

Operating Well

Actions That Managers Should Take in Turbulent Times

Part 1 of 3



Operating Well: Actions That Managers Should Take in Turbulent Times

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About Building Engines

Building Engines is a web-based suite of integrated modules that provides owners and managers of any property type with a comprehensive solution for improving operations and workflow management.

Building Engines helps companies increase occupant satisfaction, manage assets more efficiently, and limit exposure to risk and liability while reducing costs and enhancing management visibility into operations.

Advanced Technology. Superior Support. A Flexible Fit



Executive Summary

This white paper is designed for property owners & managers and is part of a series that focuses on the conditions created by the current economic crisis and the challenges and opportunities those conditions create. It outlines the actions that owners must consider and presents specific strategies, methodologies and systems for surviving and thriving in the real estate downturn.

Simply put, the contraction of the U.S. economy heralds a dismal performance for commercial real estate in the coming quarters. The current climate of a continuing decline in GDP and plummeting consumer spending, when viewed in conjunction with commercial real estate's traditional lag behind the national economy, means rough times for the industry in 2009 and 2010. Fortunately, that same lag provides owners and managers with time to prepare for and to benefit from the coming industry sea change.

To successfully adjust during the coming months, building managers need to capture building activity data to assess how their buildings are performing and identify which performance-influencing factors can be changed.

The challenging conditions that real estate managers face today require that they question their assumptions and embrace the tools and techniques necessary to stabilize, strengthen and then grow property NOI.

The following table summarizes our model of the effect of improved operations management in a property. It illustrates how real estate managers who are proactive will have the opportunity to generate significant value.

Effect
on
Cash
Flow

(\$ per SF)	Before	After
Effective Rent	\$36.00	\$36.05
Expenses	\$10.03	\$9.83
NOI	\$25.97	\$26.56

*Numbers for a typical 500,000 SF Class A Building

An increase in NOI of \$0.25 per square foot over a 500,000 square foot building for five years will result in \$625,000 in additional cash for its owners.

Introduction

This white paper will identify both the challenges the current economic climate presents and the key levers that building owners can use to preserve and then to increase asset value in the face of this challenge, focusing on those activities that are likely to have the greatest positive impact. The paper will also note less impactful, but still significant, operating improvements that drive building performance and it will suggest ways to pursue these within a property portfolio.

The Current Economic Climate

From 2003 until late 2007, the United States experienced unprecedented growth in real estate investment in virtually all sectors and markets.

Growth was fueled by a dramatic increase in available capital that drove up other asset valuations (e.g. housing, commodities) and that created an industry-wide epidemic of over investment, which drove down cap rates and sent valuations soaring.

By early 2007, valuations appeared unworldly and unsustainable - later that year, both observations came true. As institutional investors became skittish about the underlying credit quality of the massive amounts of asset-backed securities they owned, the value of those securities plummeted, lenders weakened and credit dried up.

As credit disappeared, the value of all classes of commercial real estate stalled in their upward march and began to deteriorate.

Credit is the modern economy's lubricant. Without it, the economic engine seizes. The commercial real estate industry is bracing for the effects of the downturn, and the possibility of a full-blown global recession.

Owners will face a challenging operating environment for several quarters, likely encompassing 2009 and 2010. Successful owners and managers through this period will look inward for relief, and refocus their operations to first survive and then to prosper.



Levers That Drive Down Cost

This white paper will focus on five areas of potential major cost savings in this white paper:

1. Improved Energy Management
2. More Effective Preventive Maintenance
3. Improved Staffing Management
4. Reduced Risk and Liability
5. Capturing More Billable Revenue

These factors are modeled in a financial analysis at the end of the paper.

The paper will also discuss two additional topics whose benefit is not included in the financial analysis:

1. Reduced Tenant Churn,
2. Green Building Initiatives

Levers That Drive Down Cost

Improved Energy Management

Building energy consumption presents a significant potential savings opportunity. Electric utility expenses are among the largest controllable operating expenses in some regions of the country. According to Energy Star, energy represents thirty percent (30%) of the typical office building's costs.

