NEW RESEARCH FINDS **MARKET CONDITIONS ARE IDEAL FOR SURPLUS PROPERTY DISPOSAL**

ARE YOU READY TO TAKE ADVANTAGE?
Global industrial firms hold billions of dollars in idle surplus properties. Also known as redundant properties, surplus properties are owned or leased, vacant, or operational buildings targeted for disposal. For instance, a company may need to relocate an automotive manufacturing plant, shut down an outdated oil and gas refinery or consolidate operations. Surplus properties can expose an organization to enormous financial, social, reputational and political risk. With the industrial real estate market booming in western economies, according to a 2017 Avison Young market report\(^\text{1}\), there has rarely been a better time to dispose of surplus properties. To take advantage of these ideal market conditions, firms need to have the right strategic approach.

Our research indicates that surplus properties typically remain dormant for an average of 18 to 20 years\(^\text{2}\), creating decades of potential risk exposure and cost. Why are they held for so long? Several reasons. First, management believes properties have value, and by holding on to them, they are sitting on an appreciating asset. Second, they feel trapped into inactivity because of the real or perceived risks associated with the property such as environmental remediation. Lastly, they misunderstand the true costs of holding onto the property and the potential value locked within.

Some market-savvy industrial firms are generating value by strategically disposing of their surplus properties. By doing so, they are seeing major benefits ranging from higher profits and asset sales, reduced liabilities and healthier balance sheets, as well as enhanced reputations and improved public image.

With the 2017 Global Surplus Property Disposal Benchmarking Survey, Arcadis set out to discover what differentiates these more progressive firms and why they succeed where others struggle. We completed benchmark surveys with executives from more than 30 large, primarily multi-national firms representing a variety of industrial sectors with a combined annual gross revenue of $1.5 trillion (USD). These firms’ surplus property portfolios range in number from dozens of assets across a limited geography to thousands of properties spanning the globe and equate to a total book value of approximately $2 billion (USD). This report shares the findings of our survey and offers perspective on the current state of the surplus property disposal market. Our goal is to help companies realize the opportunities for selling redundant properties and unlock the hidden value of those assets.
THE STATE OF SURPLUS PROPERTY DISPOSAL TODAY: 10 KEY RESEARCH FINDINGS

Our research reveals 10 key findings on how companies approach property disposal.

1. A centralized corporate function led by a real estate group is used to drive surplus property sales
   Our research reveals that 83 percent of respondents placed the responsibility for property disposal at an enterprise level. More specifically, 62 percent said they directed their corporate real estate departments to manage surplus property disposal. This means 17 percent are still delegating responsibility to individual operating business units, which is less efficient and reduces the ability to sell a large portfolio of properties simultaneously.

2. Property disposal is predominantly driven by financial considerations
   Seventy-two percent of respondents said they based disposal decisions on financial factors. While our benchmark survey found that social responsibility, sustainability and public image are important to industrial firms, the overwhelming drivers for sale of surplus property are financial, providing benefits ranging from cost reduction to cash generation.

3. Environmental liability is relatively low
   More than half (52 percent) of firms reported their provision for environmental cleanup of surplus properties was less than $25 million (USD), with 35 percent reporting the cost of cleanup per property was less than $500,000 (USD). Further, 82 percent of respondents report their environmental liability was concentrated on only a few properties. This shows companies often perceive environmental remediation as a financial barrier to disposal, but the numbers suggest otherwise.
4. Internal company barriers impede disposal

Our study finds 32 percent of respondents believe that non-economic factors like poor disposal planning, lack of interest, and restrictive company policies can prevent them from disposing of surplus property. Successful firms are better at overcoming the value, demand and cost of remediation barriers that can help pave the way for divestment.

