Rediscover your company's real estate

How you can learn when and how to profit more – not less – from the properties your company owns

Sally Zeckhauser and Robert Silverman

In the wave of real estate hysteria that hit the United States in the last part of the 1970s, it seemed as if companies, like many American citizens, were riding high. Big deals made and still make news – the sale of the Woolco stores (complete with rumors about shadowy Arab investors) is only one of the most recent and colorful examples.

The reality of the corporate boom doesn't quite live up to the journalistic glamour, however. Many companies don't even know what property they own, let alone what to do with it. Those that have sought to profit from sales are more often prompted by visions of bankruptcy (like Woolworth's) and not a bottomless pot of gold. To sort out the facts about companies and real estate, Harvard Real Estate conducted a survey of 300 U.S. companies. The authors use the findings to offer advice to corporations on how to manage their real estate holdings. That involves not only learning when to sell, but also how to control costs.

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Photographs courtesy of Stock, Boston.

Corporate real estate – the land and buildings owned by companies not primarily in the real estate business – is an aspect of corporate affairs largely ignored in boardrooms across the country. Results of a recent study conducted by Harvard Real Estate, Inc., a subsidiary of Harvard University, confirm the lack of management of this asset. Only 40% of American companies clearly and consistently evaluate the performance of their real estate; most treat property as an overhead cost like stationery and paper clips.

In fact, it's an important asset. The study estimated that American companies' real estate typically accounts for at least 25% of their total assets and is worth in aggregate between $700 billion and $1.4 trillion – a sum equal to, or greater than, the wealth of the nation's pension funds. The holdings include four to seven billion square feet of buildings owned outright, two to seven billion square feet leased, and 70 to 140 million acres of undeveloped land – an area larger than Great Britain.

Barely 20% of American corporations manage their real estate for profit. Most look at it simply as a necessary overhead and can only guess at its fair market value. Senior management often justifies such lack of attention by the observation: "We're not in the real estate business."

After the real estate "revolution" of the 1970s and 1980s, companies can no longer responsibly have this attitude. The truth comes through loud and clear: a $1 billion company *is* in the real estate business, probably to the tune of $250 million. And if such a company doesn't exploit its real estate, these assets will almost certainly exploit the company.

Even companies that decide *not* to earn income from real estate should look at the needless costs that property incurs, most commonly through simple omissions. In a leading computer company studied, for example, a new real estate director, brought in to create a cost center, found the accounting department readily disbursing property taxes without any consideration as to the possibility of abatements for overassessment.

A company that owns or leases more than 10 million square feet, especially if the sites are widely dispersed, may neglect property management because of the difficulty in establishing uniform standards. The survey showed, however, that a majority of these companies could set up an effective property management program.

Other advantages come with the simple exercise of reevaluating property assets besides those arising from cost control. The Financial Accounting Standards Board Statement 33 asks companies to present net assets stated in terms of constant dollars and current costs. Historically undervalued properties may reduce overall rates of return well below those calculated on a current-dollar value basis. Properly valued real estate assets might increase a company's total asset base by at least 10%. Some 15% of the companies surveyed believe their real estate would be worth 50% of their assets in the marketplace, and a few even think their holdings might buy several times the book value of the entire company.

A new look at corporate real estate

The need to rethink real estate holdings cuts across boundaries of company size or business activity, the quantity and value of property held, or its geographic distribution. The study shows that the proper management of real estate assets by any company can make a significant, positive short-term as well as long-term impact.

From the results of the study (see the ruled insert for details of the research), Harvard Real Estate identified seven steps that a company can take to make better use of this asset.

Determine property assets

Of the companies surveyed, 20% have not compiled a property inventory and presumably do not know exactly what they own or lease. In addition, the "inventory" many companies claim to maintain is no more than a file folder containing a list of most of their properties. To be useful, an inventory must be an up-to-date, consolidated record of all properties owned and leased, including location, use, general description, size, age, zoning, acquisition cost, capital improvements, capital needs, and historical bottom-line performance.

