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

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

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Prof. dr. T.A. Arentze
Prof dr. ir. B. de Vries
• INTRODUCTION
• RELEVANCE
• PROBLEM STATEMENT
• HYPOTHESIS
• METHODOLOGY
• RESULTS
• CONCLUSION
• *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
**Methodology**

- 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>
<th></th>
<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>
</tr>
<tr>
<td><strong>Manufacturing</strong></td>
<td>54 Companies: Consumer Goods (15); Engineering (26); Industrials (13)</td>
<td></td>
<td></td>
<td></td>
<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>
</tr>
<tr>
<td><strong>Retail</strong></td>
<td>23 Companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td>£7,417 m</td>
<td>36%</td>
<td>Freehold Value</td>
<td>£1,888m</td>
<td>39%</td>
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<tr>
<td>Profit</td>
<td>£345.7m</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>
Cooke et al 2017: Adjustment of Corporate Real Estate
### 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>R²</th>
<th>Adju. R²</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>5.960</td>
<td>7.971</td>
<td>-0.0</td>
<td>0.731</td>
<td>0.728</td>
<td>0.035</td>
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<tr>
<td>Previous Lease Term Over 5 Years</td>
<td>0.510</td>
<td>20.717</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Dummy2</td>
<td>-3.738</td>
<td>-2.123</td>
<td>0.035</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| RETAIL - OWNED CRE                      |                                 |         |         | 0.995 | 0.995   | 0.0          |
| (Constant)                              | 10.370                         | 0.402   | 0.688   |      |         |              |
| Previous Year Owned CRE                 | 1.039                          | 183.594 | 0.0     |      |         |              |

| RETAIL - TOTAL CRE COST                 |                                 |         |         | 0.992 | 0.992   | 0.0          |
| (Constant)                              | -48.125                        | -0.802  | 0.424   |      |         |              |
| Previous Year Total CRE                 | 1.049                          | 142.609 | 0.0     |      |         |              |
H1: Predicted values of leases over 5 years will fall
H1: Total CRE Commitment Will Fall

TOTAL CRE COST

- 350,000  300,000  250,000  200,000  150,000  100,000  50,000

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>Variable</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>(Constant)</td>
<td>104.666</td>
<td>1.308</td>
<td>0.193</td>
<td>0.996</td>
<td>0.996</td>
<td>0.038</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>
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<tr>
<td>Dummy2</td>
<td>241.589</td>
<td>2.126</td>
<td>0.035</td>
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<tr>
<td>Previous Year Profit</td>
<td>0.459</td>
<td>2.093</td>
<td>0.038</td>
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</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>0.992</td>
<td>0.992</td>
<td>0.013</td>
</tr>
<tr>
<td>Previous Year Lease Total</td>
<td>0.958</td>
<td>65.691</td>
<td>0.0</td>
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<tr>
<td>FTE</td>
<td>0.054</td>
<td>8.176</td>
<td>0.0</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Previous Year FTE</td>
<td>-0.051</td>
<td>-7.345</td>
<td>0.0</td>
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<tr>
<td>Dummy7</td>
<td>-172.074</td>
<td>-2.523</td>
<td>0.013</td>
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</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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