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# THE LEADER

## The Evolving State of Portfolio Planning: A Critical Discipline for Uncertain Times

By *Sven Pole, Matt Werner, and Allison Hoiberg*

How can a large corporation best manage its real estate portfolio in the face of today's uncertain markets, economic volatility, and rapidly changing competitive landscape? We believe the answer is "not well," unless it has invested in fundamental portfolio planning tools, qualified staff, and processes.

Real estate is a long term asset class, highly idiosyncratic, and more capital-intensive than most other corporate asset types. As the pace of business accelerates, corporate real estate (CRE) departments require increased sophistication in planning and forecasting rapidly changing space needs. Without this sophistication (and additional resources aimed at planning), corporations eventually experience a mismatch between the supply and demand (business needs) of real estate. Add these mismatches up across multiple transactions and you get a significant negative impact on corporate performance.

The challenge is immediate and the opportunities are tangible in today's recessionary environment. How are the world's best corporate real estate departments responding?

In 2008, CB Richard Ellis convened a consortium of corporate real estate executives who are leading their organizations toward increased focus and investment on strategic portfolio planning. The Portfolio Research Consortium was arranged in concert with CoreNet Global, around three objectives: Survey the current state of portfolio management to understand how it has evolved and changed over the past ten years; Identify emerging trends, challenges, and needs for improving CRE portfolio management; Collect information and advice to refresh the Portfolio Management course taught in the CoreNet Global Executive Development Program. As a core class in the Executive Development Program curriculum, this is a course many MCR candidates have taken in the past.

This article is written to share our research findings and conclusions. We hope it will provide inspiration and support for corporate real estate leaders challenged by today's environment. We believe most corporate real estate departments under-invest in portfolio planning, and that significant opportunities can be realized by applying greater focus on the discipline: reduce costs, generate working capital, improve productivity, enhance sustainability, and decrease risk.

### Do planners have the information they need? Respondents state they have "good" info on:

- 61 percent - Serviceability & Condition – current condition, and investment needed to achieve optimal performance
- 61 percent - Capacity & Utilization – what business groups are where, doing what, at sub-asset level
- 78 percent - Supply Forecasts – when leases expire, potential space available, termination or contraction options
- 89 percent - Location & Functional Profiles – standard criteria and rating system
- 94 percent - Financial Structure – not just own/lease, but lease breaks, options, rent bumps, etc.
- 100 percent - Market Conditions – cost of similar space by submarket, likely short/medium term movement

- What Do Corporate Real Estate Portfolio Managers Do?  
 (An Aggregate "Portfolio Management Charter" Reflecting the Priorities of Multiple CRE Portfolio Planning Organizations)
- Meet business objectives via the real estate portfolio
  - Manage and optimize the real estate portfolio in a cost-prudent manner in order to increase shareholder value
  - Ensure that CRE assets support long term strategy of company and business units:
    - Minimize business operational constraints and impacts
    - Meet the workplace needs of business growth
    - Maximize portfolio and workplace flexibility
    - Maximize facility appropriateness to enhance productivity
  - Provide a robust decision making framework for portfolio
  - Ground real estate strategies on sound financial doctrine
  - Develop policies to ensure:
    - Business continuity, reduction of risk and costs, and rigor in decision making

The material in Figure 1 defines the current state of CRE portfolio planning, outlines key trends and issues, and shares best practices for CRE portfolio management.

**The Portfolio Management Research Consortium**

Today there are a number of CRE organizations with robust portfolio planning departments helping to navigate their firm's real estate decisions through today's turbulent environment – at a strategic level. This is in stark contrast to 10 years ago, when the CoreNet Global EDP Portfolio Management class was first introduced. We asked leaders from 16 CRE organizations, along with four additional service providers, to join forces and undertake research on portfolio planning (see Figure 2). Consortium members participated in conference calls, detailed interviews, and a two day summit. At the end of this three-month process, they succeeded in advancing our understanding of the discipline, its current state, and its future.

**Current State: Key Findings**

**How to Start a New Portfolio Planning Organization (the "Front Nine")**

1. Create portfolio planning charter and organizational mandate
2. Develop ongoing planning process
3. Develop analytical methodology and framework
4. Articulate objectives and variables
5. Create financial doctrine/charter
6. Ascertain overall company and business unit strategies
7. Identify required decision support tools for business units
8. Identify required data and sources
9. Identify and deploy requisite IT and analytical tools

**How to Optimize an Existing Portfolio Planning Organization (the "Back Nine")**

- 1) Deliver ongoing planning process
- 2) Utilize codified analytical methodology and framework
- 3) Educate BU decision makers to portfolio planning objectives and variables
- 4) Underwrite decisions to financial doctrine/charter
- 5) Continually ascertain and update overall company and business unit strategies

As expected, our research identified significant strides in the acceptance of portfolio planning as a required discipline for corporate real estate. We also found evidence of increasing sophistication of tools, practitioners, and metrics. Portfolio planning organizations typically share a common set of challenges across organizations (see Figure 3) – suggesting that the industry would benefit by developing a relatively standard set of processes, technologies, and training tools.

