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

H. Cooke
Dr. ir. H.A.J.A. Appel – Meulenbroek
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
**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><strong>Turnover</strong></td>
<td>£5,522m</td>
<td>47%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>£475m</td>
<td>-4%</td>
<td><strong>Freehold Value</strong></td>
<td>£797m</td>
<td>22%</td>
</tr>
<tr>
<td><strong>FTE's</strong></td>
<td>27,842</td>
<td>11%</td>
<td><strong>Property Provision</strong></td>
<td>£17m</td>
<td>145%</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><strong>Turnover</strong></td>
<td>£5,575m</td>
<td>34%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>£486m</td>
<td>-12%</td>
<td><strong>Freehold Value</strong></td>
<td>£177m</td>
<td>-4%</td>
</tr>
<tr>
<td><strong>FTE's</strong></td>
<td>30,944</td>
<td>11%</td>
<td><strong>Property Provision</strong></td>
<td>£25m</td>
<td>150%</td>
</tr>
<tr>
<td><strong>MANUFACTURING</strong></td>
<td>54 Companies: Consumer Goods (15); Engineering (26); Industrials (13)</td>
<td></td>
<td><strong>Turnover</strong></td>
<td>£3,730m</td>
<td>48%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>£514m</td>
<td>51%</td>
<td><strong>Freehold Value</strong></td>
<td>£1,666m</td>
<td>28%</td>
</tr>
<tr>
<td><strong>FTE's</strong></td>
<td>18,768</td>
<td>8%</td>
<td><strong>Property Provision</strong></td>
<td>£3m</td>
<td>200%</td>
</tr>
<tr>
<td><strong>MISCELLANEOUS</strong></td>
<td>45 Companies: Health (12); Leisure (8); Transport (8); Utilities (7)</td>
<td></td>
<td><strong>Turnover</strong></td>
<td>£6,579m</td>
<td>95%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>£465m</td>
<td>-28%</td>
<td><strong>Freehold Value</strong></td>
<td>£687m</td>
<td>9%</td>
</tr>
<tr>
<td><strong>FTE's</strong></td>
<td>22,755</td>
<td>13%</td>
<td><strong>Property Provision</strong></td>
<td>£6m</td>
<td>133%</td>
</tr>
<tr>
<td><strong>RETAIL</strong></td>
<td>23 Companies</td>
<td></td>
<td><strong>Turnover</strong></td>
<td>£7,417m</td>
<td>36%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>£345m</td>
<td>-1%</td>
<td><strong>Freehold Value</strong></td>
<td>£1,888m</td>
<td>39%</td>
</tr>
<tr>
<td><strong>FTE's</strong></td>
<td>45,268</td>
<td>13%</td>
<td><strong>Property Provision</strong></td>
<td>£40m</td>
<td>135%</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Lease Total</strong></td>
<td>£354m</td>
<td>18%</td>
</tr>
</tbody>
</table>
Cooke et al 2017: Adjustment of Corporate Real Estate

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>(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>
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<td></td>
</tr>
<tr>
<td>Dummy2</td>
<td>-3.738</td>
<td>-2.123</td>
<td>0.035</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RETAIL - OWNED CRE</td>
<td></td>
<td></td>
<td></td>
<td>0.995</td>
<td>0.995</td>
<td>0.0</td>
</tr>
<tr>
<td>(Constant)</td>
<td>10.370</td>
<td>0.402</td>
<td>0.688</td>
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<tr>
<td>Previous Year Owned CRE</td>
<td>1.039</td>
<td>183.594</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RETAIL - TOTAL CRE COST</td>
<td></td>
<td></td>
<td></td>
<td>0.992</td>
<td>0.992</td>
<td>0.0</td>
</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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</tr>
</tbody>
</table>
H1: Predicted values of leases over 5 years will fall

LEASE TERM OVER 5 YEARS

2007 2008 2009 2010 2011 2012 2013 2014

ALL COMPANIES OFFICES MANUFACTURING MISCELLANEOUS RETAIL
H1: TOTAL CRE COMMITMENT WILL FALL

TOTAL CRE COST

- 2007 - 2014
- ALL COMPANIES
- OFFICES
- MANUFACTURING
- MISCELLANEOUS
- RETAIL

Cooke et al 2017: Adjustment of Corporate Real Estate
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>
<td>0.996</td>
<td>0.996</td>
<td>0.038</td>
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<tr>
<td>Profit</td>
<td>1.264</td>
<td>5.918</td>
<td>0.0</td>
<td>0.996</td>
<td>0.996</td>
<td>0.038</td>
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<tr>
<td>Profit Margin</td>
<td>-2,744.11</td>
<td>-3.496</td>
<td>0.001</td>
<td>0.996</td>
<td>0.996</td>
<td>0.038</td>
</tr>
<tr>
<td>Dummy2</td>
<td>241.589</td>
<td>2.126</td>
<td>0.035</td>
<td>0.996</td>
<td>0.996</td>
<td>0.038</td>
</tr>
<tr>
<td>Previous Year Profit</td>
<td>0.459</td>
<td>2.093</td>
<td>0.038</td>
<td>0.996</td>
<td>0.996</td>
<td>0.038</td>
</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>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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<td></td>
<td></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>
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<td></td>
</tr>
<tr>
<td>Dummy7</td>
<td>-172.074</td>
<td>-2.523</td>
<td>0.013</td>
<td></td>
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</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 straightforward

• 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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H. Cooke (hc@core-consult.co.uk)
Dr. ir. H.A.J.A. Appel – Meulenkoek
Prof. dr. T.A. Arentze
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