



# Property **for** business

An essential guide for senior executives

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## Foreword



After three years I am very pleased to present to you the second edition of the CBI *Property for business* guide.

Although much of the content has been refreshed, the CBI's aims and objectives for publishing the guide remain the same: to help businesses make the most of their property in an increasingly competitive environment.

The use, development or sale of property assets should be a central consideration for any business wishing to meet the needs of its customers and compete with rivals.

The impact of property on a business's profitability should go hand in hand with recognition of property's impact on the environment. Meeting the 2050 target to reduce CO<sub>2</sub> emissions by 60% will require us all to make some difficult decisions in the years ahead. Non-domestic property accounts for almost a quarter of all UK CO<sub>2</sub> emissions; understanding how your property estate contributes to this statistic will be an important first step towards reducing carbon emissions, and helping to avert lasting climate change.

By highlighting best practice and identifying current and future risks, I hope this refreshed guide will enable you to manage your property more productively and more imaginatively.

A handwritten signature in black ink that reads "Richard Lambert". The signature is written in a cursive, flowing style.

Richard Lambert  
Director-General, CBI

## Introduction



This update of the CBI's *Property for business* guide addresses the importance of property by suggesting ways in which you can both reduce property costs and improve property performance to better serve the needs of your business.

But this financial objective alone is neither the whole story, nor is it any longer enough.

The last few years have seen major changes in a number of policy areas that have direct impacts on, for example, how property is designed and constructed (through the planning system), and accounted for (in accounting standards).

Perhaps the greatest opportunity and challenge is establishing how property can play its part in supporting wider corporate sustainability strategies. If we are to take full responsibility for our actions, property must be managed 'from the cradle to the grave' – from construction, acquisition and occupation, and on to disposal and possible remediation, making the least possible carbon and environmental impact in the process. As part of a wider corporate social responsibility agenda, 'sustainable property' is a discipline that will develop rapidly over the next few years.

We hope this guide will give you some idea of what governance procedures can be put in place, and what you might do differently – now and in the future – that will have a positive impact at each stage of the property life cycle.

A handwritten signature in black ink, appearing to read 'Julian Lyon', written in a cursive style.

Julian Lyon  
Chairman, CBI Property Group

## 1. Defining your property strategy

*“Although property is typically the second highest fixed cost for most businesses surprisingly little attention is paid to it by business schools. For the UK and corporate competitiveness, it is vital that property is used efficiently and effectively, and managed competently – the development of a property strategy will be a vital prerequisite for this.”*

Julian Lyon, Manager – European Real Estate,  
General Motors

Property is an important strategic resource and a range of property solutions can be employed to reduce costs, improve business output and increase competitive advantage. But a firm’s property can also make a significant contribution to the achievement of wider corporate goals.

Innovative companies know what they want from property in terms of location, operating environment and financial returns. They recognise the role that the right property can play in improving operational performance and shareholder value, attracting the right staff, encouraging business change, contributing to sustainability goals and even fending off unwanted predators. Every firm should challenge how well its own property contributes towards and helps underpin these business goals.

The property strategy is the product of this careful consideration of property requirements, and the high-level plan for how a business meets these requirements.

This should not be about property deals. Rather, a pragmatic starting point for most strategies is that property is a necessary support to the operational business. For the vast majority of corporates, the reality is that you are more likely to maximise business returns by using property to help optimise the efficiency of your core business than you are from the occasional property transaction or short-term accounting ‘exercise’.

Getting your property strategy right requires a complete and detailed understanding of the wider business strategy and its operations, followed by a careful appraisal of how property options will impact on operations, finances and the environment.

Consider property as a core operational asset. Only a property strategy carefully designed in full consultation with the core business has a chance of delivering the business’s expectations.

### The challenges...

- What do you require from your property to support your business’s strategic goals, now and in the future?
- What are your plans for your core business? Can your property support this pace and degree of business change? Worse, could it constrain it?
- What does each of your business units ideally require from property to maximise their operational and environmental performance?
- How much space do they really need? Of what type? And at what cost?
- Where does your business need space? Is location critical?
- What services are required to support it? What will be the associated environmental impact?

