Do You Have a Real Estate Strategy?

Your company's CRE functions should fit seamlessly into an integrated business plan, with an eye toward boosting revenues through effective management.

By Nevin D. Cooley, President, High Real Estate Group

THE IMPORTANCE of a strategic real estate plan to a successful business plan is no Mickey Mouse affair. Walt Disney needed to learn that lesson only once when he set out to create what have since become the world's most successful theme parks. Just before World War II, Disney envisioned an eight-acre amusement park. When his plans were delayed by the war, he used the time to expand his dream, ultimately purchasing a 160-acre tract of orange groves in Anaheim, Calif. There, he built Disneyland.

By any standard, the park has been a success. At the time, Disney's decision to acquire a larger tract of land than he thought he would need was seen as extravagant. And yet even that seeming extravagance proved inadequate. Shortly after the park's opening day, Disney predicted, "We're gonna kick ourselves for not buying everything within a radius of 10 miles around here."

Decades later, while planning for Disney World in Orlando, he was determined not to make the mistake he'd made in California. In Florida, he developed a long-term master plan for future growth, acquiring a land holding that rivals many midsize cities. The result has been decades of continual expansion of Disney World — driven by a sound, strategic real estate plan with flexibility that is still in sync with the company's overall business vision.

Few of us will ever be challenged to develop a master plan of this scale. But all businesses rely on some form of real estate to execute their business plans, whether it's a one-person consultancy in a shared office space, a multimillion-dollar manufacturer, or behemoths like Wal-Mart or McDonald's. As Disney learned in Anaheim, the lack of a fully developed strategic real estate plan can limit a company's ability to respond to future opportunities and challenges.

Today, executives who have the responsibility of aligning their corporate real estate strategies with overall business plans see the need for more real estate assets on the balance sheet. Yet, current business trends often dictate that real estate assets consume less of the company's capital.

However, some firms do plan larger real estate investments. Today, 30 percent or more of the value of American corporate holdings currently is allocated to real estate. A new study by Ernst & Young LLP shows that 42 percent of the businesses surveyed plan to increase the amount of real estate they occupy in the next 12 months. Further, 65 percent plan to increase their investment in real estate. Whether a firm is planning to increase or decrease its real estate investment, all firms share the same fundamental mandate: real estate investments must be tied strategically to the business plan.

Who Will Take the Lead?

Though it may represent a substantial part of the balance sheet — and often one third of a corporation's assets — real estate planning receives a disproportionately lower amount of staffing, budgeting, and other resources when compared with other corporate functions. Most manufacturing companies, for example, have in-house expertise in engineering, financial management, communications, and human resources. Some larger companies have substantial in-house real estate planning and management expertise. But it's rare for small to midsize companies to have any in-house real estate capability.

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Perhaps this state of affairs occurs at many firms because real estate is not a discipline through which decisions are passed routinely. Because of that, real estate planning frequently has no in-house champion, making it all the more difficult to assemble the necessary resources when real estate decision-making is critical. With a global market and ever-more sophisticated and complex business environments, it's apparent to most that the days have passed when key corporate real estate decisions could be made on an ad-hoc basis by people who are skilled in other areas but unprepared to develop strategic approaches to real estate.

The low priority that strategic real estate planning too often receives is especially troublesome given some recent events. For example, prior to September 11, major corporations generally considered it sound practice to concentrate corporate offices in a central location. After all, this tends to maximize efficiency. In the wake of that day's devastation, however, prevailing wisdom has challenged this monolithic, all-in-one-place approach.

Dispersal to multiple locations that are linked by technology dominates the current debate on how best to locate corporate operations. To illustrate the point, in the week following September 11, AT&T reported a 20-percent increase in its teleconferencing business. Similarly, a Prudential videoconferencing facility that rents to the public doubled business that week.

Manufacturers once distributed their inventories to small warehouse facilities in many locations. Now, so-called super-regional distribution centers and just-in-time through-docking facilities — which take products in the front door and push them almost immediately out the back — are best serving changing business needs. Add to that the weaker economy and it is clear that companies need more flexibility than ever to shrink or grow their real estate assets in lock-step with the demands of the marketplace.

Implementation

At this point, some readers of *Area Development* might think, "Tell me something I don't know!" Every corporate real estate executive, CFO, or CEO at least gives lip service to the idea that strategic real estate planning is critical to business success. In much the same way, every football coach knows that a team must run and block well, that quarterbacks need good arms, and that receivers need good hands. Just about everyone knows what it takes to be successful. Yet some teams win consistently and some almost never do. The winners are able to move from knowledge to execution.

Typically, thinking about real estate is limited to factors such as how a facility contributes to creating a product, how it affects the supply chain, whether or not it contributes to client intimacy, and how it contributes to employee morale and satisfaction. But real estate can affect many more factors that directly impact the bottom line. Good or bad real estate choices invariably have an impact on recruitment, training, client relations, corporate image, efficiency of workflow, the ability to deploy new technologies, and the return on public or private equity investments in a company.

