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Track the right metrics

Keeping corporate and real estate strategies aligned

BY **PETER HOLLAND** AND **RON ZAPPILE** | MARCH 2020

Corporate strategy isn't static. Real estate strategy shouldn't be, either.

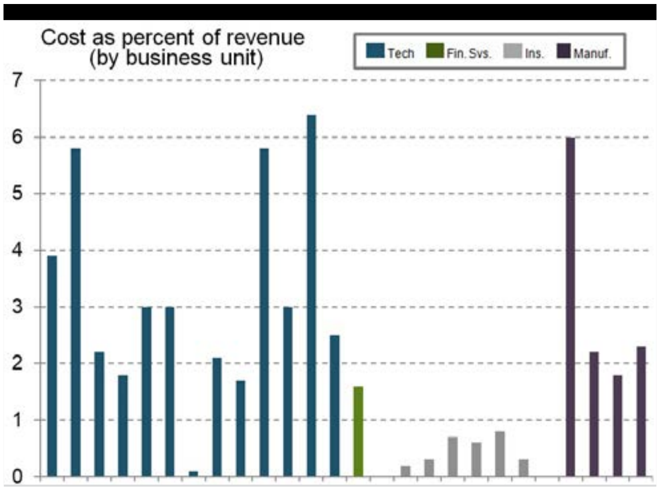
As economic or market conditions force corporate priorities to evolve, a company's business mix and talent requirements change. The ever-present challenge for corporate real estate, or CRE, executives is to keep corporate and real estate strategies aligned. Analytics and benchmarking can help inform the decisions that ensure that alignment.

What are some of the more common strategic priorities that affect – and could be affected by – real estate decisions? Is the company seeking organic growth or looking to grow via acquisition? Has the company changed its business mix by divesting business units that don't fit with the corporation's direction or aren't performing as desired? Does the company want to improve the efficiency and profitability of a mature business unit? Does the company want to rebalance its owned vs. leased ratio so its real estate portfolio fits the company's long- or short-term asset strategy? Is the company seeking to upgrade its talent or hire specialized professionals not already in its internal talent pool or not in ready supply in the corporation's locations?

"It's imperative that corporate real estate is aligned with business goals, and to be a valued strategic partner requires not only a deep understanding of those enterprise strategies but also being judicious about the data, benchmarks and metrics you analyze," says Alison McCormack, director of Real Estate Strategy & Insights at Liberty Mutual. "Data analytics enable CRE to positively influence and support the organization, but only if you're focused on the right data. And that can evolve as strategies change."

The highest-priority real estate metrics should be those that align with corporate strategy. For example, a company growing organically might expect real estate costs to grow at a pace consistent with revenue growth or, in a best-case scenario, to shrink relative to revenue growth. Logically, the metric to watch is Cost as a Percent of Revenue.

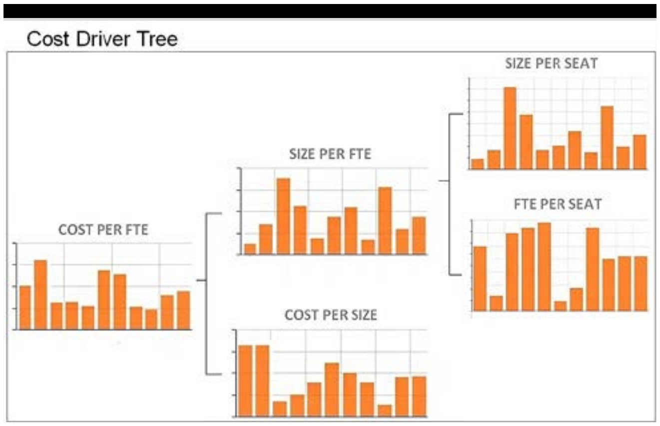
A more detailed look at this metric might be useful. When there's a wide variation within the cohort, as is the case within the BenchCoRE Tech cohort (in blue), it could be illuminating to identify which of your company's divisions are accounting for the company's overall revenue growth and which aren't, and to see how real estate costs correlate to corporate performance. If some divisions' Cost of Revenue metrics aren't measuring up to those of other divisions, what is the root cause?



