# Creating Value with Strategic Asset Management

BY GORDON E. MACNAIR, SR/WA, AACI, P. APP

While a real estate appraiser's job is to place a value on the future benefits of a particular property, an asset manager's role is to realize those benefits. By working collaboratively, the real estate appraiser can help the asset manager achieve their objectives throughout the asset management cycle.

There are diverse complexities associated with real property asset management. In many cases, it may be in the company's best interests to have strategic professional staff oversee the process on behalf of the ownership.

## Asset Lifecycle Phases

Asset management has been defined as the process of creating value within the owner's objectives through the acquisition, use and disposal of real property assets. Alternatively, it has also been defined as the practice of maximizing the value of a portfolio of properties, within the objectives of the owner.[1]

The process begins with understanding the need and the owner's objectives, followed by planning, moving through the acquisition phase, the operation and maintenance phase, the refurbishment and enhancement phase, and, finally, the disposition of the asset. This is illustrated in Figure 1 – The Phases of the Real Property Asset Life Cycle.[2]

As outlined in *Corporate Property Management: Aligning Real Estate with Business Strategy,*[3] property is a corporate asset and is held either as an investment asset or as an operational asset.

Property held as an investment asset, like any other investment asset, is expected to earn a rate of return on capital employed for the holder and, particularly in the case of freehold, appreciate in capital value. Property held as an operational asset serves to support the activities of the business occupying the property. This type of property is sometimes referred to as corporate property.

The Phases of the Real Property Asset Life Cycle

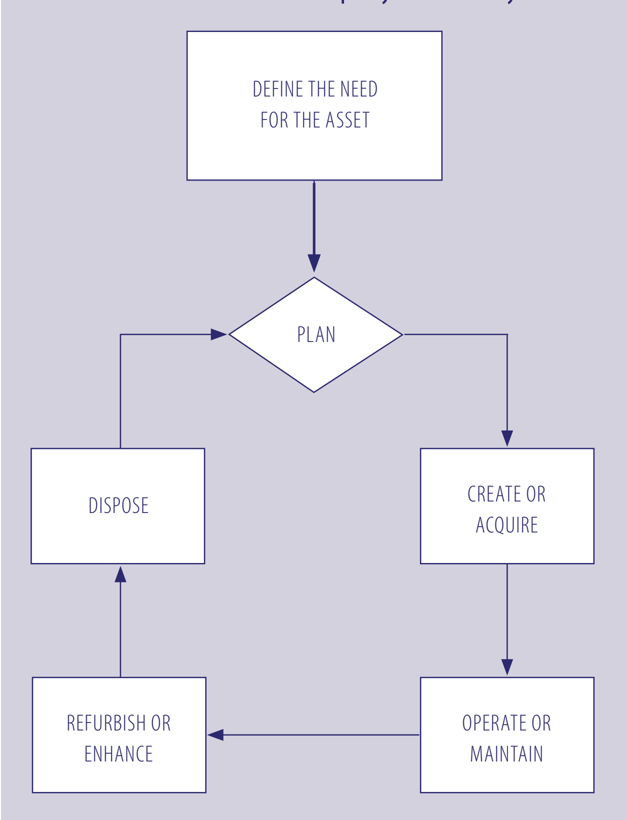


**Figure 1**


## *Public and Private*

There is a difference between private and public sector real estate objectives. From a private perspective, the primary driver is financial, since an acceptable return on the investment and capital appreciation is expected. However, it is recognized that, with current market demand, there are environmental sustainability needs that may be analyzed in order to address greening initiatives, such as LEED and BOMA.

With the public sector, the objectives are broader and consist of the four pillars: financial, social, cultural and environmental. It is a matter of balancing the various pillars to accomplish organizational objectives for the public sector asset manager. An example would be a large tract of land owned by the municipality. It may have subdivision potential, but over half of the parcel is a woodlot, which has natural environmental features. In this instance, it is possible that the municipality would probably retain all or most of the woodlot to satisfy its environmental objectives. Clearly, the financial return would be greater by permitting housing development, but this would be in conflict with municipality's environmental responsibility.

## *Asset and Ownership Objectives*

It is important to thoroughly understand the need for the asset and the owner's objectives, which serve as the foundation for building an asset management plan. The ownership objectives wil vary widely among individual, corporate, fiduciary and government owners. In addition to the identification of specific assets that align with the user's need, it is also relevant to consider the application of an effective methodology, which will help rationalize the acquisition of any asset. This will also ensure an appropriate and sustainable end-state property solution.

