German corporate property and the conflict between real estate investment and operating resources

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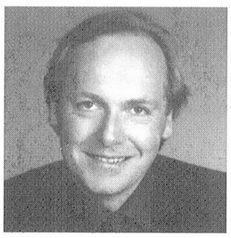

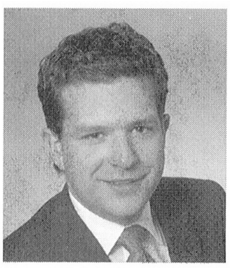

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Abstract

A great number of German companies are suffering an acute financial crisis. Financial optimisation of the substantial property holdings owned by German companies offers an opportunity to reduce costs and to free up capital. However, the demands on property for operational purposes create difficulties when optimisation is carried out exclusively for financial objectives. In this paper it will be shown, by means of an empirical investigation of real estate directors and financial managers of the leading German undertakings, that companies are failing to take the decisive step towards optimisation. The reason for this lies in inadequate internal preparations, manifested in the lack of a linkage between real estate strategy and corporate strategy. Property rights-oriented analyses of real estate assets create new scope to refinance existing holdings, without sacrificing the important requirements of the units occupying them. This paper discusses the essential steps to a solution and explains the potentials that can be enhanced by a structured financial optimisation of property holdings.

Keywords: corporate real estate, real estate finance, real estate strategy, financial optimisation, real estate property rights

INTRODUCTION

An acute financial crisis is threatening many German companies. The main causes are the disclosure of hidden reserves associated with the change in accounting methods to International Accounting Standards (IAS); the current massive pressure on costs; tighter restrictions on corporate financing (Basel II); and in particular German companies' shortage of capital resources. At the same time, German corporations have, on average, 10 per cent of their capital tied to real estate.[2] As a result the core business is deprived of the capital tied up in property, which moreover is often shown below its market value in balance sheets. In 1991, in absolute figures, the real value of the property assets of German companies was DM3,176bn (*c.* €1,600bn).[3] Considering the financial problems, the current very high level of real estate, in terms of both assets and costs, in German companies no longer makes sense. What is required is a substantial reduction in the amount of capital tied up in property, with the aim of improving balance sheet ratios and increasing value added, as well as reducing property-related costs.

However, the financial optimisation of property assets is not without its problems.[4] In non-property companies, there are dual objectives for real estate assets. On the one hand, the properties are needed to provide a physical covering for operational processes. To provide the best possible services, internal company users are interested in spacious and comfortable workplaces, with a high level of architectural and technical features, over which they have unrestricted powers of disposition.

On the other hand, real estate — because of the costs it creates and its capital intensity — is subject to the typical freeholders' financial goals such as maximising return on capital or value added. Unfortunately there is a conflict of objectives between operational aims, directed toward optimal use of floorspace, and the financial aims of the company's owners.[5]

A survey of corporate real estate managers from the largest German companies has shown that the two objectives are given almost the same level of importance.[6] Optimising corporate property on the basis of financial targets, for example with the help of shareholder value management, jeopardises productivity in operational divisions. Although in principle it is possible to optimise corporate property according to the aims of the owner and the user simultaneously, in practice there are a number of obstacles, including a considerable dearth of information about property costs and uses, as well as principal–agent problems.[7] The above-mentioned study therefore showed that German companies' cost structures are ill-defined and this, combined with inadequately developed control systems, practically encourages uneconomic dealings with property.

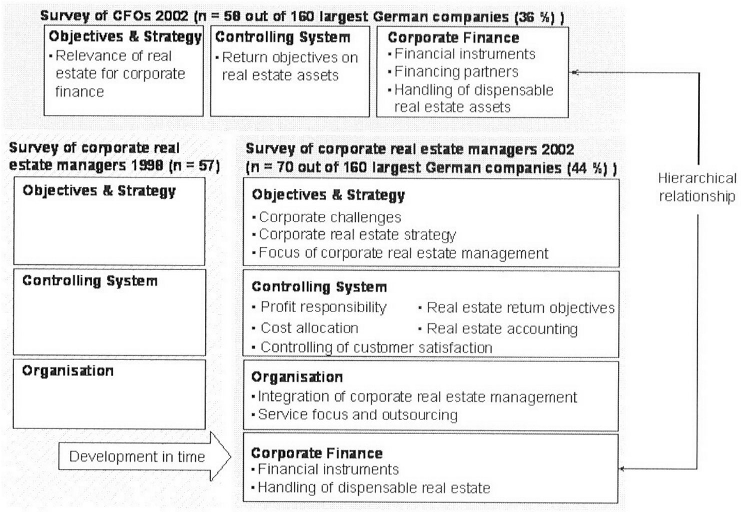
This paper will show that a financial optimisation of property assets is possible without neglecting the interests of users. The results are based on a survey of major German companies carried out in 2002. The results of the study provide a basic understanding of the currently observed stagnation in German corporate real estate management and give valuable pointers for the financial optimisation of company property assets.

EMPIRICAL RESULTS

Methodology

A telephone questionnaire of property managers of German non-property companies was carried out in 2002.[8] The aim of the survey was to draw conclusions about the importance of property assets. An intensive preliminary study had justified the suspicion that, in contrast to the comprehensive introduction of capital-oriented management systems in major German companies, no attention was being paid to the capital engaged in property. The current poll, in contrast to a survey of

Figure 1 Topics and general content of the empirical investigation



corporate real estate managers in the same statistical population carried out in 1998,[9] was expanded to include a survey of financial directors on the role of property assets in corporate finance. The reasons for this were, first, that property managers are not usually responsible for the finance of real estate assets, and secondly that financing pursues corporate, rather than property, objectives. The structure of the questionnaire is shown in Figure 1.

