PROPERTY IN BUSINESS – INEFFICIENCIES IN CORPORATE PROPERTY INVESTMENT IN AUSTRALIA

Full Paper

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ABSTRACT

Australian companies still do not adequately recognise or manage their corporate real estate. The estimated total cost of office accommodation in Australia is identified and the value of wasted space quantified. Some $550 million could be added to business's bottom line if new office techniques and basic strategic asset management planning were to be adopted. The consequences on the future need for office development may also be affected by developing facilities management techniques.

Keywords; Corporate real estate, property performance, resource sustainability, Australia

INTRODUCTION

The management of corporate real estate by facilities managers can represent a major contribution to the profitability of an organisation. The facilities management profession grew out of the recognition that the property assets of business represent a significant proportion of the company's available assets, both as a proportion of total investment and in terms of annual operating costs. This investment in property has been recognised for many years. Back in 1983, (Cock, R. and French, N. 1997, Zeckhauser, S. and Silverman, R. 1983) urged business to *'Rediscover your company's real estate'*. In a survey of 300 US companies, the authors found that at least 25% of total companies' assets were held in real property. The total invested in US corporate property is estimated at nearly 45% of the total market capitalisation of US companies. (Roulac, S. E. 2003) In Europe, research reflected the results of those in the US. (Varcoe, B. J. 1993) reported that leading UK businesses had 30% to 40% of their capital held in real property and that 10% to 20% of annual operating cost was property related. (Gibson, V. A. 1994), highlighted the need for organisations in the public and private sectors to develop strategic management tools and to gather property information in order to understand how this enables the effective delivery of business functionality. Thus corporate real estate is an important contributor to the economy and efficiency of business.

INVESTMENT IN THE BUILT ENVIRONMENT

Investment in Australian corporate real estate constitutes a very significant proportion of the nation's total wealth. Before proceeding to analyse the effectiveness of that investment, it is necessary to quantify the level of investment and to define corporate real estate. The total value of the developed environment in Australia is estimated at almost $3 trillion, (Ruthven, P. 2002), which is more than four times GDP. The investment can be subdivided using Australian Bureau of Statistics' classifications of residential, engineering and non-residential. The non-residential and engineering categories represent an estimated $1,140bn or 39% of all built assets, while residential totals $1769bn. The area of most interest to business, non-residential, can be further split into a number of sub-categories to differentiate the various classes of property use; commercial, industrial etc. as shown in .

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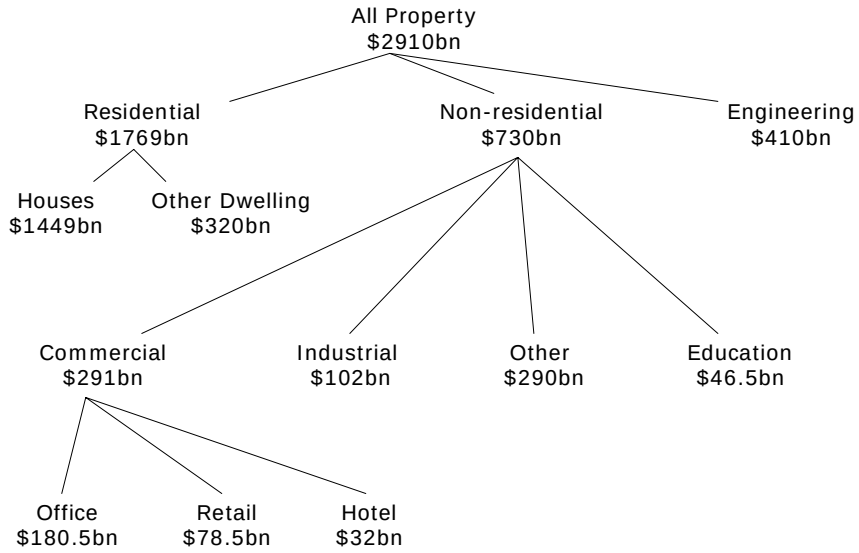
Figure 1 The Built Environment



Source: Ruthven, P. 2002

The sector comprises a number of uses ranging from business use to public sector property use, which includes schools, hospitals and other organisations with a 'not for profit' objective. If one deducts from the total non-residential those assets which are generally not of a corporate or business nature, the health, education and public sector investments, then there remains the commercial and industrial properties. These can be calculated to represent a value of $393bn or 13.5% of the total built environment.