By definition, asset rationalization reduces the risk of improper acquisition. Some owners perceive real estate as an investment, while others possess real property for their own benefit and are simply interested in preserving the value of their investment. Most institutional and corporate investors have well-defined written goals in the form of policy statements or investment guidelines that are readily obtainable from their website.

A good example of this is readily available on the website for Brookfield Properties,[4] which states that the company "is committed to building shareholder value by investing in premier quality office assets and proactively managing each of our properties to increase cash flows and maximize return on capital."

From a public perspective, the City of Ottawa is proud to state on its website that it is "strategically driven to optimize the value of city-owned property holdings based on balancing the City's financial, social, cultural, and environmental objectives for these holdings."

## *Strategic Plan*

The role of the asset manager has evolved over the last 50 years, as cited by John McMahan in his book, *The Handbook of Commercial Real Estate Investing*.[5] This evolution is a result of real estate migrating from individual to institutional ownership and from the old practice of managing a few properties in a single market transitioning to a practice of managing a large portfolio of geographically dispersed properties.

Today's real estate asset manager is a multi-disciplined, highly trained real estate professional who is expected to not only be responsible for managing investment assets during the investment holding period, but to be an integral part of both the acquisition and disposition process. To ensure a strategic approach is employed, the asset manager may be tasked with a host of potential objectives.

Some examples of asset management objectives include:

- Support corporate objectives using the four pillars approach (financial, social, cultural and environmental) through redevelopment or other initiatives.
- Implement asset management strategies for all owned and leased facilities.
- Develop value-added real estate solutions for core and non-core assets.
- Stipulate strategic portfolio planning and expert real estate advice to ensure owner's real estate needs are met efficiently and effectively.
- Generate development strategies to maximize the value of corporate real property holdings.
- Identify effective options for ownership that support a balanced and affordable solution.
- Determine the portfolio's suitability and affordability in meeting the needs of all client groups.
- Develop facility and portfolio plans with recommendations for the disposition, remediation, redevelopment, retirement and/or retention of, and reinvestment in, those properties that are demonstrably sustainable, affordable and appropriately utilized.
- Analyze, rationalize, demonstrate and communicate the accurate whole-life cost implications of real property solutions or policies that are introduced in response to client needs.

## Acquisition Objectives

The specific reasons for purchasing or leasing real estate should be established up front as part of the owner's overall objectives. Some scenarios include the purchase of an existing property, purchase of a vacant site for development, redevelopment of an existing property or the decision to lease.

With any acquisition, the buyer and seller ultimately enter into a purchase and sale agreement, which serves as a legal contract between the two parties and forms the basis for how the purchaser will obtain control of a property. However, in some instances, a letter of intent may be prepared prior to this stage to outline the potential business terms.

## Due Diligence

With the purchase of real property, it is critical to perform the proper due diligence by investigating and verifying information as it pertains to the subject property. This important process should always be completed before an offer is made. However, if the offer is made first, it will typically include clauses that allow for the completion of further due diligence, such as title search, environmental investigation, building condition audit, designated substance profiling, engineering and structural reviews. The amount of time that a purchaser needs to satisfy due diligence requirements is a critical part of the negotiation process. Clearly, the transaction cannot close until the due diligence process has been completed.

Due diligence for a vacant parcel of land may include confirmation of zoning, official plan designation, satisfactory financing, obtaining an appraisal, title search, assessment of environmental issues, review of survey plan, consultation with the local municipality, determination of geotechnical condition of soil, private/municipal services, accessibility, review of future development in the area, development charges, off-site obligations, archaeological issues and wetland concerns.

Similarly, the due diligence process for an improved property might include all those noted for a vacant parcel, as well as a host of other considerations. These may consist of a building condition audit, review of lifecycle costs, historical operating costs, environmental issues within the building (mold or asbestos), copies of all leases (if an income producing property), any outstanding work orders, barrier free issues, code compliance, estoppel certificates for tenants, confirmation of chattels vs. fixtures, special local improvement charges, property taxes and confirmation of building permits.

## Whole-Life Costing

In the economic appraisal associated with evaluating asset acquisition proposals, whole-life costing[6] is a key component. An economic appraisal is generally a broadly based assessment, considering benefits and indirect or intangible costs as well as direct costs.

