

What Leaders  
Should Know About  
**Real Estate**

Mahlon Apgar, IV



Harvard Business Review

*[www.HBROnline.com](http://www.HBROnline.com)*

# If You're On Land, You're In Real Estate

## *Introduction*

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[ Ubiquitous, indispensable, impossible to ignore ]



[ Easy to take for granted ]



[ Challenging to manage ]



## ***FIVE REAL ESTATE MAXIMS FOR LEADERS***

*“We shape our buildings and they shape us.” Churchill*

# Real Estate's Complexity, Scope, Scale

## *Introduction*

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- 6? major asset types, 10? industries, 12? professions
- 20% GDP in developed countries, 33% in developing countries

- Single building: \$10-100M+ / 2-5 years
- Major development projects: \$2-20B+ / 20 years

- Significant asset and operating expense
- Risks increase with scope and scale



*What are implications of these factors on public policy, business strategy, corporate structure?*

# “Real Estate Business” vs “Business Real Estate”

*The Apgar Rubric*

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## ***Real Estate Business***

- Industries and professions that create the built environment
- Add value by developing land, infrastructure, buildings

## ***Business Real Estate***

- Organization's and individuals' workplaces
- Organization's property

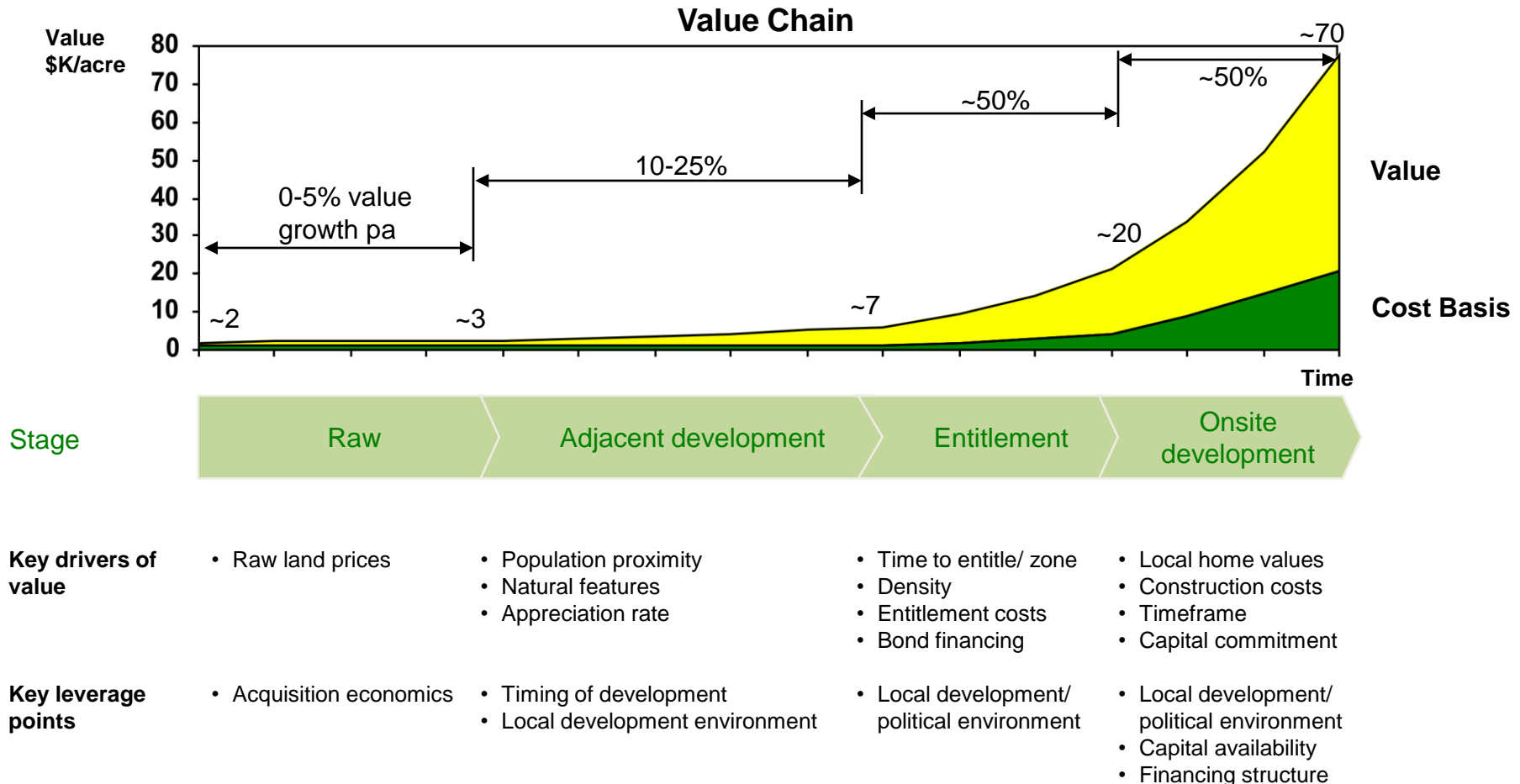


*RE can leverage strategy, costs, and productivity*

*Business should drive RE; RE should support Business*

# Real Estate Value Chain

## Stages, Initiatives, Investment, Time



# 1. Manage the Portfolio – As Well As Projects (I)

## *The Five Maxims of Real Estate*

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### *Portfolio View*

#### *Pathway to Strategic Decisions*

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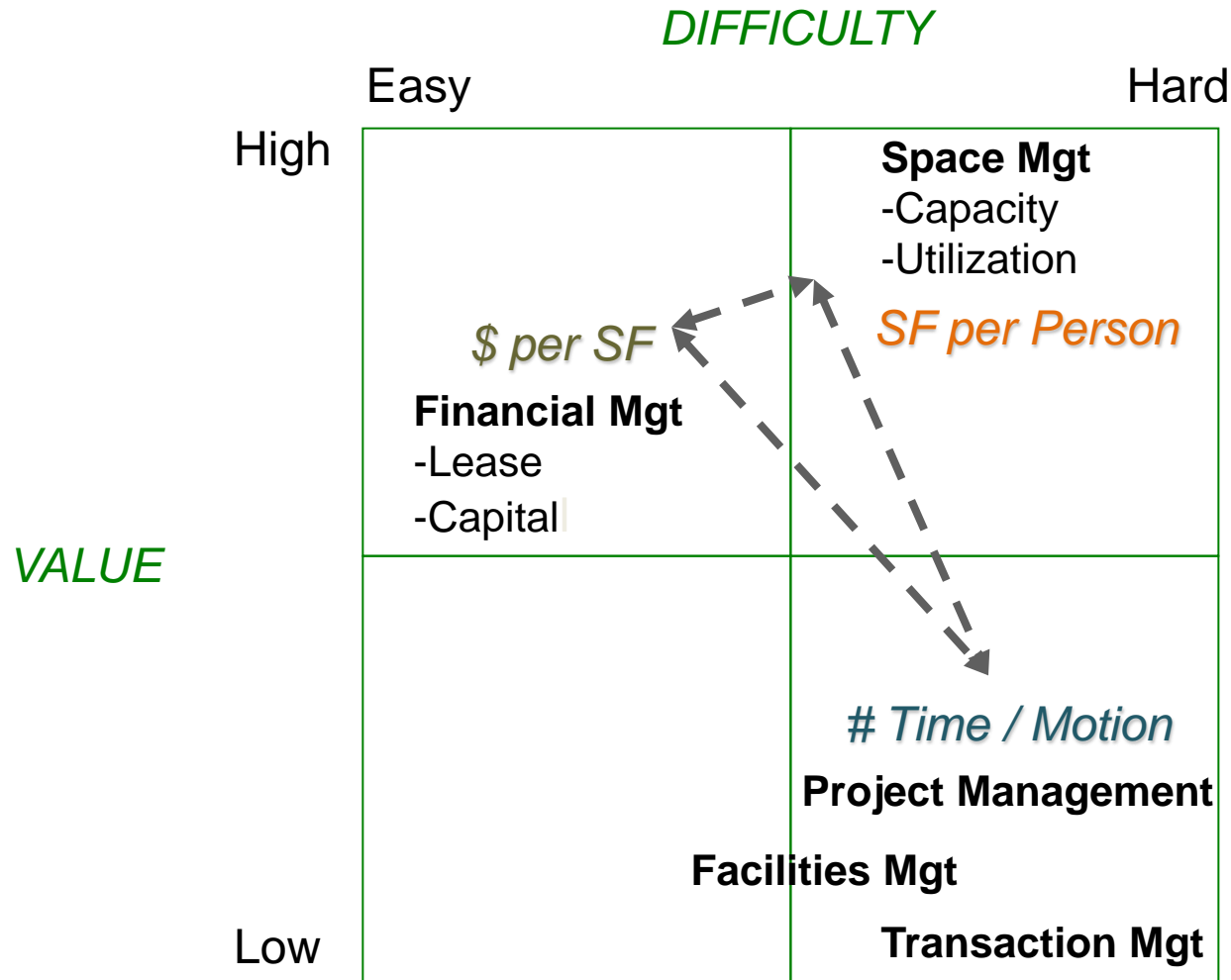
- Determine optimal footprint
- Compare with future needs
- Identify misalignments
- Eliminate ‘pockets’ of surplus space
- View costs over lifecycle



*Managing a series of discrete real estate projects overlooks – and may undermine – strategic opportunities*

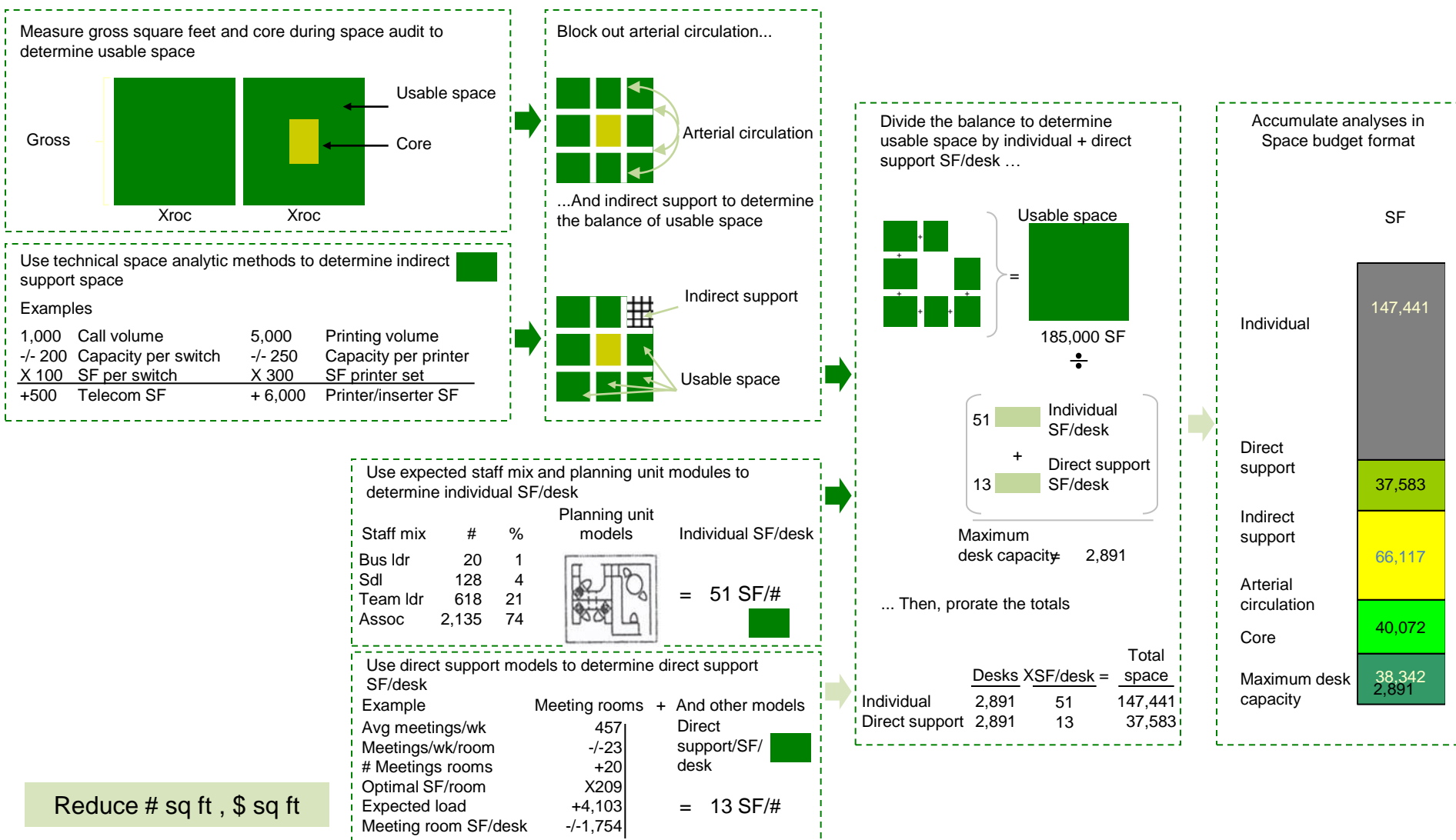
# Business Analytics Should Drive Decisions

