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CORPORATE REAL ESTATE & WORKPLACE

Perspectives from the CFO: Four key areas for strengthening alignment

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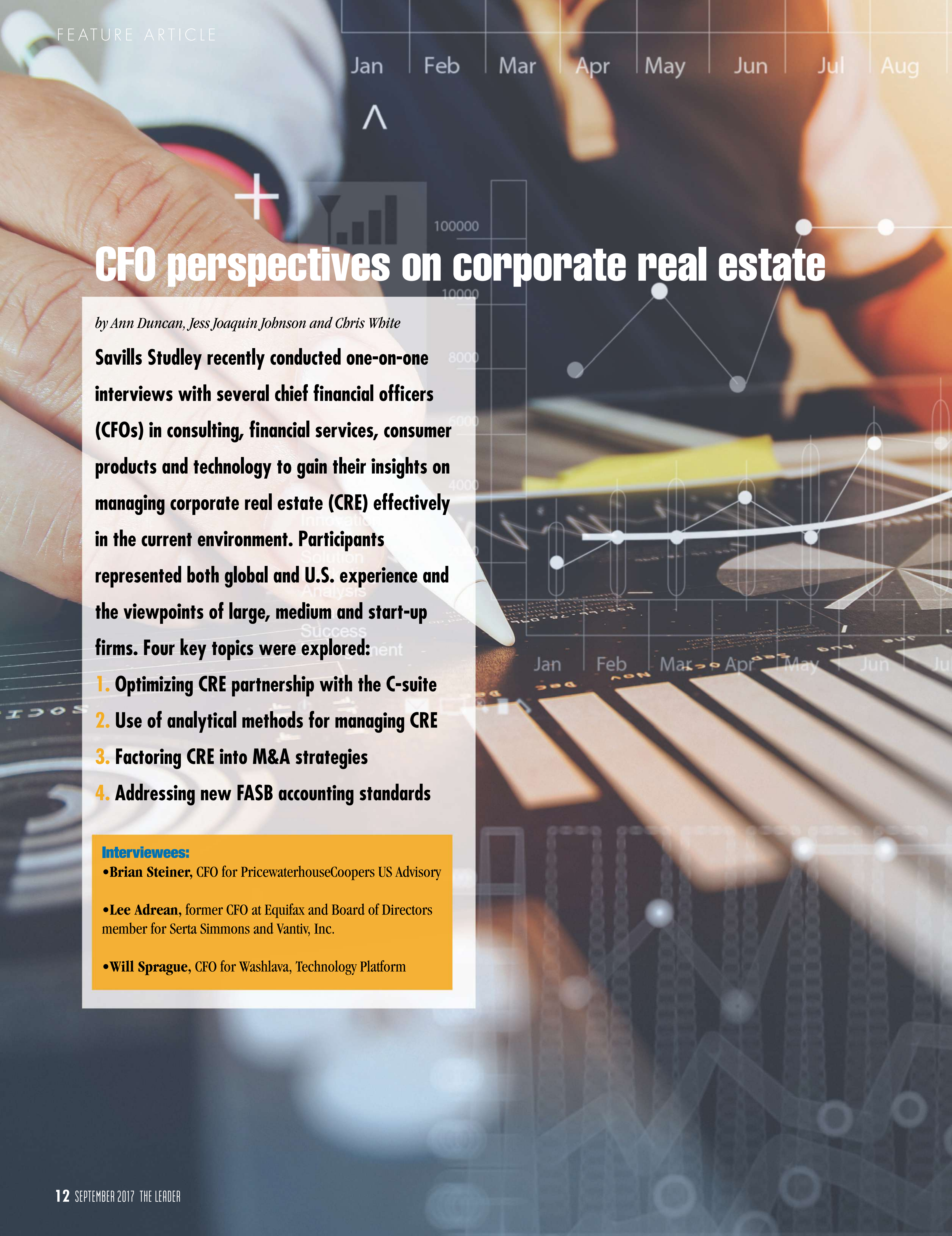


CFO perspectives on corporate real estate

by Ann Duncan, Jess Joaquin Johnson and Chris White

Savills Studley recently conducted one-on-one interviews with several chief financial officers (CFOs) in consulting, financial services, consumer products and technology to gain their insights on managing corporate real estate (CRE) effectively in the current environment. Participants represented both global and U.S. experience and the viewpoints of large, medium and start-up firms. Four key topics were explored:

1. **Optimizing CRE partnership with the C-suite**
2. **Use of analytical methods for managing CRE**
3. **Factoring CRE into M&A strategies**
4. **Addressing new FASB accounting standards**

