IRES Working Paper Series

Corporate Real Estate: Perspectives, Evidence and Issues

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Acknowledgement
The first author wishes to thank the Singapore Ministry of Education’s AcRF Tier 1 funding support for his research project entitled “corporate real estate performance effects and strategy dynamics of international retail companies” (research grant number: R-297-000-083-012) upon which this paper was based on.
CORPORATE REAL ESTATE: PERSPECTIVES, EVIDENCE AND ISSUES

Abstract
A significant proportion of capital is tied up in corporate real estate (CRE) by the US, European and Asian non-real estate firms. As CRE can function as either a production factor or profit centre, providing flexibility not common to other corporate assets, the firm must recognize their strategic importance and manage them efficiently. Alternatively, the firm may consider appropriate exit strategies such as real estate disposals, sales-and-leasebacks or strategic outsourcing to reduce substantially the amount of capital tied up in the CRE. This paper discusses the business, financial and capital market perspectives of CRE and some potential issues, supported by key research studies and evidence drawn from the retail companies in the international environment.

1. Introduction
Corporate real estate (CRE) refers to the land and buildings owned by companies not primarily in the real estate business. In conventional economic theory, these non-real estate firms regard their CRE primarily as a “factor of production”, providing space for the manufacturing and delivery of goods and services. However, in recent years CRE has taken on a higher level of importance as the “fifth corporate resource” after capital, people, technology and information. Along with this increased importance of real estate as a corporate resource, Roulac (2001) has also pointed out how the management of CRE itself has evolved significantly over the last several decades, from the trend of custodial approach prior to 1970s to the current trend of strategic approach in which the real estate function is moving towards growth, efficiency and effectiveness.

In today’s business environment, many non-real estate firms are investing significantly in properties which are used for operational (i.e. business) or investment purposes. In some cases real estate has become the corporations’ largest asset. From an international perspective, the ownership of significant amounts of real estate by corporations in the United States is well documented, estimated approximately
at about 25% of corporate wealth (Rodríguez and Sirmans, 1996). In the United Kingdom, real estate represents on average 30%-40% of total assets and 100% of capital in the balance sheets of industrial companies. Many of the largest non-real estate companies control property portfolios that are comparable in value terms with those owned by mainstream real estate companies (Debenham Tewson and Chinnock, 1992). Comparatively, European non-real estate firms own higher percentage of CRE than the US firms, and owner occupation of real estate has historically been part of the corporate culture in the UK and some European countries (Laposa and Charlton, 2001). Similarly, Asian non-real estate firms report higher property holding intensity (i.e. percentage of property held as total tangible assets) than the US and European firms, with many large business firms own their prestigious administrative headquarters in order to boost their corporate image. For example, Singapore business firms invest, on average, at least 40 per cent of their corporate resources in real estate (Liow, 1999).

One interesting question to explore is why do many non-real estate firms own as opposed to leasing space needed in business operations? Clearly these companies must have benefited from the real estate assets that are left in their balance sheets. For example, if much is held primarily for the operational purposes of a company, and so long as its value increases, then real estate will be important for the part it plays in enabling the firm to be efficient and make profits (Scarrett, 1991). According to Machlica and Borunch (1989), other main reasons cited by the CRE managers include, (a) CRE is a figure on the annual balance sheets that reflects organization growth, (b) CRE is a necessity for achieving the firm’s operational mission, (c) CRE is a source of cash in bad time, (d) CRE ownership provides a source of capital growth, investment income, and disposal and development profits, and (e) CRE is capable of improving the firm’s stock market performance.
Management philosophy and attitude towards real estate also explains partially the main reasons for CRE ownership. To date, many traditional firms still adopt facilities management approach by leasing all or most of their real estate to support business operations. On the other hand, asset management involves a more proactive approach, where the management seeks higher returns from its “surplus” real estate by taking on more risks. These companies are more willing to invest in real estate; however, speculating on real estate capital gains is not a fundamental part of their corporate strategy. Finally, some conglomerates who adopt a business real estate approach have at least two core business components: the traditional core business (non-real estate) and real estate business. Similar to the mainstream real estate companies, these firms develop real estate space for owner-occupation and also hold a significant real estate portfolio for investment and development.1

