Recent Trends in International CREM

(Abstract for ERES Vienna 2013)

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Structured Abstract:

1. Purpose

Corporate properties (i.e. land and buildings) are generally identified as the biggest fixed asset item of companies. Thus, they have a significant impact on financial statements in terms of equity ratio and average capital employed. In general, properties represent approximately 6% of the total assets of large companies. Ownership rates vary significantly over Europe – with German companies still showing the highest rate of approximately 70%. Further, properties are routinely identified as the second biggest cost within a business organization after staff and are thus a major cost driver on the P&L account. Property related occupancy costs amount to 10-15% of the total operating costs. The operating property costs per employee amount to 4,000 – 6,000 € per year in manufacturing companies.

According to unanimous opinion, Corporate Real Estate Management (CREM) is mainly responsible for providing appropriate and cost-effective properties in order to ensure the successful operation in the companies’ core businesses. That means that CREM strategies have to be aligned to the corporate strategy. But the figures mentioned above outline the increasing importance of a value-based view on CREM. Globalisation trends increase the pressure on the effective management of corporate properties. FM business models for multi-national companies have been constantly developed and improved
during the last decades having reached a mature status. CREM business models are facing a new stage of development towards a global management approach.

The purpose of this paper is to describe the latest trends in CREM/FM for multi-national companies as well as best practice models showing how to ideally implement CREM/FM in the corporate organization structure and, at the same time, to cope with emerging challenges of further internationalization of core businesses.

2. Findings

2.1 Key development stages of international CREM/FM in the past

CREM and corporate FM have developed constantly during the last decades and now face a strategic realignment towards a globalized approach. In the past, the development of CREM/FM in Europe was mainly characterised by centralizing corporate real estate activities:

- In the early 1990s, corporate real estate activities often were organized decentrally within the core business entities. Main tasks were to provide appropriate spaces for core business operations, to ensure flexibility and quality of the provided space and to prevent risks to daily production.

- In the last 10-15 years, real estate activities were increasingly bundled. In general, strategic decisions were centralized in CREM units whereas operational FM entities were decentralized on a regional level. The main responsibilities of CREM/FM were to manage and to reduce property costs, to ensure performance for core businesses as well as to set up standards and to optimize owning structures with regard to taxes.

- Most recent developments in the last 2 years showed the total integration of all real estate activities within centralized CREM entities having a broader perspective beyond the core business. Besides of defining superior guidelines, standards and SLAs, the main objectives of CREM is now to increase the company’s profit and shareholder value by providing a broad real estate expertise.

2.2 Conventional types of CREM/FM business models

In order to cope successfully the emerging challenges of international real estate management, simple and flexible structures are required. Three conventional typologies of CREM/FM business models are presented and evaluated hereinafter.

2.4.1 Service provider model (focused on FM)

According to this model, the FM unit is acting as a service provider for the core business entities, which are not obligated to enter into contract with the internal FM service provider. Thus, the internal FM service provider enters into direct competition with external service providers. The range and depth of services performed by the internal FM provider depend on the core business needs and are adjusted according to these requirements.

Figure 1: Service provider model

The FM unit is organized as a profit center. FM services are offered to all users within the whole group in a fully competitive environment. Users can freely choose the internal or an external service provider without any restriction or obligation. Users perform some property related tasks on their own (e.g. portfolio & asset management). Being organized as a profit center, the FM entity has to be headed according to entrepreneurial aspects including the possibility of acquiring third-party business.
Having said that, the FM unit provides customer close support to the company but has also the opportunity to expand its business beyond the company based on existing service capacities.

The portfolio & asset management is conducted by the core business units themselves. As no uniform group-wide asset and portfolio management is implemented, an overall view of all assets cannot be given. Asset management functions are dealt with only on a case-by-case basis, thus lacking a strategic alignment.

With regard to development and project management, the FM unit is competing with other service providers units being part of the core business entities (users) – as far as they have the capability to provide the required services. If this is not the case, the FM unit provides services and know-how to the users. If appropriate, the FM unit can confine itself to provide capacities or single functions.

Because of the centralization approach of the service provider model, a comprehensive strategic facility management is provided by the FM unit. On operational level, the FM unit tends to offer only a few commercial, infrastructural and technical services.

In evaluating the strengths and weaknesses of the service provider model, it is evident that the potential of a professional real estate management approach is not being adequately leveraged by this model. Thus, the service provider models often failed in the past for the following reasons:

- As users are responsible for some real estate related tasks and, at the same time, also buy such services on the market, the service provider model causes a fragmentation of CREM/FM activities in the company. In conclusion, effects resulting from economies of scale and from the experience curve vanish.

