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BEOS Survey 08: January 2015

Asset Management for Corporate Real Estate: Stable Distributions through Intense Tenant Management

INTRODUCTION

BEOS Survey is an analytic series that reports quarterly on the latest issues in corporate real estate. Its purpose is to help enhance the transparency of and acceptance for this asset class. Survey 08 discusses the specificities of asset management (AM) in the context of corporate real estate, presenting above all the findings of a recent empirical survey.

AM is generally considered a key factor for any type of asset. In the case of corporate real estate, the asset manager's qualification attains an even greater significance than with other single-use property types because of its mixed use nature and its frequent letting activities that are explained by the large number of occupiers. The subsequent sections will profile these tasks and specificities, and compare them to those of other property segments.

ASSET MANAGEMENT TASKS

"Asset management is the responsible strategic and operative management of all yield- and risk-relevant measures on the property, portfolio and company level, taking into account the entire life cycle of a given property."[1]

The Professional Group Asset Management (PGAM) of RICS Deutschland has gathered and defined these managements tasks in the form of modules. These modules and their key activities are presented below. Since not every company covers all modules, and since a given account rarely requires all of them, they form a certain hierarchy in terms of professional significance. The spectrum of deliverables within each module breaks down into core elements and deliverables less essential. The simplified representation affords only a rough outline of the diversified service options that may be specified within the framework of an asset management agreement. Any final catalogue of services is likely to be customised to meet the specified requirements of the account at hand.[1]

Asset Management Service modules according to RICS

Module	*Key Activities*	
Investment strategy, investment policy	Planning, creating and implementing measures on the portfolio and property level	◕
Acquisition of properties	Pre-acquisition audit, due diligence and organisational coaching	◑
Financing	Executing, supervising and monitoring financial arrangements	◑
Budget, business plan, controlling	Conceptualisation, monitoring, and analysis	●
Reporting	Reporting on the property and portfolio level	●
Research	Souring, staging & evaluating relevant market data	◑
Data and document management and security	Aggregating, staging, processing, storing, and archiving personal and property data	●
Risk management & compliance	Quality assurance and quality control of risk management processes and risks, as well as of internal & external standards	◕
Selecting and controlling service providers	Selecting, commissioning, controlling and monitoring third-party service providers (PM, FM, etc.)	●
Company management	Assuming delegable duties of the owner for managed properties (commercial management)	◔
Property management	Commercial & technical monitoring services supplement the property management	●
Claims management	Recognising, appraising and collecting accounts receivable	●
Liquidity management	Aggregating, monitoring, analysing and reporting the inflow and outflow of funds	●
Accounting	Taking over and continuing the current accounting	◔
Construction management	Ensuring compliance with the scheduled deadlines and costs and quality assurance	◔
Property development, refurbishment	Conceptualisation, organisation, coordination and monitoring	◔
Letting	Marketing, organisation, monitoring and documentation	●
Property valuation	Preparing, controlling and monitoring valuations	◕
Sales	Preparing, facilitating and controlling	◑

● ◕ ◑ ◔ ○ Lateral relevance on the same management level

↔ Shifting dependencies among the levels

Fig. 1: Asset management service modules according to the PGAM of RICS Germany[1]

STRATEGIC APPROACHES IN ASSET MANAGEMENT

The strategies adopted in AM are as diverse as its service spectrum. Generally speaking, they tend to be adapted to the portfolio / property at hand – regardless of whether the AM is handled internally by in-house staff or externally by third-party service providers. Either variant has its own benefits, depending on the outcome sought. Small portfolios tend to be managed in-house. Large, regionally spread or complex portfolios, by contrast, tend to be externally managed, often by different AM providers depending, for instance, on asset class or country.[2]

Next, the investment targets chosen (with or without AM input) by the property owners need to be defined and implemented. These frequently include a cash flow target and a longer-term appreciation target, potentially with exit requirements. Large-scale office buildings in Class A cities occupied by a tenant with strong credit on long-term leases tend to require less of an AM effort. Conversely, a housing estate with hundreds of tenants is much more costly to manage. Elevated churn rates coincide with a higher management effort, e.g. for the purpose of re-letting and refurbishing vacant premises. Depending on the range of deliverables, it therefore requires a greater AM effort to ensure that the predefined targets are met.[3]