The basic statistical population of the study included all 160 German companies employing more than 9,000 staff: 58 financial directors and 70 property directors took part. The proportion responding, 36 per cent of financial directors and 44 per cent of property directors, was considerably higher than is usual for such studies. For an outline analysis of the respondents by business sector, see Figure 2.

The most important results are briefly described and interpreted below.

Results and interpretation

Requirements lacking in property management

Only about half the companies had the first prerequisite for effective property management: a rigorous real estate strategy for the group and its subsidiaries. Less than half the companies surveyed had linked such a strategy with the strategy of their core business (see Figure 3). In view of the high stickiness and illiquidity of real estate as an economic good, the lack of a longer-term, but at the same time flexible, strategy for real estate assets holds incalculable financial risks.

Ever more frequently, office buildings are being constructed on factory sites for divisions of companies that, following the strategic concept of their group, should long since have been rationalised or sold off. The lack of coordination between corporate and real estate strategy can also mean that property management opportunities are being thrown away; only in rare instances are users asked for their opinion on the quality of accommodation. It remains questionable whether effective real estate strategies for the company can be followed, in view of the lack of guidelines and controls.

Instead of this, companies are concentrating on increasing the capacity of their property departments by building up a full range of services. 'One-stop property management' and 'insourcing'

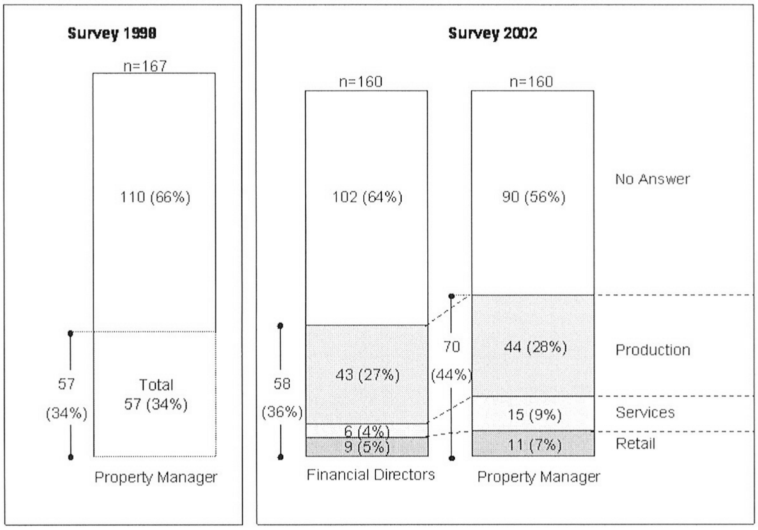


Figure 2 Breakdown of participants

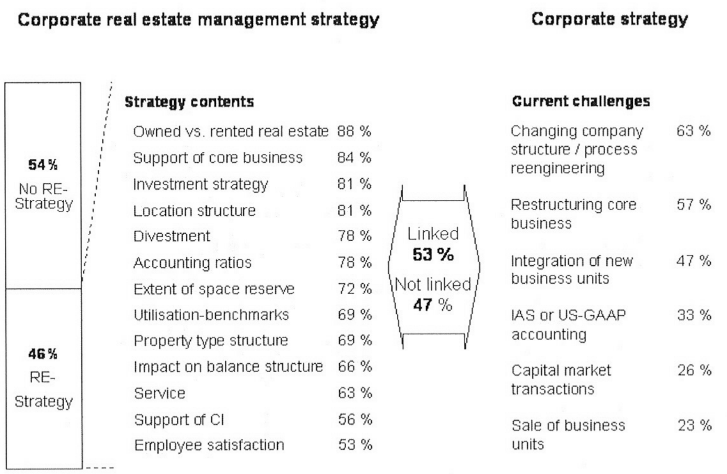
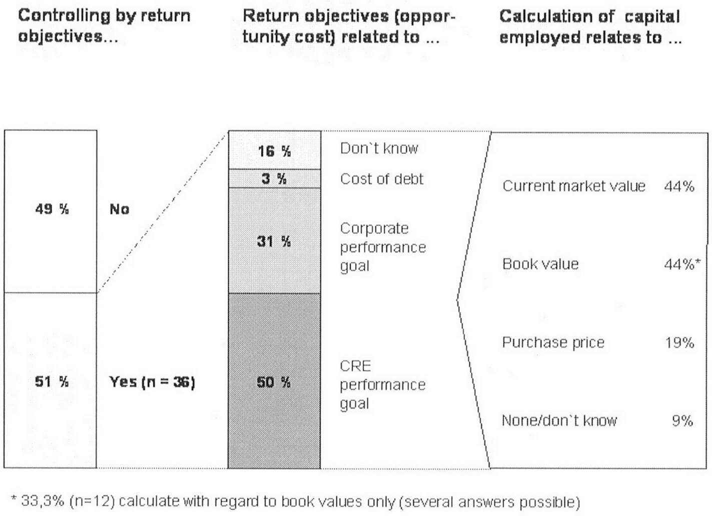


Figure 3 Linking real estate strategy with corporate strategy

are the watchwords. In this way the companies have created largely self-sufficient 'property islands', a long way from the 'mainland' strategies of the group.

