



Monthly Research Briefing: May 2007 Transaction Management Performance II:

Setting Performance Standards Pre-Deal and Evaluating Performance Post-Deal

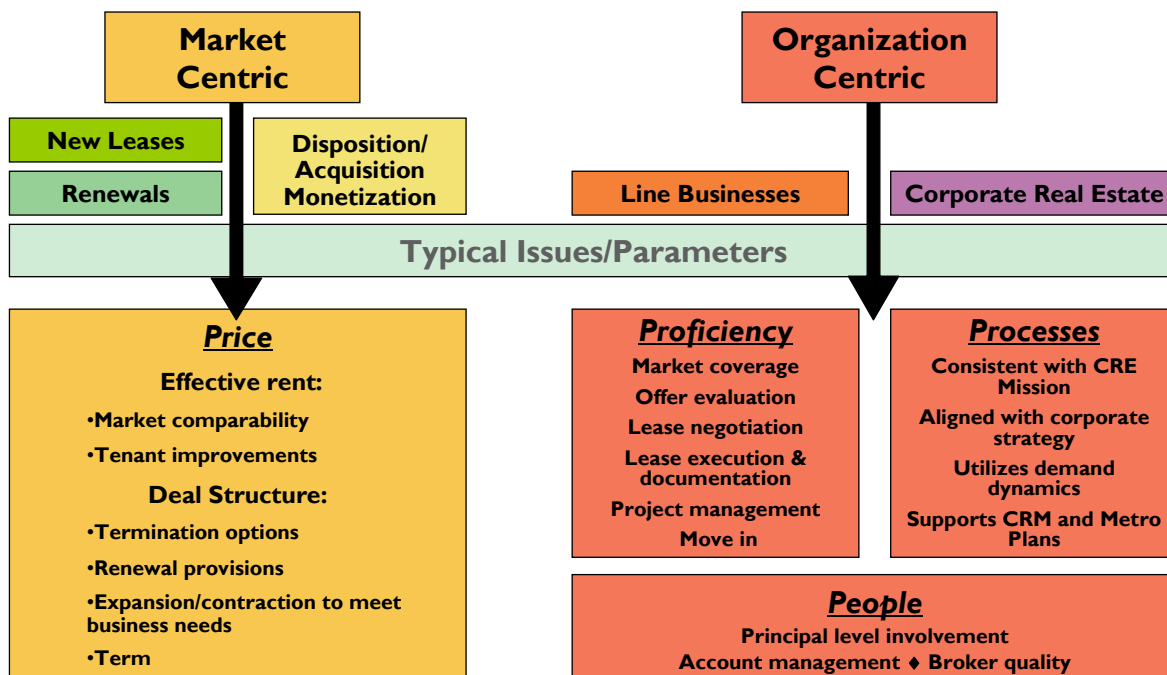
Proper alignment of incentives fosters better transaction management performance, yet such alignment can only be achieved when there are established frameworks and metrics for success. We believe that transaction management performance measurement remains more subjective than necessary, and this month's research brief provides a framework for action on how your CRE platform can establish performance standards that translate to being more opportunistic, cost effective and service driven. These standards also can form the basis for establishing incentives with your transaction service providers ("TM") that truly "pay for performance". As discussed in our April Research Brief and Webinar, **optimum deal pricing and structure is a much more important financial objective than commission rebates and represents THE central financial opportunity in transaction management.** In this Brief we present a framework for identifying the essential elements of transaction management performance. We then explore a "market centric" method for establishing a "Deal Zone" which sets performance parameters prior to the lease negotiation and then provides a basis for quantifying the actual broker performance on that deal.

Establishing your Transaction Performance Standards It is important to assess both the what and the how of the deals produced by your TM. In Figure One on the following page, we present a graphic framework for identifying the essential elements of a transaction performance measurement system. We divide the framework into both external forces – in this case how your TM serves you in the external real estate market, and internal considerations – how the TM works with your organization, the skills and resources they bring, and the way they service your account. We will discuss Organization-Centric factors, which play a large role in the selection of TMs for "preferred provider" or "sole source" contracts, first.

Organization-Centric Performance Parameters We've grouped the organizational parameters for transaction performance measurement into three categories: "proficiencies", "processes" and "people".

