Accommodating Change

The changing face of property acquisition - a business guide

Foreword by Mike Field,
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(part of Provident Financial)

For all of us involved in the acquisition of commercial property, regardless of whether we are from a property, financial, operational or senior management background we all share the same challenge; finding affordable accommodation over the right duration to meet the demands of our business. Furthermore, we need to do this without incurring undue risk whilst at the same time trying to incorporate the flexibility to accommodate future change. This is true irrespective of where the economy or our business sits within the boom/bust cycle.

I think we can all agree however that the traditional methods of procurement such as a property lease or a capital acquisition often do not meet this challenge. To thrive, businesses require agility and flexibility and there is little of these attributes in a long-term property lease or purchase.

At Vanquis Bank we found a way to overcome these issues with a cost effective alternative approach to property procurement that did not compromise our accommodation requirements. It delivered us customised, flexible and zero-capital accommodation, over a term that matched our foreseeable planning horizons on an 'operational' lease basis.

This booklet highlights some of the pitfalls associated with acquiring accommodation and introduces the model that we adopted. It is not intended to be a formal guide to property procurement, there are other more comprehensive [1]publications available that cover this, however we believe that it outlines a common sense approach to accommodation that has the potential to be a very powerful tool in any company's armoury.

Acquiring new accommodation – the challenges

Whether we intend to consolidate, expand, or react to changes in the local demography or the market at large, we need to know that we can adapt our accommodation plans quickly without committing to long-term liabilities. In a dynamic commercial and economic environment however, planning accommodation can be a tough challenge; one that is fraught with risk and uncertainty. Failure to secure the right property solution at best can result in high profile financial embarrassment to the company or in the worst case can even threaten the entire business itself.

During its lifetime a business will need to react to its market whether this is to grow, shrink, move or enter a new market altogether. Almost all of these changes will necessitate a revision of the property portfolio, however the traditional routes for the supply of property are not always able to react as quickly as other business resources. This is where property can expose the business to risk.

The table below highlights some of the problems and constraints with the traditional methods of leasehold and freehold:

PROBLEM	CONSEQUENCE
Property is usually owned or leased and both forms of holding carry significant acquisition and disposal costs.	
Purchase and sale of property will incur agents fees, legal fees and tax (either in the form of stamp duty or capital gains)	Costs could be disproportionately high compared to the business returns from the move
Lease contracts are all bespoke and require specialist advice on entry and exit	
Leases are usually for a term of at least 10 years and often have no provision for early exit	Exits are usually by negotiation and typically cost as much as the rental payments due to the end of the term
Property will usually require some adaptation to the user	
The supply chain for design and implementation of alterations, e.g. the fit out is complex	Unfamiliarity with the supply chain often results in significant budget and time overruns
The total or actual costs of property occupation are not always obvious	
Freehold ownership does not make the occupation free	The opportunity cost of the cash tied up in the property needs to be considered
Leasing costs are more than just the rent stated in the contract	Rates, services, maintenance and ultimately dilapidations need to be included in the budget. The rent will also be subject to review and the new rent may be significantly higher than the original amount
Capital investments need to be written down over time	An early exit from the property may result in a depreciation sum outstanding in the accounts and so preclude the exit
Property is an imperfect market	
Property supply is lumpy and not available in readily divisible blocks	Often larger amounts have to be taken than are really required leading to even more complex contractual arrangements or larger liabilities
Property is not available in every location at any one time	Alternatives can be difficult to find and compromises are nearly always required

When accommodation plans go wrong!

A major international company shocked the City by revealing substantial leasehold exit liabilities that would be crystallised by a critical business restructuring.

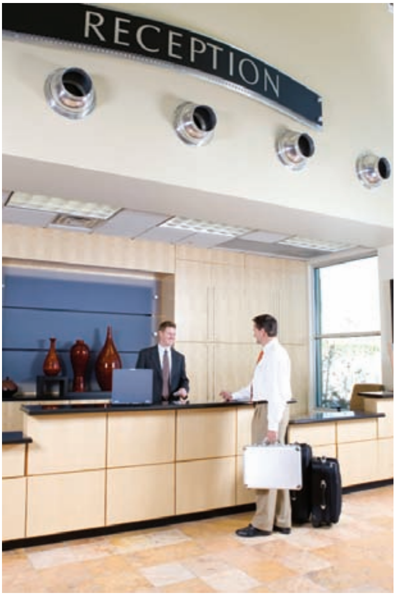
A financial services firm was seeking 30,000 ft^2 of office accommodation in a major UK city while a subsidiary was disposing of the same in another part of the city.

A high street clearing bank took a lease on a building adjacent to a vacant building already owned by a different part of the bank.

Examples taken from the CBI's guide to property

Serviced offices

Another option available to satisfy an organisation's accommodation requirements is using Serviced Offices. These solutions 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 workstation and length of stay have been reached.



These solutions are ideally suited to smaller businesses or larger companies that need a small city centre office on a short term basis. Typically larger organisations need the accessibility of an out of town facility, work within a secure and controlled IT environment and/or make extensive use of break out areas such as meeting rooms and private office space. It is likely therefore that only under special circumstances, such as the need for temporary 'stop-gap' accommodation, that Serviced Offices would make economic sense, compared to a lease or capital purchase alternative.

SUMMARY

All of us that are involved in property procurement know that implementing an accommodation strategy that meets all of our requirements is far from easy.

There are myriad essential factors that need to be taken into account, including the quantity of space required, the delivery, the flexibility and the level of risk.

PLANNING – the first step is often the hardest!

The first step in any property procurement project is probably the hardest and the riskiest. We need to formulate a capacity plan that not only satisfies the operation’s requirements today, but also has the flexibility to accommodate the changes that will inevitably occur during the lifetime of the occupation. Often we land up with a conflict and a resulting gap between the operational needs of the business and what can be delivered from a property perspective.

Here are just some of the aspects that we need to consider when planning for new accommodation:

- **Location** - what are the demographics of the area? Will local labour pools be enough to satisfy the requirements both now and in the future? Does it have good communications links?
- **Design and infrastructure** - will the new facility meet current and future legislation? Does it meet ‘sustainability’ objectives? Will the staff be comfortable working in the new space?
- **Management overhead** - new accommodation projects require a significant amount of management time to ensure that everything is delivered on-time.
- **Budget** - property and accommodation projects are notorious for budget overruns. Will the budget be flexible enough to meet future changes?
- **Exit** - can we walk away at the end of the term? What about if the business needs to leave early? What are the penalties? Will we be stuck with a ‘White Elephant’ that will inhibit the Company?

DELIVERY – how fast can a new facility be brought to market?

Once the planning and budget have been agreed the next challenge is how the project will be delivered. However, as we all know delivering additional accommodation quickly is not easy.

The management effort required is considerable; the traditional model of assessing, planning, acquiring, fitting out and delivering a new facility can be a major project management headache that is charged with unknown, unplanned, long-term problems that can deflect management attention away from its core business.

Another drawback of the traditional model is that it can back us into a "timing" corner rather than enabling us to make a move at a time of our choosing.

Here are some of the problems encountered when trying to establish new capacity quickly:

- For new-build projects the planning, acquisition and fitting out can take years
- Projects need to be approved quickly before the 'passion' dies and the board changes its mind and moves on to other priorities. Questions are asked about the commitment to long-term lease agreements as they expose the business to long-term risk
- In-house resources are committed to running the daily business and new projects fight for management attention
- Fit-out including the IT infrastructure are notorious for being late and over budget

Once the accommodation has been delivered the problems do not end; delivery is an ongoing issue. In the future the occupier may wish to make changes or rectifications however, under a lease arrangement this can lead to frustrating 'stalemates' between the occupier and the landlord as there is no real benefit to the landlord. Once the lease has been signed the leverage for future change is lost.

FLEXIBILITY – does your new accommodation strategy have the agility to react to change?

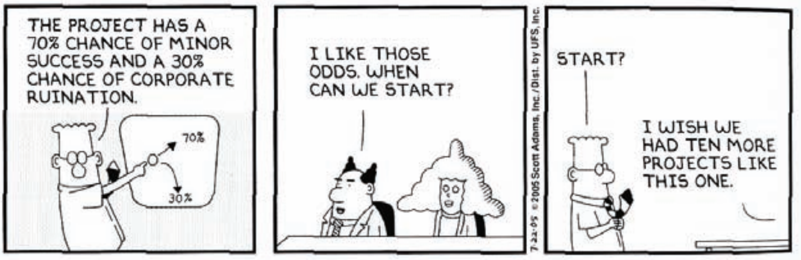
In any accommodation project the only certainty is that whatever you plan for today will certainly change tomorrow. One such example is companies that operate large operational centres, which are prone to fluctuations in size, labour pools, and business demand. These organisations have significant investments in buildings, technology, infrastructure and staff and are particularly prone to the impact that change can bring.

As we know, a rigid framework in business does not work. It cannot react quickly to change and often results in loss of revenue, market share and opportunities. We all know that one of the biggest threats to our business is competition from smaller, more agile organisations. It is therefore imperative that we preserve agility in our business in all respects.

The following are just some factors that can occur at short notice, and result in either an under or over-sized operation:

- An unexpected change in market conditions causes either an increase or decrease in planned workstation capacity
- A competitor moves into the same location causing a dilution of skills and a reduction in the labour pool
- A change of strategy e.g. introducing an offshore component of delivery
- A company re-structure, acquisition or merger results in changes to the capacity requirements and/or configuration
- Advances in technology that make platforms uncompetitive before the capital investment has been fully written down

It is critical that we retain the agility and flexibility to adapt to internal and external changes quickly. The traditional model, based on long-term leases however does not support this philosophy. Although they have not been designed to actively undermine flexibility, often the risks associated with change are wholly borne by the occupier in order to satisfy the long-term security requirements of the landlord and investors.



Flexibility

One solution that many organisations have adopted to overcome this issue is to outsource some of their business processes to a third party, but this can be a false dawn, resulting in loss of control, dilution of brand values and expensive "locked-in" contracts.

IS THERE ANOTHER WAY? – introducing 'Occupier Solutions'

As senior professionals, what we are looking for is a solution that eliminates these issues and thus makes accommodation planning and procurement a manageable exercise like any other aspect of our business. In many circumstances investing in property can be a sound long-term proposition, however the danger is that if this is not part of our core business, left unchecked it could expose our organisations to more risk than it should.

Fortunately the industry and astute individuals are waking up to this fact. There are now organisations that are offering accommodation propositions based on 'Operational Leases' which are flexible, risk averse and contained within a term that meets the realistic planning horizons of the business.

The next chapter discusses how one such approach, termed 'Occupier Solutions' can offer organisations an alternative to the lease/capital purchase stranglehold. In many ways it deals with or avoids the accommodation dilemmas we typically face.

"This new proposition provided a major advantage over a lease or a freehold property because it could be custom-built to our own specifications, without the need to make a major capital investment or take on a long-term liability. In fact, for us it was the commitment that was the critical factor, just 5 years, with ongoing flexible terms for the future – which was in stark contrast to normal lease agreements." Simon Maingay, E.ON

CHAPTER TWO - **'Occupier Solutions', a new approach to accommodation procurement**

'Occupier Solutions' deliver a complete turn-key accommodation solution, from term to fit-out specification to support services delivered, to meet the specific requirements of the organisation. They align the supply chain by providing a single point of responsibility. They thus mitigate the risk of multi-supplier management, relieving the organisation of a large part of the management burden that accompanies property acquisition.

Recognising the problems caused by the traditional methods, the Occupier Solution approach is now being adopted by many forward-thinking companies because it offers flexibility reduces risk and delivers accommodation solutions fast.

These organisations have concluded that if implemented correctly these solutions can provide a genuine alternative to property leases, and the investment in time and capital required for new builds. (See case study section – E.ON and Vanquis Bank).

How does the 'Occupier Solutions' approach work?

'Occupier Solutions' specialists will work in close partnership with you to ensure that every aspect of the accommodation provision process is encompassed within the plan from initial planning and acquisition, right through to fit-out and the on-going support and management to service level for the entire term of the agreement.

A typical approach – a step-by-step guide

1. Planning and assessment

The partner will work with you to determine exactly what is needed, when you need it, and where you need it, they will also factor in your current situation and constraints and identify ways to lower potential barriers to moving such as exit costs from your existing facility.

2. Acquire or build?

Depending on the planning outcome, the next decision is whether to acquire an existing facility and make it fit for purpose, or to commission a new build. In both cases the partner will remove the property acquisition headache by simplifying the supply chain and providing a single point of responsibility. They will take on the mantle to acquire the building, taking away all the issues such as negotiating the lease, and the license for alterations and thus remove much of the inertia caused by drawn out discussions with the landlords. Furthermore the terms that they will offer will be more flexible and typically range from 1-5 years for a facility within their existing portfolio, from 3 years in an existing but non-portfolio building, and typically just 5-10 years for a build-to-order solution.

3. Implementation

Once acquired the facility will be fitted-out to your exact requirements with the latest services and technology. This can include; all the common break-out areas, offices, workstations, and all the IT if necessary.

4. Delivery

On day one the facility is delivered "ready-to-go". The Occupier Solutions specialist will ensure that everything is 'live' and available as agreed in the contract. Charging throughout is rentalised, including the fit-out, and therefore appears on the Profit & Loss rather than Balance Sheet. In addition dedicated on-site support staff are provided to

guarantee that the service level delivery continues throughout the length of the contract, allowing you to concentrate on what is important – running your business.

5. On-going monitoring and support

Once the accommodation has been delivered the Occupier Solutions specialist will then provide a fully managed solution to service levels agreed for the entire contract.

6. Clean exit

Perhaps one of the biggest attractions of this type of approach to accommodation procurement is that at the end of the contract you can simply hand in the keys and walk away. There are no exit costs, no legal fees, no dilapidations and most importantly no legacy that could hinder the continued development of the business.

FLEXIBLE 'OPERATIONAL LEASE'

The beauty of using the Occupier Solutions model is that unlike traditional methods of property procurement there is no commitment to either a capital purchase or long-term lease.

This proposition offers a tailor made accommodation solution designed around your business requirements. It bundles a fully managed facility plus all the bespoke capital expenditure components into a fixed price, rentalised agreement for an agreed term.

Essentially an operating lease is taken over the required accommodation, which can be structured flexibly so as to provide phased initial occupancy as well as options during the life of the agreement, including the ability to extend.

Operational leases overcome the 'stalemate' scenario described in chapter one. With this model ongoing delivery is supplied on a monthly basis and underpinned with service level agreements (SLAs).

The solutions are further characterised by their "clean exit" nature: no dilapidations, overhang lease liability or capital expenditure write downs.

THE KEY BENEFITS OF 'OCCUPIER SOLUTIONS'

These are some of the benefits realised by companies who are embracing this model.

- **A flexible term** – that matches the dynamic needs of the business
- **Speed to market** – enabling occupiers to adapt to market and business changes much more quickly and cost effectively than other options
- **Low capital investment** – the 'business ready' accommodation solution is delivered on an operational basis, on a per workstation, per month fee
- **Mitigated risk** – risks associated with property acquisition are transferred to the solutions partner, who is better placed to manage that risk, allowing companies to focus on core business activities
- **Flexibility** – enabling the business to more readily adapt its accommodation portfolio to meet needs
- **Phased occupation** – enabling expenditure to track usage during initial occupation rather than being hit with the full premises costs on day one
- **Clean exit** – walk away at the end of the contract with no exit costs or write-offs

SUMMARY

Major corporations usually need a blended portfolio of capacity; some leasehold or freehold, some flexible and some outsourced. In reality however, this rarely occurs, most organisations instead have a polarised portfolio, with a very static and cumbersome in-house component and some outsourced capacity that has often been driven by short-term tactical decisions.