Contrary to what is commonly assumed, corporate real estate, much of it representing multi-occupied properties, is rarely subject to increased churn rates, if the asset manager is well aware of his tenants' needs and able to accommodate their changing floor space needs. The background to this is the often small footprint of such rental units, and the highly diverse floor space needs of companies. Depending on the order book balance, a company's premises in a building may have to be expanded or reduced on short notice. The tenants of a landlord showing flexibility in this regard are far less likely to relocate, yet the flexibility comes with increased administrative costs to ensure full occupancy of the floor areas.[4]

This raises the question of how labour-intensive the asset management of a given property actually is. How much floor space, and how many tenants and buildings can an asset manager handle without compromising the service quality? Another question presenting itself regards the way in which the AM is organised and what strategy it pursues. Options include an in-house solution or the outsourcing to a service provider. Is the AM centrally organised or is it important to integrate local know-how and to be as close as possible to the property and its tenants? In what ways are property management (PM) and facility management (FM) integrated? There are any number of ways to answer these questions, which require individual study of the respective asset class, ownership structure, history and the specificities of location and tenant.

Accordingly, the strategic approaches outlined below only represent just a few options among many. Some asset managers are in charge of just one property and one tenant, while others handle portfolios of more than 100 properties. If the service performance meets the expectations of the occupier as the end client, the question of right or wrong is moot. The important thing is that the occupier, not the client, should be the yardstick for measuring the management quality.

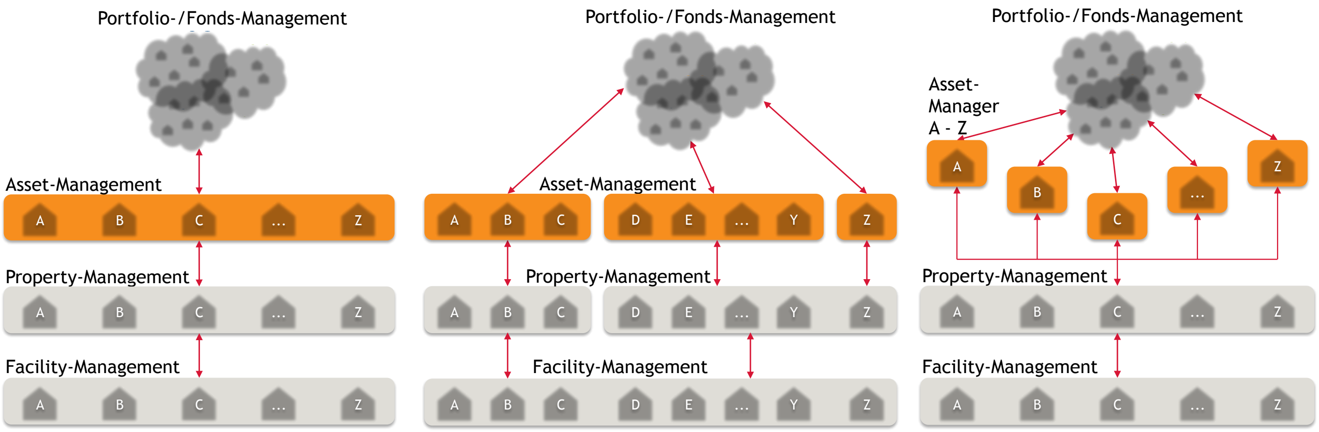

Fig. 2: Various examples for strategic approaches in asset management (source: bulwiengesa, 2014)[5]

PROACTIVE ASSET MANAGEMENT THROUGHOUT THE LIFE CYCLE OF A PROPERTY

Even if the general services to be provided and the strategies to be pursued have been defined, an AM approach committed to sustainability for the purpose of value retention and appreciation presupposes a proactive approach throughout the life cycle of a given property. To this end, the successive steps need to be repeated in each cycle. A sophisticated reporting system between management levels and involving direct feedback from the tenants lets asset managers take proactive measures to address an issue before it escalates. While further increasing the AM complexity, this will bolster tenant loyalty to the property.