Proficiency Job one is selecting a transaction manager that has strong broker coverage in your key locations, either as part of their firm, or through networks and alliances. Coverage in the right mix of property types found in your portfolio - commercial office, industrial or retail - is also important. If you anticipate heavy disposal activity, or monetization of assets through sale-leasebacks, you will also want to focus on that firm's connections to the investment real estate community. What kind of market muscle and connections will they bring to your more complex deals? The way in which market intelligence is acquired and used to your benefit is becoming an increasingly important criterion – however, while many TM firms today either produce or buy **market data, few brokers are trained in its proper application to portfolio decisions. The TM firm should be able to present a clearly defined process for shopping deals, evaluating offers, negotiating leases and executing transactions, as well as defined time and performance standards, such as turn-around times and the number of detailed comparables to be submitted.** Some corporations are also looking for "one-stop shopping" capabilities that include project management and move-in coordination services, especially for projects located outside of the headquarters metro area.

Figure One: Parameters for Transaction Performance Management Standards



Processes Processes are the “how” of your account management. How well will the TM firm support your internal CRE goals? Do they demonstrate knowledge, and more importantly, curiosity, about how CRE supports the overall competitive mission of the organization? Do they provide analyses that can be easily incorporated into your demand forecasting and metro planning processes? It is important that the corporate real estate buyer clearly articulates the type of strategic support they desire from the TM firm, and how that support will be paid for, either as a separate consulting fee or rolled into the contract. Some Place Strategy Partners report that there is a tendency for TM firms to “over-promise and under-deliver” **strategic planning support unless it is clearly specified in the contract and there is a means to measure both the quantity and quality the support delivered over time.**

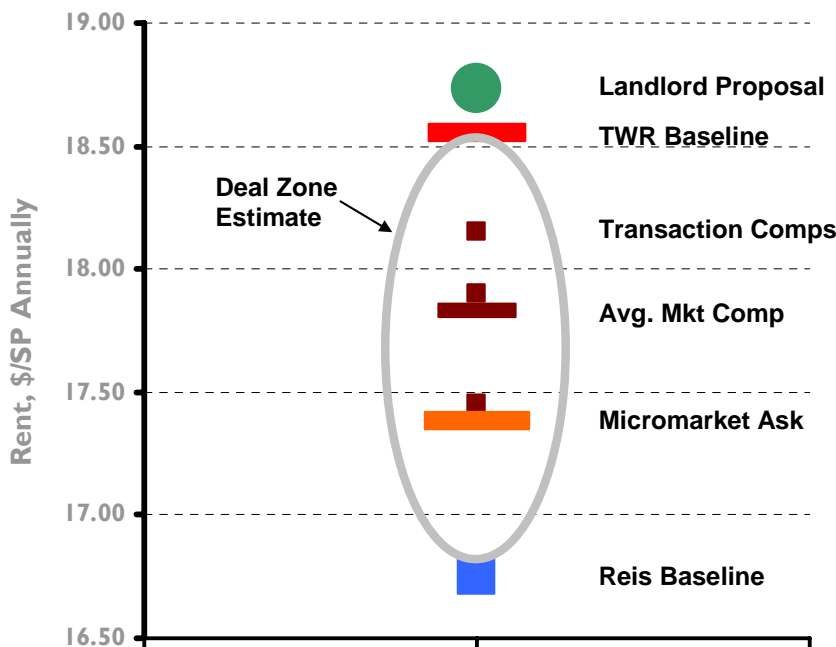
People While proficiency and processes can be directly compared across firms, in the end it is the quality of the people who manage your account, their responsiveness on a day-to-day basis, and the talent of the brokers in the field, that will matter the most. The biggest pitfall here is the “bait and switch” at the time of TM selection. Too often, our Place Strategy Partnership members report, the highest Principal of the firm under consideration will all fly in for the “pitch”, but when the work is actually delivered, the day- to-day account management is handled by individuals who have much lower positions in the company, and over whom the corporate real estate manager has limited authority. Since lack of control over personnel is one of the major disadvantages of outsourcing, care should be taken to include elements of an employment relationship into the agreement. **Contractually specifying the management level, or even the actual Principals to work on your account, as well as the means to remove unsatisfactory performers from your account, will help you to replicate the control over human resources you would have if TM was performed in-house.**

We believe large, complex, national portfolios can greatly benefit from engaging more than one transaction management firm, either dividing up the country geographically, or by property type, to ensure a consistently high quality service, and the ability to learn from the “best practices” of each provider. The pros and cons of sole source, preferred provider, or multiple provider models will be an important research topic for the Place Strategy Partnership in the coming months.