Investment in property continues with the total value of the built environment growing at about $48.5billion annually. The construction industry is an integral part of the economy, contributing 4.6% of the gross product of all industries and employing 7% of the workforce, which translates to 668,000 individuals. Last year some $12.6bn was invested in new, non-residential construction. Of this total, 19%, or $2.3bn, was invested in office and retail, while $790m, or 6%, of the total was spent on industrial building. Table 1. It can be seen that a very significant investment has been made in our built environment, and this investment increases annually with a 1.6% addition to the estimated total value.

Table 1 Value of Non-Residential Building Work Done

	2001 $m	% of total
Total	$12,615	
Retail	$2,366	19%
Office	$2,337	19%
Other business	$1,558	12%
Factories	$790	6%
Entertainment	$886	7%

Source: ABS Building Activity (8752.0)

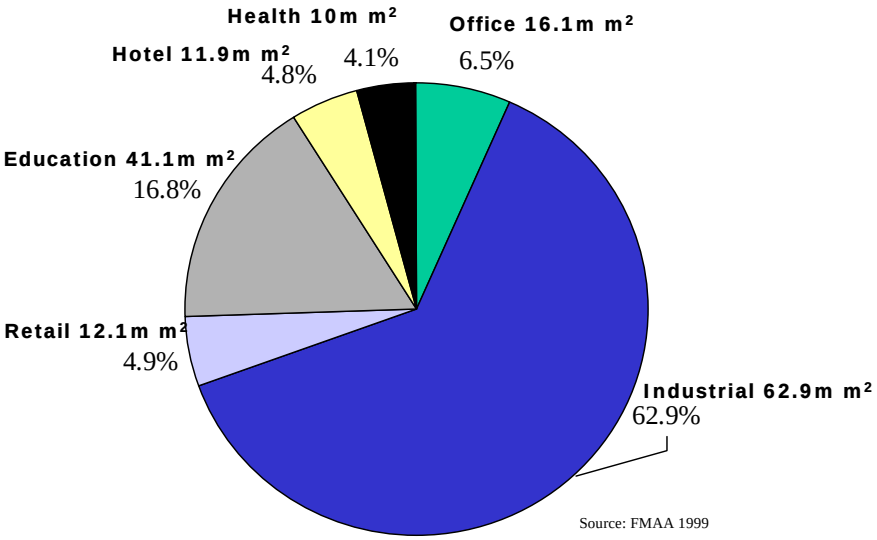
Buildings are constructed for a variety of purposes; to provide shelter, security, amenity and a place to carry on business, improving the utility of our environment. The focus of this paper, as previously stated, is in the non-residential category and, more specifically, the premises occupied for business purposes. Property assets are held principally for two purposes, as owner occupiers in which the property provides a place from which to conduct business, or as investments. The property in the latter category is held by organisations that acquire their assets to derive an income flow from tenants.

Property occupied as a place to conduct business is commonly termed Corporate Real Estate and is defined as property assets held by a company for the purpose of providing that company with enabling resources of shelter and a place to operate the business from. It has a fundamentally different ownership purpose from property assets held by companies for investment purposes. The investor wants to maximise the return on investment, while the corporate occupier seeks to maximise the benefit to the business from ownership. In considering this division between owner-occupied property and that held for investment, it becomes evident that, from a corporate real estate perspective, the investment properties of one organisation become the leasehold properties of another. It is further evident that the eventual leasehold occupier of the property will be in occupation to use the property as a business base and, therefore, has the objective of deriving maximum business advantage out of the property for the duration of the lease. Thus, in considering the total stock of property, the important differentiation comes between owner occupied and leased property and not whether it is held for investment or owner occupation.

Ultimately all commercial property is occupied as corporate real estate, with the exception of space vacant which is to let or withdrawn from the market for refurbishment. Some allowances, therefore, must be made in calculations for vacant property within the total stock, as this does not form a part of what may be described as corporate property. The amount of office stock which is vacant and available to let varies from location to location, over time depending on economic cycles, with the level of new stock entering the market and the demand for additional space from corporate occupiers. Current vacancy figures range from a high of 27% for C grade in Adelaide CBD, to lows of 8% for Prime and A grade stock in Brisbane's and just 4.5% in Canberra.

The total stock of Corporate Real Estate comprises some 245million metres square of gross area. Figure 2 shows property classes with estimated percentage of total stock. (FMAA 1999) Industrial property comprises the largest proportion by area at 62.9%, while, by comparison with only 14% by value of non-residential capital expenditure.