*Potential Value to Business vs. Likely Difficulty in Execution*



# Space Budgeting “Zero-Bases” Needs / Facility Size

## Assumptions of Need are Built-up By Category to Determine Capacity



Reduce # sq ft , \$ sq ft



# Space Budgeting “Zero-Bases” Layout

*Analysis of ‘Building Blocks’ to Reduce Space / Increase Utilization*

Individuals

Open plan

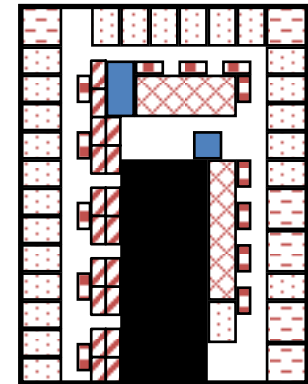
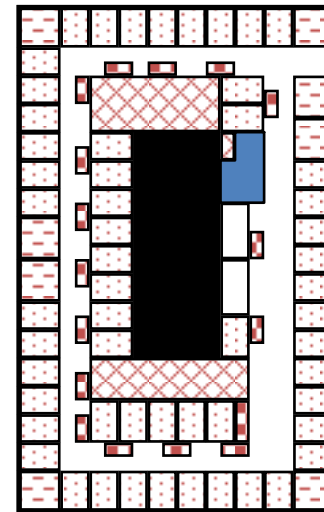
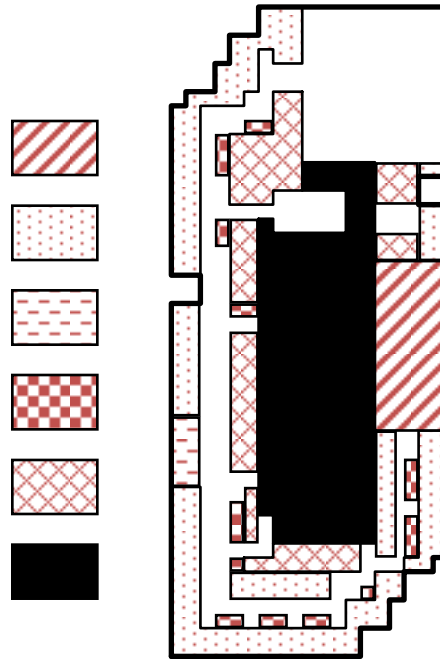
Standard office

Manager office

Secretary

Support

Loss factor



Current

Alternate A

Alternate B

Staff #	80	80	80
Private office %	60%	100%	60%
Rentable sq ft	16,620	16,380	14,220
Rentable sq ft/staff	208	205	178

# 1. Manage the Portfolio – As Well As Projects (II)

*Global scope and scale benefit from portfolio approach*

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## ***Example: Pfizer “GO” initiative from 2006-2010***

- Excess, redundant, poorly utilized space
- Daunting real estate portfolio, “silo” management
- Portfolio approach yielded \$250 million in savings, \$350 million in synergies



***CAVEAT: Beware the “shadow” portfolio – indirect but real responsibility for outsourced functions***

# Pfizer GO's Organizational Model

**\*Lead Account Relationship Managers Drive Teams That Ensure Cohesive Service Delivery and Customer Value at the Global Level**

## Centers of Excellence

**REFM \***

- Strategic RE&FM analysis
- Proactive RE portfolio mgt.
- Capital planning
- Integrated facilities mgmt.
- Acquisitions and divestitures
- Workplace strategies
- Surplus asset disposal

**CSBO**

- Global travel service
- Global fleet services
- Colleague services
- Document solutions
- Business planning
- Operational performance
- Continuous improvement
- Knowledge management

**RM**

- Global EHS & EHS sourcing
- Colleague / Operational security
- Business continuity planning
- Supplier risk review
- Product stewardship
- Sustainability

## Regional Operations Teams

*International*

*Americas*

*APAC Region*

*EMEA Region*

*Americas \* Commercial*

*PDB\**

*R&D\**

*PGM*

**Real Estate and Facilities Management  
Global Programs & Standards Deployed Regionally**

**Corporate Services & Business Operations  
Global Programs & Standards Deployed Regionally**

**Risk Management  
Global Programs & Standards Deployed Regionally**

## 2. Build in Flexibility – Throughout Portfolio

*Agility / responsiveness to rapidly changing conditions...*

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### **The *AGILE* Organization** -----

