Corporate Real Estate & Facilities Management — Adding Value During Pandemic Disruption

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The speed with which the Covid-19 pandemic has affected the global economy is unprecedented. Corporations are racing to protect their core business and customers in a time of economic volatility and disruption, where entire industries are essentially closed (travel, lodging, hospitality, theaters, education, entertainment parks, etc.) while others are greatly reduced. The impact of this disruption on Corporate Real Estate and Facilities Management cannot be understated. This article will examine key areas clients need to examine in order to leverage their Corporate Real Estate and Facilities Management (CRE/FM) supplier relationships to create shareholder value in a time of pandemic uncertainty. Doing so will require understanding the impact on the supplier market, how supplier relationships are designed to operate under pandemic duress and the ability to make short-term reductions while preparing for an eventual ramp-up.

Covid-19 impacts need to be considered in a global context first and foremost. Challenges facing CRE/FM in, say, APAC, may be different than those in EMEA or the Americas based on a broad range of market maturity as well as pandemic related issues. Regardless of region, we will examine how the CRE/FM sector is not only coping but also adding value.

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The Impact of Sourcing Strategy

Corporations that have consolidated their CRE/FM supply chains into a few supplier relationships are facing a very different scenario than those who have not. Customers with integrated or consolidated CRE/FM supplier relationships are managing risk through governance and working with global suppliers, some of whom had prior experience with SARS or other similar outbreaks in certain parts of the world. Companies who have largely locally managed, fragmented pools of thousands of sub-contractors, are facing a very different challenge as they communicate with and negotiate reductions with hundreds of suppliers into supporting them during the pandemic crisis.

Developing a strategy towards short-term service and cost reductions while retaining the ability to ramp up post-crisis is a key focus. Of course, the consideration here is how deep should the cuts be, how are existing agreements capable of handling these changes, and how stable will the supplier base be after the pandemic subsides.

There are three areas to examine:

- Operational Demand
- Supplier Market
- Legal & Financial Mechanisms

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Operational Demand

Operationally, clients will face significant challenges in a broad range of areas, such as projects, operational routines, service changes, site closures and staffing. Projects or capital works "in-flight" may have to be suspended due to labor shortages or lack of access to the site. There may be supplier service "hubs" that could be affected by Covid-19 – such as call centers, lease abstracting/service centers, data processing centers, etc. Additionally, sub-contractor labor may also be disrupted causing operational challenges in sub-contracted services. In APAC, we are seeing a far greater range of issues related to labor shortages, particularly in India, China and Singapore due to a mix of government regulations, migrant labor access and lack of skilled labor. For EU clients, the imposition of border controls and closures is causing similar issues, but not to the same extent as APAC due to complexity of APAC and differences in market maturity. In the Americas, a relatively late entrant to Covid-19 lockdowns, we are seeing a broad range of challenges that are too early to clearly decipher at this stage other than the significant slowdowns in certain industries. But certainly, there are similarities.

New operational routines have to be deployed, and staffing has to be optimized as clients are closing and mothballing segments of their portfolio while trying to protect the core supply chain.

Supplier Market

Suppliers that are concentrated in the hospitality, education, travel and entertainment sectors will face higher challenges than those more diversified.

Certainly, there will be regional market maturity differences that affect these challenges across the Americas, EMEA and APAC. We are seeing some clients

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pause their RFP processes while others only accelerate them, albeit in a virtualized way. Those clients that were thinking of going-to-market, are reconsidering, opting for short-term extensions rather than RFP launches during Covid-19. On the other hand, many clients are developing virtual sourcing methods to not only launch, but also accelerate the RFP process as calls for efficiency gains mount. One issue will be the stability of the supplier base. Smaller and larger suppliers with balance sheet risks that are heavily exposed to sluggish sectors may or may not be able to support clients effectively when demand for services spikes post-crisis. How the crisis will affect the viability of the supplier base has to be evaluated. Clients will have to determine not only what rights their agreements provide them, but also whether they should be exercising these rights in this environment. What adds a layer of complexity are the stimulus packages issued by governments. It is vital to understand the impact of these packages to your supplier base in a scenario where clients may be considering lenient treatment towards suppliers that have already qualified for stimulus pay-outs.

Legal & Financial Mechanisms

The financial models put in place by clients were not designed with Covid-19 in mind. Transparent and/or pass-through costing models are easier to adapt to site closures or service volume reductions. Fixed price and/or opaque structures face a higher hurdle for adjusting to Covid-19 driven changes in services and portfolio. In addition, commercial models that can adapt to changes in operational routines (e.g. sterile cleaning) will serve clients better.

Today, companies are closing facilities and asking employees to work from home as a key response to limiting exposure. In some cases, site closures are at the discretion of the company, done voluntarily without a government directive. In other cases, such closures may be mandated by a government body. With outsourced CRE/FM services, these two situations will require different treatment. The key issue is how to modulate or calibrate payment obligations as it relates to services.

