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Secondary Site Location Analysis

What Factors are Required to Provide Knowledge Workers with the Incentive to Relocate to Secondary Locations?

Highlights

- Beyond its direct purpose, real estate plays additional role of satisfying human resource requirements by providing mix of facilities and amenities that serve to attract people
- Cost reduction now only part of reason why companies opt for secondary locations; other factors include creation of new identity and gaining market share
- Criteria for secondary site location include well-educated workforce, quality of life and access to research universities
- University proximity provides pipeline to high-degree pockets of knowledge capital and system of colleges and universities that satisfy HR requirements for large organizations
- Workers can be lured to secondary sites at a high cost; this can be mitigated by selecting areas where innovation, creativity and quality of life interact and combine to create optimal business environment
- Communities need to be innovative and capitalize on strengths imbedded within their region; being dynamic is critical to community's growth
- "Next generation" communities will capitalize on educational infrastructure to build self-contained communities
- Creating higher degree of organizational flexibility can be accomplished by constructing model incorporating several factors

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Introduction

This discussion brief has been prepared to address some of the human capital issues organizations face when conducting an initial feasibility study of the costs and benefits associated with establishing a decentralized facility strategy. Specifically, it addresses the following issues:

1) What are some of the desirable characteristics of smaller markets, and how might these markets be staffed?
2) How can a large organization maximize the flexibility of its lease commitments?

The answers to these questions are not readily apparent, however, this document highlights some of the nuances of the inquiry, and thus provides a preliminary framework for finding solutions.

I/ DESIRABLE CHARACTERISTICS OF SECONDARY MARKETS

A Fundamental issue faced by large organizations contemplating the establishment of operations in secondary markets is ensuring the skill level of employees in such areas is equal to those in more central locations. The primary issue to be considered is how does an organization create incentives for employees to move from well-established urban areas, to smaller secondary markets. The second issue to consider, especially in an era when organizational decentralization plays a more prominent role in both the public and private sectors, is what communities possess a labour pool whose characteristics and skill sets are comparable to labour pools found in much larger urban areas? This section provides a summary of some of the issues that address this organizational concern.

1) Tying Real Estate Policy to Labor Nuances

In order for wider scale decentralization initiatives to take hold and sustain their viability, organizations need to be able to draw talent from labor pools separate from those in central business districts. Therefore, the first step in launching this program is conducting an analysis on labor force characteristics in secondary markets. Real estate policy cannot occur in isolation, as it needs to be aligned with larger directives including labour force analysis. Organizations no longer look to find the best and lowest cost building, but now assess how the location and facility affect their ability to acquire and retain skilled workers. Therefore, if the labour force in a given community fails to satisfy the basic organizational requirements it is pointless to even commence a search for available real estate. The primary driver for organizations is finding the right number of people with the right qualifications at the right price. In a dynamic environment, real estate in addition to its primary role, plays the additional purpose of satisfying human resource requirements by providing the optimal mix of facilities and amenities that ultimately serve to attract the right people.

2) Success Factors of a Secondary Market

The dynamics involved in corporate relocation have evolved beyond the point where organizations make decisions based imply on incentives and inducements from a local community, to a more sophisticated approach where cities, and economic development agencies are becoming more strategic. In the US for instance, some markets are hiring consultants to analyze the particulars of their market and then best match the nuances of that market with the most appropriate organization or industry.

Costs are an important component of relocation or decentralization initiatives, however, they do not constitute the entire solution. Companies now make moves in order to create a new identity, gain market share, obtain a competitive advantage, or to mitigate the risks associated with clustering.

The primary differences between the way relocation/satellite locations were determined in the old economy versus the new economy, according to Mark Klender, national director of the Fantus Corporate Real Estate Consulting Group in Los Angeles, is as follows:

In the old economy, people believed that:	In the new economy, people believe that:
Being a cheap place to do business was the key.	Being a place rich in ideas and talent is the key.
Attracting companies was the key.	Attracting educated people is a key.
A high-quality physical environment was a luxury that stood in the way of attracting cost-conscious businesses.	Physical and cultural amenities are key in attracting knowledge workers.
Regions won because they held a fixed competitive advantage in some resource or skill.	Regions prosper if organizations and individuals have the ability to learn and adapt.
Economic development was government-led.	Only bold partnerships among business, government, and the non-profit sector can bring about change.

