Summary

Introduction

Corporate real estate (CRE) is real estate property held by a non-real estate company to support core business operations. While often taken for granted, corporate real estate holdings are sculpting the financial DNA of firms around the globe. Ever since Zeckhauser and Silverman (1983) called upon corporate managers to rediscover their company's real estate, a large literature has evolved around the strategic importance of these corporate assets.

In this era of liquidity constraints and at the dawn of IFRS Lease Accounting transparency, it is time to prioritize and focus on the financial effects of corporate real estate decisions.

In this thesis, we present the results of an international study on the financials of corporate real estate ownership. We extended the current available CREM frameworks and provide corporate boards with a adequate framework to give good answers to hard questions that will soon be asked by their stakeholders.

Review of current CREM models

The rich management literature offers a wide supply of 'qualitative' strategic studies that discuss how CRE can help to increase productivity, can strengthen corporate marketing, help firms to trigger innovations, and foster flexibility. Regarding asset management, we have seen literature that discussed how Corporate Real Estate Management (CREM) can assist in cutting costs, and increase the value of the asset base. A wide set of CREM models and frameworks that take this corporate value perspective have emerged and can help us to identify the prime relationships that need to be considered when taking action.

While analysing the current literature it striked us that:

- Remarkably little of this literature relate to the corporate financials.
- There is little attention for priortizing.

In regard to the financing perspective, in the current literature remarkably little evidence is offered. Given the vast flow of funds that are involved with CRE, one would expect that a clear analysis on the impact of effective corporate tax rates, capital structure, cost of debt, and dividend policy is available. This however is not the case. Also when it comes to the working capital and capital expenditures of firms, we notice that little evidence is offered for how decisions on whether to own or to rent space has any pervasive effects on these two value drivers.

The need to priortize is not discussed extensively either. One of the reasons may be that the different qualitative strategic aspects have different measures. This makes them hard to compare. For example: How to rate the effect of CRE on marketing with the effect of CRE on the cost of debt with the effect of CRE on productivity?

The Value driver model for CREM

Figure 1 gives an overview of the macro value drivers of shareholder value and their corresponding management focus (micro value drivers) that can be influenced by the corporate real estate decisions that need to be made.

In essence, shareholder value is the result of cash-flows and the cost of capital (valuation component). Generating cash flows comes from two main clusters, the business and the management of assets (investment).

From the business perspective, cash flows can be strengthened by increased productivity, a higher profit margin, and a longer period of competitive advantage. In order to maximise shareholdervalue CRE management needs to focus on the effect of CRE on strong marketing, successful innovations, high employee satisfaction and an adequate level of flexibility.

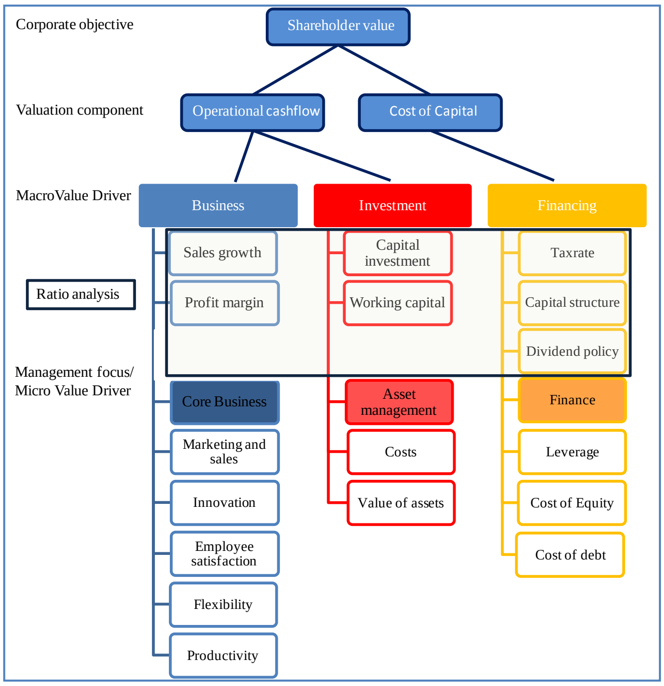

Figure 1: Value driver model for CREM

From the investment perspective capital investement and working capital should be reduced.

Management focus should be on the costs and the value of its assets.

From the financing perspective taxrate, capital structure and dividend policy are the main aspects. Management should focus on the leverage , the cost of equity and the cost of debt.

The advantages of this model over 'the current models in use' are:

- It provides a link to the key business drivers
- It provides a single performance measure.
- It expresses the added value in the language of corporate management.

By expressing the strategic 'qualitative'aspects in a single 'quantative' measure we can compare and prioritze them. The outcome in a single measure also makes it possible, by comparison with peers or results of past years for example, to valuate the CRE- performance.

The framework and the suggested value drivers can be used by managers to effectively improve the organisational performance by means of real estate interventions, and allign CRE with their organisation's main objectives, and monitoring the effects.

In other words: by using this model, it becomes clear what and how CRE contributes to the organisation and which choices should be made.

Global 1200 analysis

To help firms gain a fuller overview of the consequences of real estate decisions on their value drivers, we have performed a 'Global 1200 analysis'.