The Occupier Solution approach is different. It affords occupiers the flexibility and adaptability required in today's business environment without the long-term commitment to buildings and infrastructure.

'Occupier Solutions' enable companies to structure themselves in the highly valuable middle space between long-term commitments to property and whole outsourced solutions, to achieve cost effective capacity that is adaptable, low risk, and yet, without compromise.

CASE STUDIES

E.ON

Executive summary

This case study describes how E.ON, one of the world's largest investor-owned energy services providers, that employs around 18,000 people in the UK used the 'Occupier Solutions' approach to react quickly to new market conditions caused by de-regulation. The company needed a new 52,000 sq ft facility to accommodate displaced operations in its retail division. The solution delivered a new 'built-to-order' facility within 14 months of the first conversation. It included all the fit-out and services for 500+ employees on an operational contract basis.

Facilities Manager at E.ON Simon Maingay, said *"This new proposition provided a major advantage over a lease or a freehold property because it could be custom-built to our own specifications, without the need to make a major capital investment or take on a long-term liability. In fact, for us it was the commitment that was the critical factor, just 5 years, with ongoing flexible terms for the future – which was in stark contrast to normal lease agreements."*

Challenges – new competition, new opportunities, more risk

Simon Maingay encapsulates the problem, *"Prior to de-regulation we could comfortably plan our capacity requirements over 10-15 years, therefore a new build or a lease option would easily meet these needs and in many circumstances this is still the case. However, for some of our business units, competition changed all this, our retail business suddenly took-off and our previous capacity plans went out the window."*

THE KEY CHALLENGES FACED BY E.ON WERE:

- The utility market had become dynamic overnight and with it a significant foreshortening of the planning horizon; adaptability and responsiveness had become key attributes of any solution
- New regulations introduced new competition, more opportunity, but also more risk
- Their existing property portfolio was geared towards stable growth plans, and did not have the ability to react to short-term market fluctuations

WHAT THE APPROACH DELIVERED FOR E.ON AT SHERWOOD PARK, NOTTINGHAM:

- A 52,000 sq ft facility Built-to-Order, within the agreed time
- All the infrastructure, including fit-out and telecommunications, air conditioning and back-up power generators
- All the workstations, breakout areas, offices and meeting rooms
- The in-house restaurant
- All of the facilities management support services
- A fast route to market with low risk

The dilemma for E.ON was that they needed accommodation fast, but they were reluctant to tie themselves into a long-term lease or build commitment on a planning horizon that was no more than 36 months.

The solution – a Build-to-Order 'Occupier Solutions' approach with minimum commitment

Simon Maingay explains how E.ON took the unique decision to explore a third option, an option that could deliver E.ON a property built to their own specification, delivered, complete with all the infrastructure and within the required time window with commitment that suited both parties.

The key benefit of the solution was its ability to meet a direct need of the business within the agreed timescales and within budget. He explains, *"The beauty of this offering is that we only needed to consider the questions relevant to the business opportunity at the time, not what they might be in the future."*

SUMMARY

The 'Occupier Solutions' approach avoided some of the main constraining factors of traditional solutions such as:

- Implementation overruns of time and cost
- Delays caused in signing off traditional capital projects
- Long-term leases and the associated liability created
- Expenditure of capital and the associated risk of write-offs
- Rigidity – inability to adapt to changing circumstances

In addition the following provided the Company the means to gain more financial clarity:

- Guaranteed pricing that avoided any nasty surprises
- Operational contracting meant that infrastructure and support services were governed by service level agreement
- Predictability of cost from the outset.

