Are you taking a realistic view of risk across the full spectrum of corporate real estate management?

A programmatic approach can turn the uncertainties and anxiety of “what if” into accurate, actionable business intelligence.
There are far more unknowns challenging corporate real estate (CRE) executives today than ever before. Will the structure of a particular telecommuting and mobility program enhance employee productivity or reduce it? What are the chances of opening a new store before missing the market? How does a CRE executive, who faces the need to close a large office, make the right decision? As corporate real estate (CRE) executives’ strategic role elevates, involving more complex decisions and long-term commitments, so, too, does the susceptibility to error, accident and risk. Management of risk thus has a natural and necessary place in our industry.

Risk management is a continuous, forward-looking process used to anticipate and diffuse issues that may compromise a business. It is most commonly known as the well-articulated specialty for managing financial risk, but, as a broader discipline, it has routine application elsewhere. The principles for non-financial risk management are seen in those industries with persistent exposure to severe and long-term consequences that threaten enterprise objectives.

The financial, operational and strategic impact of today’s real estate decisions, particularly in the context of lean resources, requires a more comprehensive and realistic approach to risk management. Once-safe assumptions are increasingly unsafe, because the cost of guessing wrongly—in managing transactions, projects and facilities—is going up. CRE executives’ ability to manage risk has become their most important, and largely undeveloped, contribution to an organization.

This paper presents the framework for a programmatic approach to managing risk across the total spectrum of CRE activities. It introduces fundamental concepts in non-financial risk management, and suggests a process for assessing, prioritizing, reducing and governing cross-functional risks. The focus here is on requisite skills because, although risk management does not require large capital investment, it requires a high level of discipline. The resulting CRE risk profile can then be used to rationalize competing priorities and capital investment, drive management attention, and cultivate meaningful dialogue with business partners.
Are you taking a realistic view of risk?

A formal framework for managing risk

A formal, common framework for managing risk greatly improves cross-team alignment and underscores the real estate implications of business decisions. A programmatic approach for CRE must examine the myriad real estate issues and how they relate to business objectives in a consistent and comparable manner. Since there is one finite source for funding all risk mitigation, lease risks must be able to be compared to environmental risks, and critical downtime risks to regulatory risks.

The output for a non-financial risk management program should help to prioritize investment decisions in a business-relevant dialogue, answering the questions, “Where are the highest risks?” and “What’s the best use of my budget?”

The approach detailed in this paper is semi-quantitative, meaning that when the right structure and scoring system are in place, unlike events can be compared on the same impact scales.

Regardless of the size or nature of the subject in question, a risk management program enables an organization to display and communicate accurate risk profiles, which are snapshots of the range, sources and relative levels of risk currently under management.

FMEA: Practical, disciplined and intuitive

While there are scant industry best practices in place that are adaptable to CRE’s risk management needs, the program suggested here draws on Failure Modes and Effects Analysis (FMEA), a widely used and intuitive framework for risk assessment.

FMEA is a tool used in Six Sigma methodology to proactively assess and prioritize a set of risks. In the facilities world, the subject of an FMEA is

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**Figure 1** Failure Modes and Effects Analysis (FMEA) is a flexible and scalable tool for assessing all risks in CRE functions.

**Step 1** Identify potential risks according to:
- What can go wrong?
- What are business ramifications?

**Step 2** Calculate Risk Prioritizational Number (RPN) based on:
- Severity of outcome
- Probability of occurrence
- Detectability of cause

**Step 3** Develop a risk management plan that will:
- Minimize severity of potential outcome
- Reduce probability of potential outcome
- Improve detectability of cause

**Step 4** Turn your risk management plan into action:
- Assign management responsibilities
- Set completion dates
- Recalculate original RPN

**Step 5** Govern the risk management plan with leaders who:
- Report new and existing risks under management
- Track and analyze risk profile
- Manage resources
- Ensure program adherence

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As corporate real estate (CRE) executives’ strategic role elevates, involving more complex decisions and long-term commitments, so, too, does the susceptibility to error, accident and risk.
usually a piece of equipment or, more broadly, system infrastructure. FMEA is also practical for assessing risk in processes, which makes it useful for profiling risk in preventive maintenance routines as well as in the transaction and project management activities of CRE. In short, FMEA is flexible and scalable enough to cover the scope of all risks in CRE functions through a five-step process, displayed in Figure 1.

