Strategic Advantage
Real Estate Insights, Forecasts & Strategies
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Are Today's Real Estate Business Valuation Models Outdated?

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Friends & Colleagues:

For decades, the business models and enterprise valuation methodology for real estate firms and operating platforms have been a multiple bottom-line profitability on earnings (EBITDA). Revenue streams were defined by transactions (sales or leasing commissions), fee income (e.g., development fees), and contractual fees for service (e.g., property management, construction management, asset management, etc.). Multiples are applied to each business line and/or to the overall EBITDA to determine enterprise value. This valuation methodology may be beyond its life of utility. Real estate firms should be valued as high-growth companies. **As long as real estate firms focus on transactional/contractual-based fees/revenue rather than the source of these fees and revenues, valuations will continue to be dramatically understated**.

Business models designed to produce one-time transactional events and/or growing fixed assets are becoming dinosaurs in the Age of Transformation. Old school, the-way-we-have-always-done-it and annual repetitive business planning processes are becoming inhibitors to achieving and exceeding Stakeholder expectations and potentials. How often does your prior year's business plan look similar to the previous year's plan…with maybe a few minor tweaks? How often is "more-of-the-same" your business focus? **Only with a desire to step out of the past…get out of one's comfort zone and realize the value and potentials lost…will the necessary change occur. Valuations must consider the value of touch points, not single touch events.**

Perhaps yesterday's business model being used today is not the best strategy or priority to follow. **Perhaps valuations today are weighted too heavily on retrospective vs. prospective outcomes/potentials**.

Over the next 20 years or longer, real estate firms of all types, sizes and ownership structures will undergo a transformation significantly different from the comfort zone where many are operating today. Many, if not most, CEOs, Division Executives, Board of Director members and other key leaders are now between age 55 and 75. They were age 21 between 1963 and 1983… over 30 – 50 years ago! What occurred in the 1980s and 1990s is now obsolete on many levels. At that time, use of and reliance upon technology, PDAs and social media was nonexistent. The Internet wasn't invented until 1990, and real estate transactions were often back-of-the-envelope, gut-feeling, seat-of-the-pants and/or handshake events. Business models were conceived and structured around successfully achieving/completing detached or impersonal events (securing a lease, management contract, entitlement or financing; acquiring or selling an asset; or being awarded a development opportunity). The consummation of a contract became the driver(s) of the real estate business models and valuations for over 50 years. That is rapidly changing.

This issue of *Strategic Advantage* will examine the problems of continuing the business models of the past and reveal the new business valuation models very likely to drive real estate activities and value in the future.

The Redefinition Of Real Estate's Value Proposition

For hundreds of years, real estate was viewed primarily as a fixed asset to be acquired, developed, financed, leased, managed, sold and/or maintained…very asset- and market-centric. The focus was on the four walls, not what was inside the walls. Where and how a site was acquired, a building sited and designed, selection of construction materials, management standards, leasing priorities, capital structure and exit strategies – all were transaction-based. While real estate developers reshaped and redefined the suburban and urban marketplace, the focus was on buildings, building operations and transactional events. **Real estate became a business process driven by entrepreneurs but guided by functional activities**, tax policy and incentives, transactional events, supply/demand metrics and financial engineering. **Tenants, residents, visitors and users became sources of rent…and nothing more.** The legal community defined property law as ownership or tenancy in real property. Success was measured by the size of the development pipeline, number of square feet leased, assets under management, number of starts, property and/or portfolio value, yield, IRR results and capital (equity and debt) characteristics. Awards and accolades were given for design, transaction size, building operations and use of building construction materials (e.g., LEED certification). Process, efficiency and systems ruled the day. Honors went to Developer of the Year, Broker of the Year, ULI awards ("for professionals in the build environment") and TOBY awards ("recognizing quality in buildings…and building management"). NMHC's lists of Top 50 Developers and Managers are based on total number of units. Customers were often called "occupiers;" a very impersonal and commodity-based characterization. Although nice recognition, **these awards and definitions perpetuated a building-first, size-matters, moment-in-time mindset. Lost were the customer, recurring connectivity and the value chain**.

