



# FINM3406

## Real Estate Finance

### Week 11

### Corporate Real Estate

# Outline

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- Overview of the role and function of Corporate Real Estate
- Outline the relationship between real estate strategy and business strategy
- Overview of the decisions making framework to determine if a business should buy or lease real estate

# Objectives

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- Understand be able to explain the relationship between real estate strategy and business strategy
- Understand the critical factors associated with decisions to determine if a business should buy or lease real estate

# CORPORATE REAL ESTATE (CRE)

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# Portfolio Management

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- **Investment**
- Return on Investment
- Diversification
  - Sector
  - Location
- Risk Management
- Modern Portfolio Theory

# Portfolio Management

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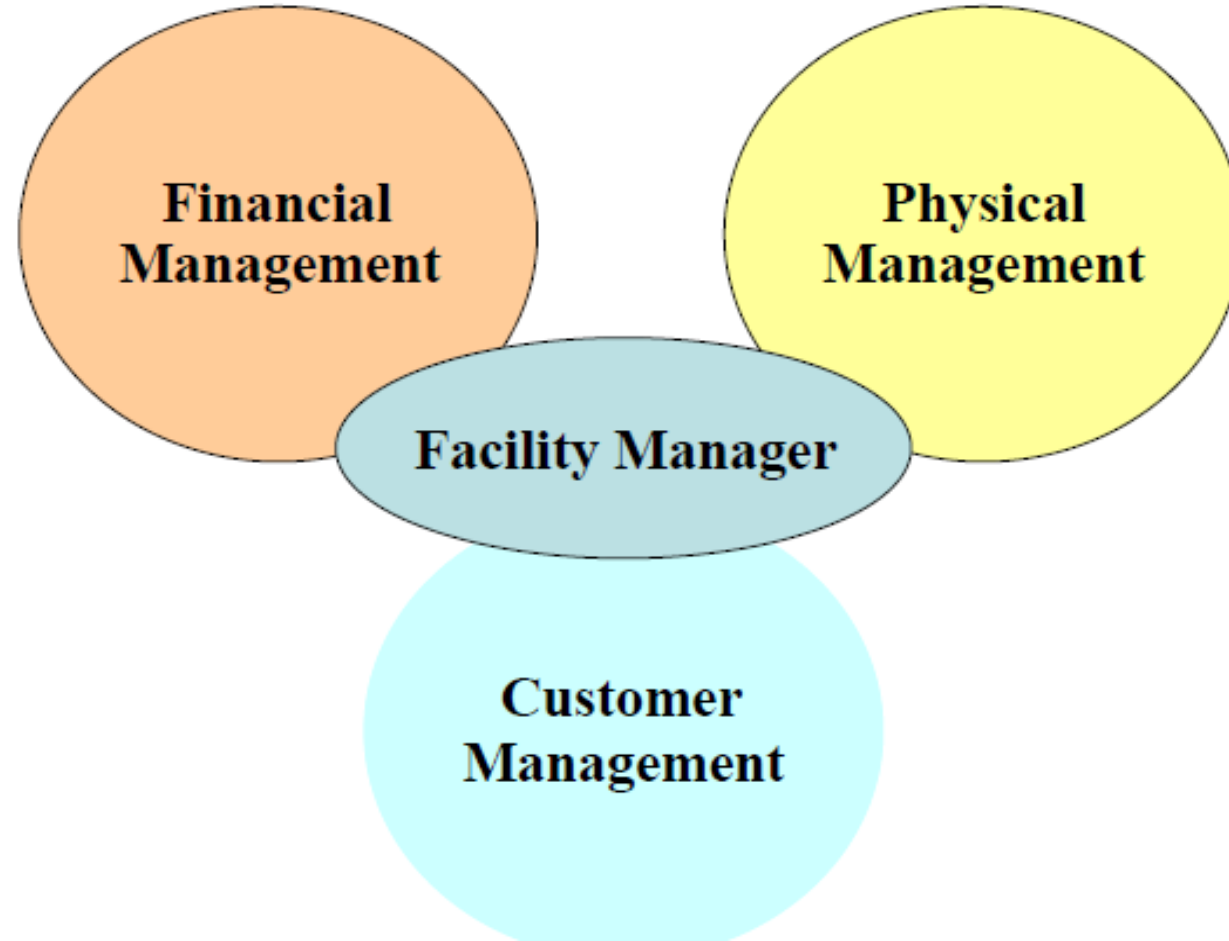
- **Corporate**
- Business Strategy
- Operational Strategy
- Core Business
- Risk Management
- Outsourcing

# CRE & Facilities Management

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- *‘Facilities Management is responsible for co-ordinating all efforts related to planning, design and managing buildings and their systems, equipment and furniture to enhance the organisations ability to compete successfully in a rapid changing world’*
  - Becker, F

# Facilities Management Process





# Strategic Asset Management

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- Asset strategic planning is defined as the process of developing management strategies that will:
  - contribute to the best utilisation of assets in the delivery of services to the community in line with corporate plans and service delivery strategies.
  - ensure ongoing compatibility between the composition of an asset portfolio and the changing environment within which it operates.
- It is an ongoing management process.
  - The development of asset strategies through analysis and direction-setting processes provides a basis for compiling asset strategic plans, and disposal, capital, maintenance and management-in-use programs formalised through the annual budget process.