For those willing to dive more deeply into that all-important metric, the BenchCoRE Cost-Driver Tree breaks down real estate costs to their most basic components. Each branch of the Cost-Driver Tree isolates a metric that could identify an opportunity.

Consider the following corporate strategies and the metrics that might best align your real estate strategy with them.

Growth via acquisition: Acquiring a business entails acquiring its assets, including its real estate assets and their corresponding liabilities. Your company's overall

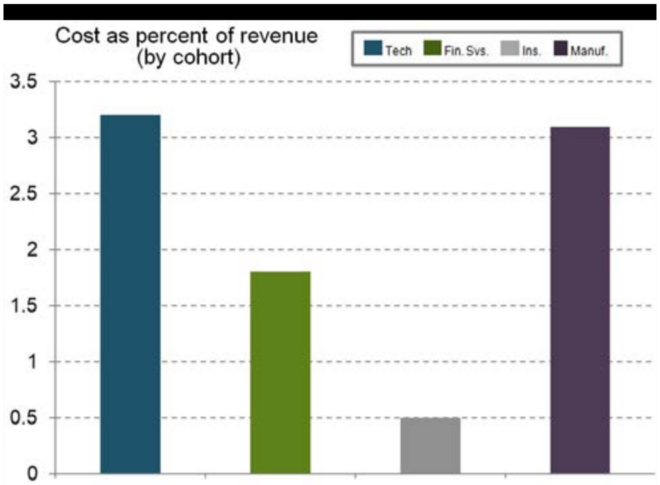


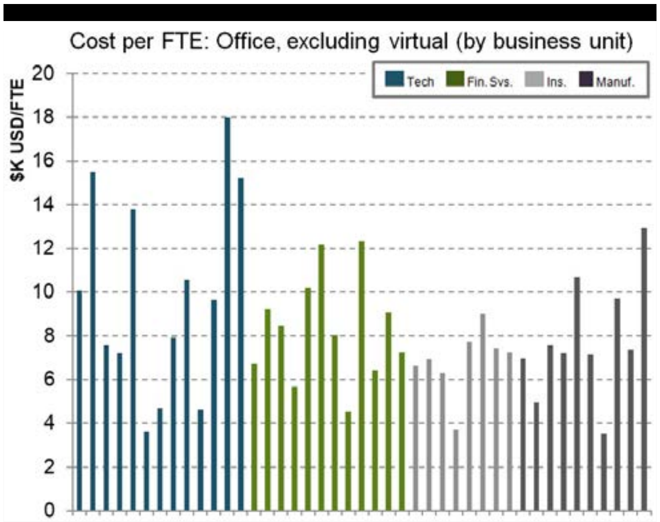
Cost per FTE (full-time equivalent) or Cost as a Percent of Revenue might be one of the best among the peers in your cohort. But if these aren't priorities for the target company, the acquisition might throw off your metric on the day the deal closes. Once you aggregate the acquired costs into your database, you can determine the direction and the degree to which the acquisition tilts your aggregated costs. As the charts show, there are often wide variations among real estate costs. If the acquired company's costs are higher than your current costs, you might have an immediate need to reduce the acquired costs simply to maintain your standing among peers. If the acquired company's costs are lower, it might suggest that you could do more to reduce your existing real estate costs.