A good inventory process focuses attention on the dollar value of a company's real property. Management can then charge fair market rents to individual departments as well as to tenants, account for real estate assets individually, and apply more sophisticated forms of investment analysis to each. Often companies assemble information only as a last-minute effort when they contemplate sale, lease, or development of a particular property. A properly constructed inventory not only provides data for decisions but also serves as a strategic planning tool enabling senior executives to consider which projects require their attention–and in which order.

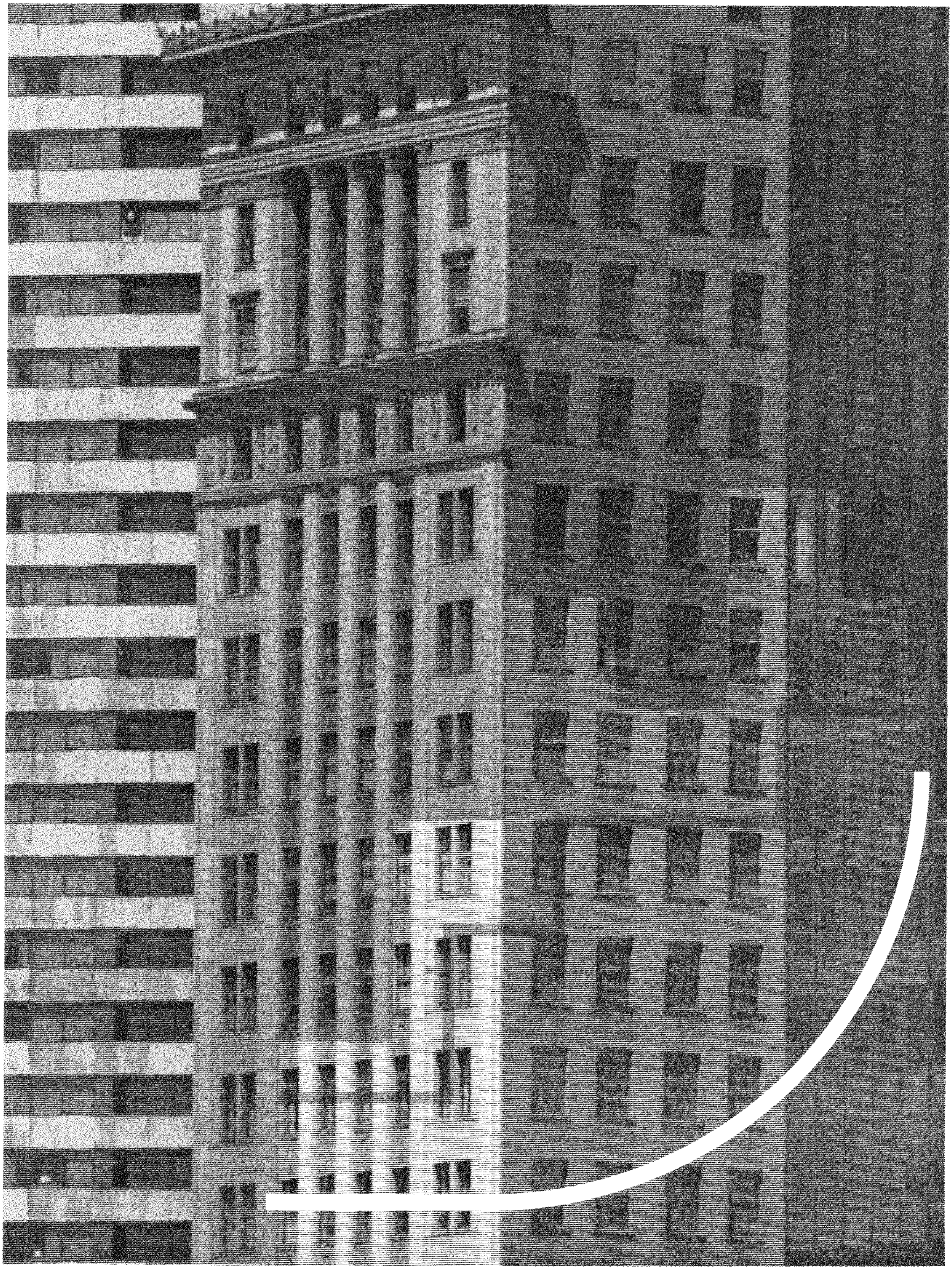
Without such an inventory, companies often overlook opportunities. One of the world's largest engineering firms, for example, has been unable to exploit its holdings, including the better part of a valuable county in an eastern state as well as thousands of square feet of prime commercial space in a sunbelt metropolis, because it doesn't have enough specific information on them. In part, this organization's problem can be blamed on the absence of a real estate unit, although the survey indicated that the existence of such a unit doesn't ensure organized data.

