BNP PARIBAS REAL ESTATE

WHITE PAPER

MANAGED OFFICE SOLUTIONS

DEFINITIONS, MODELS, FINANCIAL PERSPECTIVES & TRENDS

INTRODUCTION

In today's dynamic market, many occupiers are looking to move away from the traditional methods of acquiring property such as buying and long-term leasing, and adopting accommodation strategies that are flexible and more risk averse. One such option that promises to deliver on these benefits is Managed Office Solutions (MOS). Attracted by the potential of this new demand a number of suppliers have entered the market to supply this service, including; Port@l, Instant Offices, Managed Office Solutions, Avanta and the Asset Factor.

Nonetheless, there is a scarcity of information on this subject and occupiers and suppliers alike are confused about the concept of MOS, how it is defined and what it really offers. For example a recent workshop/forum, including representation from many of the above mentioned companies, failed to fully agree on a unified definition. As a result of this white paper research, the following working definition was reached:

Managed Office Solutions is the provision of accommodation configured to the exact requirements of the occupier at a location of their choice, comprising completely managed facilities with a fixed price per workstation during the contract length, with no capital expenditure or risk carried by the occupier.

According to some providers of MOS however this definition conflicts with some of the MOS offerings now being promoted by traditional serviced office providers which they believe to be just a simple re-branding of the 'serviced office' concept. Others such as the Business Centre Association ('BCA')[i], the trade body representing the flexible space market whose 860 members accommodate some 40,000 customers of all sizes, from start-ups to FTSE 250, prefer the term 'managed business space'. They believe it offers the twin attributes of flexibility and customer service and that managed business space is not just offices and serviced offices, but also includes business centres incorporating small workshops/industrial units and studios.

This white paper therefore attempts to explain what MOS is, what it is not, and how it compares to other options for acquiring and accessing property and office space. In addition, the document highlights the balance sheet and cash flow issues that are associated with MOS, while also considering its future, both in terms of the demand and supply of such products and services.

About the Author

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DEFINING MANAGED OFFICE SOLUTIONS

A fundamental challenge for the uptake and success of MOS is partly due to an imprecise definition of what the concept actually means. It has been suggested that MOS aims to *"Bridge the gap between traditional leasing and serviced offices"*[ii], where the latter is a highly effective solution for small or short term occupation and the former for larger, long term needs[iii].

The key characteristics comprise at least some of the following elements:

Term: not as flexible as serviced offices, but with negotiation, MOS can introduce levels of flexibility unheard of in traditional lease agreements

Location: not restricted to fixed locations, some providers also offer MOS on a green field 'build-to-order' basis

Low capital investment: accommodation is typically provided 'business ready' on an operational 'service' type contract on a per workstation per month basis

Risk: risks associated with property acquisition holding and disposal, are transferred to the solutions partner, who is better placed to manage that risk, allowing companies to focus on core business activities

Phased occupation: contracts can allow occupiers to 'fill' a building on an incremental basis rather than take the entire building on day one

Bespoke/turn-key: location and office space design is determined by the occupier and not the provider as with serviced offices

DIFFERENTIATING MOS FROM SERVICED OFFICES

"At the moment there is much confusion within the property profession between Managed Office Solutions and Serviced Offices, they both offer similar characteristics – the main differences being that MOS typically offer solutions to larger organizations and occupiers can choose where they wish to locate rather than being restricted by the location of the serviced office provider."

Matthew Wylie, Hewlett Packard (Director EMEA Real Estate HP Enterprise Service. Chair, CoreNet Thames Valley Branch)

The industry is already familiar with the concept of serviced offices, that are ideally suited to smaller businesses or larger companies which need a small city centre office on a short term basis. The occupiers in these centres include a high proportion of firms local to the centre[iv].

Serviced offices offer the greatest level of flexibility in terms of space and term, but are limited in the choice of location, which is typically within a city centre. They can also attract a heavy price premium once certain parameters such as number of workstations and length of stay have been reached; therefore they are less suitable for organisations wanting to accommodate larger numbers of staff on flexible terms. Furthermore, occupiers are normally restricted to using the infrastructure as supplied by the centre for example telephony, IT which again can be price prohibitive. Also, there is little or no ability for the occupier to project their own brand in a way that they would at their own facility. In fact, it is the serviced office provider's brand that is likely to prevail.

MOS is a similar concept that offers typically larger businesses fully functional office space for a fixed monthly cost. However, with MOS, the equipment needs and office design can be bespoke to the business's needs and requirements. The key characteristics of MOS are twofold; firstly, there is more choice in terms of influencing the location and design of the office space to ensure that it fulfils all of the business needs and secondly, there is more flexibility within the contract to increase or decrease workstation requirements as business demands change.

TIME FOR OCCUPANCY

There is a perception from some property professionals who have yet to embrace MOS that, depending on the complexity of their business needs, acquiring office space through the MOS may be time-consuming, as the service provider may have to build or redesign current offices to meet the business needs. However, occupiers such as Vanquis Bank were able to move into a new headquarters two years earlier with MOS, compared with using a traditional lease approach.

Even if the timings are similar, MOS can take away a significant element of the property risk as it ensures that businesses obtain offices that are tailored to their needs, and even though these requirements can be considerable in terms of capital investment, this investment is shouldered by the MOS provider and not the business itself. As such, both the hassle and risk is transferred to the service provider.

MANAGING THE SUPPLY CHAIN

Unlike other models MOS includes a bespoke service with one partner/provider who, not only delivers the required buildings, but who also simplifies the operational supply chain involved in property and office management. This means that the occupier only deals with the service provider, who in turn manages contractors, water supply, electricity, security, parking, internet connection etc. This allows the occupier to focus on its core business activities.

MITIGATING RISK – HANDING CONTROL BACK TO THE OCCUPIER

MOS offers a more bespoke and turn-key option, as it is the occupier that decides location and layout, and the capital investment and risk is taken by the service provider, who procures the property and manages the fit-out. This may include communication rooms, cabling, IT, power provision, workstations, kitchen and break-out facilities.

ALIGNING PROPERTY PORTFOLIOS

According to the British Property Federation (property review 2010), the average lease has now dropped significantly over the last two decades from 21 years in 1991 to 5.9 years in 2010[v]. However, for many organisations even this period is beyond any sensible business planning horizon, even if a break period is included in the deal these often cannot be exercised due to high exit costs. The contract lengths for MOS, however, differ and typically range from 3-5 years and therefore enable companies that typically require 100+ workstations, to more closely align their accommodation requirements with their actual business needs. Furthermore, at the end of the term, as MOS is based on an operational contract, they have options to extend, or exit without any costs, such as dilapidations or legal fees.

MOS can provide greater flexibility in terms of location and service, and the contract can be designed to incorporate the company's growth or reduction, ensuring that businesses can respond more rapidly to changes in the market environment.

THE CHARACTERISTICS OF MOS COMPARED WITH OTHER PROPERTY SOLUTIONS

	Serviced offices	Leasehold	MOS
Size of organization*	Less than 100 workstations	1+ workstations	**100+ workstations**
Location	Restricted by service provider	Free choice at start of contract but fixed for term of lease – 8 plus years	**Flexible, but fixed for term of contract typically 3 plus years**
Average Term (typical)	1 month	Approx. 6 years	**3-5 years**
Capital Investment Risk	None	High	**Low**
Time to occupancy	Immediate	9 months +	**3 months +**
Degree of flexibility of occupation (potential to upsize/downsize	High	Low	**Medium**
Ownership options	None	Possible opportunity to buy at end of lease	**Options to change ownership can be built into contract**
How are they costed?	Per workstation per month	Per Sq Ft per annum	**Per workstation per month**
Exposure to property risk	None	High	**Low**
Exit Costs	None	High	**None**

MOS VERSUS LEASING – THE EFFECTS ON BALANCE SHEET AND CASH FLOW

Compared with traditional leasing, MOS has a number of financial advantages:

1) New regulation, which is expected to be enforced in 2013[vi], requires all property leasing to be included on the balance sheet. This means that the balance sheet must include the fair value of the leased property, or, if lower, the present value of all minimum lease payments. Since property is often one of the biggest expenditures for companies, the increased level of asset and debt can have significant effects on corporate key financial indicators. For example, this could lead to lower return on capital and higher debt-to-equity ratio, which in turn could have implications for borrowing capacity[vii].

   One advantage of MOS is that property rents and other payments are currently not part of the balance sheet, because they are considered to be an operational cost. Furthermore, because the MOS is fully functional and can include the necessary equipment such as computers, the business also reduces its capital costs.

2) With traditional leasing, a firm invests in a property, paying for both maintenance and office space. This means that the cash flow expenditure for property/office is uncertain and is likely to fluctuate. But with MOS, occupiers pay a fixed price per workstation, and any maintenance or fitting of the property is paid for by the MOS provider. The fact that the occupier pays a fixed price per workstation also ensures that payments reflect the actual needs of the occupier, whereas with leasing, occupiers often pay a fixed price per sq ft, leading to wastage if the occupier does not utilise all of the property. Consequently, MOS can significantly reduce overhead and administration costs since the property is fully equipped and managed and may also include both receptionist and security personnel[viii].