- What is the most cost-effective way of meeting these needs? What is available in the market?
- How does your use of space (both cost and environmental performance) compare to your competitors?
- Does the associated income justify the costs?
- Do you know what risks are associated with your properties?
- Do you have the right mix of internal and outsourced resources to manage your properties?
- Does your property strategy contribute towards meeting the needs of sustainable development?
- If you do not have any of this information, where can you get it?
- Labour costs can be up to five times property costs. If you are considering a business move, availability of labour should be the biggest influence on operational effectiveness and cost.
- BT's £2bn sale of its property portfolio to Telereal was part of a strategy to raise cash, but also to change culture and working practices, to reduce floor space and to provide flexibility in its real estate.

#### **Did you know... ?**

- One size rarely fits all. A well-known retailer used to automatically renew all leases for a five-year term. Following a property strategy review that identified many core properties on which it could make a 15-year lease commitment, it achieved immediate annual savings on rental outgoings through renegotiation with its landlords.
- Floor space is the single biggest property cost driver. A lack of forward planning will lead to an expensive mismatch of space against need. In almost all cases short-term property solutions to meet crisis requirements are the most expensive.
- It is possible to measure output for any department or division against the amount of space employed. It is then possible to ask the question: what could we do to increase output per square foot?

## 2. Property, sustainability and climate change

*“We have to take climate change seriously. It is not a flash in the fashionable political pan. It marks a permanent change in the business climate, and in the expected behaviour of the property and financial markets.”*

Stephen Barter, Group Projects Director,  
Grosvenor Estates Ltd

It is fair to say that no single definition of ‘sustainability’ has emerged since the term came to prominence in the late 1980s. But people today broadly regard sustainable activities as those that ‘meet the needs of the present without compromising the ability of future generations to meet their own needs’. They tend to focus on the rate at which human beings are depleting the world’s natural resources and how this will impact on the wider environment.

People’s understanding of sustainability has been sharpened more recently by a growing awareness of the effects of climate change caused by man-made greenhouse gas emissions.

### Your property strategy and sustainable business models

To be successful your property strategy must be an integral part of a wider corporate strategy to promote and deliver a more sustainable business model. Such an undertaking will mean understanding and communicating the impact of your property portfolio on how your organisation consumes resources for example in terms of its implications for:

- How employees travel - in terms of distances and modes of transport
- The consumption of resources, such as energy and water, and
- The generation of waste which may be re-used or recycled.

Success will also be affected by how well your property strategy can minimise your overall need for space and wider consumption of resources.

For organisations with large property portfolios a sustainable property strategy will require a long-term ‘cradle to grave’ perspective that integrates key sustainability objectives throughout the lifecycle of the portfolio. Your property strategy needs to provide the framework for ensuring the property is developed, procured, occupied and disposed of in a coordinated and sustainable manner.

### Sticks and carrots: the business drivers for sustainable property use

The drivers for developing a more sustainable business model will vary depending on the nature and size of an organisation, but they are likely to come from three areas:

#### Corporate social responsibility (CSR)

For larger organisations, sustainability targets may often be intertwined with CSR objectives. For listed companies these objectives are coming under increasing scrutiny from shareholders and customers.

#### Managing costs

Improving your financial statements is a clear driver for any commercial organisation. More sustainable practices have the potential to reduce substantially bills for energy, water and waste services. Over time costs are also likely to be lower for property that is resilient to the emerging and long-term impacts of climate change.

### Government regulation and incentives

There are several policy developments at the national and the European level, some of which are optional and designed to help business adopt more sustainable practices, such as the Carbon Trust's programme of Enhanced Capital Allowances for energy and water-efficient technologies.

Others, however, have been or will shortly be introduced to improve environmental benchmarking of business assets or to penalise poor environmental performance, including the Climate Change Levy and the introduction of Energy Performance Certificates (EPCs).

But moving beyond regulatory compliance however can often be a corporate objective in itself: there may be opportunities to aim for more ambitious standards simply because it is the right thing to do.

### Climate change and business

Following the Stern review, the CBI set up a Climate Change Task Force in early 2007 to assess the challenges to business and identify the actions to overcome them. The Task Force published its report *Climate change: everyone's business* in November 2007. Analysis carried out for the task force by the consultants McKinsey & Co identified buildings as the single largest area for potential carbon savings by 2030.

Achieving the potential reductions in property will require business, government and consumers to work together. Government needs to establish the appropriate frameworks, consumers (or clients) need to drive competition for energy efficient buildings, and business needs to provide the low-carbon solutions. By incentivising consumers, government can encourage demand for energy-efficient buildings. For business this will mean those which are green will be rewarded – business therefore will need to be green to grow. In part this will also require businesses to consider how their assets and operational needs are resilient to the impacts of climate change.