The New Business Paradigm

As the real estate industry rapidly moves to 2020, 2025 and beyond, the new transformational era will be exciting, challenging, and fully loaded with disruptive technologies and surprises. **To prosper in the years and decades ahead, the real estate industry must move from an asset-centric to a client/customer-centric, to a knowledge-centric and ultimately to a polyhedral-centric model of connectivity. The shift from fixed assets and transactional events to monetized knowledge from a suite of connective points (tenancy, residency, transactional, etc.) will dramatically drive business valuations upward and provide many sources of recurring revenue.** If building owners and operators view their asset like a website or launch pad for connectivity, rent becomes just one of many sources of income. **The real value is based on repeat connectivity.**

For example, if a typical community shopping center receives 10,000 visitors or so per week, that center (or site) will have approximately 520,000 visitors annually. If one owned 50 similar centers, the number of site visitors (first-time and repeat) would be up to 26 million per year. A 1,000,000-square foot office portfolio has over 1.7 million site visits per year! If a 300-unit apartment complex has 600 or so residents who come and go daily, there could easily be 600 events/visits per day or 219,000 visits per year. A portfolio of 50 apartment properties would have nearly 11 million site visits a year. For even larger portfolios, think of the possibilities!

In other words, **if real estate assets were viewed as a site similar to a website, the number of site visitors would make a portfolio of assets one of the top "sites" in the U.S.** Ironically, **nearly all real estate owners/operators do not**: (1) collect real-time data on tenant, resident or client activities; (2) collect proprietary data that could be used to enhance predictive analytics; (3) utilize existing technologies to gather data and push communications to the "site visitors;" (4) generate sponsorship and/or advertising income; and/or (5) leverage/utilize customer behaviors to achieve a competitive advantage.

What if real estate owners and operators viewed each building as a "site?" What if each transactional event were viewed as a knowledge-gathering event in addition to a financial outcome? What if real estate operators drove ancillary income, developed customer loyalty and gained a competitive edge from proprietary data? What if real estate firms' business models were more analogous to leading tech firms? Interestingly, JLL just announced "JLL Spark," an entity focused on creating new products, investments and supporting start-ups in the real estate tech industry. Real estate firms are slowly adopting augmented and virtual reality technology. Robotics and AI software are reshaping the industrial, retail and construction sectors. **RFID and IoE connectivity are redefining the way real estate connects with customers.**

The transformative real estate business models of the future will look, feel, act and replicate what we are currently experiencing from Google (Alphabet), Marriott, Amazon and/or Facebook. Real estate should be focused far more on what is inside the four walls, not just designing and maintaining those walls. Data, knowledge storage/retrieval, the Internet of Everything (IoE) and, most importantly, client connective and predictive analytics will shape, guide and facilitate real estate company business practices, processes and organizational architecture. By creating, managing and/or leasing space, real estate companies will be exposed to valuable data. **Today, no real estate firms have grasped the totality of the data they have and are exposed to**. I repeat…no one! To my knowledge, no real estate firms in the U.S. employ a full-time artificial intelligence officer. Can you imagine the possibilities if your real estate firm could collect behavioral data on your clients (tenants, residents, investors, etc.) based on their past and current actions and customize options and solutions? **It is not the product that creates value…it is the customer who creates sustainable value!**

The True Value Of Real Estate Operating Companies

For decades, private real estate operating companies have been valued based on a multiple of EBITDA, discounted cash flow or a percentage of revenues. The typical span of multiples generally ranges between 3x and 7x with most in the 4x – 6x range. The typical span, using percent of revenue valuation methodologies, has been in the 75% - 85% range. In both cases, there have recently been some select exceptions to this general, rule-of-thumb methodology.

I **contend that many leading real estate firms (public and private) are properly valued based on their current value proposition and business models but are woefully undervalued when they restructure to become asset, service and customer portals and sites for data collection and analytics**. For example, AvalonBay Communities, Inc. has a PE Ratio of around 25; Marriott with its full suite of assets and data has a PE Ratio of around 37; ProLogis has a PE Ratio of around 27, while Amazon has a PE Ratio of around 184. What if CBRE, which has a PE Ratio of around 20, had a data analytics platform that was analogous to Google (Alphabet), which has a PE Ratio of around 32? The possibilities are unlimited! However, **as long as real estate firms remain asset- or services-centric and not knowledge- or data-centric, the enterprise values will be significantly understated.**

Valuation Comparisons

	Company (Symbol)	P/E Ratio*
Tech-Based Firms	SalesForce (CRM)	507.99
	Netflix (NFLX)	226.05
	Amazon (AMZN)	184.23
	Expedia (EXPE)	75.24
	Alibaba (BABA)	68.42
	TripAdvisor (TRIP)	60.11
	Facebook (FB)	43.74
	Alphabet (GOOG)	31.67
Real Estate Firms	Ventas (VTR)	34.95
	Public Storage (PSA)	29.24
	ProLogis (PLD)	28.32
	Simon Property (SPG)	27.07
	AvalonBay (AVB)	25.05
	CBRE (CBRE)	19.87
	Jones Lang LaSalle (JLL)	18.44
	General Growth (GGP)	16.96
	Camden (CPT)	10.09

* Data as of September 1, 2017
Source: Yahoo Finance.