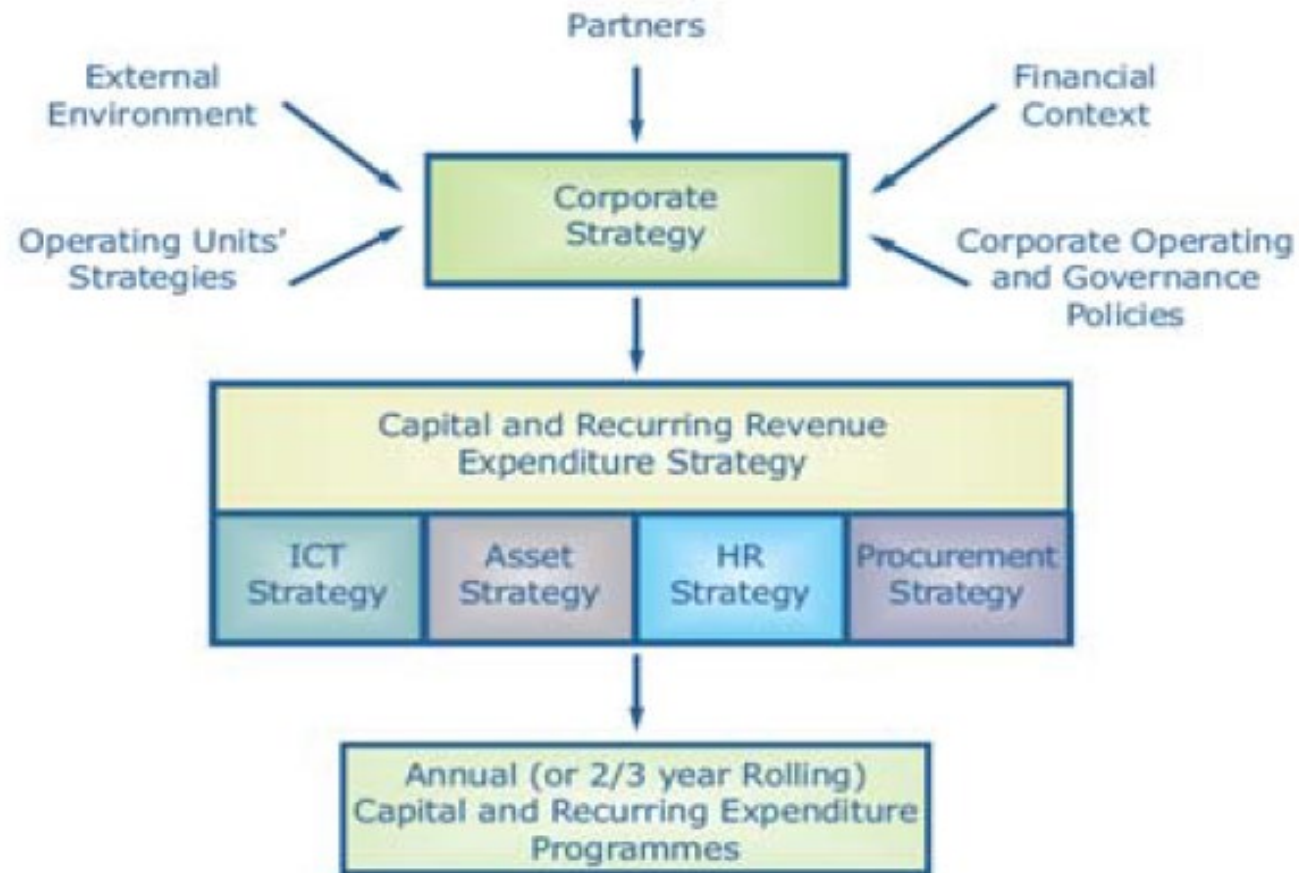
Source: Qld State Government Asset Plan

# Strategic Asset Management

Inputs into strategic asset planning



# Strategic Asset Management



Source: Jones & White 2008

# Strategic Asset Management

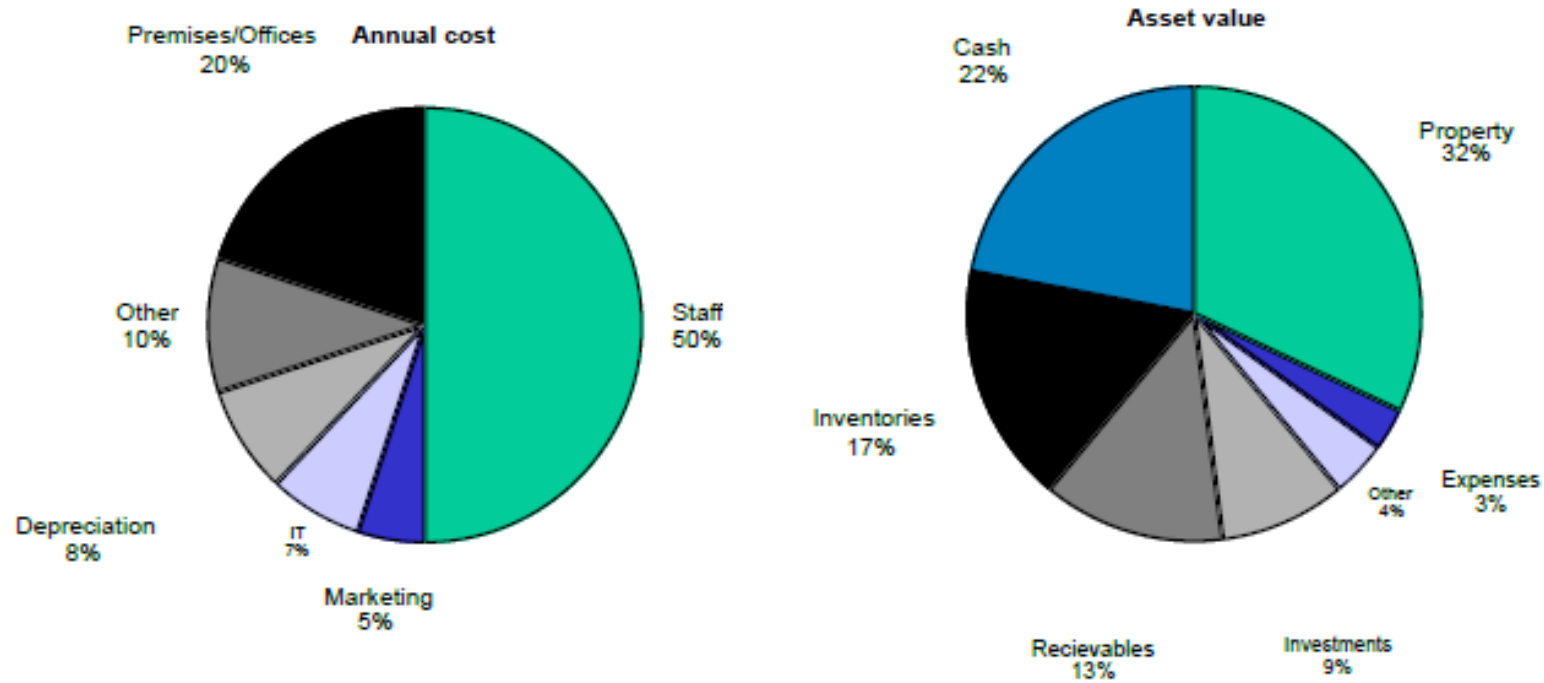
## Asset Management Process



Source: RICS Public Sector Asset Management Guidelines 2008.

# Changing Perception of Property

**Property as a Valuable Asset: 30%-50% of Assets –  
20% Annual Costs**



Source: Varcoe B.J.

# Changing Perception of Property

- The separation of capital and recurrent costs for budgeting purposes militates against a whole- of-life approach to asset management. Assets purchased with capital funds once approved, are treated effectively as ‘free’ goods in subsequent years so there is little ongoing incentive to ensure service potential is optimised.’
- *ANAO*

# Changing Perception of Property

- Property as “A FREE GOOD”
  - Historic way of thinking
  - Often seen in Public Authorities and long term property owners
  - Doesn’t properly allocate cost of capital

# Changing Perception of Property

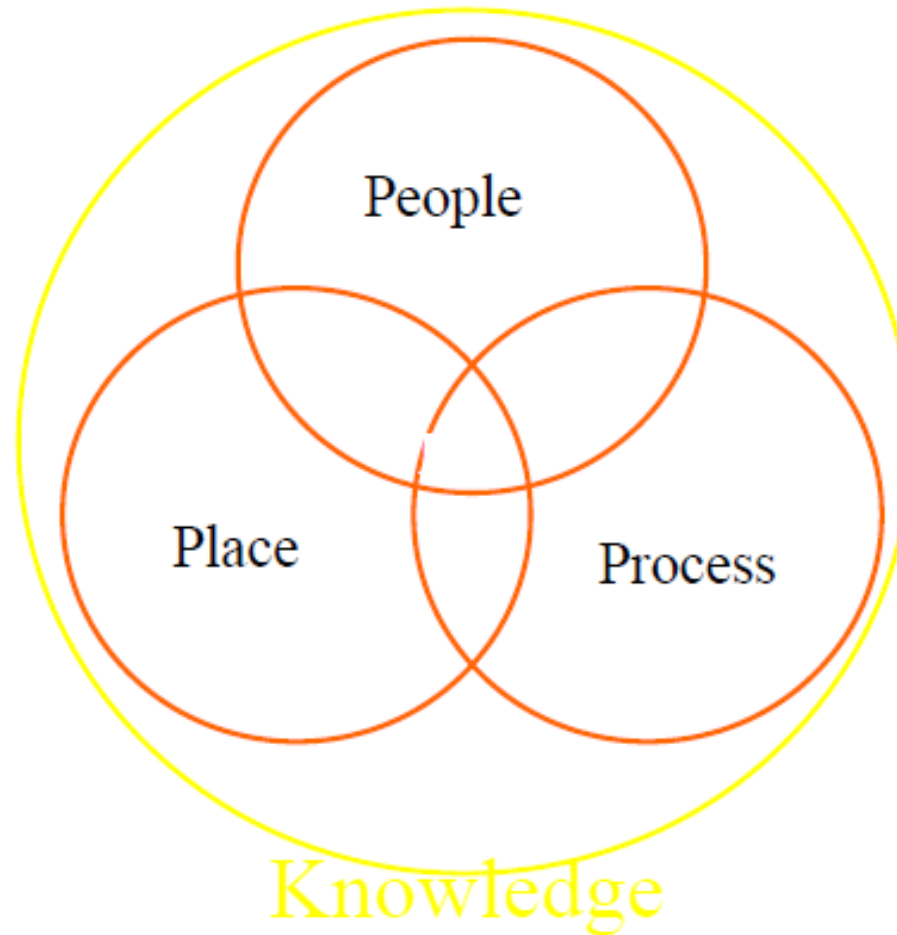
- Corporate Property Research
- Avis Gibson Watts
  - more than half the organisations had 30% or more of their total assets value in property
  - 40% Public Sector / Private Sectors 20% have detailed policies and procedures for management of property



# Changing Perception of Property

- IDRC - ‘Corporate Real Estate 2000’
  - Like Cinderella before the ball, corporate real estate holdings have often been overlooked by senior managers as they strive to structure their firms and reengineer their work processes. But now, all parts of the firm are required to cut costs; all operational units are required to enhance business flexibility and otherwise add value to the core business. Under- management of corporate real estate is no longer acceptable.’

