Adjustment of corporate real estate during a period of significant business change

Citation for published version (APA):

Document status and date:
Published: 29/06/2017

Document Version:
Other version

Please check the document version of this publication:

• A submitted manuscript is the version of the article upon submission and before peer-review. There can be important differences between the submitted version and the official published version of record. People interested in the research are advised to contact the author for the final version of the publication, or visit the DOI to the publisher’s website.
• The final author version and the galley proof are versions of the publication after peer review.
• The final published version features the final layout of the paper including the volume, issue and page numbers.

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Adjustment of Corporate Real Estate During a Period of Significant Business Change

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Dr. ir. H.A.J.A. Appel – Meulenkoek
Prof. dr. T.A. Arentze
Prof dr. ir. B. de Vries
• **INTRODUCTION**
• **RELEVANCE**
• **PROBLEM STATEMENT**
• **HYPOTHESIS**
• **METHODOLOGY**
• **RESULTS**
• **CONCLUSION**
INTRODUCTION

• *Sustained Competitive Advantage* (Porter 1985) – Managers look to improve Value Chain through efficiency, effectiveness and productivity

• Business environment continually changing. Has evolved to:
  – *Transient Competitive Advantage* (McGarth 2013)
  – *Blue Ocean Strategies* (Kim & Margborne 2015)

• Business now has to be agile, dynamic and flexible, capable of quickly adjusting to grasp opportunities

• Dynamic strategic fit requires a learning mind set and iterative feedback loops for the individual and organisation

• CRE Portfolio has to be agile, dynamic, and flexible, therefore, capable of quickly adjusting to changed business needs.
RELEVANCE – SCALE OF COMMITMENT

Total CRE Commitment

- Manufacturing
- Miscellaneous
- Offices
- Retail
- Portfolio

Owned (£m’s)  Leased (£m’s)
RELEVANCE – EXAMPLE OF ISSUE

City of London Office Rents

- City Of London Headline Rent
- Rent Payable if Lease Taken in 1983
- Rent Payable if Lease Taken in 1985
PROBLEM STATEMENT

• To meet today’s challenges a business needs a flexible CRE portfolio capable of Dynamic Alignment

• Performance measures provide assessment base for business – both financial and CRE

• Performance measures linking business and CRE are Efficiency, Effectiveness, Productivity and Flexibility (Van Ree 2002)

• Flexibility can be defined as: Physical, Functional, Financial (Gibson 2000) and Legal

• Has business learnt from the past and built a CRE portfolio that facilitates Efficiency, Effectiveness, Productivity and Flexibility?
HYPOTHESES

**H1:** Over time the length of commitment to leased property will reduce to reflect improved CRE flexibility and effectiveness of CRE use

**H2:** As turnover and profitability decline/increase management will react by reducing/increasing the proportion of total costs committed to CRE

**H3:** As the number of FTE’s increases or decreases there will be a corresponding change to the CRE portfolio
METHODODOLOGY

- Financial and CRE data extracted and grouped –
  - Offices
  - Manufacturing
  - Miscellaneous
  - Retail
  - All Companies.
- Descriptive analysis of sectors to provide overview
- Distributed time lagged auto regression model:
  - 1 year lag
  - Stepwise adding in of independent variables
  - 95% confidence limits
## Mean Values Per Company