**Step 1: Identify**
Function by function, location by location, goal by goal; ask yourself what could go wrong. The identification process has two components: (1) articulating what can fail from a real estate standpoint and (2) acknowledging the ramifications for the business.

The sheer scope of this endeavor can seem daunting, so start with your most important programs, i.e., the ones you must achieve this year. Once you develop your skills on apparent risks, turn your focus farther out.

Risk identification is a team exercise to be repeated at all levels of the organization. Online collaboration tools can be used to brainstorm and collect input from distributed teams.

**Step 2: Prioritize**
After risks and potential failures have been gathered into the FMEA tool, the next step is to prioritize. Urgency is dependent on these three risk factors, which are qualified and quantified as part of the second stage of the process:

- **Severity** of the outcome
- **Probability** of occurrence
- **Detectability** of cause

**Severity** answers the question, “How bad would the effect of this failure be?” To the unsophisticated eye, big incidents might appear to have big outcomes; and small incidents, small outcomes; but most events have multiple repercussions. Severity should be defined in terms of the key risk drivers important to the enterprise rather than to CRE alone (see Figure 2). This presupposes advance dialogue between CRE and at-risk areas of business to correlate the full impact of real estate related issues and incidents. Using the FMEA tool, the varying severities of these effects can be measured using an agreed-upon numerical scale so that unlike failures can be compared. Is a missed lease date worse than hazardous material mishandling? Both are to be avoided but where you invest improvement resources is only partially a function of which costs more money.

Typical approaches to problem avoidance often stop after considering the worst-case scenario. The other two dimensions of risk must be considered to ensure that your actions are reasoned and appropriate.

**Probability** is the likelihood that a failure will take place. By assessing probability, you avoid over-focusing on one-off failures. Empirical data about failure rates can be difficult to assemble. Look for published failure rates on certain pieces of equipment. Gather industry benchmarks and anecdotal reports. Probability scales may be established subjectively through expert opinions and outside consultants. Over time, probability ratings will be tested and refined by historical
Are you taking a realistic view of risk?

Lastly, recognize that if a failure has multiple root causes it is more likely to occur than failures that have limited causes.

Detectability is the degree to which you can intervene and arrest a chain of events before they negatively impact your business. Because the purpose of risk management is to prevent issues from affecting business rather than to react to failures that have already occurred, detectability is a central feature in program success. For example, if the chiller on the roof of a building housing a production data center is compromised, do you have a way to detect it before the entire HVAC system fails, the building temperature rises too high and e-commerce servers shut down? In another vein, if you are constantly playing catch-up to build new office space to seat already higher headcounts, you have a detectability problem: the risk of insufficient seating is undetected before it negatively impacts the business.

Once the three risk factors are quantified, they are multiplied to derive a single Risk Prioritization Number (RPN). The RPN is an indicator of a risk’s importance. By using the same framework for formally capturing risks, a CRE organization can determine which ones must be addressed first, regardless of the real estate functions they are in. For example, the workplace design risk in a new office building may turn out to have a much higher RPN rating than a mechanical risk involving an old chiller. If the chiller is scheduled for replacement in the annual project plan, would it be wise to proceed with that project or reallocate funds to address the workplace design risk?

Step 3: Plan

Completion of the first two steps has surfaced the top-priority risks. Cross-functional prioritization allows the CRE organization to evaluate disparate areas of management through a single bias—that is, through the enterprise specific risk drivers. The singular RPN rating method makes the risk assessment and prioritization process scalable. This allows a CRE organization to survey risks across a global portfolio (see Figure 3), identify the service area that bears the highest risks, determine the location at which those services are most vulnerable and finally zoom in to act. Before proceeding, challenge the results of your scoring and make sure that the results make business sense.

In the planning stage, the specific approach for managing peak risks is deliberated and

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**Figure 3** The singular RPN rating method makes risk management scalable across a global portfolio.
Proper risk mitigation could have prevented $35 million loss.