Even if there is no dedicated planning and control of property services in the group, it could at least be expected that the company would set up measures to increase cost efficiency. The most tried and tested possibility is to introduce market mechanisms. On this point the theory of cost allocation says: 'Wherever there is a market price, use it!' The application of near-market prices should restrict users, to a reasonable extent, to their actual space requirements. However, as Figure 4 shows, even in this respect only about half the companies surveyed are prepared to follow this maxim.

Figure 4 The use of market mechanisms



Looking at the results of the investigation as a whole, it is clear that in many companies the opportunities for optimising added value in property management are far from being exhausted. The necessary strategic concepts are just as lacking as the methods of supervision and control.

Real estate is largely dead capital

In Germany, more than three-quarters of corporate-occupied property is in the freehold ownership of the company (see Figure 5).

The high level of freehold ownership by companies in Germany is in stark contrast to other countries, particularly the USA, where companies own only about a third of corporate-occupied property. This may not be a mistake in itself, as, unlike most operational resources, property can also be a capital investment, if properly organised in terms of tax, yield and risk diversification. However, the high level of ownership is open to question when — as in 46 per cent of the companies surveyed — no standards have been set for the yield on the capital tied up in property.

Up to the present, alternative methods of raising capital, such as the issue of property investment funds, the securitisation of property assets or the issue of participating certificates are hardly — or at most marginally — used as part of the financing armoury of the property departments. Here there is further confirmation of the situation demonstrated by the organisation of property management: in the last few years efforts have been made to unravel property management from the organisation rather than towards an integration of property-specific opportunities for added value. For their management, the 'property islands' that have been created lack any incentive to contribute to corporate finances. Quite the opposite: merging the equity tied up in property would endanger the fabric of the empires that have been created.

Unlike the property managers, financial directors are slowly recognising the scope offered by alternative methods of financ-

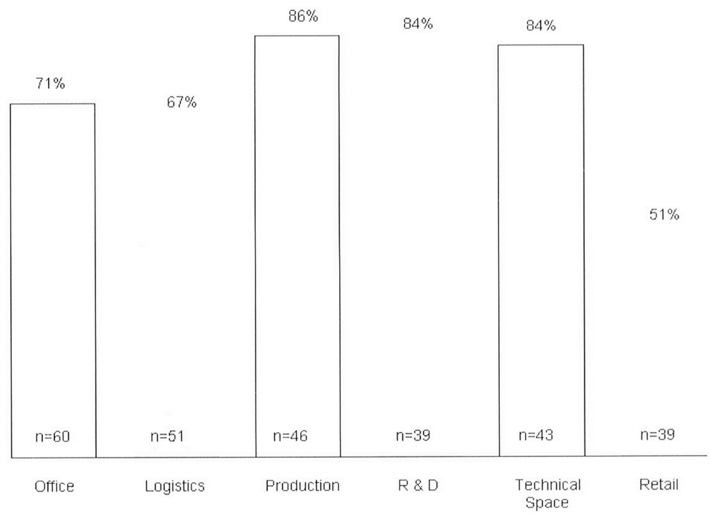


Figure 5 Corporate-occupied property: Breakdown of ownership

ing. For example, 17 per cent of the financial directors surveyed are planning securitisation of property assets, compared with only 3 per cent of property managers who intend to adopt this method; and 21 per cent of financial directors are planning to use fund-financing models compared with only 13 per cent of property directors. The shortcomings become evident when looking at how managers include real estate for corporate finance purposes. Table 2 indicates the small proportion of planned corporate finance volume taking the company's real estate assets into account. These discrepancies illustrate the theory that there is a lack of coordination between group and property management.

The empirical results make one thing quite clear: at the moment German companies are underestimating the financial potential for optimising their property assets. The possibilities offered by a growing market for real estate finance are largely being ignored. Instead of integrating the potential value from property into the activities of the company, the main task of the property divisions is a one-dimensional strategy of disinvestment.

THE MISSING LINK BETWEEN PROPERTY OPTIMISATION AND FINANCIAL PERSPECTIVE: AN ANALYSIS

The state of the evolution of property management in major German companies presents a sobering picture. In view of the pressing financing problems in many companies, it must be questioned why, until now, nothing more has been done to improve the financial potential of corporate property.

Closer analysis of property management shows that, currently, the starting point has not been properly identified, and that the real problems are not being addressed.

If the companies mainly continue as they have so far, it is evident that there will be a considerable gap between an optimal solution in terms of 'best practice' and the status quo of property management as evidenced by the survey. A gap analysis makes clear the key points required to close the gaps in implementation.

Lack of transparency

The basis of the dilemma in the real estate economy is the lack of transparency

Table 1: Employment of alternative forms of financing to refinance property assets

Financial instruments	*CRE-Managers* *Importance (1–7)*	*Implementation (planned)*	*CFOs* *Importance (1–7)*	*Implementation (planned)*
Mortgages	2.5	7%	2.3	5%
Registration of land charges	2.9	4%	2.9	3%
Sale and leaseback	2.8	13%	3.0	2%
Securitisation	1.7	3%	2.1	17%
Fund investment	1.6	13%	1.8	21%

Table 2: Volume of real estate financing expected in the next three years

Volume of Finance in € million	*Proportion of Companies Surveyed*
0	22%
<50 million	16%
>50 million	33%
No answer	14%
Don't know	16%

in property management observed by Pfnuer.[10] In this respect, for many companies, nothing has changed up to the present. Their problems are based not just on *won't* but also on *can't*.

