

Corporate Real Estate Management (CREM)

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SUMMARY

Many corporate groups want to reduce the amount of capital which is tied up in real estate. They want to invest more capital in the core business.

In view of cost pressure and ever-shrinking budgets, local authorities have similar aspirations. As a consequence, they think about selling their real estate.

One solution is to launch a process to establish a real estate portfolio with the aim to generate added value through creation of transparency and improvement of cash fees. The tied-up property should be made available through reduction and an optimizing process.

Some ideas will be presented about an integrated concept and the realization of real estate portfolio management.

ZUSAMMENFASSUNG

Viele Unternehmen wollen ihre Kapitalbindung in Immobilien reduzieren, um damit Finanzmittel für das Kerngeschäft freizusetzen.

Ähnliche Bestrebungen gibt es bei Kommunen unter dem Kostendruck den immer beschränkter werdenden Haushaltsmitteln.

Eine Lösung besteht darin, einen wertschöpfenden Immobilien-Portfolio-Prozess in Gang zu setzen.

Einige Ideen zu einer integrierten Konzeption und zur Realisierung werden dargestellt.

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1. MOTIVATION

In view of today's globally difficult economic situations more and more groups of companies realize that their real estate property does not belong among the core business anymore. Therefore, an ever-growing number of major companies is concentrating on their original business with which the value-added process is highest.

In order to remain competitive, also German companies must detach themselves from their real estates in order to reduce their capital investments. After all, they are frequently the second-biggest cost pool with a share of five to fifteen percent of the total expenditure. As it appears, that was recognized earlier in other parts of the world. While in German companies the degree of real estate ownership lies between 50 and 80 percent, the ownership ratio in the USA equals only ~ 33 percent, in Asia even only ~ 25 percent.

The overall real estate property listed on the German DAX is estimated at 170 billion euro. It can be assumed that some of this real estate will be offered on the market in the coming years, all the more so as this process was already initiated a couple of years ago and has been pursued successfully since. The time is long gone when real estate was regarded as an inalienable property and inviolable reserve (although this can also result in gross misjudgements).

The sale of large property holdings, however, can be very problematic for companies, because in many cases their real estate assets have been dealt with poorly. Often enough, the management does not even know about the properties' sizes and/or market values. That can sometimes lead to disaster, as for example in the case of METRO Group, which is the third-largest trading group in the world and the market leader in Germany. In the year 2003 the METRO wanted to sell 350 items of property as a total package. The sale foundered because the vendor wanted to impose the risks associated with the real estates on the acquirer. As a result of this action METRO again had to include in the balance an unexpected debt that amounted to more than 2 billion euro. The stockholders were not especially amused at this situation.

2. STATUS OF CREM

The current situation of companies requires a group-wide adoption of responsibility for the real estate management. In this process the following tendencies can be observed:

- The globalization of the markets provides increasing competition pressure associated with a growing influence of the financial markets on the management (Keyword: Shareholder Value Management).
- According to a regulation of the European Commission of 19th July 2002 all listed companies must prepare consolidated accounts in compliance with IFRS (International Accounting Standards) by 2005 at the latest. Thus real estate has to be shown in the balance sheet at market value. This fact may have serious consequences for the property, financial situation and profits. As far as German Telecom is concerned, assets amounting to 22 billion Euros were removed from the balance sheet with the result of considerable slumps in stock market prices.
- The appearance and strategy of companies undergoes sudden changes because of the surge of mergers and acquisitions.
- Basel II (that implements an EU directive) requires a new quality of risk transparency and risk management, in order to obtain more favourable conditions on the capital market.

These tendencies lead to challenges on the real estate management as follows:

- Reduction of the capital tied up in real estate and cost minimization in the use of real estate for financial benefit
- Creation of transparency in the stock of real estate and in its utilization
- Efficient setup of a stock of strategically important real estate and liquidation of strategically insignificant property
- Value adding in real estate management and transparency and follow-up of property risks.

These statements go to show how changeable the world of real estate has become and what great efforts will have to be made to pursue real estate policies that facilitate successful business. While up to now the focus was on growth, on securing the company's location and the development of secret reserves, there will be a shift to portfolio optimization, minimization of space requirements and reduction of the additional costs in future.