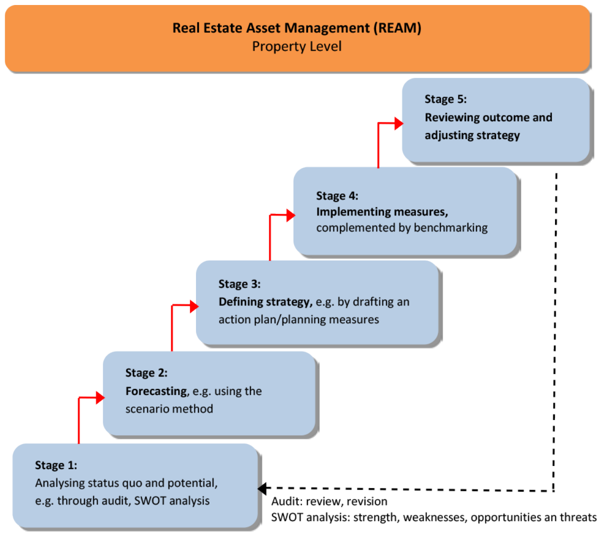

Fig. 3: Top-down AM tasks during the life cycle of a property[3]

BRIEF SURVEY: "THE QUANTITATIVE EFFORT OF AN ASSET MANAGER"

At first glance, AM may appear to require precious little effort. It is often assumed that AM only sets the parameters for the actual work done by PM and FM. One look at the outlined service modules and the extra jobs of an asset manager[6] makes it perfectly obvious that the opposite is true. Yet while the overview illustrates the depth of service in AM, there is little material quantifying the effort involved in this line of work. "What is the performance profile of the individual asset manager? What defines the asset manager?" To address these questions with facts and figures, a brief survey[7] was conducted whose findings provide a rough idea of what AM is about. Yet they also highlight the complexity of its requirements and with it the need for detailed analysis to differentiate each case in terms of service depth, asset class, and the qualities of a given property and location.

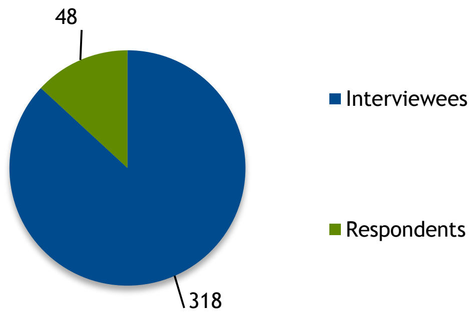

Fig. 4: Participant statistics of AM survey (Source: bulwiengesa, 2014)[7]

Survey participants had to answer 13 questions, the majority of which sought to quantify the effort involved for the individual asset manager. The brief survey is not supposed to provide a comprehensive overview of the market but only to map current market trends.

Office segment topping the list

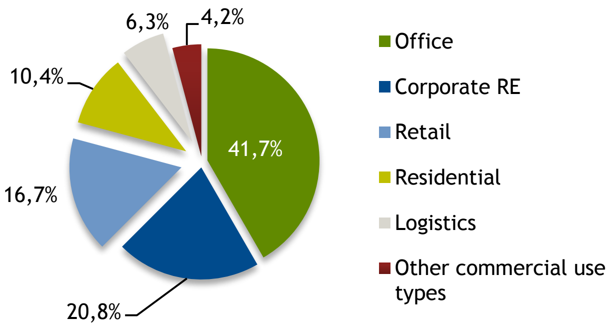

Fig. 5: Outcome of question 1: Which is the most frequently managed property segment? (Source: bulwiengesa, 2014)[7]

The majority of the polled asset managers are hired to manage office property, with corporate real estate representing the second largest property type. For the other property types, please see the chart. The demand for the AM of logistics properties and other commercial use types is negligible. In the absence of a sufficient quantity of meaningful results, these will therefore be ignored in the sections below. Except for the complex of quantitative questions, they will moreover limit themselves to AM comparisons on the top level and to the AM of corporate real estate.[7]

Asset management tends to be handled in-house ...