Because real estate decisions can affect so many things, truly strategic real estate planning is linked closely to the business plan in realistic and practical ways. Assembling a complex real estate plan is precisely that — a complex undertaking with many parts that must be integrated seamlessly to form a coherent picture. Yet far too many real estate plans fail to account for all of the pieces of the puzzle.

For example, if your company were to consider buying the "perfect" building today, how perfect will it be when the size of your business doubles in accordance with your business plan? Would it be smarter to lease space in a corporate-center environment where the landlord has ample motivation to accommodate your expansion requirements? Would a stand-alone building be the only way to project the high-end image that's also demanded by your business plan? Or would a stand-alone facility belie your market position as the value provider of your product or service?

The following questions deserve consideration in any such analysis:

◆ Should you be deploying any capital to bricks and mortar when your business plan calls for capital investments in other areas of your company?

◆ Would that capital provide a higher return if it were used to support the purchase of new capital equipment, increase marketing, or fund other capital requirements?

◆ Are your facilities geographically aligned with your targeted growth markets?

◆ Are you considering the locations, technologies, and amenities that are required to attract and keep the kind of workers you need?

◆ Conversely, how will your real estate plan accommodate an unexpected downturn in sales?

Real Life Real Estate

These and other questions were among the challenges considered recently by executives at Philips Communication, Security & Imaging, Inc., which is now pending acquisition by German-based Bosch GmbH. The Communications, Security & Imaging unit — currently a division of Philips North America Corp. — designs, manufactures, and supports communications and security products and systems, including closed-circuit video surveillance, paging, and public-address systems. The company's U.S. headquarters were housed in an antiquated facility that was inherited when the current parent company purchased the firm. The executive team agreed that the facility did not support the business strategy in many ways.

The building had been retrofitted so many times that materials no longer flowed through the facility efficiently and departments that needed to relate physically could not do so. The building was not attractive, a factor that had real consequences for a firm known in its industry as a technology leader. Also, the building didn't offer a pleasant working environment, which had a profound effect on employee morale and productivity. Further, the facility was leased from a landlord who didn't share the firm's desire to make the infrastructure improvements that were sorely needed, such as sophisticated telecommunications systems, high-speed Internet access, and HVAC improvements. This was a straightforward case of a company's real estate being out of sync with its business planning.

Philips executives reached a number of conclusions. First, they did not have the in-house expertise to assemble their complex real estate puzzle, and, second, they did not want to take on the overhead of a full-time, in-house real estate planning and development team.

So Philips hired the expertise it needed. The company's requirements included locating the new facility within close proximity to the existing facility and avoiding any disruption to the commuting patterns of the current work force — which would reduce the need for a large recruitment and training effort. Philips wanted its manufacturing and distribution facilities to be connected to its office facilities, yet also saw the advantage of having some separation between them. Company executives also wanted a large amount of office space outfitted with the high-end look and sensibility they needed to support their position in the marketplace. Finally, despite the highly customized requirements they had, they did not want to invest their assets in owning a facility.

The firm that Philips chose was a full-service real estate company that was able to locate and purchase the real estate; design, specify, and handle permits; build the facility; and create a lease structure that was attractive both to Philips and to the real estate company, which would also serve as Philips' lessor. And, because the real estate firm specialized in development projects within the same geographic areas in which it operated, it also helped Philips take advantage of special state-level funding programs that provided incentives for companies to expand or retain jobs in the state.

Honest Evaluation

It's useful to look behind the scenes at decisions that were made in the Philips deal. The facility that Philips needed was unique. For the real estate company, it would not have been economically sound to build so much office space in a manufacturing facility — if the tenant were to leave, finding a replacement company with similar requirements would be nearly impossible.

In order to serve Philips' needs and also make it economically feasible for the developer and facility owner, two buildings were designed — one for offices and one for manufacturing and distribution. The two were connected by an umbilical structure that could be removed if later required. This met Philips' needs and protected the investment of the real estate company.

How can you develop a sound real estate strategy for your business? The truth is, you probably can't do it alone. The first step is to honestly, rigorously, and objectively evaluate whether you have the in-house expertise required to tackle such a mission-critical task. If the answer is no, your first step must be to determine how to fill that need, either by building the capability in-house or engaging the necessary outside help.

Just as lawyers, accountants, and other consultants help in crafting a business's strategy, qualified real estate professionals who contribute their knowledge and guidance can yield huge dividends for an organization.

Developing any important strategy that will influence the future of your business is tough and complicated work. Sometimes, it can seem overwhelmingly complex. But as Disney was fond of saying, "It's kind of fun to do the impossible." AREA

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