



## How corporate real estate can support cost-cutting programs

The importance of real estate-related costs for non-property companies in times of the current economic downturn

**The Impact of the current COVID-19 pandemic and the structural change in Germany**

After the long economic upswing in Germany, the overall economic development must be considered much more rationally than in recent years due to the current development around the COVID-19 pandemic. As an effect of this pandemic, Germany is threatened by an economic downturn of historic dimensions. Initial forecasts indicate that the German gross domestic product (GDP) could fall by approximately 9 percent as a result of the COVID-19 crisis. It would be the biggest recession in a period of peace.<sup>1</sup>

In addition to this negative macro-economic development, the core business of many companies<sup>2</sup> is also under great pressure for change. The automotive industry and its suppliers in particular, which is sensitive to economic cycles, is facing major structural changes. This need for change is driven by the digitalization of processes, new production technologies and the shift away from classic combustion engines to alternative forms of mobility such as the electric mobility.

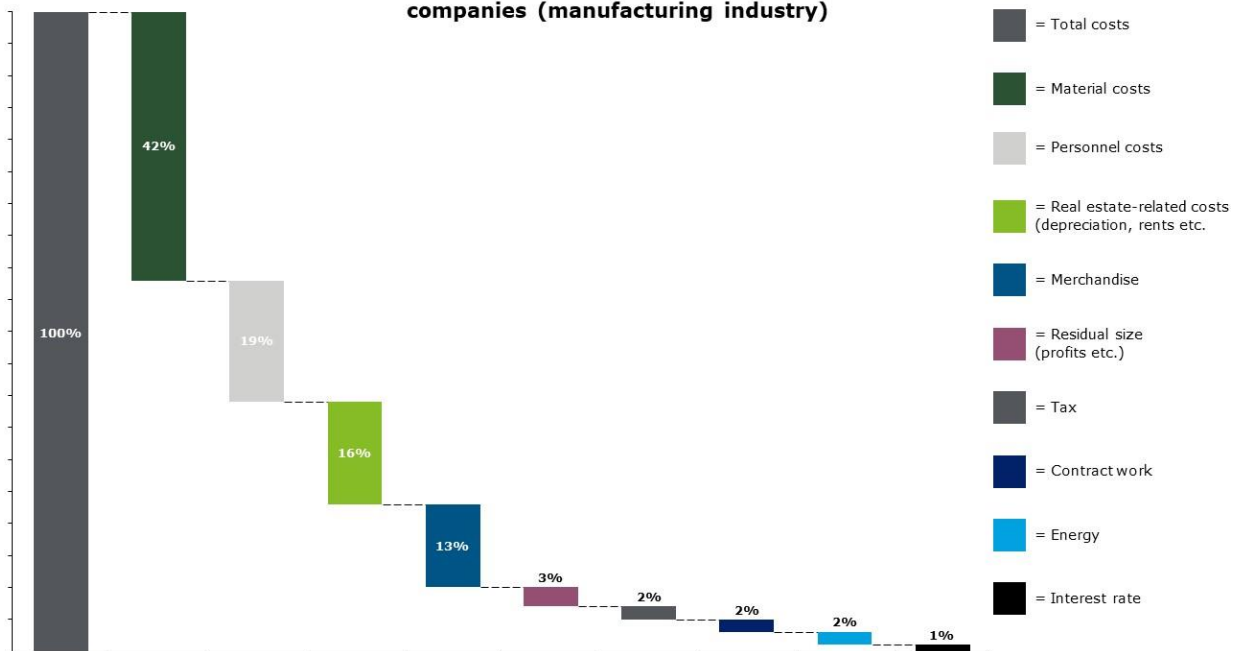
As a result, many companies are facing the great challenge of adapting their core business accordingly and making themselves crisis-proof with the help of cost-cutting programs.