# Where does real estate fit in?



# Where does real estate fit in?

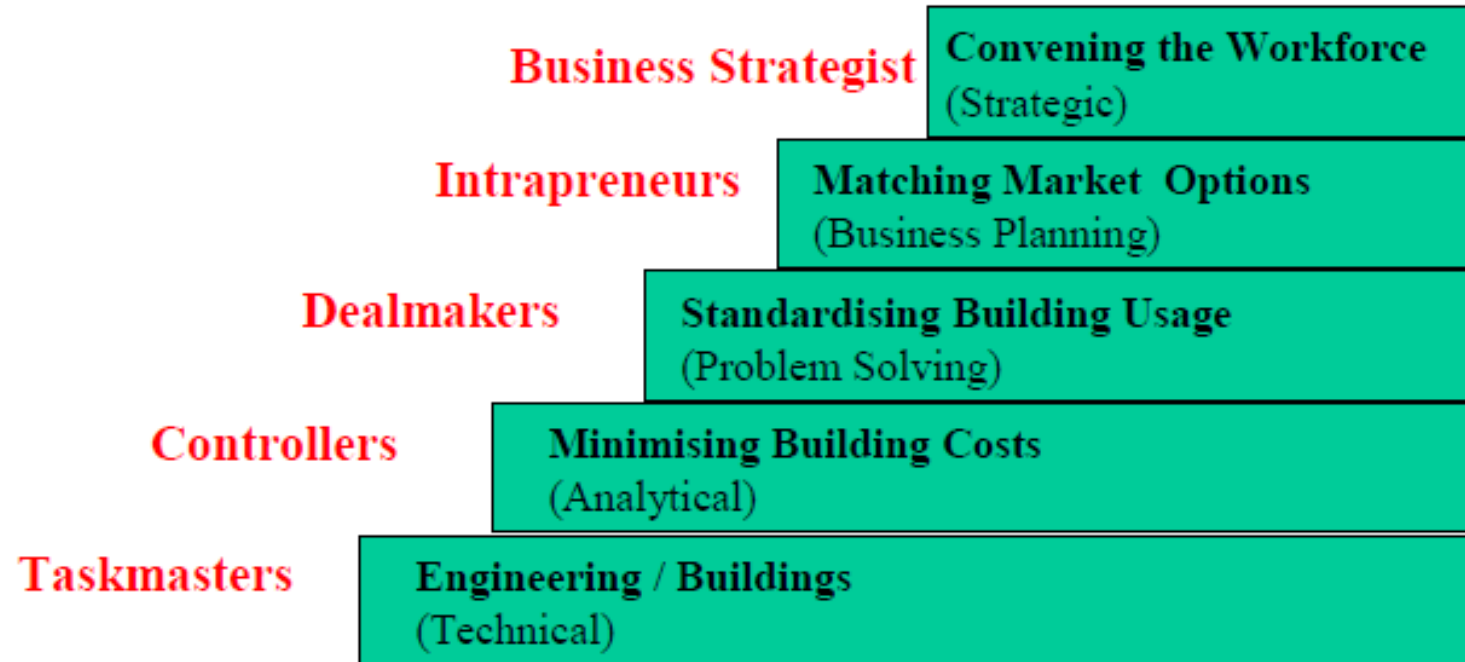
Business	Property	People	Knowledge
			

- |   |  |   |  |
|---|--|---|--|
| <ul style="list-style-type: none"><li>• Productivity</li><li>• Profitability</li><li>• \$/m<sup>2</sup></li></ul> | <ul style="list-style-type: none"><li>• Shelter</li><li>• Light</li><li>• Temperature</li><li>• Services</li></ul> | <ul style="list-style-type: none"><li>• Ownership</li><li>• Suitability to task</li></ul> | <ul style="list-style-type: none"><li>• Raison d'être</li><li>• Culture</li><li>• The unique value proposition</li></ul> |
|---|--|---|--|

# Facilities Management Process

International Development Research Council:  
Corporate Real Estate 2000

➤ Strategic Management of the Fifth Resource



# Strategic Real Estate Planning

- **Supporting business strategy by:**
- leveraging locations,
- layouts
- leases
- reduce costs
- increase flexibility and
- improve productivity.

