Corporate Real Estate: Cul de Sac or Crossroads?

Contents

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1.0 The evolution of corporate real estate

Two decades ago the activity of corporate real estate management emerged as a distinctive area of professional activity within the property industry. In the aftermath of the early-1990s recession, the UK saw the arrival of IDRC and NACORE from the US[1], and what distinguished these organisations from the prevailing approach in the UK and Europe was their focus on *operational* property, or corporate real estate (CRE) management.

Up to this point, the European approach was a traditional *asset* management one, resting on the cornerstone of the 1954 Landlord and Tenant Act. In Europe, the concept of "property" as an asset was, and largely remains, paramount; whereas the new pretenders sought to shift the focus to managing physical resources as an integral part of operational need.

The arrival of CRE coincided with the rapidly increasing globalisation of business and the development of ICT and the Internet with their manifold implications for business processes and trade. Business was beginning to move fast; demands on space started to change frequently, and occupiers began to place different emphases on their needs for property. It was in the early-1990s that "flexibility of occupation" began to emerge as a critical descriptor of operationally focused accommodation. Property had begun its journey from asset (or millstone depending upon your interpretation) to commodity; and suddenly the concept of a 25 year lease, complete with its inflexible and onerous obligations, began to look dated.

As well as their characteristic asset management focus, European property markets in the early-1990s were riven by fragmentation in supply structures. Quite distinct from "property" professionals, there were facilities management (FM) professionals, construction professionals and design professionals (see Figure 1). And within each of these there were numerous silos of activity, each with their own arcane lexicon. For a customer looking to procure a new building, the array of skills required over the life cycle of occupation was labyrinthine, inefficient and costly.

Figure 1 Property: a fragmented industry

CRE has continued to grow and evolve, but in large parts of the property industry it is more a case of *plus ca change, plus c'est la meme chose*. In some ways things have changed. There are now many larger corporate and public sector organisations where real estate is managed as a corporate resource. And outside of these there is a cadre of professionals who refer to themselves as CRE advisors. Education in CRE has emerged with MSc level education at various institutions. And some parts of the property supply industry have responded with a range of offers including serviced and managed offices, short leases and flexible terms (see 'Property industry response' below). Typical lease lengths have fallen to less than ten years, and five yearly breaks have become more common.

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But in other ways, ossified supply structures have changed very little. The property industry (as represented by BCO, BCSC, BPF, IPF and RICS[2]) is dominated by interests that are very focused on property as a tradable asset, namely landlords, developers and the large private surveying practices. This is not a criticism: the UK has a hugely successful property investment market, one that is attractive to investors from all over the world. It is simply to recognise where CRE sits in the order of things. Similarly, FM has yet to emerge as a strategic corporate function: often playing the role of Cinderella to "property" professionals, it has failed to capture its potential high ground. And the design and construction sectors remain as remote from the interests of occupiers as they ever were.

It is therefore legitimate to ask: *whither corporate real estate?* Will it evolve into a recognised profession (albeit perhaps as a sub-set of the wider property industry)? Or is it destined simply to be subsumed as part of the property supply structure just, perhaps, as Planning or Valuation exist as sub-disciplines within general practice surveying. Or is it, perhaps, on a path to somewhere else, namely, as the integrator for a new discipline of corporate resource management? Is it heading down a cul de sac, or is it at a crossroads?

2.0 Defining corporate real estate

Before progressing to discuss its future direction, it is worth pausing to define what is meant by CRE. As already mentioned, CRE is distinguished from more traditional property industry activities by its focus on linking real estate provision and management to operational requirements. In doing so, it does not distinguish between property, facilities and design and delivery. It is an integrating function, encompassing what is generally referred to as facilities management, general practice surveying and workplace design. CRE can take place in any commercial property sector, but particularly office, retail, industrial and leisure. It is practiced equally applied in the private and public sectors.