Controlling energy expenses begins with real-time data collection and equipment monitoring. With an integrated Web Based Operations Management system ("WBOM"), managers can collect interval data from a building's utility electric meters and analyze historical usage patterns to establish that building energy usage profile as in the graph below.

With that data, managers can:

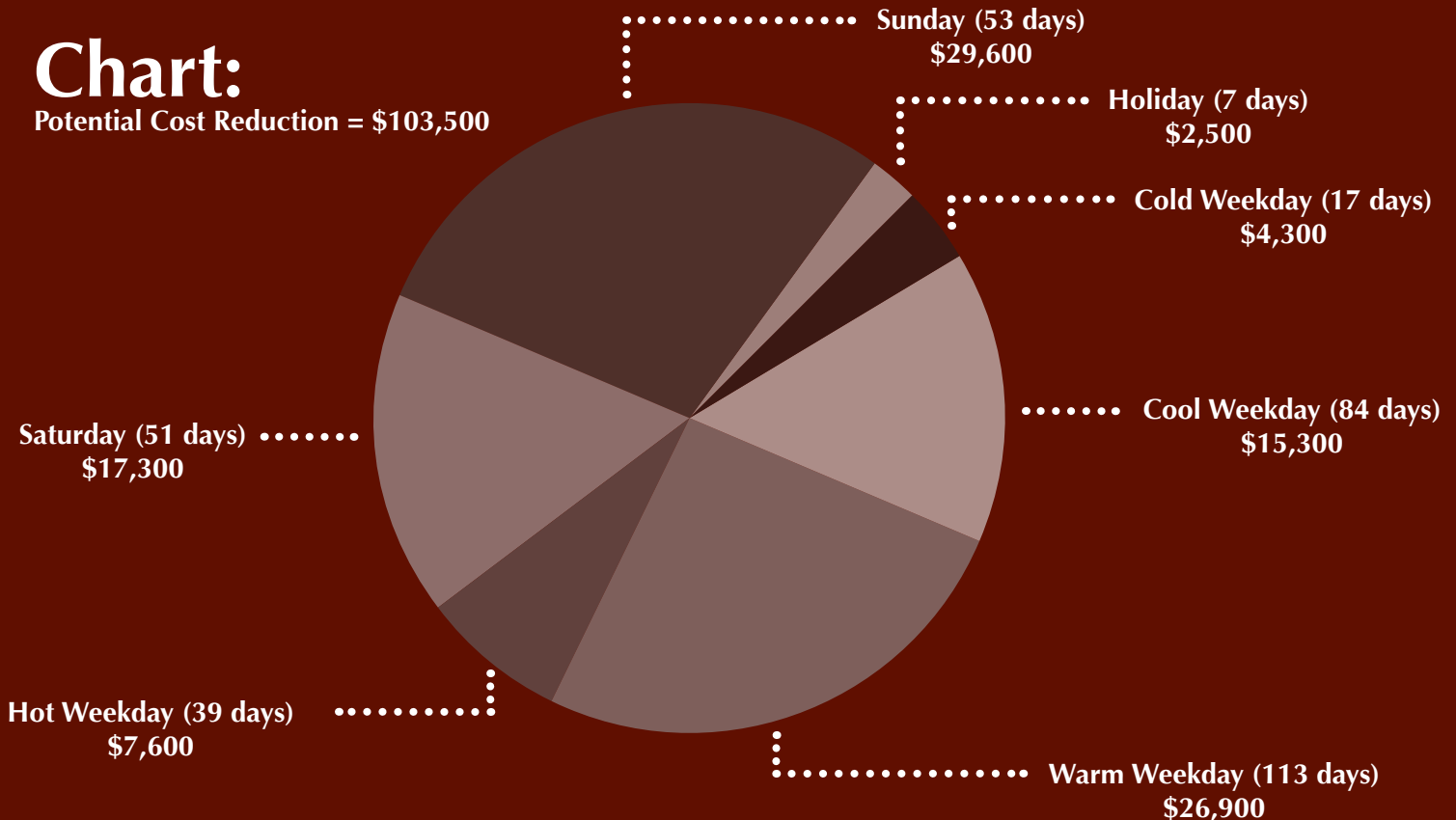
- Create more accurate electricity budgets, taking environmental factors into account,
- Establish usage thresholds and run variance reports,
- Identify out-of-threshold events and respond to them more quickly
- Identify savings opportunities and measure progress toward savings targets.
- Optimize building energy usage.