Figure 2 Non-residential Property Australia – percentage by area



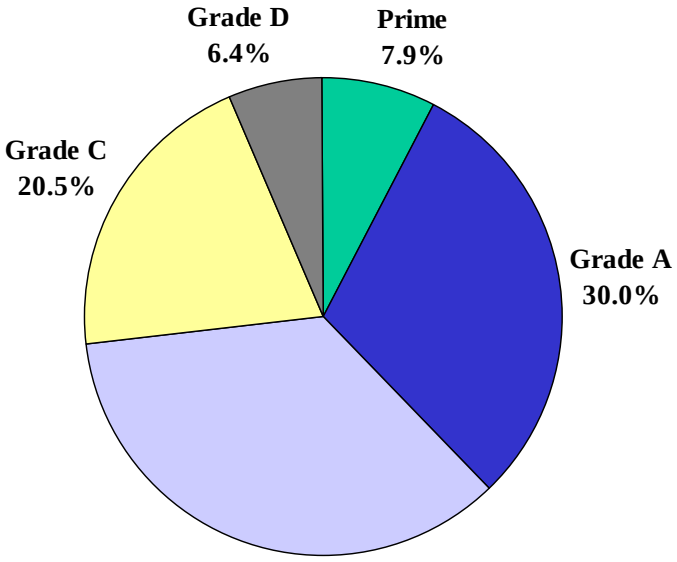
By contrast, the office sector represents just 6.5% of the total non-residential area yet comprises 25% of the invested capital. This is the highest cost to area ratio within the corporate property categories and, as such, affords the best opportunity for business to make cost and efficiency savings. The office sector is largely concentrated in the State Capital CBDs and close fringe regions. Of the 17.6 million metres square of office space monitored by the Property Council of Australia, 12.89m m^2 is located within six CBDs. The majority of the remaining 4.8m m^2 is located in twelve fringe or satellite centres around the capitals.

Table 2 Australian Office Stock - m^2

Region	CBD	Non-CBD
Sydney CBD	4,248,557	
North Sydney		782,448
Parramatta		547,992
Chatswood		300,892
Crows Nest/St Leonards		303,121
Newcastle		188,716
NSW Total	**6,371,726**	
Melbourne CBD	3,150,793	
St Kilda Road		765,505
Southbank		296,577
Victoria Total	**4,212,875**	
Brisbane CBD	1,552,558	
Brisbane 'Near City'		639,513
Gold Coast		254,166
Queensland Total	**2,446,237**	
Perth CBD	1,265,599	
West Perth		332,738
Western Australia Total	**1,598,337**	
Adelaide Core	898,152	
Adelaide Frame		211,512
Adelaide Fringe		181,710
South Australia Total	**1,291,374**	
Canberra Region	1,448,914	
Hobart CBD	326,458	
Australia Total	**17,695,921**	
Source; PCA 2000		

Office stock within Australia is categorised according to the quality of the accommodation provided, utilising PCA grading categories which differentiate buildings based on a series of locational, functionality and technological criteria. The prime category represents the few, very high quality, technologically advanced and well located properties within the CBDs.

Figure 3 Office Stock - Grade by Percentage



Source; Knight Frank Research 1998

While the majority of office accommodation falls within the A and B grades and comprises those buildings, which although still of a good quality and providing good facilities, are not quite 'state of the art'. The C and D grades tend to comprise those buildings at the fringe of the business district or which are ageing and lack some of the modern conveniences.

ASSESSING THE COST OF CORPORATE REAL ESTATE

The total costs to business of occupying corporate real estate is not simple to estimate. The costs for leased accommodation can be ascertained through records of lease deals. The costs of owner occupation can be derived from company accounts in the case of public companies that are owner occupiers. These figures, however, include items which obscure the cost of real property, as company accounts include other operational plant and machinery in this category. In order to quantify the costs of occupation, and to compare on a like for like basis, it is necessary to work from a common cost base for both owned and leased property.

It is not an unreasonable assumption to make that a competent, prudently managed company would seek to maximise the value of its assets. Thus, if a corporation in owner occupied property vacated that property, then it would seek to maximise return on the property which would be sold or made available to lease at the current full market rack rental. Alternatively, the corporate occupier could, as many have done in recent years, sell the property and lease back the accommodation at a market rent. Similarly, any lessee of accommodation could, subject to lease covenants, sub-lease or assign that lease again at the current full market rental. It is, therefore, justifiable to examine the costs of corporate real estate in terms of the rent which would reasonably be expected to be paid in the market for that class of property.