However, a Deloitte study published in 2019, and therefore before the outbreak of the coronavirus, shows that in the coming 24 months, fewer initiatives for active cost reduction were planned in German companies than in other countries. While in the US about 84 percent of the companies surveyed planned cost-reducing measures, only 66 percent of the European companies planned measures and in Germany it was only about 60 percent.<sup>3</sup> In response to the current developments triggered by COVID-19 however, this proportion will dramatically rise worldwide.

Cost-cutting programs usually relate to specific personnel reductions due to the large share of personnel costs<sup>4</sup> of the total costs (see Figure 1)<sup>5</sup>. Companies usually try to keep their core workforce and primarily rely on not filling vacant positions, the expiry of temporary employment contracts, the dismissal of temporary workers and the instrument of short-time working.

A further significant cost block with considerable potential for optimization are real estate-related costs<sup>6</sup>. However, real estate as immovable property has often been neglected in the past for various reasons (e.g. property is not part of the core business, lack of transparency regarding property-related costs, the importance of real estate as a differentiating factor is underestimated, lack of professional/strategic Corporate Real Estate Management [CREM]<sup>7</sup>). Especially in times of transformation needs and cost saving programs, unused potentials arise in this area, although the realization of these potentials must be considered in a differentiated way.

**Exemplary breakdown of cost blocks in German companies (manufacturing industry)**



**The reduction of real estate-related costs in companies offer significant potential for optimization**

In addition to personnel costs, real estate-related costs regularly represent the second or third highest cost block in companies.<sup>8</sup> Although the proportion varies depending on the industry and business mode, experience shows that it accounts for between 5 and 20 percent of the total costs. Particular relevant are the real estate-related costs that are occurring in the life cycle of the property. Usually, only about 20 percent of the costs occur in the planning and construction phase, and about 80 percent during the utilization phase.

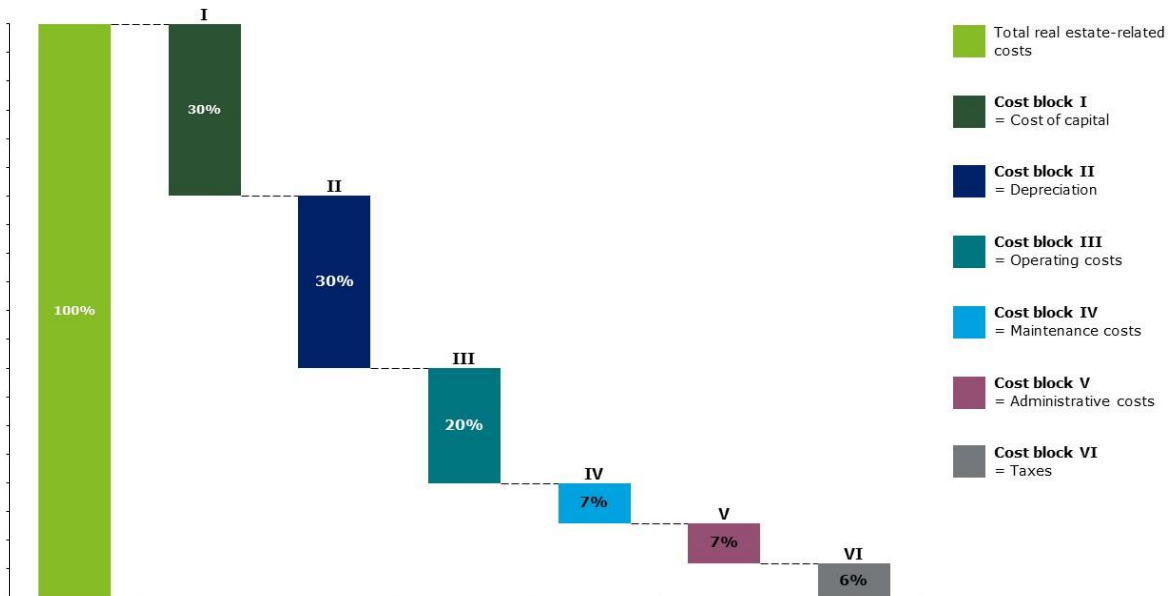
Although it should be noted that, the planning and construction phase already has a significant influence on the costs occurring during the utilization phase.