As a consequence of corporate restructuring activities involving real estate in the USA in the 1980s, the traditional notion that non-real estate firms have a comparative advantage in owning properties had increasingly been questioned by corporate management (Brueggman et al, 1990). Increasingly, more and more large corporate occupiers are looking at innovative ways of restructuring their CRE ownership through outsourcing, structured sale-and-leaseback or securitized disposal of real estate assets. By doing so, they hope to reduce substantially the amount of capital tied up in property, with the aim of improving balance sheet ratios and value added as well as reducing property-related costs. Similarly, disposals of operational CRE have become increasingly common during the past decade in the Western and Northern Europe (Louko, 2004). One of immediate reasons for the divestments of operational CRE was to lighten corporate balance sheet and redirect the capital into core business areas. It has also been reported that “companies that earn a 6 percent to 12 percent return on their real estate holdings, compared with 20 percent to 25 percent on their core business
activities have been under pressure from the major institutions to divest themselves of their real estate holdings and reinvest the proceeds in funding the expansion of their core business activities.” (Voyle, 2000)

When CRE decisions are approached from a business perspective, the main goal is to maximize the utility of space consumption, while at the same time minimizing the operational cost. From a financial perspective, corporate management wants to efficiently employ the capital for holding real estate. However, these two perspectives often translate into dissimilar and conflicting goals for CRE. Additionally, no matter which perspectives they take, the goal of all corporations is ultimately the maximization of shareholder value (capital market perspective).

In this paper, we argue that since a great deal of capital is locked-up in real estate, the role of CRE must be analyzed from a holistic perspective, i.e. performance measures are needed that reflects how CRE is being used and perceived by users, corporate management and investors from three different perspectives – business, financial and capital market. We discuss critically these three CRE perspectives and some potential issues, supported by key research studies and evidence drawn from the retail companies in the US, European and Asian countries; as real estate has always been recognized as a key value driver in the retail industry.

2. The Business Perspective of CRE

Nourse and Roulac (1993) have linked the importance of CRE to the concepts of property’s contribution to business performance and enterprise strategy. They pointed out that by managing real estate as a business function, corporate management can cut costs significantly and, at the same time, increase productivity. The role of CRE in reinforcing the competitive advantage and core competence of the firm is therefore of
paramount importance in performance measurement to specifically reflect how property is being utilized in the business.

Occupancy costs (expressed as a percentage of total business costs) affect the cost base and the net return of the firm. Strategically, decisions about occupancy strategy and cost control determine the firm’s (or a business unit’s) profit structure and competitive situation. However, there is also increasing recognition that performance indicators (or indexes) are also needed to focus on “productivity” and “profitability”. Consequently, CRE managers need to consider the linkages between business strategies, real estate strategies and real estate decisions together to encompass the “cost”, “profitability” and “productivity” indicators at three different levels of hierarchy - at the “individual property level” where the business real estate performance tends to be different for various types of buildings and uses, at the “property portfolio level” if the firm own significant CRE holdings of different specifications; and at the “strategic business unit (SBU) level” that would elevate the status of the CRE unit as an independent and autonomous business unit/division.

Ownbey et al. (1994) and Gibson & Barkham (2001) point out that retail properties have a direct influence on the business performance. The success of retailers, commonly measured by floor productivity and profitability, is strongly related to the strategic location of their shops. Brounen and Eicholtz (2004) argue that such business linkage implies that on average, many retailers may have relatively high CRE ownership without the need for acquiring highly customized properties. This is especially relevant considering that organic growth through physical expansion in the number of stores / outlets has been a popular strategy approach among retailers to boost their sales figures. Additionally, for a major retailer that commands established presence in a prime retail location (e.g. retailers in the high-end fashion industry), its CRE would be strategic to the organization. On the other hand, Andersen and Rosen (2000) argue that virtual
expansion has become a complement to physical expansion. They find that those US retailers with e-commerce capabilities (e.g. Wal-Mart, GAP) are expanding their physical presence at an above average rate of 9.2% compared to the 5.8% industry average and 2.6% for retailers without virtual presence. At the same time those retailers without virtual presence are closing stores at an above average rate of 3% compared to the industry average of 2.1%. Consequently In times to come, this might possibly suggest a larger increase in the “surplus” operational properties due to technological innovation in the retail sales. More needs to be known regarding the significant impact of virtual expansion on the retail real estate requirements and the roles of the CRE unit and executives in the new business environments.