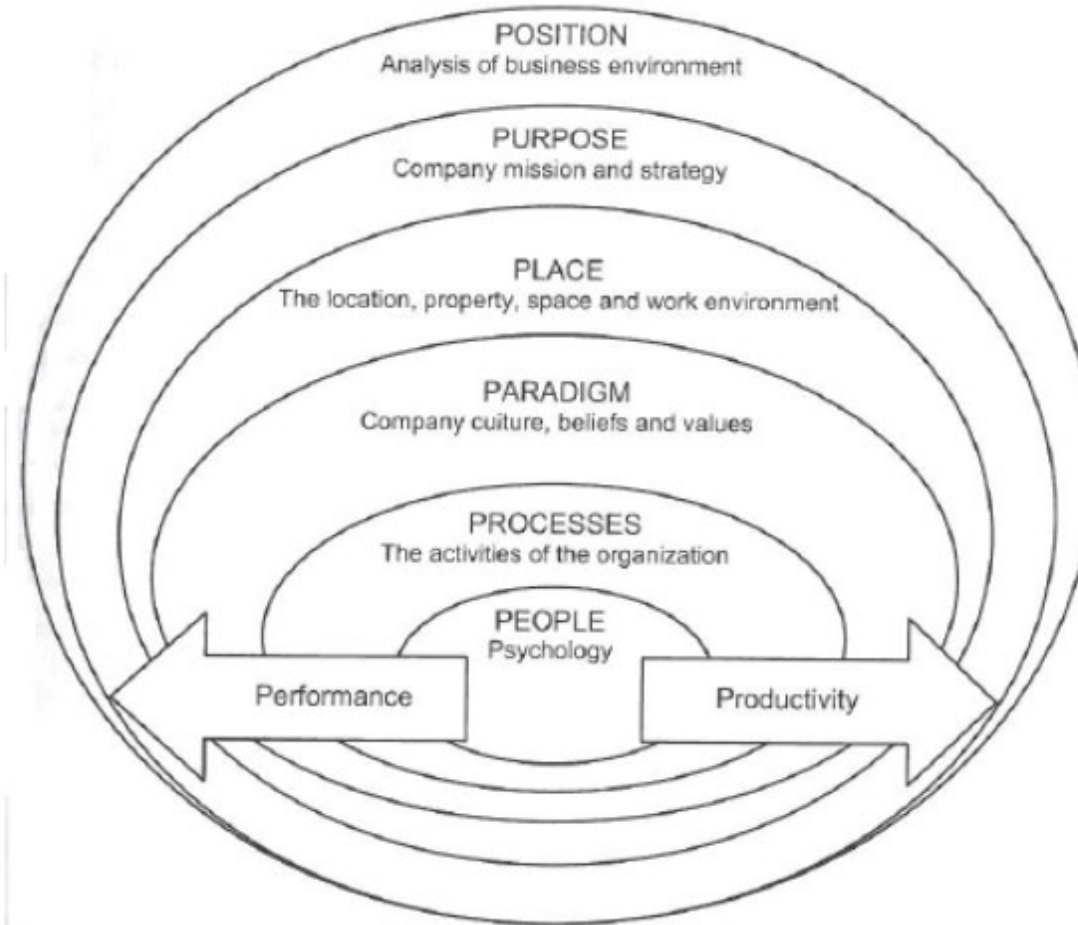
# CRE Objectives

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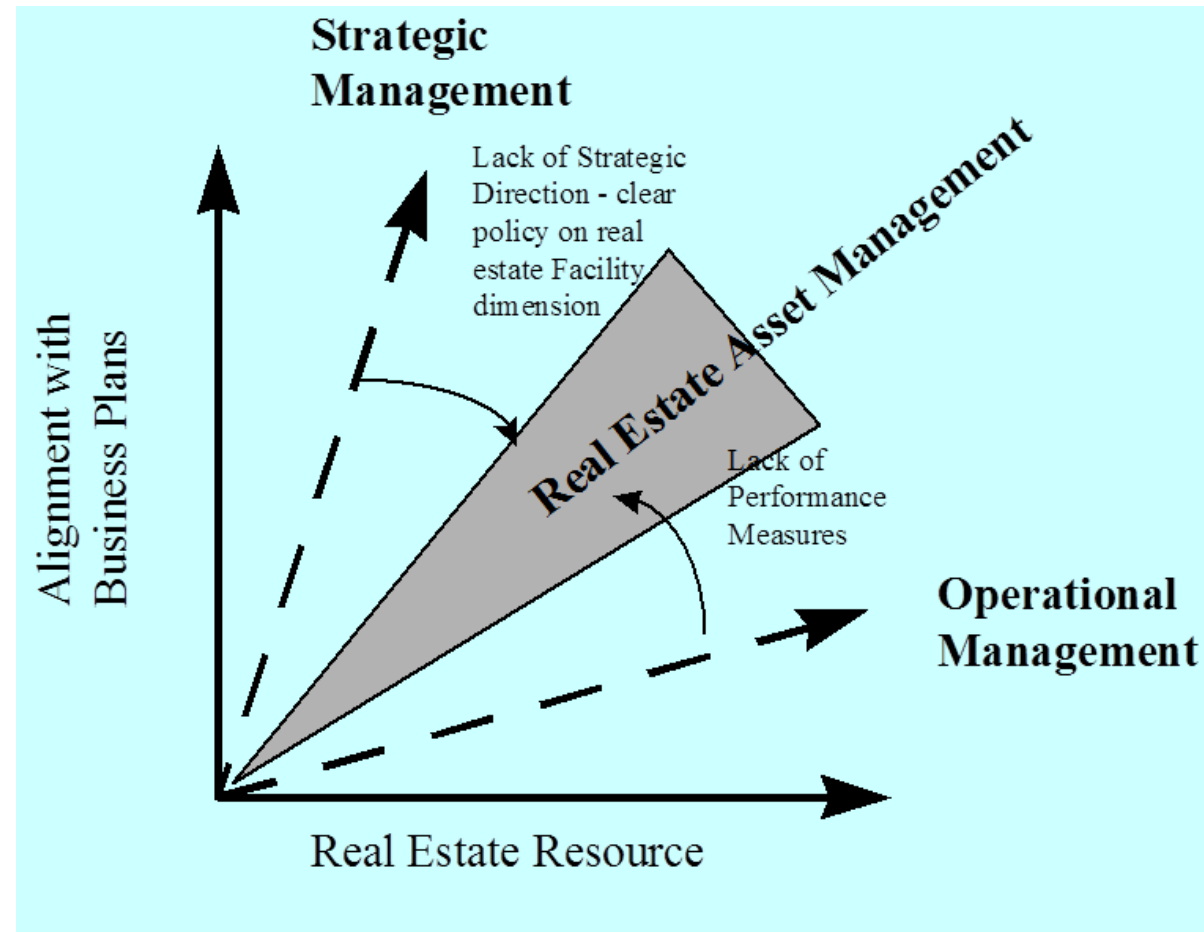
- Maximize Utility / Productivity
  - Satisfy business needs
  - Effective “factor of production”
  - Satisfy required speed to market
- Minimize Cost
  - Cash flow / NPV impact, including economic (opportunity) cost
  - Income statement and balance sheet impact
- Minimize Risk
  - Avoid surplus or shortage (flexibility)
  - Hedge against real estate market swings

# CRE and the “Business”

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# CRE and the “Business”





# CRE and the “Business”

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## Strategic Management

- Markets - global competition
- Resources-     Capital  
                      Staff skills
- Customer Service Delivery

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Core Business Goals

# CRE and the “Business”

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## **Operational Asset Management**

- Acquisition / Develop
- Holding Costs
- Disposal
- Life-cycle Maintenance
- Space use rationalisation
- Technology Management

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**Property Services Delivery**

# CRE and the “Business”

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## Operational Asset Management

- Acquisition / Develop
- Holding Costs
- Disposal
- Life-cycle Maintenance
- Space use rationalisation
- Technology Management

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**Property Services Delivery**

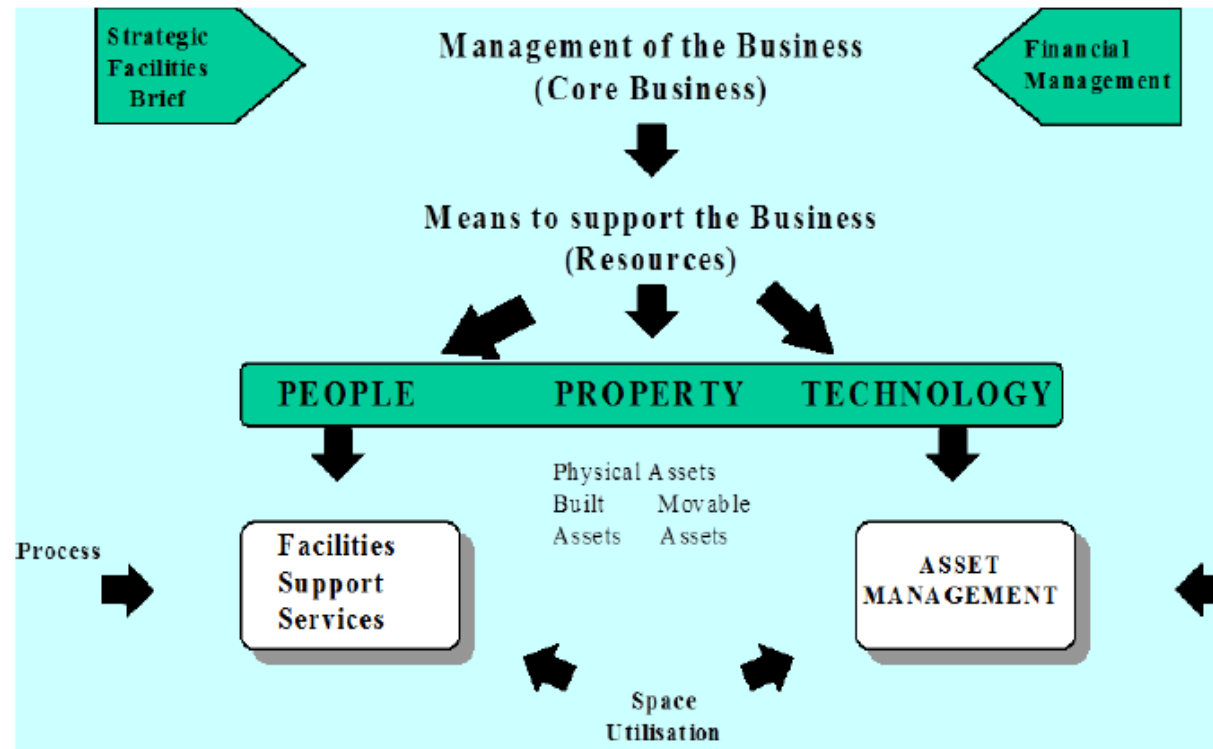
## Strategic Management

- Markets - global competition
- Resources- Capital  
Staff skills
- Customer Service Delivery