- As core business entities are not obliged to contract with the internal service provider, high acquisition efforts of the FM unit are necessary. Affiliated service providers often fail to maintain their ground in the challenging competitive environment.

- Strategic decisions are taken by both users and the FM unit what often results in contradictory guidelines.

- Portfolio & Asset management is inefficient because of its decentralization.

![Service provider model – degree of vertical integration](image-url)
2.4.2 Coordinator model

According to the coordinator model, CREM is centrally organized with one competence center being responsible for all real estate specific issues within the company. In this model, CREM is focused on controlling real estate functions in the interest of the whole company.

Having said that, the CREM unit is responsible for setting up standards and guidelines, for leading processes and for controlling asset management, facility management as well as development and project services. As a competence center, the CREM unit assumes clearly defined tasks within a given specific framework and also provides real estate specific know how to the core business entities. Outside that framework, real estate functions are performed by external service providers or by the users themselves.

Figure 3: Coordinator model

With regard to portfolio & asset management functions, CREM is responsible to implement strategic investment/divestment decisions on an operational level and to monitor property developments as well as refurbishment strategies including cost management and cost controlling.

In the area of development and project management, the CREM unit performs clearly defined tasks for the benefit of the users. Added value is achieved by setting up binding requirements and by standardizing procurement and project management processes.

The company instructs the CREM unit with the provision of strategic facility management including the definition of the strategic alignment of space productivity (output per area), operating expenses, management income and other property related criteria. The CREM unit is responsible to monitor the facility management performance by comparing the relevant criteria with internal and/or external benchmarks.

Figure 4: Coordinator model – degree of vertical integration
In conclusion, the coordinator model also does not permit to raise the full potential reserves as strategic control does not include the entire value-added chain, but only the parts of it previously being assigned to the CREM unit. By focusing on the defined range of services CREM mainly remains caught in an advising role mainly providing guidelines. Potentials of increasing value or decreasing costs can only be raised where competencies have been assigned to the CREM unit. This restriction combined with the considerable number of interfaces between CREM and users makes it more difficult to proof the contribution of CREM to the total value added.

Anyway, a continued commitment of all users is required to ensure the enforceability of guidelines set up by CREM. Otherwise, a successful implementation of guidelines would be uncertain because of their non-obligational character and the fragmentation of real estate functions.

### 2.4.3 Owner model

According to the owner model, the CREM unit performs the ownership function for the company including the entire real estate related value-added chain. With its own profit center, the CREM unit supports core business entities by instructing and controlling external service providers. Further, the CREM unit is responsible to provide space including administration, development and marketing services. Thus, CREM includes the entire asset management, development and project services as well as facility management. This CREM service portfolio can be adjusted by delegating or by outsourcing single services. Revenue from the sale of some properties or their rental and property related expenditures such as OPEX or CAPEX are directly attributable to the CREM unit. Depending on the property type and the usage, rents are calculated whether on the basis of market rents or based on the costs of providing space. If necessary, external services can be bought by the CREM unit.

The CREM unit is responsible for the entire asset management. Irrespective of whether being the owner or the lessee, the CREM unit provides space to the users by leasing the required areas to them. Productivity of space, setting off rents as well as contracting has to be determined and monitored by the CREM unit. Decisions on investments or divestments including measures of value retention or maintenance and repairs are made by the CREM unit on its own responsibility.

With regard to development and projects management, CREM is responsible for all use types (exempt production) and for all development phases. Although formally acting on behalf of the owner, CREM should plan and act user-oriented (considering user interests).

Within the scope of facility management, CREM defines interfaces as well as the alignment of the real estate strategy (including space productivity, operating expenses, management income and other property related criteria). It also determines the strategy for the operative facility management units. On an operational level, real estate specific facility management functions are assigned to and performed by the CREM unit.
In evaluating the owner model, it can be said that the comprehensive approach of CREM allows to fully raise the potentials of modern real estate management and to ideally control assets from a value-oriented risk/return perspective. By combining all fragmented property related activities into one CREM unit, duplicate capacities can be reduced. From a group-wide perspective, assets should be controlled according to their contribution to shareholder value and under consideration of income, cost and asset optimization. This requires a clear assignment of profit responsibility to the CREM unit and should therefore be implemented in the owner model.