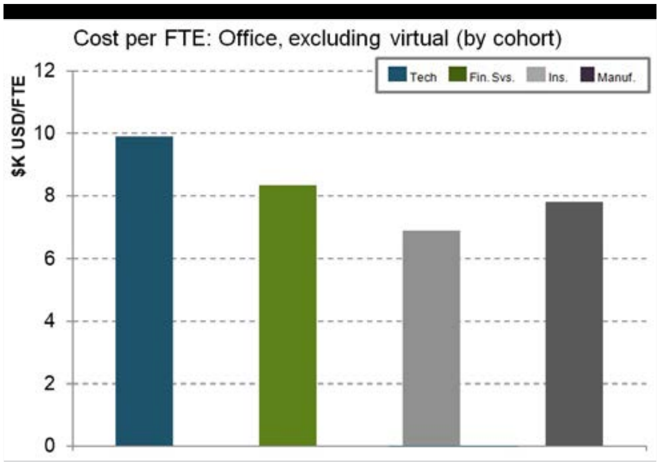
While the variations could be based on asset class or location, the metrics could provide guidance for decisions going forward. In an ideal world, these analytics would be part of the due diligence for subsequent acquisitions.

"When there's an acquisition, naturally you're acquiring the facilities involved in the transaction," says Leslie Monopoli, director of Engineering Systems at Merck, also known as MSD, which has made eight acquisitions in the last two years. "You have to figure out a plan. Are you going to keep that site, or are you going to transfer people to existing sites? We try to identify the best opportunities.

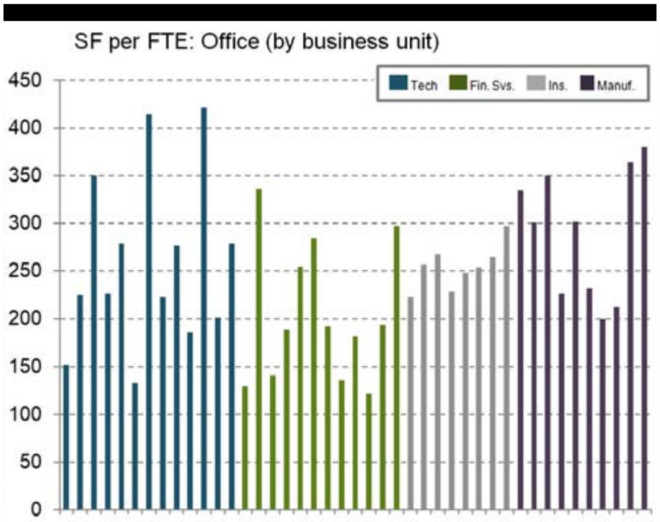
"I want benchmarking to be one of the data tools to incorporate into those decisions so we really understand our space," she added. "We'll look at Cost per FTE while taking into account the comfort of our employees and their overall work experience. But are we paying for more space than we need? I believe benchmarking is going to help us to review that information, set targets, dig down deeper, and find new insights into some of the places and opportunities to improve compared with our peers."

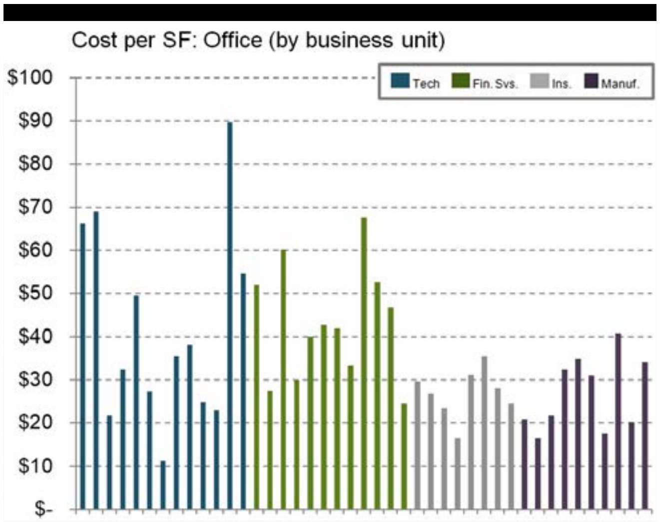






Business-unit divestiture: As with acquisitions, selling a business might tilt overall Cost as Percent of Revenue metric in one direction or the other. It might help to compare pre- and post-divestiture aggregated costs to estimate the potential impact of a particular business's sale on overall Cost as Percent of Revenue. If the overall Cost as a Percent of Revenue were to increase after the divestiture (either in reality or on a pro-forma basis), it might signal the business, or another with a relatively efficient portfolio, has been masking the performance of less-efficient businesses. This discovery might lead to metrics such as Square Feet per FTE or Cost per Space to identify the cause of inefficiency.