Other key findings include:

- Investment in the discipline (people and systems) is growing quickly – a number of participants have invested heavily to develop their platform and report a positive return on their investment in portfolio planning.
- CRE departments have largely adopted the core curriculum and vocabulary taught by the CoreNet Global EDP Portfolio Management course, including concepts such as demand forecasting, supply management, cluster analysis, sub-portfolio planning, and duration matching. They have taken the course content forward by developing strong working practices to actualize the concepts.
- Highly sophisticated decision-making tools have emerged to support PM efforts (flexibility, lease vs. own, market timing exposure, adjacency modeling). For example:
  - Sprint is running a web-enabled modeling tool for its Mosaic platform to better analyze real estate decisions impacting their retail, sales office, and network support portfolios;
  - Cisco developed a set of models to understand lease flexibility, protect against space overhang, and provide sophisticated metrics to decision makers; and,
  - AT&T purchased econometric research to help it optimally map its space consolidation initiatives against local real estate submarket cycles.
- The greatest need is in integrating data from disparate systems – all



values. It also requires a robust infrastructure that can be expanded to absorb new portfolio management responsibilities.

- Green/Sustainability Issues – Discussions indicate the first step for most organizations is creating an inventory and tracking system that addresses all areas of sustainability related to the company's footprint – including carbon emissions, waste stream, transportation impacts, and energy use. We anticipate that portfolio decision making will increasingly take into account the sustainability impacts of legacy and new locations, with wide variation among organizations as to how highly they prioritize sustainability factors.

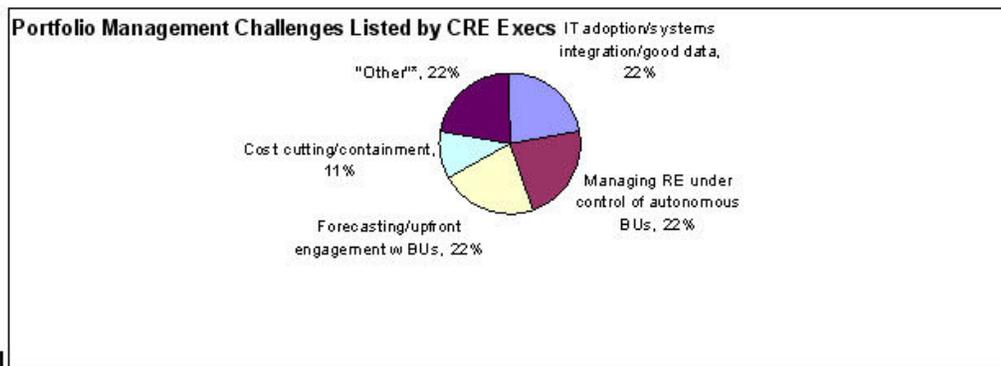
### Detailed Interview Findings

Portfolio consortium participants granted our researchers detailed interviews covering various aspects of Portfolio Management. They ranked the abilities of their teams on a scale of 1 to 5 ("poor" to "excellent") across three major Portfolio Management processes (demand forecasting, supply management, and cluster planning). They also ranked the state of their portfolio metrics and policies/initiatives under their control. The data indicates that CRE teams are rigorously engaged with evolving portfolio planning to a higher level – they have strong practices today but recognize significant opportunity to achieve more.

### Demand Forecasting

Although every organization surveyed does an annual demand projection process with its business units, and many do forecasting on a "continual" basis, only a few claim to be doing better than a "good" job. The reasons cited include:

- The fact that their industries are complex
- The experience that business units are not great at forecasting their own demand
- The belief that they themselves do not have the resources and/or relationships needed to do an excellent job



We did note that our survey participants have developed robust demand forecasting processes. Some of the best practices cited include:

- Cultivating business unit relationships to understand demand
- Participating in business unit planning meetings
- Working to understand the market/industry factors that produce real estate demand
- Coordinating with other internal support organizations (IT, Finance, HR, etc)
- Developing planning scenarios
- Revisiting demand forecasts frequently

### Supply Management

More than 50 percent of participants rated their supply management skills "very good" or "excellent." Participants were interviewed about the quality of portfolio and asset information they maintain along the criteria below, along with their ability to synthesize data. Nearly 75 percent said that it would be easy to access any and all of this information for analysis, even if it is located in some other department or with an external service provider. Sub-Portfolio Planning [by Market, Product Type, Business Unit Cohorts]

Exactly half of our participants rated themselves "very good" or "excellent" at sub-portfolio (or cohort) planning, and these departments are pressing forward with improvements. CRE organizations are very comfortable with analyzing the financial tradeoffs of various alternatives, usually related to the acquisition or disposal of a particular asset. They are now increasing their ability to address the larger "strategic" real estate questions of what assets are core and where/how to invest in the portfolio (see Sidebar).