At the height of the dot-com boom, Company X entered into a 10-year lease for land in the exurbs of an important metropolitan area. Land was cheap enough to build-to-suit a 180,000-square-foot LEED Platinum facility for $13 million. An economic incentives package was negotiated with the state, valued at $20 million over the lease term, dependent upon achieving targets for creating new jobs. Paying annual rent of $4.8 million, and having spent and additional $13 million in furniture and building expenses, Company X had made a substantial investment in its location. When the dot-com market crumbled, Company X was severely impacted. Although expansion clauses were included in the lease, there were no early termination clauses that would have been effective contingencies for a highly severe, somewhat probable risk. Although the market bust might not have been fully predicted, the need for a mitigation strategy could have been highlighted by proper risk analysis. In the end, the out-of-the-way location made subleasing extremely difficult and Company X lost $35 million by abandoning the space to one of few low bidders.

determined. An action approach should either be (1) a way to minimize the severity of the outcome (2) a way to reduce the probability of occurrence or (3) a way to improve the detectability of the cause through current controls.

Strategies to address the highest risks should include both long-term mitigation measures and near-term contingency plans. For less urgent risks, mitigation alone may suffice. Acceptable, low-level risks can simply be maintained with monitoring.

Step 4: Act
Now develop the selected management approach into a detailed action plan with accurate resource requirements. Assign accountable party roles and responsibilities, and set expected completion dates. After the appropriate approvals are garnered, the action plan is executed. In the final stage of risk reduction, the original RPN should be re-rated to reflect the results of the executed actions.

Step 5: Govern
Risk governance includes the protocols for reporting new and existing risks under management; tracking and analyzing risk profile information; assigning, approving and accessing resources to carry out mitigation action plans; and ensuring the program features are effectively utilized.

The governance model assigns process leaders and participants—risk officers who own the entire risk profile under management and risk analysts who carry out detailed risk tracking using FMEA and other tools. The system prescribes a series of independent activities to gather and document new risks, develop detailed action plans and monitor the status of risks and actions. These activities should be punctuated by periodic group meetings to develop mitigation ideas, align risk profiles with mitigation measures and solicit direction and approvals from senior management. The cadence of independent, day-to-day risk management activities and the collective, decision-focused meetings are outlined in Figure 4. The role of the real estate business partner or relationship manager is critical in the governance process. He or she translates business issues into functional concerns, and vice versa. Best positioned
to communicate the trade-offs between risk mitigation investment proposals, the relationship manager should understand how to probe into the results of an FMEA analysis and how to explain the implications to client businesses.

**Better knowledge, higher value**

In addition to its hard outputs, a risk management program has an intangible, but no less valuable, impact on the CRE profile. The process relies on full partnership with enterprise colleagues to accurately anticipate and prioritize risks. By engaging in enterprise-driven analysis, CRE executives learn the language of the customer and derive more reasoned and relevant guidance. Furthermore, by partnering on better business decisions, CRE can share the credit for what goes right.

**Start where you are**

The scope and discipline of programmatic risk management might seem, on the surface, disruptive and impractical to undertake. Yet more major corporate real estate organizations are taking the first step, motivated by costly misjudgments and the absolute need to help their organization make sounder decisions. What do CRE leaders need to do to build an organization that is not only adding strategic substance, but also minimizing downside risks?

- Start where you are by stabilizing core processes and reviewing them for risks
- Work with business colleagues to define common ratings scales for severity that are consistent with enterprise values
- Take a programmatic view of risk management by incorporating governance, defining roles and responsibilities and refining metrics

Imagine how differently you would work if the what-if questions no longer triggered anxiety and avoidance. With a comprehensive risk management process in hand and committed governance in place, the uncertainties that once kept you awake at night become the very opportunities to add depth and value to the answers you give.

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**Figure 4** Governance cadence prescribes daily activities and periodic review, alignment and approval.

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Michael is an expert in strategic planning, change management and environmental sustainability. Experienced in developing and leading programs that achieve both top-line growth and cost-savings, he has worked with organizations in the technology, legal and government sectors. Michael is a Master Black Belt in Six Sigma.