

Cost-saving opportunities for corporate real estate executives

Jones Lang LaSalle hosts an ongoing series of forums and webcasts for corporate real estate (CRE) executives. In one such forum, a multi-disciplinary panel of Jones Lang LaSalle experts tackled the top-of-mind issue facing CRE professionals in 2008: finding real estate strategies and solutions to address the challenges of a continuously slowing and sagging economy.

The forum was moderated by Richard McBlaine, President, Strategic Consulting for Jones Lang LaSalle. The four-member expert panel included: Ed Noha, Portfolio Strategy Practice Leader; Debra Moritz, Workplace Strategy Practice Leader; Mindy Berman, Managing Director, Corporate Capital Markets; and Tom McCarty, Six Sigma Practice Leader.

This paper captures the information and insights presented.

Introduction

The general economy has been in a wait-and-see mode since mid-2007 with continued troubling indicators. But wait-and-see is no longer an acceptable strategy in most industries. CRE executives now need to meet specific cost reduction targets, and positively affect the balance sheet through cash generation.

Real estate represents a valuable source of funds to generate cash and to help restore equity capital to the balance sheet and earnings to the income statement. Corporate real estate is truly a captive opportunity that achieves desired capital results without diluting shareholder equity.

Unlike the downturn of 2001/2002, the real estate function is better equipped today to respond productively to challenging times because the tools to manage the portfolio and create financial solutions have become more sophisticated and achievable. As a result, we believe that there is an opportunity for CRE executives to step up to the plate and create tremendous value. The key at the individual level is to assume a proactive stance and take strategic action to deliver measurable impact in the very near term.

Financial strategies

Financial solutions—calculated measures for transactions and other financing strategies—can drive down operating costs and immediately generate meaningful amounts of cash to help bolster the balance sheet. Fortunately, most of these solutions have nothing to do with shifts in occupancy or operational changes that can require substantial evaluation and lead time. Financial solutions focus on addressing the true impact of the economy.

CRE financial opportunities can generally be categorized as:

- Sales of assets through sale-leasebacks, dispositions and redevelopment based upon a clear understanding of core and non-core assets and identification of surplus property.
- Opportunistic restructuring of existing leases, taking advantage of market conditions and specific lease arrangements.

Sale-leasebacks

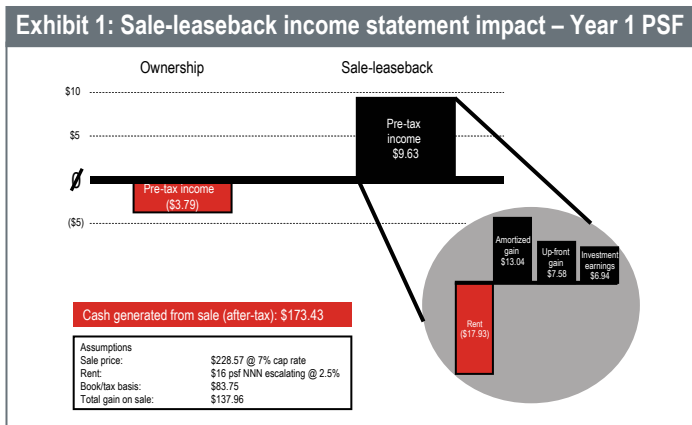
This category has the greatest opportunity for near-term impact and can accomplish a variety of objectives:

- Monetize non-earning assets—right now.
- Generate precious cash that can immediately increase shareholder equity or reduce borrowing.
- Generate gains on sale for assets that have appreciated in value. Commercial real estate, for example, has grown in value by 60 percent nationwide since 2002, and substantially more in key metropolitan markets such as New York, San Francisco, and Boston. A company's owned real estate is a treasure trove that can be used in 2008 to increase the capital base and extract one-time gains. Despite widespread expectations about across-the-board price declines of roughly 10 percent in 2008, companies still have sizeable gains to realize.
- Drive down occupancy expense, especially when there has been substantial appreciation. While the company will start paying rent on a cash basis, for book purposes, rent will be offset by the gain on sale that's amortized over the lease term.

Exhibit 1 shows an example of the power of this earnings benefit from a fairly typical sale-leaseback for an asset that has been held 10 years on the balance sheet while there's been a run up in real estate values.