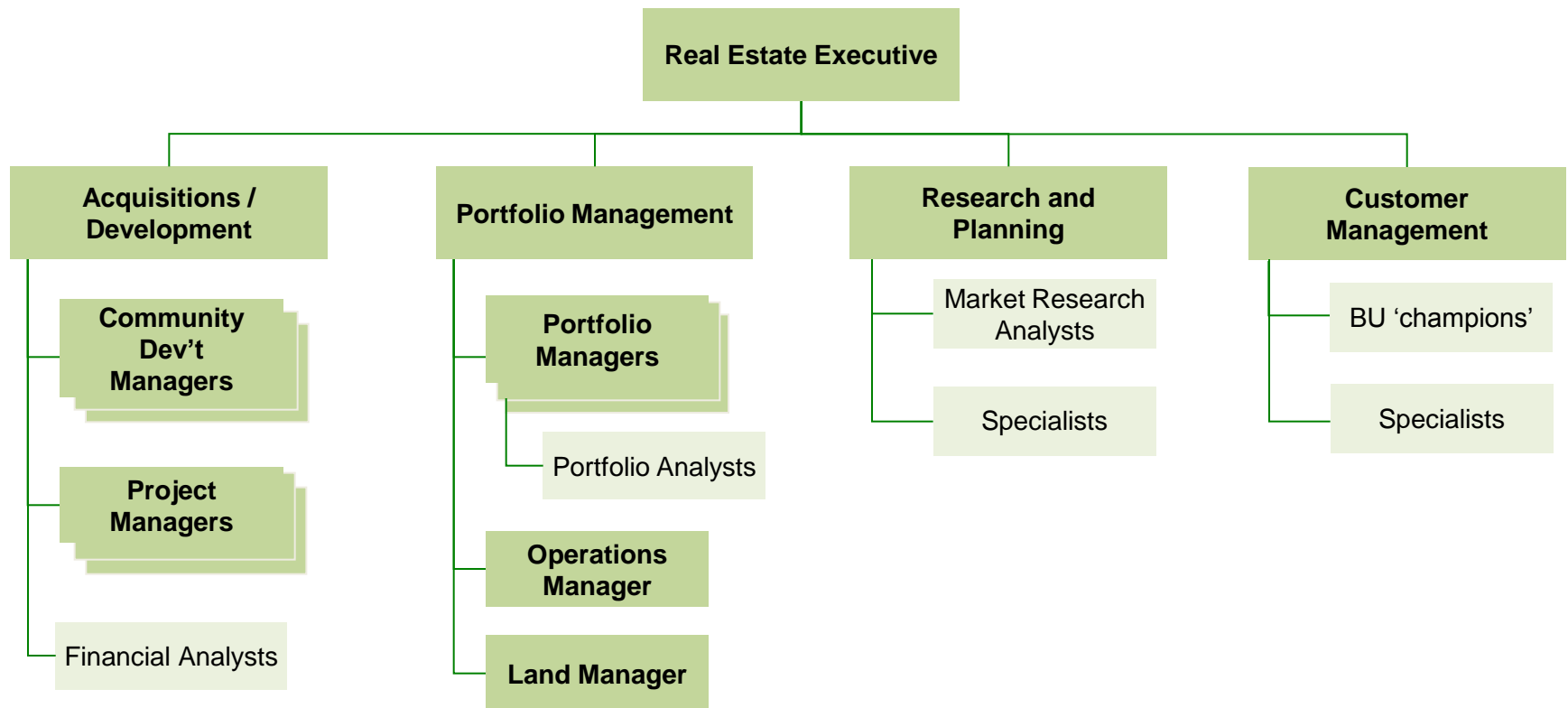
- Streamlines execution, increases accountability
  - Gains financial flexibility through leasing
  - Plans physical flexibility in layouts and future uses
  - Promotes “Alternative Workplace” arrangements
- 



*...but flexibility comes at a price...*

# Business Real Estate Organization

*Agile organization streamlines execution, increases accountability*



Role in box indicates manager level

# Benchmarks for Organization Design

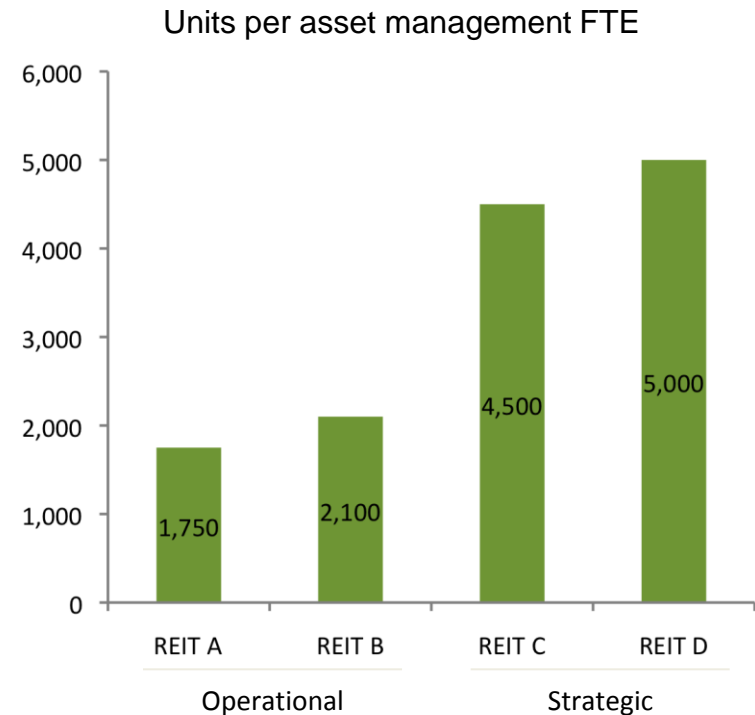
*Provide guidance on allocating key positions ILLUSTRATIVE*

## Development Managers

Benchmark	Organization	Deal flow
Developer A	<ul style="list-style-type: none"><li>• 3 Project Directors</li><li>• 2 Syndication/ Finance FTEs</li></ul>	~6,500 units developed in ~30 communities over past 10 years
Developer B	<ul style="list-style-type: none"><li>• 3 Project Developers</li><li>• 2 Financial Analysts</li></ul>	~8,000 units developed in ~40 communities over past 10 years