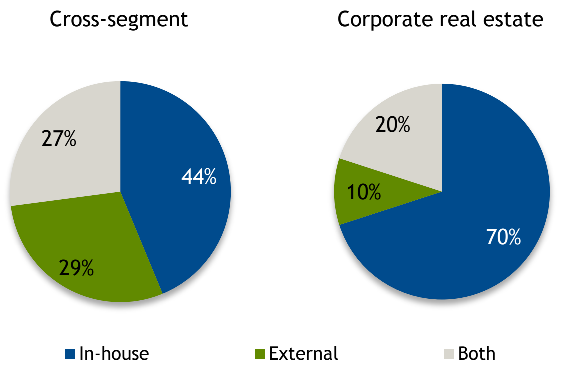

Fig. 6: Is your asset management exclusively handled in-house, by third-party service providers or both? (Source: bulwiengesa, 2014)[7]

The majority of respondents associate the term AM exclusively with in-house management of the proprietary portfolio. It is the approach taken by 44% of the respondents across asset classes. Yet over 27% of them offer their AM competence as external service, too. More than 29% identified themselves exclusively as service providers. In the case of corporate real estate, by contrast, the majority of asset managers (70%) take care exclusively of the proprietary property stock. Another 20% stated that they also offer it as a third-party service. With a share of 10%, pure service providers are rather rare in this segment.

... whereas the property management is mostly done by external providers

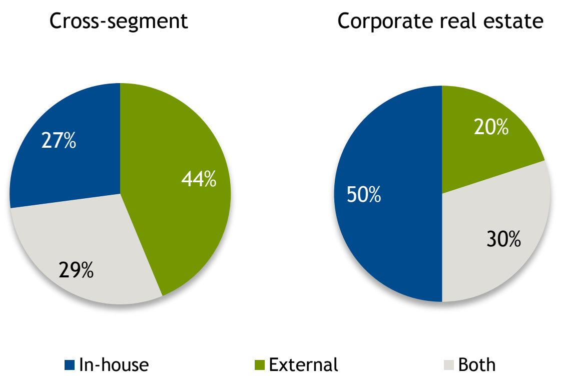

Fig. 7: Is your property management exclusively handled in-house or by third-party service providers? (Source: bulwiengesa, 2014)[7]

PM does not present as homogeneous a picture as AM does. In many cases, the AM service depth needs to be distinguished from that of PM. Nonetheless, there are discernible patterns: Any of various strategies might be chosen for the PM. Unlike AM, it is very often outsourced to third-party service providers (44%). The next largest group of 29% embraced a combined approach that works with in-house and third-party service providers both. Pure in-house PM is favoured by 27% of the respondents.

The break-down for corporate real estate looks quite different, though. Half of the asset managers active in this segment or else their companies practice in-house PM. Outsourcing is a rather unusual strategy here, accounting for a mere 20%. A combination approach to the PM of corporate real estate is taken by 30%, which matches the cross-segment ratio.

Asset management tends to be centrally handled

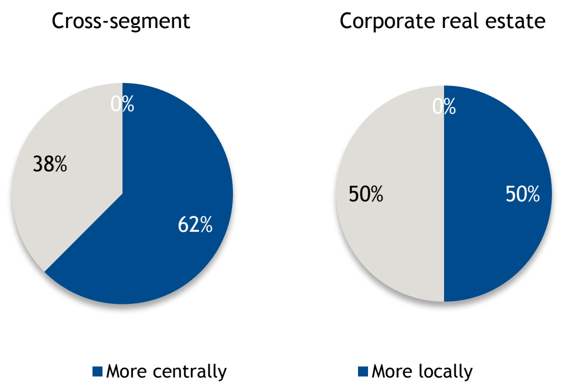

Fig. 8: Do asset managers operate on-location close to the properties they manage or rather from their headquarters? *(Source: bulwiengesa, 2014)*[7]

Across all segments, centralised control of the AM represents the predominant model at 62%. Only 38% of the asset managers prefer to be on the ground with their clients or tenants. This contrasts with the situation in corporate real estate, where local AM is more common. Here, 50% of the asset managers opt for a front-line strategy. Then again, the other half practices a centralised AM.