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**Core Business Goals**

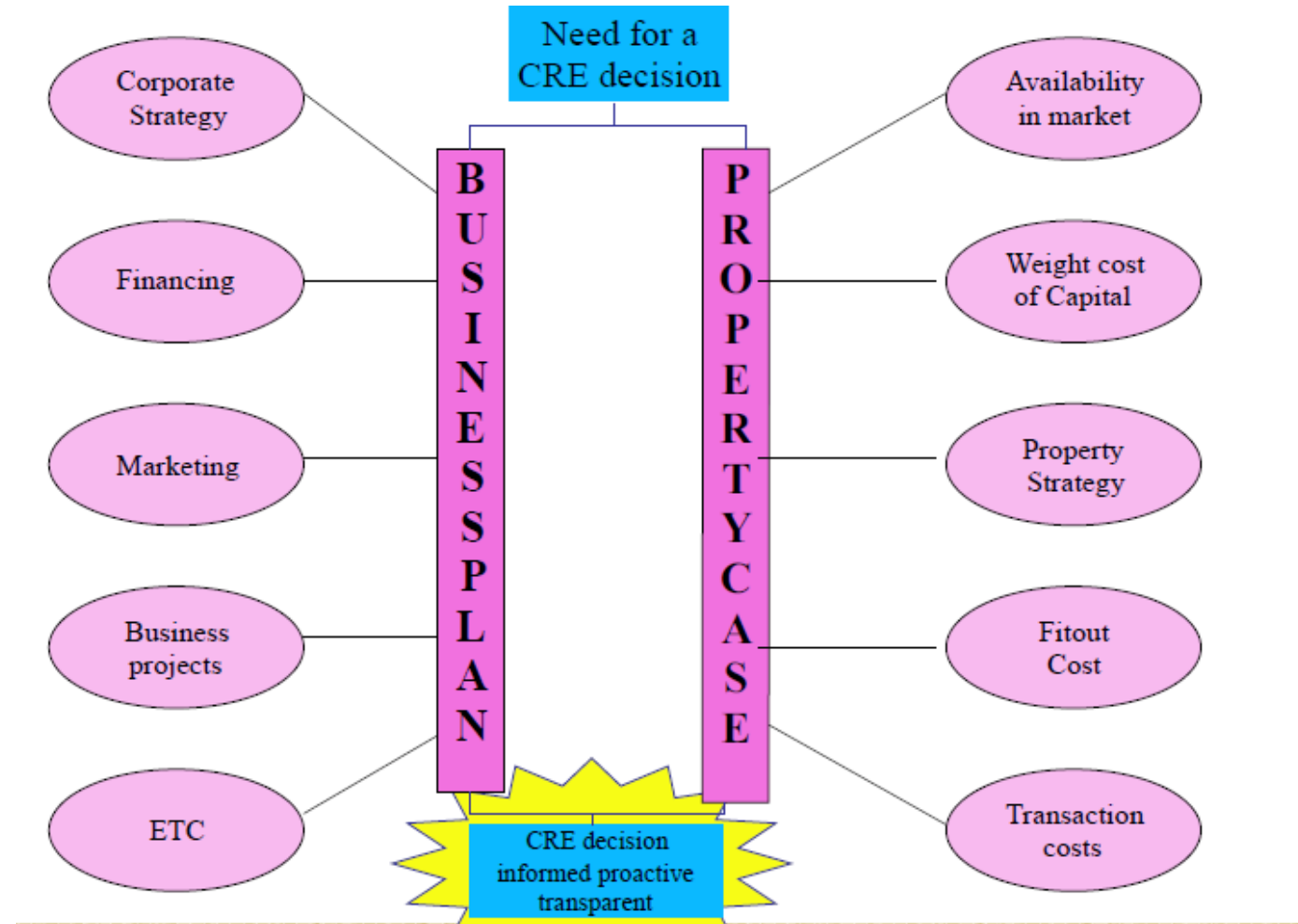
# CRE and the “Business”



Source:: D S S Then

# CRE and the “Business”

Interface between  
business planning  
and real estate  
planning



# CRE Strategic Framework

Potential for Competitive Edge	High	Strategic Control (Produce internally)		
			Moderate control needed Special venture or contract arrangement	
	Low			Low control needed (Buy off the shelf)
		High		Low

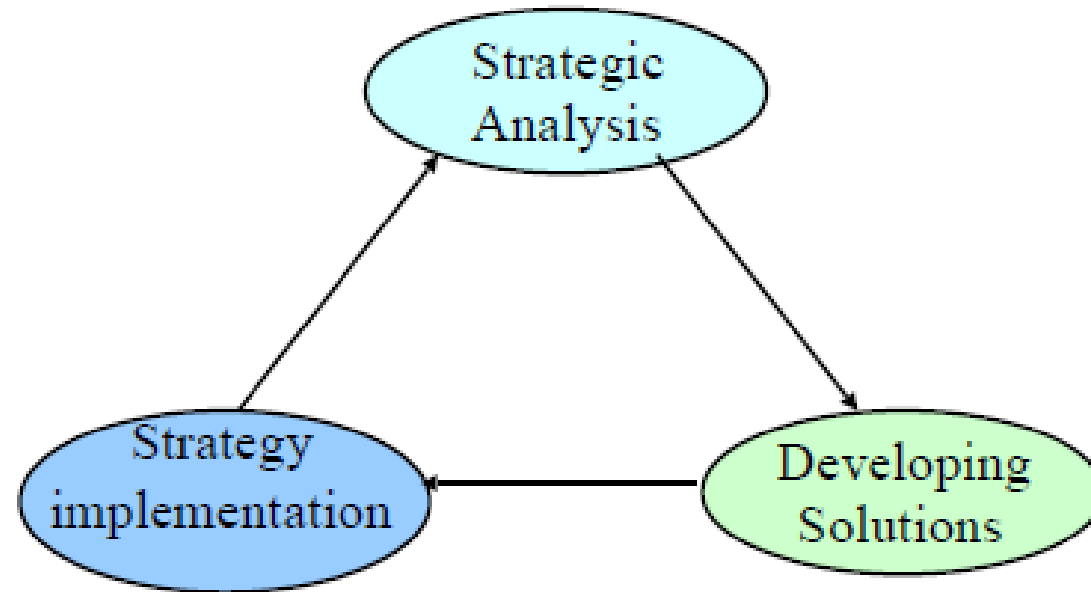
Degree of Strategic Vulnerability

# CRE Strategic Framework

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- **Developing The Strategy**
- What is needed to develop a CRE/FM Strategy?
- Stages in Developing and Implementing a Strategy.

# CRE Strategic Framework





# CRE Strategic Framework

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- **Developing The Strategy**
- Understand the property portfolio
- Understand the organisation and its work processes
- Understand the activities of each work process and their drivers for space
- Understand how the organisation and its processes map onto the current property