Real estate-related costs during the utilization phase can be broken down into the following cost blocks (please see figure 2)<sup>9</sup>.

Roughly two thirds of the total real estate-related costs are financially controlled cost types (cost blocks I and II), whereas the costs of (technical) building operation (cost blocks III-V) account for only about one third of the costs.

However, it should be considered that due to the high ownership rate of around 52 percent in Germany, Figure 2 refers to capital costs and depreciation.<sup>10</sup> In the case of a rented property, this value would account for the majority of the rent payment (cost blocks I and II). The major part of the costs incurred by corporate real estate are determined by financial and economic cost drivers rather than the technical-related cost drivers associated with building management and building services.<sup>11</sup>

**Exemplary breakdown of real estate-related cost blocks in operationally used properties**



### Measures to reduce real estate-related costs in the company

The following measures outline some of the possibilities that can help to reduce real estate-related costs in the day-to-day business operations. The focus should be on initiatives that reduce real estate-related costs in their entirety. Minimally invasive measures of individual, isolated cost blocks should be considered subsequently. Since the main driver of all cost blocks is the (usage) space, this should be the important starting point of cost reduction measures.

### Lessons from the past and caution against blind actionism





The success and amount of capital gains from the sale of corporate property is highly dependent on the right timing. This was particularly evident in 2004, when the disinvestment and sale-and-lease-back<sup>13</sup> of corporate property was trending. The high capital values of the properties (and hidden reserves) were used to increase the company's success and equity ratio.

When the global economy then deteriorated significantly during the subprime crisis of 2007/2008 and financing bottlenecks arose among institutional investors, it was hardly possible to sell property without incurring severe losses due to significant discounts from the originally planned sales proceeds. In the years following the crisis, some of the sold properties were repurchased at significantly higher capital expenditure, partly as a sign of regained economic strength. Today, sale-and-lease-back has become much less attractive due to the changes caused by IFRS 16.<sup>14</sup>

From the employees' point of view, the disposal of corporate property was usually interpreted as the first step towards the closure of a location, which had a negative impact on employee satisfaction and motivation.<sup>15</sup> This development indicates that strategic investments or the implementation of property-related measures can lead to an increase in employee satisfaction, efficiency and commitment to the company. The implementation of such measures also has a positive and direct implication on the cost-intensive block of personnel costs.

Experience shows that companies should therefore not only consider possible optimization measures and investments in their properties during crises, such as the current COVID-19 pandemic, but also in economically healthy times. A holistic real estate strategy is required in order to make strategic real estate decisions and measures in line with the corporate strategy.