Current CRE practices suggest at least four important areas in the light of a business management focus: (a) CRE planning to facilitate the development of CRE asset management (CREAM) strategy that supports the overall business strategy, (b) CRE organization structure that allows the effective implementation of the CREAM strategy, (c) CRE business performance measurement and (d) CRE risk management and assessment. The first three areas were briefly discussed by Tay and Liow (2006).

Strategic planning facilitates the development of CREAM strategies that is linked to the business strategies. However, there is evidence to suggest that while CRE managers believe in strategic planning, there seems to be difficult when it comes to implementation. One possible reason could be due to the short lead times of business and political decisions that makes it difficult to accommodate the longer planning period required for real estate (Avis et al, 1989). Another reason for the lack of strategic CRE planning may be due to poor or non-existence of real estate information systems. Inappropriate and/or inadequate real estate information systems tend to gravitate towards accounting rather than decision-making data. The existence of a real estate information system that supplies adequate and timely information such as business
needs, staff requirements, facilities, occupancy costs and market data is essential for facilitating effective strategic planning of CRE (Apgar, 1995). What this means to business is to invest in a management information system (MIS) that would link the CRE databases and analytic tools to key drivers of business strategies (Manning and Roulac, 2001).

According to Zeckhauser and Silvermann (1983), the CREAM structure can be decentralized (where management of real estate is the responsibility of each product department), centralized (where all real estate decisions for the firm are made in a centralized department) or a wholly owned subsidiary (where control of some or all of the company’s real estate is transferred). An alternative is to classify the CREAM structure into profit centers and cost centers (Veale, 1989). Moreover, profit centers appear to be aligned with wholly owned subsidiaries while cost centers appear to be aligned with centralized and decentralized departments (Rutherford and Stone, 1989). However, the simple dichotomy of CREAM structure into profit centers and cost centers is too limiting given that there are many factors influencing the type of optimal CREAM structure for the non-real estate firms. Finally, the role of CREAM units within the company, i.e., the real estate activities undertaken by the CREAM unit, is another debatable issue. Carn et al, (1999) report that the CREAM executive is often regarded as dealmaker whose main responsibility is real estate negotiations and transactions.

An effective CRE performance measurement system helps identify areas of deficiencies and set corrective actions into motion. Importantly, CRE managers need to identify the critical factors influencing the CREAM performance. According to Veale (1989), some important factors are: the presence of a formal and organized real estate unit, the use of management information systems for real estate operations, the use of real estate accounting methods, the frequency of reporting real estate information to senior management, the exposure of real estate executives to overall corporate strategy
and planning, the availability of information and methods for evaluating real estate performance and use and the performance of the real estate assets relative to overall corporate assets. Finally, Schaefers (1999) find that German firms with greater revenues and that employ more staff adopt a more proactive approach to CREAM. Hence size is another factor that could influence the CRE performance.

With a shift away from the narrow real estate perspective, business management concepts and analytical tools are increasingly being used for implementing CREAM. One such tool for the CREAM performance measurement is the Balanced Scorecard defined by Kaplan and Norton (1992). The advantage of the Balanced Scorecard is that it adopts a multiple measures of performance. Specifically, four perspectives of performance are included: financial, customer, internal processes and the organization’s innovation and improvement activities. In essence, it complements the traditional focus on financial measures (which tell the results of actions already taken) by assessing also the firm’s potential performance evidence through the organization’s learning capabilities. Amaratunga et al, (2002) argue that the strength of the Balanced Scorecard measurement system is its ability to express the CRE strategy in tangible terms. Liow et al. (2004) develop a balanced scorecard in the CREAM performance measurement of a mega-real estate in Singapore.