Low-carbon solutions will not only be key to future growth. Customers, shareholders and investors are increasingly asking about the carbon footprint of individual businesses. As this pressure increases in the future, businesses will need to quantify and locate the sources and applications of carbon in their business structures and then manage their own and their suppliers' footprints to reduce the overall carbon emissions where possible.

In summary, carbon will need to become part of 'corporate DNA'. There are many cost-effective solutions that can be implemented and businesses that take early action will be the first to reap the benefits. For more information see: [www.cbi.org.uk/climate](http://www.cbi.org.uk/climate)

### Did you know... ?

- Respondents from the financial and business services sector to the CBI/GVA Grimley 2006 corporate real estate survey rated an alignment with CSR objectives as having equal importance to utility costs for occupying energy efficient property.
- The average cost of electricity for medium sized non-domestic customers (annual use between 500 and 1,999 MW a year) has risen by 67% in the past three and a half years.
- Two percent of firms account for 80% of carbon emissions from industrial processes and business use of buildings.
- Thirty percent of the energy businesses buy on average is wasted.

## 3. Delivering your strategy

*“You need to ensure that you control property events, rather than allowing them to control your business...”*

Martin Laws, Partner,  
Deloitte

Armed with your key strategic objectives, it is essential that your business has access to the right skills and tools for the job. Your property strategy therefore must be converted into policies and plans which can be put into practice.

This section introduces a selection of good practice activities – and market anecdotes – taken from other corporate occupiers, which can help ensure that your property strategy delivers.

### **Policies – ‘the what’**

Policies are useful to clarify and document the level of service required, to ensure consistency in how business units utilise their property and related services and to feed into the process of designing specifications and subsequent procurement.

### **The property plan – ‘the how’**

The property plan provides the critical link between your key strategic objectives and the work of your property team or advisors. There is no ‘standard’ plan as every company’s needs are different. But you will expect it to set out key activities relating to the delivery of the property strategy, such as:

- Acquisitions, disposals and landlord-tenant transactions (including audit and corporate governance measures to ensure policy is complied with)
- Capital investment and maintenance projects
- Procurement of estate management and facilities management services, and

- Internal property management processes, responsibilities, skills and resources (including environmental monitoring).

### **Resourcing and structure – ‘the who’**

To implement property-related policies and plans effectively, businesses need to have access to the right skills and resources. Once property processes and objectives are fully understood, appropriate staffing levels can be set to ensure there are no omissions or duplications and that the best people are allocated to the job – internal, external or both.

It is also often assumed that property is the responsibility of just the property team. But for property to meet business needs effectively, it requires the active engagement of the main board and the business unit ‘customers’ in discussing their objectives, agreeing their requirements and managing staff expectations. A process that involves all stakeholders in property decision-making and implementation will reap real benefits.

### **Performance measurement**

Your strategy, property plan and processes may all be in place – but do you actually know whether they are delivering as planned?

Your property plan has been structured to deliver business objectives. It is important therefore that your reporting system includes measures that assess how your property resources – and your property team – are meeting those goals.

Performance measures must provide a record of past performance, but also help you to plan ahead. They must motivate staff to improve and promote good behaviours.

And crucially, for property to be considered appropriately, property performance measures must be directly linked to the key performance measures of the core business.

### Accurate information

Real estate mistakes can be expensive. Good information – accurate, complete, readily accessible and well presented – is crucial to making property work for your business. Management information is the pre-requisite to planning ahead – to control property events, rather than being controlled by them.

A basic dataset need not be complex or expensive – although for large companies with a diverse estate there will need to be a robust database – but it must be accurate. Data maintenance is as important as data assembly. Some big businesses admit to having ‘lost’ properties in incomplete or fragmented data systems, while others have missed valuable break clause opportunities. Assembling the basic critical data, maintaining the records and preparing simple reports of key events, assets and liabilities gives every occupier a solid data platform from which to avoid errors.

A good property database will comprise information such as tenure, lease dates, break options, renewal rights, rent/rates/service charges, energy performance and many other measurements essential to the business.

Depending on your reporting requirements, the database may need to hold further information including detailed occupational costs – including ‘carbon costs’, user restrictions, scanned deeds and plans, photographs, detailed budget information, key health & safety data, planning information and staff numbers.