Weaknesses of method are particularly evident in property valuation. For example, market values assessed in accordance with the *Wertermittlungsverordnung* (statutory German Valuation Order or *WertV*) are in many cases also used in internal accounting for control purposes. The *WertV* standards, which provide for 'snapshot' valuations at a particular point in time, result in valuations that are out of date before they have been determined. The main problem, however, is that, in their character as objective valuations, purposely calculated at arm's length from the individual circumstances of the owner and potential purchasers, they do not fit the valuation problem. For example, *Substanzwerte* (roughly equivalent to depreciated replacement cost (DRC) valuations), which are often used in the commercial sector for production facilities and special properties, give a false indication of the financial value of the property. Even more problematic than the use of *WertV* bases of valuation is the use of balance sheet or 'book' values of property assets for corporate control purposes.

Some German companies not uncommonly have hidden assets, in excess of 50 per cent of property values, in their capital invested in real estate. In contrast, other companies have incurred book losses in their property assets. For example, only recently Deutsche Telekom has had to lower its value estimates for property assets several times. However, the real problem is not in the fluctuating

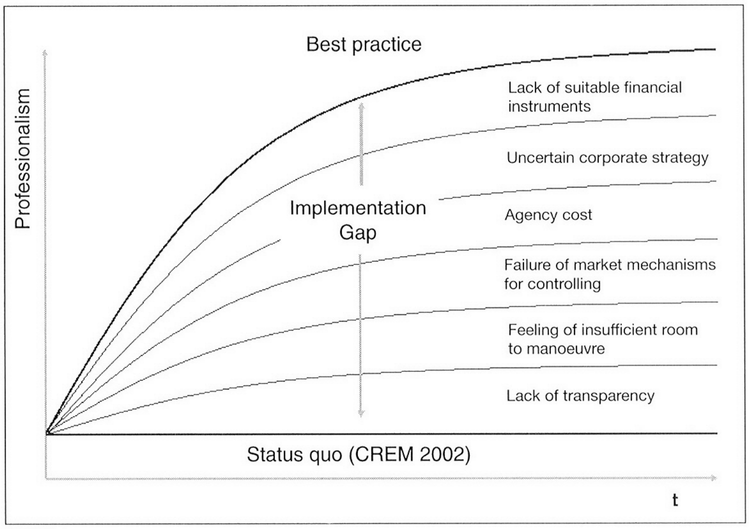


Figure 6 Gap analysis to describe problems of implementation

values of property assets and their estimated values. It is problematic, however, when companies do not know the true value of their properties and rely on book values. Without an approximate idea of the amount of capital involved and the financial effectiveness of property management processes it is absolutely impossible to utilise property resources efficiently.

The lack of transparency of the value of property assets extends outside the company. Often not only the directors but also the shareholders and stock-market analysts are in the dark about the value of the properties. An analysis of share price movements of the 30 DAX-quoted companies from 1998 to 2002 demonstrates that no significant change in share prices was observed in reaction to the announcement of major events from corporate real estate management departments.[11] In Germany therefore, unlike in the USA, the stock markets do not react to corporate real estate management changes in non-property companies. (For an outline of the position in the USA, see Table 3 and the studies there listed.)

The feeling of insufficient room to manoeuvre

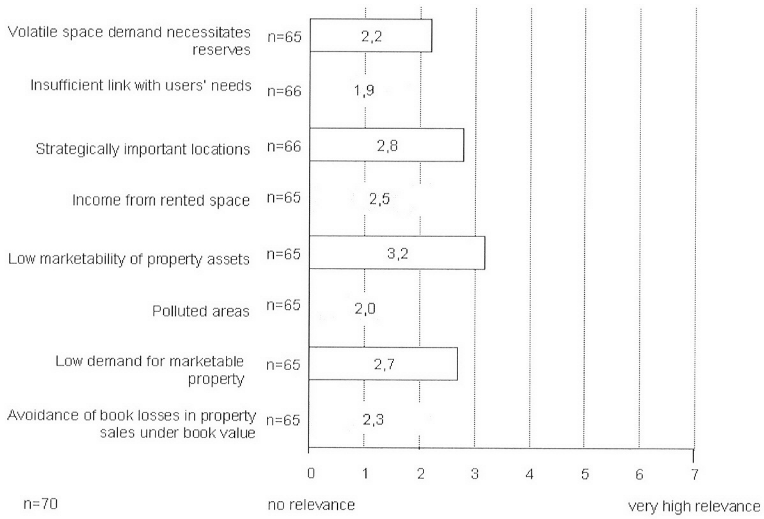
An important reason for the property managers' inactivity is the subjective impression that there is no room for manoeuvre. True to the maxim that they lack flexibility, the property managers surveyed perceived a whole series of objections to the financial optimisation of the property assets. For example, Figure 7 analyses the reasons given for retaining non-essential properties.

The major reason for the large amount of properties held in ownership is the fact that those responsible consider that the property could not be marketed at a profit. What is required here is first an innovative marketing concept for individual properties and secondly, direct disclosure of actual values. The same problem with valuation techniques that was discussed in connection with company control crops up again here. The question as to how much a property is worth is often extremely relative. For example, the value of the BASF Ludwigshafen works could be estimated, equally logically, at several billion Euro or at a negative figure. For the first scenario it is

Table 3: Overview of the financial consequences of real estate decisions of US companies