Varcoe and O'Mara (2011) provide a useful descriptor of CRE, in which they describe it as the "*function within an enterprise that manages its physical work, production and customer engagement environments*". They argue that, in many organisations, CRE has "*evolved from a narrow definition focusing on managing real estate transactions and design and construction projects*", to a far broader range of activities "*that support the physical workplace, financial and business strategy, and the implementation of work strategies that integrate advances in technological mobility*".[3]

During the past twenty years, there have been a number of studies and publications that have sought to define and describe the role of CRE. Although in the early stages mostly originating in the USA, one of the earliest texts to explicitly examine how operational property assets were being managed came from Avis, Gibson and Watts (1989) at the University of Reading.[4] While finding that most management was "*reactive rather than proactive property management*", the report found that, generally, "*property was not accorded the managerial attention that its value and importance warrants*".

By the early-1990s management consultant Arthur Anderson (1993) was calling for the effective alignment of "*the CRE function with corporate objectives and the goals of business units during a period of rapidly changing business practices*".[5] But at the same time, Apgar (1993) was highlighting that "*Most facilities decisions are fragmented by organizational boundaries and the traditional support role of real estate staff*".[6]

A key step towards demonstrating the potential role of CRE was the seminal work of Joroff et al (1993).[7] This report referred to CRE as the *fifth resource*, alongside capital, people, technology and information. The challenge for corporate real estate executives, they argued, is to "*learn the needs of the corporation ... and then to devise a strategy to satisfy them even when the answer may not involve traditional forms of real estate*". A similar message was outlined by Akinori et al (1993).[8] As well as laying down the challenges for the "new profession", a number of studies began to provide metrics to allow CREs to measure their impact. These included those by Noha (1993)[9]; Nourse (1994)[10], and Apgar (1995).[11]

In the UK, Avis and Gibson (1995) followed up the 1989 Reading report with a detailed study of real estate management in the UK. While recognising recent progress in the quality of management of real estate, the authors concluded that "*real estate still lags other resource areas in terms of attention given and performance achieved*".[12] By the mid-1990s, a number of of major studies had addressed this question head-on, including those by IDRC/E&Y (1996)[13], Weatherhead (1997)[14] and Deloitte & Touche (1997).[15]

For example, Weatherhead (1997) stressed "*the importance of real estate as a corporate resource which should be included in corporate strategy*". The notion that real estate should be treated as a corporate resource rather than as something special was gaining traction. This concern was fleshed out in a number of detailed publications; notable among these was McLennan, Nutt and Kincaid (1999).[16]

But there remained a schism between "property management" and "facilities management". This is seen in a number of publications that sought to establish FM as a "strategic function", covering many of the activities expected of CRE. This could be seen in early writing such as Nutt and McLennan (2000)[17] and BIFM (2004)[18], but has persisted to the present time; see for example: RICS (2009)[19]; Ware and Carder (2012)[20] and Workplace Futures (2013).[21]

Despite this ambiguity over CRE's "home", it is clear that there is an emerging consensus over its role. For example, Apgar (2009) argued that "*Business real estate is not merely an operating necessity, it's a strategic resource*".[22] Kadzis (2012) goes further, arguing that CRE finds itself in the "*middle of a multi-faceted dynamic that far exceeds the management of facilities, transactions or projects*".[23] He goes on to argue that CRE is "*at the nexus of a new business model", in which "demographics, economics, technology, talent and sustainability are shaping work-support factors*", and that the "*latter have moved to the top of the hierarchy of corporate business drivers, and CRE is in the thick of where it all intersects*".

The view of Kadzis is perhaps a somewhat optimistic perspective, as many CRE functions are still seen as "cost savers" rather than "value creators" within their client organisations. Also, Apgar (2009) cautions that "*In many organisations, real estate remains a reactive, second-order staff function, focused on discrete projects and deals rather than on the company's broader strategic issues*". Despite this note of caution, the direction of travel is becoming clearer. Again, Apgar (2009) suggests that real estate "*is never neutral*"; it can "*multiply shareholder value or diminish it*" and it can "*help an organisation achieve its mission, implement its strategy, and compete effectively*". Conversely, it can "*hinder ... market position, organisational development, and long-term growth*".

This is a sweeping review of the CRE literature, and is far from complete: many worthy texts are omitted. For example, there is a plethora of literature of the role of CRE within the public sector, an overview of which is provided by Harris (2012).[24] However, it provides context to the following discussion.