Evaluation of the Complex of Quantitative Questions

The answers seeking to quantify the AM effort in regard to the managed properties, tenants and floor areas are visualised in Figure 9. It presents a highly valid picture across segments. Broken down by asset classes, the information density is in some cases

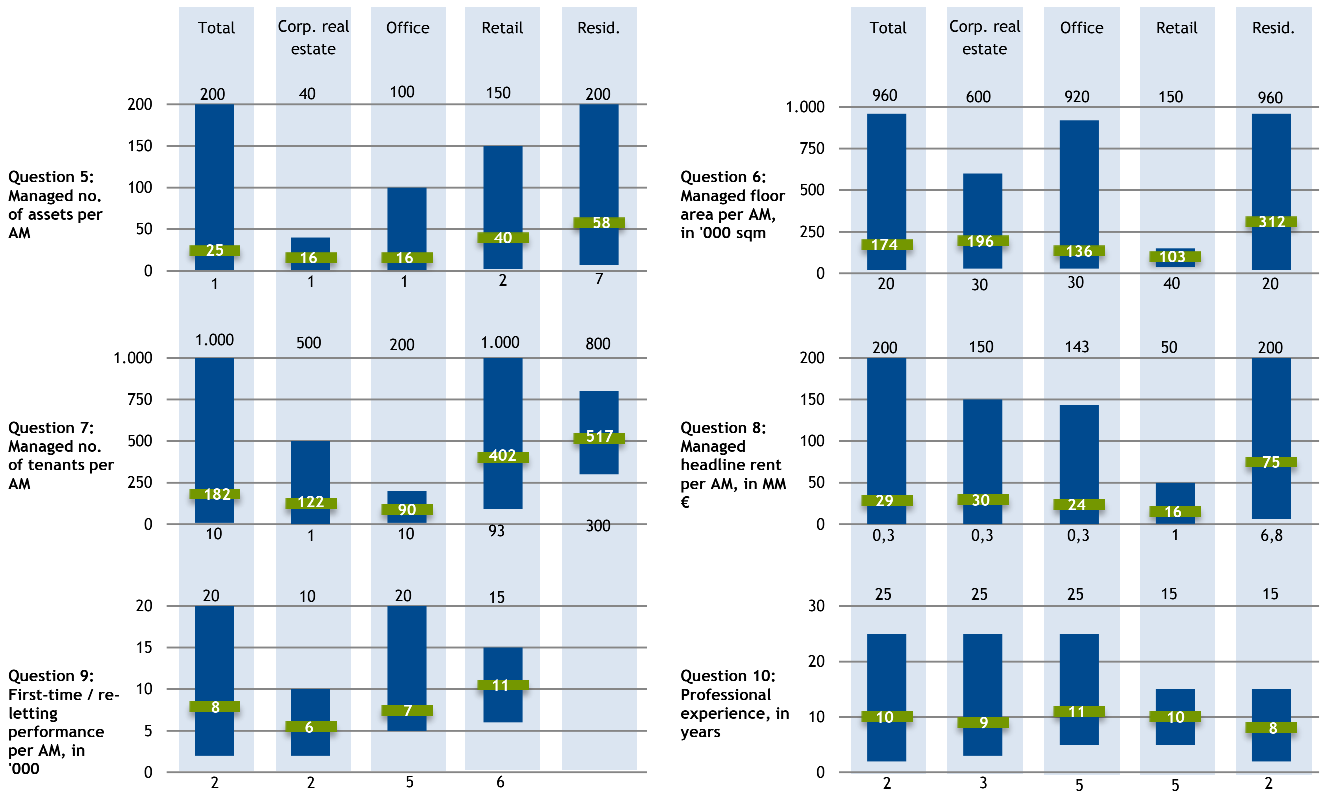

Fig. 9: Answers returned for questions 5 through 10 *(source: bulwiengesa, 2014)*[7]

indicative only – and all the more so because the ratios also depend on the property type, the floor area size, the investment volume, and the number of tenants.