We have found that certain companies need an inventory more than others. In general, if an organization owns 500,000 square feet of space or more it should conduct an inventory. If a company owns less, leases most of its space, or limits real property holdings to a single metropolitan area, it may be able to manage without one–although companies that hold capital leases (agreements simulating ownership) on 500,000 square feet or more should treat these leaseholds as owned property.

The survey suggests that corporate size and business activity have little bearing on a company's ability to compile an inventory. The time and money involved naturally will vary from one company to the next, depending on the type of organization and record keeping. Most can complete the job, using in-house staff, in 6 to 12 months, at a typical cost of only 0.1% of the fair market value of the real estate portfolio.

Set clear, achievable goals

Recently, outside real estate experts have strongly recommended that executives manage corporate real estate responsibly, for profit. The need to consider real estate as an investment that must be supervised does not depend on whether management wants to generate profits from property holdings, or simply to limit costs. These two decisions can be taken independently. Our survey showed that the



number of companies treating their real estate holdings as cost centers is about the same as the number choosing to run them as profit centers. The real problem is that 60% of America's corporations do neither.

Those companies adopting a clear corporate philosophy toward real estate have learned to control costs, generate supplemental cash, or diversify into the real estate business. Some companies simply adopt one approach across the board, others apply two or more objectives to different parts of their real estate portfolio. Holdings that service main business activities are considered in terms of cost control; others are viewed as investments to generate income or as diversification. About 6% of the companies surveyed have a real estate department to control parent company costs that operates as a profit-oriented subsidiary.

Controlling costs

Cost control is one of the strongest motivations for a hands-on approach to corporate real estate. In one billion-dollar company, senior management assumes the role of landlord, casting the central real estate group as a property manager with appropriate performance-based incentives. Individual departments then negotiate rental agreements with the real estate unit; as a result the company reduced the real cost of operations in its 250,000 square-foot headquarters building by almost 30% over three years.

Opportunity costs are also an issue. One nationally known brewer treats an extremely valuable property in a prominent tourist community as a beer-making cost center because it calculates that, soaring real estate values notwithstanding, it could not possibly profit more by selling, leasing, or developing the site.

Generating income

A recent decision of General Tire & Rubber Company to sell a property in Washington, D.C. for 12 times its book value illustrates how some companies can generate supplemental cash from real estate portfolios. According to Alan Higgins, head of the company's real estate subsidiary, "A few years ago we would not have considered selling the property. Our retail store on the site earned 25% of book value annually. But with land appreciation, the store would have had to continue its performance for 22 years to equal the gain on the sale of the land." More dramatic examples are the recent sale of the Pan Am Building in New York City to keep that airline flying and that by American Express of its Manhattan headquarters, at a reported 300% profit. Profitable divestitures enable companies to consolidate their operations and restructure their investment portfolios.