3.0 Commoditisation and the new workplace

To fully understand the role of CRE, it is necessary to recognise the changing nature of demand for real estate. Over the past thirty years and more, the UK economy has switched from an essentially manufacturing model to a service model. To illustrate this, the amount of office space has doubled since 1975; while manufacturing space has shrunk, perhaps by a third (it is instructive to note alongside this the enormous growth in the logistics sector). The significance of this switch in the national economy is that in the "old model" many companies owned real estate because it was an integral part of their business process. For example, most manufacturing companies owned their property, whether factory, warehouse or office.

By contrast, companies in the service economy operate in a far less tangible environment: they rely for their prosperity on ideas, knowledge and employees' skills. The knowledge economy accounts for over a fifth of UK output, and one in eight jobs. Knowledge-based business services have been responsible for nearly 40% of all economic growth in the UK since 1970, and have created 1.8 million jobs over that period.[25]

What relevance does all of this have to the commoditisation of real estate? The point is that the economy has changed dramatically: companies – occupiers – have been transformed in business terms. Most large corporate occupiers now operate in international market places, where competition is intense; where speed to market is critical, and where change is the only real constant. The huge impact of technology on operating models has been profound. The explosive growth in e-commerce – from basic goods to complex financial services – is transforming the manner in which many businesses operate (cf the impact of change on the high street). As a result of these trends, occupiers' relationship to real estate is changing.

In short, real estate is becoming a corporate resource, increasingly controlled by Treasury or Procurement, and managed like equipment, office services, and back office services. Many larger occupiers now outsource functions, ranging from procurement, to sales, to customer support, to distribution; increasing numbers are setting up shared service functions, whereby back office functions are pooled to provide shared (and more efficient) services to multiple client businesses. Similarly, growing numbers of organisations are now changing their approach to property: it is becoming commoditised. And alongside these macro-economic drivers, a related but separate set of drivers if fundamentally changing the way in which offices are used and managed. There is now a broad literature on workplace change and flexible working styles (FWS), and an overview of the evolution of the new workplace can be found in Harris (2012).[26] A number of the key trends are summarised below.

- The workplace is changing from a leaden and inflexible consequence of work, to a key enabler of organisational success.
- Expensive and valuable property is being used far more efficiently *and* effectively.
- Staff are more mobile, and team work, collaboration and meeting space are critical.
- Technology and business change programmes are enabling flexible working.
- Sterile, production line-style space yielding to dynamic work environments.
- The workplace is increasingly used to remind staff of their purpose and to convey to clients and visitors the values and objectives of the organisation.
- The disciplines of real estate, technology and people are working in concert to support change programmes.

The outcome of these changes in the way in which real estate is used and managed is a need to design and manage work places less as static backdrops to solitary work, and more as 'hotel' facilities, where guests demand a high level of service. This requires a different approach to the provision and management of support services provided to workers.

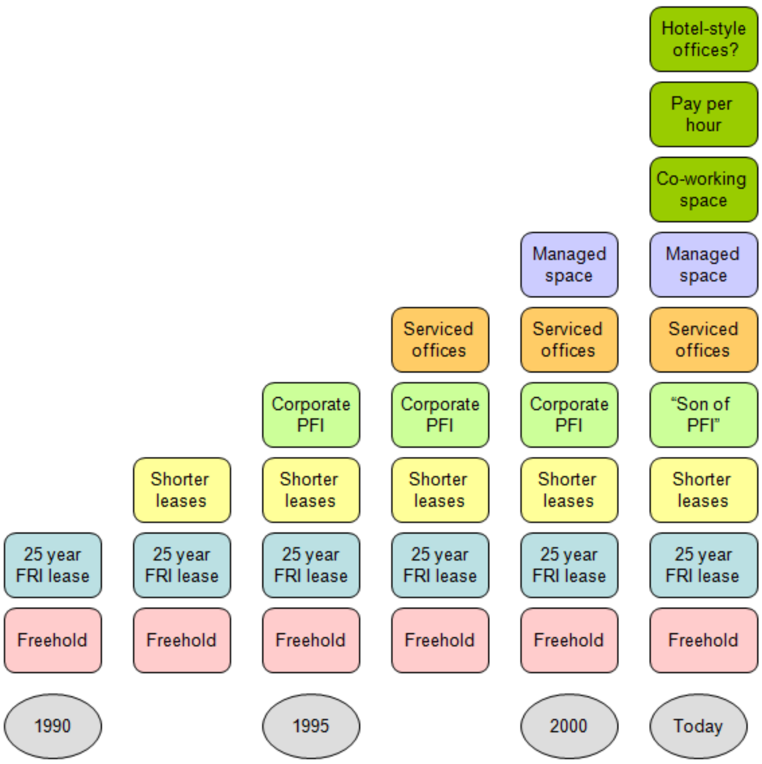
Property costs will ensure a continued focus on efficiency: big savings can be captured through smart space management. But cost cutting has limited strategic value; it is necessary but not sufficient. Instead, three is a need to shift the CRE focus from service delivery to a value-adding role. CRE is an essential part of the *experience* of an organisation, whether for employee, customer or visitor. It has a key role to play in supporting organisational goals by making people more *effective*. Motivated and supported people are likely to be more productive.