It might be argued that a long lease at below market does not fit the assumption, as the lessee is receiving a benefit, in valuation terms a profit rent. Like an owner occupier, however, it is not unreasonable to expect that the lessee could realise this value in the market by assigning or surrendering the lease. The only exception to this assumption would be in the currently rare case of an over-rented property. This basis is to some degree supported by the increasingly common practice within major corporations of charging internal rents based on market equivalent figures to their individual departments. (Cock, R. and French, N. 1997). This supports the notion that the cost to the occupying department is the market cost of providing that accommodation in the open market and that any costs or benefits associated with ownership or otherwise of the asset is a matter of sound corporate asset planning and not a factor of business production.

METHODOLOGY

The estimation of the costs of occupation of office accommodation is derived from a series of market based cost parameters, including rent, outgoings and vacancy rate. The current effective rental paid, not asking rents, or face rents, is used as the levels and type of lease incentive vary from location to location and can be as high as 30% of rack rent. Using effective rents reflects the actual cost of occupation.

Figure 4 Effective Rents shows the rental rate and applies this to the estimated total office area in each location from Figure 2 These rents were sourced from published data from leading valuer and agency firms. (Colliers International Aug 2003, FPDSavills Research 2002, Laing Simmons 2003) Allowance is also made from the total office stock for vacant space using published average vacancy rates. (Property Council of Australia 2000),

Figure 4 Effective Rents

Region	Net Effective Market Rent / m/pa					Net Effective Rent				
	Prime	A	B	C	D	Prime	A	B	C	D
Sydney CBD	$666	$495	$350	$280	$224	$235,778,074	$572,715,139	$486,867,542	$208,035,400	$52,685,465
North Sydney	$350	$350	$320	$256	$205	$12,887,700	$73,858,426	$122,652,708	$25,147,112	$2,104,320
Parramatta		$270	$216	$173	$138	$0	$64,465,008	$24,144,130	$16,750,028	$8,286,404
Chatswood		$330	$264	$211	$169	$0	$50,219,358	$24,408,578	$7,827,546	$263,467
Crows Nest/St Leonards		$350	$280	$224	$179	$0	$16,308,597	$26,724,963	$29,396,496	$2,512,026
Newcastle		$270	$216	$173	$138	$0	$10,724,113	$15,262,461	$10,281,828	$683,518
Melbourne CBD	$470	$300	$190	$152	$122	$272,876,543	$250,173,479	$152,457,577	$75,265,335	$22,637,056
St Kilda Road		$210	$165	$132	$106	$0	$44,628,578	$47,448,423	$21,126,077	$989,476
Southbank		$210	$165	$132	$106	$0	$24,385,586	$15,264,087	$8,096,806	$333,471
Brisbane CBD	$235	$131	$105	$84	$67	$23,843,282	$67,550,103	$63,342,134	$14,156,075	$3,579,147
Brisbane 'Near City'		$166	$133	$106	$85	$0	$26,989,734	$36,308,142	$10,926,238	$1,649,865
Gold Coast		$166	$133	$106	$85	$0	$13,740,133	$11,721,478	$5,100,896	$713,336
Perth CBD	$300	$235	$140	$120	$95	$54,962,950	$109,468,795	$33,934,252	$25,706,203	$1,094,908
West Perth		$200	$160	$100	$80	$0	$11,402,079	$19,752,578	$10,116,274	$1,286,828
Adelaide Core	$230	$165	$125	$100	$80	$11,132,797	$47,188,703	$26,091,187	$15,013,099	$6,369,053
Adelaide		$160	$110	$88	$70	$0	$4,827,341	$8,239,523	$3,851,285	$2,833,464

Frame Adelaide Fringe		$150	$105	$84	$67	$0	$2,968,950	$10,689,589	$3,277,070	$497,694
Canberra Region		$215	$172	$138	$110	$0	$79,235,095	$77,120,599	$52,020,869	$20,138,880
Hobart CBD		$140	$112	$90	$72	$0	$12,965,510	$8,759,382	$6,061,015	$2,974,589
Australia Total						$611,481,346	$1,483,814,728	$1,211,189,334	$548,155,651	$131,632,966
	Total Rent Australia					**$3,986,274,025**				

The effective rent is also typically quoted on a net rent basis that excludes the outgoings for the property. The outgoings costs vary by location and property grade and represent the costs to the lessor of statutory outgoings, energy costs, and repairs and maintenance for the operation of the building. These costs should be accounted for in deriving the total costs of occupation. (Property Council of Australia 2002)

In order to derive an estimate of the total costs to Australian business of their corporate office accommodation, the cumulative cost of net effective rent and outgoing for each property grade and location are calculated. This figure is then multiplied by the net Lettable area for each market after allowance is made for vacant offices. Using the PCA source, the estimated total office space is 17.7 million metres square. This total space is reduced to 16.1 million metres square of space when the vacancy rate for each locality and grade of property is equated. (Property Council of Australia 2000).