Some of this information may require sourcing from the company and from external sources, such as lawyers, accountants or property advisors. And a golden rule: before making your database too complex, ensure that you can collect and maintain the data.

### The challenges...

- Do you have appropriate property-related policies in place?
- Do you understand how your property strategy supports any wider drive to deliver key corporate sustainability objectives?
- Do you have a property plan that includes all activities related to the delivery of the strategy and the subsequent management of the portfolio?
- Does your business have well-defined property-related processes? Does it involve other parties from outside the property team? Do you have wider ‘buy in’ from colleagues across your organisation? Are all parties aware of their responsibilities?
- Have you assessed the short, medium and long-term business requirement (financial and environmental) for every property that you occupy?
- Do you know when the next opportunity to exit each property comes up?
- Can you accurately quantify your leasehold liabilities?
- Do you know the monthly/annual running costs of your real estate?
- How energy efficient is your property portfolio? How does it perform relative to the wider market? How does it compare to your competitors?
- Do you know your space utilisation rate?
- How much vacant space do you hold on the books?
- Are you on budget? Are you sure there are no nasty surprises in the pipeline - unbudgeted end-of-lease commitments (dilapidations)?
- Are your running costs per person higher or lower than your competitors?
- Does your plan allow for a regular and automatic refreshing of the property strategy, plan and processes?
- Who owns all of these at board level in your organisation?

**Did you know... ?**

- A major international company shocked the City by revealing substantial leasehold exit liabilities that would be crystallised by a critical business restructuring.
- A food distribution company had grown by acquisition and merger. It had no list of properties and was surprised to receive large bills for property it did not realise it owned and had no budget for.
- A chemical company negotiating to extend a plant onto adjacent land found it was negotiating with a subsidiary.
- A food manufacturer extended a factory onto land it did not own.
- A financial services firm was seeking 30,000 ft<sup>2</sup> of office accommodation in a major UK city while a subsidiary was disposing of the same in another part of the city.
- A high street clearing bank took a lease on a building adjacent to a vacant building already owned by a different part of the bank.

## 4. Maximising workplace effectiveness

*“There has been an unprecedented increase in life expectancy over the last half century and this will continue. Life expectancy at 65 stood at 12 years in 1950, 19 years in 2006 and will be 21 years by 2030. This requires a significant reappraisal of retirement and employment policy – as well as property use and design.”*

John Cridland, Deputy-Director General,  
CBI

Labour costs are typically the highest of all business costs. With consistently low unemployment rates, an ageing workforce and increasing business concerns over the demographic availability of skilled resources in the future, informed businesses recognise that the labour market is becoming increasingly competitive.

The idea of a job for life is a redundant concept in the modern labour market. Structural changes to labour markets over recent decades mean employees have become increasingly footloose. The CBI calculates that the average labour market turnover across the private sector is 16%. As a result, the attraction, retention and motivation of good staff are key business issues.

Patterns of living and working in the UK are also changing. A symptom of the ‘demographic time bomb’ is that the average age of your workforce is likely to rise substantially over the coming years. Attracting the ‘youngest and brightest’ to your organisation will remain important but more experienced employees can bring equally important qualities to the work place. The increasing age range of staff therefore needs to be part of any property strategy.

Property strategies should also pay close consideration to the accessibility requirements of the entire workforce it caters for, and how it provides equal opportunities for those who are disabled.

In recent years there has been recognition that improving employees’ work-life balance can achieve significant improvements in staff productivity. An increasing number of organisations now challenge the conventional ‘9 to 5’ commuter model and offer flexible working arrangements that enable employees to complete work either at a different time, in a different

location or in partnerships with other colleagues. Of the employers surveyed in the 2007 CBI employment trends survey, 60% now offered at least three flexible working arrangements to their workforce, up from 35% in 2005.

Many of these changes are due to advances in mobile telephony and ICT services, and where appropriate, provide real opportunities to improve workplace efficiency and working practices to get the most (and best) out of your people. An effective workplace – whether office, shop or factory – is not therefore just about space and fit-out, but needs to be a careful combination of IT, support services and HR policies. The impact of these trends in lifestyle and working practices should be assessed and incorporated into your property strategy.

