asset's strategic value to the organisation affects decisions about the manner of 'ownership', that is the method of gaining access to the operational benefit from the property. Corporates constrained by strategic requirements for specific properties and tight capital measures are examining non-traditional financing methods to gain access to the property. Traditional ownership and financing methods revolve around freehold and leasehold methods financed by corporate resources like cash flows, retained earnings or corporate equity and debt instruments. These typically invoke issues of the capital consequences of property. Because decisions about property expenditure are decisions about capital, property financing decisions are decisions about financing the organisation. Property as a 'real' asset with potential income streams allows a variety of property specific non-traditional financial and ownership methods. The corporate focus group identified several methods:

- Property trusts (listed and unlisted);
- Securitisation of income;
- Debt/equity risk and reward sharing;
- Build, Own, Operate, Transfer (Boot) schemes; and
- Recycling of existing property assets through development for new organisational uses or development for use by others, which are then on-sold.

Decisions about ownership methods are also decisions about asset tenure. Flexibility in tenure arrangements, to meet strategic ends, was identified by the corporate focus group as important. Organisations are changing their ownership methods from outright freehold to a variety of long and short-term lease arrangements and the various non-traditional methods identified above. For leases, exit strategies are now considered an important part of property tenure arrangements. The other financing methods considered, like 'Boot' schemes and securitisation, involve alternative ways of giving the organisation de-facto ownership of the real estate while sharing financial risks and rewards with the debt and equity providers.

A strategic approach to property also means that the customer interface is important in creating wealth for the organisation. The focus group participants identified that the selection of the right location and design for a customer interface, either a retail outlet or other form, contributes to the organisational strategic and financial outcomes. Strategic property management was more than just providing property at the cheapest cost.

**Government organisations**
Strategic management of corporate property in government organisations has arisen from the imposition of forces external to the organisation. In Victoria's case these forces have included municipal amalgamations, privatisation of government business units and government legislation requiring market testing of organisation's service delivery through mechanisms such as compulsory competitive tendering and now best value analysis.

Government organisations are also now using non-traditional property practices. However their strategic and operational environments are quite different from the corporates.

Government organisations identified that the return on property assets is the derivation of community benefit, rather than the creation of organisational wealth. This is not to say that financial measurements are not important. They were identified as a key corporate objective. However, service measures now stand alongside financial measures and are receiving more emphasis than in the past. These service measures were identified as having to fit with the organisation's objectives, which itself is a manifestation of a strategic approach to property management.

Strategic management of government property was identified as consisting of the following elements:

- Financial, or cost criteria;
- Community benefit, or service delivery from the asset; and
- Governance, including good management of the asset and accountable decision making incorporating balancing the first two elements.

In practice this has meant linking:

- Community and operational requirements;
- Availability of existing, or new, facilities; and
- Ongoing facility management.

These two linked groups of criteria gave rise to a hierarchy of strategic and surplus properties:

- Essential community properties;
- Essential operational properties;
- Surplus to strategic ends but investment valuable with good financial returns; and
- Surplus to strategic ends and under-performing on all measures.

The focus groups identified that good information presenting total, or true, costs of property holdings, was pivotal in strategic decision making about assets. Total costs of property included valuation and maintenance information. Without the clarity this information provided, any decision-making was susceptible to influences from both sectional interests within the organisation and from the wider political context. It was felt that providing good information and applying strategic management principles provided policy setters with the ability to make informed decisions in awareness of the consequences of the decisions.

An additional benefit of access to relevant information was that by identifying under performing assets the organisation's strategic aims could be furthered by finding more relevant uses. Greater utilisation may be achieved through development of the asset by third parties or by selling the asset. Either action would be conditional on provision of a stipulated community benefit by the developer, or subsequent owner.

It was identified that perceptions of existing community benefit derived from under-performing assets influenced policy makers' decision making about particular properties. Fears about perceived loss of those benefits, or loss of control of those benefits, affected the type of development finance mechanisms considered acceptable. Joint ventures with private developers were particularly noted as susceptible to perceptions that limited the use of this financial method to gain increased value from existing assets.

The government focus group identified a variety of methods of financing community beneficial property that they used or considered using. These included:

- Self-funding through revenue from asset;
- Internal organisational 'loans' to fund development with payback on completion from revenue;
- Private sector joint venturing through a developer funding a community benefit project in return for the development of the site to provide economic benefit to the developer (as discussed above); and
- Build, Own, Operate, Transfer (Boot) schemes.

In addition, several ways of deriving greater financial and community benefit from existing assets were identified. These include:

- Sales of surplus property assets with conditions attached of providing community benefit;
- Development of surplus assets, by others, with the process expedited by the government organisation through facilitating approvals;
- Sale of development rights, like air rights, with retention of ownership by the organisation; and
- Developers' contributions provided as part of development approvals which may be converted to a community service obligation rather than being provided in monetary form.

**Comparison of corporate and government groups**

The financial and service provision contrasts between corporate and government organisations can be summarised in tabular form as shown in Table 2:

It can be seen that some aspects are common or analogous. Others are quite at variance between organisational types. Presented in this manner the emphasis of corporates is clearly in the financial aspects. Government organisations emphasise service and accountability aspects.

**Table 2**: Comparison of Financial and service provision

| Corporates | Government |
|---|---|
| Property as capital | |
| Cost of capital | Cost of property |
| Property as an investment | |
| Property financial methods | Property financial methods |
| Customer interface | Service delivery |
| Retail or service provision | Community benefit |
| | Governance |
| | Accountable decisions |
| | Good asset management |

## CONCLUSION

This paper explores the current attitudes and practices of industry leaders in CRE management. Particular emphasis is given to contrasts in property management between corporate and government organisations and the implications for the wider property and construction community are identified.

The shift towards strategic management of property is changing the provision of property for organisational operational requirements. The common move towards strategic property management as a means of delivering the organisation’s business aims generates different responses from each organisation type.

For corporates, the financial imperative of wealth creation means that financial concerns predominate in strategic considerations. Capital on the balance sheet and return from other capital investments drive decisions about gaining access to the operational benefits from property. Strategic property management also incorporates customer aspects of property in building wealth for the organisation. Flexibility of ownership and tenure of occupation are also issues in property procurement as property is required to meet changing organisational strategic emphases.

Government organisations emphasise service delivery and community benefits in property procurement. These supplement more traditional financial aspects that focus on the cost of the property. Flexibility of tenure is less of an issue for these organisations. Provision of community benefit in increasing asset utilisation is more relevant.

The change to strategic management encourages the use of non-traditional methods of ownership, tenure and finance. Gibson and Lizieri (1999) identified the change and need for further change in the UK property supply side to meet organisational needs. This study identifies similar demands for non-traditional means of acquiring operational benefits from property from Australian organisations. These non-traditional arrangements are now under consideration by both corporate and government organisations. For suppliers of property and property related services to organisations, awareness of the change to strategic property management is the basis of understanding organisation’s property procurement decisions.

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