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It identifies the components of the earnings benefit. By doing a sale-leaseback, the property converts from an expense drag due to depreciation to an earnings generator.



If a company occupies less than the entire premises, operating expenses can be even more greatly reduced through a sale and leaseback of the portion of the premises the company wants to retain for its own use. Such a sale will result in lower overall rent expense, and the company will no longer bear the operating costs of space it doesn't use. Companies can usually structure sale-leasebacks with flexibility for future occupancy based on the length of lease term and expansion and contraction rights. Similarly, sale-leasebacks can give the company long-term control through structured renewal options, while eliminating future real estate market exposure and allowing for exit flexibility.

Dispositions and "exit/sale-leasebacks"

This category enables the company to shed surplus assets while maximizing exit value. Assuming the company has surplus properties—perhaps from rationalization of locations or back office assets obtained through acquisitions—or properties that will become surplus due to portfolio reconfiguration, the sale of assets accomplish

most of the same results as a sale-leaseback. Most importantly, it cuts occupancy expense, in some cases where vacant property was being carried, and generates cash and book gains for the institution.

An exit/sale-leaseback entails selling a property asset in anticipation of vacancy, but with a short-term leaseback that allows the company to occupy it for a time. This strategy increases the sale price by giving a buyer or investor time to reposition or re-tenant the property while enjoying the cash flow from the company's rent to carry the property during this period. In addition to the higher price, the company can recognize a substantial portion, if not all, of its book gain upon the sale of it. This action can contribute to earnings in 2008, generating cash today without creating a future liability.

Lease restructuring

This opportunity takes space the company occupies, but does not own, and re-engineers the lease obligations to result in lower operating costs. Lease restructuring is focused on taking advantage of unique, property-specific situations. This means combing proactively through the portfolio of leased assets and searching for certain key indicators in major space leases such as:

- Short remaining lease terms
- Above-market rents
- Purchase options

Examples of lease restructuring solutions include:

- "Extend and blend" leases with above-market rents, creating a new lease for accounting purposes and lowering the reported rent over the remainder of the original lease term.
- Buy-down the rent today by making a payment to the landlord for the difference between the stated rent and market price. This would work if the company can absorb a loss today in exchange for future rent relief.
- A fixed purchase option, if one exists and is "in" or at the money, can be used to execute a sale-leaseback or as leverage for renegotiating more favorable lease terms.
- Short remaining lease terms, and/or situations where the landlord has put the asset on the market, can enable the company to acquire the property at a price near the investor value, enter into a long-term lease, and then sell the asset subject to the new lease, extracting value from the property. The company can then capture that value through a sale-leaseback at a price greater than the original acquisition cost. This explains the somewhat complex name: acquisition/sale-leaseback.

- Lease buyouts or restructurings for partially occupied or vacant space can reduce current rent requirement and/or book rent expense if the company can absorb losses.

In all of these examples, if the company has the tolerance to approach financial engineering on a portfolio basis, generating gains to offset losses can clear the way for far lower operating expense in the future.

The take-away lesson is that companies can harvest considerable value from their owned and leased portfolio. It requires creative, tailored solutions and dedicating significant resources, including technical tax, accounting, and legal, to identify and evaluate the opportunities in order to structure and manage the execution.

Portfolio Strategies

Jones Lang LaSalle has identified five pillars that serve as the foundation for creating results-focused real estate strategies and real competitive advantage:

1. The technology and systems required to produce accurate and timely portfolio data, without which, strategy is impossible
2. An effective CRE organization that can connect to the business and focus its resources on sound strategy creation
3. Governance that empowers and drives effective decision making
4. Real estate metrics and dashboards that connect to business objectives and drive performance
5. High-quality, consistent execution across the portfolio, especially in occupancy planning.

If real estate professionals can put these five pillars in place, they can make sound decisions based on great data, feed up-to-the-minute business intelligence to the strategic planning function, and help manage the existing portfolio to meet changing business needs.

That's the ideal. In reality, laying this foundation and making it work present major challenges, especially given that business can always move faster than real estate. Nonetheless, this foundation is critical to meeting the "Ask" of the business, which in the current economic environment means cost reduction. Here are three ideas for getting to a workable portfolio-based cost reduction strategy.