Despite significant dependencies of anchor tenants, third-party participations as well as the ability to operate on the capital market can be realized in this model. In case of single-user properties, potentials can be leveraged by reducing the level of dependence on individual tenants (e.g. transition from a conventional single-user site to an industrial estate with several establishments). Substantial cost saving can be obtained by cutting jobs and by outsourcing several real estate functions. Finally the owner model provides the highest possible flexibility in case of a change in group strategy.
2.4.4 Summary of conventional types of CREM business models

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Figure 7: Summary of conventional CREM business models

2.3 CREM Business Models in Practice (according to ICME project experience)

Based on the theoretical models described above, the following 4 typologies of CREM business models have emerged in practice. The business models presented hereafter are ideal-typical versions which vary according to the industry and the special needs of each individual company. In our presentation at the congress we will show a selection of business cases and best practice approaches.

Type 1: CREM Competence Center

The organizational concept of a **CREM Competence Center** is broadly in compliance with the theoretical service provider model. Here, core business units remain responsible for operational FM activities. The central CREM/FM unit sets standards and consults the operational FM units on a local level. Thus, strategic approaches and standards can be recommended and group-wide saving potentials can be identified whereas their implementation and realization remain under the responsibility of the operating units. This bears the risk of inconsistencies of Real Estate activities within the whole group.

Figure 8: Structure Chart – CREM competence center
**Type 2:** Centralized Real Estate Management Business Unit

A second concept observed in practice is a **Centralized Real Estate Management Business Unit** which is responsible for budgets, qualities and resources. In contrast to the aforementioned competence center concept, the operational CREM/FM units are not part of the core business entities but are attached and subordinated to the centralized CREM/FM unit. This ensures that strategies and standards are implemented on an operational level. The Centralized Real Estate Management Business Unit is able to provide a transparent overview of assets, expenditures and services. This overview serves as basis for a proactive real estate management including all contracts. In conclusion, this model enables CREM/FM to implement standards what is necessary to consolidate the number of external FM service providers significantly (single provider approach).

**Type 3:** Total Outsourcing of FM

The concept of **Total Outsourcing of FM** refers to the outsourcing of the entire real estate operation to one external FM service provider. The remaining real estate management unit within the company is restricted to coordinate and to control the external provider. This includes setting up policies and guidelines in order to maintain uniform standards (SLAs, quality, time, costs) as well as monitoring the compliance of the service provider with all contractual provisions and company regulations.
Type 4: Carved-out CREM/FM

The most far-reaching model is the concept of **Carved-out CREM/FM** what means bundling all CREM and FM activities and spinning them off into a subsidiary entity. Owner functions (real estate management) and operator functions (FM services) are often separated into different entities. The concept of carving out the entire Real Estate activities opens up the possibility of third-party business as a new strategic option.

2.4 Recent trends in international CREM

Based on ICME Management Consultants project work experience and on a 2012 survey of large corporates in Europe, the following trends can be identified.

2.4.1 Existence and responsibilities of CREM departments

The clear majority of the multinational companies in Europe have already set up a CREM department within their organizations. The responsibilities of these units are generally focused on portfolio management, property management and space management.

2.4.2 Organization structure & self-image of CREM

The vast majority of the companies organize CREM in special units within the corporate group structure. Only few companies have carved out all CREM activities into independent entities. If not being carved out, CREM units mostly are organized as profit centers. More rarely, they are organized as cost centers (if CREM is an internal monopoly service supplier). In the last case, the revenues cannot be attributed to the CREM unit. The importance of the shareholder value remains significantly low in the daily operations of many CREM departments.

Most of the CREM units tend to take the role of the property owner. In general, the owner function (real estate management) and the operator function (FM services) are performed in separate units although, in practice, a close relationship between the both functions can be observed.

In international comparisons the analyses show that in all successful companies user-oriented functions are dominant in their CREM organization. This service approach is more pronounced in USA and Asia whereas in Europe, more attention is given to owner-oriented functions – to the disadvantage of the core business operation units (users).

2.4.3 Sourcing trends (make or buy)

According to the current practice, most of the CREM activities are performed in-house, showing – in contrast to FM services – a low level of outsourcing. Although a slight outsourcing trend with regard to CREM services can be noticed, neither ambitious outsourcing measures nor the concentration of service providers could be observed on the European market. Technical and infrastructural facility management services are the main targets of outsourcing. The high level of standardization of these services as a result of comprehensive outsourcing measures diminished the user satisfaction.

Currently, the main external sourcing fields are FM services, development and project management. Owner functions performed by CREM is generally planned to remain in-house with an increasing strategic importance. The most important
motivations for outsourcing are cost cutting and increasing performance quality. In general, only single services are sourced out. A global outsourcing approach (“total outsourcing”) is not planned by the majority of the European companies.