CRE risk management strategies must be integrated with the overall corporate risk profile. From a strategic perspective, corporate managers need to understand the types of risks associated with an organization’s CRE portfolio, assess the intensity of these risks within the corporate context and devise appropriate structure and strategies to avoid, insure, transfer, hedge or diversify the risks as appropriate. At least three major categories of the CRE risks are relevant. Financial risk relates the impact of CRE on both the P&L statement and the balance sheet. Some examples of these risks include reversion risk in lease/purchase decisions, liquidity risk, default risk and interest rate risk.
CRE ownership is also systematically exposed to the property market risk as any other property investors, quantified in term of volatility of real estate returns. Finally, business risk is linked back to the business. These risks include changes in the business condition, the firm’s competitive market position, the cyclicality of demand and the demand elasticity that will affect business performance. Consequently, the requirements for business real estate are affected.

Finally, in line with the move towards outsourcing in many parts of corporate life, non-real estate businesses in many sectors have started to realize that property is not their expertise. Even retailers with a long heritage of real estate ownership are not immune to this outsourcing trend. In particular, the implications for retailers and retail landlords about the long-term value of property in a world where electronic commerce is becoming important are immense: will online shopping reduce retailers’ demand for shop space? Will they want different types and specifications of space? Will they want it located in different places?

3. The Financial Perspective of CRE

By virtue of the large capital intensity in property investments, CRE assets can have a significant impact on the firm’s credit facility, its financial statements and its operating economics (Manning and Roulac, 2001). In addition, Miles et al, (1989) argue that real estate is capable of affecting many corporate financial parameters such as cost of equity, cost of debt, debt capacity, systematic risk and market-to-book ratio of a non-real estate firm. It is thus necessary for real estate to move into the mainstream of corporate financial management and its importance analyzed within the context of the “whole” firm.
Conceptually, the relationship between real estate and corporate finance is reflected in the balance-sheet model of a non-real estate firm. Figure 1 provides a skeleton of the balance sheet model. At least three financial decision issues emerge from the model.

Firstly, a non-real estate firm invests in properties, tangible fixed assets, cash, and other current assets. Properties include operational real estate and land and buildings held for investment purpose. As the resources are limited, investment in CRE has to compete with investment in other corporate assets. The dollar magnitude and proportion of the CRE holdings relative to the total tangible assets are strategic investment decisions. Hence the firm has to decide how much real estate, and the type of real estate, to hold in a corporate portfolio. These capital expenditure decisions are usually set by the nature of business and corporate objectives. For example, the firm having a property asset intensity (PPTY%) of 0.4 means that 40% of corporate resources are invested in operational and/or non-operational real estate and the remaining 60% are committed to investments in other fixed and current assets. Finally, although the type and proportion of assets the firm needs tend to be set by the nature of the primary business, some non-real estate firms might decide to invest more money in properties to reap capital gains and to diversify corporate risk.

(Figure 1 here)

However, the question of how much real estate to hold in a corporate portfolio is always debatable although there is some consensus that a benchmark portfolio should hold 20% real estate (Fogler, 1984). Little agreement has also been reached as to the level of CRE holdings (in both absolute and relative terms) that can be considered as “real estate intensive” or “real estate rich”. Moreover, because the importance of real estate varies between business sectors, it is not necessarily the case that larger companies are particularly rich in real estate holdings. Consequently, the understanding
by corporate management regarding the optimal proportion and importance of real estate in corporate financial statement is very limited.

Secondly, due to the lumpy nature of real estate and significant transaction costs, a non-real estate firm inevitably needs financing to invest in properties. Consequently, the firm has to decide on the proportions of its financing from current liabilities, long-term debts and shareholders equity. Such decisions have to be taken in the context of the firm's capital structure. Usually if the firm decides to invest a large amount of money in real estate, it has to raise cash from a combination of debt and equity for the required capital expenditure and this will inevitably affect its financial leverage and cost of capital. Furthermore, the firm can allow more debt in its capital structure if it owns significant real estate. This is mainly because real estate assets are usually used as secured collaterals for other corporate loans. However, higher financial leverage is normally associated with higher distress and bankruptcy risk if the firm is not able to sell off some of their properties in order to meet debt charge.