WHO IS USING MOS? – OCCUPIER CASE STUDIES

Vanquis Bank (part of Provident Financial)

By adopting the Managed Office solution approach Vanquis Bank, part of Provident Financial, was able to acquire a new operational headquarters in Chatham, Kent, to house its 400 plus employees two years earlier than would have been possible by traditional means. In doing so it halved the long-term risks associated with a property acquisition and provided options for future expansion that did not require any up front financial commitment. It also made provision for a clean exit in due course.

> **"Managed office solutions seem to come in many flavours. For us the solution enabled the Bank to take account of its business drivers, objectives and constraints to deliver a tailored, flexible and cost-effective accommodation solution that we could flex up or down over the term of the contract."**
>
> *Mike Field, Head of Projects & IT, Vanquis Bank*

A large Business Process Outsourcer (BPO)

One of the UK's largest BPO operators required two new properties to bring a new outsourcing contract to market quickly. By adopting a MOS they were able to access two 30,000 sq ft buildings that provided the 5-year solution that they required, with a clean exit at the end: no dilapidations, legal fees, existant leases or capital write-offs. They were also able to include a mechanism that enables them to reduce their workstation numbers by circa 30% and thereby achieve better alignment between their business needs and their accommodation cost.

> **"Managed Office Solutions provides organisations with the option to acquire the accommodation solutions that match the needs of their business, whilst avoiding a lot of the hassle normally associated with property (at a fixed known cost)."**
>
> *Spokesperson, a UK BPO*

TRENDS – THE FUTURE OF MOS

It is clear that the market for MOS is still relatively small when compared to both leasing and serviced offices. However, it is also apparent that a number of property and office providers are increasingly considering the MOS market. At the moment less than 5% of the commercial property market can be classified as managed space[ix]. The interviews conducted as part of this research suggest that part of the problem is a lack of clear understanding from both businesses and MOS partners, but as organisations are reassessing their exposure to property risk it is not unreasonable to expect this figure to grow in the future.

However there are no formal figures published to support the growth in MOS but as more occupiers begin to understand the benefits of acquiring managed space it is possible that MOS could follow the predictions of a serviced office market which, in 2011 is expected to grow by 3%, and in the following four years market analysts anticipate stronger annual growth of between 4% and 6%[x].

So far it appears that MOS is something that predominantly large businesses have utilised[xi], despite estimations that 8 out of 10 small firms would benefit from more flexible office solutions[xii]. However, for providers of MOS, dealing with small to medium businesses carries considerable risk, which may explain why, to date, providers have opted to work with predominately larger companies with stronger covenants.

At present, MOS appears to be most suitable for either fast-growing businesses, or those that are trading in uncertain environments and require flexibility in the medium term[xiii].

The question however is how can MOS providers develop their market if they are predominantly suited for businesses that experience fluctuations in their need for property to a degree that makes typical lease commitments incongruous. Indeed, one view is that MOS are not particularly suited for mature businesses with mature estate departments, which can easily write off the capital cost and can themselves mitigate asset risk through contracting, break-clauses and depreciation. In that respect two problems have been highlighted by one occupier:

One is the lack of proof that MOS are economically efficient. The concept of cost and risk is often mixed together, which makes it difficult to understand the real benefits of MOS. Solution providers therefore need to highlight and disentangle the cost/risk issues and seek to provide companies with a decision-based framework that allows potential occupiers to estimate financial and asset risk benefits. However a recent report by Actium, the organisation responsible for researching and publishing the TOCS report (Total Office Cost Survey) concluded that in researching five properties delivered by one MOS provider to various blue chip clients, that their cost per workstation was lower than the TOCS standard workstation cost, with significantly lower risk[xiii].

It is not just the private sector that is beginning to open its eyes to MOS. The OGC (Office of Government Commerce) has published a paper 'working beyond walls, the vision of the workplace 2010', which actively examines the scope for increased use of what they term as 'Flexible Managed Office' and is adopting pilot schemes. The objective is to demonstrate and publicise its use within Government and actively use this approach by 2015[xiv].

Perhaps the key issue highlighted by this research is the lack of awareness of the MOS option. This suggests that service providers need to do more to promote the viability of the concept and its financial benefits over and above other options.

CONCLUSION

The market for office acquisitions has changed significantly over the last decade. The traditional leasing approach is becoming an outdated option for businesses that need their property portfolio to change in accordance with their foreseeable business horizons and the changing economic conditions.

As a result, a new option for office acquisition has emerged – MOS, which may not suit every business, but is now being seriously considered by organisations that require more flexibility in terms of contract, location, term and occupancy. It also offers a more bespoke service compared to its leasing and serviced offices counterparts.

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DUBAI
FRANCE
GERMANY
HUNGARY
INDIA
IRELAND
ITALY
JERSEY
LUXEMBOURG
POLAND
ROMANIA
SPAIN
UNITED KINGDOM
USA

ALLIANCE OFFICES

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