In this analysis we relate CRE ownership of the 1200 largest stock listed firms of the world to the following financial value drivers, that thus far have been under-examined in the literature.

- Taxrate
- Cost of debt
- Cost of equity
- Dividend pay-out

In order to quantify the current 'qualitative' strategic aspects, we have CRE ownership is linked to the following macro value drivers:

- Sales growth
- Profit margin
- Capital investment
- Working capital

Firstly the analysis showed CRE-assets are, on average, about 15% of the total firms assets. This differs significantly from the impression of previous research (based on the PPE ratio), which suggests that CRE is about 30% of the of the total firms assets.

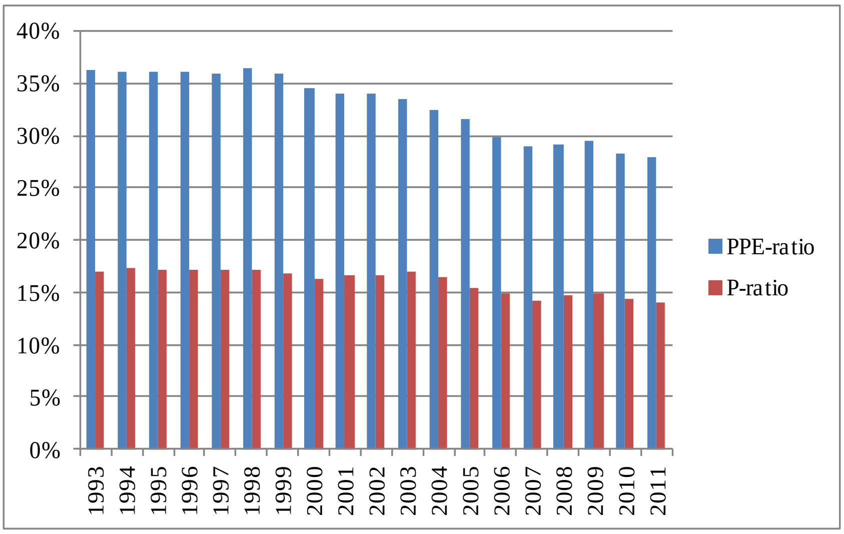

Figure 2: PPE-ratio vs P-ratio for the years 1993-2011.

Secondly, the analysis shows, that, after correcting for the wide variations we observe across industries, that owning more real estate than your competitors tends to weaken cash flow generation measured as sales growth and profit margin, and lower the cost of capital. The reduction of the cost of capital is the combined effect of a lower tax rate, higher debt rate, lower cost of debt and a higher dividend payout. These effects, however, are moderate in seize and vary greatly across industries.

Thirdly, we find that the financial impact of real estate ownerships varies with the relative size of real estate portfolios, and with the strategic value of this real estate. For firms with little or standard real estate, the effects are almost absent, while firms where corporate real estate holding are vast and buildings and locations are important for the primary business process, we find the strongest financial effects.

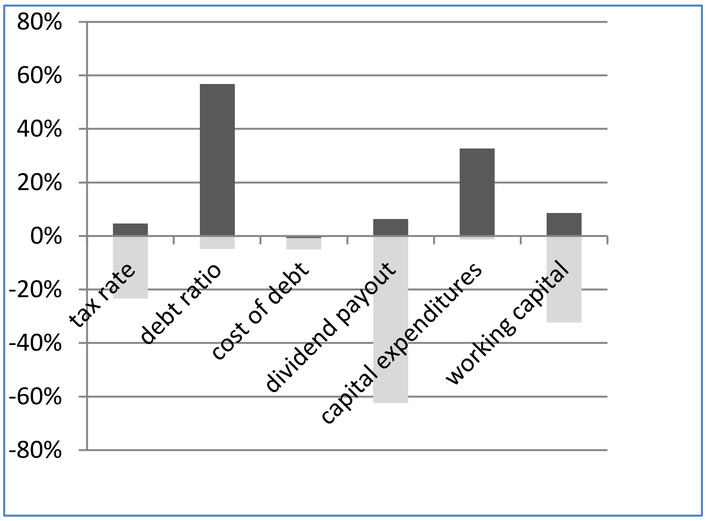

Figure 3: Range of correlation between real estate ownership and value driver variation

Figure 3 shows the range of correlations between real estate ownership and value driver variation that we find across the eight industries are plotted.

Epilogue

The proposed framework is, to my opinion, of prime importance because performance measurement has become a essential part of today’s business. Top organizations are doing more than just measuring performance; they use sophisticated analysis as a strategic resource and a winning advantage.

Using the old framework and models, CRE professionals keep communicating too much blur; the essence of CRE and strategic choices made cannot be explained. IFRS will probably be a first wake-up call. This framework should be seen as a first step, in a new approach to communicate the value of CRE in those terms, corporate management most wants to hear. And subsequently a framework to focus on activities that truly matter to the organization’s success.

It will need further development and testing. But it is a start to create and communicate clear and substantive performance metrics that link real estate to the larger objectives of the business. By designing and reporting metrics in a relevant and insightful way, real estate will become an integral part of the vision and success of their organizations.