Innovative workplace solutions can offer significant productivity paybacks through:

- Reducing costs
- Reducing the carbon footprint of your business through limiting the need to travel
- Facilitating team-working and breaking down barriers
- Streamlining work processes and improving communications
- Improving work-life balance
- Improving asset utilisation
- Making future business change easier and cheaper.

The careful consideration of workplace effectiveness in any property strategy has the potential to add real value.

### The challenges...

- Do you know, through regular staff surveys, how your people feel about their working environment and how improvements could be made?
- Could a change in environment help establish valuable business process changes?
- How well did your HR, IT and property teams work together on your last major workplace project? Are their objectives and drivers aligned?
- Do you consider how IT, telephony and other business services can be better aligned to help achieve your property objectives?
- Have you looked at introducing home-working, hot-desking or hotelling on an ad hoc or permanent basis?
- Do you consider the workplace environment – and options such as remote working – as part of your HR package for existing and future staff?

### Did you know... ?

- A well-designed and managed property can lead to significant improvements in staff productivity. A building that creates an environment where people will give their best is likely to yield far greater returns through increased productivity than through any short-term construction-related savings, which sooner or later are likely to prove a false economy.
- Staff turnover is costly: replacing mid-level managers has been estimated to cost 50% of annual salary each time – there is a business benefit in investing to retain staff.

- Questioned for a recent study undertaken by Gensler, middle and senior managers thought that improvements to their workplace could improve their productivity by 19%. The same study also found that:
  - Thirty-three percent of professionals felt that their working environment was a contributing factor in their decision to accept or reject a job offer
  - One fifth of professionals would be embarrassed to show customers around their working environment.
- Sixty-five percent of businesses surveyed in the 2007 CBI employment trends survey said that permitting the right to request flexible working improved their ability to recruit and retain staff. The same survey also found that:
  - Ninety-five percent of employers offer at least one flexible working arrangement (up from 84% in 2004)
  - Forty-six percent offer employees teleworking (up from 11% in 2004)
  - Forty-five percent offer employees flexi-time (up from 31% in 2004)
  - Fifty-five percent offer employees job-share arrangements (up from 38% in 2004).

## 5. Optimising your property costs

*“UK businesses are throwing away up to £18bn a year through inefficiency in their use of property. Cutting this out would improve gross trading profits by up to 13%.”\**

Roger Bootle, Economist

With a clear framework now in place to drive your effective property decision making, it is possible to make considered judgments on how to improve efficiency.

Given that the workplace can account for between 10% and 40% of a firm’s structural cost base, it is right that many businesses seek to reduce these costs and there are many ways that occupiers can improve property and facilities costs. Yet crucially, cost reduction at the expense of operational performance will not be sustainable and can easily undermine the core business performance.

Here are some useful tips to optimise your property costs, while at the same time increasing your knowledge of your property requirements.

### The challenges...

- Can you identify the true costs of occupying your property? If asked to make cost reductions, can you readily identify the real cost levers?
- Have you challenged service specifications and requirements? Are services at the right level to support the business at the lowest cost? Are there unchallenged differences in the services required by different business units?
- Do you make the most of your buying power? Could you combine the purchase of facilities management and property services with other services?

### Did you know... ?

- Lease flexibility comes at a price: a 5-year break clause has been estimated to cost between 10%-20% a year in terms of higher rent.
- Yet research suggests that many expensive break clauses are never exercised. Some are drafted in such a way that they can be difficult to operate. Compliance with lease terms, including ‘fully repairing’, can be problematic and contentious at break time. Avoid paying for flexibility that you do not need. One occupier was able to trade an unwanted break clause for a 20% reduction in annual rents.
- The voluntary Code for Leasing Business Premises ([www.leasingbusinesspremises.co.uk](http://www.leasingbusinesspremises.co.uk)) sets out good practice for lease negotiations and landlords are encouraged to promote it to prospective tenants. It is important that you read the Code (the Occupier Guide, part of the Code, is specifically designed to help business occupiers to understand the process of leasing property). It is vital that you are an informed buyer and that you get what you want from a lease – if you don’t ask, you don’t get!
- The average office space utilisation rate is just 40-45% for commercial occupiers.