The whole-life costing model allows for the periodic lifecycle (capital) replacement of major components and systems, which, in turn, establish the cradle-to-grave requirement for measuring and managing a physical asset's useful life. A whole-life costing model can assist in determining the true value of any leveraging opportunity and to ensure the proper balance of risk and opportunity in structuring any leveraging arrangement.

In this way, the whole-life costs and benefits of each option are considered and usually converted using discount rates into present-value costs and benefits. This results in a benefit-cost ratio for each option usually compared to the 'do-nothing' counterfactual. Typically, the highest benefit-cost ratio option is chosen as the preferred option.

As part of this analysis, the cost of capital relative to business opportunity costs is an important consideration for the private sector and could result in choosing another option, such as leasing. With respect to the public sector, this would be balanced with the four pillars approach, and it is also recognized that the cost of capital is less than the private sector. Simply put, whole-life costing is analyzing the true cost of ownership. This is demonstrated with Figure 2.[7]

## Operations and Maintenance

Property management professionals who are responsible for overseeing the day-to-day operations of a property will typically maintain it. This usually includes custodial services, maintenance and dealing with tenants. At a more strategic level, the ownership will require a business plan for each property. This requires an ongoing review of the real property inventory, as well as financial reporting to the ownership on a regular basis.

As part of any effective asset management plan, an accurate inventory is required to describe all real property assets. The inventory database should be updated on a continuous basis. In addition, an inventory review should include a review of all leases or lease abstracts, rents, operating costs, lease rollovers, tenant relocation and additional rights, such as a first right of refusal or right to purchase.

For strategic planning purposes, real property assets can be categorized into core and non-core assets. Core properties are primarily used to accomplish the operational purposes or service-delivery objectives, which could include improved properties and/or vacant land. Non-core assets, which are functionally obsolete or near the end of their economic life, could be considered as surplus or underutilized. In essence, non-core assets are those properties that are considered to be excess to the corporate mission.