The total costs to business of occupying this 16.1 million metres square of space is calculated to be total net effective rent, equating to A$3.986 billion per annum. The total operating costs paid for this space adds a further B$1.36 billion to the rent. Thus, we are now able to estimate, with a reasonable level of confidence, the market equivalent cost of providing all corporate office space within Australia. This figure is expressed as the gross rack effective rental of all occupied space and is estimated to be C$5.34 billion per annum. Having quantified the cost of providing corporate office space, it is now possible to apply this figure to measures of space efficiency to give an indication of what potential savings may be available if sound management is applied, or innovative occupancy techniques employed.

THE COST OF WASTED SPACE

The design and use of the workplace has significantly changed over the past few decades as business strives to maximise its efficient use of assets. The office layout has developed from rigid cellular designs, through open plan, to multi-function, team based workspace. This change has resulted in a deconcentration in which property and information systems have been fused and work is no longer bounded in place and time but enabled to work flexibly anywhere. The enabling infrastructure becomes a strategic resource of the organisation, no longer a sleeping asset, but a source of competitive advantage. (Apgar IV, M. 2002)

The changing pattern of work has spawned new innovative techniques to intensify the use of space and free workers to be more flexible in their work hours, location and type of workplace. Hot-desking and hotelling seek to directly increase the ratio of employees to workstations by requiring employees to share workstations at different times, while virtual officing and teleworking free employees to work from home or a satellite or drop-in centres. The reengineered workplace, which promotes flexibility, knowledge exchange and is responsive to the unstable business environment, provides for greater efficiency in capital expenditure on space. (Lizieri, C. M. 2003)

The extent to which Australian business has recognised the potential savings from reengineering or deconcentrating their office has a direct, proportional financial return to the organisation. The intensity of space use ceteris paribus, when professionally managed, can add to the strategic advantage of the company and provide a positive

return from property assets. Studies in the UK show that business could save £18 billion per annum, or add 13% to their bottom line profit, by properly monitoring property use and adopting benchmark occupancy standards. A staggering £7 billion could be saved by owner occupiers just by being as efficient as tenants in their use of space (Bootle, R. and Kalyan, S. 2002). A comparative study in Australia (Warren, C. M. J. 2003b) reveals an even greater spread in the intensity of office use, with average office densities of 20.6m^2 per full time equivalent employee (FTE), compared to the UK figure of 16.3m^2 (RICS and Gerald Eve 2001) Comparison of UK and Australian office use data consistently shows that Australian office use is much less dense than that in the UK, however, the increased office densities resulting from the take up of new office techniques reveals similar space savings between the two countries. (Warren, C. M. J. 2003a)

The study of corporate office space reveals that, even after several decades of research and attention being paid by the property and facilities management professions in Australia to the strategic use of real property assets, only two thirds of organisations are benchmarking their property use. This means that of the $5.34 billion calculated above, which corporations spend annually on rent, some D$1.76 billion is paid but yet remains unmeasured as a corporate resource. More importantly, by comparing those business organisations which do benchmark their property performance with those that don't, there is a 10.3% saving in space, equating to E$550 million which could potentially be added directly to the bottom line of those companies which benchmark. A similar saving of 5.2% of office space, or F$278 million, could be saved if the 35% of organisations which do not have a strategic property plan for their organisation were to implement this basic management technique.

The waste of corporate funds is highlighted in a number of other areas. The difference between owner occupied and leasehold space, discussed above in the UK research, is repeated in the Australian market. The space efficiency of tenants reveals a 13% space saving compared to their owner occupier counterparts. The ratio of owner occupiers to tenants within the market is 31/69, thus the organisations which own their accommodation are potentially wasting the equivalent of G$215 million.

There has been a tendency for corporations to move from owner occupation toward leasehold premises to release capital back into their organisations. This move could also increase the efficiency of space use, resulting in the savings above, if these organisations implement the same management strategies of those organisations currently leasing accommodation. There is some evidence that corporations which have little directly owned property are more profitable than corporations with large property portfolios, (Liow, K. H. 2003). It could also be argued, however, that these savings are there to be achieved through efficient management of those facilities and the loss of flexibility resulting from sale and leaseback arrangements could be avoided.

