



CB RICHARD ELLIS
GLOBAL RESEARCH AND CONSULTING

SPECIAL REPORT

When Companies Combine Optimizing Physical and Human Capital Post Merger

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CHANGING LANDSCAPE

After a merger announcement, companies are left with myriad questions on implementation and integration. Although initial information has been gathered during the acquisition decision and due diligence process, it is after this short and often chaotic time period when the real research, analysis and decisions begin. This period is increasingly getting shorter as well, according to a recent report from consulting firm Towers Perrin which stated that the average duration between M&A deal signing and closure narrowed from 142 days in 2007 to just 80 in 2008.

This is putting increasing pressure on operations, human resources, IT and executive management, the typical drivers of this process, to align synergies and design the “new” organization appropriately and effectively, or connecting the addition with the core business to achieve synergies. This also typically leaves real estate departments with the role of reacting to these changes and meeting their internal client needs of realigning space and disposing of unnecessary property. Many companies erroneously make dispositions the first step in their post-merger portfolio optimization, making costly decisions purely on market rates, lease terms, or utilization ratios rather than holistically evaluating each location for its best use. Preferences on key management, locations and best practices begin to emerge based on local experience or emotions.

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At this critical time, it is important to look at the new company and portfolio cohesively and objectively. It is no longer effective to analyze the portfolio based on separate pre-merger strengths or weaknesses. The merger has created a “new” company and portfolio—with unique location requirements and strategy design challenges.

SURVEYING THE AFTERMATH

In the immediate aftermath of a merger, corporate real estate departments are often left with a puzzle of locations to sort through and assess. As Operations aligns business units, services and management, Real Estate is often asked to identify vacancies, potential duplicate locations and potential expansion options if the merger is forecasted to lead to volume growth. Initial portfolio assessment may include understanding:

- Facility locations and terms
- Facility use, size and special requirements
- Vacancy, capacity or other utilization components
- In-progress transactions or construction

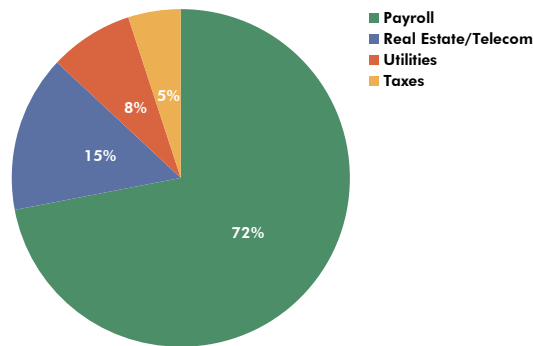
This initial survey is only the beginning to better understand and configure an optimal portfolio that best suits the new needs of the company. Once these new facilities have been added to the initial portfolio, multiple combinations, inefficiencies or opportunities can be derived, such as:

- Duplicate geographic locations
- Multiple locations for identical functions
- Consolidation opportunities
- Expansion requirements
- New services or locations

For operational and financial purposes, Real Estate departments will be asked to examine these combinations—or act on these decisions as instructed by internal clients such as HR or Operations. Driving enhanced efficiencies by reducing duplicates, optimizing capacity, and positioning locations for future requirements is essential to the initial and lasting success of the merger. However, to most effectively posture the company, it is important to go above and beyond the basic comparison of real estate values, lease term projections and geographic redundancies to effectively position the real estate portfolio for its highest and best use—**servicing the workforce and functions performed in the facility.**

A location that is unable to fill to capacity; locate productive, high quality labor forces; or that requires a premium to meet its labor requirements will deplete the value of the operation far beyond any market value or facility costs.

Payroll often comprises over 70% of operating costs for high density operations. For example, if a company must pay a \$2/hour premium in a market due to competitive measures or limited labor supply, for a 500-person operation this premium can equate to over **\$2 million per year**—the equivalent of **\$33.28 per square foot** for a high density operation. Understanding how physical assets are utilized to strengthen the services and performance of the company is vital to enhancing efficiency and developing an effective strategy for the new portfolio.



Strategic Real Estate departments ask:

- How do we utilize our new and old locations to their fullest potential?
- If we have duplicate sites in one location, do we run the risk of cannibalizing our own labor force by growing too large in a market for one company?
- Outside of facility costs, what are the differences in labor and business costs between locations? Do they outweigh any real estate differentials?
- What competitive risks do we face in these markets?
- What incentive negotiations or considerations are associated with the facilities, size requirements and capital investments?

ALIGNING AND REBUILDING

At this critical intersection of Real Estate and operational alignment, corporations have the greatest opportunity to optimize the new portfolio and improve operational costs and efficiencies. There are several steps a corporate real estate department can take in order to realign the portfolio with the operational design of the merger.



Evaluate Location Strategy

First, it is important to examine the operational strategy and align the locations of the real estate portfolio to best serve these requirements. Does Operations need several moderate sized locations or fewer large sized operations? This is an integral step in determining not only how well the size of facilities aligns with operational structure, but more importantly the ability for each labor market to optimally support the functions performed in each location.