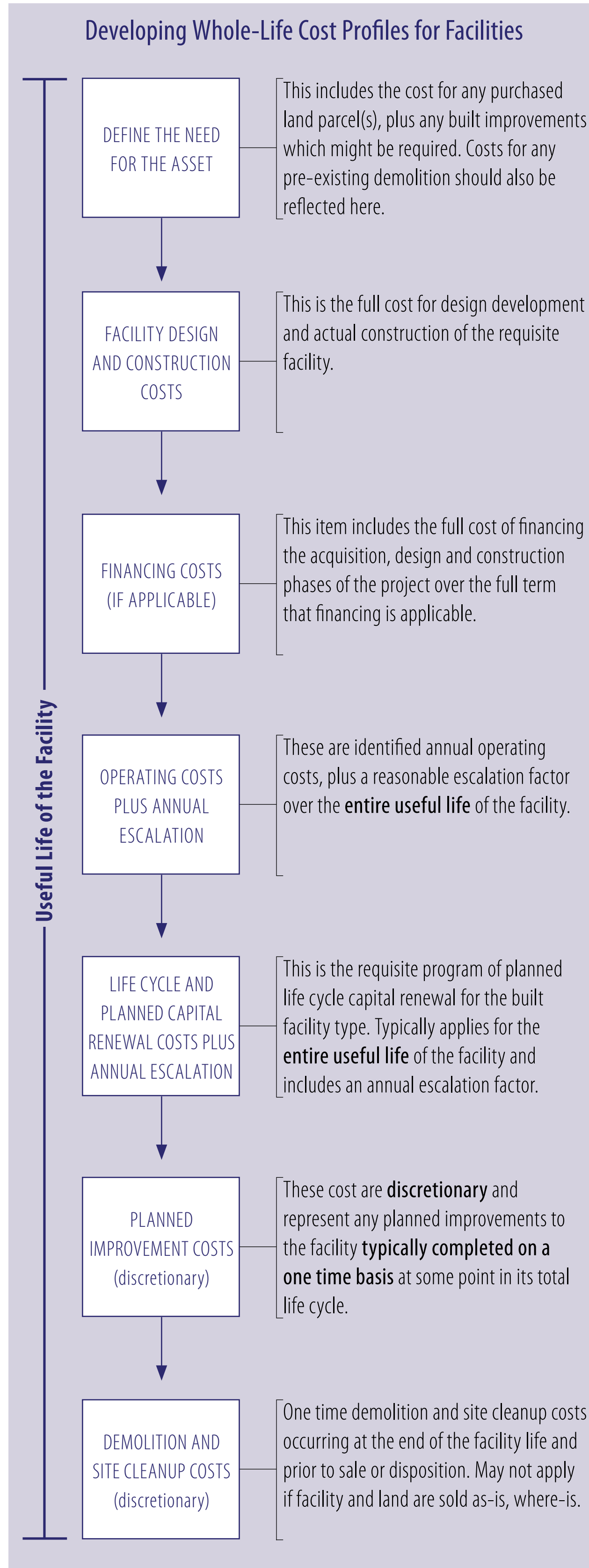


**Figure 2**

As part of any effective asset management plan, balanced performance measures must be in place to ensure that you are being competitive within the marketplace. Benchmarking is a form of measurement based on a continuous improvement process that can be compared and measured. This could result in outsourcing or insourcing of various functions.

## Refurbish/Enhancement Analysis

This stage includes a review of the owner's objectives relative to the current market conditions and completion of a cost-benefit analysis by the asset manager. Once completed, one or more of the following analytical tools can be used:

- Net present value (NPV)
- Internal rate of return (IRR)
- Return on investment (ROI)

The analysis may result in several scenarios, such as maintaining the status quo, initiating a change of use due to a highest and best use analysis, modernization or renovation of the property, and possible disposition.

## Disposal Decisions

Factors that may contribute to an owner's decision to sell can vary significantly, although financial reasons are typically involved. Some considerations may include whether it is currently a seller's market, if improvements are needed at the end of the asset's economic life, the cost for major lifecycle work, a change in ownership strategy, such as a lease to offer more flexibility, and the need for cash or liquidity.

Similar to the acquisition phase, the ownership would typically complete its own due diligence analysis before the disposal. Some areas to consider at this time would include commissioning an appraisal, confirming market conditions and business cycles, reviewing leases, rents and operating costs, obtaining estoppel certificates, conducting a title search to ensure that there are no surprises, identifying requirements for lifecycle work and completing a Phase I Environmental Site Assessment.

The ownership must also determine whether or not they are prepared to sell the property 'as is, where is' or alternatively, what warranties and representations they are prepared to accept. There could also be consideration as to whether or not there are any outstanding work orders or restrictions on title, such as easements and covenants that would need to be addressed. With respect to a marketing strategy, the type of property, market cycle, method of sale and geographic location are the types of factors that require consideration. For commercial properties, potential purchasers will be interested in the tenant mix, quality of tenant and contract rents, which are all components of the quantity and quality of income.

There are a number of options that an owner can choose for disposal, such as listing with a real estate broker, direct sale, auction and tender.

## Conclusion

The primary focus of asset management is the creation of value to achieve owner objectives. In the real estate ownership cycle, this process begins with understanding the owner's objectives, planning, and moving through the acquisition phase. It continues through the operation and maintenance phase, and the refurbishment and enhancement phase; and, finally, ends with the disposition of the asset. Due to the complexities of asset management, it is also important to have strategic professional staff overseeing this mandate on behalf of the ownership.

## References


[1] Asset Management, BOMI Institute, Defining Real Estate Asset Management, pg. 1-2

[2] Queensland Government Government of Works www.build.qld.gov. au/downloads/bpu/sam_overview.pdf

[3] Corporate Property Management: Aligning Real Estate with Business Strategy, by Victoria Edwards and Louise Ellison, pg. 4

[4] Brookfield Properties http://investors.brookfieldproperties.com/phoenix.zhtml?c=91790&p=irol-irhome

[5] The Handbook of Commercial Real Estate Investing, John McMahan, McGraw-Hill, 2006, pg. 164

[6] Wikipedia http://en.wikipedia.org/wiki/Whole-life_cost

[7] Real Estate Partnerships & Development Office, City of Ottawa.



**Gordon E. MacNair, SR/WA, AACI, P.App**

*Gordon is Director, Real Estate Partnerships and Development Office for the City of Ottawa and is a direct report to the City Manager. He is responsible for leading key development initiatives set out in Council's Strategic Plan, enhancing the value of the City's real estate assets, and setting long-range strategic real estate asset rationalization and management plans. Gordon and his team oversee all real estate matters for the City of Ottawa. Email gordon.macnair@ottawa.ca.*