The likely outcome is that CRE managers will work less in isolation, and instead will collaborate, providing support to complex business processes though space and time. The typical CRE skill set will evolve from an old-style property management set into one with a broader, business base, allowing CREs to translate the needs of the business into a coherent supporting strategy; to communicate effectively with managers of the business; and to adopt techniques to demonstrate the impact of the workplace on business performance.

4.0 The property industry response

Against the backdrop of enormous and on-going change in occupiers' requirements, there have been significant shifts in the nature of the property products available from owners. While the Landlord & Tenant Act, with its attendant feudal terminology, continues to underpin the market, a far more dynamic offering is now available (Figure 2). Up until the 1990s, the only real options for an occupier were either to own premises or take them on very long, full repairing and insuring leases, complete with onerous obligations.

Figure 2 The growing diversity of product offerings



Following the recession of the early-1990s, a number of attempts were made to provide more flexible responses to occupier needs, beginning with shorter (albeit still onerous) leases. Despite its shortcomings, the PFI model (and variants on the theme) sought to provide certainty for both owner and occupier, albeit PFI was limited in its attraction to the wider market. The rise of the serviced and managed office market provided another solution. More recently, co-working space and pay-by-the-hour space has emerged. Clearly the breadth of procurement opportunities has changed for occupiers, providing them with greater flexibility and agility.

This growth in occupancy options is a welcome development, providing businesses with greater flexibility and efficiency in responding to volatile market environments. But the fact remains that many occupiers remain locked into long-term leases; and while they are under pressure to bring their costs down and become more agile, they are grappling with property portfolios that restrict their agility, and in reality their options.

And setting aside landlord issues, there is the structure of the property supply industry. As we have seen above, CRE is an integrating function, encompassing facilities management, general practice surveying and workplace design within an operational context. It also works in tandem with HR and ICT and other corporate resource functions as it seeks to align occupation with business objectives. However, when it engages with the property supply industry it is confronted with an entirely different scenario, consisting of fragmentation, duplication and inefficiency. Some of the symptoms and implications are listed below.

- Separate design and construction, property and facilities management silos defeat presentation of a coherent discipline to clients.
- Duplication in activities and a lack of joined-up planning creates inefficiencies, and inconsistency in methods, approaches and standards.
- There is a focus on transactional/procurement activity rather than delivering value.
- The focus on transactional activity leads to a culture in which property is seen as an end in itself, rather than as an aspect of corporate resource planning.

There are countless vested interests maintaining the status quo within the property supply industry, and some of these for good reason: as already noted the UK has a very successful property investment market. But the industry has failed to keep pace with changes affecting occupiers. Whether in health care, leisure, logistics, offices or retail, large swathes of the occupational market have been, and continue to undergo, enormous change in their operating models. Yet the property supply industry has lagged, preferring instead to hang on to out-dated practices and legal procedures.

5.0 Wither corporate real estate?

The previous sections have argued that the role of real estate within corporate organisations has been undergoing a process of radical change: it is increasingly becoming a commodity resource, and at the same time is being managed to promote organisational efficiency and effectiveness. As we have seen, CRE management is a relatively young discipline and it continues to evolve with these changes.

So, wither CRE management? Figure 3 presents four possible scenarios, with increasingly radical profiles. The ‘Business as usual’ scenario remains the reality for many in-house real estate teams. It is the traditional approach to management, with a focus on acquisition and disposal, capital projects, facilities management, and planned maintenance. It is largely reactive and, particularly in recent years, has had a tight focus on cost containment in areas such as facilities contracts.