The changing characteristics of a new economy have created the need for some larger organizations to consider decentralizing their operations. Some of the key factors associated with a viable decentralized location, would include the following:

- Culturally diverse and well-educated educated workforce
- Near proximity to a prominent research university
- Favourable business climate
- Reasonable tax structure
- Excellent quality of life
- Generous mix of cultural, creative and recreational amenities
- Good schools, low crime rate, and a location requiring no commuting
- Ability to recruit, attract and retain a high-quality labour force

3) University Proximity Edge

A key ingredient to a successful decentralization program is directly tied to Canada's post-secondary educational system. At the municipal and provincial level, an ongoing commitment toward education is demonstrated through long-term support of universities and community colleges. Despite recent funding-related debates among policy makers, Canada is universally recognized for its educational excellence. Various regions across the country are poised to use their undergraduate programs as well as their network of community colleges as the primary vehicle for delivering skills required for staffing positions in decentralized markets.

Given this advantage, the attributes listed above suggest that Corporate Canada can solve many of the problems associated with finding adequate secondary locations simply by considering moves to university towns and cities, as these provide organizations with an educated workforce, and access to and the potential to form key alliances with universities. Forward-thinking communities (a prominent example of this in the US is Raleigh, North Carolina – see example that follows) combine academic components with business and also highlight obvious lifestyle advantages associated with a smaller, more manageable community as a way of attracting high profile organizations.

If organizational momentum can be established within a community, growth can provide an incentive for other companies doing world-class research and development to establish facilities in these locations as well. Communities such as Waterloo, Hamilton, Kingston, and London are examples of areas that draw upon the competitive advantage of nearby world-class Universities.

4) Optimizing Site Selection

If an organization is considering establishing operations in secondary locations, they will face the issue of transferring knowledge capital from central locations to these secondary sites. How can they provide the incentives necessary to induce a skilled worker and his/her family to consider a move of that magnitude? On the surface, they might offer inducement packages consisting of bonuses, moving allowances, family trips and spousal employment assistance but this can be so expensive that it becomes uneconomic, leaving companies to seek alternate ways to induce existing employees. Thus it is critical the organization carefully analyze factors such as marketplace, accessibility, quality of life and business climate.

Companies should pinpoint communities that are growing, but not so fast that their operations will be saddled by escalating costs and future labour shortages. Ideally, the growth rate over 10 years should be moderate (say 10 to 20%), as hyper-growth may be indicative of industries that are popular in the short-term, but may not be sustainable over the longer-term (think of communities that experienced hyper-growth during the Internet bubble, who are now plagued by high vacancy rates, and numerous business defaults). In the present economic cycle, this consideration really isn't that important a factor, but one to keep in mind as the economy strengthens. It is important that a targeted community move slowly, and methodically continues to build on its strong foundation.

The optimal sites for decentralization are places where innovation, creativity and quality of life interact and combine to drive the economic growth of a community. Therefore, communities possessing these elements should work towards building an environment that encourages adaptation and innovation in public and private institutions, as well as on the part of individuals.

Such initiatives need to be carefully coordinated between business, community and government leaders, and they should be forward looking. The challenge at the outset is how do such programs take root and ignite? Obviously, change has to occur over several years, but changing the profile of a community is certainly attainable. Consider Austin, Texas for instance. Michael Dell enjoyed living in Austin when he was a student at the University of Texas – in fact, if there was a well established job market in Austin, he would stay. There wasn't one, so he spearheaded an initiative to position Austin as a robust business community. In 1989, Austin had 177 firms. By the end of 1998, there were more than 600. The community had effectively cast away its old image and reshaped itself within just a few years. Austin's relative strengths are innovation, creativity, and entrepreneurship, which are embedded in its people, existing firms, community institutions, and the natural environment in which the city is located.