2.4.4 Financial controlling

Most of the CREM units still do not consider profitability criteria with regard to the managed properties. Only one third of the CREM units have defined profitability targets. Two thirds of the companies do not control the financial performance of their properties at all, but a few disclose WACC, return on equity or the property yield. Only a very small proportion of all CREM units consider corporate profits. All that points to the fact that corporate real estate is considered as purely operational equipment preliminarily serving to support the core business.

2.4.5 Real estate strategy

Almost two thirds of the companies have set up a real estate strategy with the issues of user satisfaction and benchmarking given only a secondary importance. Although a majority has set up property specified strategy, you can still find companies which have not. For sustainably implementing any property strategy, the user should be at the forefront of attention. In order to control the implementation efficiently, benchmarks are required.

2.4.6 Major targets & degree of target achievement

The most important targets of CREM are to support the core business units and to provide efficient space for them. But during the last years the degree of target achievement was considerably low. Often, the following targets could not be achieved:

- Appropriate support of core business units / increasing user satisfaction
- Reducing property costs / increasing property profitability
- Optimization of space

With regard to achievement of the above mentioned targets, there is still potential for improvement. Corporate real estate is largely seen as an operational resource. Innovative forms of financing are rarely used and, thus, potentials to enhance the return of the core business by releasing real estate equity are leveraged insufficiently. In contrast to CREM practice in Anglo-Saxon countries, financial goals are neglected in most of the other European countries. Generally showing a lack of experience with alternative forms of financing corporate real estate, divestment measures are planned and realized to a very limited extent so that opportunities to strengthen the capital ratio remain unused. Aspects such as return or risk are only of secondary importance. Despite the central importance of returns in core business operations, CREM still does not support enhancement of core business yields by releasing real estate capital. For example, rental and leasing solutions (mainly sale-and-lease-back) and the sale of real estate considered non-essential to operations are effective methods to reduce capital tie-up. The released capital could be reinvested in core business. Further, properties facilitate future borrowings by securing bank loans.

Despite these opportunities, many companies are not experienced in marketing their corporate real estates. Selling possibilities have often not been considered yet by CREM units. In general, the main motivation for divestments is portfolio optimization but not the strategic release of equity.

3. Outlook

The major structures of CREM (organization and tasks) have stabilized in the last years so that, in future, no significant changes are expected in that field. Corporate real estate activities will focus on the user-oriented FM services, considering the inappropriate level of user satisfaction in the majority of the European companies. An often unused leverage opportunity is the bundling of FM services which have already been outsourced.

The most important leverage in CREM activities is the divestment of company site in order to enhance core business yields by releasing real estate capital. Rental solutions provide the required flexibility whereas property secures the companies maximal independency. Although the ability to adjust space requirements shortly depending on the economic situation becomes more important in the course of globalization, the conservative strategy of owning the majority of operating locations is still maintained by many European companies. In times of economic downturns, transactions may take longer or even impossible without considerable price discounts, which can mean a serious threat for business contingency in some
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cases. ICME Management Consultants has developed a new approach ("CoRE-Fund") of setting-up a portfolio of corporate real estate with an optimized risk-return profile and thus being considered as an attractive investment vehicle.

The challenge of an increasing internationalization of core businesses will be the main driver for the future trends in CREM and corporate FM development. Corporate real estate management will mainly be organized as a global center of excellence providing a global strategic network of CREM entities. Main tasks of this center will be to ensure a high transparency of the global real estate portfolio, to optimize costs and space needs on a global level, user-orientated and cost efficient space provision as well as global exchange of know-how.

The main challenges in CREM are increasing quality demands and space requirements of users. Therefore, CREM activities should be realigned and clearly focus on user requirements. In future, space optimization, reduction of operating costs and flexibility of space are the major tasks for CREM. Apart from the already listed challenges, image (corporate identity), sustainability (green buildings) and new work places have to be considered as the most important topics.

As pressure on companies and on their real estate management increases further in the course of globalization of core business activities and given increasing user demands, the separation of owner functions (CREM) and operation functions (FM) cannot longer be maintained. It is expected that CREM and corporate FM will merge in future. As a result of comprehensive FM outsourcing measures during the last years, CREM and the remaining corporate (in-house) FM services came close together, pursuing in some fields the same objectives and performing the same functions. In order to bundle more services and to leverage synergies, a merger to one single corporate real estate entity would create additional potential for realizing sustainable value added to the company.

Keywords: Corporate Real Estate Management, Facility Management, Multinational Corporates, Business Models, Trends

Article Classification: Case study

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Running Heads: