BOMA·Kingsley REPORT

Practical Industry Intelligence for Commercial Real Estate

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Data Drives Performance

By Lorie Damon, Ph.D

There's no question that measuring operational performance is key to running a good, profitable business—particularly in commercial real estate. As an asset class, commercial office buildings lend themselves to data-driven decision-making, in part because their operations are imminently "measurable." From the standards for measuring and classifying the office space itself, to metrics for tracking income and operating expenses, to gauging consumption of energy, water and other consumables, the office building industry offers countless opportunities for tracking performance. And, savvy property, facility and asset managers not only measure these elements of an asset's performance, but use them to drive value to building owners.

As market conditions continue to pressure managers to deliver strong NOI, the desire for tools to track various elements of performance has only increased. In this edition of the *BOMA•Kingsley REPORT*, we explore BOMA's 2011 *Experience Exchange Report®* (*EER*) and highlight the aggregate changes in office building expenses in the last year. We also explore the changing impacts of increased density on office building operations—and highlight ways in which traditional models for leasing space and allocating operating expenses back to tenants are becoming increasingly inadequate as the "Twittersphere" gives rise to densely packed "collaborative workspaces." And, we explore the next generations of benchmarking, as emerging technologies converge with occupier demands to drive better, faster, "real-time" data into the hands of both occupiers and managers of office space.

The Numbers Tell the Story

By Phil Mobley

The 2011 BOMA *Experience Exchange Report* (*EER*) is a unique tool for real estate professionals across the United States and Canada seeking to create performance benchmarks on office building operations. But the wealth of available data also affords the opportunity to examine trends in the industry at large and test the validity of some commonly held assumptions. Even a brief, high-level look at this year's data set is revealing. This report will look at only a few of the key takeaways from this year's data set.

But first, here are a few clarifying notes about the analysis. While the *EER* contains information from 6,572 office buildings across the United States and Canada, this trend analysis focuses only on buildings meeting a specific set of criteria: those for which data was submitted in both 2010 and 2011, whose total rentable area did not change by more than 10

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percent and whose occupancy did not change by more than 15 percent. This two-year, same-building analysis nets out the potential impact of changes in occupancy, building size and overall building composition, thus providing a truer picture of the trend in building expenses. This year's same-building data set includes 1,790 buildings and represents nearly 375 million square feet.

General Expense Analysis

During 2010, owners and operators of private-sector office buildings in the United States spent $0.07 more per square foot than in 2009—an increase of about one percent. This followed a decrease of similar magnitude from 2008 to 2009 and is not surprising given the low rate of inflation in 2010 (the Bureau of Labor Statistics reported a non-seasonally adjusted increase in the Consumer Price Index of 1.5 percent as of December 31, 2010).

This modest increase was by no means uniform. The largest increase in percentage terms occurred in the repairs/maintenance category, where expenses increased an average of $0.07 (4.1%) per square foot. Roads/grounds expenses were up only $0.01 per square foot, but that represented a 3.6 percent increase for this small category. Rounding out the major non-utility categories, administrative expenses increased by $0.02 (1.6%), while cleaning and security expenses were essentially flat, with increases less than one percent.

Key Trends in 2010

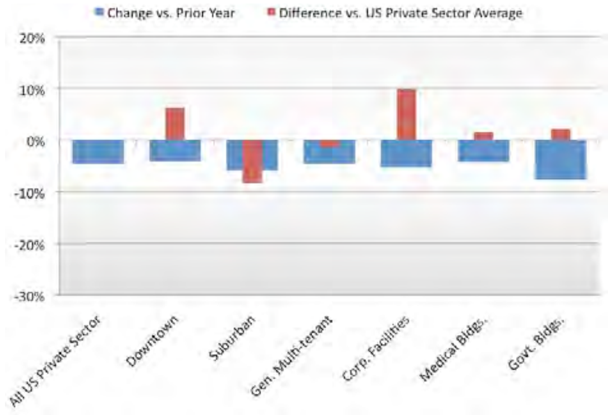
But the most interesting operating expense trend in 2010 was a continuation of something that began in 2009: decreasing utility expenses. Managing utility expenses through design, operation and consumption has clearly been a key focus area in commercial real estate, and the fruit of these efforts is visible in the form of a savings of $0.11 (4.3%) per square foot over 2009. Further, as the charts illustrate, the decrease is broad-based, both by building type and geography.

Perhaps an even bigger—if less surprising—story was the decline in fixed expenses. Fixed expenses (which are overwhelmingly comprised of real estate taxes) fell $0.40 in 2010, a decrease of 8.8 percent. Moreover, this decrease in fixed expenses was more than large enough to offset the modest increase in operating expenses. In a market that yielded a relatively slow flow of capital transactions in 2010, it is apparent that anecdotal reports of successful tax appraisal appeals have been accurate.

Digging Deeper

Office buildings are far from monolithic, and the *EER* tracks dozens of building demographics that allow its users to zero in on the most relevant comparative information possible. At a high level, the downward trends in utility and fixed expenses are broad in nature. Even so, a glance at general location and building type reveals some fascinating subplots.

Utility Expense Comparison—Building Types

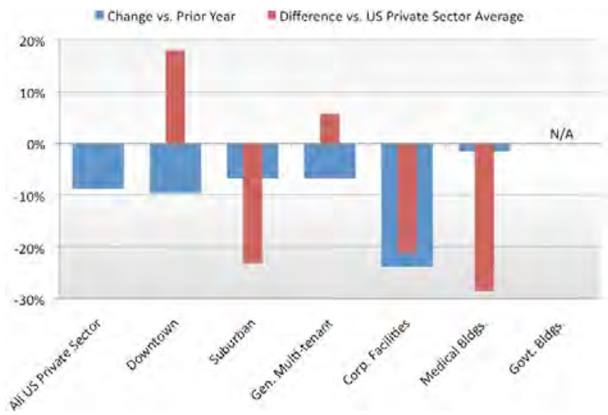


As the "Utility Expense Comparison—Building Types" chart indicates, utility costs were, on average, 6.2 percent higher at buildings in downtown locations for 2010 when compared to all U.S. private-sector buildings. Conversely, suburban buildings experienced utility costs 8.4 percent below this average. But the downward trend was similar for both, with a 4.2 percent decrease for downtown buildings and a 5.9 percent decrease for suburban.

There was a similarly consistent trend across major building types in 2010, though it is notable that government buildings outdid their private-sector counterparts in utility savings with a 7.7 percent decrease (compared to 4.6% for U.S. private-sector buildings). And, despite a 5.3 percent decrease that exceeded the overall trend, corporate facilities continued to report relatively high utility costs—9.8 percent above the U.S. private-sector average.

The "Fixed Expense Comparison—Building Types" chart illustrates that the trend in fixed expenses, while similarly downward, was less consistent across location and building type than that of utility expenses. Buildings in downtown locations saw a substantial decrease in fixed expenses (down 9.6%, by implication, through relatively steep valuation adjustments), but still reported expenses 18 percent above the U.S. private-sector average. Fixed costs at suburban buildings decreased only 6.8 percent, but remained 23.1 percent below average.

Fixed Expense Comparison—Building Types

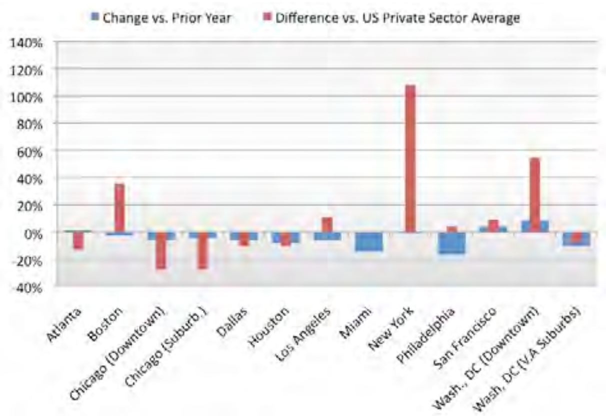


Differences in fixed expenses are more pronounced across building types. Corporate facilities (doubtless by virtue of their highly motivated occupants) led the way with a stunning 23.8 percent decrease from 2009 to end up with 21.1 percent lower fixed expenses as compared to all U.S. private-sector buildings. Medical buildings, on the other hand, saw a much smaller annual savings (1.5%), though they still have low relative fixed expenses, at 28.6 percent below average.