\* Bootle, Roger. *Property in business – a waste of space?* (RICS 2002). To be updated in 2008

- In 2002 Prudential plc reduced its need for space by 25% following its relocation of headquarters. This has translated into estimated savings of £1,000 per employee per year and was achieved principally through introducing ambitious hot-desking arrangements supported by advanced use of emerging teleworking technologies.
- A planned approach to leasehold maintenance can reduce lease-end dilapidations by up to 50% and can be budgeted for instead of being an unbudgeted surprise.
- Unless well planned and well appraised, moving can be very expensive in cash terms. Most businesses underestimate the real costs of exiting existing premises, especially in poor property market conditions.
- Studies have identified freehold property owners as being 'more wasteful' managers. Manage the space tightly and you will reduce rent, rates and stock (inventory) costs.
- The total UK-wide business rate harvest for the Treasury is c £21.9bn a year. Market evidence suggests that, on average, business rates are over-assessed by 10%: a good understanding of your rates bills could therefore save you money – you can appeal if you think your properties have been over-assessed.

## 6. Unlocking asset value

*“The successful management of any property estate depends upon a sound understanding of its value, and the reasons for its value.”*

Ann Allen, Head of UK Property & Strategy,  
HBOS plc

Unlocking latent property value can be a straightforward way of improving shareholder returns. The right property ownership structure can unlock value and save unnecessary expenditure by delivering the same property solution at much lower cost, or an upgraded solution at the same cost.

Business owners of freehold property should regularly review their policy on asset retention, asking whether cash locked up in freehold assets could be better spent on investment in the core business.

Value to a business can come from two main scenarios:

### Alternative use

You may own property with a higher alternative use value. This may greatly exceed the value you are gaining from the operation of your core business on the site or the cost of relocating to a suitable lower-value site. For example, many long-established manufacturing companies may find their sites often near city centres - becoming more valuable for other uses, such as retail and residential. In these scenarios, if the facility is still required, developers will often provide alternative (more modern, better) facilities for the occupier and limit operational down-time as part of the deal.

Alternative use strategies will inevitably require planning consent and it is important that you understand how your ambitions fit in with local, and possibly regional, land use planning strategies. Always engage your local planning authority early to understand whether there are any wider considerations that you may need to factor into your project strategy. Failure here may cause costly planning delays that could hold back your planned objectives for months,

if not years. Advice from specialist consultants and agents should be sought at the outset.

### Property disposal

Provided the business does not require the advantages freehold ownership can offer, then it may be worthwhile considering a sale. The need for additional cash, as well as the effects on financial statements and key ratios, may determine the best way forward. Just some of the options include traditional sale and leaseback, structured sale and leaseback, debt finance and ‘corporate PFI’.

Regardless of the right answer – which will be particular to each business and even each property – the priority objective should be to ensure this issue is considered regularly so that the options are at least recognised and understood by the business, even if not exercised. As a relatively illiquid asset, any property transaction needs planning and forethought. Some companies maintain regularly updated alternative use strategies, including sales data packs, for their key properties.

### The challenges...

- Do you regularly review your property assets to ensure they are being put to best use?
- Are you aware of the open market value of your assets and the potential for alternative use?
- Do you understand the real potential to release value latent in your property portfolio?
- Would the disposal (or acquisition) of property and related services meet business needs as well as enhance financial ratios?

## Case study: Cadbury Schweppes plc

In 2006 we sold a distribution centre to a US Pension Fund for £31.5m, and took a ten-year leaseback. While that is the headline news, what went on below the surface is much more interesting...

To ensure this was an operating lease and not a finance lease, the terms of the leaseback were based on an arm's length transaction, including a full market rent and an open market review.

We insisted on having a break clause after five years. We were offered a higher sale price in return for committing to the full ten years, but we accepted the lower figure as the price of flexibility. Managing your exit strategy is part of managing your entry strategy.

Out of the sale proceeds, we made a financial provision for a claim for repairs in the first 2-3 years, the rationale being that the new owners would probably want to keep the property in better condition than we had done as owner-occupiers.

The cash proceeds contributed to our cash-flow for the financial year in question. For us, cash-flow is almost as important a financial measure as profit. With this we were able to reinvest the proceeds in our core confectionery business. This is what we are good at, and where we add shareholder value.

**Robin Worthington**  
Group Property Director

- Remember, your assets can always be devalued as a result of the activities of others. Are you aware of neighbouring development plans that could restrict the use of your site in the future?
- If you wish to improve a leasehold building, the landlord may be willing to finance the work in exchange for a restructured lease. It may be possible to do this by extending the lease term rather than by increasing rent.