Figure 3 CRE scenarios for change

Scenario	Model	Function & role	Skills & capability
Business as usual	In-house property team	Traditional property role; reactive; cost management focus.	Traditional palette of RICS skills.
Modest change	Business-aligned CRE	Workplace focus to support corporate objectives.	Client-facing; operationally-based CRE planning
Significant change	Intelligent client unit	Mostly outsourced; focus on business relationships.	Broadly-based business management skills.
Transformational change	Integrated business resource management	ICT, HR and CRE managed centrally.	New discipline of corporate resource management.

Figure 4 presents the modest change, or business-aligned, CRE model. The features of this model are that it requires CRE to understand the core business in a meaningful way and to be able to engage with it at a senior level in order to understand and interpret its key priorities, uncertainties and needs. The model implies deep engagement at business unit level in order to be able to tease out the plans and objectives of the key areas that will drive demand for space and services. The model also ensures alignment between corporate objectives and CRE actions, because the plan itself is based on feedback from the business, in key areas such as strategy, financial planning, staff retention and corporate culture.

Figure 4 Business-aligned CRE

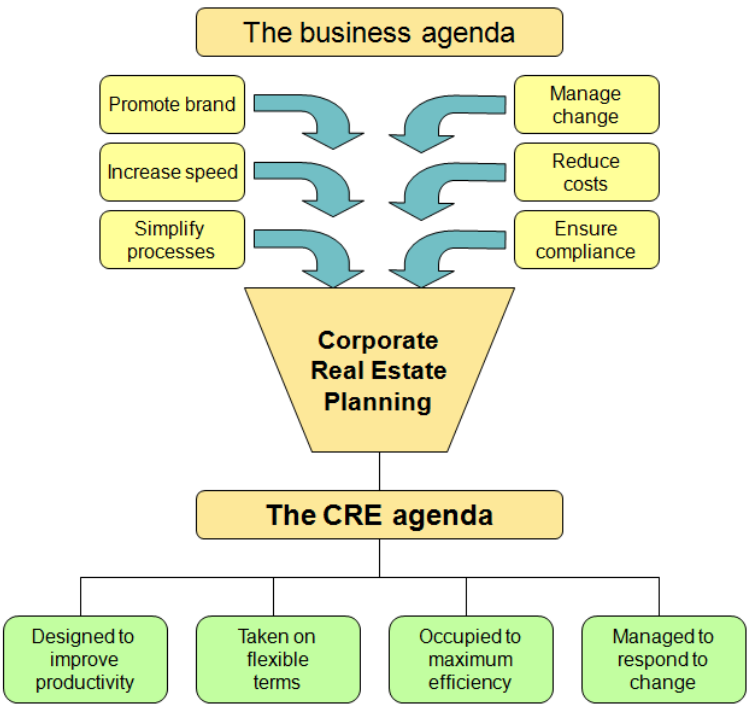
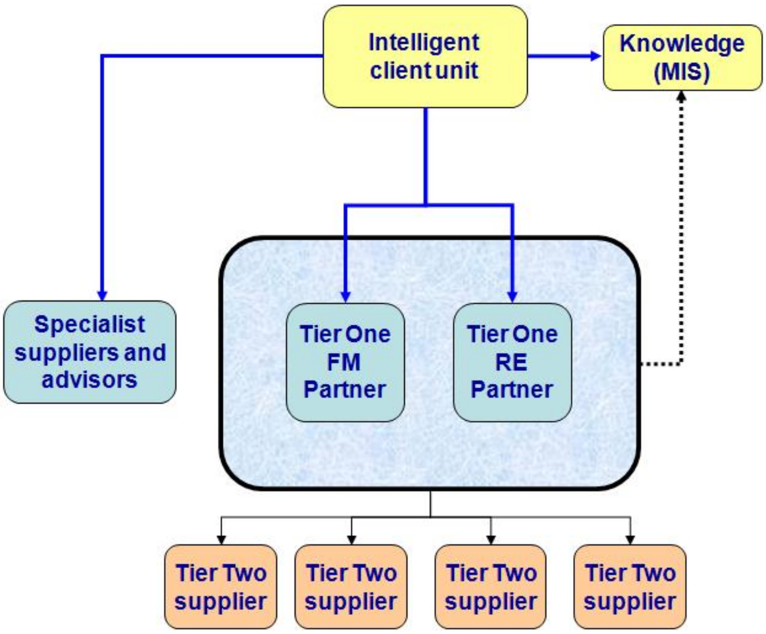