Market-Centric Performance Measurement Along with the capabilities, personnel and processes the TM firm brings to your account, the true test of performance is the quality of the deals they identify and negotiate on your behalf. This capability is hard to determine in advance, although the firm’s reputation and your experience with them in the past will be an indicator, as will references from other large corporate customers of the firm. **As discussed in our April Brief, it is now possible to set quantifiable performance benchmarks both prior to a deal, and to use these benchmarks as part of a performance measurement system.** Our primary tool for assessing leasing performance is to calibrate a “Deal Zone”, which is designed to portray a reasoned range of expected performance. (see Figure 2) Using objective real estate market data from a variety of external sources, the likely upper and lower ranges that a particular lease price should fall into can be calibrated. While every deal is different, and qualitative factors will play a role in the final outcome, our examination of well over one thousand positions over the past two years has shown the ability of market metrics to reasonably estimate current lease value compared with current lease rates.

While we will describe the sources and uses of market intelligence data in further detail in our June Brief, let’s examine the “Deal Zone” method. We use several sources of market intelligence to determine the expected range of lease rates in a particular location. Using their own proprietary methodologies, both Torto Wheaton Research (TWR), a subsidiary of CB Richard Ellis, and Reis Inc. (Real Estate Information Systems) produce estimates of current baseline rent levels by submarket, as well as projected price forecasts (typically five years) by submarket. Currently we are using both firms baseline rent estimates when developing our individual “Asset Action Plans”. Reis also provides average submarket lease terms from their survey data base, which can be referenced when evaluating deals. Since both Reis and TWR effective rent estimates are made at the submarket level, we provide a further check by determining the “micromarket” asking rent. This figure is based on the current asking rent as collected through surveys for buildings which are of similar age and quality and immediately proximate to the building we are assessing. This can be as small as a 1/10th mile radius in a downtown location, up to several miles in a suburban location. Finally, we perform a “reality check” on the data, especially if the range seems excessively wide.

Figure Two: Establishing the Deal Zone



As shown in this generic Asset Action Plan, which is based upon an actual deal, defining the desired “Deal Zone” can help develop the negotiating strategy prior to the deal execution, in concert with the five year pricing forecast data. This particular example suggests that the prospective building rent is at the top end of the “Deal Zone”, as banded by TWR and Reis estimates. Market comps also show a range of prices. Absent unique qualities or exceptional TI in this transaction, further negotiation appears warranted.

The “Deal Zone” analysis can also be used to compare transaction management performance post deal. While every deal is different, **we have found that patterns of broker performance can be assessed over a series of deals, usually over a year-long time frame.** In this way, adjustments to the measure can systematically be made for particular lease terms (such as additional security, early-outs, ultra class A building locations, amenities, etc) that could affect price. A performance bonus based on “beating” the market can be made part of the firm’s compensation agreement/bonus system. We will discuss those methods in a later Brief.

Final Thoughts: Calibrating transaction performance standards that realize opportunities, enhance cost performance, and increase your customer service standards are paramount to achieving CRE success. Corporate real estate managers who have applied the “Deal Zone” method report (and we hope to someday test this hypothesis through PSP) that providing independent market intelligence alone can motivate better broker performance. By implementing methods for evaluating both Organization Centric and Market Centric performance, which provide the TM with a clear scope of expectations and specific success measurements, Place Strategy Partner companies can improve their transaction results and significantly reduce real estate operating costs.

Questions for further PLACE STRATEGY PARTNERSHIP Discussion:

- How many service providers do you have? What was the logic behind the number?
- When will you next compete TM services? What standards will you utilize to make selection decision (s)?
- How do you measure their performance in getting the best economic deal possible; a) while the deal is in progress?; b) after the deal is completed?
- How do you “independently verify” the transaction service provider’s performance?
- How do you ensure that your performance incentives are aligned with your transaction service providers?

Future Briefing Topics:

Future topics related to this Brief include:

- Sources and Uses of Market Intelligence
June Brief
- Aligning Service Provider Incentives
Customizing best investor due diligence practices to corporate real estate
- Developing the Metro Strategy

Additional forthcoming briefing topics:

- Enabling “Best in Class” Relationship Management - Part Two: Processes and Tools
July/August Brief
- Applying Duration Matching to Portfolio Planning
- Understanding Your Business Drivers Using the Place Strategy Diagnostic Framework
- Demand Forecasting Methods

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