### Exemplary measures to reduce real estate-related costs

Cost saving through	Achievement through	Conditions for implementation	Barriers/risks to implementation	Efficiency level and time horizon <sup>11</sup>
<b>Reduction of owner-occupied space</b>	<ul style="list-style-type: none"> <li>- Consolidation and relocation opportunities for employees</li> <li>- Compaction of the area through e.g. desk sharing</li> <li>- Reorganization of floor plans/division of the existing space</li> <li>- Renegotiation of existing rental agreements</li> </ul>	<ul style="list-style-type: none"> <li>- Creation of portfolio transparency (including company locations, property costs, current space utilization)</li> </ul>	<ul style="list-style-type: none"> <li>- Completeness of the required data sets often not given</li> <li>- Desk sharing is closely linked to an adjustment of the entire space concept in the company</li> <li>- Negative mood among employees in the absence of change management</li> </ul>	
				Short - to medium-term
<b>Exploitation of available real estate space that is not required strategically anymore</b>	<ul style="list-style-type: none"> <li>- Sale/lease/ subletting of unused and required properties</li> <li>- Redevelopment of the areas no longer required</li> </ul>	<ul style="list-style-type: none"> <li>- Transparency of current and future real estate requirements planning</li> <li>- Understanding the portfolio and its composition</li> <li>- Clearly defined business and corporate strategy</li> </ul>	<ul style="list-style-type: none"> <li>- Sale of e.g. production facilities often difficult due to low third-party usability</li> <li>- Planning uncertainties due to current political and economic developments</li> </ul>	
				Short - to medium-term
<b>Adaptation of Service Level Agreements (SLAs)</b>	<ul style="list-style-type: none"> <li>- Review and timely adjustment of qualities (service level) in the real estate services</li> <li>- (Temporary) reduction of the qualities in the real estate services</li> <li>- (Re-)negotiation of service provider contracts</li> </ul>	<ul style="list-style-type: none"> <li>- Transparency over services, service levels, billing models and external contracts</li> </ul>	<ul style="list-style-type: none"> <li>- Problems with the design of SLA elements in the absence of or unclear objectives</li> <li>- Negative impact on employees when service level quality is reduced</li> <li>- Reduction of quality has no effect on internally provided services without personnel adjustment</li> </ul>	
				Short - to medium-term
<b>Adaptation of the service provider models</b>	<ul style="list-style-type: none"> <li>- Strategic outsourcing of selected services</li> <li>- Adjusted price and performance remuneration models</li> <li>- Consideration of various procurement strategies</li> </ul>	<ul style="list-style-type: none"> <li>- Overview of current performance widths and depths</li> <li>- Uncovered competence/performance gaps</li> <li>- Evaluated process and workload in terms of complexity, business risk and resource allocation</li> </ul>	<ul style="list-style-type: none"> <li>- High inefficiencies with an inadequate balance of the operator model between in- and outsourcing</li> <li>- Loss of direct control and management of externally contracted services</li> </ul>	
				Middle to long-term

### Recommended steps to make your company crisis-proof

**1. Create transparency about your properties, real estate portfolio and the breakdown of real estate-related costs in your company.**

**2. Identify real estate-related optimization opportunities, taking into account the resulting short, medium and long-term effects.**

**3. Prioritize, evaluate and realize real estate-related optimization opportunities to be implemented in the short, medium and long term.**

**4. Professionalize your Corporate Real Estate Management in order to be able to deal with your real estate proactively, strategically and sustainably in the future.**

When implementing cost reduction measures, it must be taken into account that these measures often do not have an immediate effect due to the typical characteristics of the property in a fast-moving market environment. In order to keep this time lag as small as possible and to be able to identify the effectiveness of the corresponding measures, a professional Corporate Real Estate Management or short-term support by experts is required. It is not sufficient just to manage the real estate operation. It is essential that CREM is strategically and professionally positioned in the company.

However, current study results show that a large part of the CREM departments surveyed in companies are not (yet) ready for it. According to a ZIA study published in 2019, the real estate economic opportunities and risks of structural changes are clearly recognized by the respective decision-makers in the companies, but only a few real estate departments are relevant for action.

In only 31 percent of the surveyed companies, the CREM department recognized to be impacted by structural change.<sup>16</sup> Recent studies indicate that since the introduction of a professional CREM in companies, the real estate costs could have been reduced by around 30 percent after ten years. This could have been accomplished through short-, medium- and long-term investments with a simultaneous increase in the quality of space and services.<sup>17</sup> This clearly shows that professional Corporate Real Estate Management must significantly gain importance, and develop from a pure space provider and administrator to a value, cost and user-oriented internal service provider.<sup>18</sup>

Due to the negative economic forecast caused by COVID-19, companies with a professionally positioned CREM will have advantages in the implementation of short-term real estate-related cost-saving measures.