Figure 5 shows the significant change scenario in the form of the intelligent client unit. In this model, the in-house team is minimised in size and is reliant upon outsourced, genuinely integrated (rather than bundled) service provision. Many service providers claim to offer integrated service provision but in reality most simply bundle services.

This model encourages partnership working with minimal "Tier One" providers who work in partnership, themselves integrating "Tier Two" providers into their seamless offer to the client organisation. The ICU concentrates on developing relationships with the business to understand and anticipate operational demands. In this model the ICU is in a strategic planning role; it manages knowledge and it co-ordinates business critical issues. It is able to contemplate innovation with service providers in the delivery of services to the client body.

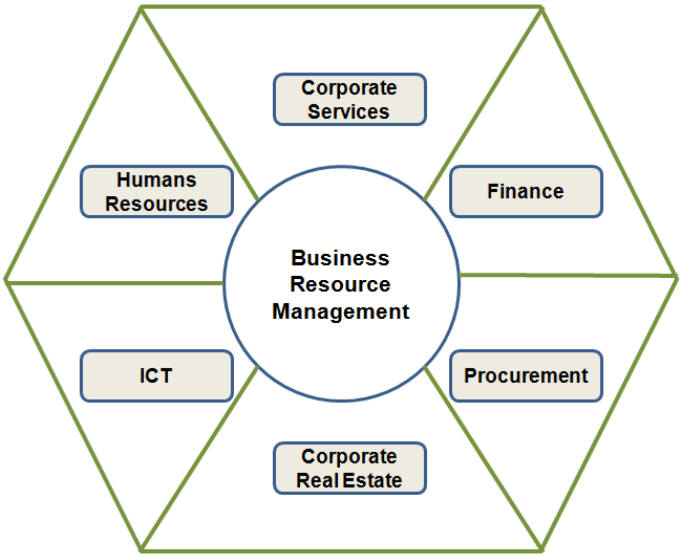
Figure 5 Intelligent client unit



The final model (Figure 6), is the integrated business resource model, and represents transformational change in the role of CRE management. In this model, CRE management is subsumed into a much broader "business resource management" function, which is responsible for a variety of non-operational functions. The primary motivations for such a model are the integration of processes and systems which support an organisation, but which can result in friction when managed separately.

There are already a number of examples of this model being put into practice, but it is yet to become commonplace. In many larger, more complex organisations there are often well defended territorial boundaries that defeat integration.

Figure 6 Integrated business resource management



The four scenarios for the future of CRE management present options for the discipline. It is important to stress that they are not mutually exclusive; nor do they present an inevitable evolutionary path. However, they do illustrate that CRE management could develop in a number of different ways.

6.0 Conclusions

In this paper we have traced the development of CRE management; its sphere of activities, and the context within which it continues to evolve – particularly the commoditisation of real estate and the new workplace. We have seen that the traditional property supply industry has generally lagged the rapidly changing needs of the occupier market, with its fragmentation and inefficient approach. And we have reviewed four potential scenarios for the future of CRE.

The changing world of work will continue to be a primary driver of change within CRE management, as the nature of the workplace demands fresh approaches. The critical opportunities for CRE management include connecting with the business; work enablement; a focus on people (not simply physical environments); integrated management. These areas will require a shift in mindset, and a corresponding acquisition of new skills and capabilities.

In short there is an opportunity to position CRE management as not only the focal point for workplace planning and provision, but as an integral and integrating part of core business planning. At a time when management teams are recognising the direct link between business performance and the quality of the workplace, those responsible for delivering a “high performance” workplace are in a position to take on a front-of-house role.

But to achieve this CRE management must break away from the cul de sac confines of the traditional property supply industry and process – which largely seeks to maintain the status quo. Instead it must traverse the crossroads of choice toward an integrating, value-adding and collaborative future, working with other business resource areas to support complex organisational processes though space and time.

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