Finally, the management of operating cash flows is associated with the firm's net working capital (i.e. working capital = current assets - current liabilities). The inclusion of the real estate in the firm's asset structure is likely to create some mismatch between the cash inflows and outflows. This is mainly because real estate is a long-term investment and its acquisition usually involves significant capital outlays. Investment in the CRE would therefore strain the corporation's cash and liquidity and give rise to mismatch problems of maturity structure between the real estate holdings and corporate liabilities.

Empirically, the significance of the real estate on corporate balance sheet can be analyzed from estimating four financial ratios from corporate balance sheet: (a) real estate as a percentage of total tangible assets (PPTY %), (b) real estate as a percentage of net assets (PPTY/NA %), (c) real estate as a percentage of equity (PPTY/BV %), and (d) real estate as a percentage of market value (PPTY /MV %).
These four financial ratios jointly indicate the influence of the CRE holdings on the overall financial structure of the firm. As reported in Liow (1999), about 77% of shareholders’ funds of the “property-intensive” non-real estate firms are in the form of real estate.\textsuperscript{2} Property further represents about 62% of these corporations’ market value.

In addition to the direct impact of CRE ownership on a non-real estate firm’s financial position as discussed above, CRE also has a significant role to play in driving some non-real estate firms to achieve certain financial corporate objectives. During good times, some obvious motivations for a non-real estate firm to dispose of their CRE, either through direct sales or the sales-and-leasebacks (SLB), are to generate cash to finance a business expansion or capital acquisition, to provide additional working capital to the business or to strengthen the balance sheet by recognizing undervalued properties. Farragher (1984) find that most retailers view real estate assets as a source cash and/or a source of earnings. This seems to be a prevailing position among the retailers in Europe, as some have been jumping on the SLB wagon, with Germany’s Metro Group AG and France’s Carrefour SA being particularly active, using the money raised from the disposal to finance expansion into Central and Eastern Europe markets (Louko, 2004).

On the contrary, CRE is considered as a strategic asset in achieving certain corporate financial objectives in times of economic difficulties, and is often helpful in disguising any sign of underperformance in the company’s core business. This is particularly the case as the increasing focus by investors on financial ratios such as return on invested capital, return on equity and weighted cost of capital has caused corporate management to be increasingly conscious of the fact that real estate capital is likely not earning what it ought. During the 1997 Asian financial crisis period, several Asian major non-real estate firms sold their CRE to repay debts, raised cash for the business and improved their liquidity and earnings performance. Figure 2 shows the average property asset intensity (2001-2005) for the Asian listed retail companies. As
observed, retail companies in China, Taiwan, Japan and Korea appear to maintain a rather stable level of property asset intensity in their balance sheets; retailers in Hong Kong and Singapore appear to have taken a more asset-light approach by opting for lower CRE ownership in their balance sheets and hoping to improve their corporate performance.

(Figure 2 here)

4. The Capital Market Perspective of CRE

Capital markets today are putting tremendous pressure on corporate management to maximize shareholders’ value. As CRE is a major component in some non-real estate firms’ financial statements, one question of interest is: given that management is committed to increasing shareholders’ wealth, what role, if any, can CRE play in achieving that aim? This concern is justified on the ground since at least 20% of corporate value is property in non real estate companies, investors might reasonably expect at least part of the variance in stock returns could be traceable to the value of their CRE holdings.

The concept of shareholder value provides a direct capital market indicator to demonstrate to management how real estate could affect the health of the company (Louargand, 1999). There are two ways in which real estate might affect firm valuation. Firstly, occupancy costs play a very important role in determining the cost base and hence the net operating profit of the firm. The proportion of fixed occupancy cost to total business cost affects the profitability and return of the firm through the simple equation: \[ \text{Profit} = \text{revenue} - \text{cost}. \]

The second way is through its cost of capital. The presence of real estate on the balance sheet could mean a high cost of capital that includes a substantial risk premium to account for higher operating leverage arising from the ownership of real estate.
Another source of risk comes from the increased financial leverage as a result of financing CRE using debt. Financial theory postulates that cost of capital is the weighted average of cost of equity and cost of debt of the firm. It is able to influence the systematic risk and hence the pricing of the firm in the stock market. Higher CRE ownership normally suggests that the firm is likely to have a higher debt (i.e. high-geared). As debt financing has the effect of leveraging (positively or negatively) any changes in the company’s returns, a higher CRE / higher-geared firm may be riskier than a lower CRE / lower-geared firm, and consequently, will result in unfavorable stock market valuation.