Statement	*Verifying Study*
The more extensive the property ownership, the more likelihood there is of a hostile takeover	Ambrose[12]
Relocating the head office leads to an increase in share price	Alli/Ramirez/Yung[13]
Except for: relocations motivated by the personal interests of the management lead to share price falls	Ghosh/Rodriguez/Sirmans[14]
Companies that rent property rather than buying it have higher stock market values	Allen/Rutherford/Springer[15]
Buying property does not lead to a positive movement of share prices	Glascock/Davidson/Sirmans[16]
Selling property leads to an increase in share price	Glascock/Davidson/Sirmans[17]
Stock markets react positively to joint ventures in the property area	Elayan[18]
Sale and leaseback transactions lead to a significant rise in share price	Slovin/Sushka/Polonchek and Rutherford[19]
Hiving off the property department causes an increase in share price	Ball/Rutherford/Shaw[20]

Figure 7 Reasons for retaining non-essential property holdings



assumed that Ludwigshafen will remain a prosperous economic location and that BASF will continue to occupy the space. In the second instance the presupposition is that BASF will cease occupation. As a result the site would be comparatively worthless, particularly as comprehensive decontamination would be required before it could be put to an alternative use. Against the background of the second scenario it quickly becomes clear why property managers could see no possibility for making a profit. However, it is also evident that reality must lie somewhere in the middle, between the extremes of these scenarios. Companies that do not have a technically sound method of assessing property values would probably never discover this.

The failure of cost pricing in controlling

Up to now all the hopes of property experts, both in research and in practice, have rested on the healing powers of market mechanisms for the control of holdings. It is undisputed that, on paper, an efficient allocation of resources can be achieved with the help of market price systems. However, in property management this outcome remains just theoretical. In its application, the gently acting power of market prices is not quite as good at fulfilling the controlling function as it is at allocation. At times when things are going either particularly well or particularly badly for the company, stronger controlling forces are needed than can be provided by market-pricing mechanisms alone. When the company is doing well, department heads are inclined to build up reserves. In the time-honoured way, overheads then rise. In times of recession, as at the moment, the controlling pressure that market prices can exert fizzles out. It is therefore hardly surprising that the market orientation of corporate property management has only been adopted to a limited extent, despite being continually demanded by the research and consultancy sectors. The current problems of property management are not likely to be solved by bringing in market-price mechanisms.

Agency problems

It is well known, from the new institutional economy, that corporate decisions are made by people whose primary aim is to maximise their own personal benefits. It is the task of management to set up structures that make sure that the employees' interests are not too far removed from those of the company. Properties are places to live and work, and as such they are considerably more than just operating resources. Whether used commercially or privately, they display a whole range of psychological, sociological, town-planning related, ecological, economic and management effects. Real estate decisions are therefore subject to management rationality only to a limited extent. There are no real estate decisions that are influenced by corporate aims alone. Examples that are widely known include the 'image' of a location or property, proximity to a place of residence or the social effects of the size and standard of fit-out of offices. With regard to the methodological problems in the estimation of management costs and benefits of property, there is hardly a more penetrating fog than that from hierarchies in which each decision maker can pursue their own interests in a largely uncontrolled way. Not least because of this vague situation, the control methods that are available, in particular the market price system discussed above, lose their striking power.

Uncertainty about corporate strategy

Viewed strategically, companies are navigating into an uncertain future. Without doubt this problem has effects on their property holdings. The inherent inflexibility of real estate resources ensures that not every strategic reorganisation can be put into action without delays caused by property resources. On the other hand, strategic flexibility often implies a special type of property fit-out. The result is a more or less extensive stockpile of property in German companies. In this respect the directors responsible are generally unwilling to take risks. If the sale of property threatens the company's strategic options — however realistic these may or may not be — no more sales will take place. Often the mere worry that the space might one day regain its relevance is enough to have the property classified as a strategically significant resource and therefore no longer available for disposal outside the company.

Decision theory can offer only one tried and tested way to combat uncertainty: flexibility. In the future, the company's property managers must ensure that the core business has property holdings at its disposal that are characterised by optimal strategic flexibility. As flexibility is usually linked with costs, this does not mean that increased flexibility will automatically mean increased efficiency. It is much more important to give thought to how the benefits of strategic flexibility can be assessed in order to compare them with the resulting costs.

Whereas the uncertainty about the strategy of the company presents a problem for property management that is hardly capable of complete solution, in the strategic area there is an unnecessary but considerably more serious weakness. Hardly any German companies have corporate and real estate strategies that are interlinked. As a result their property managers build, buy or lease properties inappropriate to needs; or they dispose of properties that would be valuable for the current corporate strategy. Put another way, optimal strategic positioning of the company necessitates the optimal utilisation of all resources. Particularly in times when increasingly sophisticated advantages over the competition in property resources can be achieved, a detailed analysis of property resources is a prerequisite for the formulation of an effective corporate strategy. In corporate property management, what is needed is a much stronger integration with the strategic processes of the company, in stark contradiction of the tendencies towards independence and hiving-off seen in the last few years.

Lack of suitable alternative financing methods

A further obstacle for property management in Germany in the next few years will be dealing with innovative financing instruments. As the empirical analysis showed, only a few companies have experience of establishing property funds, securitisation of property assets, or loans by participating certificates. This is not the fault of the companies themselves but is rather due to a general lack of marketable products. In order not to part with the family silver too hastily, companies need a close cooperation between their financial and property departments to examine the new products closely and to organise a financial strategy adapted to their circumstances.

As a closing observation on the causes for the stagnation in the development of property management in German companies, it must be made clear that there is a whole string of good reasons for it. In the end all these reasons lead back to the fact that there are hardly any answers to the following key questions, which each company must answer for itself: How important is it to own property? And what importance does the occupation of property have for the company?