Diversifying into real estate

Many companies that own valuable properties as a consequence of early business activities

The Harvard study

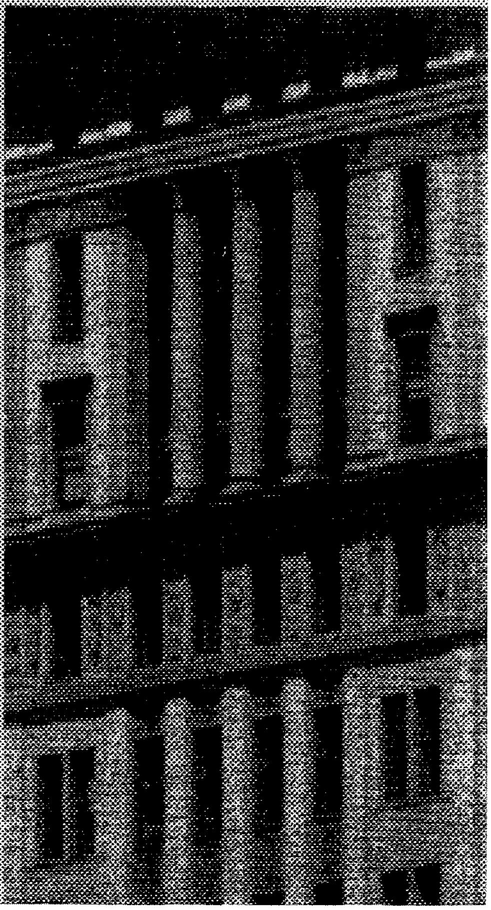
We undertook this survey to learn from the experience of other corporate real estate executives those management techniques that could best be applied to Harvard's real estate portfolio.

In June 1981, we mailed 1,377 questionnaires to the following groups: the *Fortune* "500" (as listed May 4, 1981); the 50 largest retail, financial, banking, transportation, utility, and insurance corporations listed in the *Fortune* "Double 500" for 1980; companies with at least one member in the National Association of Corporate Real Estate Executives; and a selection of large nonprofit institutions, including universities, hospitals, and foundations. A total of 300 usable questionnaires were returned.

A random sample of this size would, 95 times out of 100, represent the characteristics of the entire population with a 5% margin of error; however, the random character of this sample cannot be assured. Respondents, for example, exercised a certain amount of self-selection with respect to the availability of data needed to fill out the questionnaire. Those companies with the most organized real estate records would have found it easier to respond.

The survey, therefore, almost certainly understates the lack of organized thinking about real estate in American corporations. We have been careful to apply several tests for statistical significance to the raw data, and have avoided making major statements of fact unless the raw data and the tests supported the conclusion.

We sent a modified version of the questionnaire to nonprofit institutions, taking into account their special activities and tax-exempt status.



have created subsidiaries to exploit these underutilized assets. Greyhound Corporation has created a real estate subsidiary, Greyhound Realty, to buy, sell, and lease property. This move is seen as a natural extension of Greyhound's involvement in the real estate market. In 1980, according to Armen Ervanian, the new subsidiary's president, "The corporate real estate department closed some 220 transactions. The staff was involved in every aspect of the business, from buying and selling property to assessing values. We now have a vehicle to actually participate in the profitable development of the projects that come to our attention, and to study the investment potential of all Greyhound/Armour properties, particularly existing downtown bus terminal sites."

Select appropriate activities

The survey showed that the more experience companies have, the more they appreciate the need for property management as differentiated from facilities management. The latter does not distinguish between buildings and the activities that go on in them. Property managers consider business and real estate costs separately in order to protect business activity while reducing real estate costs.

Hands-on property management does not necessarily create a large blue-collar work force. Most companies prefer to conclude an agency agreement with a professional management company and then assign one executive to translate general corporate objectives into specific instructions and oversee their execution by the managing agent.

The choice of real estate activities other than property management depends on the nature of a business and the historical legacy of its real estate portfolio. For example, many older enterprises have begun to dispose of surplus properties. Standard Oil Company (Ohio) has a group working almost exclusively on such "divestments." Retail chains, on the other hand, sometimes own little property; they prefer to lease outlets. The real estate group at Consumer Value Stores, a New England regional drug chain, consists almost exclusively of lease negotiators. But some of the older retail companies, like F.W. Woolworth, own valuable main street properties.

It is a real estate's unit involvement in development that distinguishes it from those chiefly concerned with cost control. Those companies committed principally to cost control do not routinely develop properties.