Interviewees:

- **Brian Steiner**, CFO for PricewaterhouseCoopers US Advisory
- **Lee Adrean**, former CFO at Equifax and Board of Directors member for Serta Simmons and Vantiv, Inc.
- **Will Sprague**, CFO for Washlava, Technology Platform

1. Optimizing partnership with the C-suite

Savills Studley: ***With CRE teams under increasing demands to deliver superior results, it's important that they understand how to partner most effectively with the C-suite, especially the CFO. What advice would you offer?***

Brian Steiner: The expectations of the CRE function have changed significantly in recent years. The discussion isn't simply around negotiations and the bottom line anymore. A higher-level strategic discussion of the alignment of CRE with business goals is imperative.

This strategy must reflect a multitude of factors. These include our evolving workforce, work spaces and work styles, collaborative spaces, adaptable station design and amenities. There's also the impact of technology, which affects commute patterns and remote workers.

On the global level, aligning corporate culture with the local culture is imperative, and interconnection of workspaces is mandatory. You must allow for differences in negotiation style and logistics.

Our primary objective is to maximize profit per square foot. But the way we do this varies by geography. What works in one setting may not in another. You have to find a balance between labor and real estate cost.

Importantly, it's crucial to anticipate flexibility for change. Events occur so quickly that facilities built three years ago are already outdated. So creativity and the ability to "push the envelope" are increasingly important.

It's wise to leverage third-party providers. In my experience, "buying the expertise" may be faster and more effective than handling internally.

These are all important strategic objectives where the CRE leader can initiate and steer progress.

Lee Adrean: In one sentence: Be a better strategic partner. First, address big issues over the long range by taking into account the impact on the corporation overall, not just particular business wants and needs. This means you have to avoid falling into the traps of tactics and execution. Too often, the temptation is to focus on immediate capital requirements and project needs.

Get involved early, and make sure to understand the true criteria. To do this, the CRE team needs to consult all the key decision makers and influencers, not just the specific client. You'll find criteria can vary greatly from different viewpoints. For example, is cost most important? Proximity to clients? Productivity improvements? Image? Identifying valid criteria early on and gaining agreement can prevent costly surprises farther down the line.

Drive the dialogue, but be collaborative. Start by asking questions, and make sure to listen to the answers. Then come to the C-suite armed with a well-supported point of view. Phrase your recommendations in terms of "what and why," not how.

Will Sprague: My perspective reflects experience with small- to medium-sized businesses, from startups to 500 employees. At this scale, the impact of CRE gets to the core since it's one of the most important factors affecting cash flow.

For smaller companies, the right decision to lease or buy is vital to protecting the business. In a fast-growing business, leasing is generally the best choice. That's because the buying process is too lengthy, stretching from strategy development, property selection, and negotiations to decision. Also, the flexibility for expanding or downsizing to adjust to changing priorities or markets is essential. Think out the provisions, and know your options for termination, renewal or alternative locations.

If purchasing, consider whether real estate will become an asset or a cost. Financing conditions, cash-flow effect and balance-sheet impact will play a role in the final recommendations.

To make effective CRE decisions, consider the type of business. The needs of service businesses vs. product companies are quite different. A service business may well focus on location, talent attraction, and the brand or market presence of the property. On the other hand, with a product company, manufacturing locations, supply chains and logistics are often the determinants.

Culture of the organization is increasingly important. For example, location may outweigh all other factors, even cost.

2. Leveraging use of analytical methods to manage real estate

Savills Studley: ***Do you use data, metrics, modeling or predictive analyses to manage and align real estate with business goals?***

Brian Steiner: We absolutely rely on access to robust data and an advanced, proprietary set of tools that enable us to build a business case around analyses of client base, profitability, head count and the like. With this information, we can scale up or down in a market very effectively. It's basic to our approach.

Lee Adrean: I believe rigorous quantification is key. Begin with benchmarking the amount of space needed, overall and per person. This will obviously vary by property type: office, warehouse, data center, retail, etc. Look at cost of construction, equipment and furnishings, and infrastructure requirements. With a new tenant, consider the cost of improvements. Then compare your benchmarks to trends.

Next, move to modeling. Examples of factors to model include: commitment, assumptions, assumptions vis-à-vis benchmarks, discount rate, and so on. It's also important to model contingencies, such as capacity, expansion, and accurate construction costs.

With this information, the CRE team can add perspective that aids management decisions.