### Your contact persons

**Jörg von Ditfurth**

Partner | Real Estate Consulting  
[jvonditfurth@deloitte.de](mailto:jvonditfurth@deloitte.de)

**Steffen Skopp**

Senior Manager | Real Estate Consulting  
[sskopp@deloitte.de](mailto:sskopp@deloitte.de)

**Ben Martins**

Consultant | Real Estate Consulting  
[benmartins@deloitte.de](mailto:benmartins@deloitte.de)

## Footnotes

- [1] Unternehmen aller Industrien, für die die Immobilie nicht als Kerngeschäft gilt, sondern bei denen die Immobilie das Kerngeschäft (ähnlich zu IT, HR etc.) unterstützt bzw. ein maßgeblicher „Enabler“ ist.
- [2] D. Eckert (2020), Ökonomische Vollbremsung verursacht größten Einbruch seit 1930.
- [3] Deloitte (2019), Save-to-transform as a catalyst for embracing digital disruption.
- [4] Diese Herangehensweise ist besonders stark in Deutschland zu beobachten, da Deutschland innerhalb der Europäischen Union die vierthöchsten Personalkosten im verarbeitenden Gewerbe aufweist.
- [5] Statistisches Bundesamt (2017), Kostenstruktur der Unternehmen des verarbeitenden Gewerbes.
- [6] Unter immobilienbezogene Kosten fallen direkte und unmittelbare Kosten für die Planung, die Bereitstellung, den Betrieb und die Verwertung immobilierender Betriebsmittel.
- [7] In den Unternehmen werden diese Abteilungen häufig auch als „Facility Management“, „Immobilienmanagement“, „Real Estate Management“ o.Ä. bezeichnet. CREM bündelt regelmäßig alle liegenschafts-/immobilienbezogenen Aktivitäten eines Unternehmens, dessen Kerngeschäft nicht in der Immobilie liegt. CREM befasst sich mit dem wirtschaftlichen Beschaffen, Betreuen/Betreiben und Verwerten der Liegenschaften von Unternehmen aller Branchen in Abhängigkeit von der Unternehmensstrategie.
- [8] Dies ist besonders bei dienstleistungsnahen Unternehmen zu beobachten.
- [9] A. Pfnür (2014), Volkswirtschaftliche Bedeutung von Corporate Real Estate in Deutschland
- [10] A. Pfnür (2019), Mitten im Strukturwandel – Herausforderungen für das CREM.
- [11] A. Pfnür (2002), Betriebliche Immobilienökonomie.
- [12] Der Wirkungsgrad der Maßnahme ist in Bezug zu den in Abbildung 2 aufgeführten Kostenblöcken zu sehen. Unter Zeit ist hier Zeitraum zu verstehen, der benötigt wird, bis die jeweilige Maßnahme Wirkung zeigt. Kurzfristig  $\leq 1$  Jahr, mittelfristig  $\leq 5$  Jahre, langfristig  $\geq 5$  Jahre.
- [13] Unter Sale-and-Lease-Back wird der Verkauf von Vermögenswerten des Anlagevermögens und das anschließende Zurückmieten dieses Vermögenswerts verstanden.
- [14] Leasingverbindlichkeiten werden, im Gegensatz zu IAS 17, als Nutzungsrecht aktiviert und die korrespondierende Leasingverbindlichkeit passiviert.
- [15] A. Pfnür/S. Armonat (2004), Desinvestments von Unternehmensimmobilien unter besonderer Berücksichtigung der Vermarktungsmöglichkeiten.
- [16] A. Pfnür (2019), Mitten im Strukturwandel – Herausforderungen für das CREM.
- [17] A. Pfnür/S. Hartmann/M. Lohse (2007), 15 Jahre Corporate Real Estate Management in Deutschland.
- [18] Zentraler Immobilien Ausschuss e.V. (2019), Agenda für die Weiterentwicklung des Corporate Real Estate Managements.

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