The blue bar represents the overall value spectrum, whereas the green bar traces the weight of the distribution. A crossbar is used to indicate an insufficient number of relevant replies. Outliers were ignored in order to improve the comparability. They are, however, mentioned in the notes.

Bespoke Property Management for Corporate Real Estate

The number of properties managed by a given asset manager generally depends on the segment as well as on the size and value of the assets. It is also subject to the service depth provided for each property. An asset manager delivering a great depth of service, will have to reduce the overall number of properties he handles.

AM for corporate real estate gravitates toward custom management more than any other property segment. Here, the spectrum of services ranges from the bespoke management of a single asset to a maximum of 40 assets under management. On average, an asset manager will handle 16 corporate properties. The number of AuM per asset manager varies from one property type to the next, with office having the lowest count, residential the highest, and retail being in between. The average number of AuM is particularly high in the retail and residential property segments, which average 40 and 58 assets, respectively.

Retail Shows Smallest Floor Area Total per Mandate …

One of the key ratios in AM is the floor area managed by a given asset manager. Again, a breakdown by segment reveals considerable differences. Across the board, though, a minimum of 20,000 sqm is considered the threshold for a management mandate. Especially in the residential and office segments, the floor area under management tends to be much larger, and can go up to nearly 1 million sqm per asset manager. In corporate real estate, the area managed is considerably smaller, never exceeding 600,000 sqm. And even this maximum volume is usually limited to the corporate property segment of large conglomerates, whereas operators tend to remain below this figure. The picture shifts, however, when you look at the weight of the distribution. While the residential segment remains in the lead with well over 300,000 sqm in AuM per asset manager, the office segment registers barely 140,000 sqm, which undercuts corporate real estate average of nearly 200,000 sqm. The smallest AuM contingent in terms of floor area was registered for retail property with just over 100,000 sqm per asset manager.

... but Highest Number of Tenants per Asset Manager

The retail segment has the highest management ratio in terms of tenants or leases, with asset managers handling up to 1,000 tenants each. That said, the segment also shows a great bandwidth, with some mandates handling as few as 93 leases. The average number of tenants that an asset manager takes care of is 400, which is topped only by the residential segment with a mean of almost 520 tenants per asset manager. However, the residential segment has a much narrower AuM bandwidth, as the number of leases an asset manager handles ranges from 300 to 800. The AM of corporate real estate is much more bespoke in nature. Moreover, the number of tenants per asset manager is notably lower. No asset manager seems to handle more than 500 tenants, the average being just over 120. The management of office properties is even more customised. Here, the management ratio averages 90 and never exceeds 200 tenants per asset manager.

Floor Area / Tenant Ratio is most Differentiated in Corporate Real Estate

When read side by side, the above notes on questions six and seven imply additional insights regarding the relation between the lettable area managed by each asset manager and the number of tenants managed. On the basis of the survey findings, the average floor area rented by tenants is lowest in the retail segment. This explains the high number of tenants under management in retailing, illustrated e.g. by all the relatively small storefront units in shopping centres (though not by large-scale units such as electronics big boxes or superstores).

In the residential segment, the ratio at the lower end of the scale more or less reflects the average footprint of a typical German flat. So it is safe to assume that this represents a rather adequate ratio. In the average and maximum range, however, it is to be assumed that the high figures should be blamed on certain exaggerations by the panel participants.

	Total	Corporate real estate	Office	Retail	Residential
Max.	960	120	4,600	150	1,200
Avg.	956	1,607	1,511	256	603
Min.	2,000	30,000	3,000	430	67
Median	**1,305**	**10,576**	**3,037**	**279**	**623**

Fig. 10: Floor area / tenant ratios of typical rental units, derived by matching the floor area under management with the number of tenants handled by each asset manager *(Source: bulwiengesa, 2014)*[7]

In the residential segment, the ratio at the lower end of the scale more or less reflects the average footprint of a typical German flat. So it is safe to assume that this represents a rather adequate ratio. In the average and maximum range, however, it is to be assumed that the high figures should be blamed on certain exaggerations by the panel participants.