Source: W McGregor

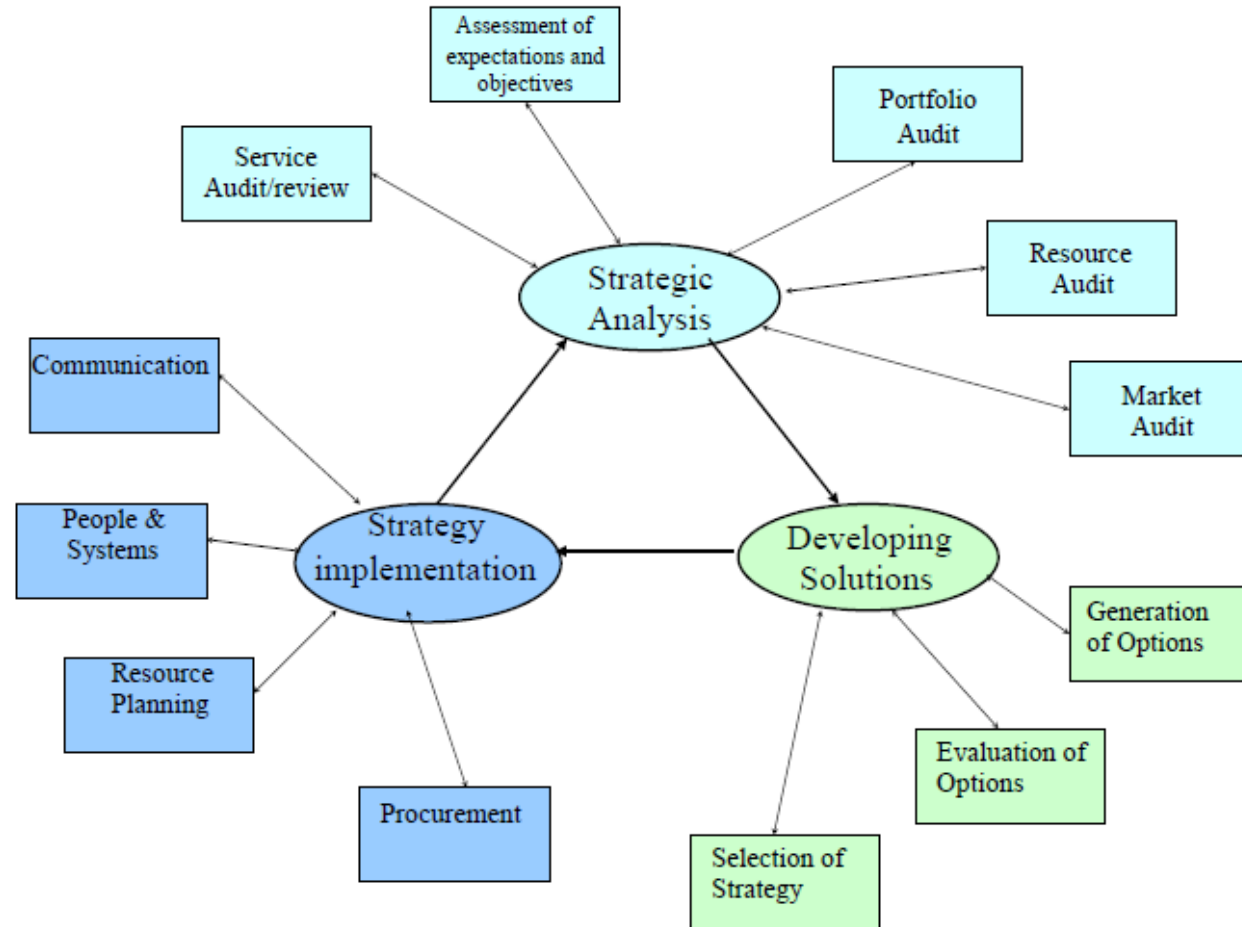
# CRE Strategic Framework

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- **Developing The Strategy**
- Understand the external influences
- Understand the likely business scenarios for 1, 2-3 3-5 years
- Model the implications of each scenario
- Understand the workspace drivers
- Model how the existing property can meet needs
- Develop migration strategy

Source: W McGregor

# CRE Strategic Framework



# CRE Strategic Framework

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- **Maintaining The Strategy**
- Monitor the strategy in use
- Evaluate its effectiveness
- Determine and implement corrective action
- Revise the strategy where required

Source: W McGregor

# CRE Strategic Framework

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- **Asset Management Systems**
- **ISO 55000:2014 Asset Management**
  - Factors which influence the type of assets that an organization requires to achieve its objectives, and how the assets are managed, include:
    - Nature and Purpose of the organisation
    - Operating context
    - Financial constraints and regulatory requirements
    - Needs and expectations of organisation and stakeholders

# CRE Strategic Framework

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- **Lease / Own Strategies**
- Financial
  - Capital invested – debt / equity
  - Cost equilibrium.
- Business Strategy
  - Image
  - Accommodation Strategy.

# CRE Strategic Framework

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- **Accommodation Strategy**
- **Non-property Solutions**
  - New offering/out-sourced option
  - Head count
- **Location**
  - Size of organisation
  - Company Structure
  - Technology,
  - Work patterns / team size
  - Visitors
  - Future adaptations.

# CRE Strategic Framework

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- **Lease / Own Strategies**
- Business Criticality - Portfolio Approach
- Core Accommodation.
  - Long lease – own
- Flexible Accommodation
  - Lease – medium to short term
  - Serviced - Licensed



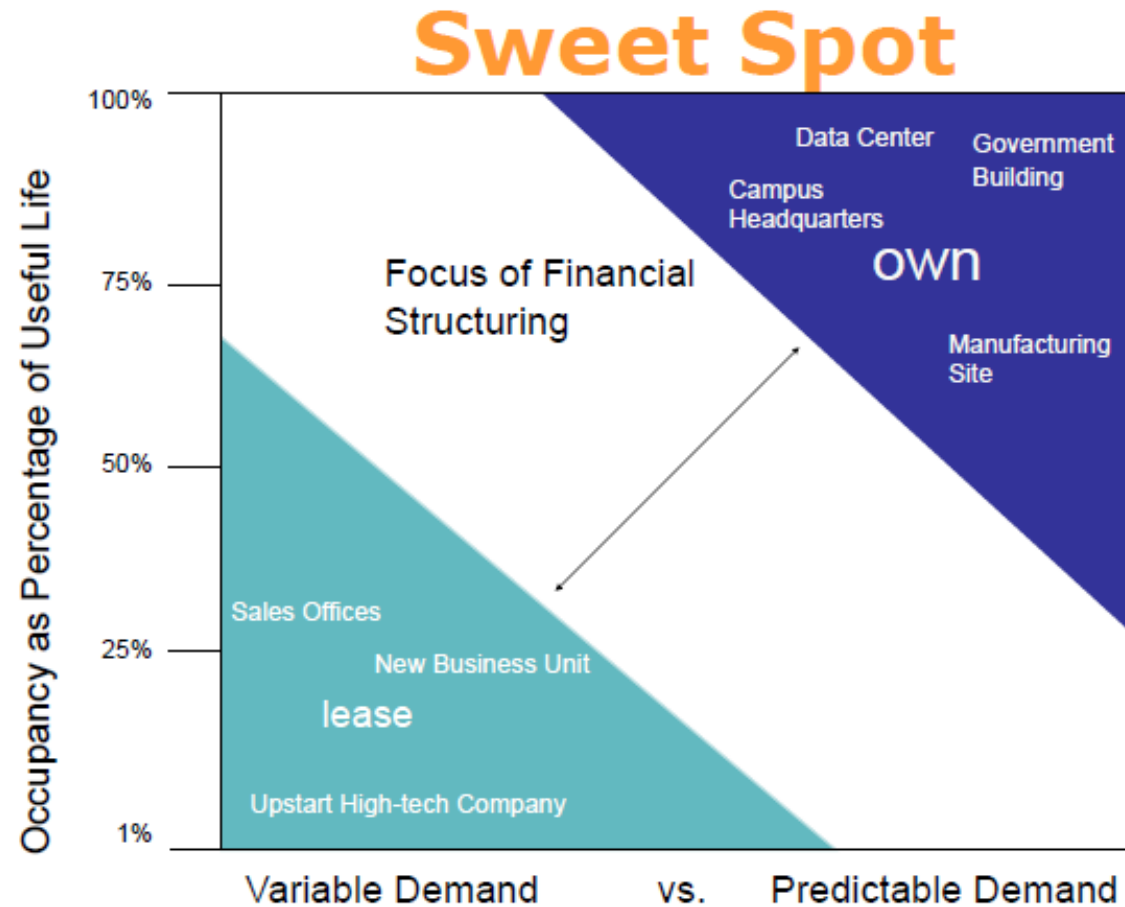
# CRE Strategic Framework

## Occupation Duration



- Occupation duration is a measure of capital at risk in property
  - Duration of a lease is its term
  - Duration of ownership is effectively 15-25 years
- Longer duration = more capital at risk
- Short Duration = market exposure

# CRE Strategic Framework



i. Krzysko & C. Marciniak; *Optimizing real estate financing* – Journal Corporate Real Estate V3, #3

# CRE Strategic Framework

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- **There are Two Decisions Involved: Investing & Financing**
- Financial management is comprised of two distinct decisions
  - Investing decision
    - What assets should we acquire?
    - Risk v return
  - Financing decision
    - How should we pay for the assets?
    - Financing cost, capital structure considerations
- Overall objective is to maximize net present value