3. INTRODUCTION OF CREM

The basic principles of a successful real estate policy are a customer-oriented organisational structure as well as the creation of efficient business processes. This goes along with a concentration of responsibilities within a group or company that includes the requirements of internal and external customers. Only that way a readjustment of real estate affairs is achieved, which allows to stick to the core business. Comprehensive services are offered from a single source that brings about higher quality and improvement of the efficiency. This leads to an organizational adaptation, which consists in the creation of a central CREM board with a strong orientation to the company management policy. This board places requirements on the operational sectors such as project development, facility management, purchasing and sales departments. Further subordinate service units that need to be set up are valuation, property management and project controlling.

4. NEW CRITERIA FOR CORPORATE REAL ESTATE

In future, the classification of real estate will have a stronger focus on the features of efficiency and usability than in the past where the emphasis was rather on operational necessities. As a first step of assessment it is necessary to prepare all areas of land in terms of real estate development, then to review the usability of sites and sub areas (such as reserve areas) as well as the profitability of sites and sub areas (for example power station sites), and finally, to match site-specific identifiable potentials.

Existing procedures of exploitation and optimization show clear limits, too. The present approaches of individual or block sales or the issue of closed or open funds offer us advantages and disadvantages. However, an inter-company joint property product could turn problems into opportunities. In this context one could think of closed funds focussing on high-quality items in a perhaps suboptimal location (for example head offices of great companies). This way, thanks to common interests, deconsolidations with regard to the intention of long-term lease (high credit standing of the tenant) can be achieved through reduced share property.

5. TRANSPARENCY AS AN ESSENTIAL COMPONENT OF CREM

Since the big companies and groups have large real estate portfolios, only a multistage analysis and data collection will prove successful due to the sheer volume of the holdings and the limited data available.

But before starting the analysis, it is crucial to take the following measures towards establishing an active, value-oriented real estate management:

- The definition of unambiguous internal identification keys for sites and buildings to be applied throughout the whole corporate group.
- The determination of a data model to illustrate the structure of site and building complexes as well as of users and tenants, respectively; and the possibility of tracking the histories of real estate sites and buildings.

The mere analysis of the original and production costs as well as of the book values as stated in the balance sheet will give an idea of the structure of the real estate portfolio.

After that, a multistage analysis and data collection can be conducted, which should start with carrying out a data collection of the overall stock for a segmentation into "necessary for business; not necessary for business". In order to minimize the processing time on the part of the data providers involved, only few decisive criteria are to be collected in this stage (for example, ownership structure, postal address, type of building, type of use).

This should be followed by a data collection that permits a segmentation of the total real estate holdings into either "for sale" or "for development" categories as well as an assessment of the potential proceeds arising from CREM. In this connection, data such as year of construction, building vacancies, actual market prices, equipment features, operational costs are to be extracted.

For a further elaboration the following exemplary data are of special interest if you want property items to be sold or to be developed: Planning law, investment costs, site and building inspections, financial resources, areas, etc.

In the case of real estate that shall be retained it is advisable to extract the relevant data only in the long run. These data include: tenants, periods of lease, space occupied, operational costs according to cost categories.

The data collections are in part very time-consuming and therefore costly. So here is an optimization problem between depth of information and partly considerable expenditures. For this reason, the before-mentioned segmentation can help avoid redundant data collection.

This is also in the interests of the in-house units providing the data and facilitates a quicker evaluability as well as a demonstration of success of the ongoing operation.

A special problem is the refinancing of the CREM organization to be built up, which primarily has a service function within a given corporate group. In order to enhance acceptance, the author favours a cost centre organization for the sake of leaving added-value contributions with the respective corporate sections. This is the only way to achieve smooth cooperation for the benefit of common business objectives.

6. SUMMARY

Every decision in the framework of real estate management implies long-term consequences. So it is important that these decisions are closely in line with the corporate goals, which, in turn, are subject to varying requirements. The company policy depends on industry-sector-specific factors; therefore, there is no unique model solution for the implementation of corporate real estate management, all the more as the existing transparency and expertise in real estate matters even within one and the same corporate group (with maybe global activities) can vary considerably. Some basic information can be supplied by consultants, who can offer structured methodical solutions, but even so it seems necessary to build own real estate capabilities, and, as the case may be, find an in-house solution in cooperation with one's own specialists (for instance, controlling staff).

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