THE BASICS OF FINANCIAL OPTIMISATION IN CORPORATE REAL ESTATE MANAGEMENT

Property offers important opportunities for corporate finance: it can be used as security for borrowed capital and has income as well as balance sheet effects when appropriately structured. As the empirical study demonstrated, it is precisely these resources that are still being left unused.

Property management units and also financial directors have hardly recognised the potential. An important approach to reducing the conflict between corporate financing and corporate real estate management lies in reducing the amount of capital tied up in property assets. There is sufficient capital currently available on the German capital markets to be placed in real estate investments.

For example, in 2002 the open-ended property funds received a net inflow of €14.9bn.[21] The stock-market slumps of 2001 and 2002 led private investors increasingly to shift their assets into less volatile investments. In both economic and psychological terms, property investments, in the form of either direct or indirect vehicles, have a high importance in this regard. The capital flows into the open-ended property funds are not necessarily due to the advantages of these investment alternatives as far as the objectives of the investors go. Other financial forms could be significantly more suitably tailored to the real estate investment requirements of private and institutional investors, but are at present not available on a sufficient scale.

With the help of their properties, many companies could take advantage of this supply of capital. If property can be successfully refinanced while preserving the rights of disposition (property rights) needed,[22] the cost of owning real estate can be substantially reduced. In addition the company acquires fresh capital, which can be applied to the core business. A prerequisite for optimisation is the granting of the necessary powers of disposition to the corporate real estate management. The aims of shareholder value management are biased towards the investment perspective and cannot result in a simultaneous optimisation. The equal levels of importance given to the user perspective and the investment perspective in German companies appear to require a simultaneous optimisation.

A varied range of products has been established on the financial markets in the last few years.[23] Figure 8 illustrates the different variants that are available for property finance.

The varying provisions conferring property rights in each financing variant allow for alternative financing to be structured according to the rights of disposition desired. The choice of the optimum form of financing should reduce the capital commitment as much as possible while at the same time recognising the protection of the defined property rights. In this way the characteristic conflict of objectives between corporate finance and the use of property as an operating resource can be overcome.

Specific analyses of the property rights of real estate assets create a scope that goes beyond unilateral optimisation. The different forms of financing instruments (ownership, renting, leasing, asset-backed securities (ABS), etc) are associated with differing and highly distinct property rights. Freehold ownership ensures that the company owns all rights to use, rearrange and dispose of the property. ABS, for instance, allow comprehensive rights of use up to the dissolution of the securitisation instrument. However, the company loses the chance — but at the same time the risk — of making a profit on disposal. In many cases the property rights conferred by an alternative form of financing the properties are sufficient for them to retain their strategic importance. For a comparison between the effects of three different methods of holding property, see Table 4.

Financial potentials can be increased by structured preparation in the course of an effective real estate corporate finance. The expression 'real estate corporate

Figure 8
Alternative methods of financing: The spectrum

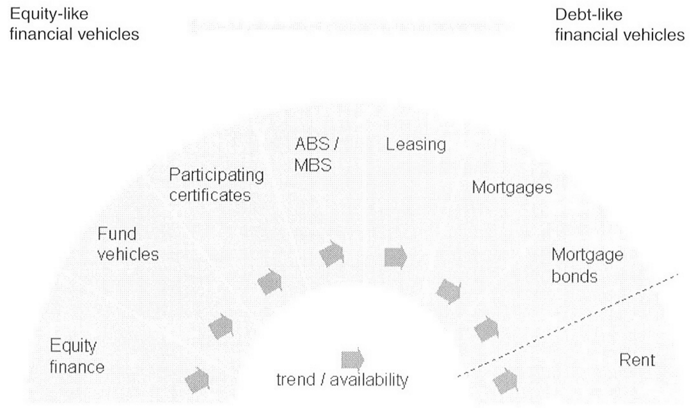


Table 4: Property rights under alternative forms of financing[24]

Right	*Purchase*	*Renting*	*Leasing*
Use	• Limited only by statutory restrictions	• Limited to the use in the lease agreement • Contractual liabilities • Limited period	• Limited only by statutory restrictions • Limited period
Disposal	• At any time, provided a purchaser can be found	• No	• After exercising the option to purchase, provided a purchaser can be found
Realisation of profits and losses on disposal	• Unlimited	• Subletting depending on individual contract: usually expected	• Subletting depending on individual contract: usually permitted
Modification of form and substance	• Limited only by statutory restrictions	• Requires agreement with the landlord	• Requires agreement with the leasing company

finance' can be defined as the aggregate of all measures for the financial optimisation of property holdings for corporate finance objectives.[25] The financial and real estate departments must take joint responsibility for resolving the optimal application of capital to corporate property assets. In the future their contribution to the structure of the liabilities side of the balance sheet will increase considerably. However, they must not interfere with strategic demands

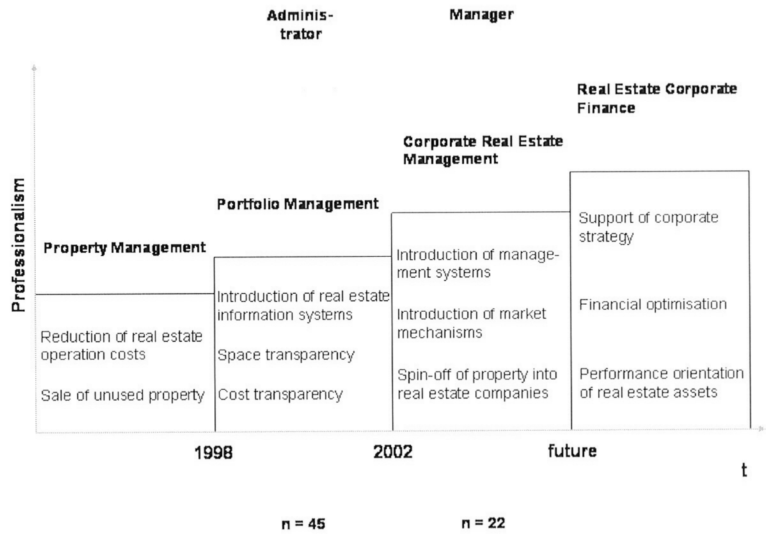


Figure 9: Development of corporate property management in Germany

for use of the properties.