The belief that CRE is undervalued – at least until a company is “put into play” – appears almost universally held by the corporate management and investment bankers. Properties that were purchased years ago are carried on the balance sheet for a fraction of their market value - real estate has been categorized as “latent assets” where value of the assets owned by a corporation might not be accurately reflected in its share prices (Brennan, 1990). For publicly listed non-real estate firms, their shares are valued in the stock market, whereas the CRE assets are valued by reference to the real estate market. Hence whether the CRE is valued by the stock market on a different basis from its market value is definitely of great concern to corporate management. One implication is that if share prices do not reflect the CRE at current values, there are arbitrage opportunities either for companies or in the stock and real estate markets!

The existence of “latent assets” justifies a corporation in “signaling” to the market the value of their CRE assets in order to encourage shareholders to capitalize any potential future value into share prices. As shareholders are concerned with the net present value of the firm’s current and future investment opportunities, several non-real estate firms are seeking and implementing feasible CRE asset strategies that would
enable investors to explicitly recognize the “hidden” real estate values and enhance the market valuation of the firms.

On a positive side, it has been documented that CRE acquisitions, leasing, dispositions, sell-offs, SLBs and spin-offs could have significant enhancing effects on corporate value (Rodriguez and Sirmans, 1996). One possible explanation is that sometimes the stock market fails to recognize the values of a non-real estate firm’ CRE holdings when they are held a part of the conglomerate and are carried at low balance sheet values. If investors think of (say) retail companies as retailers per se, then the share prices reflect this image rather than that of retailers with significant CRE holdings hidden in their balance sheets. Then, at the time of announcements of the real estate disposals or SLBs, the market value of the CRE would be disclosed, and if this has been underestimated, the share price will increase as the property assets are divested. Secondly, from the synergy perspective, negative synergy can be undone by getting back to basics (i.e. what a firm does best!). A retailer who combines his trading business with the CRE holdings may not optimize the use and value of the real estate assets. Instead, the firm will increase in value it sells the real estate assets to (say) a real estate company and concentrates on retailing. In such situations, the market will welcome favorably the surplus property sales or SLBs made by the retailer who hopes to release the values of the CRE assets that have been otherwise “hidden” in the balance sheet. Many examples of large UK retailers such as Burton Group plc, Next plc and Asda Group plc in the early 90’s might well support this argument. Another innovative change on store ownership is by J Sainsbury, the UK’s second largest food retailer who raised 340m pounds through SLBs of 16 food stores in 2001. The deal allowed the company to redevelop properties without seeking permission from landlords and to substitute other stores within its portfolio. The rents were set to only rise by one percent per year of the 23-year lease (Killgren, 2001).
The hostile retail environment characterized by rising costs, price inflation and increasing shareholder scrutiny is prompting more retailers to re-examine more closely at their property portfolios (Killgren, 2001). Consequently, many European retailers such as J. Sainsbury, Tesco, Marks and Spencers, Kingfisher, Carrefour and Metros have been selling their property portfolios over the past few years. The main motivations cited by these retailers are that they hope to rationalize the corporate capital use by focusing all the resources in the core business (i.e. retail) as well as reducing corporate debt. In the USA, when Kmart filed for bankruptcy in January 2002, the total value of the company’s real estate portfolio (including 1,513 stores) was valued at $879 million. In September 2004, the company was able to fetch $846.9 million through the sales of its 68 stores to Home Depot and Sears. Additionally, other giant US retailers with significant real estate holdings such as Home Depot, Wal-Mart and Toys ‘R’ were also successful in realizing significant gains from the undervaluation of their existing property portfolios in the real estate markets.