# CRE Strategic Framework

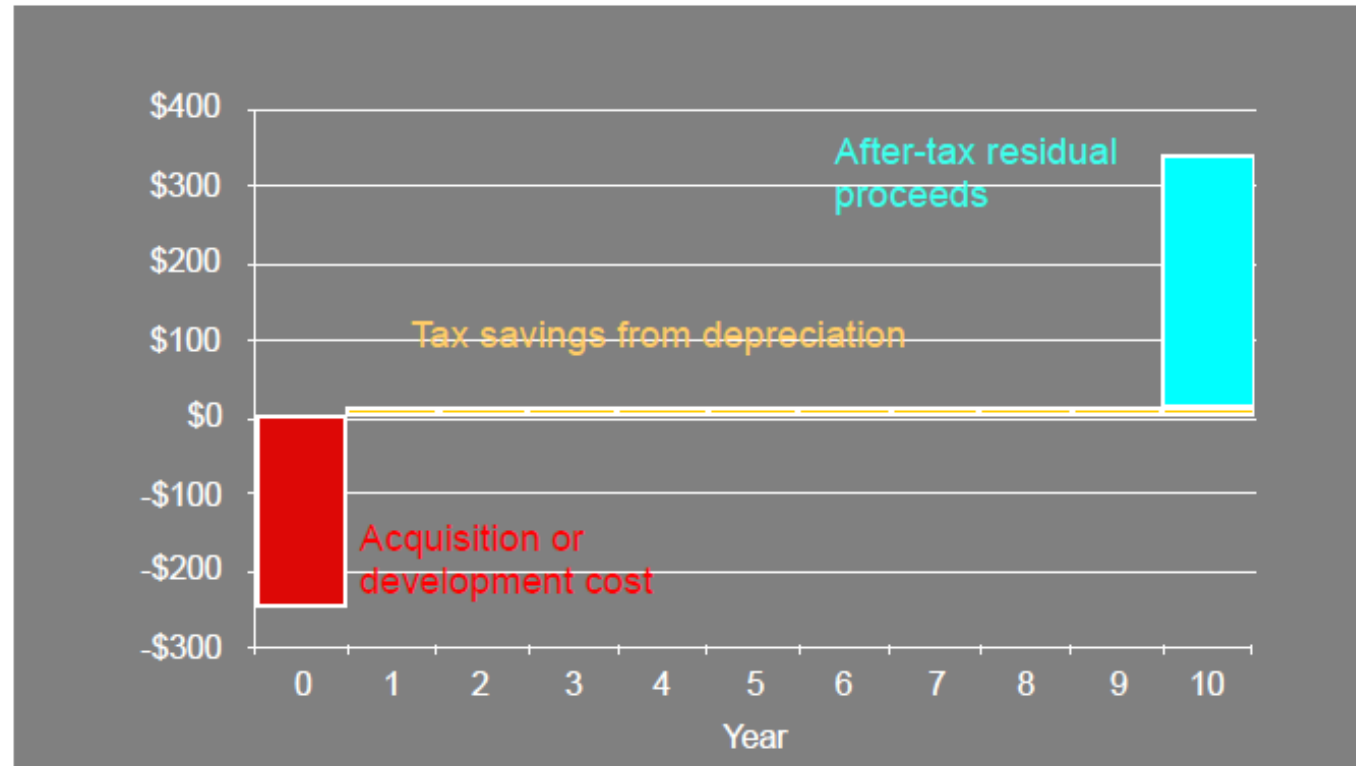
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## Cash Flows

- Ownership has three cash flows
  - Initial investment
  - Tax benefit (Tax Shield) resulting from depreciation
  - Residual value
- Lease has one (sometimes two) cash flows
  - Lease payment
  - Sub lease payments (receipts)