Market Variability

Equally interesting are variations in these two categories across private-sector buildings in the major markets in the United States. While the general trend of lower utility and fixed expenses held in most cases, there were exceptions. Atlanta and San Francisco both experienced slightly rising utility costs (up 1.3% and 4.1%, respectively), though Atlanta was 13.1 percent below the U.S. private-sector average for 2010 and San Francisco was 9.2 percent above. Washington, D.C. experienced one of the more peculiar trends in this year's results: Utility costs in the District of Columbia proper—already 54.8 percent above the national average—increased 8.3 percent, while in the Virginia suburbs they fell 10.3 percent and were 7.6 percent *below* the national average. Miami and Philadelphia are both notable for the magnitude of the utility expense decreases they witnessed (14.4% and 16.8%, respectively). Utility costs changed very little in New York (down 0.9%), but remained extremely high at 107.8 percent above the national average. Chicago remained a market with relatively low utility expenses—27.5 percent below the national average downtown and 27.4 percent in the suburbs.

Utility Expense Comparison—Markets



With respect to fixed expenses, buildings in Chicago enjoyed the most substantial savings vs. 2009 among the largest markets. Downtown buildings reported an average fixed expense decrease of 18.4 percent, while fixed expenses were down 29.6 percent in the suburbs. Fixed expenses were still relatively high in downtown Chicago (43.5% above the national average, compared to 23.8% below in the suburbs). Double-digit percentage decreases also occurred in Houston, San Francisco

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The Next Generation of Benchmarking

By Lindsay Tiffany

With a lack of transaction activity and a limited amount of available capital, the last few years have ushered in a back-to-basics approach to building management where maximizing operational efficiencies is key. To stay competitive in a tight market, the reasoning goes, you have to know what it costs others to do what you do.

Many companies rely on the *Experience Exchange Report (EER)* to give them an edge. At CB Richard Ellis, asset managers use the *EER* when evaluating the upcoming budget year compared to historical trends for the major expenses categories. "In our forecasting, we analyze market data, asset data and the comparable property data, which includes the *EER* data," says Pam Huning, director, Asset Services, CB Richard Ellis. "We use it to evaluate our cost per foot compared to what's going on in the marketplace."

William Jegher, vice president, Ernst & Young Real Estate Services Inc., also uses it to evaluate operating costs: "The *EER* is a great way to see how your property is operating vis-à-vis the guy across the street. Let's say you're operating at a level higher than the guy across the street on certain cost items. The *EER* helps you identify that. From there, you have to find the reason behind it and implement an action plan to try and get to a competitive cost."

Cushman & Wakefield has established a sophisticated benchmarking system that is modeled on the *EER* data charts, but that is customized to fit the needs of its clients. "We recognize that, since we manage corporate facilities as well as investor-grade properties, there are a number of facility-specific expenses that are not included in the *EER*," comments Gary Merron, CPA, senior managing director, Global Head of Financial Management, Corporate Occupier & Investor Services, Cushman & Wakefield of Pennsylvania, Inc. "We've created our own categories of accounts, such as concierge services, daycare services, gymnasiums—all things that are provided by a corporate facility."

Merron is now exploring what he calls the next generation of benchmarking. "Benchmarking is not just about cost per foot. There is an awful lot of benchmarking that is necessary outside of that. We are also measuring consumption, productivity and sustainability," he says. Productivity, for example, will include statistics like the total cost per foot of running the building divided by the number of client employees, the number of leases in the building divided by the number of Cushman & Wakefield accountants working on the account and the number of mail room employees per square foot.

While there seems to be an adequate supply of detailed benchmarking information available to property professionals, some clients are continually asking for more. Remarks Merron: "More and more of our clients are asking for very specific benchmarking, almost on a daily basis in different parts of the country. Technology is finally making it possible to deliver that data with increased frequency. Now, we are just waiting for the utilities industry to catch up with us on cost segregation."

Deconstructing Density

By Laura Horsley

You don't have to work at Facebook or Google or any of the Silicon Valley behemoths to know that the big corner office, or any office for that matter, is becoming a threatened if not endangered species in some office environments. An increasingly mobile workforce is spending more time in home offices and on the go, and, when they do come "into work," they are collaborating with co-workers in team spaces with more open floor plans.