5. Portfolio size is small

Most firms’ surplus property portfolios are relatively small, with 83 percent of respondents indicating they hold fewer than 200 such properties globally and 60 percent reporting less than 50. These assets are diverse in nature, ranging from very small parcels to massive manufacturing complexes and from properties in high-value locations (i.e., near major transportation corridors, urban areas, ports, etc.) to more challenging markets in isolated, rural areas. Small portfolio size often leads to easier management and a faster track to a divestment opportunity.

6. Property disposal is not a high priority for executive leadership

Only 19 percent of firms in our survey prioritized surplus property disposal at an executive level. Nearly half of firms (47 percent) delegated property disposal to environmental and/or real estate personnel who may not hold ultimate authority for property disposal. Interestingly, despite the financial significance of surplus assets, 25 percent reported redundant property disposal was not a management priority at all.

7. Individual transactions are favored over portfolio sales

Ninety-two percent of respondents reported they sell surplus properties as individual facilities rather than portfolios. While owners “cherry-pick” for the greatest value, they are then often left with hard-to-sell, lower valued properties.
8. One-third of firms do not have well-defined disposal plans

Ninety-one percent said they have a current inventory of all their surplus properties, yet only 65 percent have a disposal plan. That leaves 35 percent of firms with no formal plan for disposal of surplus property, resulting in missed opportunities to reduce risks and costs.

9. Remediating and selling property is favored over redevelopment

Nearly half (47 percent) of respondents chose to clean up the environmental liability and sell the surplus property. Despite the opportunity to significantly enhance property value and potential financial gains, few firms invested in redevelopment.

10. Annual carrying costs of maintenance and operations are relatively high

In 54 percent of responses, firms claimed the cost associated with holding surplus properties is more than $5 million (USD) per portfolio each year. Carrying costs include compliance, permits, licenses, taxes, utilities, security, and site maintenance. By disposing of surplus properties, companies can alleviate themselves of the burden of carrying costs and long-term risks.
Bayernoil operated three refineries in the Bavarian region of Germany, historically supplying oil and gas to Germany, Austria and Switzerland. In response to declining demand for gasoline and heavy fuel oil, Bayernoil developed a plan to dispose of surplus properties and improve its competitive position.

The plan included closing the 266-acre Ingolstadt refinery where gasoline and heavy fuel oil were produced. After the refinery was dismantled, the property was sold in parcels to generate cash that enabled remediation and clearance operations for the remaining parcels. Due to decades of operations, soil and groundwater restoration was needed in order to redevelop the site. Additionally, Bayernoil wanted to align their restoration plan with Germany’s sustainability strategy and redevelop the one-half mile site.

Bayernoil sought expertise from Arcadis to plan and implement disposal of the redundant refinery.

Arcadis was extensively involved with asset evaluation, environmental cleanup, facility demolition and transactional management for sale of the property. Arcadis real estate experts assessed the site and identified considerable development potential, setting the stage for successful reuse of the entire site.

Within two years, the first parcel was decommissioned, remediated and converted into a 16,000-seat stadium. The remaining property was development ready and sold for multiple uses, and the site is now home to a business park and an innovation campus for automotive research and development.

The closure of the Ingolstadt refinery has created a new legacy for the site resulting in an attractive urban center for the community, improving quality of life for residents and a better bottom line for Bayernoil.
Three Large Redundant Automotive Manufacturing Plants Closed and Sold

During the global economic downturn in 2008, the automotive industry was weakened by an increase in fuel prices and declining demand for larger vehicles such as SUVs and trucks. Most automotive companies experienced double-digit declines in new car sales. Auto companies found themselves with massive excess manufacturing capacity and faced the need to close plants in order to reduce costs, improve profitability and survive.

One global automotive manufacturer based in the United States faced with this challenge elected to permanently close three manufacturing plants located in multiple countries. Three plants, totaling over 300 acres of land, were considered surplus property, with ongoing carrying costs, environmental liabilities and, in some cases, community disfavor toward the company for the economic impacts of closing the plant.