Reorganize the real estate group

A real estate group can be either a department or a subsidiary. More than 80% of the companies surveyed prefer the more conservative alternative of a department and retain title to all properties. The department is simply an accounting unit. Subsidiaries commonly hold title, are taxed separately, can sell property, sue, form their own subsidiaries, and engage in real estate brokerage. Of course, they can also go bankrupt. This independence, while a worry to most corporations, is popular among companies seeking profits from real estate.

About half of the subsidiaries surveyed (especially those owned by companies in heavy manufacturing) have returns that equal or exceed those of their parent companies. Many subsidiaries, however, do not produce big cash earnings. Those of banking, finance, and insurance companies often earn less than the parent company but provide the latter with valuable tax shelters.

Most of the subsidiaries surveyed work with properties whose estimated worth lies between \$100 and \$250 million. Virtually all these holdings consist of properties in the United States owned for some time by the parent company. Because they have usually been created to further diversification into several types of real estate activities, most are full-service companies.

At first the subsidiary may provide services such as leasing, acquisition, or property management only to the parent company. As the organization develops, however, the subsidiary may sell services to others. A good example is Seraco, a wholly owned real estate unit of Sears, Roebuck and Company that combines a shopping center development company, a large savings and loan, a private mortgage insurance partnership, a mortgage banking enterprise, and an employee relocation service.

While professionals from the real estate industry or from other corporate real estate units often hold positions in subsidiaries, knowledge of overall company objectives, corporate experience, and established relationships with senior management are as important as real estate expertise when selecting executives. A billion-dollar company offers a good example of personnel mix between parent company and real estate professionals. The company conducted a nationwide personnel search for its new real estate subsidiary and selected a staff member with little real estate background but substantial knowledge of, and experience with, the workings of the parent company as president. One vice presidency went to another staffer, the other, and the post of treasurer, went to highly experienced real estate professionals.

Clarify responsibilities

Corporate real estate involves three areas of activity:

1. Acquisition and divestiture, including identification of real estate investment needs, site selection, acquisition of property, identification and disposal of surplus property, design decisions, and construction supervision.

2. Finance, including capital budgeting, financial analysis, and property tax evaluation.

3. Custodianship, including property management and real estate record keeping.

The survey suggested no ideal way to divide these activities between a real estate department or subsidiary and other corporate units. It did find, however, that companies profiting most from real estate centralize responsibility in a real estate group that is consulted when any decision affecting real estate is made.

The survey found little disagreement in most companies about assigning responsibility for property management and real estate record keeping to a real estate group. Many think that this unit can make a valuable contribution to discussions on acquisition, divestiture, and financing of corporate property. Because the real estate staff normally must solve problems arising from defects and shortcomings in existing facilities, they can often see the best and the worst features in projects on the drawing board. For example, in one ten-story corporate headquarters the architect and engineers decided to build fire stairs of expensive, top-grade stone normally reserved for foyers, and skimp on elevator timers. The property manager was very critical of this decision: "People constantly complain about how slow the elevators are," he said. "They complain to me, they complain to the executive vice president – I think they even complain to the CEO. I don't think anyone will notice how beautiful the fire stairs are even if they ever have to use them."

Choose consultants carefully

Because a corporate real estate office is usually small, outside consultants are often necessary. The more complex the service or problem, the more willing people are to bring in a so-called expert. They value specialists with the most arcane knowledge – lawyers, architects, bankers, or developers. Dissatisfaction is common, however, with the views of consultants – relocation specialists like brokers and leasing agents – whose expertise lies in areas where the corporate executive may also be knowledgeable.

To lay the groundwork for a successful consulting relationship, a company should always remember that real estate counselors will help plan and execute an assigned project but won't determine whether it makes long-range sense. Few consultants will help set corporate real estate priorities – they assume that the client has done that.