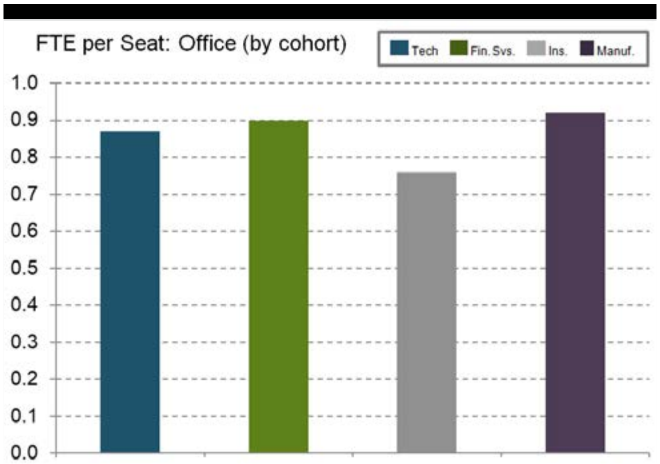




Increasing efficiency: For a mature business unit whose growth is steady but not accelerating, it might be useful to benchmark Cost per Space in addition to Cost as a Percent of Revenue. This would help to ensure that costs are stable or moving in a favorable direction over time, and to gauge where you stand vis à vis peers. Assuming that these metrics don't reveal a weakness, the next step might be to seek opportunities to wring more efficiency out of your portfolio. Metrics such as FTE per Seat or Virtual FTE as a Percent of Total FTEs might point to opportunities, as they both contribute to Cost per FTE. Cost per FTE invariably is lower when FTE per Seat or Virtual FTE as a Percent of Total FTEs is higher.

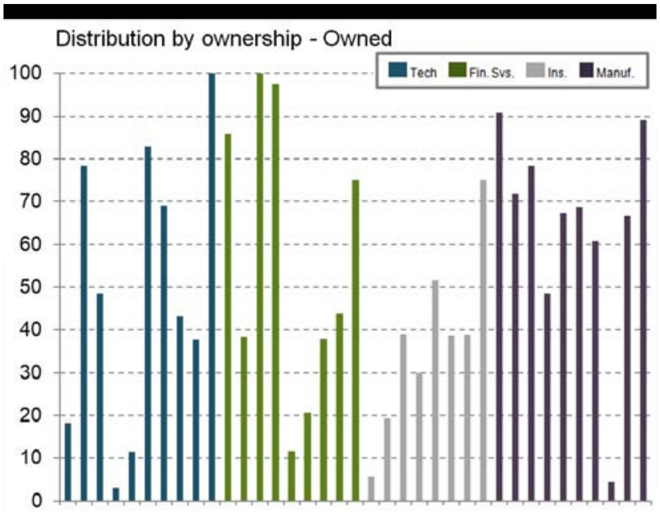
"As work styles continue to evolve, it's important that corporate real estate teams keep up with the latest trends, best practices and data related to workspace designs," says Mike Walling, vice president of Corporate Real Estate at Travelers. "We're in the midst of a multi-year exploration and implementation of a new workplace standard to provide more agile and collaborative spaces. Employee engagement and experience have been the driving factors throughout the process, but we're also looking at relevant data to optimize our space and ensure that we're creating versatile offices."

Similarly, at Liberty Mutual, a shift to activity-based work environments with unassigned seating requires different metrics. "While traditional space metrics such as RSF per Seat and RSF per FTE continue to be measured, FTE per Seat becomes a better indicator of efficiency," says Liberty Mutual's McCormack.