When one views the new real estate value proposition and platform opportunities through fresh lenses, the outcome can be a rewarding range of opportunities and value creation. However, if real estate Boards of Directors and leaders adhere to past successes as a prediction of future success, they should remember the statement, **"People are very open-minded about new things, as long as they're exactly like the old ones."** Or as Peter Drucker stated, "The greatest danger in times of turbulence is not the turbulence…it is to act with yesterday's logic."

So, what are some initial steps real estate firms can or should do now to increase their value to all Stakeholders?

Six Recommendations To Increase Your Value To All Stakeholders

To capitalize on the transformative changes occurring within the real estate industry, real estate companies and the clients/customers of real estate firms have six strategic actions they can take immediately:

Six Ways To Increase Value

1. Centralize Data Management
2. Leverage Data To Achieve A Competitive Advantage
3. Mine For Proprietary Data
4. Create a Business Intelligence Capability
5. Utilize A Real-Time Dashboard
6. Integrate Business Analytics Into Your Long-Term Plan

Source: CEL & Associates, Inc.

❒ **Centralize Data Management**

Too often real estate firms become compartmentalized and information/data becomes very personalized so that creating and leveraging a centralized data base is difficult. Client, tenant and marketing contacts often are not shared. Daily events, meetings, customer contacts, service requests, progress reports and key operating metrics are not gathered **in a centralized location**, not combined or analyzed to identify trends/patterns, and clearly not utilized to achieve future strategic advantages. **To be successful and achieve a competitive edge now and in the future mandates the elimination of "my data, my contacts and my relationships."** Best-in-class real estate firms must transform digital data into improved decision-making and operating results. Real-time or nearly real-time information (centralized) enables an organization to react quickly to opportunities and challenges and provides agility…a necessity in today's highly competitive marketplace. Every customer (tenant, resident, client) has hundreds of collectible data points. To be successful, a real estate firm needs only ONE overall customer/prospect mailing list and only ONE centralized data set. **In an era of information overload, the need to leverage data via a centralized data management platform is essential, not optional**.

❒ **Leverage Data To Achieve A Competitive Advantage**

Data that can be converted to knowledge and predictive analytics will provide a significant strategic advantage. Business and marketing plans, presentations and proposals that lead with (1) "We have been in business for X number of years;" (2) "We have done Y number of deals or have Z million SF under management;" (3) "We have the best people and the best system;" and (4) "We have a track record," are non-starters. According to thousands of recent client/customer surveys collected by CEL & Associates, Inc. regarding new business development within the real estate industry, **the overwhelming response by clients of real estate firms has been, "show me something new, unique and of strategic value."** One interviewee recently commented, "everyone says that they have the best people, the best abilities, the best contacts

Business Models
"Which One Have You Embraced?"

▪ Client-Centric	▪ Asset-Centric
▪ User-Centric	▪ Market-Centric
▪ Capital-Centric	▪ Service-Centric
▪ Talent-Centric	▪ Shareholder-Centric
▪ Franchise-Centric	▪ Personality-Centric
▪ Network-Centric	▪ Financial-Centric
▪ Legacy-Centric	▪ Generational-Centric
▪ Knowledge-Centric	▪ Data-Centric

Source: CEL & Associates, Inc.

and best processes…I am looking for differentiators." **Proprietary data, analytics, prospective modeling, insights and knowledge are the primary elements that can achieve a competitive advantage**. Information from data providers tends to be mostly historical, non-proprietary and available to all who subscribe. **Leveraging data and analytics that no one else has will truly increase your new business success rate and ultimately enterprise value**.

- **Mine For Proprietary Data**

Real estate firms use less than 20% of the data readily available and less than 5% of the data accessible only to that firm. Data on tenant activities, retail visitor/shopper patterns, apartment resident lifestyle/use patterns, traffic (pedestrian and auto) patterns, length of stay, equipment usage, customer preferences, etc., *are not* collected by real estate firms. Technologies now available to real estate firms can track customer behaviors and preferences. Collecting WiFi data, heat mapping, and other available "interim analytics" can facilitate better asset designs, improve operating patterns, increase rents, drive traffic to one's website, provide unlimited potential sources for ancillary income, increase worker productivity (in office buildings), etc. Remember that to get "tech-like" enterprise valuations, gathering data from multiple sources will be essential. The battle today between Google, Facebook, Apple, Microsoft, Cisco and Intel puts them in a race to gather and control data. **Why should the real estate industry remain a bystander to a parade of opportunities? The sooner real estate firms start collecting data that reflects on what is inside the four walls (not just financial, accounting and operating data), the more valuable the enterprise will become**.