INNOVATIVE OFFICE DESIGN

The adoption of innovative new office techniques has revealed a considerable space saving, particularly for larger companies. Those organisations utilising, to some degree or another, techniques such as hot-desking, hotelling, home-working and virtual office solutions are, on average, saving 4% of their office space. The take up of these techniques within Australia is encouraging, with 43% of organisations using home-working for some employees. The adoption of hot-desking and hotelling is

much less, with 14% and 5% of organisations respectively using these techniques. (Warren, C. M. J. 2003b). The financial savings afforded by hotelling and hot desking are, however, significant. Those organisations using hotelling occupy, on average 16.7m^2 /FTE which is 20.8% less than the Australian average for all offices. Hot-desking is saving 11.4% of the average, at 18.7m^2 /FTE. In financial terms this 19% of companies are saving $155 million by hotelling and a further $30 million by hot-desking. Thus the savings from changing patterns of office use in Australia are not insignificant. Widespread adoption of these innovations could save up to $1.1billion, though it is recognised that these techniques are not applicable to all situations.

The underlying occupancy densities in all categories of office property are considerably less than those found in the UK. (Warren, C. M. J. 2003a) If office densities were increased to match those of the UK and, assuming this paradigm shift in space use could be achieved without any significant loss in productivity of the organisation, then the potential saving, as previously indicated, could be as high as 4.3m^2 for every employee. This is far from an insignificant space saving. When equated across the whole market it would inject some $1.1 billion or, in terms of space which potentially could be vacated, 3.68 million metres square, an area equivalent to half of the Sydney CBD. Figure 5 provides a summary of the potential savings. It is obvious that not all methods of space reduction can be applied in all situations, nor is it suggested that by applying all techniques that the savings become cumulative. They are based only on comparison of organisations applying the various techniques with those yet to undertake change. Also, the calculations are based on market figures and thus do not make any allowance for changes that might occur in the market should widespread adoption of these savings techniques be adopted.

Figure 5 Summary of Potential Savings

Space Innovation	**Percentage space saved**	**Potential $ saving pa**
Strategic Space Planning	5.2%	$278million
Space Benchmarking	10.3%	$550million
Owner become Tenants	13%	$215million
Use Innovation Hotdesking / Hotelling	20.8% (assumes100% use)	$1.1billion
Density equal to UK	21%	$1.1billion

CONCLUSION

Corporate Real Estate in Australia is still a grossly undervalued asset. Our companies are failing to recognise the huge potential locked up in their real property assets, be they owner occupiers or tenants. The potential to save a staggering $3.68 billion dollars every year and add this directly to the bottom line of the organisation is being overlooked. Even if our cultural and workplace practices are so different than those in Europe and we cannot, or do not want to, achieve their levels of office occupancy density, ignoring the potential savings from proper space use planning and monitoring cannot be justified. The expenditure of $550 million dollars per annum by companies, simply because they fail to monitor and plan for their real

property use, is an unacceptable waste of potential shareholder revenue. In an age of triple bottom line reporting, it is evident that wasting office space assets in this way significantly contributes to overbuilding of cities and the overall sustainability of our office environments.

The message for the investment and construction industries is clear. Corporate occupiers are beginning to look at space use and recognise that huge savings are available. The continuing adoption of innovative office use solutions, combined with ever increasing technological advances in computing and communication, and a focus or human resource effectiveness will see the office environment change and result in greater intensity of use. (Materna, R. and Parker, J. R. 1998). This will require buildings that are able to meet these demands of a flexible, high-use, highly serviced space. The challenge for the design and development industries will be to provide buildings that attract tenants. The challenge for the investment industry is to find solutions that provide this space in a market which potentially has a diminishing demand. The challenge for facilities managers is to strategically manage space requirements while implementing new space use innovations and at the same time, maintain an efficient and effective workplace which adds value to the organisation.

If corporate real estate management continues to grow at its current pace and implements the potential savings identified in this paper, then our cities will undergo a dramatic change. As space use intensifies, older, less flexible buildings will fall by the wayside. The potential release of surplus space into the market would create a significant vacancy factor, with flow on effects on rentals and property capital values. Developers and institutional investors should be cognisant of this potential contraction in office space demand and carefully monitor developments in corporate real estate practices. They will need to find new, innovative features to attract and retain tenants in an increasingly tenant led and volatile office market of the future.

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