

Corporate Real Estate Commentary

The Excess Space Challenge

by Tom Driscoll

Disposing of excess space is not a tenant's core business.

Critical disposition process elements:

- Strategy
- Stakeholder Management
- Marketing Plan
- Decision-Making
- Acquisition Process Review and Revision

Certainly no one wants or needs to be reminded of the numbers relative to the Bay Area's imbalance between the supply of workspace and demand for it. What is noteworthy about the current market is that the burden to lease most of the vacant space falls on tenants, not landlords. Even with the assistance of consultants and brokers, tenants face real challenges in managing the disposition of excess space, because unlike landlords, it's not their core business.

How the market got to this point is fairly easy to understand, but is not the critical issue going forward. For companies with excess space, the critical issue is determining what must be done to effect dispositions that create the most favorable economic results and avoiding the problem in the future. Having worked on dispositions from the perspectives of both a corporate real estate executive and a service provider, I have learned a great deal about what is required to successfully dispose of excess space. In my experience, what is most significant is that there are certain "critical elements", many times omitted, that must be part of almost every disposition project. Omitting one or more of these elements can be costly, ultimately impacting profitability and other key performance metrics like EPS, P/E ratios and share price.

These "critical elements" are the disposition strategy, stakeholder management, the marketing plan, decision-making and acquisition process remediation.

Disposition Strategy

The primary purpose of a disposition strategy is to:

- Establish & Communicate Clear Disposition Objectives
- Ensure that the Ultimate Outcome Supports the Business Strategy
- Recognize the Reality of Current Market Conditions
- Incorporate Projections of Future Market Conditions
- Consider all Viable Approaches to Disposition (sublease, buyout, renegotiate, etc.).

Many times a disposition project is viewed as a real estate project rather than a business project. This can be a mistake because the business drivers for a disposition project are almost always financial and operational. For example, mitigating financial losses, transitioning operations and creating the most favorable economic outcome are objectives in virtually every disposition project. Therefore, a successful disposition strategy will be linked to business and financial objectives. This linkage ensures that the ultimate outcome enhances business performance. In addition to linking the strategy to business drivers, it is important that all viable disposition options are considered and the final selection is made in the context of the business objectives.

DISPOSITION PROCESS MANAGEMENT

Situation Analysis

- The Business Situation
- Market Conditions
- Projected Market Conditions
- Property Assessment

Strategy Development

- Financial Objectives
- Operational Needs
- Disposition Objective
- Marketing Plan

Implementation

- Assemble the Marketing Team
- Take Property to Market
- Manage Stakeholder Expectations
- Evaluate Proposals

Successful dispositions require a comprehensive, market-tested approach and a team with relevant expertise and experience.

Successful dispositions contribute to bottom-line performance and provide a great opportunity to make significant, measurable contributions to company success

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Stakeholder Expectations

Based on my experience as a corporate real estate executive, many times the toughest sell is not the market sell, but rather the "internal sell". The internal sell must convince stakeholders that any given proposal will solve their problem or meet their requirements. Building consensus as to what constitutes "the most favorable outcome" can be difficult. Explaining the disposition process and market conditions to stakeholders and keeping them apprised of progress will help assuage dissenting stakeholders when a consensus is not reached. Failing to manage the expectations of stakeholders can result in the wrong decision being made or losing a deal because consensus cannot be reached quickly.

The Marketing Effort

The marketing plan and its execution is the "meat" of the disposition process. The plan should be concise, clear and driven by the disposition strategy so that the ultimate outcome supports business objectives. An effective plan will:

- Thoroughly "Characterize" the Property
- Define the Market Context
- Identify the Property's Competitive Position in the Market

The marketing plan also becomes the basis for selecting the broker with the specific expertise and experience to execute the primary thrusts of the plan. Finally, it will contain action plans to hold the broker accountable by specifying responsibilities, activities and timelines.

Decision-Making

Decisions must be made expeditiously and tied to project objectives (desired outcomes). Analytical models are required to evaluate both the operational and the financial impact of a proposed transaction. Financial models must consider the impact on cash flow, financial

reporting, accounting, tax liability and internal metrics. Models to compare proposals should be created in the event of multiple offers. Moreover, many times the question, "should we wait for a better deal?" arises. In this circumstance it is wise to have a model that assesses the "real" cost of waiting for a better deal. Such a model should consider both holding and opportunity costs.

Acquisition Process Remediation

"How did we get here in the first place?" is a valid question once the disposition of excess space is underway. Successful companies simply don't repeat mistakes of the past, particularly in areas like real estate where mistakes are very costly. A review of the assumptions, processes and decisions that resulted in excess space should be reviewed. The actual process employed should be contrasted with the intended process. Process elements that resulted in faulty assumptions or poor decisions should be eliminated. Process elements that were skipped or not part of the process should be added. Also, a review of disposition "best practices" can be helpful. Aligning real estate capacity with business expansion and contraction is critical and requires a well-tested, effective methodology.

The Bottom-line

Effective dispositions require a comprehensive, market-tested approach and a corporate real estate team with relevant experience and expertise. A disposition project provides a great opportunity for the real estate director or the executive in charge because the manager, who facilitates successful dispositions, makes significant, measurable contributions to the success of the company and his/her career.

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