Customers that make voluntary closures will need to take a closer look at their pricing terms, their right to modify the volume of services received and even their termination rights, or more specifically, partial termination rights. Whether the customer is obligated to continue to pay its outsourced service provider for services curtailed will depend on how specific pricing terms were written. Small details could cast a long shadow on client rights and flexibility. Exercising the right to decrease demand for services is essential for controlling costs. If a facility is going to be closed for an extended period and the customer has a fixed price contract or a contract that does not support reduced fees for services not delivered, clients can explore a partial termination of the contract in order to limit payment obligations. The right to terminate should also be reviewed along with the right to ramp back up after the crisis passes. Most long-term outsourcing contracts should have mechanisms for adding new facilities to scope. Those terms should be reviewed for their use in adding back services at facilities after they reopen. Leaders need to not only prepare for closures or service modifications but also rapid growth upon relaunch.

Unexpected reductions in services can have a serious impact on some suppliers, and the liabilities that result may also have to be considered.

In circumstances where a governmental body has ordered the closure of facilities, the force majeure clause found in most contracts may be triggered. Force majeure is a legal concept that excuses a party's failure to perform if the reason for such failure is out of the reasonable control of the party who is supposed to perform. Examples include war, fire, earthquakes, etc. If a customer closes a facility due to a governmental order, the force majeure clause needs examination to understand the implications.

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The specific pricing terms of the contract should be reviewed together with the force majeure clause and other related provisions to determine the customer's obligations to pay the supplier fees while sites are closed under governmental orders. In addition, any exposures from the supplier's right to trigger force majeure need to be considered.

Well-designed outsourcing relationships should allow the customer to flex and continue to meet its business objectives over a period of years, if supported by an effective SRM, governance structure and process. In addition to supplier governance, terms in outsourcing contracts that should be examined during the Covid-19 crisis are:

1. The Customer's right to increase or decrease demand for services
2. Pricing terms related to services not delivered by the service provider
3. The terms of the force majeure clause
4. Partial or full termination rights for the customer
5. Termination costs associated with a partial or full termination

Turning Challenges into Opportunities

In disruptive economic environments, corporations need to fine-tune their CRE/FM, Workplace, Sourcing, Contracts and Supplier relationships to create value-added responses. This can be done from a dual perspective – making changes in the portfolio (closures) and FM services as well as readiness for relaunch during a potential post-crisis boom. In a post-crisis boom, clients may face different types of workplace challenges – from labor shortages, supplier capacity constraints, to space shortages as workers come back to operate factories, offices, labs and warehouses, and demand the same services at the same time.

A key area will be space planning. Historically, the focus of space optimization strategies has evolved to focus on two primary concepts – open plan office space design and increases in occupant density. "Social distancing" turns those strategies upside down. Corporate Real Estate leaders will have to revisit how space can be optimized post-crisis where social distancing constraints are likely to remain in the workplace for an extended period of time even as sites reopen. This is particularly relevant as fears of a "second wave" of infections will mean some degree of countermeasures will be in place even if sites are to open.

To add value during crisis, CRE/FM organizations need to have an in-depth understanding of how the current supplier relationships are designed to perform under stress. Rapid responses that leverage global supplier partnerships to address supply chain challenges will be key. And finally, financial interventions need to happen to ensure costs for services are flexing to meet portfolio and service changes. In addition to responding to contraction, Corporate Real Estate leaders need to prepare plans to respond to growth when the economy roars back in this potentially V-shaped downturn while keeping a keen eye on any "second wave" risk.

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Rakesh Kishan is a founding partner of Trascent Management Consulting, LLC and the Managing Principal for the Americas and EMEA region. He advises leading companies on global CRE/FM outsourcing initiatives to increase efficiency in FM through best practices. Mr. Kishan is an expert in the growing market for outsourced Workplace services. He has spearheaded outsourcing initiatives on a global scale and within diverse portfolios and has advised major corporations in virtually all aspects of the entire outsourcing life-cycle: from structuring global Facilities Management outsourcing initiatives, to optimizing governance structures and processes for sustained improvements, and to implementing interventions to renew troubled relationships. Mr. Kishan has pioneered innovative approaches to structuring contract pricing to foster continued supplier innovation across each stage of the contract lifespan.

Mr. Kishan holds a BS degree in Economics and Political Science from the University of Wisconsin and an MBA from Columbia University.

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Kevin Rang is an Executive Managing Director at Trascent with 20 years of experience negotiating and resolving disputes involving complex global outsourcing transactions. He brings a unique perspective to negotiations and advising on large complex commercial transactions, based on his experience negotiating some of the industry's most innovative deals as well as his experience resolving disputes under these same agreements as a lawyer with Mayer Brown. His specific areas of expertise include leading complex contract negotiations for global facilities management deals, global IT deals and global BPO deals as well as helping clients resolve disputes under those agreements.

Mr. Rang holds a BA from Michigan State University and a JD from the University of Michigan Law School.

About Trascent

Trascent, a premier global management consulting firm, drives measurable performance improvements and generates quantifiable results in Corporate Real Estate and Facilities Management (CRE/FM).

The firm's clients span biopharmaceuticals, consumer packaged goods, diversified industrials, financial services, high technology, media, oil and gas and other sectors.

Main areas of focus include current state assessment, sourcing & outsourcing strategy and implementation, supplier governance and CRE/FM technology strategy. Trascent Conferences are attended by CRE/FM and business leaders and held in North America, Europe and Asia Pacific. For more information, *visit www.trascent.com.*

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