Blake Peterson, MBA, RPA, LEED AP O&M, senior property manager with Ashforth Pacific of California, LLC, sees the second wave of the tech boom creating a more sophisticated workforce. "This workforce wants very collaborative spaces, so they're much smarter than the dotcom crowd that came in and wrote big checks and took tons of space," says Peterson, who explains that collaborative space might include conference rooms with removable walls and rolling desks that can move to designated team space at any moment.

This changing office environment allows for more workers per square foot and more collaboration, as well as more challenges for the property professionals that manage and benchmark their buildings. "The way most buildings are set up is based on the assumption that all users [tenants] are doing the same thing—if two tenants lease the same amount of space, it's assumed that they will flush the toilet the same number of times and use the same amount of toilet paper," explains Peterson, "but if one of those tenants doubles their headcount, their consumption is also going to be doubled. Leases are written so that tenants will continue to pay their cost per square foot of the building, but, as a manager, you may have to increase overall expenses to accommodate the extra wear and tear and demand on consumables as occupancy increases."

Large accounting firms and companies with employees that spend the majority of their time at client sites are reducing square footage through space strategies such as hoteling, where employees are assigned space for the days they are in the office. When they are not in the office, that space is filled by someone else, thereby reducing dead space and empty offices.

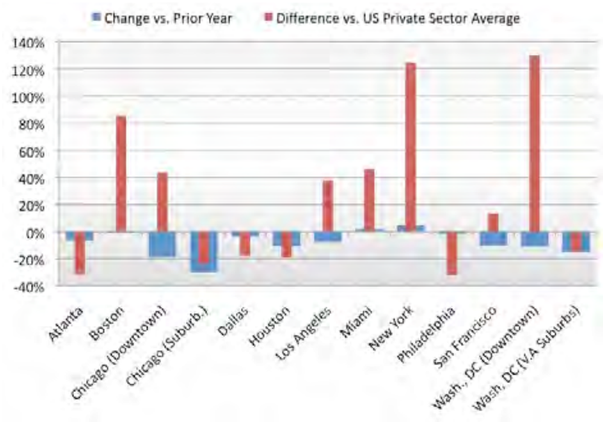
The public sector is also rethinking density. Plans are under way to redesign the space of the D.C. headquarters building of the U.S. General Services Administration (GSA) from a space that currently accommodates 2,500 people to one that accommodates 6,000 people. This is part of GSA's enterprise-level plan to modernize public buildings to provide more green, flex space to meet the demands of a more mobile workforce.

Interesting to note is that the trend toward increased density is occurring at a time when square footage per worker is actually ticking up slightly nationally. 2011 *Experience Exchange Report* data showed an increase of one square foot per office worker. This incongruity is due, in part, to the prevalence of shadow space or space that is leased but not occupied—and, in many cases, is tied to downsizing. Relatively healthy firms making efficient use of space are slowing the shadow space trend.

and Washington, D.C. On the other end of the spectrum were New York, where fixed expenses actually increased 4.9 percent, and Miami, where they increased 2.0 percent.

Irrespective of time trends, Atlanta and Philadelphia were among the markets with the lowest fixed costs in 2010 (31.3% and 31.5% below the national average, respectively). Boston (85.8% above the national average) and New York (124.9% above) had relatively high fixed costs. As with utility costs, Washington, D.C. was again mixed, depending on location. Despite annual decreases similar to those in the Virginia suburbs, the District of Columbia proper led all major markets with fixed costs at 129.7 percent-above the U.S. private-sector average, while the suburbs reported fixed costs 14.7 percent below average.

Fixed Expense Comparison—Markets



Some Conclusions

The 2011 *EER* clearly shows that building owners and managers were locked in on controlling utility costs and receiving equitable tax treatment in 2010. While there is no indication that this will change any time soon, the increase in repairs/maintenance expenses hints that this may be an additional area of focus for 2011. Even so, market realities in some geographies make expense control particularly challenging. Macro trends, after all, are created by the sum of individual efforts. With employment stagnant and the larger economic outlook far from certain, there will be continued pressure to manage all the expenses tracked by the *EER*. BOMA

Access the 2011 *Experience Exchange Report (EER)* by visiting www.bomaeer.com.

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