Build the pillars that create cost savings opportunities. ASAP.

First, if you haven't done so already, do whatever it takes to get your data in order—the cost, condition, occupancy, vacancy, exit and expansion options for the owned and leased assets in your portfolio. Accurate decision-making information is absolutely critical to identifying and realizing cost savings in the current environment. Ensure that your data are of the highest quality and as current as possible, data you can stand behind and act on with confidence.

Next, focus on governance and decision making. Identify the sacred cows, the inefficiencies and unnecessary costs that you've known about for years, develop alternatives to them (with estimated savings) and bring them to the table. You may never have a better opportunity than now to make the changes you've always known you should.

What sacred cows? The dedicated offices for executives at every facility they visit. Cost allocation methodologies that create no incentive to free up vacant space. Decision-making processes that consistently result in your company losing out on prime opportunities. Business units that still find a way to execute their own deals or create their own space standards. Service levels that are far higher than industry standard. None should be sacred in times like these.

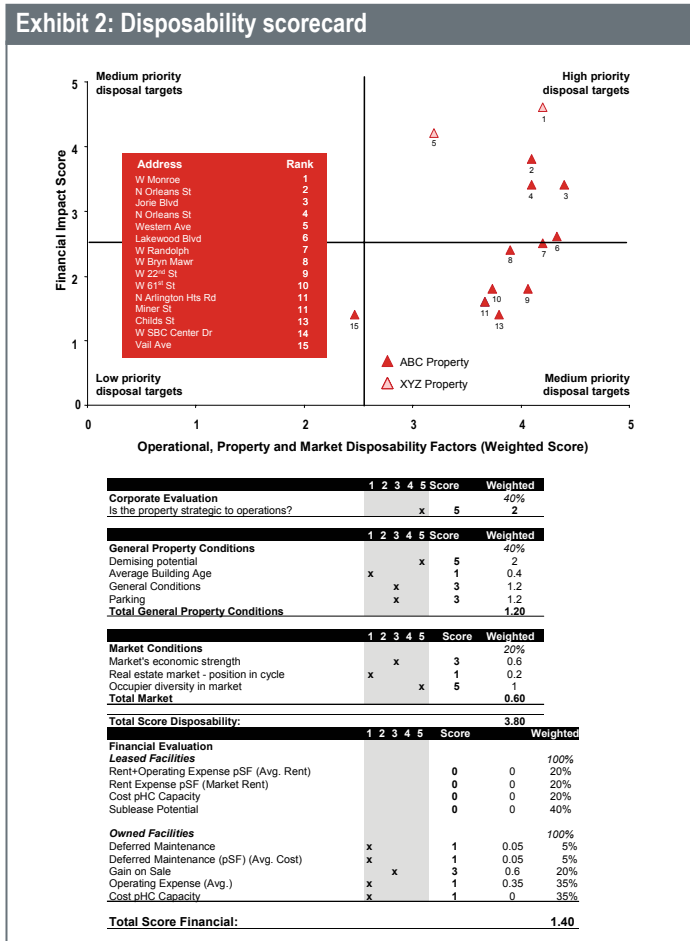
Anticipate business direction and mine data for relevant opportunities

Even if you don't have direct access to information about precisely where the business is heading, you can begin to identify likely business scenarios and plan corresponding real estate responses. For example, if downsizing appears likely, anticipate which business units it will affect most and address the relevant portfolios first. After that, you can examine the remainder for more holistic opportunities.

Using the current, accurate database you've created, screen it for opportunities to:

- Dispose of vacant buildings
- Renegotiate leases, taking advantage of real estate markets to blend and extend
- Consolidate offices
- Reconfigure space for greater efficiency
- Consolidate vacant space for disposition of the most marketable space
- Consolidate like functions across geographies

To find such opportunities, you can adapt or develop screening tools such as the disposability scorecard shown in Exhibit 2. This example plots “financial impact” against “operational, property, and market disposability factors” to assign a disposal priority to each property.



In this way you can evaluate all your options at the same time and set strategic priorities with greater confidence.

Use location strategies to save real dollars

The third area of portfolio strategies relates to labor-based savings. Whether you're looking to attract and retain labor in a growth mode or scouting for optimal labor markets in a downsizing mode, evaluating labor demographics and matching them to business needs can create a huge opportunity for cost savings.