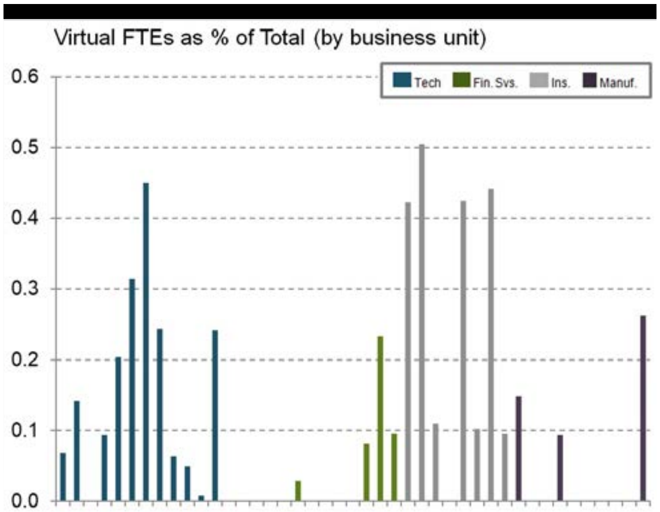
Short-term vs. long-term capital investment: Does the company have a long-term capital strategy? Or is short-term flexibility a higher priority? This question could have an impact on the strategies discussed above. But either way, the Distribution by Ownership metric helps determine if your real estate mix is consistent with that strategy. More than those in any other cohort, manufacturing companies tend to own most of their assets (65 percent owned vs. 43 percent for the next-highest cohort). This is likely because manufacturing companies are capital-intensive industries that consider real estate a strategic asset, rather than merely a cost.

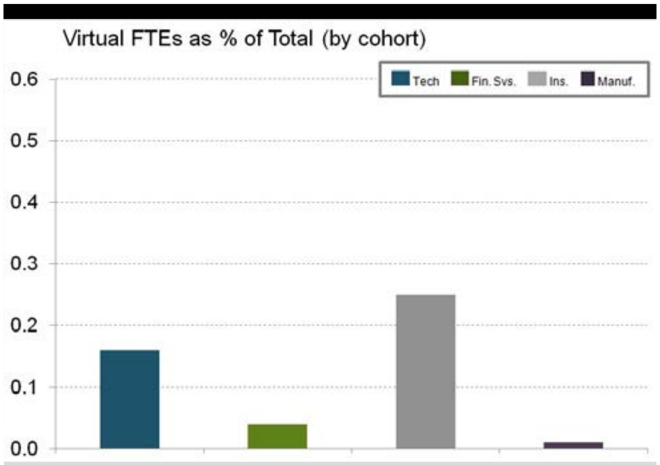
But though the asset mix is less consistent across other cohorts, the lease-vs.-own decision could have long-term consequences for any company's future profitability. New FASB rules regarding lease capitalization are making differences in the lease-vs.-own decision less stark, at least as the decision affects the balance sheet. However, the real estate strategy – and the metric that's tracked – should still be consistent with overall capital strategy.



"Softer" strategies: Secondary – some might say softer – strategies also present opportunities to align corporate and real estate strategies. Higher Cost per Space, which most CRE executives would argue should be avoided, could actually be a positive. Sometimes a corporate priority is to fill high-level knowledge-based jobs or locate near a highly educated labor pool in cities or districts whose lease rates are particularly high. Lower lease rates might actually be counterproductive in these cases.

To use a different example, if offering remote or flexible work opportunities is part of a corporate strategy, a high Virtual FTEs as a Percent of Total might be a priority. In the Insurance cohort, where remote work (e.g., for call-center employees) is often part of the staffing equation, Virtual FTEs as a Percent of Total is significantly higher than in other cohorts. Benchmarking within the cohort could help indicate how closely real estate aligns with that strategy.





That analytics and benchmarking lead to real estate decisions with more demonstrable (and sustainable) performance improvements is becoming accepted wisdom. But just as each metric is a dynamic measure of real estate performance, application of analytics should also be dynamic as corporate priorities shift. “Our first priority, and fundamental to who we are, is to stay connected to and respected by the business at every level,” says Travelers’ Walling. Using analytics and benchmarking to tie real estate strategy to evolving corporate strategies – as in the examples here – could prove these tools’ value even further.

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