It is important to hire consultants that clearly understand how the company does business. A real estate entrepreneur operating alone or in a small partnership may employ tactics that a large corporation would find unacceptable. One company hired a consultant who was a brilliant operator but a lone wolf with little sensitivity to corporate image problems. He advised his clients that they could improve real estate performance dramatically, moving from an $800,000 annual cash loss to a $2.3 million cash surplus in just two years. His plan, however, rested largely on savings derived from property tax abatements and the use of nonunion contractors and employees for real estate operations. In reality, the company's property tax payments were already so low as to arouse damaging public criticism in several communities where it operated. And large-scale introduction of nonunion labor probably would have precipitated a strike and lawsuits by unionized employees.

Set up a real estate information system

The inventory we have suggested provides only a static profile of real estate holdings. Prudent decision making requires monitoring a collection of data on the changing costs of utilities, insurance, taxes, repairs and maintenance, reserves and debt service; gross possible income; vacancy and occupant use. To assess performance accurately, a company must segregate real estate from non-real estate operating data. In a retail outlet, for example, property taxes should be distinguished from the salaries of salespeople, not lumped together as operating costs. At a manufacturing facility, building maintenance costs should be separated from equipment maintenance costs unless the equipment is part of the real estate. It is extremely difficult, if not impossible, to make informed real estate decisions without an independent real property management information system. One-third of the companies surveyed have such systems in place; many of these manage real estate for profit.

Real estate financial data may be organized on a property-by-property basis, by property categories, or in a defined pool of properties. Property-by-property accounting is the best approach because it enables management to evaluate each piece of real estate individually and to combine figures on individual properties when appropriate. Real estate, after all, is bought, sold, leased, and normally taxed property by property. Category and pool accounting obscure physical and financial problems, which makes it difficult to distinguish real estate performance from other management performance.

From facilities to property management

Most American companies share a common real estate history. Perhaps as long as a century ago, today's typical corporation began to build up a real estate portfolio to meet the needs of its principal business activities. After acquisition, the company did not evaluate properties for their intrinsic worth but rather for their usefulness in supporting activities.

But once a company has acquired considerable amounts of real property and the nature of its principal activities changes, its real estate holdings take on a new complexion. The value of corporate real estate demands that it be put to its highest and best use, either by the company or by others. Certain properties formerly subordinated to the company's principal activities may become more valuable than the activities themselves. In the most extreme case, corporate real estate may become a company's largest asset. Every corporation should review and adjust its real estate policies to reconcile operating objectives with contemporary real estate values and opportunities.

Dementia praecox

Since fear is all we have to fear,
As F.D.R. was prone to say,
I launched my corporate career
By casting all my fears away;
Speak up, speak out! and, most essential,
Display your management potential!

So, in my best dynamic style,
I shot my cuffs and banged the door;
And, with assured aggressive style,
Walked tall across the boss's floor.
"Shut up, get out! I'm in a meeting!"
Was all he said by way of greeting.

I set a later time to meet,
Perhaps a modicum deflated;
And practised yoga in retreat,
To get my psyche re-instated.
Breathe in, breathe out!–and off once more,
Ambitious, through the boss's door!

"So, with respect Sir, I've concluded"
(Was this my former, timid self?)
"Your whole damned strategy's deluded–
I move you put it on the shelf!
You're in, you're out! Your profit's shrinking!
You need some new, dynamic thinking!"

The silence which ensued was total,
Though the thunder in his eyes,
Through the threatening bi-focals,
Left but little to surmise.
Then up! and out!–his voice pursuing,
With "What the hell d'you think
you're doing!"

So now I nurse my injured id,
And feel a somewhat chastened fool,
Who tried to climb the pyramid
My first day out of business school!
But work! and wait!–that's tough for me,
With 'A's in Corporate Strategy!

Ralph Windle

Ralph Windle is an Englishman who has held senior executive positions with two major U.S. multinational corporations. He now teaches business policy at the Oxford Centre for Management Studies. His verse appears regularly on the management page of the Financial Times *under the pseudonym Bertie Ramsbottom. Some of his poems have been collected in a book titled* Boardroom Ballads *(Bertie Ramifications Ltd., 1982).*