For the German market it is possible to outline a route for the development of corporate property management in Germany, which comprises the four steps outlined in Figure 9.[26]

Whereas, during the property management and portfolio management phases, only one-sided demands were placed on corporate real estate management from the corporate finance, in the meantime this approach has reached its limits. Cost reduction and disinvestment measures have reached a position which demonstrates a higher degree of efficiency. Further optimisation is possible only by weighing up the consequences for, and restrictions on, the core business.

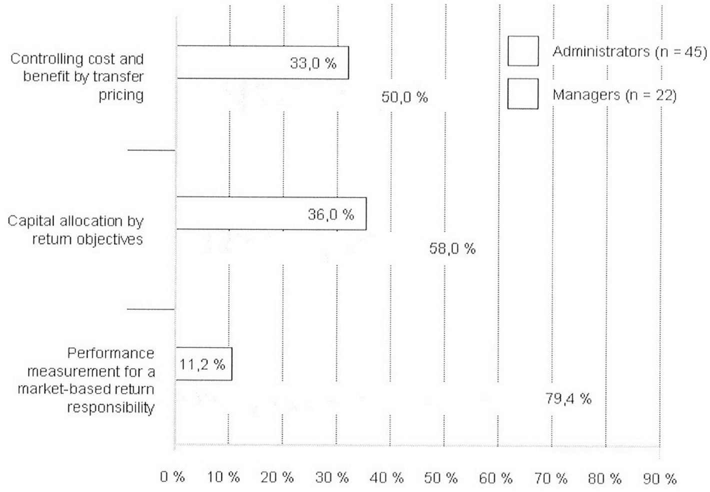
The current survey not only shows the general route, but also allows for statements about the stage of development which individual groups of German companies are currently experiencing. The cluster analysis reported in Figure 10 identified two groups of companies that differ considerably in their stages of development.

As Figure 10 shows, the stages of development of corporate property management differ enormously. Although in a third of the companies it is possible to refer to professional management of the property as corporate real estate management, two-thirds of them manage their property resources as supply managers *mehr schlecht als recht* — that is in at best a rough-and-ready manner.

It is clear, however, that all companies are fighting shy of the last stage — real estate corporate finance. It is precisely for this decisive step, by which the considerable remaining potentials could be enhanced, that companies lack clarity as to the strategic importance that should be allocated to their respective property assets. The cause is the lack of interlocking between property strategy and corporate strategy. The companies are not aware of a suitable set of instruments that allows them to assess and to overcome the restrictions hindering the financial flexibility in the use of their property.

If these companies want to continue the optimisation of corporate real estate

Figure 10 Stage of development of property management in German companies (cluster analysis)



management, a complete definition of the property rights and user demands on their property assets will be essential. The results will determine the strategic requirements according to which the financial optimisation of their corporate real estate can take place.

PREPARATION OF CORPORATE REAL ESTATE FOR REAL ESTATE FINANCE TRANSACTIONS

It appears obvious that it is mainly internal obstacles that contribute to the unsatisfactory development of corporate real estate management. Many companies are prevented from taking advantage of attractive potential benefits in the use of real estate corporate finance if they have not succeeded in structuring their property assets appropriately. The integration of the property users' requirements and the optimisation of financial demands at corporate strategy level first needs to be prepared. The stages of this preparation can be divided into three core points: first the introduction of a thorough process of optimisation of accommodation: secondly, linkage with the planning system; and thirdly, derived from that, the definition of the property rights required for the real estate assets.

Optimisation of accommodation

The way out of the current dilemma can only be achieved by a fundamentally fresh start to corporate property management. The paradigm of this new beginning will be dominated by the idea that each property should be put to its highest and best use.[27] In place of the price mechanism, this situation demands strong leadership. Failing that, it will not be possible to breach the present barriers preventing the unravelling of properties from their former uses. The next step will be a notional disposal of the properties that have been freed from their current uses. The notional sale of the properties will provide a true indication of value and will show the financing potential of the real estate holdings.

Users will then be confronted with the (opportunity) costs of their accommodation, measured on the newly introduced cost concept of the property holdings.