The corporate real estate group and team from the environmental office were chosen to lead divestment of the properties, contracting with Arcadis as their primary surplus property disposal consultant. Arcadis worked with the client team to decommission and decontaminate the facilities, support negotiations with local and central governments, sell manufacturing equipment, demolish plant structures, and prepare the assets for sale.

All three properties were transferred to new owners and are now being redeveloped. The manufacturer was able to generate more than $250 million (USD) from the divestment, providing balance sheet relief for the cash-strapped company.
CONDITIONS IDEAL FOR DISPOSAL OF SURPLUS PROPERTY

Industrial markets, particularly in western economies, are robust. Industrial real estate and redevelopment in the United States has remained exceptionally strong in 2017, building on a record-setting 2016. As noted in the chart below, the industrial market remained strong in the first quarter of 2017 with vacancy rates at record lows.

According to Prologis\(^4\), rental growth for warehouse/distribution properties in the U.S. ranked the highest in the world in the face of historically low vacancy rates. The U.S. rent growth in 2016 increased five percent in some markets compared to an average four percent globally.

Driving these statistics are that some manufacturers are moving production back to the United States as they factor in variables such as technology innovations, the high cost of transporting goods, pressure from the Trump administration, and risks associated with foreign manufacturing. For these reasons, companies are increasing investment in, and construction of, industrial properties. Demand for industrial real estate in the past five years, coupled with the current level of property under construction, means the U.S. industrial market will add nearly 1 billion square feet by 2018, according to JLL\(^5\). This upward trend has also driven increased transaction volumes. Almost $14 billion in industrial assets were transacted in the United States in Q1 2017, which is three percent higher than a year ago, according to Colliers International\(^6\).

One area of very high global activity is e-commerce, which has transformed consumers’ buying experience and is a driving force for industrial real estate today. Owners are seeking warehouses that are located adjacent to freeway intersections. There is also growing interest in “final mile” fulfillment centers, providing opportunity to develop smaller sites located close to large populations. U.S. e-commerce sales grew 15 percent in Q1 2017 and now represents 8.5 percent of total retail sales, according the U.S. Department of Commerce\(^7\). We are also seeing greater interest in secondary and tertiary real estate markets as demand for industrial property outstrips the core market’s ability to supply it.

Rising demand for industrial property is also seen in other western economies such as Europe. Here, industrial and e-commerce warehouse vacancy rates remain low at 5.5 percent with new construction and speculative development rising throughout 2016, according to CBRE\(^8\).

\(^3\) Colliers International

\(^4\) Absorption = the total new square footage leased
TAKING ADVANTAGE: OUR PERSPECTIVE

Based on the results of this research, our experience in assisting clients in disposing of their surplus properties, and the current robust industrial property market, we strongly believe that now is an ideal time to sell redundant property.

To take advantage, businesses can implement the following six steps:

1. Elevate the issue to the executive level or C-suite
Making the topic of surplus property disposal a routine agenda item for top executives results in swift action and leads to large financial and social benefits. Our experience suggests that when top executives are providing oversight, the bulk of surplus properties can be sold relatively quickly and the leadership assigned to this activity can be re-engaged in other core business activities. This opportunity may be strongest now given current market trends.

2. Empower a senior leader with the authority to dispose of surplus property
Assigning a senior leader the authority to sell property and committing the appropriate funds necessary to affect a successful transaction (including environmental cleanup, permitting, etc.) is essential. The absence of a single, clear authority often leads to internal politics and infighting that prevent timely and effective decision-making.

3. Set a clear divestment plan with an exit strategy
Successful firms develop clear strategies for the disposal of the bulk of their surplus properties with a well-defined endpoint, normally not more than five years. While changes in business strategies and conditions may lead to additional surplus properties in the future, most of the current surplus properties can be disposed of relatively easily. What’s more, the resulting best practices for property disposal can be incorporated into normal business operations.