Organizational Structures

▪ Functional	▪ Virtual
▪ Flatarchies	▪ Divisional
▪ Holacracy	▪ Matrix
▪ Line	▪ Flat/Organic
▪ Product	▪ Geographic
▪ Process-Based	▪ Service-Based
▪ Project-Based	▪ Network

Source: CEL & Associates, Inc.

- **Create A Business Intelligence Capability**

Collecting, processing and utilizing data is far more than an assembly task. The creation of a business intelligence capability which is both prospective and a value opportunity identifier is a key tool to increase opportunities, revenues, enterprise value and sustainability. A belief that historical data reflects the future or that universally available information will somehow add a competitive edge is wishful thinking. Business intelligence capabilities provide valuable insights into what is working and what isn't. **Owning the data isn't enough. Converting the data into an advantage is the key**. Rather than follow the latest GlobeStreet article, the loudest opinion or what your competitors are doing, use the data to question, inform, challenge, educate and shape strategy. A properly structured and staffed business intelligence function can provide insights, refine intuition and develop understanding. W. Edward Deming once said, "If you do not know how to ask the right question, you discover nothing." Deming also stated, "In God we trust, all others must bring data." **A robust business intelligence capability can bring clarity to a landscape of opportunity**.

- **Utilize A Real-Time Dashboard**

Ok…let's assume you are now collecting proprietary data, using a robust business intelligence platform and mining for data. The next step is to create a real time (24/7) dashboard that provides, on one screen/sheet graphic, the quantitative, trending and financial data in graphic and/or table form. Drawing from real-time information, a valued dashboard can track KPIs, performance metrics and other key data points. An effective dashboard will shift the organizational mindset from an historical to a prospective business platform with greater productivity, increased profits and improved results. However, **the foundation for a valued dashboard is accurate, reliable, current and consistent data**. Providing total visibility into your business, a real-time dashboard encourages collaboration, transparency and enterprise value.

❒ **Integrate Business Analytics Into Your Long-Term Plan**

Only 95% of today's real estate annual and strategic plans use quantitative data to validate and/or support key business strategies. However, a very small percentage of real estate firms collect and integrate business analytics into their long-range planning process. For example, would you design an apartment's trash area differently if you knew that 68% of women do not like to take their trash to a dark or remote location? Would you staff differently if you knew that 75% of apartment residents and 83% of office tenants leave their unit or enter their workplace building between 6:30 a.m. and 8:30 a.m.? Would you restructure your tenancy at a retail center if you discovered that 84% of visitors go to just one tenant at each visit? If you knew that a prospective apartment resident dined out four times a week, would you shape your leasing pitch differently?

Advantages of a Dashboard

- KPIs in one location.
- Enables prior, current and prospective comparisons.
- Real time performance results.
- Focuses leadership on top priorities.
- Places business intelligence in the hands of key leaders.
- Provides actionable information at a glance.
- Enables benchmarking.
- Identifies emerging trends ("trending visibility").
- Provides ability to align strategy with goals.
- Measures an organization's efficiencies/inefficiencies.
- Increases productivity.
- Reduces the need to create multiple static reports.
- Constant data flow.

Source: CEL & Associates, Inc.

Real estate firms have a sea of available data but fail to capture more than an occasional data point. The real estate industry is where people live, work, shop and recreate, and the industry has readily given up its data to others…and received no value in return. When preparing for your next business planning meeting, I encourage you to ask, "So…**what proprietary data and business analytics will we be using to shape our future goals and key strategies?"** The time to act is now.

Notable Value Creation Quotes

- "Creating value is an inherently cooperative process, capturing value is inherently competitive." *Barry Nalebuff*
- "The most meaningful way to differentiate your company from your competitors…is to do an outstanding job with information." *Bill Gates*
- "Set your standards so high that even the flaws are considered excellent." *Debbi Fields*
- "If you don't have a competitive advantage, don't compete." *Jack Welch*
- "Information is power, particularly when the competition ignores the opportunity to do the same." *Mark Cuban*

Closing Comments

Perhaps today's current valuation models are accurate if you are evaluating a static company. However, the true value resides with the prospective knowledge gathered from your customers. Why approach each real estate occurrence or interaction as a "one-and-done" event? Perhaps one needs to do different things not do things differently?

I welcome your comments, feedback, insights and perspectives.

Regards,

Christopher Lee

SPECIAL ANNOUNCEMENT

Over the past 23 years, we have received hundreds of emails and inquiries asking us to create a more frequent "one- to two-pager" on matters of strategic importance. We are pleased to announce that **we have launched a bi-weekly brief entitled *Leadership Conversation***. This features one topic, provides recommended strategies, includes a prediction and highlights key questions to ask at your next Executive or Management Committee. The feedback for this concept and format has been very positive, and we are excited for this kickoff. ***Strategic Advantage*, our regular newsletter, will continue as a quarterly publication.**

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