If communities make the commitment to be innovative and capitalize on the strengths imbedded within their region, the change that ensues in the short-term will cause uncertainty and disruption, however, being dynamic is critical to a community's growth; thus, these areas need to promote change and innovation.

5) Snapshot of a Next Generation Community

If any community has capitalized on its educational infrastructure to lure companies to its area, it is Raleigh, North Carolina. This area provides organizations and communities with a glimpse of the future, as civic officials, working alongside North Carolina State University (NCSU), have partnered with business leaders to launch the Centennial Campus, a 1,330-acre science/business park situated next to the university campus. To date, more than $200 million in public and private funding has been committed to the project. It's a dynamic environment that combines high-tech businesses with government, research centres, faculty, and students. It offers firms the opportunity to work closely with academia on projects. Once completed, the campus will include upscale residential components, a hotel/conference centre, restaurants, shops, and a golf course. The park's major selling points to organizations are its manageable scale, and that its pedestrian friendly. The concept is to create a self-contained academic village that combines living, learning, and leisure in one location.

II/ THE ECONOMICS OF FLEXIBILITY

One of the challenges faced by organizations in the midst of change is devising robust facilities planning that provide it with enough flexibility to react to changes (expansion or contraction) in a manner that results in the lowest amount of business disruption as possible. The primary stumbling block for creating a desired degree of flexibility is the institutionalized notion within commercial real estate that the minimum period over which space decisions can be made is five years. More times than not, large organizations who lease space will do so over periods that more typically are over ten years or more. The limitation of this model is that if any change organizational changes occur during the course of a lease, particularly the contraction of space, the organization is left to its own devices to come up with a solution (typically a sublease). If disposition is an absolute necessity, and subleasing is unsuccessful, the organization will is left to pay a hefty penalty to the landlord for breaking the terms of the lease (one way to deal with this issue is to deal with real estate service providers whose economic model is not directly tied to commissions).

The systems of long term leases has become so institutionalized that flexibility is often out of the question. Although the prospects of obtaining complete flexibility for leased premises is remote (unless the tenant is willing to pay a hefty premium for that flexibility), there is a way to create a model that might enhance the predictability of the costs associated with a desired degree of flexibility. In our model, we feel the following factors are particularly important:

1) Building and Space Analysis Across Different Markets

- Analyzing the prevailing lease rates for 5 or 10 year terms among different asset classes (i.e. A-class, B-class, C-class, etc.)
- How do the rates among these classes change in CBD markets versus outlying markets
- Measuring the vacancy rates and existing supply of product among different markets
- Creating an ownership profile of buildings across different markets (smaller, less institutional landlords might provide greater flexibility, yet the services/amenities they offer tenants might be inferior to the offerings of a larger landlord

2) Analysis of Office Centers across Different Markets

Office centers are complexes that allow tenants of all sizes to take space on a short-term basis (often month to month); thus, it is an option that permits tenants complete flexibility. Because these operators are assuming a greater risk position (i.e. vacancy risk), they incorporate that uncertainty into their model and price this type of space accordingly. This segment represents the highest space cost option for a potential tenant, and thus represents a worst-case scenario for prospective tenants from an expenditure point of view. Given the nuances of this segment, it would be useful to further determine the following:

- Analyzing the supply of office centres in a given market
- Segmenting the office centre operators into different tiers (i.e. creating measurement criteria similar to A-class, B-class, C-class used within direct office)
- Conducting a pricing analysis of these segments across different markets
- Conducting a management analysis of the operators of these business centres

3) Capital Investment Represents Greatest Area of Risk

- Institutional-grade landlords can provide a low-cost method of financing capital improvements, by amortizing the costs associated with upgrades and incorporating them into the lease rates
- If a tenant wishes to assume shorter lease term, they can still have the landlord provide the capital financing, but because this is over a shorter term, lease rates are higher
- Penalties for lease cancellation are often driven by capital expenditures
- Penalties might be mitigated and greater flexibility achieved by investing in mobile capital expenditures that can be transferred between locations

When these three areas are completely analyzed, it is possible to construct a model that incorporates the nuances of the factors presented above to that can be used to specifically price the cost of flexibility across any targeted market.