While the larger floor area handled by an asset manager in the office segment far exceeds the figures for these two segments, the gap is even wider when it comes to corporate real estate. Here, you may encounter ratios of up to 30,000 sqm and a median of still well over 10,500 sqm. The wide spread between maximum and minimum value nicely illustrates the complexity characterising corporate real estate. On the one hand, there are very large units under management in this segment. On the other hand, there is a plethora of very small rental units in business parks and transformation properties that require an intense management effort.

Asset Managers of Residential Real Estate Range Highest in Terms of Headline Rent

The question regarding the total headline rent under management is generally hard to answer because the figure strongly depends on property quality and location. That said, two key patterns may be derived.

In keeping with the number of assets or floor area under management, the residential segment far exceeds the commercial asset classes in this category. Residential asset managers tend to have c. 75 million euros in headline rent under management. The maximum is c. 200 million euros.

Despite their differences in management costs, the commercial segments show only minor deviations in regard to the average headline rent total handled by each asset manager. The sum is more or less 30 million euros across the board.

Letting Requirements per AM Differ for New and Subsequent Leases, Respectively

Answers to the question concerning the re-letting performance per asset managers were a mixed bag, because this is an AM requirement difficult to pinpoint. Many replies suggested that letting is not subject to fixed quotas, but need-based and handled on a case-to-case basis. Whenever the need to act (vacant units) arises, the AM is expected to launch a coordinated re-letting effort. Asset managers are often supposed to bring down the void rate by a set annual percentage. The benchmarks quoted in this context ranged from 12.5% to 30% and all the way to 50% of the vacant space, where applicable. Others quoted a requirement of renewing 90% of the leases with maturing break options, or 10% of the unexpired leases. Some replies also mentioned rent increase requirements, e.g. by 50,000 to 100,000 euros annually.

Specific bandwidths were not quoted very often. Wherever they were specified, they differed strongly from one segment to the next. The largest bandwidth was identified in the office segment. Here, asset managers are expected to achieve a net absorption of around 5,000 to 20,000 sqm annually. The average requirement is 7,500 sqm per year.While the maximum requirement in the retail segment is only 15,000 sqm, the average of 10,500 sqm is substantially higher than in the office segment. The requirements in the corporate segment, by contrast, are much lower. The required net absorption starts as low as 2,000 sqm and may go as high as around 10,000 sqm p.a. maximum. The low figure is possibly explained by the stable tenancy or, differently put, the low tenant churn rate. The data submitted for residential properties were insufficient to derive any valid conclusions.

Asset Managers Tend to Have an Average Professional Experience of 10 Years.

The question concerning the average professional experience returned comparatively uniform replies. Respondents quoted an average professional experience of around 10 years. The emphasis ranges within a narrow bandwidth from 8 years in corporate real estate to 11 years in the office segment. The spread for either property type though extends far beyond these limits. Asset managers with 25 years of professional experience are much more common than in segments were the maximum quoted is 15 years. The youngest asset managers are found in the residential segment, where an employment history of just two years is anything but unusual. Corporate real estate is next in line, boasting the youngest asset managers with an entry-level employment history of three years.

*The asset manager's job is defined by a very high level of training**

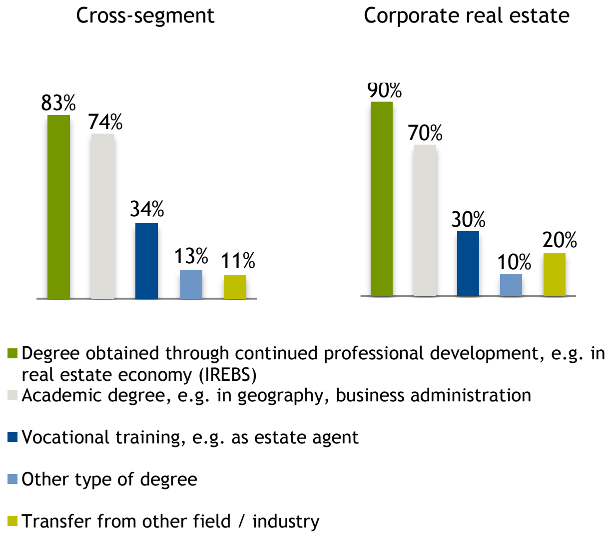

Fig. 11: What is the typical training / degree of an asset manager in your company?[7]
**More than one answer permitted*
(Source: bulwiengesa, 2014)

Asset managers generally meet a very high training standard. There are virtually no differences between the various segments.