**Suggests ~1 manager and ~1 analyst per 3-4 new developments per year**

## Portfolio Managers



# Alternative Workplaces Increase Flexibility

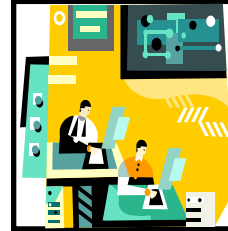
*Programs and formats include Hoteling, Satellites, Home Offices*



Private / fixed office space



Cubicles

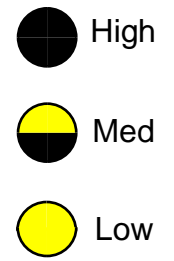


Hot-desk / Hoteling



Home office

Driver	Impact	Trend
Technology	●	Evolution / price declines of broadband, cloud, laptops, other capabilities
Cost savings / avoidance	●	Senior management taps real estate to drive cost savings / contain increases
Market conditions	◐	Rapidly changing market dynamics in many industries
Employee retention	◐	Stronger focus on individual flexibility / retaining top talent

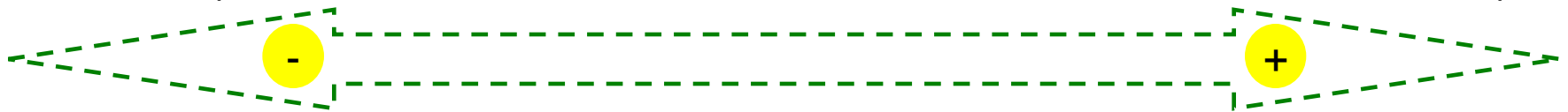


# Alternative Workplaces Can Take Many Forms

*Location and design can be tailored to specific needs*

Traditional workplace

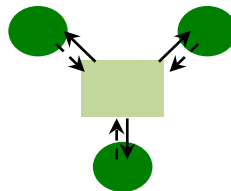
Alternative workplace



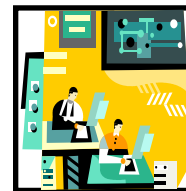
Workplace  
(location)



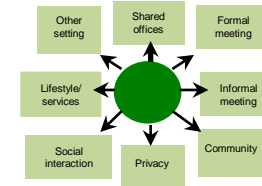
Cubicles



Shared office



Hoteling

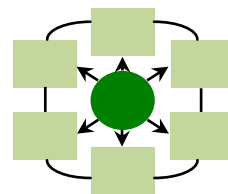


Free address

Workspace  
(design)



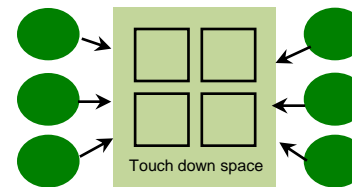
Designated  
office / workstation



Satellite office



Home office



Touchdown office



# Workplace Tools and Technology

*Support Alternative Workplace programs*

**COMMUNICATIONS**

Office-bound



Travel-driven



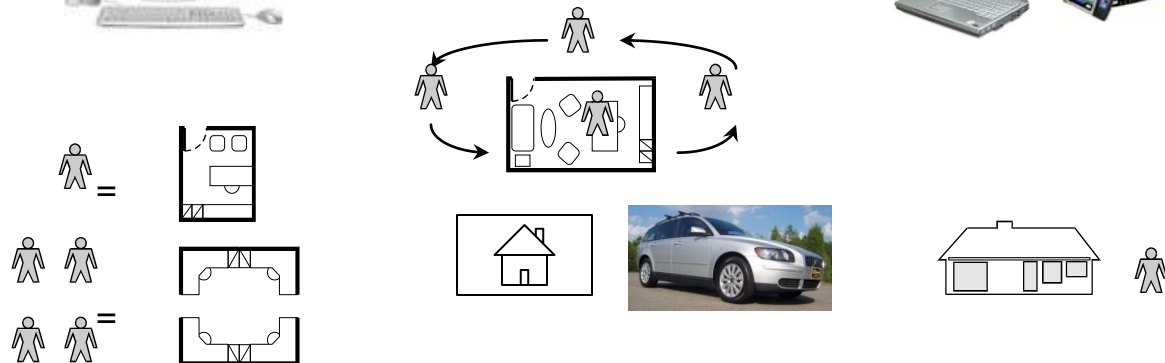
Home-based



**PRODUCTION**



**WORK ENVIRONMENT**



**Advances in technology – broadband access, wi-fi – and integrated access devices – iPhones, Blackberries – enable workers to de-couple from physical location**

# 3. Cultivate Real Estate “Intelligence” ...

*Convert data to information and insights ...*

## **INFORMATION**

- Accurate data
- Synthesized into relevant information
- Interpreted in the corporate and competitive context
- Communicated in actionable formats

## **KEY RATIOS**

- Occupancy cost \$ per person and unit
- Occupancy cost % of revenues
- Utilization SF per person and per unit
- Asset performance \$ ROCE / ROI

## **TOOLS**

- Benchmarking
- Space budgeting
- Lease decision analysis
- Employee location mapping
- KPIs
- ‘Apgar Score’



*...It's about **thinking**, not just mechanics...*

# Overview of Real Estate Model

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## ***Real estate model is an economic representation of the deal***

- Uses key assumptions on cost, structure, operating performance
- Calculates how and when money will be spent
- Projects operating performance during lease-up and after stabilization
- Calculates returns to key owners / stakeholders based on operating performance

## ***Model is used to evaluate potential deals and in-process deals***

- Enables “what-if” scenarios and testing assumptions
- Compares costs / returns for different stakeholders
- Documents model analyses and outputs