In the context of modern portfolio theory, CRE ownership may provide a diversification benefit to non-real estate firms. If this is the case, then those non-real estate firms with significant property assets would outperform, on a risk-adjusted return basis, similar firms (in the same industry) without any or have little real estate in their balance sheets. Consistent with the findings of Seiler et al. (2001) regarding the negative impact of the CRE ownership on the US firms; Liow (2004) find that CRE ownership in Asia is associated with lower returns, higher risks, higher systematic risk and poorer abnormal return performance particularly after the 1997 regional financial crisis. Moreover, the unfavorable (negative) stock market performance impact of CRE is consistent for the non-real estate firms from different industries and with different real estate holding intensity. One interesting implication here is that if there is lack of stock market benefits associated with CRE ownership, then it is obvious that non-real estate
firms are likely to own properties for other reasons in addition to seeking improvement in their stock market performance. We argue that these reasons may be broadly associated with cultural, institutional and financial factors. A case in point is that many Asian firms are still hanging on to their real estate assets even though real estate is neither the core business nor the only business at many companies. In contrast, Brounen et al., (2005) find that the CRE ownership for listed retail companies is generally associated with positive relative risk and risk-adjusted return performances. Expanding this body of CRE evidence is thus a fruitful area for future research.

Whether CRE is a “value-enhancing” asset has also recently received attention in the literature. In this regards, the concepts of Economic Value Added (EVA) and Market Value Added (MVA) are appropriate to measure the attractiveness of real estate as an asset class and as a business entity. Very briefly, the EVA measures whether the operating profit is enough compared to the total costs of capital employed. If the real estate impact of the EVA is zero, this means that shareholders have earned a return that compensates the real estate market risk. The MVA is identical by meaning with the market-to-book ratio. It is the difference between a company’s market and book values and is equal to present value of all the future EVAs. Increasing the EVA through its CRE assets, a non-real estate firm increases her MVA. Empirically, Liow and Ooi (2004) find that CRE ownership destroys shareholders wealth of Singapore non-real estate firms under the EVA and MVA metrics. The negative impact of CRE on the EVA (and MVA) prevails for non-real estate firms from different industries. In addition, the higher the real estate holding intensity, the greater the negative impact on the firms’ EVA and MVA. One major implication arising from the quest for value is that it would put greater pressure on the corporate management to review its competitive advantages (if any) of owing real estate since the inclusion of the CRE in a business portfolio is likely to decrease shareholders’ wealth. In some cases, divestment of non-core CRE might
become a viable option for the corporate management to boost their share prices. At the same time, corporate management will also be pressurized to boost returns through effective CREAM. According, the existing CRE assets would thus subject to more frequent and rigorous evaluation to justify their continuing inclusion in the firm’s asset portfolio. The CRE performance would also be benchmarked against the optimal cost of capital to support the business and real estate strategies.

With the move to outsource ownership and operation of real estate, there is a strong likelihood that more and more retailers will separate the real estate holdings from their balance sheets. This “asset-light” trend may also be accelerated with the development of Real Estate Investment Trusts (REITs) in markets such as Japan, Singapore, Hong Kong, Korea, Malaysia and UK. Thus, it makes possible for retailers to sell or SLB their CRE assets to the REITs, thereby reducing the amount of capital tied in the CRE. Nevertheless, for some retailers that have specific requirements for their business space, e.g. strategic location in prime retail areas for the high-end fashion retailers and specific space requirements for the large format retailers, they need to carefully consider the strategic role of the CRE in their core businesses. Figure 3 suggests the North American / West European /Oceania retailers appear to hang on their CRE assets, without any significant decline in their average property asset intensity observed over the last five years. Consequently, active asset management (i.e. CREAM) will assume a more important role if these retailers have to own some specific / specialized properties.