Offshore vs domestic

Offshoring as a location strategy is an obvious choice, but difficult to execute in the very near term—2008 timeframe—unless your company already has significant offshore operations. However, finding the optimal domestic labor markets for specific functional areas—inbound call center, for example—and then consolidating those functions in the best markets might be realistic for 2008. Here's a case where vacant

or underutilized space in the portfolio might enable a faster solution. This is where a close relationship with the HR and IT experts can prove especially valuable.

Contractors vs employees

Another opportunity, especially for companies that have grown up in some of the larger Midwestern cities, relates to contractors. Over time, because many such companies have had trouble attracting labor, their number of contractors has grown dramatically compared to their own employees. Assuming contractors cost more—often twice as much in fact—CRE executives that can identify more favorable labor markets may realize big savings by enabling the business to replace contractors with employees.

Negotiated incentives

As another component of location strategy, think of every transaction in an existing or new market as eligible for economic incentives. At Jones Lang LaSalle, we continuously surprise—and delight—our clients by unearthing incentives, when none were anticipated. But make sure the incentives are collected. Many companies do not track the economic incentives they previously negotiated and consequently do not file for the benefits. CRE executives should partner with the business to track any and all negotiated incentives to ensure that the appropriate documentation is completed and filed.

Workplace Strategies

Many CRE executives have tried to introduce workplace strategy in the past only to have it rejected or sidelined by business unit leaders or middle managers who were less than comfortable with a “new concept.” The current environment, however, has created a burning platform and the opportunity to introduce and implement ideas that may have seemed too bold not that long ago.

A different way of working demands a different place to work

A very brief look backward provides some context for workplace strategies today. Although many of the good ideas in the last downturn in 2001 still apply today, the world of work has changed significantly in just the past few years :

- Blackberries and laptops were the exception; now they're the rule.
- The idea that business could be done on the internet was a novelty; today, most of our tools and process are web-enabled.
- We once worried about data security in wireless offices; today it's a non-issue.
- Meetings were face-to-face; now, we're accustomed to meetings where some if not most participants phone in. And, except for the occasional technology glitch, it works!

These are notable changes, of course, but a larger, more pervasive transformation has occurred during the same period as shown in Exhibit 3.

Exhibit 3: Work evolution	
Work in the past:	Work today:
Individual	Collaborative
Scheduled	Spontaneous
Information silos	Distributed networks
Paper based	Electronic
Face-to-face	Virtual
Centralized Systems	Highly mobile IT
Single location	Variety of locations
Fixed schedule	Flexible schedule

Source: US General Services Administration; March 2006

It's likely that many companies may be leveraging the work approaches highlighted in the right hand column without having done much in terms of space and support services to accommodate this evolved way of working.

Today's office work is highly collaborative, workers are highly mobile, and electronic solutions are the norm. Yet many workers still occupy space designed for the work styles of ten to twenty years ago. Alternative solutions not only have the potential to yield near-term cost savings, but also can lay a strong foundation for longer-term solutions more aligned with the way people work naturally.

Why your workers work where they do

Whether it's a relocation, a lease renewal, accommodating growth, or a refresh of owned space, every workplace solution must take the mobility of today's workforce into account. That said, there are basically three modes of introducing workplace solutions into an organization: business unit led, associate choice, and portfolio optimization.

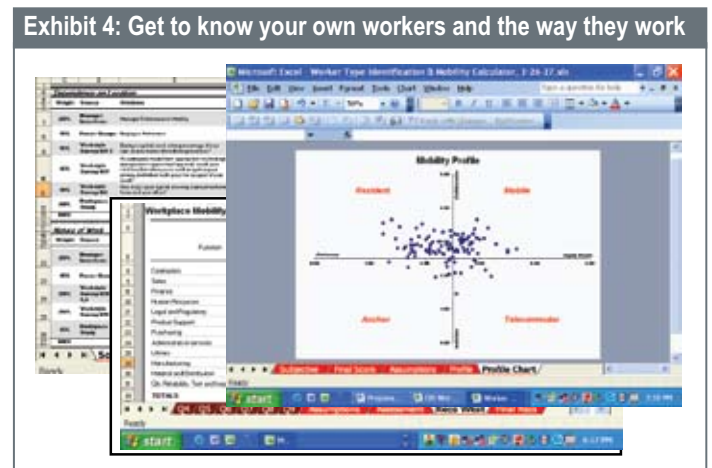
The first two—business unit led and associate choice, don't necessarily contribute to cost reduction. In fact, overall costs may increase because of dedicated workstations for every employee and other amenities such as privacy rooms and casual meeting areas. Home-based solutions and investing in mobility toolkits can also increase operational cost.