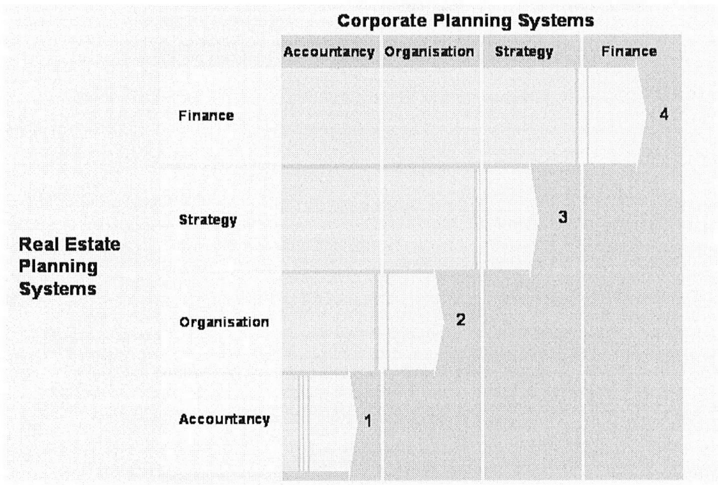


Figure 11 Integration of the planning system

A consolidation of accommodation will follow, in which the available accommodation will be put to efficient use. A constituent part of the consolidation will, where necessary, be a revitalisation of the space. The space could be disposed of to third parties; or internally redistributed; or remain in its previous use. As a result, the company's accommodation will have been rearranged to cope with the demands of its users to the best possible extent.

Integrating the planning system

At the same time as the accommodation is being optimised, financial optimisation of the property assets will be carried out. As well as the necessary property rights, efficient alternative financing instruments, which will strengthen the financial position of the company, will be sought out. The freeing-up of financial resources is the current objective of a range of services offered by the banking sector under such designations as 'real estate investment banking' or 'property banking'. In order for such measures to be successful it is crucial that the importance of the particular property to the company is first clarified. This is to ensure that property rights, which cannot be restored later, are not relinquished in haste. A fundamental success factor for alternative financing concepts for property holdings is to run through the process outlined in Figure 11.

A mutual pushing through of the planning system for property management and the corporation in the stages of accountancy (1) and organisation (2) creates the prerequisites for the effective integration of property into the (3) corporate strategy. Without a linkage to the accounting department the potential for optimisation can be only very roughly assessed. The connection at organisational level establishes the absolute prerequisite of actually being able to put the potential optimisations into action without disagreeable side effects. From this linkage it will be clear which property rights the corporation should retain over its holdings. It is only on the basis of this preliminary work that (4) alternative financing concepts can lead to real improvements in effectiveness.

Defining necessary property rights

In German companies it is not only the determination to apply this procedure consistently that is lacking. Even when space planning already constitutes a permanent component of property management activities, an important aspect is often overlooked. In many cases the company needs only limited property rights over its land and buildings. It is far from necessary to own the freehold interest in every case. The problem of property rights required is of fundamental importance in the improvement of financial reserves in property assets. It makes a major difference, for example, whether the corporation wishes merely to occupy the space or whether a continuing right to alter the accommodation needs to be retained. In the latter case the company must retain freehold ownership, or ensure that appropriate contractual rights are reserved in an individual agreement. In the former case, a sale of the accommodation would normally present no difficulty.

The property rights analysis shows the objectives that the company is pursuing with its properties. In the results it can also emerge that, corresponding to the strategy being followed, the company views some properties as having a high potential for growth in value. From a financial viewpoint, there would then be no question of a sale during the planning stage.

For the majority of properties, the results of the analysis of property rights necessary for the corporation create additional scope for negotiation in financing. The main argument against sale — that the properties are necessary for the company's activities and are therefore not available for disposal — is then no longer tenable. It is high time to sweep away a common mistake in Germany: it is not the freehold that the company needs, but rather particular property rights which can be derived from the corporate strategy, over the corporate property.

Measures towards financial optimisation

The key question to be answered is: what are the specific measures available to companies to optimise the financial structure of their property holdings? In principle, there is a varied range of instruments for the provision of equity, borrowed and mezzanine capital. Mezzanine finance combines characteristics of both the first two types of capital. In addition to receiving a fixed rate of interest, in this instance the lender is also regularly paid a proportion of the income from the investment being financed. This proportion can be determined in very different ways, of which a typical example is the issue of participating capital. As well as traditional real estate loans, large tranches of outside finance can be raised in the form of bonds, ABS or mortgage-backed securities. In the equity capital area there is a choice between the issue of company share certificates or investment funds. In a special purpose vehicle (SPV) the total amount of finance is pooled and then refinanced, applying the instruments mentioned, as a structured financing with different layers of risk.

SUMMARY AND CONCLUSION

This paper first explored the scope German companies have between the aims of financial optimisation and corporate use of their property holdings. An empirical study demonstrated that the effects of the latest developments in real estate finance and the resulting opportunities for non-property companies in Germany are still insufficiently recognised and made use of. The reasons for this can be traced principally to the lack of the fundamentals of corporate property management. The absence of a linkage between corporate and real estate strategies results in companies not being able to define clear future requirements for their property holdings. The future value of property for the corporation remains just as uncertain as the existing possibilities for optimisation. At present, to release financial potential German companies are using only properties that are no longer necessary for corporate purposes.

Between the two viewpoints — of the employment of real estate in corporate finance and as an operational resource — an increasing conflict of objectives has built up. This can only be alleviated by a comprehensive examination of all the economic consequences for each company, in the course of a real estate finance scheme. In the future, to raise the financing potential of property which will continue to be used by the company, planning systems must be instigated. These will make the costs and benefits of the company's property holdings clear, both in terms of internal uses and for disposal externally. To this end the property management planning system must be integrated with the corporate planning system.

On the basis of this, more sophisticated real estate planning financial opportunities can be identified. These can be improved by applying modern financing instruments that so far have hardly been used in Germany. Which of the available financial instruments should be employed will depend first on an analysis of the property rights that the company needs to retain in each property unit. On the other hand, the properties must be capable of placement on the capital markets, so that current taxation and general market conditions for the raising of fresh capital from property assets must be taken into account.

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