### Did you know...?

- A high-technology occupier used the 'alternative use' property value of a London fringe property to re-invest in a global production facility in Wales. Further, by moving to a grant-aided location they gained net financial benefits to invest in state-of-the-art production equipment to improve their business capacity.
- Unrecognised value within the estate is increasingly being seen as a way of raising finance to support hostile acquisitions, particularly within the retail sector. Recent high-profile acquisitions by venture capitalists demonstrate that corporates have an obligation to ensure that the value of the corporate estate is reflected in the share price and not used to finance a buy-out by a third party.

## 7. Regulatory, accounting and legal influences

*“Well informed businesses are all too aware of, and prepared for, the growing interest that is being taken in their property. Changes to accounting rules and corporate governance regulations suggest real estate will come under ever-increasing scrutiny.”*

Martin Laws, Partner,  
Deloitte

If simple financial gain or operational benefit were not enough to prompt an enthusiastic review of property strategy and ownership, then a number of new regulatory influences are also serving to move property further up the board agenda.

These influences should prompt the informed occupier to review new liabilities and statutory responsibilities with due care and attention. They can also combine to create a shift in market demand towards shorter leases – typically representing a more expensive option in the UK commercial property market.

These issues can only be fully addressed as part of a clearly defined property strategy, plan, process and management framework.

### **Accounting issues: current and emerging**

Regulatory scrutiny of financial reporting in the UK continues to increase and with the increased complexity of the financial standards to be applied, the mitigation of the risk of error remains a challenge.

Shareholders pay close attention to how property assets are accounted, particularly where market conditions are volatile. The implementation of International Financial Reporting Standards (“IFRS”) by listed companies in 2005 and the subsequent moves to converge UK reporting standards towards IFRS have resulted in significant changes to the reporting of property related balances, often not wholly expected at the date of transition, including:

- Full provision for contingent capital gains tax on revaluation surpluses, often reducing the net assets of entities with significant property portfolios
- Revised definitions of operating and finance leases, resulting in companies having to review their property portfolios and potentially change their method of accounting for their properties through the differentiation of the land and building components of leases
- New and potentially complex accounting rules for ‘embedded derivatives’, such as where rent reviews are linked directly to RPI or other indices
- Recognition of fixed rental uplifts evenly over the course of a lease, resulting in higher up-front costs for occupiers.

In addition, companies with large vacant portfolios remain under scrutiny by their auditors and analysts to ensure they are making adequate provision for the cost of holding these assets, especially in difficult letting markets.

The International Accounting Standards Board (IASB) has announced a ‘quiet period’ for new IFRS following a period of unprecedented change, but work still continues to eliminate differences with US accounting principles. Of particular importance is the leasing project to address accounting by the lessor and the lessee, the cornerstone proposal being to eliminate the distinction between operating and finance leases. Such a change would be radical and will be eagerly awaited by the owners of corporate property portfolios.

### Corporate governance and reporting issues

Since the early 1990s the UK sought a market solution to the issues of corporate governance and a voluntary Combined Code (bringing together previous codes) was introduced in 2003 based on the principle of 'comply or explain'.

The UK approach is well respected but the importance of companies providing robust explanations when they choose not to follow the code has been re-emphasised following the most recent review.

In the EU, the Commission is working through its Action Plan on Company Law and Corporate Governance published in May 2003. This includes over 20 proposals covering issues such as shareholder rights, capital maintenance, directors' remuneration, the role of non-executives and the publication of an annual corporate governance statement. It has been decided that the proposals on audit committees and the corporate governance statement will be introduced by amendments to the FSA Listing Rules. The proposals are now being consulted on at present and will directly affect UK companies.

Following the government's decision to remove the statutory requirement for an Operating & Financial Review (OFR), changes were made to the Business Review requirements for inclusion in the Directors' Report. The purpose of the Business Review was to inform members of the company and to help them assess how the directors have performed their duty to promote the success of the business. This was to be achieved through a fair review of the company's business and a description of the principal risks and uncertainties it faces.

These requirements have been strengthened further by the Companies Act 2006, where since 1 October 2007 a quoted company's business review must disclose:

- The main trends and factors likely to affect the future development, performance and position of the company's business
- Information about environmental matters (including the impact of the company's business on the environment), the company's employees social and community issues
- Information about people with whom the company has contractual or other arrangements essential to the business of the company.