Will Sprague: As a startup, our process is necessarily fluid rather than established. However, CRE still has to find ways to quantify the differences among properties so that decision makers can understand recommendations. This includes "quantifying the qualitative," which is where the real challenge lies. Although you can't assign a numerical value per se, there needs to be a method for addressing it.

3. Factoring CRE into M&A strategies

Savills Studley: ***What role does CRE play in M&A activities?***

Brian Steiner: You must conduct due diligence on the opportunity. One of my first questions is, "What does the real estate portfolio look like?" Knowing that can help determine whether the new entity stays in place, folds into existing facilities, or is completely re-engineered to achieve the best synergies. But making a blanket statement is difficult because each situation is different, and you always need to take into account intangibles such as cultures, personalities, and emotional components.

Lee Adrean: There are different approaches, depending on the reasons for the merger. For example, is the merger between companies in different lines of business? If so, you can expect moderate consolidation. There will probably not be need for two accounting teams. But separate production facilities, sales forces, etc., may still be required.

On the other hand, if the entities are in the same line of business, you need to look at the reasons behind the merger. Is it a matter of gaining scale? Or is it to add a new products or customer segments? In either case, there's likely to be more extensive consolidation to eliminate redundancies.

CRE has to understand the rationale for the merger and prepare for the consequences.

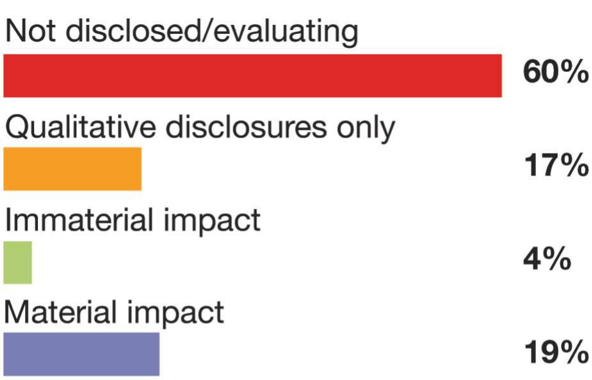
4. Addressing new FASB accounting standards

Savills Studley: ***What can CRE do to facilitate the accounting task?***

Brian Steiner: Real estate has to get in front of it. But most companies are still evaluating the effect FASB will have. For example, will the revised balance sheet change how analysts view the company?

FASB has two phases: Revenue recognition for 2018 and lease accounting in 2019. The reality is that focus is on the first phase now. CRE can act proactively by starting to collect leasing information so that it's ready when accounting begins on the next phase.

Most companies report little progress on assessing the impact of FASB.



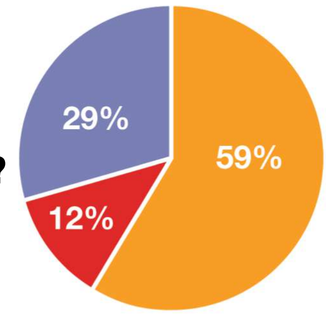
Source: PwC, *CFO Direct*, 'The quarter close,' June 12, 2017

Lee Adrean: Controller efforts are directed towards 2018 revenue recognition and probably won't shift to leasing until 1Q next year. In the meantime, CRE can help by starting to assemble the needed inventory of all leases, both capital and operating, because even terms as short as one year will be affected.

Creating a comprehensive overview is a true challenge. It should note start dates, terminations, renewals, annual increases, and a range of other options that may come into play. The problem is this information is usually scattered throughout the organization. Data may be kept in spreadsheets; terms may still be entered manually. This makes accurate information collection a big task.

Still, CRE can provide invaluable assistance by helping the corporation avoid a disruptive fire drill next year.

Which of the following are your organization's top challenges in 2017?



- Attracting and retaining top talent
- Access to capital
- Regulation

Source: CFO Forum/Atlanta, First Quarter 2017

Top take-aways

- CRE must function strategically to align with corporate goals and avoid transactional focus at the business level.
- Although the means of analysis may vary with circumstance, quantification is crucial for presenting an understandable, well-supported recommendation to aid management decisions.
- CRE has to understand the rationale for an M&A event; that is, what is driving it? The CRE team must get to the C-suite early to help with due diligence. Then the team's responsibility is to anticipate and prepare for the post-acquisition integration to drive synergies according to business objectives.
- Because real estate represents a principal expense, it can be central to the success or failure of a merger. Early involvement in the undertaking is essential.
- Most companies lack the data, systems, processes and controls to comply with FASB leasing standards.

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