(Figure 3 here)

5. Concluding Remarks

The objective of this paper is to review and evaluate the role of CRE in non-real estate firms from a combined business, financial and capital market perspective. For
many non real estate firms such as retailers, property value is largely driven by earnings and alternative use. Operational requirements and profitability of space are the key driving forces behind their real estate decisions. Some retail companies have, nevertheless, a significant CRE portfolio as a good investment. Hence their real estate decisions are expected to be more complex. From the business perspective of CRE, although real estate profits are always to be encouraged, the need to service the corporation’s primary businesses must always be given the first priority. Moreover, from the financial perspective of CRE, since CRE affects financial parameters such as firm size, return on equity, debt capacity and market-to-book value ratio of the firm, it is important that CRE be moved into the mainstream of corporate financial management and its significance analyzed within the context of the “whole” firm. This means that a non-real estate firm must understand how its CRE holdings are affecting its total market value, and this must supported by a valuation model of real estate within the corporate setting. Linking real estate and corporate financial management, on an on-going basis, is thus essential to realign CRE assets through portfolio management and allow financial impact of the CRE strategies to be assessed accordingly in the context of shareholders value maximization (the capital market perspective of CRE). Although the trend to get capital out of the CRE (e.g. outsourcing) is expected to continue, some large retailers may still favour CRE freehold ownership particularly when properties house a strategic function or are integral to their retail operations.

Arising from the review and perspectives offered in this paper, it is evident that performance measures are required to assess how CRE are being used and perceived by management and investors from the business, financial and capital market perspectives. These multiple perspectives help to position the strategic role of the CRE in the context of “whole firm” that reflects the integration of trading and real estate activities. With an effective CREAM system endorsed by top management, the CRE’s
potential contribution and incremental performance can be factored into the financial plans of the "real estate intensive" retail firms and appropriately reflected in corporate valuation!

**Figure 1**

**Balance Sheet Model of a Non-Real Estate Corporation**

<table>
<thead>
<tr>
<th>Capital</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>CRE</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>Other fixed assets</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>Cash and Securities</td>
</tr>
<tr>
<td>Other provisions</td>
<td>Other current assets</td>
</tr>
<tr>
<td>Total value of the firm to investors</td>
<td>Total value of assets</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>Intangible assets</th>
</tr>
</thead>
</table>
Figure 2
Average property asset Intensity (PAI) for Asian listed retail companies: 2001-2005

Notes:
* PAI (property asset intensity): (property/total tangible assets) x 100%
* Data extracted from Bureau Van Dijk Electronic Publishing’s OSIRIS (OSIRIS is a comprehensive database of listed companies, banks and insurance companies) around the world. It contains information – income statement, balance sheet, cash flow statement, ratios, news, ownership subsidiaries, M&A activity and ratings – on 38,000 companies from over 130 countries including 30,000 listed companies and 8,000 unlisted or delisted companies.
Figure 3
Average property asset intensity (PAI): 2001-2005

Notes:
* PAI (property asset intensity): (property/total tangible assets) x 100%
* Data extracted from Bureau Van Dijk Electronic Publishing’s OSIRIS (OSIRIS is a comprehensive database of listed companies, banks and insurance companies) around the world. It contains information – income statement, balance sheet, cash flow statement, ratios, news, ownership subsidiaries, M&A activity and ratings – on 38,000 companies from over 130 countries including 30,000 listed companies and 8,000 unlisted or delisted companies.
References


Liow, K.H., Ooi, J.T.L., Ebrahim, M.S. and Brown G.R. (2002), Performance measurement and modeling for corporate real estate, unpublished research report, Department of Real Estate, National University of Singapore


Notes

1 Liow (1999) analyzes the CRE ownership and holding profiles of Singapore non-real estate firms from 1987-1996. He finds that about 75% of the firms adopt the “facilities management” approach by only holding business properties. Another 15-25% of the firms adopt the “asset management” approach and own some investment properties. Finally, about 5%-10% of the firms adopt the “business real estate” approach. Like other major mainstream real estate companies, these companies (mainly retail and hotel/leisure companies) also involve in development properties for owner-occupation, trading and investment. Additional updates of the Singapore CRE holdings from 1997-2001 (Liow et al., 2002) find that these percentages remain fairly stable.

2 A “property-intensive” non-real estate firm owns 20% or more of her corporate resources in properties.