The Companies Act 2006 also introduces a statutory statement of directors' duties and the concept of enlightened shareholder value, where all actions of a director will be judged against the duty to:

- Act within powers
- Promote the success of the company
- Exercise independent judgement
- Exercise reasonable care, skill and diligence.

Corporate executives with responsibility for property should carefully consider what this means for their role and responsibilities. Incomplete or inaccurate data on the corporate estate will increasingly be regarded as unacceptable and a likely indication of inefficiency or poor management – even where the operational day-to-day responsibility is outsourced. Decision-making on property matters will need to reflect the requirement for the board to demonstrate that it has complied with the new directors' duties.

### Property as a revenue target

Property continues to be a soft target for revenue collection. There have recently been a number of important changes to how property is or will be taxed, including:

- Stamp duty on leasehold properties – duty is now calculated on the net present value of the total lease value
- Empty Property Rate Relief – from April 2008 100% rate relief on vacant industrial property will only apply for the first six months (as opposed to in perpetuity); relief for commercial property will be 100% for the first three months (as opposed to 100% relief for three months and 50% in perpetuity thereafter)
- Supplementary business rates – the government is likely to introduce powers in the near future allowing local authorities to levy a supplementary business rate to fund specific local, or sub-regional economic development projects.

Mitigation measures will, in the main, be driven by ensuring that robust corporate attention is paid to minimising the volume and tenure of space occupied.

## 8. Summary

Corporate property is a major cost to most businesses. Yet research suggests that UK companies lose billions of pounds every year through inefficient management of these costs.

This guide shows how a more strategic approach to property could strengthen your company's financial and environmental performance and enhance its competitiveness in the global business environment.

The importance of property decisions is clear from the increase in regulatory and corporate governance liabilities: this should be reflected in property's place on the corporate agenda and in the boardroom.

## Key issues checklist

Ten key questions to help ensure your property performs

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| 1. Do you have a property strategy that reflects the operational business plan?           | A property strategy must be business-led. If no strategy exists, or if it does not match the operational business plan, property decisions will not meet the requirements of the business.             |
| 2. Can your strategy be implemented effectively?  | To ensure your strategy performs, it should be converted into policies and plans that set out what is to be delivered and how. As ever, access to the right skills and resources will be key.          |
| 3. Do you have an accurate database of your property assets?                              | Poor records could lead to properties being 'lost' or to costly surprises such as an unexpected lease expiry or rent review.   |
| 4. Does the board receive regular reports on key performance indicators for its property? | Good information is key to efficient management. To optimise business performance a strategic awareness of property costs and future opportunities is essential.                                       |
| 5. When did you last review your property assets to ensure optimum performance?           | Property is expensive – it is important that you make best use of it. With regular reviews, you are more likely to be better at managing costs, controlling stock levels and increasing profitability. |
| 6. Are there up-to-date valuations of your property interests?                            | Companies must know what their properties are worth. Undervalued property assets flatter returns and lead to missed opportunities to make windfall gains on timely sales.                              |

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| <p>7. Have you considered how property could be used to improve workplace effectiveness?</p>     | <p>People are your most important asset. But patterns of living and working are changing and innovative workplace solutions can offer significant productivity paybacks through improved staff performance.</p>   |
| <p>8. How costly and how difficult would it be to reduce your property portfolio?</p>            | <p>Companies with shorter unexpired lease commitments are better able to adapt to changing circumstances. Knowing your weighted unexpired lease commitment – the average time remaining on your leases weighted by the yearly lease rentals – will help you know just how flexible you can be.</p>            |
| <p>9. What is the cost of putting properties you rent back into their original condition?</p>    | <p>Lease termination and exit costs are often higher than planned as many contracts require occupiers to restore any deterioration or changes made to the property when they leave. With an active property strategy action can be taken to significantly reduce these liabilities.</p>                       |
| <p>10. Are you aware of the range of regulatory influences affecting your property holdings?</p> | <p>Changes to accounting rules, stamp duty, corporate governance and environmental regulations have moved property up the business agenda in recent years. It is important that you are aware of any statutory and legal obligations relating to your properties – as well as likely future developments.</p> |

This work has been supported by the CBI Property Group, which includes as its members a range of Property Directors and advisers from some of Britain's largest corporate and property companies. They are at the forefront of maximising the value of their property assets through focused property strategies aimed at boosting returns from the workplace, reducing costs and unlocking value.

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