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All Companies</strong></td>
<td>230 Companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>£5,522m</td>
<td>47%</td>
<td>Freehold Value</td>
<td>£797m</td>
<td>22%</td>
</tr>
<tr>
<td>Profit</td>
<td>£475m</td>
<td>-4%</td>
<td>Property Provision</td>
<td>£17m</td>
<td>145%</td>
</tr>
<tr>
<td>FTE's</td>
<td>27,842</td>
<td>11%</td>
<td>Lease Total</td>
<td>£544m</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Offices</strong></td>
<td>108 Companies: Finance (39); Construction (15); Professional &amp; Support Services (29); Technology, Media &amp; Telecommunications (25)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>£5,575m</td>
<td>34%</td>
<td>Freehold Value</td>
<td>£177m</td>
<td>-4%</td>
</tr>
<tr>
<td>Profit</td>
<td>£486m</td>
<td>-12%</td>
<td>Property Provision</td>
<td>£25m</td>
<td>150%</td>
</tr>
<tr>
<td>FTE's</td>
<td>30,944</td>
<td>11%</td>
<td>Lease Total</td>
<td>£420m</td>
<td>4%</td>
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<tr>
<td><strong>Manufacturing</strong></td>
<td>54 Companies: Consumer Goods (15); Engineering (26); Industrials (13)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>£3,730m</td>
<td>48%</td>
<td>Freehold Value</td>
<td>£1,666m</td>
<td>28%</td>
</tr>
<tr>
<td>Profit</td>
<td>£514m</td>
<td>51%</td>
<td>Property Provision</td>
<td>£3m</td>
<td>200%</td>
</tr>
<tr>
<td>FTE's</td>
<td>18,768</td>
<td>8%</td>
<td>Lease Total</td>
<td>£189m</td>
<td>41%</td>
</tr>
<tr>
<td><strong>Miscellaneous</strong></td>
<td>45 Companies: Health (12); Leisure (8); Transport (8); Utilities (7)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>£6,579m</td>
<td>95%</td>
<td>Freehold Value</td>
<td>£687m</td>
<td>9%</td>
</tr>
<tr>
<td>Profit</td>
<td>£465m</td>
<td>-28%</td>
<td>Property Provision</td>
<td>£6m</td>
<td>133%</td>
</tr>
<tr>
<td>FTE's</td>
<td>22,755</td>
<td>13%</td>
<td>Lease Total</td>
<td>£354m</td>
<td>18%</td>
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<tr>
<td><strong>Retail</strong></td>
<td>23 Companies</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Turnover</td>
<td>£7,417 m</td>
<td>36%</td>
<td>Freehold Value</td>
<td>£1,888m</td>
<td>39%</td>
</tr>
<tr>
<td>Profit</td>
<td>£345.m</td>
<td>-1%</td>
<td>Property Provision</td>
<td>£40m</td>
<td>135%</td>
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<tr>
<td>FTE's</td>
<td>45,268</td>
<td>13%</td>
<td>Lease Total</td>
<td>£2,330</td>
<td>26%</td>
</tr>
</tbody>
</table>
PROFILE

ALL COMPANIES

- Turnover
- Profit
- FTE's
- Lease Total
- Owned CRE
- Total CRE
- Property Provision
PROFILE

RETAIL

- Turnover
- Profit
- FTE's
- Lease Total
- Owned CRE
- Total CRE
- Property Provision
**H1: Regression Analysis: Leases Over 5 Years Will Fall**

<table>
<thead>
<tr>
<th>RETAIL - AVERAGE LEASE TERM OVER 5 YEARS</th>
<th>Estimate (Unstandardized Beta)</th>
<th>t-value</th>
<th>p-value</th>
<th>$R^2$</th>
<th>Adju. $R^2$</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
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<tr>
<td>(Constant)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous Lease Term Over 5 Years</td>
<td>0.510</td>
<td>20.717</td>
<td>0.0</td>
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</tr>
<tr>
<td>Dummy2</td>
<td>-3.738</td>
<td>-2.123</td>
<td>0.035</td>
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<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>RETAIL - OWNED CRE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>10.370</td>
<td>0.402</td>
<td>0.688</td>
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</tr>
<tr>
<td>Previous Year Owned CRE</td>
<td>1.039</td>
<td>183.594</td>
<td>0.0</td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>RETAIL - TOTAL CRE COST</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>(Constant)</td>
<td>-48.125</td>
<td>-0.802</td>
<td>0.424</td>
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<tr>
<td>Previous Year Total CRE</td>
<td>1.049</td>
<td>142.609</td>
<td>0.0</td>
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</tbody>
</table>
H1: Predicted Values of Leases Over 5 Years Will Fall

Lease Term Over 5 Years

- ALL COMPANIES
- OFFICES
- MANUFACTURING
- MISCELLANEOUS
- RETAIL
H1: *Total CRE Commitment Will Fall*

**TOTAL CRE COST**

- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014

- ALL COMPANIES
- OFFICES
- MANUFACTURING
- MISCELLANEOUS
- RETAIL
**H1: CRE Declines over Time**

- Length of leases over 5 years increasing
- Ownership increasing, bar Offices and Miscellaneous
- Total costs of CRE increasing, bar Offices and Miscellaneous

Increase in ownership arguably providing a more flexible portfolio.