### Metrics

Almost all of our survey participants have established robust portfolio planning metrics to support decision making

and improve portfolio performance. Some participants are experimenting with new measurement and reporting systems that will make metrics more clear and easily actionable, more immediately drive desired behavior, and appear more relevant to business leaders. Fully half of our interviewees feel there is room for improvement by creating metrics that better speak to their clients' interests and help them make better decisions (see Figure 5).

### Policies & Initiatives

Policies and initiatives are "where the rubber meets the road" – where sound planning manifests itself in actions and activities that impact the portfolio. We asked our respondents to rank and comment on their implementation priorities, distinguishing between policies (ongoing management protocols) and initiatives (one-off programs or projects that change aspects of the portfolio). Here's what we learned:

#### Top-Three Policy Priorities

1. Obtaining charter and maintaining control over real estate decisions easily ranked as the top policy priority, with nearly half of the organizations rating it as their #1 priority.
2. Risk mitigation came in second place, with a strong subset of this being "achieving flexibility on lease terms/conditions."
3. The broad area of green/sustainability practices came in third.

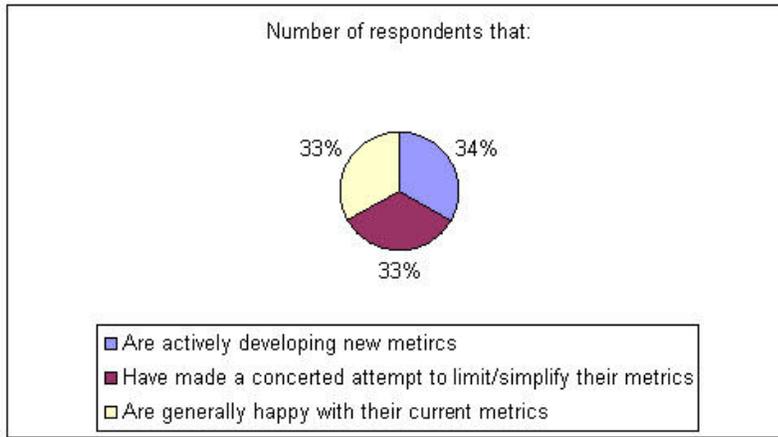
#### Ten Traits of Best-in-Class CRE Portfolio Management Organizations

1. Owns all real estate and facilities occupancy costs
2. Maintains accurate data
3. Relationship savvy
4. A steward for asset classes
5. Its processes, policies, and analytics rooted in solid financial doctrine
6. Maintains a robust infrastructure (rules and tools)
7. Represents a learning organization
8. Is trusted by business units
9. Strongly linked to other support organizations in the corporation (IT, M&A, HR, etc.)
10. Able to satisfy clients while maintaining a "bigger picture" viewpoint

#### Top-Three Initiatives

1. Cost reduction initiatives were ranked #1, by a large majority – more than half said it was the number one priority and over 80 percent said it ranked in the top three. (Please note: These interviews were done in the first half of 2008, before the financial crisis and severe economic downturn that characterize the current environment. Subsequent conversations with these organizations reveal an even greater focus on cost reduction. Although others cited "alternative workplace" and "space consolidation" initiatives as important, they noted that the priority derives from impact to cost reduction efforts (using alternative workspace to allow for space consolidation to reduce costs), as opposed to employee productivity or talent retention motives.
2. Initiatives that enhance core business revenue generation, such as retail repositioning, de novo roll out of business networks and hospital/clinic reinvestment, came in second place.
3. Initiatives that address a business event that created a major impact on the portfolio (merger, acquisition, business process outsourcing) came in third.

It is important to note that these are the top policies and initiatives for organizations that have already established a robust portfolio planning capability. For organizations that do not have an organization clearly accountable for portfolio management, priority actions will include developing the roles, infrastructure, and mandate for the portfolio planning team (see text box).



**Conclusion**

As the global economy tries to find equilibrium, and companies race to react to new market conditions, corporate real estate departments are working overtime to develop plans to reduce their portfolio footprint and related occupancy costs. We believe that companies who have made the investment into the discipline of CRE Portfolio Management are better equipped to respond to today's changing environment and will enjoy a competitive advantage over their peers. We also believe that CRE professionals can gain a similar competitive advantage by remaining educated and current on this subject matter. There are two ways readers of LEADER can get more involved: 1) The newly refreshed EDP Portfolio Management course is a great resource. It includes new teaching methods that rely heavily on case studies, real-life examples, role playing and take-home applications. It is designed to convey practical, useful concepts of immediate benefit to CRE professionals. 2) Based on heightened interest in this topic, CoreNet Global is developing a Strategy and Portfolio Management Community, which will be launched at the CoreNet Dallas World Summit in April 2009. The Community will re-create the open, content-rich, peer-to-peer environment members of the Portfolio Research Consortium enjoyed. It will be focused on further advancing the discipline, and provide a forum for leading practitioners to inspire each other. If you are interested, please join us in Dallas.

**About the Authors**

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