CONCLUSION

Asset management is one of the key aspects in the value-driven management or real estate. Depth of service, strategy, and method, however, vary considerably. The asset management of corporate real estate present a more complex picture, and is characterised by a very intense dialogue between tenant and landlord. It therefore tends to be more bespoke in nature, implemented on location by in-house staff.

Interview with Martin Czaja, Head of Asset-Management at BEOS AG

“Seeing Eye to Eye with Tenants”

Martin Czaja, what is your take on the RICS catalogue for asset management services?
Martin Czaja: Principally speaking, there is nothing wrong with drawing up a catalogue of service, not least because the term “asset management” is rather hazily defined. But if you take a closer look at the 19 service modules, you will note that the majority of deliverables focus on the service needs of the owner or the investor. This is all very well, and no doubt important. But in my opinion it lacks a more dedicated focus on the tenant. The RICS catalogue only tentatively touches upon tenant needs in the “letting management” module. The real estate industry is out of touch with reality if it fails to focus its efforts on the tenant. By no means should these efforts limit themselves to the letting of floorplate.

How would you put the focus on the tenant?
Let me illustrate by citing the example of BEOS and of corporate real estate. We believe in seeing eye to eye with our tenants. This cannot be achieved except through direct communication on the ground, including regular visits by the project manager to the occupiers or to the decision makers of the various companies. Our tenants are personally acquainted with these liaisons and know whom to contact with strategic issues concerning their premises. Just about as important is that an asset manager understands the nature of the tenant's core business. It is the only way to adapt the lease – as much as possible – to the respective occupier's needs. Our familiarity with our tenants also enables us to respond to changed floor plate requirements, e.g. by enlarging premises whenever a company is expanding, or by reducing them when it is downsizing.

Does this not involve an unreasonable effort?
It is a huge effort, no doubt about it. But it pays. Unless we understand our tenants and their needs, we will simply be unable to provide them with the floorplate they need. Shortcomings in this regard will breed discontentment, and the respective company will seek to relocate as soon as its lease expires, at the latest. Inversely, maintaining a regular dialogue between tenant and project managers will achieve a high level of stability. The tenant is tied to the premises occupied, because they are customised to the tenant's requirements. By the way, I believe this also explains why the annual take-up that asset managers of corporate real estate quoted in their replies to the bulwiengesa poll is lower than that of other asset classes. For it is probably attributable to a higher rate of lease renewals. This means: Sound asset management bolsters a tenant's commitment to a given location, lowers the necessary re-letting costs, and ultimately helps to find new tenants, too. After all, a satisfied tenant will be more inclined to recommend his former premises within his network.

According to the poll conducted by bulwiengesa, the asset managers handling corporate real estate are comparatively young. Why is that?
Again, I can only speak for BEOS. Since the qualifications that we require are not obtained through any single training or degree program, our project staff tend to have undergone interdisciplinary professional training. They tend to have a dual qualification, which may include both engineering skills and commercial know-how, for instance. In addition, BEOS provides hands-on training on the job. The core responsibility of our project managers, for instance, is to facilitate and structure a project from day one, from the acquisition to the asset management, and all the way to the exit. All of our services are generally delivered for our tenants by in-house teams on location, controlled by regional BEOS offices. Having this structure in place helps us ensure that no information is lost between project stages while also helping us avoid liaising issues.

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7) Brief survey “QUANTITATIVER AUFWAND EINES ASSET-MANAGERS,” bulwiengesa, 2014. Poll conducted among an expert panel of 344 asset managers or asset management companies between 10 and 14 November 2014. The response rate was well over 15%, which may be rated as high, considering the ad-hoc nature of the panel of specialised respondents. For queries and detailed results, please write to us at kassner@bulwiengesa.

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