Often, companies with a business unit led solution do such a good job of selling the benefits of employee attraction and work/life balance that such benefits become the only rationale for workplace strategy. Similarly, where the overriding focus is on associate choice, employees decide if they want to participate in a flexible work program. It's a non-threatening approach to a shared workplace solution that lowers resistance to change and shortens the implementation cycle. It can also result in increased productivity and employee satisfaction. The downside? It costs more unless it is tied strongly to portfolio optimization.

In some recent engagements with companies like Motorola and HSBC, Jones Lang LaSalle has delivered double-digit space efficiency gains, which translate to reduced costs, by engraining mobility solutions into standard processes. Every factor—growth requirements, business spin offs, contractors requiring space—triggers this process to evaluate the types of jobs involved, what work set-ups are feasible, and ultimately arrive at the optimal solution for reducing or redeploying occupancy expenses.

How your workers work

In most organizations, there is a mismatch between worker types and the space they occupy. Why? Because most companies really don't know their employee population as well as they should and haven't developed strategies to address their various pools of talent. Ideally, companies would know their associates well enough to group them into specific worker types. For this discussion, consider four high level categories as shown in Exhibit 4: resident, mobile, anchor, and telecommuter.



Those who perform highly transactional types of work, call center employees for example, do not depend on location to fulfill their job requirements. This may present an opportunity to develop a work-from-home program with potential not only for enhancing employee morale and supporting sustainability initiatives, but also for reducing occupancy costs. Or, you may have groups of highly mobile workers who could be likely candidates for a more distributed worker solution.

In a recent assignment for a major insurance company, Jones Lang LaSalle developed a work-from-home program to improve retention of key talent. The participants, the technology team, viewed it as an opportunity to improve work-life balance by reducing commute times in a highly congested urban area. Not only did the program yield positive results in terms of employee satisfaction, occupancy costs were reduced by over 65 percent with less than a one-year payback.

Cost savings can be achieved with many different types of workers and various portfolio solutions. Work-from-home is certainly not the only solution, but for those focused on the short-term payback with minimal investment, it is worth considering for certain types of workers.

Putting ideas into action

What's the most effective way to turn your cost savings strategies into action? When facing clear goals and tight timeframes, consider developing cross-functional "blitz" teams. Having been charged with cost-cutting for several consecutive quarters, CRE executives likely feel that they have exhausted every cost-saving avenue. Small in size, cross-functional teams effectively identify and implement cost savings strategies with speed and agility.

To identify cross-functional teams, target areas where business processes naturally overlap. Supplier relationships and intersections between similar functions, such as property management and small projects, can be particularly fruitful places to start. Be sure to include team members from business units who will be impacted by the changes underway.

Strong sponsors. Tight charter. Clear goals.

Once you've identified your teams, hold a cost reduction workshop, and focus on accelerated process improvement tools. Challenge the team to prepare and implement cost savings improvement opportunities within a 60-day timeframe. Engage strong leadership sponsors to provide ongoing coaching, transferring the skills, knowledge and tools of continuous improvement methodology to the team. It is equally important that executive sponsors guide the team in creating a business case for their improvement ideas that links directly to the core strategy and key metrics of the business.

When your project is underway, a blitz structure will help to maintain momentum. In keeping with this structure, clearly identify your team leader, who is ultimately responsible for results. Throughout the process, maintain clear articulation of your goals. Tight governance by your leadership will keep your team motivated. Actively communicate any changes throughout your organization, and celebrate results.

Cross-functional teams are valuable to CRE executives for their power to drive process improvement and cost reduction quickly.

Conclusion

While most of the ideas discussed here are not new, the current environment affords tremendous opportunities for CRE executives to take strategic action. Be proactive and take advantage by optimizing your portfolio for the long-term.

For more information on cost reduction ideas, please contact:

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