Owners using energy management tools in conjunction with a WBOM solution can average net savings of 5% on an annualized basis, which translates into net savings of \$0.10 - \$0.15 per square foot.

One of Building Engines' clients generated an ongoing cost reduction of \$103,500, or \$0.27 per square foot on a 400,000 square foot office property, using a variety of tools, including a WBOM, to monitor and manage energy consumption.

Chart:

Potential Cost Reduction = \$103,500



Levers That Drive Down Cost

More Effective Preventive Maintenance

Preventive maintenance is essential to quality building management and is the core activity of your property engineering team. More important, the single largest long term costs savings program an organization can implement is a standards-based preventive maintenance program.

Properly managed preventive maintenance schedules lead directly to extended usable life of your key pieces of equipment; better and more accurate warranty management; reduced equipment repair costs; longer and more reliable uptime on your major building systems, and happier, better serviced tenants.

According to a report on the value of preventative maintenance by Jones Lang LaSalle, a property manager whose building expenses are at market levels will experience an annual net saving (after investments in systems and processes) of \$0.33 per square foot annually from implementing an effective preventive maintenance program. Additionally, the paper found that a standards-based preventive maintenance program is much more cost effective than deploying new equipment.

In our financial model, we have conservatively assumed a savings of \$0.05 per square foot from implementing an improved preventive maintenance program.

Improved Staffing Management

The number one suspect in big-ticket savings is staffing. Ask yourself – does your staffing level meet the current need at your building? How do you determine what is an appropriate staffing level? Effective managers use data to determine the level of need and then match that need.



To illustrate what we mean by measuring need, we analyzed data generated by a commercial real estate organization with three Class A commercial office buildings, all of equal size, located in a major metropolitan city. This analysis focuses on the Engineering Department only in a portfolio where engineers were assigned to specific buildings, but also shared over the entire portfolio.

Using a WBOM system over a six month period, the property team collected enough data to create a load-to-resource analysis to measure staffing efficiency in the engineering department. It determined that its portfolio engineering staffing levels were in excess of the required need and that the engineering team could be reduced by at least one Full Time Employee (FTE), while maintaining a sufficient staff to address the work load and continue to meet required service level standards.

As a hypothetical example, consider a portfolio with 1.5 MM square feet of space supported by 10 building engineers with an annual FTE load (including benefits and payroll taxes) of \$60,000 per engineer. If each of the engineers completes 3.0 work orders or preventive maintenance tasks daily and, through improved systems and processes, is able to complete an additional 1.5 work orders weekly, the equivalent of one (1) FTE would be freed up to work on other properties, reducing property operating expenses by \$0.04 per square foot.

With the right tools in place, an owner can actually downsize staff and increase customer service by offering tenants multiple channels to access information about the building.

Levers That Drive Down Cost

Reduced Risk & Liability

Risk and liability reduction are a critical component of any operations management discussion. The core activities that pose increased risk and liability are:

1. Visitor management,
2. Incident management,
3. Certificate of insurance management,
4. Fire & life safety training and management, and
5. Emergency communications.

Through increased preparedness; rapid, more informed response; complete data capture; coordinated communications management, and comprehensive controls, property managers can reduce claims and mitigate insurance expenses. A WBOM solution better enables operations, finance, and risk managers to work as a team to achieve these results.

A leading private commercial real estate owner reduced its total incurred GL premium from \$30.65 to \$2.42 per 1,000 square feet over a five year period using a WBOM solution integrated with their risk management provider (a reduction in \$.028 per square foot annually). The costs savings directly enjoyed by the building owner included a 17% drop in the premium for buildings higher than 25 stories, a 55% reduction in premiums for buildings lower than 25 stories, and a 13% reduction in excess contingent liability.