Increase in lease length is not providing more flexibility
H2: CRE FALLS AS TURNOVER/PROFIT INCREASE/DECLINE

Positive Coefficient Independent Variables
• Previous Year’s Profit – All Companies; Offices; Manufacturing & Retail
• Profit – Miscellaneous & Retail
• Turnover – Offices & Manufacturing

Negative Coefficient Independent Variables
• Previous Years Turnover – All Companies; Offices & Manufacturing
• Profit – Manufacturing

Hypothesis broadly proven

<table>
<thead>
<tr>
<th>RETAIL - TOTAL CRE COST v PROFIT &amp; TURNOVER &amp; PROFIT MARGIN and TOTAL CRE COST v FTE</th>
<th>Estimate (Unstandardized Beta)</th>
<th>t-value</th>
<th>p-value</th>
<th>R²</th>
<th>Adju. R²</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>104.666</td>
<td>1.308</td>
<td>0.193</td>
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<tr>
<td>Previous Year Total CRE</td>
<td>0.892</td>
<td>57.656</td>
<td>0.0</td>
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<tr>
<td>Profit</td>
<td>1.264</td>
<td>5.918</td>
<td>0.0</td>
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<tr>
<td>Profit Margin</td>
<td>-2,744.11</td>
<td>-3.496</td>
<td>0.001</td>
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<td></td>
</tr>
<tr>
<td>Dummy2</td>
<td>241.589</td>
<td>2.126</td>
<td>0.035</td>
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<td></td>
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</tr>
<tr>
<td>Previous Year Profit</td>
<td>0.459</td>
<td>2.093</td>
<td>0.038</td>
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</tr>
</tbody>
</table>
H3: CRE FALLS/INCREASES WITH DECLINE/INCREASE IN FTE NUMBERS

- Absolute Change in CRE cost per FTE: Offices -9%, Miscellaneous -0.6%, All Companies +8%, Manufacturing +20%, Retail +16%
- Positive coefficient FTE numbers with Total CRE Costs for All Companies & Manufacturing. Negative for Previous Year FTE Numbers

H3: CRE LEASE COSTS DECLINE OVER TIME RELATIVE TO FTE NUMBERS

- Positive for FTE – All Companies, Manufacturing & Retail
- Negative for Previous Years FTE – All Companies, Manufacturing & Retail

Business increases space as it takes on people
Business is not reducing lease costs needs relative to FTE numbers

<table>
<thead>
<tr>
<th>RETAIL - LEASE TOTAL v FTE</th>
<th>Estimate (Unstandardized Beta)</th>
<th>t-value</th>
<th>p-value</th>
<th>R²</th>
<th>Adju. R²</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>-1.159</td>
<td>-0.038</td>
<td>0.970</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous Year Lease Total</td>
<td>0.958</td>
<td>65.691</td>
<td>0.0</td>
<td>0.992</td>
<td>0.992</td>
<td>0.013</td>
</tr>
<tr>
<td>FTE</td>
<td>0.054</td>
<td>8.176</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous Year FTE</td>
<td>-0.051</td>
<td>-7.345</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dummy7</td>
<td>-172.074</td>
<td>-2.523</td>
<td>0.013</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CONCLUSION

• Evidence of improved portfolio flexibility and capability for Dynamic Alignment is limited
  – Only evident through increase in ownership
  – Lease increases reducing flexibility
• Relationships between variables not straight forward
• More consistency appears to exist across Manufacturing & Retail

• Further Work:
  – More granular analysis – business sectors, but sample size issue
  – Bring in other independent variables
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