For example, multiple small locations may allow the company to take advantage of smaller labor force locations and potentially lower labor costs by locating in Tier II or Tier III markets. These markets may present a “big fish in a small pond” strategy—allowing the company to be an employer of choice with minimal competition and lower payroll and attrition costs. However, this often requires additional focus on training and may be better applied for functions that require less experience or certifications. Additionally, requiring large locations may restrict the company to larger labor markets where there is typically higher competition presenting a “small fish in a big pond” strategy. This typically results in higher costs of labor, yet more experience for higher qualification requirements.

Different strategies may be deployed for each line of business within the company. Synergies may also be found between business lines with similar skill set requirements. Understanding the driving needs, based on the skill set and function requirements, is essential in determining whether or not the locations within any portfolio will optimally serve the business.

Optimize Locations by Service

A company must assess how the newly combined portfolio aligns with its location strategy. Typically, the greatest area for improvement is examining where skill sets, not locations, overlap. By evaluating each skill set across the portfolio, there may be instances to reduce costs and choose more favorable locations for each skill set to drive operating efficiencies. For example, the acquisition of the new portfolio may contain a site that is better positioned for back-office skills because it is a lower cost, less competitive market. Realigning the operation to fit the demographic characteristics of the market would significantly reduce operating costs and increase performance. Without evaluating how each skill set and location align, that site may have been disposed of if it were not performing well for another activity that was misaligned with these demographic characteristics, thereby missing an opportunity to improve bottom line results.

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Initial review of the portfolio should include examining each skill set for the following:

- Where is the function performed today?
- What is the total required headcount?
- What is the ideal headcount per operation?
- What capacity or addition does this create?
- Where is each service best employed?

These questions must be answered through partnership with HR and operations to understand the company's Operational strategy and how real estate can bring value by enhancing these decisions.

Optimize Locations by Geography

After determining which locations are best positioned to deliver services, there may be multiple sites within that location that require evaluation. Individual sites should be evaluated on a micro basis, examining facility costs, lease terms, accessibility, local competitors (both service and employer), logistics and infrastructure. There may be cases where multiple sites are a benefit to the company, for example reducing consolidation and migration costs or accessing workforce in dense commute locations. In addition, there may be cases where multiple sites are a disadvantage, such as decentralizing operations, workforce and synergies.

A challenge often faced when evaluating multiple sites within a labor market is the potential of cannibalizing a labor force by growing too large for the market. It is essential that the operation sizes are aligned with the supply of each skill set in the labor market, despite number of locations, to avoid intra-company competition or restricted labor supply.

Identify New Service Requirements

One of the final steps in aligning the combined portfolio is evaluating markets for new services that may develop from the merger. Often, the merger can create new products or service lines from the shared intellectual capital. Evaluating locations for any logistic or infrastructure need, as well as the accessibility to skill sets required for the service, will ensure that the remaining locations in the portfolio are best utilized.

Dispositions and Subleasing

After the portfolio has been evaluated and aligned from a service and labor standpoint, disadvantageous locations will be apparent. Sites that are located in markets that do not align with the operational strategy of the company should be considered for disposal or sublease. Advancing to this step prematurely can reduce the bottom line efficiencies of operations and cost the company millions in long term operational costs for a short-term real estate decision that has far less impact on operating expenses.

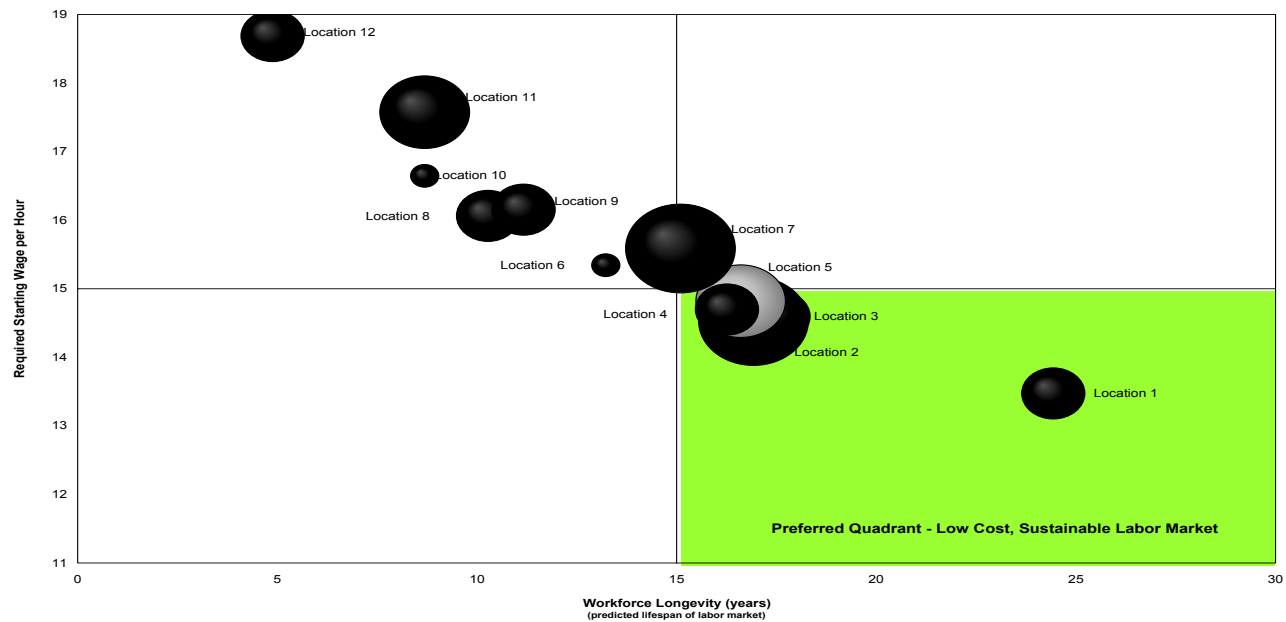
Many companies erroneously make dispositions the first step in their post merger portfolio optimization, making decisions purely on market rates, lease terms or utilization ratios rather than evaluating each location for its best use.