## ***Model is only as good as the data input and assumptions***

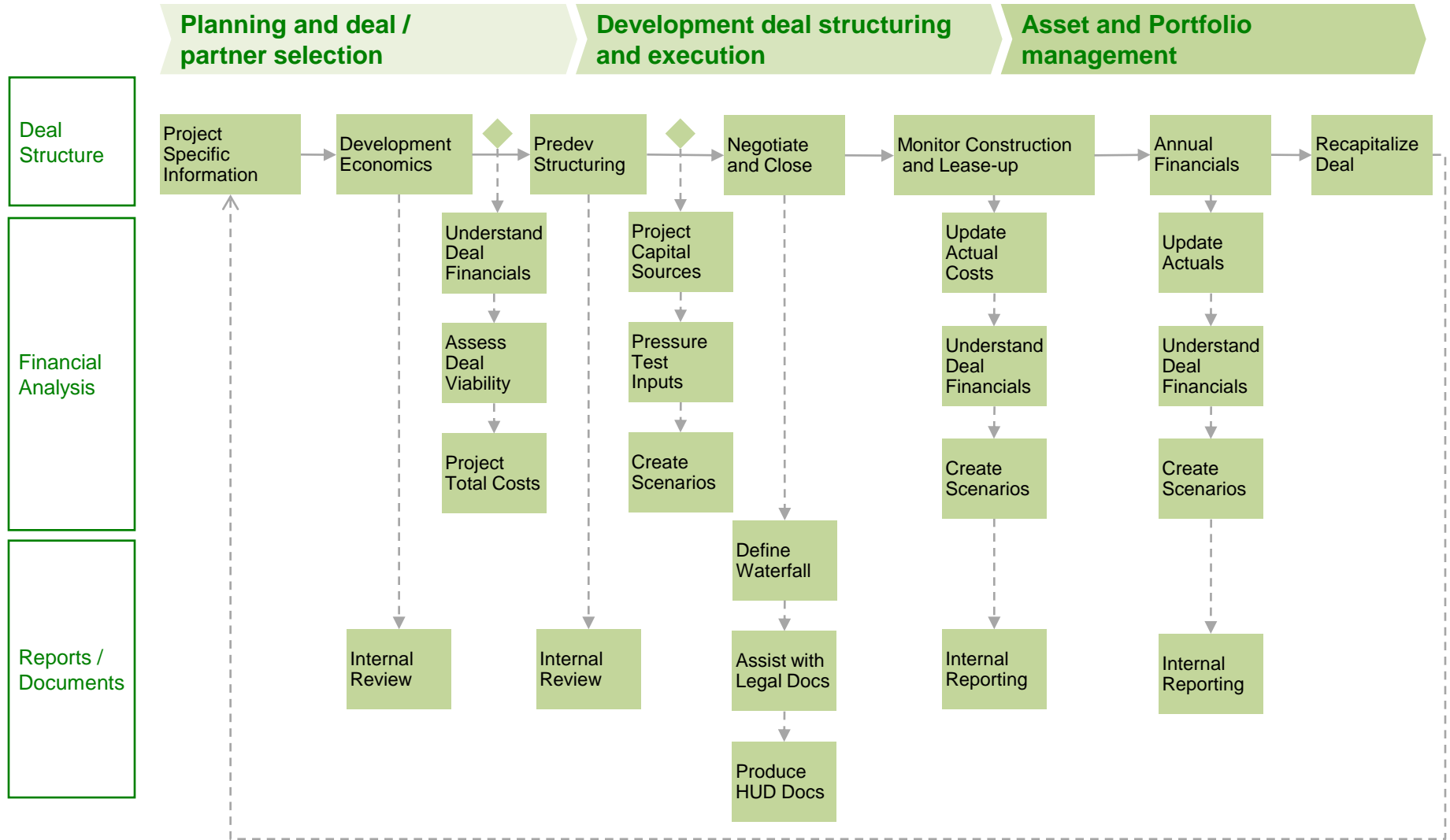
- Critical that inputs and assumptions are accurate, consistently used across deals, agreed with stakeholders



***CAVEAT: Beware “modeler’s hubris”...seek experienced judgments...examine model failures...***

# Real Estate Model performs basic functions

*Designed to improve entire deal underwriting and evaluation process*



# The Apgar Score

Quick measures of “real estate health” on 5 key factors

Factor	Definition	Measures	Scale
<b>AMOUNT</b>	Quantities of space in organization's real estate portfolio	<ul style="list-style-type: none"> <li>• Sq. ft./employee</li> <li>• Revenue/sq. ft.</li> </ul>	0-2
<b>PRICE</b>	Cost of real estate portfolio, including lease, capital and maintenance	<ul style="list-style-type: none"> <li>• \$/sq. ft.</li> <li>• \$/employee</li> <li>• \$/revenue</li> <li>• \$/facility</li> </ul>	0-2
<b>GRADE</b>	Building class and fit-out standards in portfolio	<ul style="list-style-type: none"> <li>• % class A/B/C</li> <li>• % office/retail/other</li> <li>• \$/sq. ft. capital and depreciation</li> </ul>	0-2
<b>AREA</b>	Sub-market and site locations in portfolio	<ul style="list-style-type: none"> <li>• % primary/secondary</li> <li>• % CBD/suburban</li> </ul>	0-2
<b>RISK</b>	<p>Portfolio's exposure to market, financial, and environmental volatility</p> <p>Exposure of real estate-related investment to capital market volatility</p>	<ul style="list-style-type: none"> <li>• \$ market value/\$ book value</li> <li>• % debt/equity</li> <li>• # customers/facility</li> <li>• \$ capital/# hazardous sites</li> <li>• \$ capital/# asbestos locations</li> </ul>	0-2

# 4. Partner with Producers – While Retaining Agents

*Balance in-house and external resources*

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## ***Producers help to execute complex projects, accomplish goals***

- Service alliances
- Lease ‘partnerships’
- Developer partnerships

## ***Successful partnerships benefit both sides***

- Structure of costs, incentives, risks
- Sharing of information, analytics, models