VANQUIS BANK (part of Provident Financial)

Executive summary

Vanquis Bank, a 'specialist' credit card provider, is a wholly owned subsidiary of Provident Financial. In the five short years that it has been in business it has grown to be a leading 'player' in its field and is now threatening its larger and more established competitors.

This case study describes how Vanquis halved the long-term risks associated with property acquisition. In doing so, it gave itself options for future expansion that did not require any up front financial commitment and made provision for a clean exit when it was time for them to move on.

The solution provided a new operational headquarters in Chatham, Kent, to house its 400 plus employees two years earlier than would have been possible by traditional means.

Head of Projects and IT at Vanquis Bank Mike Field said, *"The 'Occupier Solutions' agreed with Port@l took true account of Vanquis's drivers, objectives and constraints to deliver a tailored, flexible and cost-effective solution. It threw an umbrella over all of these components and simultaneously provided accountability, transparency and simplicity. From our perspective this continued for the entire duration of the engagement from implementation, through delivery and on to exit."*

The challenge – *increasing capacity without incurring high legacy costs*

Established in Chatham in 2003 the Bank's business had expanded rapidly, and its operation was split over two locations. The bank recognised that it needed to consolidate its business into one centre to maximise its efficiency and provide room for future expansion.

This presented the company with a dilemma. Should they carry the overhead of two existing properties and commit to all of the space available at Pembroke Court on day one, a total of 51,000 sq ft, when their current operation demanded only 34,000 sq ft?

Solution – a 'holistic' approach reduced the Bank's commitment to property by almost 50%.

Mike Field explains how 'Occupier Solutions' specialist Port@l provided a unique solution that had the potential to solve their property dilemma; *"Port@l stepped-in and suggested a 'third-way', a unique approach to property procurement that would enable us to occupy our preferred choice immediately, on a 'managed' rather than lease basis."*

According to Field, Port@l was able to bundle the Bank's requirements into an operational solution that included the following elements:

- The space the bank required at the time – with options to move into additional space in the future
- The infrastructure, including the comms room, cabling, power provision and resilience, workstations, security components, kitchen and break-out facilities
- Support services, including FM and security
- Guaranteed initial delivery and then ongoing delivery of the infrastructure and support services to specific standards
- Clean exit – no legal fees, dilapidations or capital write-offs, and no lease overhang

RESULTS – a new managed facility, delivered within three months, with minimum disruption

This solution enabled the bank to achieve the following:

- A new operational centre that could accommodate their entire operation under one roof delivered within 3 months of agreeing contracts
- Ability to move 2 years earlier than it would with other alternatives
- Flexibility to occupy additional space if and when the business demanded and pay only for what they used
- Mitigated the risk of unpredictable future developments such as credit crunch, property slumps, variations in product demands and other imponderables
- Port@l shouldered the capital burden of the 'fit-out' costs as part of their solution
- A term that was much more in keeping with the Business's planning horizon and enabled a clean 'walk away' at the end of the contract with no legal fees, dilapidations or capital write-offs, and no lease overhang.

SUMMARY – a blueprint for the future

Mike Field concludes, *"We are bankers, not property experts. By becoming a strategic partner in the provision and delivery of the property solution, Port@l have not only shared in the risk but were motivated to manage risk out of the project, allowing us to concentrate on our core business. A win-win situation for both parties".*

ABOUT PORT@L

Established in 2000 Port@l is part of a unique amalgamation of funding, development and service delivery. The core offering of this amalgam is space and infrastructure (environment, IT and telephony) on a managed service basis. Port@l terms this 'Occupier Solutions' and it allows their clients to retain ownership of their "crown jewels" such as brand custodianship, culture, people, processes, intellectual capital, business applications and, in the case of call centres, the actual interaction with customers.

Port@l has delivered its solutions to a number of prestigious clients, including: RBS, HfS Loans, Barclays Bank, E.ON (Powergen), BSkyB and Vanquis Bank.

Port@l's head office is in Banbury and they have operational centres in Glasgow, Rotherham, Nottingham, Chatham, Coventry and Leeds.

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