PAVING NEW ROADS

As with any real estate portfolio, once the base is aligned there will always be an ongoing process of adjustment. As the company expands, contracts, and repositions itself, the requirement for a forward-looking plan is imminent. Proactively identifying expansion, consolidation, and new location targets will allow real estate to add timely value to internal client requirements rather than reacting to requests.

Identify Ongoing Growth & Exit Strategy

A best practice for any Real Estate department is to proactively identify how each market is positioned for future decisions. By implementing a strategy around markets to exit, maintain or grow, real estate will stay a step ahead of operational requests and lease decisions.



Portfolio Optimization Strategy: Ranking Cost and Longevity for Expansion and Consolidation Prioritization

Expansions: Identifying “go-to” markets for potential expansions allows for timely growth of services, enabling revenue production, customer satisfaction and market share growth. These decisions should not be made purely on capacity, but where the capacity aligns with skill set availability. Understanding which markets will provide the workforce and logistics for service delivery based on quality, availability and cost of labor is crucial in recommendations for expansions. Identifying these markets proactively will prevent “knee jerk” reactions to additional capacity requests and will also prevent unnecessary costs.

Proactive expansion strategy reduces the chance of:

- Labor force cannibalization
- Premium wages
- Increased attrition
- Competition
- Poor performance

Consolidations: Markets should also be prioritized for exit strategy. Renewing or remaining in a poor performing or high cost location can increase costs or performance issues for the company. Optimizing the renewal or exit strategy for leases or owned property should consider the following:

- Longevity of labor force
- Ability to relocate key employees
- Competitive presence
- Cost of business (including market rates, facility costs and labor costs)
- Performance of location
- Alternative skill set employment or use of building

After evaluation, markets should be prioritized by level of risk and cost to create a consolidation or exit timeline.

Identify New Location Requirements

The potential for new locations may arise based on the expansion and consolidation strategy of the company. New services or market share may spur the need for identifying new sites, often pertinent to the growth fostered through mergers. In addition, through the evaluation of the portfolio during the merger process it may be beneficial to look for a new site to replace current locations based on cost or skill set requirements that are not optimal within the current locations. In the site selection process, real estate departments should consider:

- Skill set availability
- Labor force costs
- Competitive presence
- Workforce longevity
- Logistic requirements
- Infrastructure
- Language availability
- Accessibility
- Geographic alignment
- Financial and tax implications
- Real estate market rates

Under current economic conditions, higher unemployment levels from restricted hiring and mass layoffs have resulted in an increasing availability of labor. With current rates at 6.5%, the highest in 14 years, and projections to surpass 8.5% in 2009 according to Goldman Sachs, temporary availability of labor may skew the perception of local labor markets. Understanding the future implications on operations by evaluating which markets can sustain operations when the economy returns to historic averages will be a crucial success factor as companies decide which markets to invest in today. By identifying new locations that align both with the location strategy set forth initially, as well as the specific skill set and logistic requirements of the internal client, real estate can react quickly and locate the company in optimal labor markets for years to come.

CONCLUSION

During mergers and acquisitions it is important that corporate real estate departments work closely with Operations, HR, IT and executive management, aligning locations and planning portfolio decisions around the purpose of each physical asset—to support the human capital and service delivery of the company. By engaging the business for portfolio decisions, corporate Real Estate departments can create proactive strategies that align with operational objectives. Through this integration, companies can significantly improve profit margins, improve reaction time, and design migration plans that support the main driver of the business—human capital.



ABOUT THE AUTHOR

Kristin Beatty focuses on developing portfolio optimization, location analysis and workforce development strategies for LAG clients. Her responsibilities include development of analytical models for use in labor assessment and site selection, such as LAG's Workforce Longevity Model, winner of the H.B. Russell CoreNet Global Innovator's Award.

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