***EXAMPLES P&G, Army RCI, PAL .....***



***CAVEAT: Beware the “sweetheart deal” – e.g. prohibit company’s finance arm from underwriting BUs’ operating facilities***

# Public-Private Partnerships – KFS / Outcomes

*Example: Army's Residential Communities Initiative (RCI)*

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## **Leverage**

- 11:1 private to public investment
- \$6B maintenance backlog cleared / \$10B new development value

## **Resident satisfaction**

- Higher product quality
- 98% on-time service response / higher reliability

## **“Open book” relationship between Army and real estate partners**

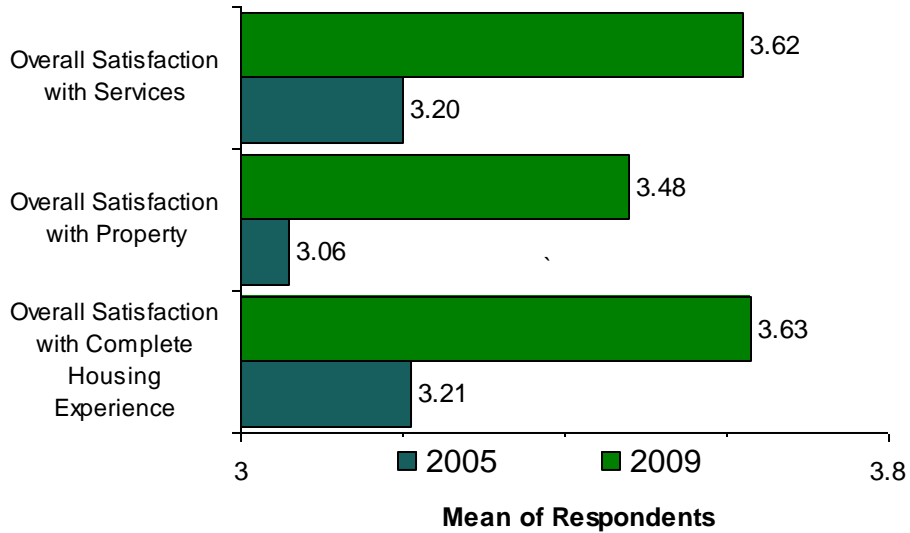
- Shared vision, goals, strengths / weaknesses
- Agreed assumptions, models, analytics

## **Bi-partisan engagement and support**

- House Republican-Democratic leaders forged alliance to support program
- Clinton-Bush transition continued program / increased resources

# RCI Resident Satisfaction

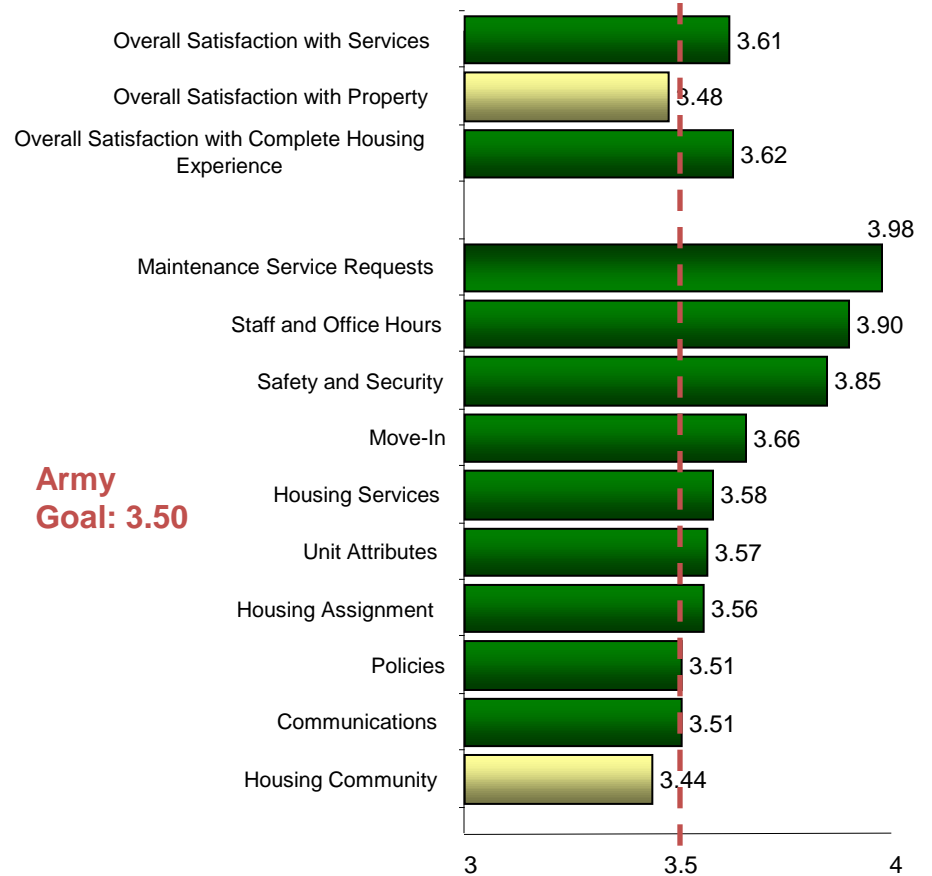
## Improvements from 2005 to 2009



**\*Above chart includes 33 installations continuously participating in the annual survey since 2005**

- **Overall RCI Aggregate Mean: 3.58**
  - High: 4.51
  - Low: 2.79
- **Project Partnership & Action Planning**