4. Adopt a portfolio strategy
Selling surplus properties solely on an individual basis, rather than in portfolios, is slow and costly. In contrast, the transaction cost of a portfolio is relatively low, and owners can bundle low-value properties with higher-value assets. This can persuade buyers to purchase a broader suite of assets. Not taking this approach can leave property owners with a portfolio of economically unattractive assets. Instead, balance individual transactions, which may still make sense, with a portfolio approach.

5. Sell environmentally contaminated property
Progressive firms are successfully selling contaminated surplus properties with few legal or financial problems. Several conditions make it easier to sell contaminated property today: 1) most environmental regulations are mature and well understood, 2) there are not very many new significant regulations being issued, 3) the level of agency enforcement practices are well known, can be predicted and are pro-actively addressed, and 4) there is a low incidence of surplus property buyers returning environmental liabilities to the sellers. When issues do arise, typically the cost of correction is far less than the overall carrying costs.

6. Profit should not be the sole motive for surplus property disposal
When firms focus more on timely and effective disposal rather than on a simple calculation of profit, they are more likely to reduce their portfolios rapidly, lower total cost of ownership significantly, and enable leadership to focus on their core business.

Many corporations are generating value by following a strategic plan for divesting their surplus properties. As a result, they are realizing increased asset sales, lessening their risk and exposure, and generating a healthier bottom line, all while improving their reputation and public image.

By following these six steps, we have helped our clients reap significant rewards. For a more in-depth consultation about the options available for your surplus property disposal, please contact Arcadis.

“SELLING PORTFOLIOS OF SURPLUS PROPERTIES RATHER THAN INDIVIDUAL SITES HAS BEEN KEY TO THE SUCCESS OF OUR REDUNDANT PROPERTY PROGRAM”

JONATHON ELTON
General Manager, Post-Closure Rights & Obligations, Shell
Facing volatile and declining oil prices in 2008, large oil companies began to exit the retail gas business - a market where profits were diminishing as crude oil prices rose. As a result, the low-margin gas stations, and the property they sat on, became surplus property. The decision to divest the surplus properties not only generated cash for the struggling oil and gas sector, but it also allowed them to focus on higher-profit resource production and refinery operations. Today, major oil companies own fewer than 5 percent of U.S. gas stations.

One such oil company embarked on an aggressive plan to divest more than 770 of its retail petroleum stations located throughout 15 states in the US. The divestment strategy was to sell the sites as is and retain the environmental liability in order to secure the highest market value. With Arcadis’ experience in successfully extinguishing environmental liabilities and securing regulatory closure, the company turned to Arcadis. Arcadis developed a solution for the oil company to meet their divestment goals within 10 years, well in advance of their original schedule. This plan involved assembling portfolios rather than selling individual sites, and it entailed the creation of portfolio-specific project management tools to streamline execution. The plan also called for using innovative clean up technologies, enabling the company to leverage its experience from one site across dozens of other sites to accelerate closure. These strategies lowered the cost of clean up significantly.

Within four years, 40 percent of the sites were market-ready. To date, the company has received regulatory closure for 72 percent of the sites, substantially extinguishing environmental liabilities, associated with these and other retail sites that are still in their portfolio. As the highly competitive oil and gas business continues to evolve, this oil company is well positioned to improve profitability, provide higher returns for shareholders and plan for growth.
BENCHMARKING SURVEY METHODOLOGY

The purpose of the Surplus Property Disposal Benchmarking Survey is to understand organizational maturity with the management of surplus properties, identify areas of strength and best practices, as well as areas of opportunity for improvement in surplus property management approaches.

The Surplus Property Benchmark Survey was conducted in person or via online survey with industrial firms in Europe and North America from November 2016 to March 2017. The survey contains 28 multiple-choice questions on characteristics of surplus property portfolios, organizational management practices and disposal activity.

Collected survey data was analyzed by the Arcadis Strategic Research team. Benchmark survey data is confidential and reported in only aggregate form.