The WBOM solution supporting these savings included integrated incident tracking, certificate of insurance tracking, fire and life safety, visitor access control, and broadcast communications functions. Their risk management consultant is an active user of the WBOM system, which enables:

- Immediate incident notification resulting in rapid response and reduced asset damage.
- Real-time fire & life safety performance audits providing to up-to-date contact information and exception reporting.
- Emergency response support resulting in full messaging capabilities and rapid response.
- Customized notifications for any incident providing the right information to the right person as quickly as possible.
- Full incident records capture producing data quickly and completely. Combined with “anywhere” password-protected access to information, managers can better mount a defense and prevent a claim.

We assume an annual saving of \$0.02 per square foot annually through more effective liability management.

Levers That Drive Down Cost

Reducing Operating Expenses

Capturing More Billable Revenue

Building owners lose up to 10% of their potential billable revenues to incomplete data capture, poor reconciliation and lost forms.

To be conservative, the model assumes that an additional 1% of non-tax operating expenses can be captured from tenants through more accurate and timely tracking of lease terms.

Reduced Tenant Churn

Reduced tenant churn increases effective rents by reducing downtime. It can also reduce money spent on tenant improvements and leasing commissions. Effective property managers achieve this by:

- Improving and maintaining customer service through real time communication with tenants,
- Ensuring a timely response to tenant requests (work orders), and
- Arming their leasing team with tenant activity data for renewal negotiations.

Detailed activity data gives the leasing team insight into the tenant's usage profile and can be used to demonstrate the quality of services provided.

The effects of reduced tenant churn are not included in the financial model.

Green Building Initiatives

Green building programs can also generate tremendous long-term savings. A recent white paper by the Leonardo Academy compared LEED data against data from BOMA's Experience Exchange Report 2007.

While the overall cost of LEED-EB implementation and certification ranged from \$0.00 to \$6.46 per square foot, the Leonardo Academy Report noted that LEED-EB certified buildings achieved superior operating cost savings in 63% of the buildings surveyed and that "the operating costs are lower for LEED-EB certified buildings than for the BOMA buildings for 7 of the 11 buildings..." surveyed.

In addition, green buildings are viewed favorably by the market. A recent report by Costar showed that LEED buildings rent for \$11.24 per square foot per year more than non-LEED buildings and had 3.8% higher occupancy rates. With a stream of new LEED projects coming on line in the next 1 – 3 years, LEED certification will be an important differentiator.

The effect of LEED certification is not included in the financial model.

Levers That Drive Down Cost

The following is a summary of a financial model of a typical, 500,000 SF, multi-tenant, Class A office building that illustrates how improved management can affect cash flow and value. The assumptions driving this model are described in the balance of the paper and are based on industry standards.

Benefits from Improved Operations

	Before	After	Difference
.....			
Revenue			
Effective Rent	\$36.00	\$36.00	NA
Bill Backs	NA	\$0.05	\$0.05

Total Revenue	\$36.00	\$36.05	\$0.05
.....			
Expenses			
Energy	\$3.00	\$2.90	(\$0.10)
Maintenance	\$1.00	\$0.95	(\$0.05)
Staffing	\$1.00	\$0.97	(\$0.03)
Insurance	\$0.03	\$0.01	(\$0.02)
Taxes	\$5.00	\$5.00	NA

Operating Exp.	\$10.03	\$9.83	(\$0.20)
=====			
NOI	\$25.97	\$26.22	\$0.25

An increase in NOI of \$0.25 per square foot over a 500,000 square foot building for five years will result in **\$625,000** in additional cash to its owners.

How You Get There

Improved communications, more accurate data tracking and more consistent processes are critical to capturing the savings that we have outlined here.

Using a Web Based Operations Management system will enable you to take advantage of the web and enable your tenants, managers and vendors to communicate in real time through a variety of channels. It will also enable you to set up consistent work flows and procedures, track and store key documents and standardize request and maintenance procedures.

With a WBOM Solution, an organization will:

- Improve energy management and drive down energy costs,
- Run a standards-based preventive maintenance program, reducing capital costs and maintenance expenses,
- Make staff more productive, reducing the staffing cost per square foot of managed property,
- Reduce risk and liability by accurately documenting minor events as they occur - consequently driving down insurance costs,
- Capture more billable revenue by accurate tracking lease terms and making that data available to the entire management team.

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