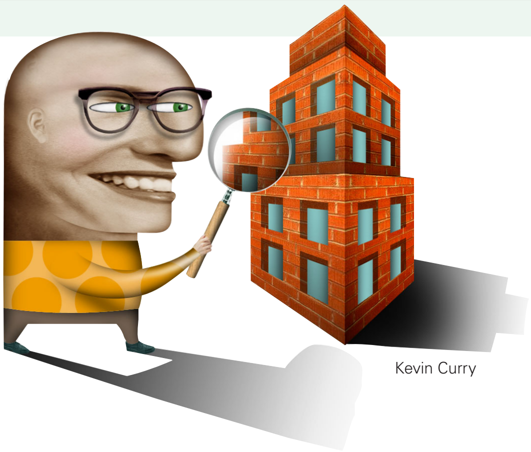
Managing the cost of **real estate**



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To cut real-estate expenses, corporations must learn to calculate their true occupancy cost and to measure their performance.

Real estate can account for up to 15 percent of total operating expenses for many companies. Yet a study of real-estate-management practices shows that a significant number of corporations fail to control their occupancy cost—though opportunities for savings abound.

Despite the trillions of dollars real estate consumes, we found that for most companies this area is chronically under-managed, to the extent that basic business tools—guidelines for when to acquire new space, whether to buy or lease, and how much to spend—are frequently absent. In fact, many corporations actually outsource these vital decisions or assign employees to deal with them only on a part-time basis. The result is often a patch-work of excess locations and costs.

The companies most adept at real-estate management, our study found, assign employees with skills in property, finance, legal, and workplace design to manage corporate real estate on a full-time basis. Even with clear guidelines and best practices, many companies still fall short when deciding how much to spend on occupancy and how to manage real-estate portfolios. Two measures can help improve management and control costs.

EXHIBIT 1

Saving occupancy cost

Total cost of occupancy = Usable space × Cost per unit of usable space

	Untapped opportunities	Time frame for implementation
Usable space	• Redefine space standards	• Short to medium
	• Outsource or centralize support functions	• Short to medium
	• Obtain options to expand/contract in small increments	• Medium to long
	• Sublease, cancel lease, or sell excess space	• Medium to long
Cost per unit of usable space	• Manage standards for build-out costs of facilities	• Short to medium
	• Improve site management (cleaning, maintenance, services, taxes)	• Short to medium
	• Audit leases for overcharges	• Short to medium
	• Seek market-timing opportunities, including reduced rental rates	• Medium to long

First, companies should use a broader definition of occupancy cost than just rent, since the failure to account for operating costs, depreciation, and the cost of capital yields an incomplete picture and doesn't reveal the areas that might be improved. Calculating the total occupancy cost focuses attention on space and site management as well as external factors, such as the impact of changes in financing options and in the market value of real estate (Exhibit 1). Reducing certain components of the occupancy cost—eliminating excess space by liquidating assets or by changing financial structures, for example—might take several years to accomplish.

By contrast, site-management agreements, including maintenance, cleaning, and service contracts, are easier to control, and competing vendors can bid on them annually. A large engineering company, for example, found that its true total occupancy cost was $9.9 million more than it had calculated for rent and related operating expenses alone. The company's efforts to reduce its occupancy cost by controlling entire categories of unmanaged expenses it had previously considered insignificant generated annual savings of $2 million.

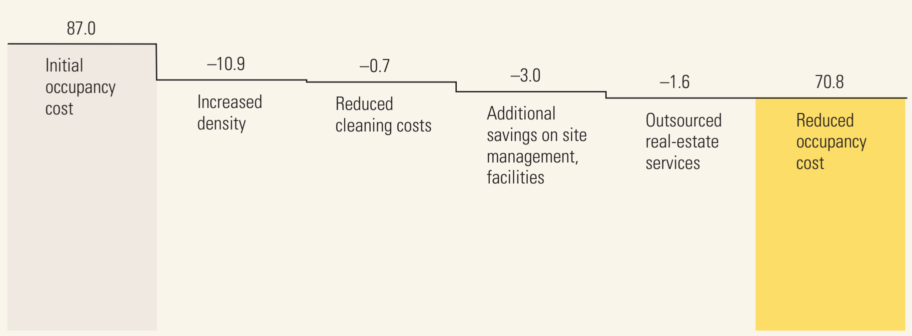
Second, companies must use internal and industry norms to benchmark their performance systematically, with the intention of highlighting potential opportunities for improvement. With these calculations in hand, managers are far better equipped to set reasonable spending targets and to find opportunities for cutting costs. Before setting annual spending targets, companies should benchmark to uncover inefficiencies and to calculate potential savings. The first step is to gather comprehensive, current data—a difficult task, since information on the real-estate market is often out-of-date and resides in many dispersed sources. For these reasons, it is important to develop a plan to find the most recent information and keep it current.

The metrics most commonly used to gauge occupancy are density, cost as a percentage of revenue, and cost per full-time employee. In our view, density—which is the only metric not affected by market pricing and currency exchange rates and isn't related to other performance measures, such as revenue—provides the best indication of how well a company manages its real estate. The optimal

EXHIBIT 2

The impact on one retail bank

Estimated occupancy cost for regional bank, $ million



density of office space, taking into account all other uses for it, ranges from 150 to 200 square feet per full-time employee, which represents the minimum amount of space a person needs to work efficiently. Raising density is usually the most effective way to save money; one regional bank with a total occupancy cost of $87 million identified more than $16 million in annual savings—$11 million of it solely from this source (Exhibit 2).

Companies that determine their true occupancy cost and measure their performance can align real-estate decisions with their business strategy while supporting larger corporate goals, such as growth, making employees more effective, and improving return on equity.

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