## 2009 Resident Perceptions of Housing Experience



**\*Above chart includes all 44 RCI installations**



# Public-Private Partnerships – KFS / Outcomes

*Example: Army's Residential Communities Initiative (RCI)*

## **ARMY RCI OUTCOMES – 1999-2008**

<b>Elements</b>	<b>Metrics / Indicators</b>	<b>Beneficiaries</b>
Scope	88,000 housing units; 45 installations; 23 states	All
Speed	50-200% faster than prior government-managed approach	Soldiers, Army
Quality	100% market standards; 2x more maintenance / service visits	Soldiers
Satisfaction	NCO: "I'll reenlist for an RCI home"	Soldiers, Army
Backlog / shortage	100% of housing deficit met; original \$6 Bn maintenance backlog cleared	Soldiers, Army
Service	98% on-time response for maintenance problems	Soldiers
Construction costs	30% lower than prior government-managed approach	Army
Funding	11:1 leverage of private-to-public funds	Army, Taxpayers
Development value	\$10+ Bn increase in 10 years	Army
Sustainment	100% sustainment funding for full project lifecycle	Army
Environment	100% "green building" standards for new housing	Soldiers, Army

# Public-Private Partnerships – KFS / Outcomes

## *Example: Privatization of Army Lodging (PAL)*

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### **Leverage**

- “Infinite” because no government investment is required
- \$500M new development value
- 100% lifecycle sustainment funding

### **Resident satisfaction**

- Product quality: 30% increase in customer satisfaction
- Service response: 50% faster, improved reliability

### **Speed**

- 200% faster construction / development

### **Green**

- 100% LEED or equivalent standards

# Public-Private Partnerships – Outcomes

## Example: Privatization of Army Lodging (PAL)

### PRIVATIZATION OF ARMY LODGING (PAL) OUTCOMES – 2003-2010

Elements	Metrics / Indicators	Beneficiaries
Scope	3,500 lodging units; 10 installations; 8 states	All
Speed	200% faster than prior government-managed approach	Soldiers, Army
Quality	100% market standards including mid-scale brand standard facilities and services	Soldiers
Satisfaction	“I have been working here for 19 years. I think it’s the greatest thing that ever happened. Because to me the Soldiers are finally getting the services they deserve and the amenities that they deserve,” said Gabriel Whitaker, former Army Lodging General Manager, Fort Sill, OK	Soldiers, Army
Backlog / shortage	Right-sizing each installation’s lodging inventory to match the needs of official travelers. Maintenance backlog to be eliminated	Soldiers, Army
Service	Guestview customer satisfaction was 3.1 at transfer and is now 3.95; 30% increased satisfaction scores in 18 months	Soldiers
Construction costs	Different product types make direct comparison difficult, but efficiencies related to scale and scope; new buildings will be delivered in the future for comparison	Army
Funding	Infinite leverage of private-to-public funds since no government contribution	Army, Taxpayers
Development value	\$132M in first two-years; \$336M total for initial development period	Army
Sustainment	100% sustainment funding for full project lifecycle	Army
Environment	100% "green building" standards for new lodging	Soldiers, Army

# 5. Embrace Sustainability (I)

*Top management drives “Green”, technical capabilities support*

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## ***Beyond Ownership and Occupancy*** .....

- US buildings produce +40% of carbon emissions (vs. transportation 32%)
  - Green challenge obligation AND opportunity (eg, WPP)
  - Green buildings can cost more upfront, but higher returns long-term
  - Green buildings are 21st C's 'trophies': e.g., Bank of America, Hearst Corp.
  - Dow Jones's 'Sustainability Index'
-

# 5. Embrace Sustainability (II)

*Top management drives “Green”, technical capabilities support*

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## ***Beyond Ownership and Occupancy*** .....

Criteria for success in “Green” policies / projects:

- Strategic
- Measurable
- Operational
- Aspirational



***SUSTAINABILITY in ACTION > WPP, Ford, Google, Citi, Limited***

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# What's the leader's role in real estate? SA's view...

*A changing tableau of attitudes and skills*

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## ***Revitalizing the organization***

- Inspiring the team
- Managing up, across and out

## ***Rethinking strategy***

- Framing the issues
- Repositioning how business is done

## ***Restructuring information***

- KPIs, “real estate intelligence”
- Reports, Systems, Processes

## ***Reforming yourself?***

- Listening and learning
- Personal and organizational civility

# The Leader's Role in Real Estate

## *Agenda*

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### ***PONDERING “TWELVE BIG ISSUES”***

- Where will we work?
- How will we shop?
- When – and how – will social media change real estate?
- Whither (or Wither?) the home mortgage market?
- What's next for “public housing”?
- How will the “tiny house” movement shape expectations?
- What's the role of real estate education in the new economy?
- How much will you pay CEOs and bankers?
- How can organizational change become easier?
- How can you manage what you can't measure?
- What's the role of entrepreneurs in the future real estate industry?
- ADD 12<sup>TH</sup> BULLET



# Big Issues (I)

## *Closing*

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### ***Where will we work?***

- People increasingly resent daily commute to fixed office location
- Alternative Workplace (telework, satellite offices etc) becoming a trend?

### ***How will we shop?***

- Local neighborhood vs. regional mall?
- Online vs. onsite?

### ***Whether (or Wither?) the home mortgage market?***

- Regressive? Budget buster?
- The 50-year mortgage? Mortgage interest deduction?

### ***What's next for "public housing"?***

- Continue "warehousing the poor"?
- MI/MU/MF communities?

# Big Issues (II)

## *Closing*

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### ***What's the role of real estate education in the new economy?***

- Creating new businesses vs. optimizing old?
- Changing the 'entitlement culture'?

### ***How much will you pay CEOs and bankers?***

- Limits from public perception of excess?
- Board's compensation philosophy and role?

### ***When – and how – will social media change real estate?***

- Network-based vs. location- and deal-based business models?
- Groupon today vs.???? tomorrow?

### ***How will the 'tiny house' movement affect expectations?***

- Paring down possessions: "living small, consuming less"?
- 75-150 SF / \$30-50,000

# Big Issues (III)

## *Closing COLLAPSE*

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### ***How can organizational change become easier?***

- Values of openness, humility starts at the top
- Limits of ideology, resources

### ***How can you manage what you can't measure?***

- Old adage doesn't work in subjective situations
- Sustainable communities are a critical test for real estate leaders

### ***What's the role of entrepreneurs in the future real estate industry?***

- XX
- YY

### ***XX?***

- XX
- YY

 ***...and your issues...???***