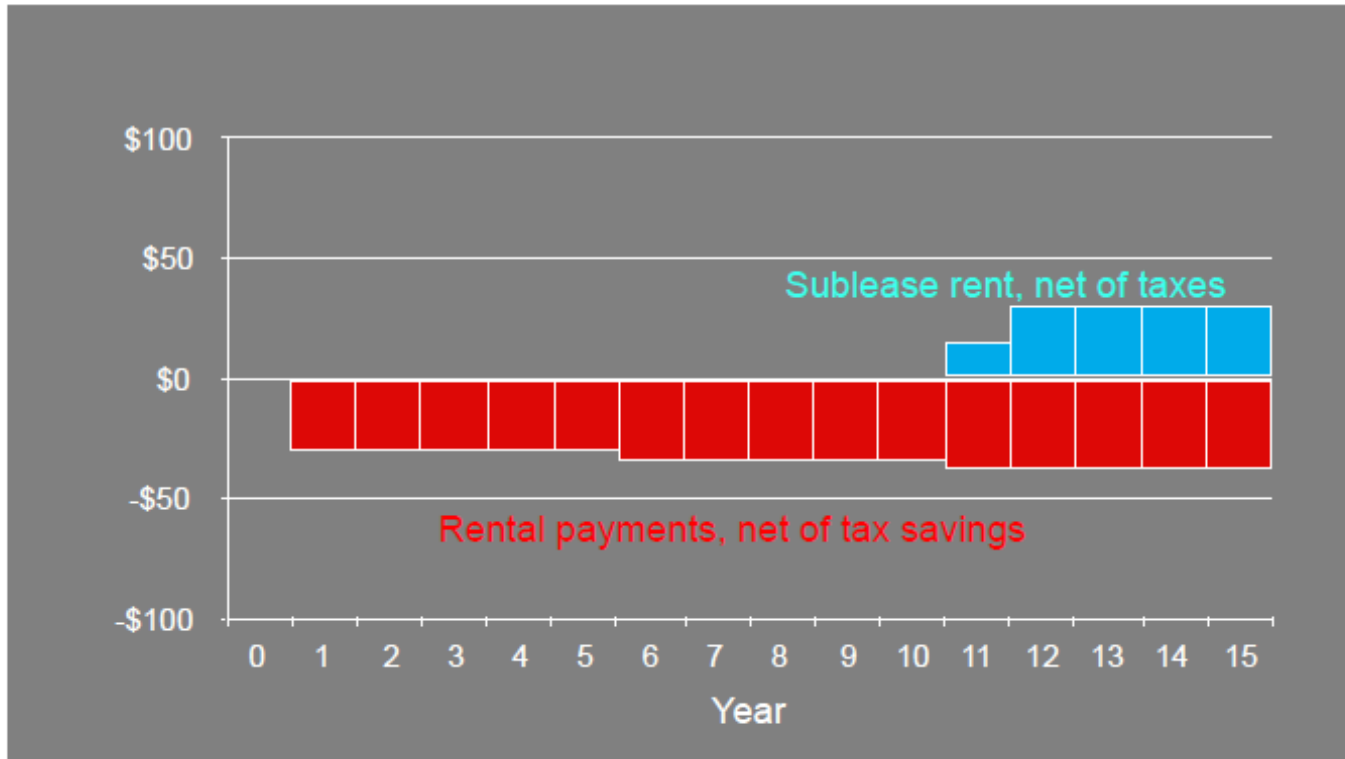
# CRE Strategic Framework

## Cash Flow Forecast – Own



# CRE Strategic Framework

## Cash Flow Forecast – Lease



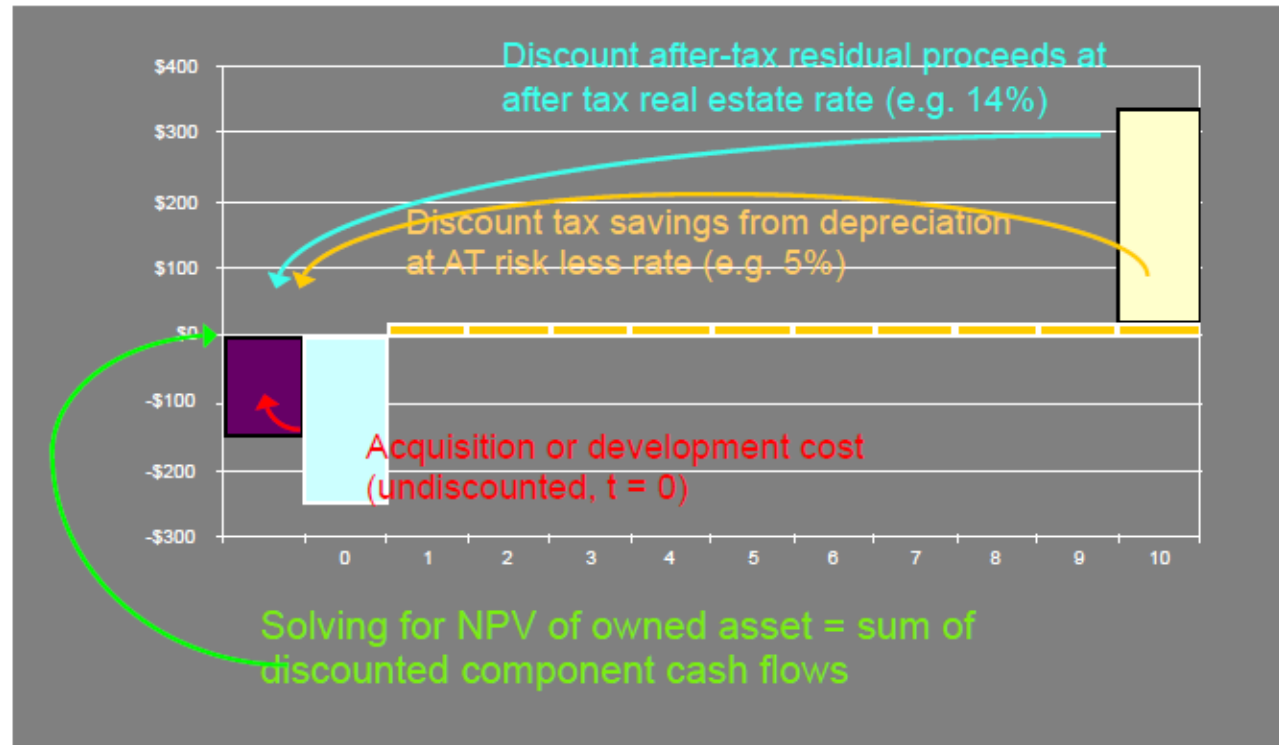
# CRE Strategic Framework

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- **Select Best Discount Rate**
- Which is the right discount rate to use?
  - Cost of debt
  - Weighted average cost of capital (WACC)
  - Typical real estate investment return
  - Hurdle rate (WACC + risk premium)
  - Other?

# CRE Strategic Framework

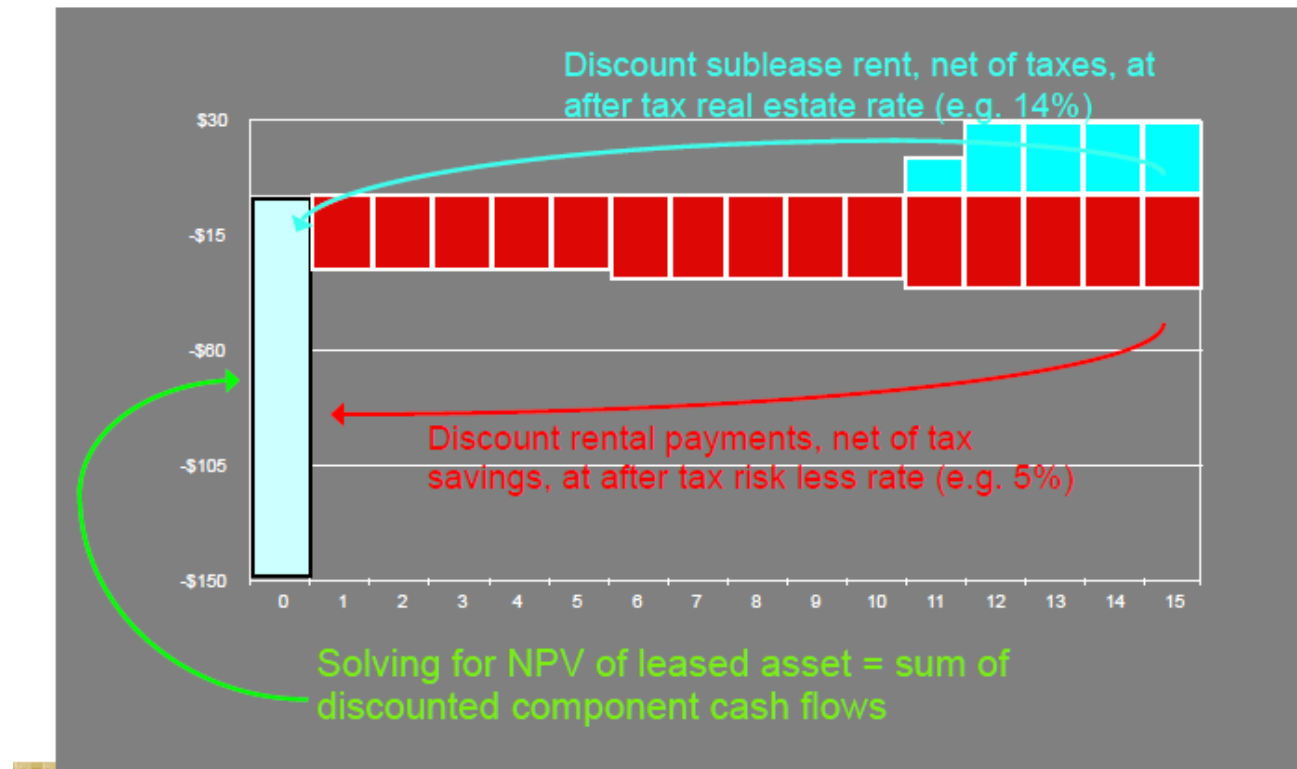
## Calculate NPV – Own





# CRE Strategic Framework

## Calculate NPV – Lease



# CRE Strategic Framework

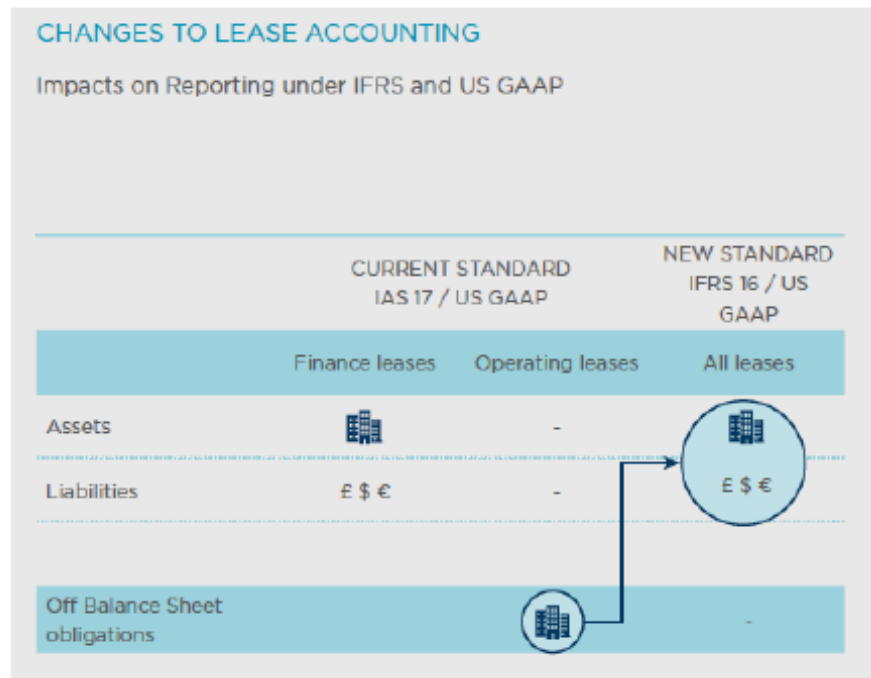
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- **Compare NPVs**
- NPV of ownership = (\$ X) NPV of lease = (\$ Y)
- Select alternative with highest (i.e. least negative) net present value
- Consider Tax implications
  - New IAS 17 Leases

# CRE Strategic Framework

## IAS 17 – IFRS 16

- Under IFRS 16, all leases will be reported on the Balance Sheet, similar to finance lease treatment under IAS 17.
- Operating v Finance Lease
- Own v Lease Impact





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Questions?